DIAGNOSTIC TO ACTION:

MICROFINANCE IN AFRICA

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Foreword

Message from the Chair

Africa is a very rich continent. It holds massive natural, mineral and human capital resources. Yet Africa is rated by World Bank as one of the poorest continents, with most of its inhabitants living on less than one (1) US$ a day. Inflation continues to rise in many African countries, forcing central banks to act sharply in attempts to fight inflation. Indicators suggest that Africa will not achieve its Millennium Development Goals (MDGs) by 2015 unless ways and means are found to accelerate growth for the majority of countries where zero percent growth has been recorded.

The questions often asked in relation to Africa's poverty are many, and range from "Who lost Africa?" to "Who will salvage Africa?" There are no easy or simple answers to these questions. There is, however, a growing consensus that Africa must solve its problems from its own perspective, and involve the rest of the world where the need arises.

It is essential to adopt an African-driven social enterprise model that addresses all dimensions of poverty. There is also a pressing need to develop an African agenda and an African-driven strategy for accelerating the development and business of sub-sectors through sectors and institutions that target poor people, in particular using approaches that are based on accurate data from an African perspective.

One of these sectors is the microfinance sector. Microfinance has been perceived as one of the most effective poverty eradication strategies. If this is so, there is an urgent need to do the following:

- Develop an accurate picture of microfinance in Africa in order to build international recognition in the global industry—a "microfinance map" for Africa that will help business people globally feel comfortable about conducting business with MFIs in Africa.
- Make available specific financial support for microfinance industry development in Africa, to facilitate support for start-up businesses of poor people and especially women who are the mainstay of the economy in Africa. The G8 last year promised this support. It has yet to be realized. WWB

- is formulating an African strategy based on an African perspective. This is the approach that global institutions operating in Africa should support. Non-African prescriptions for Africa should be avoided.
- Spell out role of governments in formulating policy and providing enabling regulatory frameworks that address business development needs, for example, regulations related to savings, insurance, etc.
- Discourage corruption and create systems to ensure accountability for results and enhance business interests. Poor governance has been a bottleneck to Africa's development.

Africans need to drive this perspective for the sake of Africa. AMAF members have started the process and call on the world for support. Publishing this study is the first step to an African articulation of its own strategy to solving its problems.

Jennifer N. Riria, PhD, MBS, ICON-HP
AMAF Chair
Chief Executive Officer, Kenya Women Finance Trust

Executive Summary

Africa's Growth Trajectory

Something decidedly new is on the horizon in Africa since the mid-1990s. Many African economies appear to have turned the corner and have moved towards a path of faster and steadier economic growth. Their performance between 1995 and 2005 has reversed the economic collapses that marked the period from 1975 to 1985, and the stagnation that was rife between 1985 and 1995. Moreover, per capita income is now also increasing in tandem with other developing countries. The ability to boldly improve governance and to support, sustain and diversify the sources of these growth indicators will be critical to the elevation of countries to middle and high income countries and to meeting the Millennium Development Goals (MDGs).

Countries such as Ghana and Uganda appear on course to meet these goals, and others including Ethiopia, The Gambia, Ghana, Mauritius, Mozambique and Rwanda have undergone important positive developments. The challenge is to facilitate such achievements in a sufficient number of African countries to decrease the number of poor on the continent; of the 937 million people living in Africa, the number of people living below their national poverty line is a staggering 411 million. Poverty remains a critical challenge for the region.

Financial services to low-income households, by increasing employment, income, consumption and the empowerment of disadvantaged groups, have proven to be vital to breaking the vicious cycle of poverty. Financial services create tools that enable low-income households to improve their living conditions if some of the multiple other challenges they are facing are also addressed through parallel initiatives in the areas of water, health and sanitation, education, market access and governance.

The objective of this diagnostic of Microfinance in Africa is to develop an understanding of the major achievements, challenges and growth trends in the microfinance sector in Africa, so as to inform strategic decisions to realize the scaling up of microfinance on the continent. Microfinance holds the promise to contribute to broader financial sector development as well as to more systematically contribute to acute poverty-alleviation needs, making it an especially well-timed initiative.

The study is commissioned by the Africa Microfinance Action Forum (AMAF) and Women's World Banking (WWB), which jointly initiated the Africa Microfinance Strategy Initiative. This initiative is inspired by AMAF's vision of effective microfinance solutions that are anchored in the realities of the African continent, and that are successful in providing lasting economic and social benefits for low-income individuals and families in Africa. Launched in March 2006, AMAF is a voluntary advocacy group of African leaders who are committed to the advancement of microfinance in Africa.

Access to Finance for Low-Income Households in Africa

With low bank penetration and a very large informal sector, Africa is fertile ground for microfinance. This is reflected in the wide variety of financial service providers operating in lower income market segments and employing a range of savings products and lending methodologies: credit unions and variations of mutualist organizations such as Caisses Villageoises d'Epargne et Crédit Autogerées and Financial Service Associations (FSAs), commercial banks, savings banks, community banks, rural banks and non-banking financial institutions (NBFIs), and NGOs. For the lowest income market segments there are community managed loan funds and telephone companies offering mobile phone banking and at the higher end, for the lower middle-income market segments, there are consumer lenders and banks that have downscaled. Moreover, informal financial services remain popular alternatives to or supplements for semi-formal or formal financial services, even in more widely banked markets.

This diagnostic found that more and more people in low-income market segments in countries across Africa are now able to access an increasing range of financial products. Some of the business models have proven very successful and are spreading fast. The community managed loan funds, for example, will be scaled up to reach 30 million poor by 2015. Credit unions, with a proper support structure, can serve millions of people in lower income markets. In particular, some of the home grown MFIs (microfinance institutions) have demonstrated the capacity to reach very large numbers of clients and appear to have the capacity to do so efficiently even in very harsh environments.

The primary condition for success appears to be related to leadership. Senior MFI and bank managers need both the vision and the managerial capacity to find a business model that can create efficiencies in the particular context, plan for its execution, know the risks, chart a path that overcomes the major challenges and stay the course. Related to the basic need for good leadership is the issue of information and transparency, which in this industry has emerged as a critical element in the successful growth of MFIs. Those institutions able to produce accurate and timely reports are more likely to make appropriate decisions and mobilize commercial funds.

Other accomplishments are that NGOs have demonstrated that it is possible to transform into regulated institutions in order to offer a broader range of services, while commercial banks and other formal financial institutions such as postal office savings banks increasingly have moved down-market. The borders between traditional microfinance and the larger financial system have started to blur and although progress is uneven, we are seeing the beginnings of microfinance being integrated into larger financial systems in Africa.

However, despite this growth and promise, the current market penetration to low-income households is less than 15 percent for savers and even lower for borrowers. Outreach to savers is higher than outreach to borrowers because of the long savings tradition on the continent and the savings orientation of many of the MFIs. It is a highly valued service in Africa and in some countries people are even willing to pay to save.

A main constraint to the provision of financial services to all in Africa is the high cost environment.

Throughout Africa low population densities, weak and/or expensive infrastructure (transport, communications and electricity) combined with high labor and provisioning costs, all contribute to high operating expenses, especially in rural areas. This results in the need for economies of scale to remain competitive and responsive to client needs. The largest MFIs in Africa have been able to continuously refine their lending methodologies, and have become among the most productive in terms of both borrowers and savers per staff member. The smaller MFIs, however, continue to struggle to cover costs and diversify their products.

Another significant constraint is the scarcity of skilled manpower at loan officer, middle management, and leadership level. Moreover, there are massive training needs for the coming decade.

Lack of funding has also been typical for African MFIs, even though the average deposit/asset ratio is the highest in the world and on average capital/asset ratios are also high. If banks do finance MFIs, the financing is typically expensive and short term. Meanwhile, international microfinance investment vehicles collectively have no more than 10 percent invested in Africa; moreover, these investments are concentrated in the top MFIs. The lack of funding delays MFIs in achieving scale to overcome the high cost problem.

Trends that May Signal the Future

Astounding progress has been made in the delivery of financial services to low-income markets in Africa over the past ten years, and in particular during the past five years. In Ethiopia and Morocco there was hardly any microfinance a decade ago; each has now surpassed the million client mark and is fast moving towards two million clients served by microfinance. Information has begun to emerge about MFIs that manage to reach very poor groups; and in some markets, competition is pushing MFIs to innovate.

Furthermore, Africa now has some microfinance giants. And those giants have already weathered many storms, emboldening them. Whereas the giants in Asia became giants in an overall highly favorable environment for steady growth, with relatively low inflation and a notably higher population density than the other regions, those on the rise in Africa are growing despite very demanding macroeconomic contexts. Interestingly, many different types of microfinance providers—banks, credit unions, NBFIs and NGOs—are among those ranked as the top institutions in Africa.

The most recent growth appears especially high. Between 2006 and 2007 some MFIs have increased their borrowers by more than 150,000. In terms of savers, Equity Bank in Kenya managed to increase its customers by as much as 800,000 to 1.84 million. The total increase in clientele of some of the largest MFIs (for which we had data for the year 2007) was 30 percent. Growth during 2007 has been particularly high in Egypt, Ethiopia, Kenya, Morocco, Senegal and South Africa. We are also seeing growth rates increase rapidly in Burkina Faso, Cameroon, Ghana, Nigeria, Rwanda, Tanzania, Togo, and Uganda.

The marketplace in Africa presently has the right conditions for rapid entry by new commercial players: business models that can be copied and competencies for working with low-income populations. Institutional diversity, already high in Africa, is increasingly pronounced, as more and more formal financial institutions as well as other types of institutions—telecommunication firms, one-to-one banking initiatives like Kiva, and in some countries supermarket chains—enter the market. Product diversity, including product delivery, is being driven by new technology, such as cash machines and mobile phone banking, but also by the mission of microfinance providers to reach the financially disadvantaged. The first experiments of non-bank led models show that a population segment of "unbankable" customers

that would likely never have entered the formal financial market can now be reached. The mobile phone banking channel is significantly less costly than bank branches.

In terms of the environment in which MFIs operate in Africa, a lot has been happening at the macro level. The macro-economic environment and business climate has generally improved, finance for low-income households is being extended the recognition it deserves in the policy making of many countries, and the clarity that came with legal and regulatory frameworks addressing the specifics of microfinance boosted access to finance. Imperfections in the legal frameworks are being addressed in second or third rounds of reflections as policymakers start to realize these frameworks will continue to need refinements and improvements in line with the fast changing industry. The supervisory capacity of central banks, bearing the ultimate responsibility for the financial healthiness and stability of the financial sector, is falling behind though. Whereas a series of support initiatives has been provided it will take more time to find the right oversight solutions for the particular country context and to train and retrain staff overseeing the relatively large number of financial institutions lending to lower income market segments.

At this stage of industry development the meso level forms a key gap, in the middle between the growing retail capacity and improving macro-level issues. Some donors now combine support at the micro level with support in the area of legal and regulatory framework, but often the meso level is still overlooked.

The Road Ahead

The African microfinance market offers sound prospects for accelerated growth, though this varies considerably from country to country. Some of the more vibrant markets will experience rapid growth in the coming years while a number of smaller countries that have no significant microfinance services might have to revisit business models and sector-deepening strategies.

The road ahead needs to be travelled at various levels: the client level, the retail level, the meso level, the macro level and the regional level.

CLIENT LEVEL

Financial institutions are only as strong as the clients they serve. Client empowerment through business support, financial literacy and consumer education is proving increasingly important.

RETAIL LEVEL

Furthermore, in order to achieve the goal of access to finance for all in Africa, the retail capacity to deliver these services efficiently needs to be built further by overcoming the bottom line of high cost environments and lack of funds to fuel growth, and by recruiting skilled manpower to manage growth. In Africa, microfinance retail capacity can be boosted by following two main thrusts: getting the basics right and optimizing the use of innovations. The primary consideration in getting the basics right appears to be related to leadership. Human resources at other levels of the MFI are also key, so developing affordable in-house training methods is very important, as is ensuring performance-based payment, efficient recruitment and clear career paths.

In terms of innovation, leading MFIs in Africa demonstrate an organizational culture which embraces change and is conducive to continuous improvements in service delivery. This is usually complemented with very clear procedures for introducing new systems and piloting new services. Most successful

microfinance providers are increasingly able to ensure that products are adapted to clients' needs through research and/or mechanisms such as exit interviews. Innovations are needed to increase efficiency and to expand the frontier of finance to more rural markets and market segments including the almost bankable and hard-to-reach groups, such as youth. Innovations are also needed to offer a more diversified product menu and to create more linkages within the financial sector (for instance with insurance companies, deposit-taking or more formal financial institutions) and with other sectors (for instance education, vocational training, health, water, environment).

MESO LEVEL

Industry infrastructure is equally important for nascent, growing and mature industries, though the elements of support will vary. The diagnostic evidenced the extremely positive effect of microfinance networks in enabling MFIs to adapt to best practices and, on the other hand, the impact of the lack of credit bureaus in areas with increasing competition. Given that efficiency is critical for MFI success, industry infrastructure will become increasingly important to open doors to the next level of efficiency gain. Where possible, microfinance infrastructure should be built within the mainstream financial sector. Critical meso-level building blocks that are still largely missing are strong microfinance associations operating lasting business models, local and regional microfinance training capacity at the necessary scale, local research and development capacity, knowledge management and information dissemination, rating and technology service providers, credit bureaus, a viable business development services industry, donor coordination, and adequate funding to fuel the rapid growth.

MACRO LEVEL

An additional element necessary for the growth of microfinance in Africa is the improvement of the enabling environment. Many countries are already benefiting from better macroeconomic policies, moving away from planned economy foundations, with improvements in the performance of public sector institutions, better regulation and more investment in human resource development. In other countries, however, the investment climate is not yet conducive to flourishing business-creation and expansion. Some countries also need to continue to improve policy frameworks and adapt their legal and regulatory systems in line with rapidly changing industries, which will play a role in determining which regions and countries close the demand gap most successfully.

Successes such as Ethiopia and Morocco, which managed to build a sizeable microfinance industry with large, profitable retailers within a decade, can be replicated if stakeholders jointly analyze the key constraints and strategize on how to overcome obstacles with clear, quantitative target-setting incorporated into their national microfinance strategies.

The Dakar Declaration paved the way for high level commitment and best practice policy making to take root in each and every country in Africa.

REGIONAL LEVEL

There is a lot to learn from microfinance in Africa, and countries on the continent itself are the first ones who could greatly benefit from both information exchange and cross learning at other levels. Experiences need to be documented and made available for easy access for practitioners and other stakeholders. This knowledge building, knowledge management and information exchange is important at the country level to strategize about growing the sector at large, but also at the MFI level, so that individual MFIs can learn from one another about how to become leading institutions. Specific insights

have been and can continue to be gained from a number of country groupings, and stakeholders are encouraged to work together with countries similar in region, size or contexts.

Throughout the continent, the frontier of finance is moving towards unserved markets: poorer, rural and very remote segments of the population. The growth of microfinance in Africa could be optimized if countries build on what works (such as diversity of institutions and savings mobilization), overcome retail bottlenecks, focus on efficiency, look for opportunities beyond the traditional microfinance domain, work rigorously to build an industry infrastructure, keep the policy framework right, and drastically increase information exchange and if their voices as Africans are well heard by the international community.

RECOMMENDATIONS

1. Clients First. Introduce reforms to reduce the costs of and barriers to business registration for formal SMEs (small and medium enterprises). Create a more secure and supportive business environment for informal sector enterprises, including consumer protection initiatives. Continuously increase MFI capacity to listen to clients and adapt products accordingly.

2. Groom Leaders. Develop a strong focus on leadership development and training. Encourage long term, medium term and short term leadership training (include it in curricula and agendas, add master classes to relevant conferences, make funding available). Find sustainable solutions to strengthen governance.

3. Strengthen Human Resource Management. Develop affordable in-house training methods, and ensure performance-based payment, efficient recruitment and clear career paths, and succession planning. Build local and/or regional training infrastructure.

4. Emphasize Information and Transparency. All stakeholders should promote and support the information management capacity of MFIs, and the sharing of their information.

5. Create a Culture of Innovation. Leading MFIs in Africa demonstrate an organizational culture that embraces change and is conducive to continuous improvements in service delivery, complemented by very clear procedures for introducing new systems and piloting new services. MFIs which have been able to introduce distribution channels via POS (point of sale/point of service) technology and other innovations have seen rapid growth in client numbers over the past few years.

6. Efficiency, Efficiency, Efficiency. A clear focus on economics of scale, retaining loan clients, keeping delinquency rates low, and developing innovative savings and lending methodologies are important factors in optimizing efficiency, as the importance of efficiency is multiplied in high-cost Africa.

7. Demand-Driven Savings. To increase the MFI funding base, all stakeholders should promote aggressive savings mobilization target-setting, in terms of numbers and volume. This requires understanding the specific demands coming from various market segments. Donors could fund a massive technical assistance program to this end.

8. Campaign for Increased Access to Banks. To drastically increase the flow from banks to MFIs, make funding available to conduct workshops and study tours on lending to MFIs, with a view to encouraging banks to wholesale to MFIs.

9. Investor/Donor Coordination. Investors should be encouraged to coordinate their efforts and pay attention to their role and the absorptive capacity of the MFIs and its needs for different types of

financing at any given time (avoid over borrowing of the top MFIs). For example, commercial investors finance the top MFIs whereas social responsible investors and International Financial Institutions could take on higher levels of risk funding, medium/long term funding in local currency, while employing innovative forex solutions. Donors could offer technical assistance complementing the investor capital. Co-investment of local investors or bank financing to leverage foreign investments is desirable.

10. Risk Management. To reduce systemic risks in monopolistic markets more attention needs to be paid to the creation of a level playing field. To reduce risks at the MFI level, high end MFIs are to pay more attention to risk management and seek to create risk management units.

11. Take A Broad Perspective. The broader the perspective the faster the access to finance for low-income households can be increased. Greenfields, NBFIs and NGOs fill a particular niche, but the access to finance for low-income markets will remain low if other potential players are not identified or neglected.

12. Optimize the Product Mix to Mitigate Risks. In addition to savings and credit products, being able to offer life-, health-, crop- and weather-insurance, may significantly increase sector impact by mitigating areas that dramatically reduce the coping capacities of people in Africa, especially as the continent remains more volatile and its people more vulnerable than others.

13. Don't Overlook the Meso Level. Any industry needs an infrastructure, and microfinance is no different. It is the most underfunded and underdeveloped part of the industry. Continue information dissemination (especially in younger markets), develop and strengthen microfinance associations, promote credit bureau launch and sub-regional rating agencies; make funding available for training of external auditors in the microfinance subject matter, build local and sub-regional training and research capacity, undertake research and development on how to reach very poor, rural and hard-to-reach clients.

14. Campaign for Strong Professional Associations. As national microfinance associations play a key role in sector development, more attention should be paid to ensure their proper functioning in an increasing number of countries. Associations in Benin, Cote d'Ivoire, Ethiopia, Ghana, Madagascar and Uganda should be consulted by other associations that seem to struggle. Sister organizations could also be formed where a strong one seeks to build up a weaker association.

15. Africa-wide Association. Expansion of AFMIN to include all countries or creating a new network to this end. Find lasting business model for the supra-national association.

16. Microfinance is Finance. Keep on spreading the message to ever broadening groups of interested parties, that even though one of the effects of microfinance is to alleviate poverty, it is financial business, not a development project. Where possible, microfinance infrastructure should be built within the mainstream financial sector.

17. Enable Policy Frameworks. Governments should create a good investment climate and efficient judicial system, including property rights, court system and collateral registries. Formulate and implement national microfinance strategies or financial sector charters that promote deepening of the sector and recognize its importance in other sectoral policy documents. Governments and donors to stay out of any business that can be done by the private sector.

18. Adapt Legal and Regulatory Frameworks. Continue to improve and adapt the MFI legal and regulatory framework as the industry evolves, allowing them the flexibility needed, while nurturing

a range of regulated and unregulated institutions of all types to provide services on a sustainable basis. Continue training of policymakers in the specifics of financial services to low-income households.

19. Strengthen Supervisory Capacity. Formulate strategies, budget and support plans for the expanded supervisory capacity costs that comes with supervision of MFIs.

20. Get to Know African Microfinance. Create a website by and for African practitioners where countries can share experiences and learn about each other. Experiences need to be documented and made available for easy access for practitioners and other stakeholders. In this way accomplishments made in one country can benefit other countries in Africa, as appropriate.

21. One Size Does Not Fit All. Stakeholders are encouraged to work together with other, similar countries. Specific insights have been, and can continue to be, gained from a number of country groupings. For instance, large countries are faced with impediments in terms of the large bureaucracies and massive capacity building needs, whereas small countries face market impediments. Post-conflict countries face specific challenges of credit culture and human resource capacity. Similarly, oil-rich countries often share similar contexts and challenges. Each sub-region also has specific priorities.

22. HIV / AIDS. Take HIV/AIDS into account, in particular in high incidence areas with a view to risk mitigation, responsive products and customer loyalty.

23. Gender. Segmentation of the market along gender lines. Understand the specific gender-based constraints and the differences in demand for financial products and services from men and women, and dedicate attention to increasing the percentage of women among microfinance clientele.

24. Islamic Finance. The development of Islamic finance products has the potential to bring many unbanked into the financial sector.

25. Social Performance Monitoring. For MFIs that are interested, social performance monitoring (SPM) is a simple and cost-effective tool to better serve their clients, report to stakeholders and, through better adjusted products, improve operational performance.

26. Environment. Financially self-sufficient MFIs could look into partnering with water and sanitation or energy service firms to see if solutions can be found that will meet needs of their clientele.

Abbreviations

ADA	Appui au Développement Autonome
AMAF	Africa Microfinance Action Forum
AML-CFT	Anti-Money-Laundering and Combating the Financing of Terrorism
ASCAs	Accumulating Savings and Credit Associations
ATM	Automatic Teller Machine
AU	African Union
BEAC	Banque des Etats de l'Afrique Central
BCEAO	Banque Centrale des Etats de l'Afrique de l'Ouest
CEMAC	Communauté Economique et Monétaire d'Afrique Centrale
CAPAF	Programme de Renforcement des Capacités des IMF en Afrique Francophone
CGAP	Consolidated Group to Assist the Poorest
CIF	Centre d' Innovation Financier
CMLF	Community Managed Loan Fund
CNCA	Caisse Nationale de Crédit Agricole
COBAC	Commission Bancaire de l'Afrique Centrale
COMESA	Common Market for Eastern and Southern Africa
CVECA	Caisses Villageoises d'Epargne et Crédit Autogerées
DGSSMF	Direction Générale de la Surveillance du Secteur de la Microfinance
ECA	Eastern Europe and Central Asia
ECOWAS	Economic Community of West African States
FCFA	Franc de la Communauté Financière Africaine
FDI	Foreign Direct Investment
FECECAM	Fédération de Caisses d'Epargne et de Crédit Agricole Mutuel
FSA	Financial Service Association
HIPC	Heavily Indebted Poor Countries
IFAD	International Fund for Agricultural Development
IFI	International Financial Institution
MDG	Millennium Development Goals

(continued)

Abbreviations (continued)

MFI	Microfinance Institution
MIX	Microfinance Information eXchange
MIS	Management Information System
MIV	Microfinance Investment Vehicle
NBFI	Non Banking Financial Institution
NEPAD	New Partnership for Africa's Development
OHADA	Organisation pour l'Harmonisation du Droit des Affaires en Afrique
ODA	Official Development Assistance
PADME	Projet d'Appui aux Développement des Micro-Entreprises
PARMEC	Projet d'Appui à la Réglementation sur les Mutuelles d'Epargne et de Crédit
POSB	Post Office Savings Bank
PRSP	Programme de Relance du Secteur Prive
RoA	Return on Assets
ROSCA	Rotating Savings and Credit Associations
SACCO	Savings and Credit Cooperative Organization
SADC	Southern Africa Development Community
SFD	Système Financier Décentralisé
SME	Small and Medium Enterprises
SPM	Social Performance Monitoring
UEMOA	Union Economique et Monétaire Ouest-Africaine
UNECA	United Nations Economic Commission for Africa
VS&LGs	Village Savings and Loans Groups
WWB	Women's World Banking

PART 1: BACKGROUND

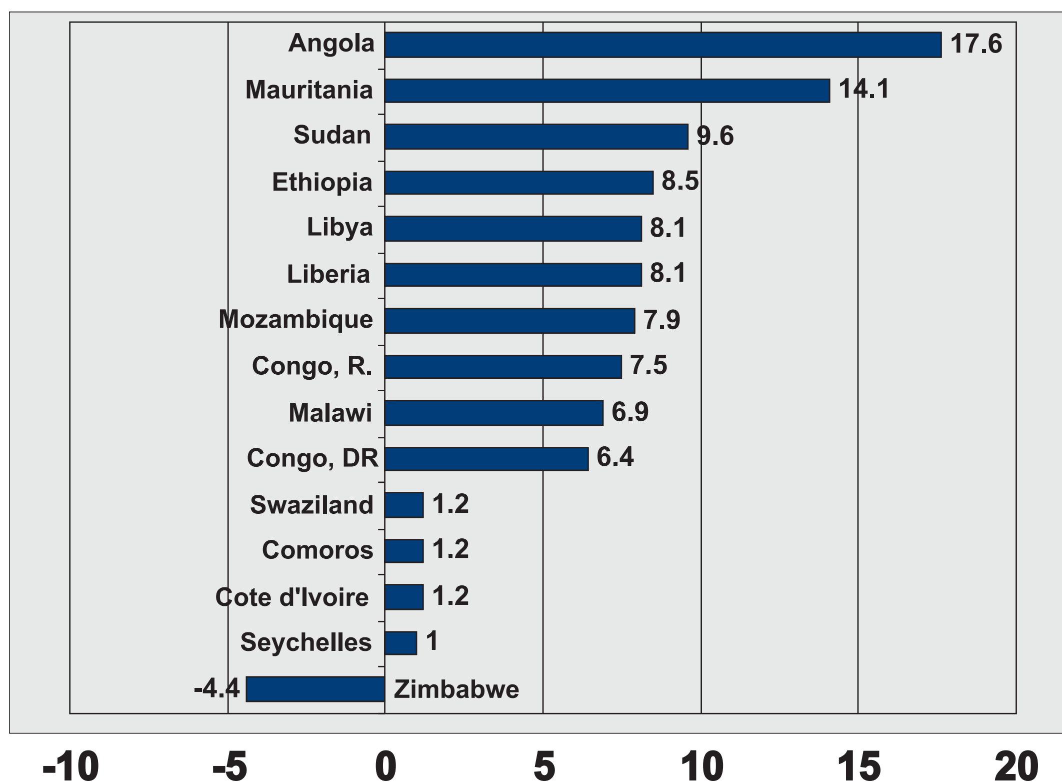
Chapter 1: Introduction

1.1 A Positive Momentum is Building

Something decidedly new has been on the horizon in Africa since the mid-1990s. Many African economies appear to have turned the corner and have moved towards a path of faster and steadier economic growth. Their performance between 1995 and 2005 has reversed the economic collapses that marked the period from 1975 to 1985, and the stagnation that was rife between 1985 and 1995 (World Bank 2008a). The continent continues to experience high economic growth with the rate of GDP growth which averaged about 5 percent annually in the past six years, rising to 5.5 percent in 2006, about 5.7 percent in 2007 and projected to rise to 5.9 percent in 2008 and 2009 (OECD / African Development Bank 2008). Moreover, the per capita income is now even increasing, in tandem with other developing countries. Growth is supported by high commodity prices, countries taking advantage of the Heavily Indebted Poor Countries (HIPC) initiative to reduce their debt stock, skyrocketing Asian investment in the continent, and though oil-exporting countries are outpacing others also a robust expansion in the region's non-oil exporting countries—where domestic demand and investment have responded to improved policies and structural reforms. For the first time several African governments and African central banks have been able to build up reserves. As many as 28 countries recorded improvements in growth in 2006, relative to 2005. The ability to boldly improve governance and to support, sustain and diversify the sources of the growth indicators will be critical to meeting the Millennium Development Goals (MDGs). Countries like Ghana and Uganda seem set to meet these goals and others including Ethiopia, The Gambia, Ghana, Mauritius, Mozambique, and Rwanda have undergone important positive developments.

However, growth is uneven, as illustrated in Figure 1, which depicts the highest and lowest growth countries in Africa. Some of the highest growth rates can be found in countries emerging from conflict and recovering from a low base, such as Angola, Liberia, Mozambique and Sudan where growth approximates or exceeds 8 percent.

Figure 1: Diversity in GDP Growth Rates: Selected High- and Low-Growth Countries



Source: World Bank Presentation, Office of the Chief Economist, Africa Region.

1.2 The Poverty Challenge

Besides the macroeconomic growth being uneven, the magnitude of poverty remains a critical issue for the African continent. Of the 937 million people living in Africa (World Bank 2008a), 14 percent of the world's population, the number of people living below their national poverty line is a staggering 411 million, almost one in two people.[1] Giants like Nigeria, the Democratic Republic of Congo (DRC), Ethiopia, and Egypt already host 186 million of poor and if you would add the next set of countries with large numbers of poor—South Africa, Tanzania and Kenya—the number increases to 238 million. A key challenge for Africa, with its delayed demographic transition, is to effect rapid economic growth in a sufficient number of African countries to decrease not only the percentage of poor on the continent but also the absolute number.

Many of Africa's poor survive through informal sector businesses. Informal sectors form an important part of African economies, yet their importance is often not recognized. In such cases, the dualism between the formal and informal economies tends to be exacerbated instead of levelled off and a chance is missed to nurture the entrepreneurial spirit of hawkers and to smoothly incorporate the larger of the informal businesses in the formal economy. In the informal sector, small enterprises face many more constraints than mainstream companies, with threats of eviction, demolishment of stalls, lack of money to purchase goods in bulk, limited access to information and markets, etc., but they also utilize lower levels of investment and less demanding skills and handle relatively simpler products. In urban areas, they range from street vendors to small manufacturing entities. In rural areas, small enterprises engage

in the production and sale of farm products, handicrafts and services (United Nations 1992). Realities for informal sector businesses are usually daunting, but once given the chance to help themselves, through finance, skills training or assistance with marketing, many businesses thrive.

Poverty is more prevalent among certain population groups than others. HIV/AIDS is more widespread in Africa, compared to other continents, causing 1.6 million deaths per year and taking a heavy toll on the productive population; Botswana lost 17 percent of its health workers to the disease. Further, it reduces the economic potential and coping capacity of individuals and communities. It has affected the fabrics of society, with communities in high incidence countries often finding themselves having to take care of large numbers of very vulnerable and increasingly poor households.

Migrants, though often motivated by dreams of being able to earn a decent living, may find themselves amongst the poorest in the destination country, being particularly vulnerable and finding themselves exposed to more risks.

1.3 Financial Sector Development to Spur Growth and Poverty Reduction

At the 2nd Africa Financial Sector Conference in Uganda in December 2007, the Hon. Dr. E. Suruma, Minister of Finance, Planning and Economic Development for Uganda, opened the conference stating that, "a well-functioning financial sector is a basic requirement for sustainable economic growth, eradication of poverty and, hence, prosperity for all people." Continent wide, this is a domain in which a lot of progress has been made over the past decade. Reform measures have included liberalizing interest rates, eliminating administrative credit allocation, strengthening the role of central banks in regulating and supervising financial institutions, restructuring state-owned financial institutions, and allowing entry of local and private banks into the market.

However, to be functioning well, a recent World Bank publication evidences that financial sectors in Africa need more than funds—they need depth and an inclusive means of channelling funds and other financial services to where they can be most effective (Honohan et al. 2007). The lower end of the market is the topic of this study, which makes it a well time effort. Financial services to low-income households, by increasing employment, income, consumption and the empowerment of disadvantaged groups, have proven to be vital to breaking the vicious cycle of poverty (Amha 2007a). It creates tools that enable low-income households to improve their living conditions if some of the multiple other challenges they are facing are also addressed through parallel initiatives in the areas of water, health and sanitation, education, market access, and governance.

Those sentiments are felt across the continent, as policymakers in many African countries are confronting similar issues and choices:

- how to get credit flowing more readily to where it can boost growth,
- how to get more finance for long-term and riskier projects,
- whether small national equity markets should collaborate across national borders,
- how best to design the regulation of banks and microfinance institutions (MFIs) in the African context, and
- where governments should concentrate their efforts.

By providing an alternative to government patronage as the basis for entry into business activities, a strong, independent financial system can transform the business environment.

1.4 Objective of the Study

The objective of this Diagnostic of Microfinance in Africa is to analyze the accomplishments, challenges and gaps in expanding access to microfinance for employment creation for millions of low-income people in Africa, especially women and youth. It will try to answer the following questions: "What does microfinance in Africa look like today? Who are the customers of microfinance institutions, what are their needs and wants and what kinds of institutions are serving them? What good practices exist in the provision of financial services to low-income people? What are the key constraints of the microfinance industry in Africa: relating to customers, microfinance institutions and the external environment? What are the most critical constraints to address in order to promote significant growth of the industry?

The study has been commissioned by the Africa Microfinance Action Forum (AMAF) and Women's World Banking (WWB), who jointly initiated the Africa Microfinance Strategy Initiative. This initiative is inspired by AMAF's vision of effective microfinance solutions that are anchored in the realities of the African continent, and that are successful in providing lasting economic and social benefits for low-income individuals and families in Africa. Launched in March 2006, AMAF is a voluntary advocacy group of African leaders who are committed to the advancement of microfinance in Africa.

1.5 Methodology

The study applied a combination of literature review (see References), interviews and on-the-ground primary information collected through face-to-face meetings with microfinance institutions and clients, industry support institutions and policymakers.

The distinguishing characteristic of this study is that it looks at financial access for low-income households in Africa as a whole, informed both by existing continental empirical information and by information from individual African countries. For primary country data collection, 14 countries were visited: Angola, Benin, Congo (Republic of the Congo), Egypt, Ethiopia, The Gambia, Guinea-Bissau, Kenya, Malawi, Morocco, Niger, Nigeria, South Africa and Sudan.

The country selection was done employing purposive sampling to cover the various sub-regions, population sizes and stages of development of microfinance service delivery.

Though coverage of small as well as large countries was ensured in the case study country selection, larger ones were included as the study objective is to accelerate financial service delivery to all:

- three of Africa's four countries with more than 50 million inhabitants,
- three of the 19 countries with less than 5 million inhabitants, and
- eight of the largest group of 30 countries with a population between 5 and 50 million.

The stage of sector development also played a role in selecting countries with well developed markets like Benin, Egypt, Ethiopia, Kenya, Morocco, and South Africa and on the other hand nascent markets like Angola, Congo, Guinea-Bissau, Sudan and some others modestly developed.

An effort was also made to select countries from all the sub-regions. As such Africa's 53 countries were divided into sub-regions, as per the World Bank categorization (except for Sudan which we included in North Africa):

Central Africa:	Burundi, Central African Republic (CAR), Chad, Cameroon, Congo (Republic of the Congo), DRC (Democratic Republic of the Congo), Equatorial Guinea, Gabon, Rwanda, São Tomé and Principe.
East Africa:	Djibouti, Eritrea, Ethiopia, Kenya, Somalia, Tanzania, Uganda, and the Indian Ocean countries of Comoros, Madagascar, Mauritius and Seychelles.
North Africa:	Algeria, Egypt, Libya, Morocco, Sudan and Tunisia.
Southern Africa:	Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Zambia and Zimbabwe.
West Africa:	Benin, Burkina Faso, Cape Verde, The Gambia, Ghana, Guinea, Guinea-Bissau, Côte d'Ivoire, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone and Togo.

The study team consisted of five people, a lead consultant and four regional experts, one each for Central Africa, East and Southern Africa, North Africa, and West Africa. This approach was chosen with a view to ensuring that above and beyond the views of local practitioners and other local stakeholders, the study could also tap into regional perspectives from the respective experts. Working with people from the region also has the benefit of seeing things from within, deepening the African perspective of the diagnostic and ideas for acceleration of access to finance for all.

The document, *Expert Group + 10: Building Domestic Financial Systems that Work for the Majority*, which is based on World Bank/CGAP and WWB frameworks for building strong microfinance sectors, served as the basis for data collection and analysis. The data collection resulted in a one-pager on all 53 countries in Africa, a documentation of 14 case studies and this main report. A lot of the data on those respective dimensions could be gathered by means of desk study and interviews with experts on microfinance in Africa. Identified areas of attention were then further investigated during in-country field visits. The research methodology for the field visit consisted of semi-structured interviews with key stakeholders such as MFIs, relevant central bank and government officials, main donors, and technical service providers.

The report has its limitations. First, information about MFIs is not uniformly reported due to the fact that definitions are not necessarily consistent across or even within countries. Second, though various standard setting initiatives have occurred at the global level, performance indicators still differ widely per MFI, region and across each data source. Third, the study had to be undertaken within certain budget limitations, resulting in the inability to perform diagnostics to verify all data and information presented by MFIs and other structures.

1.6 Definitions

For purposes of this study, the following definitions apply:

MFI. Any institution that provides financial services to low-income households and seeks to do so in a sustainable manner. This does not include organizations that provide in-kind credit or subsidized credit programs. It does include commercial banks that have offer financial products directly to low-income people. It also includes savings banks, if they reach lower income market segments, and credit unions. The study aggregates networks of credit unions or community managed loan funds in a given country, rather than listing each individual credit union or group.

Market Penetration Rate. As this study focuses on savings and other financial services in addition to loans, it uses a penetration rate based on the banked population as a percentage of the population, rather

than the size of the informal sector or number of unemployed. Because it is desirable that more than one member in a household has access to finance with lending, we will use the total size of the adult population living below the poverty line, because the number of households would overestimate the penetration rate.

Poor. When we refer to "poor" in this study, we mean and specify the poor as defined from the national perspective, meaning the group of people living below the national poverty line. In some instances, where we don't have the data to illustrate a certain point from the national poverty perspective, we will use the international poverty line data, with the dollar based classifications of people earning less than US$ 2 a day and people earning less than US$ 1 a day. It should be noted that MFIs do not exclusively service the poor. MFIs typically serve the non-banked majority, which includes poor and many lower-income households above the poverty line. Moreover there are MFIs that: (i) grow with their clients; (ii) service SMEs (as well), a market segment critical to formal employment creation; or (iii) have made a strategic decision to offer deposit services to higher income categories and intermediate these savings to lower income groups.

National Microfinance Strategy. To distinguish the national microfinance strategy document from the law or legal framework, we will use the word strategy.

Sector Infrastructure. Refers to elements of the infrastructure environment which are needed for the development of microfinance. These include microfinance associations, local microfinance technical service providers, the availability of information on the sector, rating agencies, and credit bureaus that have information on lower income market segment clients. It also includes the application of technology to the sector, the existence of payment systems, audit firms familiar with MFIs, and a body of specialist researchers.

Social Performance Management. Social Performance Management (SPM) is a tool for an MFI to achieve its social mission. It helps MFIs to regularly monitor their effectiveness in defining and reaching their clients, provide clients with services appropriate to their needs and achieve the changes in clients defined by their social mission.

1.7 Target Audience and Organization of the Report

The report is intended to be useful for:

- Anybody who is interested in microfinance or increasing the access to finance to all in Africa.
- Governments interested in seeing how other countries tackled issues they might be struggling with, or seeking a model when preparing national microfinance strategies.
- MFIs to offer insights into how to overcome particular challenges they are facing.
- Academics interested in financial service provision in Africa.
- Donors and investors seeking to deepen their understanding of the accomplishments, obstacles, specific challenges and the opportunities of microfinance in Africa with a view to allocating their resources strategically.

Chapter 2 provides background information on African financial systems at large. MFIs are part and parcel of the financial sector and their features and developments are important to understanding key issues and trends.

Chapter 3 offers an overview of microfinance in Africa considering six dimensions. First, the microfinance retail capacity is examined, including its structure, size, efficiency and the sustainability of operations and attractiveness of returns. Second, it features state-of-the-art product offerings, which are increasingly used to assess performance of sectors alongside traditional outreach indicators. Third, the report highlights issues at the client level, the micro-savers, micro-entrepreneurs, and lower income people in need of money transfer and insurance. Further, it takes stock of the depth of outreach of African microfinance. Fourth, it presents the types of funding sources at the disposal of MFIs. Fifth, it assesses the general state of the microfinance industry infrastructure. Finally, it will look at the general policy environment, including the legal and regulatory framework, and the investment climate.

Chapter 4 analyzes the constraints to the realization of domestic markets that work for the majority.

Chapter 5 highlights good practices brought to light by the diagnostic.

Chapter 6 provides a road map based on learning from the past decade of diverse experiences of microfinance in Africa to inform strategies for scaling up growth in the African context.

For country-specific analysis we refer to Volume II of this diagnositic, the country case studies (AMAF, WWB (2008), *Diagnostic to Action: Microfinance in Africa, Volume II: Case Studies*, New York, USA, soon to be published on the website of Women's World Banking).

Chapter 2: African Financial Systems and Diversity

2.1 Policy Making

Building financial systems that serve all segments of the population is already a widely shared goal among policymakers in Africa. Strong financial systems have helped deliver rapid growth overall, as well as direct and indirect benefits, across income distributions (Honohan 2007). Moreover, across Africa, access to finance is rightly seen as a key to unlocking growth for poor farming families, as much as for expanding export.

The economies of East Asia—also referred to as East Asian Tigers—have shown that putting national savings to work in productivity-increasing investments can sustain rapid growth. By bridging the gap between savers and entrepreneurs, financial systems not only reduce the risks, but also open up opportunities to both sides. This can reduce the barriers to entry for entrepreneurs, allowing the economy at large to benefit in terms of improving the price and quality of services, reducing the stifling influence of established monopolies and employment creation. Africa's leaders have undertaken major policy reforms over the past several years, especially in the area of macroeconomic management and trade policy, both of which help to underpin improved growth performance. Key policy frameworks attesting to the importance of creating financial systems that work for the poor are highlighted below.

The New Partnership for Africa's Development (NEPAD)[2] aims to improve access to capital by strengthening microfinance schemes, with particular attention to women entrepreneurs. In addition, it favors technical support to strengthen and encourage the growth of micro-, small and medium-scale industries, including the development of an appropriate regulatory environment. The United Nations Economic Commission for Africa (UNECA) is now aligned with NEPAD, as the UN General Assembly passed a resolution mandating the UN system to structure its work program in line with the NEPAD agenda. In a recent report, UNECA emphasizes diversification away from mineral resource sectors as a strategy to reduce vulnerability to external shocks due to commodity dependence and to increase domestic demand (African Union, UNECA 2007). It also calls for innovative growth strategies.

The Commission for Africa, an initiative established by the British government to examine and provide impetus for development in Africa, proposed a series of actions that would form a coherent package for addressing the interlocking problems identified for the continent. In the area of Growth and Poverty Reduction, it sets the goal for average growth rates in Africa at 7 percent by 2010. These growth rates have been attained in Asia and in parts of Africa, and can be achieved across the continent—but only if the obstacles of a weak infrastructure and a discouraging investment climate are overcome, thus releasing Africa's entrepreneurial energies. The importance of strategies that enable poor people to participate in the growth process is also underscored. It recommends a focus on fostering small enterprises, through ensuring better access to finance, markets, and business linkages, and through placing a particular emphasis on women, youth and family farms, which remain major employers in Africa.

The Dakar Declaration on Building Inclusive Financial Sectors in Africa was built around the Millennium Development Goals (MDGs), the commitment for development made by the African leaders in the NEPAD and other important initiatives. The forum from which the Declaration was developed brought together ministers of African governments, governors of central banks, CEOs of banks, insurance companies, money transfer companies, and regional and sub-regional organizations and donors, and asked that they reaffirm their commitment to financial inclusion, strengthening financial sectors and setting up a Steering Committee. The declaration reaffirmed the need to assure, throughout Africa, access to a broad range of financial services (including savings, credit, insurance, money transfer, leasing and other such financial services) for poor and low-income people, and micro- and small enterprises.

2.2 Features of Financial Sectors in Africa

While there is some variation among countries, Africa's financial sectors are on average characterized by:

- Dominance of banking in the formal financial systems. This is not uncommon in the developing world as a whole. Insurance markets are making a comeback though with the failure of state-owned insurance companies and entry of regional and international firms.

- Small size of banks and financial systems. Though dominant, the size of banks is very small. In a recent sample, the average African bank showed total assets of US$ 81 million, compared with US$ 334 million for the average bank outside Africa.

- Low levels of intermediation. Recent data shows that the ratio of liquid liabilities to GDP averages 32 percent in Africa compared with 49 percent in East Asia and the Pacific, and 100 percent in high-income countries, implying that little money enters the formal financial sector. Similarly, the ratio of private credit to GDP averages 18 percent in Africa compared with 30 percent in South Asia, and 107 percent in high-income countries. Offshore deposit accounts explain some of the missing deposits: Africans have disproportionately high offshore deposits, while the low credit numbers also reflect the apparent inability of banks to find enough safe lending opportunities (Honohan 2007). This is reflected in the high liquidity prevailing in many African banking systems. However, though the financial depth remains low, signs of recovery are unmistakable and encouraging, as many African banking sectors are experiencing a period of vibrant developments that many had not envisioned just a few years ago.

- Fragmented sectors. In principle, financial systems should serve to channel funds from those who have a surplus at any given to time those who have an excess demand for funds, and from less productive to more productive uses. In practice, this is not the case in Africa.

- **Wide intermediation spreads and overhead costs.** This is fundamentally explained by a particular *unsatisfactory contractual framework* in Africa. This includes weak protection of property rights, weak creditor rights that are seldom enforced by compromised courts, a deficient and rarely applied insolvency framework, and a general disrespect for contracts. These factors, in addition to low population densities and the overall small size of the economies, result in high unit costs.

- **Banks are able to earn significant profits** due to high risk premiums demanded by bankers for reasons described above and due to lack of competition. Most of Africa's banking systems are highly concentrated, which is not surprising, given the small size of the national markets. The market share of the top three banks (concentration ratio) in each country averages 73 percent across 22 African countries, based on total assets in the latest year for which data are available compared to 60 percent for the world as a whole. The World Bank found an average return on total assets of 2.1 percent, more than three times the profitability of non-African banks at 0.6 percent.

- **Another striking characteristic of financial systems in Africa is the concentration on short-term claims** across all financial institutions and financial markets. This characteristic is exemplified by the dominance of short-term rather than long-term government paper. However, the region's stock markets have begun to help finance the growth of African companies.

- **Limited branch network in rural areas.**

- **Volatility is a key feature plaguing Africa**, even though the general trend is one of major advances in financial sector development.

Despite these common features, there are also ample differences among the financial sectors in Africa:

- **Uneven level of development.** Africa is home to South Africa—the fourth-largest emerging market in the world—plus over a dozen other middle income countries, as well as extremely poor countries like Chad, Congo, DRC, and Guinea-Bissau. This is reflected in the size of the banking sector, with a country like South Africa having a ratio of bank assets to GDP above 100 percent, and Chad, Congo, DRC, and Guinea-Bissau where this ratio is not even 10 percent of GDP.

- **Uneven access across countries.** Though financial access can reach 50 percent, as in South Africa, some countries exhibit figures as low as one percent of the population having access to financial services.

- **Level of regional integration.** Another important determining factor in the level of financial sector development is whether the country's financial sector is or is not regionally integrated.

2.3 Sub-regional Diversity

Africa consists of 53 countries, with a total population of 937 million people in 2006 (World Bank 2008a). The region is diverse. Within it are some highly developed countries but also some of the poorest countries in the world. Financial sectors vary according to the economic development of their respective sub-regions, their history and the level of regional integration.

CENTRAL AFRICA

Central Africa is a mineral rich and very diverse grouping of countries and peoples, with the vast DRC home to more than 200 different ethnic groups and almost as many local languages. This variety in combination with arbitrarily inherited borders from the colonial days and all the intricacies that come with mineral wealth possession have not only enriched the region. Civil unrest, complex emergencies and autocratic regimes have marked the region and inhibited its growth, diversification and sharing of the wealth and serious improvement in human development indicators. The GNI/capita ranges from US$ 100 in Burundi and US$ 120 in DRC, to US$ 5,000 in Gabon and US$ 7,533 in Equatorial Guinea. Cameroon and Congo are in the middle, at close to US$ 1,000. However, the under-five mortality is around 200 per 1000 live births everywhere except in Cameroon and Gabon, which is very high, demonstrating that even in the wealthier countries, high levels of poverty continue. Yet, positive developments are now overshadowing the problematic ones. Growth in the largest country, DRC is projected to remain at 2006 levels (6.2 percent), Rwanda has experienced impressive growth poverty levels are starting to go down, and in Cameroon progress has been made in the social sphere and in diversifying the economy. Average GDP growth in Central Africa is projected to increase from 3.9 percent in 2006 to 5.2 percent in 2007 and an acceleration of growth to 6.3 percent in 2008.

The Communauté Economique et Monétaire d'Afrique Centrale (CEMAC) was created in 1994 as a customs and monetary union among six former French Central African countries. CEMAC includes: Cameroon, the Central African Republic, Chad, Republic of Congo, Equatorial Guinea and Gabon.[3] As such they share a common central bank, the Banque des Etats d'Afrique Centrale (BEAC) and a regional banking supervision commission, the Commission Bancaire de l'Afrique Centrale (COBAC).

EAST AFRICA

Whereas countries like Kenya and Uganda are known as some of the more attractive investment destinations on the continent, East Africa is also home to some of the countries hosting Africa's highest number of poor. Ethiopia has 34 million people living below their national poverty line, after DRC with 43 million the largest amount. Kenya's population living below the national poverty line amounts to almost 17 million, and Tanzania and Uganda are also high with 14 and 10 million respectively. However, besides growth prospects of Madagascar that continue to be negatively affected by the increased competition from Asian textile producers and the end of the Multi-Fiber Agreement and slow growth of the smaller economies, the average economic growth in East Africa averaged 5.1 percent in 2006, and is projected to accelerate to 5.8 and 6 percent in 2007 and 2008, respectively. Ethiopia, Tanzania, and Uganda remain the fastest growing countries in the sub-region and the more employment-based this growth can take shape, the larger the dent into poverty that can be made in the coming years.

Kenya, Tanzania and Uganda are part of the so-called East African Community, to which also Burundi and Rwanda were invited. There are discussions to fast track the regional integration process into a custom union, monetary union and even political federation. Many countries in East Africa have inherited their legal systems from the British which influenced their financial sector development. The

English Common Law tradition tends to be more protective of private property rights and less rigid than the French Civil Code tradition and generally a higher level of financial development.

NORTH AFRICA

North Africa is home to one of Africa's largest economies, Algeria. Real GDP growth in North African countries is expected to remain high at 6 percent, in both 2007 and 2008. Growth is exceptionally high in Sudan (11 percent) mainly due to increases in oil and gas production and as the country is recovering from a low because of the decennia long civil war. In Morocco, the recovery of agricultural output with the ending of the drought led to a GDP growth of 7.3 percent in 2006. Strong growth was also recorded in Egypt (6.8 percent). The economic reforms undertaken in recent years in North Africa have contributed to achieving macroeconomic stability and increasing growth, albeit slow. Economic liberalization has attracted foreign investment and officials point to better basic services and lower poverty levels than elsewhere on the continent. A key economic challenge is to reduce high levels of unemployment and underemployment. Financial sectors in North Africa, are improving fast, with increasingly healthy commercial banking sectors; expanding insurance sectors; a growing number of securities firms, leasing companies, and consumer finance firms; and emerging fixed-income and equity markets.

SOUTHERN AFRICA

Mineral rich Southern Africa is home to more middle-income countries than other regions. As such it also has some of the most developed financial sectors with the highest number of people having access to financial services. On the other hand, it is the region where countries gained independence the latest with influences from Dutch, English, German and Portuguese. This is one of the reasons of the lack of progress towards resolving the crisis in Zimbabwe, which used to be a middle income country but now is the shadow over an otherwise advanced and progressing region. The average growth rate for Southern Africa is projected to increase from 5.4 percent in 2006 to 6.1 percent in 2007. In South Africa growth—at 5 percent, its highest since the end of Apartheid—has been broad-based and mainly driven by domestic demand. The projections for South Africa indicate that GDP growth should remain robust at about 4.5 percent in both 2007 and 2008, marking an important break from the relatively slow growth rates experienced over the past ten years. Botswana is the world's largest diamond producer, with sustained healthy economic growth for over twenty years. It also is the continent's longest continuous multi-party democracy. Angola, which is recovering from one of the worlds longest civil wars and has after Sierra Leone the highest child mortality rate in Africa, is growing at a formidable 27 percent GDP growth in 2007 (largely due to rising oil sector activity in new oil fields, and to a lesser extent by increased diamond mining). Southern Africa does not have a monetary union, but the Southern Africa Development Community (SADC) foresees to accomplish on by 2016.

WEST AFRICA

West Africa is home to a group of francophone as well as a group of Anglophone countries, and two Lusophone countries (Cape Verde and Guinea-Bissau). The region has a number of countries located in semi-arid climatic zones, with very harsh living conditions and its economic performance in 2006 was affected by reductions in the output of cereals and ground nuts, as well as industrial output. However, inflation is low and economic growth in the countries of West Africa is projected to accelerate from 4.8 percent in 2006 to 5.9 percent in 2007. In Nigeria, GDP growth of 5.3 percent in 2006 is projected to accelerate to 7 percent in 2007 on account of recent increase in oil prices, increased oil production, and

non-oil sectors of agriculture and services continued their rapid growth. Sierra Leone's and Ghana's performance continued to be relatively strong in 2006 (7.4 percent and 6.1 percent, respectively).

The Economic Community of West African States (ECOWAS) is a regional group of 16 countries founded in 1975 to promote economic integration. Furthermore, the Union Economique et Monétaire Ouest-Africaine (UEMOA) was established in 1994, broadening the scope of its successors, the West Africa Monetary Union. The eight countries of the UEMOA—Benin, Burkina Faso, Cote d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo—share a regional Central Bank, Banque Centrale des États de l'Afrique de l'Ouest (BCEAO) as the supreme regulatory and supervisory body for all financial institutions operating in the UEMOA region. Furthermore, the West African Monetary Zone, a group of five countries in West Africa—The Gambia, Ghana, Guinea, Nigeria and Sierra Leone—also plan to introduce a common currency by 2009.

PART II: FINDINGS

Chapter 3: Access to Finance for Low-Income Households in Africa

3.1 Retail Capacity

3.1.1 Structure and Composition

With low bank penetration and a very large informal sector, Africa is fertile ground for microfinance. Informal finance has operated in some African countries since at least the early 20th century. Today, various informal financial services remain popular alternatives to or supplements for semi-formal or formal financial services, even in more widely banked markets. Microfinance has also taken root in many forms, and microfinance institutions have emerged in four broad categories as defined by MIX: credit unions or cooperatives, banks (including savings and rural banks), NGO MFIs, and non-banking financial institutions (NBFIs). To these we add the categories of community-managed loan funds (CMLFs) and consumer lenders, which do not report to MIX and for which there is minimal information due to their nature.

CREDIT UNIONS

Credit unions are cooperative financial institutions that began operating in developing countries after the 1950s, including Ghana in 1951, Kenya in 1964, Cameroon in 1968 and Rwanda in 1975. Credit unions in Anglophone Africa, better known as SACCOs (Savings and Credit Cooperative Organizations), do not specifically target "the poor." However, they usually attract a large percentage of people in lower income market segments, both on the savings and credit side. The advantage of having a broader client base is that, in effect, cross-subsidization takes place from some higher-income depositors who tend to contribute large volumes to the deposit base. Membership is based on the principle of a common bond such as the workplace or community; credit unions are not profit maximizers. Table 1 presents a sample of cooperative institutions that are known to serve lower-income markets and evidences how much

these types of financial institutions have proliferated in Africa. Recent data on Kenya, for instance, show even higher numbers.

Table 1: Prevalence of Credit Unions and Other Cooperative MFIs (2006)

COUNTRY	NAME	NO. OF ACCOUNTS
Kenya	KUSCCO	3,265,545
Uganda	UCUSCU	806,000
Côte d'Ivoire	FENACOOPEC-CI	598,000
Rwanda	Banques Populaires	533,000
Benin	FECECAM	378,000
Burkina Faso	Fédération des Caisses Populaires	454,000
Ethiopia	Credit Unions	381,000
Tanzania	SCCULT	500,000
Togo	FUCEC	213,000
Cameroon	CAMCCUL	197,000
Mali	Kafo Jiginew	195,000

Source: Honohan 2007; WOCCU 2006.

The importance of credit unions is not unique to Africa, and at least two recent studies of other regions have also found ample outreach. In Latin America, it is estimated that there were 6 million microfinance borrowers in 2005 from credit unions, equivalent to the outreach of all other types of microfinance institutions combined (Navajas et al. 2005, p6). In Eastern Europe and Central Asia (ECA), credit unions comprised the majority of the 5 million microfinance borrowers in the region (The Microfinance Centre for Central and Eastern Europe 2007). What is unique to microfinance in Africa, however, is the overriding importance of savings. Unlike trends in most regions around the globe, there is a long established savings culture and many MFIs are savings based, meaning savings products are the core financial service.

A Caisses Villageoises d'Epargne et Crédit Autogerées (CVECA) network is a unique type of MFI, tailored to the low population densities and harsh conditions encountered in rural Africa. CVECAs, originally promoted by the French-based Centre International de Développement et de Recherche (CIDR), grew out of an interest in improving the traditional cooperative model in West Africa (Helms 2007). CVECAs were first developed in the Dogon region of Mali in the late 1980s and later replicated in Mali, Burkina Faso, Cameroon, Ethiopia and Madagascar, with each adapting the original model to suit the local environment. Typically, CVECA clients live in rural areas, and roughly 70 percent of all loans are for agricultural activities.

Financial Service Associations (FSAs) are also member-owned institutions, but while SACCOs function under a "one man, one vote system," FSAs have voting rights proportional to the number of shares owned. FSAs initially rely on building up a strong equity base through members' shares, with the goal of leveraging that equity by taking loans from banks at commercial interest rates. Start-up costs have been subsidized by international development assistance agencies (often referred to as donors), and NGOs have done the promotional work to launch them. Comprehensive data is difficult to find on FSAs. As of 2000, roughly 160 FSAs operated in eight countries, with more than 50,000 shareholders. More recent data from Kenya shows that 59 FSAs served 60,999 members at the end of 2005.

BANKS

In the category of banks there is also a wide variety of ownership and licensing structures, ranging from traditional commercial banks to community or rural banks.

Commercial banks demonstrate increasing interest in the microfinance as well as small and medium enterprise markets. This interest was uncertain after several unsuccessful initial attempts to downscale in the 1990s. Since then, banks in Angola, DRC, Egypt, Kenya, Mali, South Africa, Tanzania, Uganda and Zimbabwe have gone down-market Ecobank has opened offices in 22 countries in West and Central Africa and offers retail microfinance services and wholesale finance in a number of them. A recent study undertaken by the Dutch banking group ING found 20 large global financial institutions involved in microfinance.

Although corporate responsibility remains an important component in their strategy, banks have started to consider a closer link between their microfinance-oriented products and their "normal" business because the sector to date has demonstrated that this market segment is bankable and profitable. An interesting evolution is that global banks have recently become involved in microfinance in African countries, a significant contribution that was rarely seen before. "Africa is going from unbanked to banked," says Frits Seegers, a Barclays executive. Hitherto, the bank had served what it calls the top of the pyramid; now spurred by competition from local African banks and by its experience in Asia, Barclays is targeting the middle and lower end (The Economist 2007).

Microfinance banks represent a subset of this category that is currently mushrooming in Central and Southern Africa. These banks are fully regulated, for profit, commercial banks that offer a broad range of products and services. But from their inception, they lend to micro- and small enterprises as their primary business purpose.[4] Business models for microfinance banks are diversifying from the dominant ProCredit Holding and Centre International du Credit Mutuel (CICM) models; more recently emerging models include Access Holding from Germany,[5] Advans group, FIDES and MicroCred from France,[6] and First Microfinance Banks funded by Aga Khan Development Network (AKDN) from Switzerland.

Rural banks and community banks are found in a number of countries, such as Ghana, Nigeria, Tanzania and Sierra Leone. The most important example is Ghana, where rural and community banks reach 2.5 million clients. In Nigeria, the government passed a law requiring all deposit taking MFIs to meet a set of criteria set out specifically for what are referred to as Microfinance Banks (MFBs). The law implied that all former community banks had to meet the requirements and re-register as MFBs; by April 2008 730 MFBs had been licensed.

Agricultural and development banks typically enter the microfinance sector through wholesale lending to NGO MFIs or NBFIs; but in some countries, such as Mali or Burundi, they also penetrate the micro- and SME finance market segments directly.

Savings Banks, including Postal Office Savings Banks (POSBs), are another type of bank, often with low minimum required balances, which make them accessible to the poor. POSBs were introduced to Africa by former colonial powers as early as the end of the 19th and beginning of the 20th centuries.

Table 2: Savings Banks in Africa

COUNTRY	NAME	NO. OF ACCOUNTS
Egypt	National Postal Authority	11,000,000
Algeria	Algérie Poste (also agent of CNE)	7,100,000
Tunisia	La Poste Tunisienne	2,254,000
South Africa	Postbank	2,100,000
Morocco	Poste Maroc	1,700,000
Zimbabwe	People's Own Savings Bank	1,695,000
Kenya	Kenya Post Office Savings Bank (KPOSB)	1,200,000
Niger	Caisse Nationale d'Epargne (CNE)	1,124,000
Tanzania	Tanzanian Postal Bank	954,000
Cote d'Ivoire	Caisse d'Epargne et des Cheques Postaux (CECP)	828,000
Cameroon	Caisse d'Epargne Postale	700,000
Madagascar	Caisse d'Epargne	574,000
Burkina Faso	Caisse Nationale d'Epargne	363,000
Benin	Caisse Nationale d'Epargne	350,000
Botswana	Savings Bank	287,000
Mauritius	Postal Savings Bank	245,000
Sudan	Savings & Social Development Bank	230,000
Namibia	Postal Savings Bank	209,000
Malawi	Malawi Savings Bank	204,000
Cape Verde	Caixa Económica de Cabo Verde	200,000
Togo	Caisse d'Epargne de Togo	200,000
Senegal	Caisse Nationale d'Epargne	197,000
Gabon	Caisse Nationale d'Epargne	175,000
Uganda	Postbank Uganda	122,000

Source: Honohan, P., Beck, T. (2007), "Making Finance Work for Africa," World Bank, Washington, DC, USA.

Most savings banks limit their services to savings and transfer services, though some have also started to lend. Given their wide network of branches, the clientele of savings banks includes people from all income levels. For instance, the Tanzania Postal Bank, similar to many other African postal banks, has a larger network of outlets than the rest of the Tanzanian banking system combined. It is estimated that 14 percent of its roughly 1 million accounts are in the low-income category (Oxford Policy Management Ltd. 2006), which amounts to 140,000 people. Postbank in South Africa reaches over a million clients with a recently introduced low-cost savings account, referred to as "mzansi." Postal banks in CAR (Central African Republic), Cameroon, Comoros, Cote d'Ivoire, Ethiopia, Mauritania, Madagascar, Senegal, Sudan, Tanzania, Togo, Uganda and Zambia are reported to operate in the lowest-income quintile. The reach of this type of formal financial institution is illustrated in Table 2.

Throughout the continent, Postal Banks reach approximately 4 million people in the lowest income markets and many more in lower middle-income. The Caixa Económica de Cabo Verde, National Kenya Post Office Savings Bank, Malawi Savings Bank, and Tanzanian Postal Bank are known to be active in microfinance. Postal banks in North Africa are extremely large and some work with MFIs to offer savings services.

NGO MFIs

NGO MFIs can be international network affiliates or stand alone local NGOs, and are largely credit-only institutions. They have often played critical roles in nascent markets. Some NGO MFIs are large in size, for example, Al Amana in Morocco (481,000 clients), Jamii Bora in Kenya (170,000), LAPO in Nigeria (130,000) and PRIDE in Tanzania (99,000);[7] however, the majority of NGO MFIs do not exceed 40,000 clients. An exception to this is North Africa, where the variety of legal options for MFIs is limited, resulting in widespread use of the NGO structure. Especially in North Africa—home to some of the sub-region's younger sectors, which are characterized by larger average loan sizes—NGO MFIs have managed to grow very fast.

NON-BANK FINANCE INSTITUTIONS (NBFIs)

NBFIs are for-profit financial institutions, which are not registered as commercial banks, and typically are characterized by lower capital requirements. Increasingly, MFIs are seeking this legal status as a means to offering a greater range of services than NGO MFIs and seeking regulated status. NBFIs have emerged in Ghana, Guinea, Kenya, Rwanda, Sierra Leone, Tanzania, Uganda and Zambia, as well as in Ethiopia.[8] Some NBFIs have transformed from NGO MFIs, while others were founded as private entities. NBFIs also count among them parastatals—a company or agency owned or controlled wholly or in part by the government—like Malawi Rural Finance Company (MRFC). Consumer finance companies providing short-term loans at high rates for consumption purposes can be NBFIs and are widespread in countries with larger middle classes. Building societies also have a long history in Africa, and, because of the challenging housing finance markets on the continent, some of them have ventured into other market segments such as microfinance.

COMMUNITY-MANAGED LOAN FUNDS

The fifth category of microfinance service provider, community-managed loan funds (CMLFs), are also referred to as revolving funds, self-managed village banks, Village Savings and Loans Groups (VS&LGs), Accumulating Savings and Credit Associations (ASCAs) and community based finance (CGAP 2006). CMLFs tend to have between 5 and 40 members and are not managed by professional staff; instead members, who are sometimes illiterate, both own and manage their funds. One of the most famous is the Mata Masu Dubara (MMD) in Niger, which managed to reach a phenomenally large group of people—196,000 by June 2007—in remote or sparsely populated areas. The outreach for CMLFs in Africa at-large was close to 600,000 by 2006 and 1.2 million now.

CONSUMER LENDERS

This category of microfinance service provider are consumer lenders, referred to as money lenders (MLs) in South Africa. Consumer lenders can in particular be found in more developed and higher income markets, but the relatively new entrant group Blue Financial Services is aggressively entering other markets as well.

CONCLUSION

Table 3, below, shows the types of MFIs reporting to MIX for each African sub-region. While this is only a subset of the total MFI landscape, with important omissions like the hundreds of community- and rural-banks in Ghana and Nigeria, we can draw some conclusions as to the resemblance or variance of this landscape per sub-region.

The table shows that though cooperative networks are represented throughout Africa, with a few exceptions (mostly in North Africa, but also Angola and Sierra Leone) they appear dominant in both West and Central Africa. This is in line with what we found in the one-pagers per country. In East Africa, the NBFI is the most prevalent type (with ten MFIs of this type in Uganda alone). Most of the reporting commercial banks and rural banks involved in retailing microfinance services are currently in East and Southern Africa. In particular, in Southern Africa, the bank model seems a driver of sector development; the NGO MFI model gives the impression to be widespread, but has been less successful in scaling up financial services to the poor. In North Africa and Southern Africa (notably South Africa, Malawi and Mozambique), the dominant type of reporting MFI is the NGO. However, only two of the nine listed NGO MFIs in South Africa reported in 2006 and some have meanwhile gone out of business so the number of active, existing NGO MFIs in this region is much less.

Table 3: Prevalence of Various Types of MFI in the Various Sub-Regions: Reporting MFIs

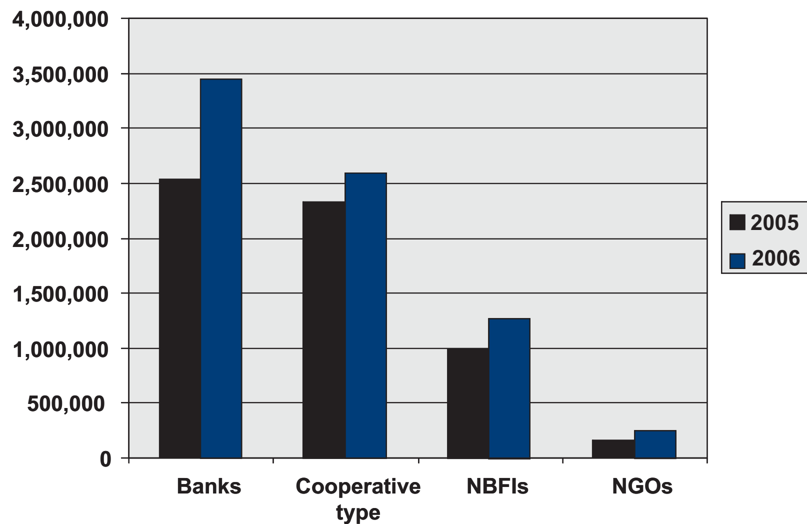
COUNTRY	BANKS (INCL. RURAL BANKS)	COOPERATIVE NETWORKS	NBFIS	NGOS
North Africa	1	0	0	22
West Africa	0	48	10	29
Central Africa	2	16	17	9
Southern Africa	7	1	13	22
Indian Ocean	0	8	1	0
East Africa	6	6	35	20
TOTAL	16	79	76	102

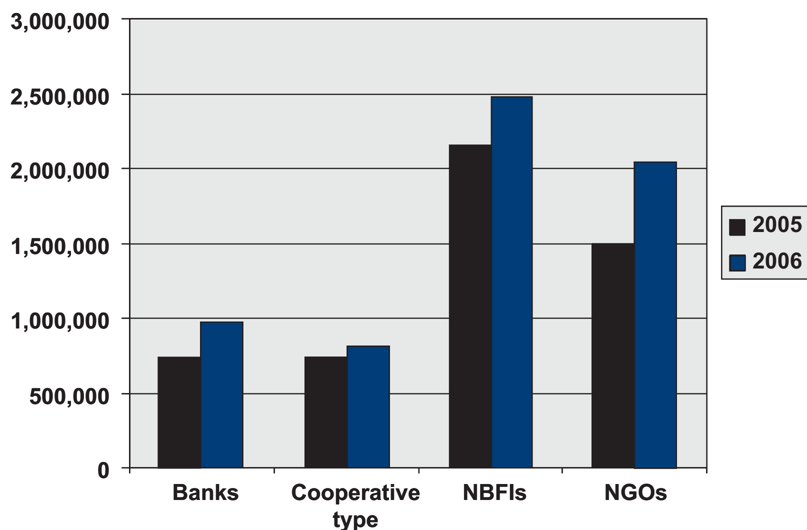
Source: MIX Demand, December, 2007.

While institutional types and structure may vary, an interesting phenomenon has been noted in about a dozen countries in Africa, mostly francophone ones: the microfinance sector is dominated by a single institution, making the market near monopolistic. Countries with somewhat monopolistic microfinance sectors include Algeria, Burkina Faso, CAR (Central African Republic), Republic of the Congo, Guinea, Côte d'Ivoire, Mauritania, Rwanda, Seychelles, Swaziland, and Togo.[9] While these large institutions have more resources to innovate, they face limited competition to encourage efficiency and pose systemic risks to these sectors.

Figure 2 below seeks to discern whether there are any trends among a sub-set of MFIs, the ones reporting to MIX. It evidences that between 2005 and 2006, in terms of savers, banks demonstrate by far the fastest growth. In terms of growth in the number of borrowers, however, NGOs and NBFIs show the highest growth rates. The rapid growth of the NGOs can be attributed to phenomenal growth rates in North Africa, where most MFIs are NGOs. Among the reporting credit unions, the growth in borrowers is very low.

Figure 2: Growth Rates of Various Types of MFIs in Africa



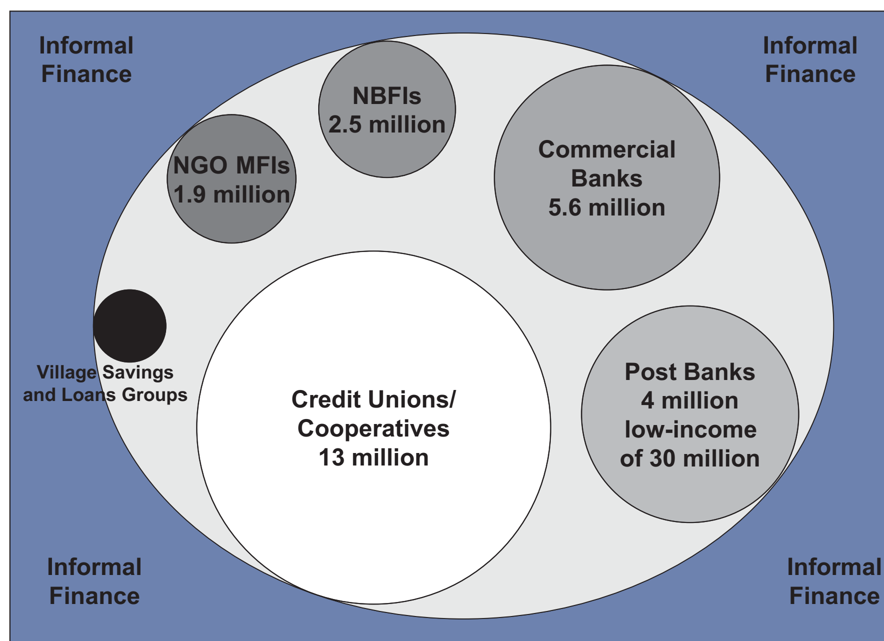


Source: Compiled from MIX Demand.

In terms of the broader dynamics in the composition and structure of sectors over time, there are two elements that should be taken into account. First, many microfinance sectors have started out primarily with NGO MFIs. Once MFIs mature and their funding needs start to grow exponentially, they often start to search for other organizational forms that can better accommodate their specific needs. Many transform into NBFIs, such as the affiliates of FINCA, PRIDE and WWB operating in a number of East African countries. Some transform into full fledged banks, like K-Rep Bank in Kenya, or on rare occasions acquire a mutualist legal form, like ACEP in Senegal. Over time, sectors also experience a diversification of their options, along with changing legal and regulatory frameworks for MFIs. The first wave of frameworks limited the diversity of MFI institutional charters in some countries; however, these limitations are now being corrected in a second wave of alterations to the legal and regulatory

frameworks. Second, the industry itself is maturing. On the one hand, this implies that some sectors attract the interest of regulators and are now being regulated earlier on; on the other hand networks or investors in MFIs, those who sponsor greenfield start-ups, are becoming more experienced in incorporating MFIs themselves as banks, NBFIs and other regulated forms from inception.

Figure 3: Financial Access to Low-Income Households in Africa: an Indication of Magnitude (2006)



3.1.2 Size

MFIs

The most distinctive feature of microfinance in Africa is the importance of savings. Unlike trends in most regions around the globe, African MFIs offer savings as a core financial service (MIX 2006a). Many African MFIs also have more savers than borrowers; in 2006, the average MFI in Africa served 60,000 savers, compared to 30,000 borrowers.

The Top 10 MFIs in terms of client numbers are presented in Table 4. It demonstrates that various types of MFIs can be among the top as the lists contains banks, credit unions, NBFIs, and NGOs. The table highlights that nine out of ten of the MFIs with very large outreach are home grown. All of those also show impressive financial performance except for FENACOOPEC-CI in Côte d'Ivoire. The first five MFIs have all the largest outreach in savings, Equity Bank in Kenya topping the list with 1.84 million savers. ACSI in Ethiopia reaches most borrowers with almost 600,000 clients at year-end 2007.

As such, the sector has seen a significant evolution since the 1999 IFPRI survey, which found that only cooperatives served more than 100,000 clients; the largest microfinance bank in Africa was Centenary Rural Development Bank, serving 86,000 clients. Today in Africa, there are organizations that reach ten or twenty times these numbers.

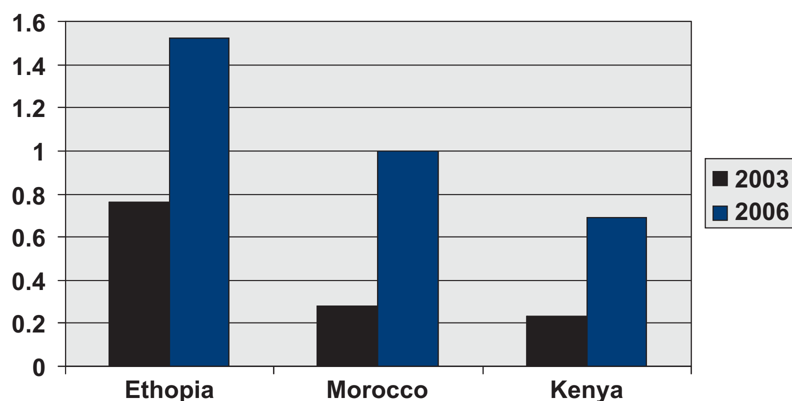
Table 4: Largest MFIs in Africa (2006/2007 data)

COUNTRY	NAME	TYPE	OUTREACH
Kenya	Equity Bank	Bank	1,840,000 savers
Kenya	KPOSB	POSB	1,280,000 savers
South Africa	Capitec	Bank	783,000 savers
Cote d'Ivoire	FENACOOPEC-CI	Credit union	598,000 savers
Ethiopia	ACSI	NBFI	597,000 borrowers
Uganda	Centenary Rural Development Bank	Bank	559,000 savers
Rwanda	UBPR	Credit union	533,000 savers
Burkina Faso	RCPB	Credit union	513,000 savers
Morocco	Al Amana	NGO	481,000 borrowers
Morocco	Zakoura	NGO	473,000 borrowers

COUNTRY LEVEL

Figure 4 below shows the rapid growth in outreach at the country level, for some countries for which we could find historical data. It demonstrates very high growth between 2003 and 2006 in both the number of borrowers and the number of depositors.

Figure 4: Evolution of Microfinance in Africa



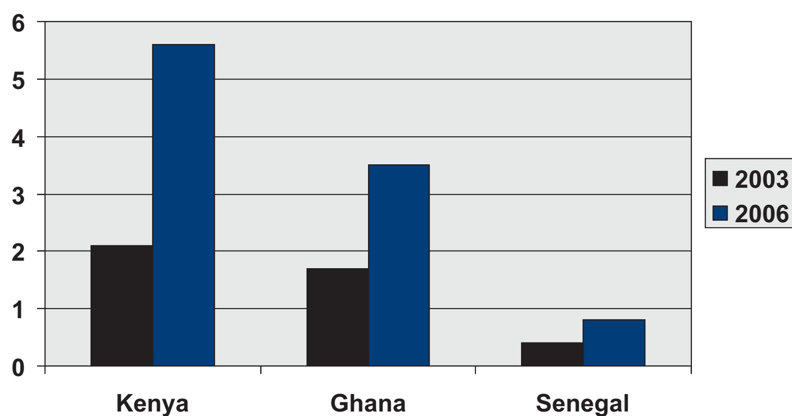


Table 5 below provides an overview of the countries with the largest outreach in absolute terms and as a percentage of the poor. In terms of borrowers, it shows that South Africa, Ethiopia and Morocco have the largest outreach in absolute terms, while Morocco, South Africa and Senegal are the greatest in outreach as a percentage of the poor with 17 percent, 10 percent and 9 percent respectively.

Table 5: Countries with Largest Outreach as of December 31, 2006

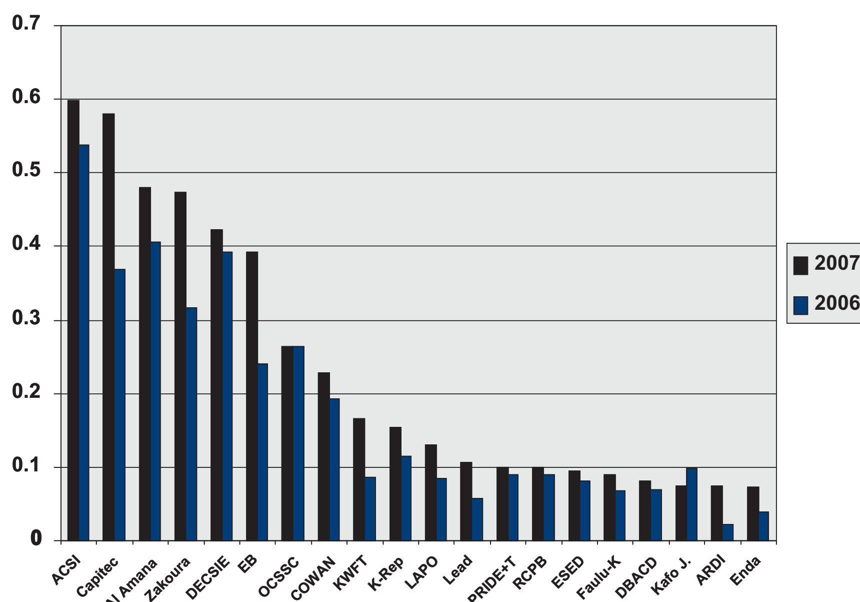
BORROWERS (AND % OF POOR)		SAVERS (AND % OF POOR)	
1. South Africa	3.3 million (10 %)	5 million (28 %)	1. Kenya
2. Ethiopia	1.5 million (5 %)	4.2 million (8 %)	2. South Africa
3. Morocco	1 million (17 %)	3 million (36 %)	3. Ghana
4. Kenya	.69 million (4 %)	1.7 million (16 %)	4. Uganda
5. Ghana	.63 million (8 %)	1 million (2 %)	5. Nigeria
6. Egypt	.56 million (5 %)	.74 million (19 %)	6. Senegal
7. Nigeria	.52 million (1 %)	.71 million (8 %)	7. Côte d'Ivoire
8. Senegal	.36 million (9 %)	.7 million (13 %)	8. Rwanda
9. Uganda	.36 million (3 %)	.69 million (28 %)	9. Benin
10. Burkina Faso	.33 million (5 %)	.64 million (7 %)	10. Mali

Further, it shows Kenya, South Africa and Ghana topping the list in terms of savings in absolute terms, and Ghana, Kenya, and Benin as a percentage of the poor with 36 percent, 28 percent and 28 percent respectively. So, though most of the specialists in African microfinance cite East and West Africa as the most advanced markets, by the end of 2006 the leading regions in terms of outreach appear to be East, North and West Africa, along with one country in Southern Africa—notably South Africa.

RECENT DEVELOPMENTS THAT MAY SIGNAL THE FUTURE

Moreover, between 2006 and 2007 growth has also been very high (see Figure 5), with some MFIs increasing their clientele with over 150,000 borrowers. The total increase in one year of the 20 MFIs presented in the graph is 1 million. In terms of savers, the additional clients served by the 20 MFIs is 1.8 million, of which Equity Bank increased its customers with 800,000. The total increase was 30 percent for savers as well as borrowers.

Figure 5: Growth in Number of Borrowers in 2007 of 20 Large MFIs in Africa (in Millions)



Growth during 2007 has been particularly high in Egypt, Ethiopia, Kenya, Morocco, Senegal and South Africa. We are also seeing growth rates increase rapidly in Burkina Faso, Cameroon, Nigeria, Rwanda, Tanzania, Togo and Uganda. The future appears bright, for microfinance in Africa. Low-income households will increasingly be able to access financial services as the increased outreach of these MFIs is being matched by similar healthy financial performance, which is the topic of the next section.

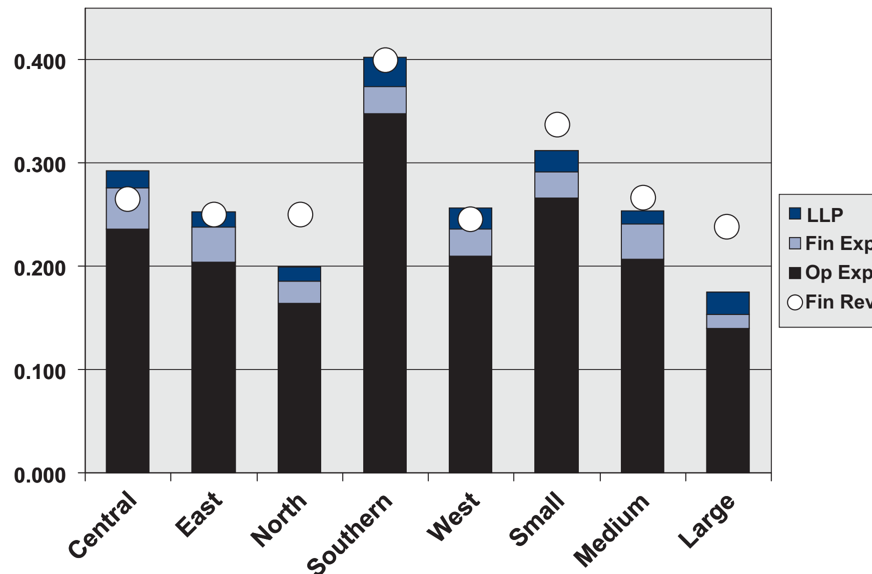
3.1.3 Profitability

PROFITABILITY IN THE VARIOUS SUB-REGIONS

MFIs in Africa, on average, appear to perform well in terms of financial health in the North Africa and East Africa sub-region. Results seem to indicate that for the Central, Southern, and West Africa regions, on average, financial performance is more marginal. Figure 6 below shows the financial revenue ratios for most sub-regions to be around 25 percent—Central, East and North Africa slightly above, and West Africa slightly below—except for Southern Africa where the financial revenue ratio reaches close to 40 percent.

It also shows large differences in cost structures, most notably in the operating expense category. On average, North Africa seems to be the best in keeping costs down, followed by East and West Africa. In Southern Africa, MFIs have very high operating expenses.

Figure 6: Revenue and Costs Ratios Compared Per Sub-Region



Source: MIX, www.mixmarket.org/demand

The main reason for lower returns can be found on the cost side as MFIs face high operating costs in Africa (see Chapter 5). The portfolio at risk is higher in Africa than other continents, which is another factor that currently drives up the MFI costs. A higher portfolio at risk reduces income and increases the costs (both in terms of provisioning for loan loss as well as the operating expenses as chasing late payments is more expensive than avoiding them). Figure 6 shows that the loan loss provision is highest in West Africa and lowest in North Africa; one could conclude from this that portfolio at risk is also highest.

However, what is interesting to note is that despite the high cost environment—operations costs, inflation, risk—African MFIs don't earn higher financial revenues than MFIs in other continents, except Asia, where costs, and in line with that the financial revenue ratio come out lowest in all surveys. Whereas banks in Africa manage to pass on their high costs to the client, MFIs do not. One reason is the large number of savings and loan cooperatives, which are member based and intend to operate profitably, but not maximize profits. Another reason is that some MFIs have opted to refrain from keeping rates high for prolonged periods like in Latin America; MFIs in North Africa reduced rates as soon as possible, thereby passing on any efficiency gains to the clients and rapidly increasing outreach. In this way they did manage to build a strong industry in a short period of time.

Evidence from the case study countries in the West Africa region reveals that in Benin and Niger many of the major MFIs posted tight or negative returns by year-end 2006. In the case of Benin, this was related to write-offs, but in other countries the reason can be attributed to low pricing. Though the return on assets increased between 2005 and 2006, from negative 1.1 percent to positive 0.2 percent in UEMOA countries (UEMOA 2007) which is quite remarkable and due to high efficiency, further improvements are needed in the legal and regulatory framework to increase or lift the interest rate cap, or else small- and medium-sized MFIs could be pushed out of the market.

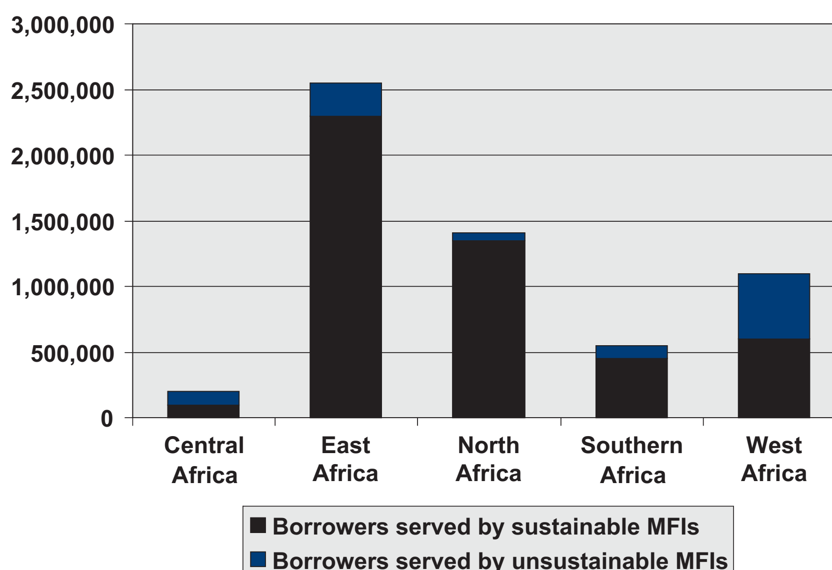
SMALL, MEDIUM AND LARGE MFIs

Figure 6 signals that, with current lending techniques, it is highly unlikely that small MFIs[10] can be a viable option in Africa, as costs are very high.[11] Their only way to remain in business would be to charge very high rates, but at some point with competitive pressures setting in, that would be hard to maintain. It would also be hard on the clients that already have to cope with higher food prices in the coming years. Even medium-sized organizations, on average, will have to find ways to find highly efficient business models or merge with others.

LEADING MFIs

MFIs that are able to reach profitability perform very well. They were not only profitable but boosted their Return on Assets (RoA) between 2005 and 2006 to a median value of around 3 percent (MIX 2008a) and an average of 6 percent. Positive returns also allowed profitable MFIs to reach twice as many borrowers as their unprofitable peers.

Figure 7: Outreach of Profitable and Non-Profitable MFIs: Borrowers in 2006



Source: MIX, www.mixmarket.org/demand

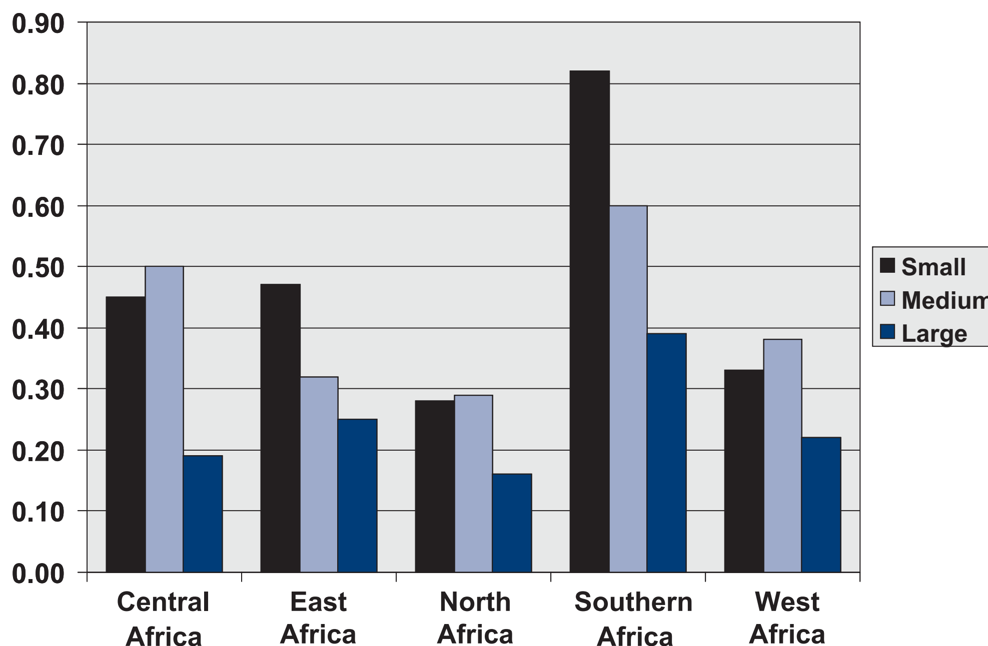
Indeed, once MFIs reached profitability, they were able to expand their operations over time, achieve economies of scale, the sought-after key to sustainability. As can be seen in Figure 7, while the number of profitable MFIs is far less than the unprofitable ones, these institutions serve a much greater number of clients in the three largest sub-regions of East, North and Southern Africa.

3.1.4 Efficiency

Like the banking sector, unit costs are higher for MFIs in Africa than elsewhere. Throughout Africa, weak infrastructure (communications and roads), low population density averages, predominantly rural markets and high labor costs, all contribute to high operating expenses. In view of this high-cost operating environment the challenges for the region are to achieve scale and reach remote areas.

The latest African benchmarking report (MIX 2007b) found that, as MFIs grow in size, productivity goes up and financial and operating expenses can be reduced. Another important finding was that when larger institutions passed the US$ 8 million threshold in loans outstanding, they could achieve high productivity and serve clients at 23 cents for every US dollar lent and thus may pass on efficiency gains to their clients through lower yields. Moreover, and while looking at averages instead of medians, in three sub-regions costs seem to on average increase when MFIs grow from small to medium, before big gains similar to what was found by MIX, in efficiencies start to set in when MFIs reach large scale. However, in East Africa, costs already drop rapidly when MFIs grow from small to medium size.

Figure 8: Efficiency and Scale: Operations Cost as a Ratio of Outstanding Loan Balance (2006)



Generally, efficiency is best for cooperatives, followed by NBFIs, in terms of operating expense per outstanding loan balance. The cost per borrower is lowest for NBFIs, followed by NGOs and cooperatives in third place. African banks show a much higher cost per borrower. Rural banks score best in terms of savings accounts per staff member, followed by credit unions and banks. NGOs and NBFIs have higher productivity in lending operations.

Remarkably, whereas one would expect that due to constraints of infrastructure and low population density productivity in Africa would be much lower than in Asia, the latest MicroBanking Bulletin, Issue 16, reports more than 140 borrowers per staff member in Africa, followed by LAC and Asia (130 and 129 respectively) and the ECA (78). As a result, it is clear that Africa's cost problem is not linked to productivity, but to high salaries and the high cost of doing business, requiring extremely tight cost controls and strong focus on client retention to overcome it.

3.2 Product Offerings

Given access to the necessary finance, farmers can move to a higher level of productivity and output. Savers, too, can share in the returns on an expanded flow of investment. Housing, insurance and pension arrangements can be lifted onto a new plane. Important foundations have been laid in Africa in terms of product offerings. This is certainly the case at the lower end of the market. Institutions that were able to build their product offerings, customer research capacity, MIS (management information) systems accommodating a broader product range and distribution systems experienced major competitive advantages.

LENDING METHODOLOGIES

Though Africa is often viewed as having a less developed microfinance industry than other continents, there are areas in which it is actually more advanced. In terms of lending methodologies, for instance, Africa is more diverse than Asia with its proliferation of Grameen replicators doing solidarity group lending, and the more recent aggressive expansion of the ASA model. In Africa, there are Grameen replicators, but also many variations and different types of group lending, village banking and individual lending. Also, as many MFIs are credit unions or banks, they are able to offer a range of products. The country case studies found that in Kenya and some other countries in East Africa, the current landscape of product diversification didn't come easily. Less than 10 years ago, many of the NGO MFIs employed similar solidarity group–lending, and they encountered ample problems in East Africa. A MicroSave-Africa report (Hulme 1999) characterized the situation as follows: "The microfinance models that have been imported to East Africa have helped the region's MFIs reach their present stage of development, but have bequeathed problems of high drop-out rates, limited outreach and mission drift."

At the heart of the drop-out/outreach/targeting problem in East Africa lies the fact that many MFIs in the region display an extraordinary degree of uniformity. Field staff implement this rigid model despite their day-to-day (often hour-to-hour) experience that it is unsuited to their clients' needs". It is only after MFIs started to invest heavily in product development and developing mechanisms for client feedback that the outreach to the low-income households started to increase exponentially. In parallel, necessary advances in MIS enabled institutions to manage the broader product offerings.

In North Africa, the solidarity group lending model prevails in Morocco. In Egypt, the market started with individual lending and only recently have MFIs started to add group-lending products.

In Southern Africa, downscaled commercial banks as well as greenfield specialist microfinance banks have emerged as the most high impact microfinance model, serving mostly savers, while consumer lenders only slowly start to master lending methodologies for enterprise lending.

In West Africa, credit unions and other savings based institutions, like community banks, or rural banks, dominate the financial landscape serving low-income households, primarily employing individual lending methodologies. Central Africa is the youngest region, and somewhat similar to West Africa in terms of lending methodologies.

TYPES OF PRODUCTS

Low-income households across the continent greatly value both credit and deposit services. Notably, in many countries, the demand for savings is even higher than the demand for credit, and one can find many savings based MFIs—thus primarily driven by a savings mandate.

Box 1: Microfinance and Housing in Africa

Housing finance represents an increasing need in many of Africa's cities, experiencing high growth rates due to urbanization. Nonetheless, housing finance meets particular challenges within many African country's legal and regulatory frameworks. Few have clear land titling systems, and several countries have competing or parallel land ownership laws that often result in questions about land ownership, difficulty in purchasing and/or transfer of ownership of land. This is coupled with poor performance in the past of building societies and specialist housing lenders.

Still, members based MFIs have long offered small loans for housing in West Africa. Other MFIs have started to offer housing microfinance to their existing clients with good credit histories. In South Africa, several initiatives, including the South Africa Rural Finance Facility, the Kuyasa Housing Fund and CHF International have offered housing finance. In Kenya, Jamii Bora is in the unique position to offer its members loans for housing plots for which it has created the construction itself, and K-REP includes construction loans for housing among its Shariah loan products offered to Islamic communities. In Rwanda, Urwego partnered with Habitat for Humanity (HFH) to offer home improvement loans, and in Malawi, HFH initiated a pilot for housing loans. In Morocco, five MFIs have recently introduced housing finance. In Ghana, CHF has joined with HFC Bank Ltd to establish a subsidiary dedicated to housing and enterprise finance.

Another type of housing loan is community based, which focuses on creating groups in low-income housing markets to save, and eventually gain access to finance. Models vary depending on the local needs. Slum Dweller's International in Swaziland and Namibia assists communities to purchase land and infrastructure in groups, as they cannot afford it individually, while the South African Homeless People's Federation created savings-first initiatives which enabled land acquisition and public lobbying.

In North Africa, MFIs are restricted in the number of products they can offer, as savings mobilization from the public is permitted only for commercial banks. Therefore, some NGO MFIs are considering scaling up by transforming into commercial financial institutions that can offer deposits and provide additional products. In North Sudan, MFIs offer only Islamic finance. The Islamic Murabaha is one of the most widely used products for short-term financing and has been adopted by MFIs. Rather than the traditional loan with interest, the MFI purchases the goods for the client, who then repays at a mutually agreed price. Margins are factored into the repayment prices. This poses both operational and logistical problems: with the need for much more stringent internal controls as MFI employees purchase goods rather than disbursing loans.

In terms of credit, many MFIs throughout Africa have moved away from a few, standardized working capital loan products, which typically catered to traders, while new entrants initiate services in a more flexible manner. Though MFIs hardly ever offer long term loans, in a number of countries they offer fixed assets, medium-term loans. Lower income housing finance has been limited both in the formal market mortgages and in microfinance home improvement loans (see Box 1)

Another interesting finding that came out of the case study countries was that in quite a number of them, agricultural finance is well developed (see Chapter 4).

Consumer lending is on the rise. In addition to typical microfinance consumption financing, such as loans for education or emergencies, the consumer finance market has skyrocketed in South Africa and made inroads into lower-income markets in Botswana, Congo, Lesotho, Namibia and Swaziland.

Local transfers and remittances play a major role in many African economies. The volumes and types of transfer services are under researched, but regarding remittances some research has been done, and the global total was estimated to be over US$ 300 billion in 2006,[12] higher than FDI and all ODA together. It is estimated that close to $39 billion was remitted to Africa. Yet, fees can be exorbitantly high. MFIs have stepped in and are seeking to find ways to reduce fees on remittance transactions, as they have recognized that their clients would benefit from a less expensive option. Furthermore, some MFIs have started to develop savings and investment products related to remittance receipts.

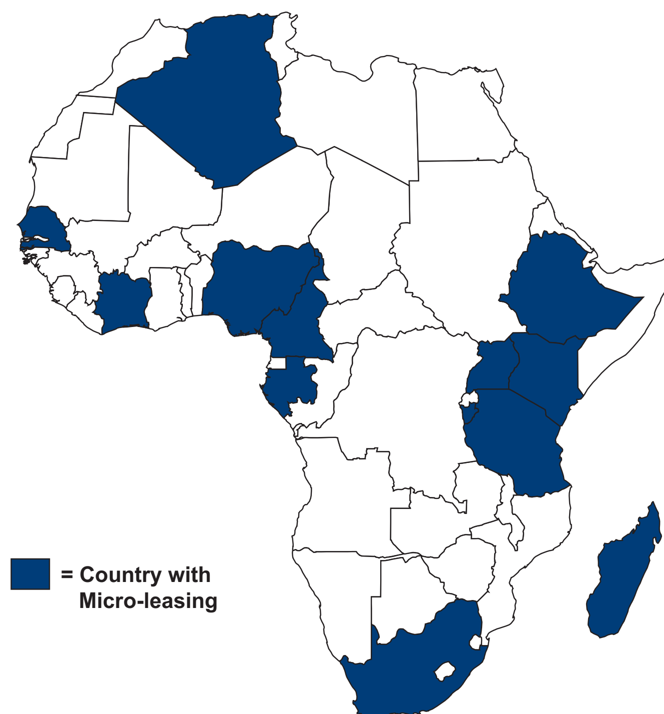
Micro-insurance is the provision of insurance services to low-income people to allow them better risk management and cope with crisis. It is finally making some headway after years of experimentation, and is even attracting mainstream insurance companies. The key insurable risks range from loan and life insurance, which are most common types, to health insurance, crop insurance, and assets/property insurance. Even the poorest of the poor operating in the informal sector in Africa often allocate a weekly or monthly amount that can help prepare for their burials and thus are a form of life insurance. CIF in Burkina Faso has developed life insurance with 6 networks in 5 countries. Health insurance is also very important in helping poor households mitigate risk and build assets. An example of a successful micro-insurer is MicroCare in Uganda (see Chapter 4). In Malawi, Opportunity International started a crop insurance program that protects farmers from severe drought that caused starvation in their villages only a few years ago. As a region, Africa has the lowest number of identified people covered by micro-insurance—with only 3.5 million lives covered. A glaring gap in micro-insurance was found in North Africa. There is some piloting of insurance products in Morocco but, as of yet, no significant evidence of micro-insurance in this sub-region.

Figure 9: Prevalence of Micro-Insurance in Africa

Figure 10: Prevalence of Mobile Phone Banking in Africa

Moreover, improvements in products, including their distribution channels, are being driven by new technology, such as cash machines and mobile phone banking, but also by the mission of microfinance providers to reach the financially disadvantaged. The first experiments in this regard are showing that a population segment of "unbankable" customers that would likely never have entered the formal financial market are now being reached. The mobile phone banking channel is also significantly less costly than bank branches. Mobile phone-based financial services have been introduced in Kenya, Senegal, South Africa and Uganda, and other countries are in the research and development phases (see Chapter 4).

Figure 11: Prevalence of Micro-Leasing in Africa



Microleasing is a service not yet offered on a wide scale. Among the case study countries, we only found micro-leasing in Ethiopia, Kenya, Nigeria and South Africa. However, there are more instances in Algeria, Ghana, Madagascar, Rwanda, Senegal and Tanzania.

The diversification phenomenon, while traditionally more widespread in Africa than in some other regions, is continuing as the latest MIX Africa benchmark report noted that empirically, it is a fact that an increasing number of financial services is being offered. Among the case study countries, Guinea-Bissau was the only country with no product diversification beyond basic savings and credit services. In most of the more mature case study country markets—Ethiopia, The Gambia, Kenya, Malawi, Morocco and South Africa—and also in Angola, major diversification efforts were going on. In Benin and Congo mobile phone banking initiatives were in advanced stages, driven by commercial investors.

3.3 Clients and Impact

WHO ARE THE CLIENTS?

Clients vary widely, and may include survivalist, self-employed people offering services or trading in one or two products, micro-enterprises, small enterprises, medium-sized enterprises, salaried people, farmers, cross-border traders, etc. Clients reside in very large markets in cities, or in remote areas dominated by the rural rhythm of life, or in post-conflict countries where clients sometimes have to start from scratch.

WHAT DO THEY WANT?

Though demand is specific to every country, for every MFI, for every market segment served, there also are some generalities to be taken into account. Clients might earn lower incomes, but they nevertheless need a broad range of financial services. Clients might be less educated than the clientele of the banking sector, but they are by no means less ingenious or less entrepreneurial. Clients are busy, with multiple household, business, and family chores: they do not want to spend hours waiting for services, and they want services close to home. Women's World Banking research has shown that microfinance customers want to be treated with respect, want simple processes and want flexible products.

Although MFIs are in close physical contact with their customers, they often lack a systematic approach to listening to their clients. For a long time the microfinance industry was one of the few in the world that was product- rather than market-driven. Product-driven companies offer their clients the products they want to offer instead of products clients want. But things are changing—the microfinance industry is catching up.

> *"Now our bank listens to us: they changed the rules to give us a grace period. So we can begin trading before we have to start repaying—so now we don't have to struggle so much to repay our loans."*
>
> *"Finally they [the MFI] recognize the seasons—there are many months in the year when we do not need credit Now we don't have to borrow all the time to stay as member."*
>
> *"The management actually came to sit and listen to us—I have never seen that before. Suddenly they seem to give us value. And we can really use the new savings account for school fees as well as when we get sick."*
>
> *Kenyan MFI Clients (Wright 2003)*

THE FRONTIER OF FINANCE: A LONG ROAD TRAVELLED OR A LONG WAY TO GO?

While financial sector integration is about the entire spectrum of finance—from enterprise and consumer finance to micro-, small-, medium- and large-size enterprise finance—it is important to reflect on where the industry is at in reaching the most difficult unbanked market segments.

We selected a number of key dimensions of depth of outreach and potential poverty impact and compiled indicators for the 14 case study countries to shed light on the progress in moving the frontier of finance in Africa.

Table 6: Depth of Outreach Illustrated: MFIs with Low and High Outreach

COUNTRY	WOMEN	AV. LOAN BALANCE PER BORROWER (IN BRACKETS AS % OF GNI)[13]—US$	AV. SAVINGS BALANCE (IN BRACKETS PER GNI)—US$	RURAL OUTREACH	PRODUCTIVE SECTOR
Angola	55 % - 64 %	315 (16 %)	—	√	√
Benin	28 % - 93 %	91 (17 %) – 1592 (295 %)	23 (4 %) – 215 (93 %)	√, every 50 km	40 %
Congo	36 % - 80 %	285 (30 %) – 1480 (156 %)	342 (36 %) – 366 (39 %)		MUCODEC
Egypt	21 % -100%	80 (6 %) – 257 (19 %)	—	√, POSB	Very Little
Ethiopia	19% - 93%	61 (38 %) – 217 (130 %)	11 (7 %) – 122 (76 %)	√	> 63 %
Gambia	39% - 100 %	38 (13 %)	—	√	Some SMEs
Guinea B	49 % - 70 %	—	—	—	—
Kenya	48 % - 100 %	84 (14 %) – 473 (82 %)	164 (28 %) – 1590 (274 %)	√	√
Malawi	40 % - 100 %	28 (16 %) – 529 (311 %)	120 (74 %)	√, MRFC	√
Morocco	32 % - 93 %	199 (10 %) – 540 (28 %)	—	—	—
Niger	18 % - 100 %	81 (54 %) – 438 (168 %)	81 (31 %) – 111 (137 %)	All regions, but little rural	—
Nigeria*	90 % - 100 %	> 71 (12 %) – 94 (16 %)	157 (25 %)	√	—
South Africa	50 % - 99 %	155 (3 %) – 1018 (21 %)	213 (4.5 %)	—	—
Sudan	68 % - 100 %	314 (39 %)	16 (2 %)	—	—

Source: MIX and case study country primary data collection.

* Does not include (former) community banks, which have a lower percentage of female clients and likely higher average loans.

Women are generally assumed to have less access to finance than men. In recognition of this reality, from the beginning of the microfinance movement, one of its cornerstones has been to strengthen purchasing power of women. Outreach to female clients is not only important because they are generally considered poorer than men, but also because they tend to spend a greater portion of their incomes on their families. Table 6 shows that there are countries where some MFIs fall short in reaching women, such as in Benin (where the dominant MFI, FECECAM, reaches only 36 percent women), Congo, Ethiopia, and Niger. But in other countries, such as Kenya, Nigeria and South Africa, MFIs often reach more than 50 percent women. Some MFIs offer services almost exclusively to female clientele. In the case study countries, examples include Al Tadamun in Egypt, GAWFA in The Gambia, AMSSF in Morocco, KWFT in Kenya, Microloan Foundation MWI in Malawi, MECREF in Niger, LAPO in Nigeria and SEF in South Africa.

It would seem that in countries where the sector has initially been driven by international NGO MFIs the outreach to women is higher; sectors that are primarily home-grown like Ethiopia and countries where

mutualist MFIs are dominant seem to struggle in reaching women. In some countries with traditionally low outreach to women, MFIs have started to partner with technical assistance providers in group lending which usually attracts women or with specialist microfinance NGOs to address this.

In terms of income levels reached, the average loan per borrower and average balance per saver are perhaps the most commonly used proxy-indicators to measure depth of outreach. Table 6 shows that in The Gambia (GAWFA), Nigeria (LAPO, Development Exchange Centre and Self-Reliance Economic Advancement Programme) and South Africa (SEF), there are MFIs that manage to reach a very poor group with loans, both in terms of absolute loan size, as well as a percentage of GNI per capita.[14] The average loan balance per borrower for all regions in the world is US$ 1,031 and 85 percent as a percentage of GNI per capita (MIX 2008c). Morocco and Egypt show that most of the MFIs have borrowers in the same low-income category. Benin and Malawi managed to grow more with their clients, serving a larger spectrum. The average savings balances in the table also demonstrate that MFIs reach some of the poorest segments, with some attracting clients who save as little as US$ 11.

In terms of outreach into rural areas, eight of the case study countries did manage to offer services in rural markets, notably Angola, Benin, Egypt (savings only), Ethiopia (almost all MFIs), The Gambia, Kenya, Malawi and Nigeria (600 Microfinance Banks, formerly community banks). In Ethiopia and The Gambia, most of the recipients of microfinance are in rural areas, which is quite exceptional (see Chapter 4).

In terms of productive sector stimulation, the value added to the local economy is higher when MFIs manage to shift away from offering just a few of the original microfinance loan products—such as standardized, short-term, and stepped working capital loans, which typically catered to traders—towards more flexibility in loans to meet the demands of manufacturing or agricultural and agro-industrial businesses. We found that the dominant player in Benin, FECECAM, has 40 percent of its portfolio in agriculture. MFIs in Ethiopia have a remarkably high percentage of loans in the agricultural sector, over 63 percent.

IMPACT ON POVERTY REDUCTION

Impact of microfinance is assumed to occur at any one or more of the following levels: the individual, the household, the enterprise and the community level (see Box 2). But determining impact on poverty reduction is difficult because "poverty" means different things to different people and is hard to measure. Effects on poverty reduction are also hard to attribute because the impact chain is complex—there are a host of mediating factors such as service features, client characteristics, geography, social structure and power relationships, infrastructure, and the macro economy. But scientific tools have been developed over the years.

A recent impact study found significant impact of the CMLFs (see Figure 12). In eight of the nine districts household income increased considerably compared to the household income levels at the beginning of the project, varying from 25 percent to eight-fold increase.

Box 2: Types of Impact of Microfinance in Africa

Impact on the business. *Participation in a microfinance program leads to improvements in the business, including acquisition of fixed assets and, in some countries, even employment levels: 91 percent of Zakoura's clients in Morocco said that their fixed assets had increased during the preceding 12 months, and 17.5 percent of the clients said that they hired new employees. In Egypt, clients that had had longer access to microfinance had 44 percent more employees, as compared to new clients. In Nigeria, LAPO's microfinance clients had higher enterprise profits and investment in some enterprise assets than non-clients.*

Business skills. *Poorer clients that have joined group-lending programs can learn during the group meetings from interactions with their peers:*

- *In Morocco, 65 percent of the clients keep capital for their business separate from household funds since they began participating in a microfinance program,*
- *66 percent of women in Ethiopia have acquired skills for calculating loss and profit since joining a microfinance program*

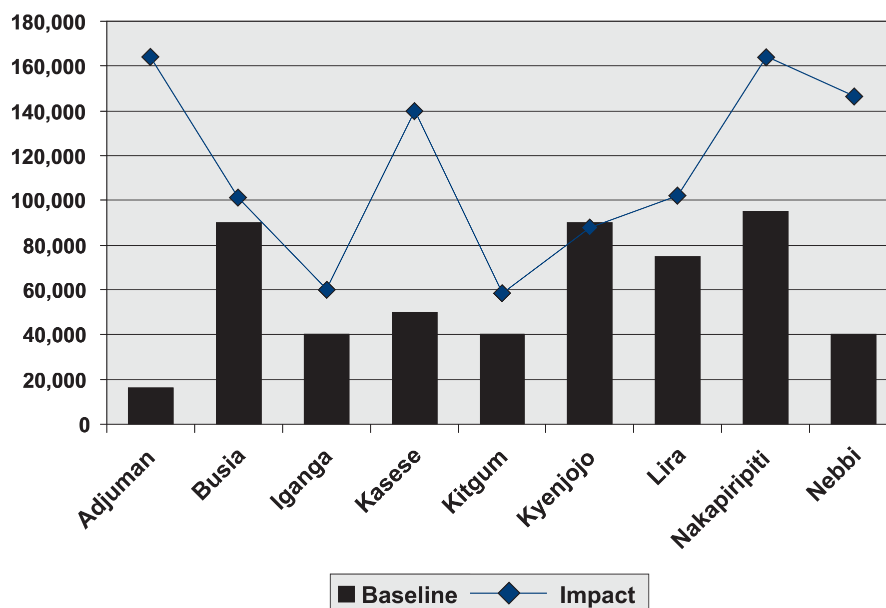
Individual level impact. *60 percent of women in Ethiopia felt stronger and had more self confidence after participation in a microfinance program. Some women end up participating in local elections, as was the case in Morocco.*

Household level impact. *Housing improvement is an indicator for impact at the household level, as it can demonstrate an increased income. In Ethiopia, 47 percent of the clients made home improvements, compared to 24 percent of non-clients.*

Education. *In Morocco, 84 percent of clients send their school-age children to school, compared to 68 percent of non-clients. In Ethiopia, the figure shows that 77 percent of the clients send their children to school, compared to 68 percent of non-clients. In Nigeria, having access to microfinance had an impact on the enrolment of secondary school by children.*

Source: Various Client impact studies—see References.

Figure 12: Comparison of Household Income at Baseline and Impact Assessment (Uganda)



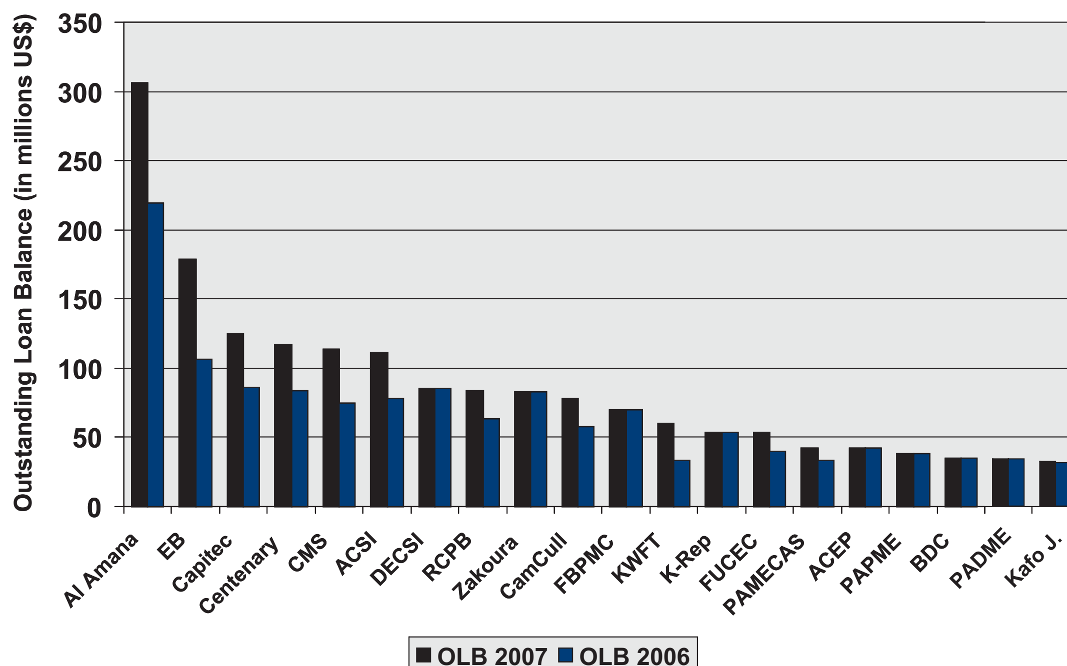
Source: CARE, SUSTAIN Program. Impact Assessment Report, 2008.

3.4 The Financing Side

Financing needs are high, and increasing rapidly. Figure 13 below shows the increase in outstanding loan portfolio of some major MFIs. The largest MFI appears to have grown with almost US$ 100 million, the second largest with US$ 80 million, another four have grown with about US$ 50 million and another three with some US$ 30 million.

If the domestic financial market is to respond to these type of funding needs of MFIs, some of the key financial instruments and arrangements needed include well developed domestic savings mobilization capacity, ample availability of local currency loans, and—as financial markets develop—bond issues, securitization and local equity markets for larger MFIs. In addition, younger MFIs also need grants and soft loans. A broad range of financing is crucial for MFIs to facilitate leverage, allowing MFIs to scale-up. By accessing all sources of capital, MFIs will become more fully integrated into the financial sector and will have the ability to raise capital regardless of market conditions.

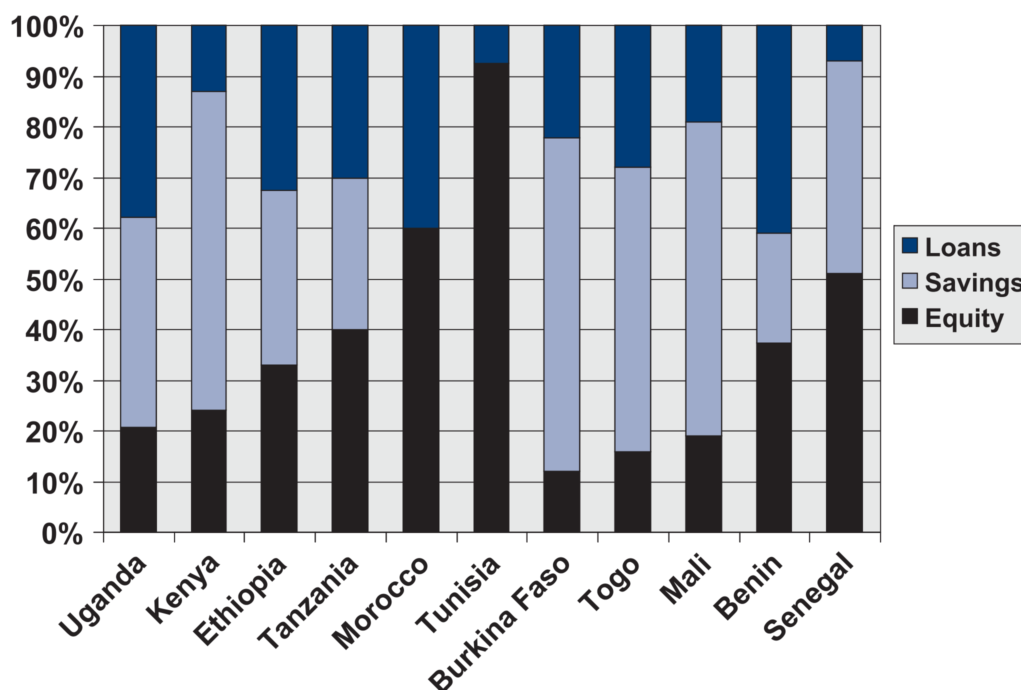
Figure 13: Growth of Some of the Top 20 MFIs for which 2007 Data was Already Available



TYPES OF FINANCING AVAILABLE

Figure 14 demonstrates some distinct features of funding sources for African MFIs. It shows that in all but one country, on average, MFIs source the largest amount of their funding from either savings (Burkina Faso, Ethiopia, Kenya, Mali, Togo, Uganda) or equity (Morocco, Senegal, Tanzania, Tunisia). Only in Benin, most of the MFI funding is sourced from loans.

Figure 14: Types of Funding Sources in Selected Countries in Africa



Source: Forum for the Performance Evaluation of African MFIs, 2006.

Equity funding of MFIs in Africa makes up the majority of funding in the North African countries Morocco and Tunisia as the prevailing NGO-MFIs are not allowed to mobilize deposits. For the other countries, for the most part the industry still remains highly underleveraged, so there is room to further leverage their level of activities through savings mobilization, loans or other debt.

To date, African MFIs appear to favour deposits over commercial loans as a source of funds, so the first thing would be to increase the savings mobilization capacity further. If one looks solely at the MFIs that report to MIX, US$ 1.48 billion was mobilized by year-end 2006. If one adds the SACCO information from WOCCU, the total comes to US$ 4.08 billion. There are ample improvements to be made in terms of demand driven product design and in the area of automation of the management information system (MIS).

However, to meet the abundant funding needs, MFIs will have to beef up their access to loans as well. The average loans in most cases hardly make up 30 percent in these eleven countries. This is partly due to reluctance of commercial banks that until recently have been unfamiliar with the MFI market segment, and partly due to the very high financing cost in Africa, that is only just starting to come down in some countries. However, this does not imply that the financing volumes are negligible. For example, among case study countries Benin, Kenya and Morocco, MFIs rely heavily on access to local banks to finance their growth. PADME in Benin had an annual need of CFA 20 billion (US$ 45 million), which it seeks to raise on the financial market.

In terms of access to international loans, for Africa, this form of financing mainly reached the microfinance banks, which covered the entirety of their loan portfolios with market-price funding. Conversely, NBFIs financed only a third of their portfolios, and NGO-MFIs only a fifth, from commercially-priced liabilities (MIX 2007 p3).

Despite the fact that there is a huge potential demand for financial services, as evidenced by the fact that MFIs in Africa make up 295 (or 24 percent) out of the total of 1,225 reporting to MIX, they have not benefited from the international and commercial funding afforded to those elsewhere in the world, most of which is in the form of short, medium or long term debt, though some now also offer equity:

- Of the total Microfinance Investment Vehicle (MIV) portfolio, over 80 percent is in the LAC and ECA regions alone (Reddy 2007, p2), with only approximately 10 percent for MFIs in Africa;
- In a smaller sample being analyzed by CGAP[15] only 7 percent of MFI investments made by 39 MIVs are in Africa.
- CGAP estimates that only 6.4 percent of total International Financial Institution (IFI) funding went into Africa in 2005 (an increase from 1.3 percent in 2003) and 70 percent to LAC and ECA (Latortue et al 2007, p 16). As at the end of December 2005, only US$ 9 million out of the International Finance Corporation's (IFC) total investment of US$ 352 million (or 2.5 percent) for Microfinance was in Africa, though the total has since increased to around US$ 600 million and the percentage going to Africa also increased.

AfriCap remains the only investment fund specialized within the African region, though there are a number of microfinance wholesale funds at the country level. Seven years after it was established, AfriCap has recently closed a second fundraising round at US$ 50 million. One other specialized microfinance fund for Africa is in the design stage and expected to be launched during 2008, CABE Microfinance Capital Management. Further, the US Government has pledged US$ 250 million to start three privately-managed funds to invest in African financial assets, called the Rohatyn Group, Millennium Global Investments and Advanced Finance & Investment Group.

Table 7 shows the main MIVs investing in Africa. It also shows that the total investment for Africa is only US$ 125 million. Moreover, funding is concentrated in a handful of the African countries, with East Africa (Kenya, Uganda and Tanzania) and South Africa being the most popular, followed by Madagascar, Mali and Ghana.

Table 7: Microfinance Fund Exposure to Africa

FUND	TOTAL MFI INVESTMENTS (US$ MILLION)	PERCENTAGE IN AFRICA	DERIVED INVESTMENT (US$ MILLION)
AfriCap	13.3	100	13.3
CORDAID	63.5	18	11.4
Dexia	125.9	2	2.5
DOEN	79.1	15	11.9
Gray Ghost	75.0	7	5.3
HIVOS-Triodos	28.8	36	10.4
I&P	12.7	22	2.8
Impulse	23.8	5	1.2
Oikocredit	304.2	15	45.6
ProCredit	110.9	6	6.7
ResponsAbility	96.2	4	3.9
Triodos Fair Share	18.6	12	2.3
Triodos Doen	45.2	15	6.8
Unitus	9.5	15	1.4

Source: www.microcapital.org; www.mixmarket.org (compiled by Opportunity International in April 2007).

Certain entities may not provide finance directly to MFIs, but their support may be of assistance. For example, some financial organizations, such as the French Development Agency (AFD), European Investment Bank (EIB) and USAID, are prepared to provide guarantees to facilitate or improve the pricing of financing from banks or other sources.

Wholesale funds and apex institutions are also useful sources of financing. These bodies provide loan funds and often complemented by technical support to MFIs, and can support the expansion of microfinance institutions at different stages. Examples are Jitegemee Trust Limited in Kenya, the Financial Sector Deepening Trust in Tanzania, the Microfinance Investment and Technical Assistance Facility (MITAF) in Sierra Leone and newly created funds Jaida in Morocco and South Africa Microfinance Fund (SAMAF) in South Africa.

CONCLUSION

In summary, while in some countries local banks are starting to fight for the leading MFIs and there are a number of promising new commercial, public and private funding initiatives in Africa, the overall quantum is still well short of that needed to reverse the poverty challenge through financial services provided by MFIs. Moreover, recently announced innovative structures for MFIs, such as the Global Microfinance Fund, the Blue Orchard US$ 96 million Collateralized Debt Obligation and a number of securitizations, tend to be for countries outside Africa.

Box 3: Microfinance Industry Infrastructure

Accurate, standardized, and comparable information on financial performance is imperative for integrating microfinance into the financial system. The lack of widespread adoption of standard terminology, ratios and indicators remains a constraint. In the same vein, there is a need for regional rating agencies and credit bureaus.

Microfinance professional associations can optimize the collective ability of financial institutions to improve transparency about their performance and the availability of information, dialogue with government and advocate for policy changes that make small-scale financial transactions possible, build up technical and managerial skills including dissemination of best practices and negotiate with service providers and funders.

The inadequate human and institutional capacity at the micro level remains a key constraint to extending access of financial services on the ground. Therefore, it is imperative to ensure that an adequate supply of technical service providers and educational institutions exists to build the skills of existing and future managers and staff within financial institutions that serve the poor.

IT platforms and the application of technology to microfinance is another important element in industry growth. Service providers such as information and point-of-sale technology vendors will ideally be locally available.

Furthermore, service providers such as external auditors that are familiar with MFIs are needed for industries to grow credibly and for early feedback to fast growing MFIs. In the same vein, a body of researchers that understands low-income finance is critical to generate a body of knowledge that will lead to a critical mass of informed actors. It is also necessary to foster innovation in the local context.

The payments systems in many countries are inadequate to enable poor (and other) clients to move money around the country in a secure, cost-effective and efficient manner. Yet the possibilities for some countries to leapfrog technologies and implement advanced electronic payment systems may help solve this problem in the future, potentially offering payment services for hundreds of millions of people.

Donors are needed to promote innovation, improve financial infrastructure, encourage increased transparency on performance, finance skill-building at all levels;, lobby for an improved enabling environment and possibly establish joint donor facilities to this end.

3.5 Industry Infrastructure: the Meso Level

In addition to strong retail capacity, and funding sources to ensure growth, domestic financial markets that work for the majority need an industry infrastructure.

Financial institutions cannot operate in a vacuum. They rely on a well-functioning financial infrastructure or "architecture," along with a web of other providers offering a range of services required to reduce transaction costs. This is called the meso level. The meso level is perhaps the least understood component of the financial system within the microfinance community. It extends from financial infrastructure to systems that promote transparency of financial institutions, technical service providers that offer training and consulting services, and professional associations and networks (see Box 3). An effective meso level is critical for the functioning of the financial system as a whole and especially for expanding access to financial services for the poor (Helms 2007)

We tried to ascertain the progress in building these elements by looking at the situation in the case study countries. In many countries in Africa, standardized, transparent MFI performance information consistent with international definitions is not yet widely available. It was found this was not necessarily a symptom of young industries as some mature markets also display large information gaps. There is a close relation between the level of information and the performance of the microfinance associations. With the exception of Egypt and Morocco, no country without a reasonably strong network has a comprehensive depository of information. It is likely that Egypt and Morocco were able to develop their capacity in this through their association with the regional Sanabel network and the Microstart projects in those countries. In those countries where transparency and employment of international standards by MFIs have taken root, this has resulted in improved performance and expanded financial markets for MFIs.

In terms of MFI professional associations, among the case study countries Ethiopia's association excels, and the association in Benin is also very strong. These two associations have resulted in the development of some of the most advanced microfinance markets. From other countries Ghana, Madagascar and Uganda are also doing a very good job. The range of activities of associations will differ depending on the stage of sector development, but its core functions of information collection and dissemination and dialogue with government are the same everywhere. As such, associations could play equally important roles in countries like Angola, Guinea-Bissau and Sudan, where the microfinance sectors are still nascent and the country context is difficult, small countries like The Gambia and large countries like Nigeria.

The increasing number of audit firms trained in microfinance as well as specialized local rating agencies is furthering improvements in reporting. Benin, Kenya and Ethiopia have audit firms skilled in microfinance. Rating agencies are starting to surface in Kenya, Morocco, Nigeria and South Africa.

As competition increases, and MFIs start to serve the same markets, credit bureaus are becoming imperative. In a number of the case study countries, the absence of a credit bureau has been felt. In some cases, the creation of credit bureaus has been discussed for many years but except for Benin and South Africa, no agencies have managed to spring up to cover the low-income market, though in Egypt, Kenya and Uganda, private sector credit bureaus are now being launched. Sometimes a phased approach is appropriate, where the credit reference function first lies with the microfinance association and later gets formalized. Benin, Ethiopia, Kenya, Malawi, Morocco, Nigeria and South Africa have research capacity in microfinance. But there are many countries were building research capacity in this field and building up specific local microfinance knowledge will need to start from scratch.

In terms of local technical service providers West African countries have benefited from the capacity building efforts of the regional support facility Programme de Renforcement des Capacités des IMF en

Afrique Francophone (CAPAF), which has trained and graduated numerous people in the region on key areas of MFI organizational development. Moreover, the Centre d' Innovation Financier (CIF), another capacity building organization with a wide regional scope, is located in Burkina Faso. Kenya has many capable local consultants in the area of microfinance. Generally speaking, the MicroSave project solidly trained quite a number of people, in demand driven product development and many other critical areas of MFI operations. Egypt has one firm with some expertise in financial sector deepening issues, but as one of many other areas.

The only case study countries with well developed payment systems are Egypt, Morocco and South Africa. With the creation of GIMUemoa, the UEMOA-wide ATM network for banks, and e-Zwich recently approved by the Bank of Ghana, there is a big push in the sector towards electronic payments and consumer lending, as well. Moreover, this is a very dynamic area. Whereas payment system development was listed as a key challenge to microfinance development in Africa by Mr. Kimanthi Mutua only a few years ago (Mutua 2003), many countries are now in the process of introducing secure, speedy, and effective wholesale payments systems.

Regarding IT platforms and applying technology to financial institutions that serve the lower-income market segments, there are many initiatives surfacing all over the continent. Sometimes associations are assisting in this, so as to optimize the utilization of scarce donor resources. Much of the research and development for mobile phone banking has been funded by private investors from the telecommunications and, sometimes, banking sectors (see Chapter 4). Off-the-shelves management information systems (MIS) in Africa include Ad-Banking, Bankers' Realm, E-merge, Loan Performer, amongst others. MIS support firms are located in Burkina Faso, Burundi, Cote d'Ivoire, Kenya, Senegal, South Africa, and Uganda.

In terms of joint donor sector facilities we found a gap in this regard. There is a financial sector deepening trust in Kenya that adds value but it has not played a major role in helping the sector to take off, which happened largely based on the individual strengths and innovations of the MFIs. Uganda and Mali have been successful in establishing effective joint-donor and multi-stakeholder coordination systems

Overall, we found that the only case study countries where the meso level was well developed were Benin and Ethiopia. Kenya, Niger and South Africa contain some of the building blocks of the industry infrastructure but lack other important ones. Uganda, while not a case study country, has much of the key elements of a well-functioning meso level.

3.6 Policy, Legal and Regulatory Framework and the Investment Climate

In recent years, considerable attention has been paid to the enabling environment. As MFIs mature, and seek to grow, raise capital and offer new products, the policies, laws and regulations of the country become increasingly important.

The following dimensions need to be considered when building policy regimes for lower-income markets, as well as middle- and high-income categories. It is important to have:

- The government's role as enabler,
- The goal of finance for all in key policy documents,
- Multi-stakeholder coordination and a national microfinance / inclusive financial sector strategy,

- Financial sector liberalization, particularly liberalized interest rates,
- Regulations and supervision capabilities for microfinance,
- A range of suitable legal structures,
- A strong legal and judicial system, and
- A conducive investment climate.

The first four items are policy-related and will be discussed in the sub-section below on policy making. The next four items deal with legislation, and will be discussed in the sub-section on the legal and regulatory framework for MFIs. The section concludes with a sub-section on investment climate.

POLICY MAKING

Until the 1980s, governments in Africa and elsewhere typically intervened directly in the area of credit through projects for specific target groups and development banks. This policy focus proved counterproductive and did not lead to lasting access to finance. As government projects extending credit ended or the lending institutions failed to sustain their operations due to (subsidized) interest rates and low loan repayment rates, access to these services was cut off. Often the financial services failed to meet the demands of the intended markets, or in other instances the (subsidized) loans would not even reach the poor. Since the 1990s, an evolution has begun, as governments all over Africa started to opt for a role of enabler, instead of direct implementation of microfinance services.

In two successful case study countries, microfinance practitioners on the ground identified the role of government as a key driver responsible for sector growth. The government of Benin recognized the importance of microfinance at an early stage and facilitated the building of the industry infrastructure through its support to an MFI association. It also provided start-up grants to MFIs, with no conditions on the lending products or the target group. In Ethiopia, the government understood that the most effective approach to ensuring healthy development of the microfinance sector was to promote supervision by the central bank rather than involvement by a development ministry. However, even in countries where governments initially positioned themselves optimally, there is a need to ensure that they continue to improve the enabling environment to keep pace with sector development. The government of Benin has now become a main stumbling block to the microfinance sector, and some proposals in Ethiopia for the financial sector at large could put progress at risk (see Chapter 5).

This diagnostic study found that many governments have incorporated finance for the poor into their overall development policies, such as financial sector reforms, rural development strategies and poverty reduction strategies.

The formulation and subsequent implementation of national strategies for microfinance can be important to sector development. For nascent industries the process of formulation allows a broad dialogue with many different stakeholders from all sectors of society, which increases the knowledge and general understanding of what microfinance can and can not do, as well as help to build a common vision for microfinance among stakeholders. It also provides a reference document with clarity on the desired direction and agreements on a number of basic issues. In several countries, national microfinance strategies have helped during initial (sometimes confusing) stages, when various actors are trying to understand their role, or actively trying to be in control of microfinance. When stakeholders disagree on projects, the use of funding or roles of government ministries, well developed strategies will usually provide guidance. For more mature sectors a national microfinance strategy is imperative if stakeholders wish to achieve the goal of reaching all lower income market segments and eventual

integration of microfinance into the financial sector. The resulting shared vision can formulate goals and set targets, optimize scarce aid resource use and thereby accelerate sector development. Networks often play an important role in the development of national microfinance strategies, many of which have been stimulated by UNDP/UNCDF supported initiatives or WWB's practitioner-led approach in supporting consensus-building processes. Policy change to support microfinance is most likely to occur when there is a critical mass of informed people at MFI, policy, central bank and civil society levels (see the example of Tanzania). We found that 17 African countries have passed a microfinance strategy and four of the case study countries had done so, indicating that this critical area remains undefined in a substantial number of countries. Furthermore, once strategies are in place, their implementation can not be taken for granted.

LEGAL AND REGULATORY FRAMEWORK

As deposit mobilization volumes increase, the industry matures and the asset class starts to attract local and international investors, the soundness of the legal and regulatory framework and its conduciveness to the art of microfinance becomes increasingly critical to the advancement and health of the sector. This is because larger NGO MFIs will start to diversify their funding base beyond donor funds and some would want to offer savings. Furthermore, whereas small savings and loan cooperative are assumed to be self-regulating and don't need to be regulated, as deposit-taking increases and extends services beyond its members, transition to prudential supervision may be appropriate.

In some countries microfinance is offered by a single type of institution, such as NGO (as in Morocco) or NBFI (as in Ethiopia), falling under a specific microfinance law and in others it is offered by a diverse array of institutional forms under a variety of laws, such as banking, non-bank financial institution, cooperative, and NGO law. The regulatory authority can also vary, centralized, delegated, or decentralized. But in all cases, legal and regulatory frameworks typically need amending to accommodate the flourishing of financial institutions that service the lower-income markets. Figure 15 highlights features of microfinance and how legal and regulatory frameworks can adjust to accommodate those particularities. These elements will be addressed in different manners in line with the country context, and the effectiveness will depend on how well it has performed in the creation of a single policy making point, a focused approach, and clarity.

Figure 15: Elements of a Good MFI Legal and Regulatory Framework

Feature of Microfinance		Responsive Legal and Regulatory Framework
Transaction costs are high	→	MFIs are free to charge the interest rates they find necessary as long as they are transparent – no interest rate caps
Clients lack conventional collateral	→	Collateral requirements for banks are relaxed for MFIs as portfolio quality is used as a basis for assessing risk
Simple loan tracking & accounting	→	Reporting requirements are microfinance specific, in line with international standards – less paperwork than for banks
Savings important to client and MFI	→	High performing MFIs are allowed to mobilize deposits
Many small branches	→	Procedures banks have to adhere to regarding the expansion of their branch network are relaxed for MFIs
Loan officers are not traditional bankers	→	MFIs are allowed to hire flexibly

Source: Adapted from WWB, "Policy Change: Experience in the WWB Network," New York, USA, 2003.

The legal and regulatory environment for microfinance in Africa is characterized by regional blocks and by country-specific regimes. In 1993, for the UEMOA countries of francophone West Africa, the BCEAO developed a common approach to the regulatory framework for MFIs, Projet d'Appui a la Réglementation sur les Mutuelles d'Epargne et de Crédit, referred to as the PARMEC Law, which was largely geared toward cooperative unions. Individual countries enacted the law in the subsequent years. In 1996, an additional "Convention Cadre" was adopted to guide registration and operational modalities for all MFIs that do not meet the mutualist registration criteria as outlined under the PARMEC law. In the same vein, In 2002, the Banque des Etats d'Afrique Centrale (BEAC) developed a common approach to the regulatory framework for MFIs under the auspices of the regional banking supervision commission the Commission Bancaire de l'Afrique Centrale (COBAC). In addition to the eight PARMEC countries and six CEMAC/COBAC countries, the other 39 countries each have their own legal and regulatory frameworks.

Box 4: Microfinance Macro Issues in 14 Countries

Centrality of CB/MoF. *In half of the countries, microfinance was logically structured under a financial entity. In others it was under a non-financial ministry or spread out and without a clear coordinated structure.*

Government Role. *Some direct lending or lending through government banks is still going on in Angola, Benin, Ethiopia, Guinea-Bissau, Kenya, Malawi, Nigeria and Sudan.*

Recognized in Policy Documents. *All countries except for Guinea-Bissau.*

National Strategy. *Only in 4 of the 14 countries.*

Liberalized Interest Rates. *This is the case in 9 of 14 countries (not in the three PARMEC countries, Egypt where there is cap for NGOs, and since recently South Africa).*

Flexible Legal and Regulatory Framework. *Most need improvements, except The Gambia and Kenya.*

Range of Legal Structures. *In Morocco you have to be NGO, and in Ethiopia NBFI.*

Legal and Judicial Systems. *A problem in all countries.*

Investment Climate. *South Africa, Kenya, Ethiopia, Nigeria, Malawi rank high. Guinea-Bissau, Niger and Angola rank very low.*

Among the 14 case studies alone, the legal and regulatory environments vary widely. The context in this regard for Ethiopia, the Gambia and Nigeria are each rather unique (see Chapters 4 and 5). Kenya has a tiered structure for microfinance regulation, like Ghana, Tanzania and Uganda, and this seems to be enabling for all of them. It also shows how similar features can be developed from different approaches, as Kenya and Uganda enacted new laws dedicated to microfinance, and Ghana and Tanzania modified existing laws. MFIs in Egypt, Morocco and Sudan operate in distinct legal and regulatory frameworks, but generally the current state in most countries in North Africa seems to be an expression of the notion that microfinance is a development-sector activity. Benin and Niger are testament to both the benefits of PARMEC and also its shortcomings (see Chapter 5). Congo is subject to COBAC regulation and, though the framework does not suffer from some of the insufficiencies of PARMEC, the sector has not been able to take off, largely because of constraints in other domains. The countries in Southern Africa have few similarities in the legal environment for microfinance.

In addition to this diversity among countries, the legal and regulatory environment in Africa's countries is also in constant flux. We are seeing a process of step-wise regional integration taking place, and if all goes according to plan, by 2020, most of the countries in Africa will be able to benefit from larger economic and monetary space. The AU meeting in Egypt in June, 2008 even discussed whether the eventual goal is a single government for the whole of Africa, but countries are still divided on that.

A major accomplishment of microfinance globally is that it is now recognized as an integral part of a country's financial system. In Africa, in particular in a number of West African countries, microfinance has become an essential market segment of the formal financial sector and Kenya is heading that way as well. Africa-wide, another accomplishment is the acceptance that because microfinance is a market segment of the financial sector and can be best housed within the realm of the financial sector instead of the trade and industry or development ministries in many countries and the build-up of the specific knowledge and institutional capacity of the monetary authorities in a number of countries. Another important accomplishment is that in many countries, a great deal of dialogue is taking place. In Tanzania, the process leading up to the creation of a tiered regulatory framework for MFIs took many years to debate, develop and pass. But now, Tanzania has one of the most favorable legislations and there are many people who have familiarized themselves with what microfinance can and can not do and with some of its features. Furthermore, the understanding has increased of gaps in the legal and regulatory frameworks, with a view towards improving them. Though in some countries, legal and regulatory frameworks have a number of constraints, bringing microfinance to the forefront, and providing it with legal legitimacy, has helped sectors to take-off. Though the PARMEC Law has various constraints that are discussed in Chapter 5, its emergence did elevate the status of the microfinance industry and strongly influenced the emergence and growth of the microfinance sector (Lolila-Ramin 2005). Importantly, in some countries, we see a second wave of action in this area, to correct some of the features that proved inadequate or out of date.

Further, legal changes are needed in many countries to enable a range of MFIs to participate profitably in microfinance. Some markets, especially in North Africa are particularly weak in this respect, allowing only one or two legal forms, thereby limiting the potential for innovation, which is inherent to the domain of delivering financial services to lower income market segments.

BROADER INVESTMENT CLIMATE

At the heart of a country's so-called investment climate is the issue of governance that underlies many of the difficulties caused by the interactions of Africa's history over the past 40 years. At the macro level, weak governance means the government and the public services are unable to create the right economic, social and legal framework which will encourage investment and economic growth and allow its citizens to participate in it. It is about physical infrastructure as much as ensuring that institutions are in place: an independent judiciary, an effective impartial police and prison system, land registries, bodies to administer ports and customs posts, etc. All these require skilled public servants and managers at national and at local government level.

A good investment climate for microfinance, for instance, implies advances in the judicial system. This is especially important in Africa, where weak property rights and inadequate legal environments make private sector lending and enforcement risky; creditors having to go through multiple steps, taking months even years and the process being so costly that it often is not worth it to seek to foreclose. The cost and ease of setting up a business in many African countries have traditionally been very high and arduous. In the same vein, overly restrictive labour laws do not only deter investors but can have adverse effects both at the client as well as at the MFI level. The situation is improving in South Africa, Kenya, Ethiopia, Nigeria, and Malawi. Nigeria is seeking to be among the top 20 economies in the world by 2020, has elaborated plans to this end and has started taking the bold steps that that requires. Ghana's Growth and Poverty Reduction Strategy (GPRS II) envisages transformation to middle-income status within the next decade so that the "majority of Ghanaians see that their real standard of living…[has] become significantly better" (Steel 2008, p2). The Government sees "developing effective markets for the Golden Age of Business" as a cornerstone of its strategy. The governments of South Africa and Kenya have also worked towards the creation of a favorable investment climate for many years now.

Generally speaking, for the case study countries, it was found that microfinance sectors have fared well in stable macroeconomic environments. Morocco has had a climate of very low inflation and steady growth since 1996. In Egypt it was good as well, with slightly higher inflation. Ethiopia has also been growing since 1996, with very high growth over the past two years, though inflation went up. Benin has had steady growth and low inflation since 1996, which stimulated sector growth for the following eight years. Kenya has been growing fast in 2005 and 2006. So the fastest growing countries were assisted by underlying economic growth. Angola's microfinance sector has also grown fast, while the country has been blessed with very high growth rates. The contrary was also observed. Microfinance sectors experienced limited growth in countries with macroeconomic imbalances and civil unrest. The economic downturn in Benin in 2005 marked the decline of the sector (see AMAF, WWB (2008), *Diagnostic to Action: Microfinance in Africa, Volume II: Case Studies*, New York, USA, soon to be published on the website of Women's World Banking). In Guinea-Bissau the country context is a main reason the sector does not seem to have developed at all, even though its sector is a decade old. Instability also played its part in Congo and is the reason Sudan has a nascent sector.

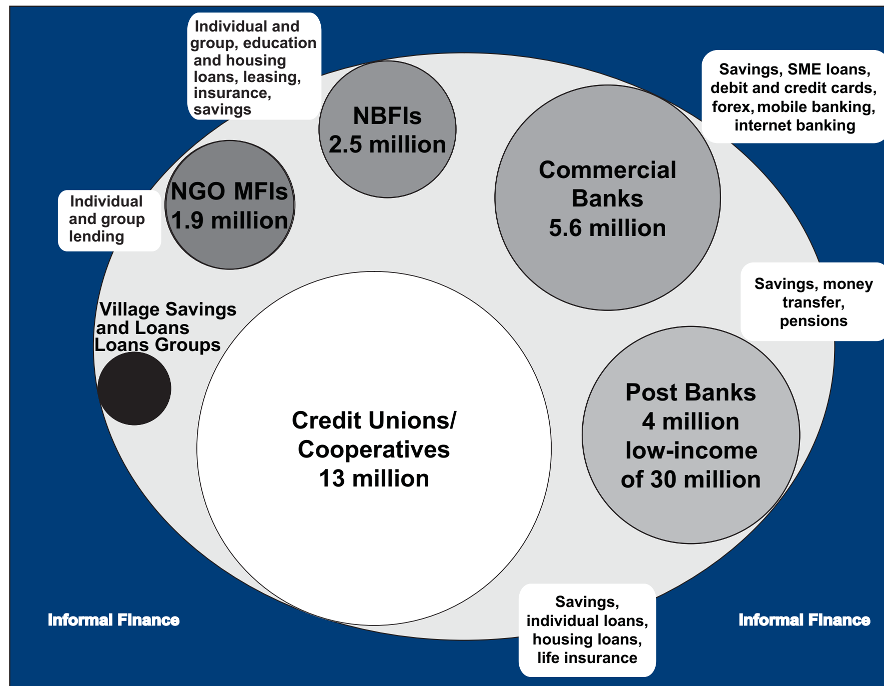
3.7 Conclusions

This overview underscores that more and more people in low-income market segments in countries across Africa are now able to access an increasing range of financial products. In some countries as a result of enabling policy environments and in some cases in spite of less conducive contexts with limited industry infrastructure, astounding progress has been made over the past 10 years. In Ethiopia and Morocco there was hardly any microfinance a decade ago and each has now reached the million clients mark and is fast moving towards two million clients. MFIs that started off as NGOs can now transform into regulated financial institutions in many countries, allowed to offer a larger range of services. Information has begun to emerge about MFIs that manage to reach very poor groups and in some markets competition is also pushing MFIs to innovate. Member based organizations such as credit unions are sprouting up in some places and becoming more streamlined in others, though some very large ones seem to have grown beyond their capacity. Community Managed Loan Funds reach less than a million people now in Africa and are set to grow very fast, to 30 million members, in the coming decade.

The larger MFIs in Africa have all already weathered many storms. Whereas the giants in Asia—including BRAC, Grameen Bank and BRI—became giants in by far the most favorable environment for steady growth overall, with relatively low inflation and a notably higher population density than the other regions, the giants that are on the rise in Africa—including ACSI, Al Amana, Capitec Bank, Centenary Bank, DECSI, Equity Bank, RCPB, UBPR, and Zakoura—are doing so despite extremely harsh conditions. This has emboldened MFIs throughout Africa.

Another accomplishment is that commercial banks and other formal financial institutions such as post office savings banks increasingly move down-market (see Figure 16). As these different institutions start to meet in the middle, they hold out the promise of serving increasing numbers of people. The borders between traditional microfinance and the larger financial system have started to blur and we are seeing the beginnings of microfinance being integrated into larger financial systems in Africa, although progress is uneven. The next chapter will elaborate on some of the good practices and innovations in scaling up, products and depth of outreach.

Figure 16: Providers of Finance to Low-Income Categories (as of 2006) in Number of Clients



Chapter 4: Existing Good Practices and Characteristics of Innovation

4.1 Retail Capacity

The previous chapter depicted the state of microfinance on the African continent. This chapter seeks to highlight some of the positive experiences that we can learn from. There is an overwhelming amount of innovation and lessons about how to advance the microfinance frontiers in sustainable ways. This needs to be shared more widely. Box 5 highlights some facts about microfinance in Africa. The case study countries show that many good practices, innovations and features needed to boost retail capacity do exist.

In Benin, some MFIs managed to perfect their lending methodologies and reach very high efficiency levels despite the high cost African context. This feature was a driver of growth and has made Benin one of the most dynamic sectors. In West Africa at large, MFIs have generally been able to operate in a highly efficient manner. This can be attributed in part to the way that cooperatives—which are the vast majority of MFIs in West Africa—work through decentralized financial architectures that keep costs down. Another innovation is the kiosk-type sub branches in The Gambia, located within walking distance of clients in market areas. This feature is also prevalent in other countries in West Africa, such as Ghana. Some of the most efficient institutions have found that strong concentration on keeping costs low and client retention help decrease costs while improving revenues. MFIs in Ethiopia have achieved significant progress in terms of efficiency and, consequently, sustainability (see Table 8). There was a consistent decline in the operating expense to loan portfolio ratio, as a result of a substantial increase in outreach. The majority of the MFIs improved simultaneously their productivity indicators (borrower per staff and borrower per loan officer) and their portfolio quality. Compared to the MFIs in the rest of Africa, the efficiency and sustainability of Ethiopian MFIs is higher (Amha 2007). The ratio of operating expenses to loan portfolio worldwide is rarely below 10 percent, it is therefore exceptional to see them below 5 percent. A critical factor in the low costs in Ethiopia is staff costs, including salaries, legally binding benefits and the costs of dismissal.

Box 5: Things You Didn't Know about Microfinance in Africa

Outreach. *Did you know that of the total of MIX reporting MFIs, five of the 14 case study countries in Africa have reached the million client milestone (Egypt, Ethiopia, Kenya, Morocco, South Africa)? This is more than in Latin America which reports three countries where the cumulative outreach is over 1 million (Colombia, Mexico and Peru).*

Profitability. *Did you know that Africa has many profitable MFIs? For instance most of the MFIs in Egypt, Ghana and Morocco are profitable and many of the MFIs in Ethiopia, Kenya, Mali, Senegal and Uganda are profitable.*

Time. *Did you know that with the right leadership within MFIs and a helping hand (local or international), Ethiopia and Morocco, vastly different countries, were both able to firmly establish microfinance industries in less than a decade?*

Home grown. *Home grown MFIs are sometimes overlooked in favour of greenfields. This is surprising because the leading and fastest growing service providers are not the greenfields, but home grown institutions. Home grown MFIs reach much larger scale in Africa, .*

The highest growth in microfinance clients over 2007 was recorded in Kenya (MIX 2007b). The market has four MFIs serving over 100,000 clients (two of which served over a million people), and another two that were close to this level. Product development and management information systems (MIS) were key to building up of retail capacity in Kenya and access to local banks is currently facilitating very rapid growth for non-deposit taking MFIs. Equity Bank in Kenya had around 70,000 clients until the early 2000s when it started to be more customer-focused which resulted in very high growth rates. By 2006, Equity Bank served over one million savers, four times as many savers as borrowers, highlighting the importance that microfinance clients place on having a safe institution with which to deposit their money. The MFIs in Kenya are successful demonstration models to the banking sector at large.

Table 8: Efficiency in Ethiopia

TYPE OF MFI	OPERATIONAL SELF-SUFFICIENCY	ROA	ROE	PAR	WRITE-OFF RATIO	EFFICIENCY
ACSI	224 %	7.9 %	25 %	1.5 %	0.1 %	5.0 %
DECSI	193 %	4.3 %	19 %	2.9 %	0.4 %	2.5 %
OCSSCO	182 %	5.9 %	12 %	1.2 %	0.2 %	6.3 %
Eshet	160 %	7.3 %	24 %	0.6 %	0.0 %	11.0 %
OMO	140 %	3.1 %	28 %	9.8 %	-0.1 %	7.5 %
ADSCI	135 %	1.7 %	2.4 %	3.9 %	0.6 %	4.0 %
Wisdom	129 %	5.2 %	12 %	5.5 %	2.2 %	17.6 %

Source: AMAF, WWB (2008), *Diagnostic to Action: Microfinance in Africa, Volume II: Case Studies*, New York, USA, soon to be published on the website of Women's World Banking.

Though MFIs in Ethiopia are faced with important challenges, there is no other country in Africa with such a large number of MFIs that have each managed to service so many clients. ACSI and DECSI have been chosen by Forbes among the 50 best MFIs in the world and ACSI and Wasasa received the 2007 Grameen Foundation Excellence in Microfinance Award. Ethiopian MFIs have attained significant outreach in a brief period of time. Towards the end of the 1990s, new approaches for delivering financial

services to the poor have been implemented in Ethiopia through deposit-taking MFIs. Key contributing factors to this success are leadership at the MFI and sector level, strong organizational cultures, transparency, high productivity, low costs and instilling a good credit culture among clients—the latter particularly important when people are used to food and other handouts.

Box 6: Characteristics of Innovative and Highly Successful MFIs in Africa

1. *Leaders with vision and the ability to set high goals, determination, strong planning and managerial skills and ability to work with the government.*
2. *Respect best practices—strong focus on transparency at all levels, clear methodology, systems which facilitate decision making, strong controls.*
3. *Priority on human resources—ensuring appropriate strategies to recruit, train and maintain staff. Clear career paths and performance-based incentive schemes.*
4. *Efficiency—strong focus on cost reduction, creation of inexpensive sub-branches in distant areas, as well as low PAR, rapid growth and high client retention.*
5. *Organizational culture—based on a shared vision among board and staff and conducive to continuous improvement and innovation.*
6. *Product innovation—starting with clear identification of market segment(s), product design around specific needs of clientele and customer focused service delivery.*
7. *Innovations in technology—which enable transfer and savings services to grow very quickly and improve credit underwriting.*
8. *Bank linkages—facilitating access to finance especially for non-deposit mobilizing MFIs which has enabled rapid growth.*
9. *Commercial banks approaching downscaling first through savings, offers a lower risk entry point for developing familiarity with the market and increased willingness to develop other financial services.*
10. *MFIs active in meso and macro level interventions—promoting appropriate legal and regulatory environment for their own growth initiatives as well as increased confidence in the sector as a whole.*

Four Moroccan institutions have been chosen by Forbes among the 50 best MFIs in the world. Fondation Zakoura (founded in 1995) and Association Al Amana (founded in 1997) are examples of success stories that other institutions in the Arab World and Africa look to learn from and emulate. The successful outreach and growth of the Moroccan MFIs is linked to their professionalism. This led to clear methodologies, MIS facilitating decision making, transparency and strong internal controls. The cost of managing one dollar per loan in the country is now below 10 percent for the largest MFI. Moreover, with the rapid growth of the portfolio, made possible because of the establishment of early linkages with local banks and ample access to funding , total MFI outreach grew from close to 300,000 to over one million clients between 2003 and 2006, a 350 percent increase.

Retail capacity is high in Egypt in terms of savings services, where the National Postal Authority remains the dominant provider of micro-savings due to its extensive outreach and low-cost application procedures. The total number of accounts is 11 million, and though the percentage of accounts of low-income families is not known, it is known that this market segment is reached. Egypt, which has also had high growth, has three banks that have downscaled, of which two are government-owned and one is a private bank. Banks in Egypt have managed to get to scale in offering microloans. Egypt benefited from the Microstart projects that disseminated best practices and advocated the employment of performance indicators.

In South Africa, a remarkable diversity of distribution channels has emerged over the past few years—including traditional branches, ATMs, mini-ATMs, retail institution partnerships, mobile phones and debit/credit cards—that has greatly enhanced commercial banks' retail capacity in lower-income market segments. After a series of mishaps in the 1990s, all the major banks have found a way to downscale in a sustainable manner (see Box 7 below). In addition, there are smaller banks, such as Capitec Bank and Teba Bank, which have been created specifically to serve low-income markets. Capitec Bank is the largest bank in South Africa involved in microfinance reporting to MIX and is

one of the largest in Africa. According to their results of February 28, 2007 there were 368,854 active borrowers and 583,000 savers. Capitec's loans are primarily salary loans for consumption, typically with monthly repayment periods. Teba Bank, which has its origins in the mining industry and has been involved with low-income communities, became a full fledged bank in 2000. In 2005, the number of active borrowers was 157,776, with a total loan portfolio of US$ 176 million. Total savings for the same period was US$ 126 million and 492,154 savers. With its main market in mining towns, Teba has a diverse range of services from credit to savings to insurance.

Box 7: South Africa Formal Financial Sector Starting to Reach Out

African Bank is the biggest consumer lender in the market to low-income clients with a loan book of approximately R8 billion and focusing on medium term loans of up to 36 months. In 2005, African Bank integrated its formerly stand-alone microcredit division, Credit Indemnity, into its operations. Prior to the integration, Credit Indemnity had a gross loan portfolio of R475 million and the number of active loans was 237,000.

In partnership with Pick n Pay supermarket, Nedbank is providing "Go Banking" services. Go Banking allows customers to do their banking at the supermarket, including withdrawing cash, checking balances, making deposits and paying accounts. By offering more flexible hours and a greater number of locations, Go Banking makes banking easier for many low-income clients who find it difficult to visit branches during banking hours.

ABSA has made various attempts to increase its services to the microfinance market. Initially it acquired consumer lending capacity through a takeover of UniFer, which later collapsed however. In mid-2007, ABSA launched its Micro Enterprise Finance unit that focuses on micro-enterprises with annual business turnover between R15000 and R70000. This unit launched two loan products for its targeted market and is designing more products to be launched in 2008. It provides its products and services through Micro Enterprise Service Centres situated in the areas where the target clients live and operate their businesses. It is experimenting with running the Service Centres on a franchise basis. This innovative model, if successful would offer entrepreneurs the opportunity to purchase a microfinance franchise from ABSA, and offer loans according to standardized methodologies and procedures. ABSA is the first South African commercial bank that opened a dedicated microfinance unit.

In 2005, Standard Bank launched a joint venture with Mobile Telephone Networks (MTN), through which it provides cellular phone banking, referred to as "MobileMoney." The banking application is fully integrated into mobile phone services. Moreover, every MTN SIM card that is distributed has an embedded banking application, so there are no extra steps required to open an account with an MTN SIM card. MobileMoney currently has approximately 80,000 users, according to a Consulting Group to Assist the Poorest (CGAP) report released in February 2008.

First National Bank (FNB) is a division of FirstRand that has rolled out 1,400 mini ATMs into low-income and predominantly rural areas that cannot sustain a bank branch or normal ATM. The mini ATMs are placed in small retail stores and consist of a POS-type device mounted on an FNB-branded display stand. The mini ATM does not physically dispense cash; it instead prints out a voucher that is handed to the retail cashier, who then pays out the cash from his or her register. At the end of each day, the system repays the retailer (into their FNB account) the same amount they dispensed that day.

Postbank is a division of South African Post Office, and has the overall goal of providing banking facilities to people who have limited access to financial services. The minimum amount required to open an account is R10. Postbank also handles some government work, serving as an outlet to more than 217,000 pensioners. As of March 2007, the number of these accounts—known as mzansi accounts—had grown to 1.2 million.

Source: AMAF, WWB (2008), Diagnostic to Action: Microfinance in Africa, Volume II: Case Studies*, New York, USA, soon to be published on the website of Women's World Banking.*

To sum up, the top 10 best practices to build retail capacity in Africa that emerged from this study (see Box 6 above) merit replication in countries with similar contexts, income levels, infrastructure and sector characteristics, and sometimes even in those from widely different contexts.

4.2 Innovations in Credit Underwriting and Products

As a result of African MFIs' years of experience and, more recently, market analyses and effective client feedback systems, many successful financial products have been developed for the poor, including savings products, loans, microinsurance, microleasing and housing finance. The pace of innovation is quickening as the sector benefits from an enhanced understanding of the financial needs of the poor, organizational cultures increasingly primed for innovation, and the wealth of new technologies becoming available. As a result, even financial markets that have been notorious for serving a small group of corporate clients, such as Kenya and South Africa, are now starting to reorient themselves.

Operational costs in microfinance are high and can erode margins. As such, a fundamental challenge for microfinance in Africa is how to reduce operational costs. This is where technology comes in, improving the outlook for microfinance in Africa. For instance, from 1999 to 2004, the number of mobile phone subscribers in Africa grew from 7.5 million to 76.8 million. This growth is not limited to middle-income markets, but is happening across all countries; in Sudan, for example, telecommunications operator Zain is growing rapidly and already covers 8.4 million customers. In the next year, this mobile phone market will increase to at least 15 million, and will keep growing for the next 3 to 4 years.

So, what are some of the most promising innovations in African microfinance? This section provides an overview of some of the technological advances, while the next section elaborates upon product innovations that extend financial services to those not easily reached by microfinance.

TECHNOLOGY ADVANCES IN MICROFINANCE

Technology can have a major impact on the MFI back office in terms of improved MIS, but it also increasingly impacts the products and delivery channels. The most significant impact of technology is the ability to offer fast, cost-effective, money transfer/payment products on a large scale. While it has the potential to increase opportunities for MFIs on the lending side, in terms of credit underwriting and product features, it is still a new area that needs to be proven.

Automated payment technologies encountered in low-income markets in Africa include mobile phones, internet banking, ATMs, point of sale (POS) card readers[16] and satellite communications. Many technology innovations are beginning to be applied to microfinance. With automated payments, MFI clients no longer have to carry cash, which makes transactions more secure. Further, financial institutions can reduce the number of branches, possibly leading to lower interest rates and fees for clients. Payments can be made in locations convenient to the client—grocery stores, pharmacies or over the phone, saving them time and transport costs.

In Kenya, Equity Bank was admitted to Visa as a principal member and licensed to issue Visa cards. SACCOs have focused on improvements in their front office operations and have also added ATMs to their services. Jamii Bora is working with a thumb imprint as identification for their hand held devices, which are charged like a cell phone and can operate for about two days before being recharged.

Celpay, a mobile phone payment company that operates in Zambia and the Democratic Republic of Congo (DRC), issues special subscriber identity module (SIM) cards through mobile phone companies. Customers can use SIM cards to make bill payments, store value and transfer money (CGAP 2007a). In a country such as the DRC (where there were only 35,000 account holders and very few bank branches after the war), this may be an ideal way to scale up quickly. The approach could leapfrog check- and card-based retail payment systems that most countries use.

Box 8: South Africa: Bank-Led Mobile Phone Banking

WIZZIT, a startup mobile phone banking provider, targets low-income customers with an interest-bearing bank account that customers access with their mobile phone. Customers can use their phones to make person-to-person payments, transfer money, and buy airtime for a prepaid mobile phone subscription. WIZZIT also gives customers a debit card—branded "Maestro"—with which they can make purchases at retail outlets and deposit or withdraw money at ATMs. While WIZZIT's current services are savings and transactional, it intends to offer consumer lending and business loans by September 2008. WIZZIT is incorporated as a division of the South African Bank of Athens. This is because the banking regulations in South Africa only allow institutions with a banking license to accept repayable funds, such as e-money proceeds, from retail customers. In South Africa, an estimated 16 million people, or 48 percent of the adult population, are unbanked or underbanked and lack access to formal financial services. There are also 20 million mobile phone subscribers, many of whom are in the low-income segment. WIZZIT offers both mobile phone-based and card-based services to clients.

Keys to Success: WIZZIT undertook extensive market research about the financial service features valued by unbanked people in South Africa, and developed products in line with what users said would be their ideal way of banking.

In South Africa, as described above, some of the major banks are offering mobile phone banking services. Moreover, new entrant WIZZIT is a start-up mobile phone banking provider that commenced operations in 2004. What distinguishes WIZZIT is that it targets the 16 million unbanked South Africans, whereas other mobile phone banking initiatives focus on offering the service to existing clients. A recent survey (CGAP 2006) shows high customer satisfaction with the WIZZIT service, prompting statements such as "more affordable," "makes banking more convenient," and "easy to access."

In Benin, leading MFIs are attempting to construct their own electronic payment card networks dedicated to low-income clients. The Ferlo technology in Senegal that uses a smart card is being seriously considered as an entry platform.[17] Making these networks operate within existing banking networks and MFIs would give low-income clients a level of access to their accounts that would be unprecedented in the region.

Mobile phone banking also addresses an often overlooked fact: the transaction costs of borrowers and savers. While WIZZIT customers spent on average 32 minutes and more than US$ 2 on transport to reach a bank branch in order to deposit, they do not have to travel at all to check the status of their accounts, make payments, or transfer money to friends and family. Many other countries are in advanced stages of developing mobile phone banking products, driven mostly by telecom operators. Mobile phone banking is an area where Africa is a leading market; even the US market can benefit from replicating elements of this service that have proven so successful for African companies.[18]

As lessons from consumer lending and credit scoring are blended into microfinance and as credit bureaus are developed in each country, the central role loan officers have traditionally played as the main connection to clients may be challenged by the drive from consumer lenders to automate

their credit decisions (Otero et al. 2007). Consumer lenders, as is extensively the case in all Southern African markets, use a "credit factory" approach, with several people performing portions of the role of microfinance loan officer. For example, this approach is being used by Centenary Rural Development Bank in Uganda. Microfinance providers may have to decide whether to embrace automated lending.

What is certain is that we will see more experiments with modified loan methodologies that still use loan officers but increase their efficiency through the use of Personal Digital Assistants (PDAs), cell phones, cards and point of sale devices, and biometric recognition. We already see a number of cases where repayments are being automated, instead of the loan officer having to spend time collecting money in person.

Box 9: Biometric enabled POS device and smart cards in Malawi

The lack of a national identification system makes it very difficult for low-income clients to access financial services in Malawi. For this reason, the Opportunity International Bank of Malawi's (OIBM) has combined biometric-enabled POS devices and smart cards to provide effective banking services to Malawi's low-income population. OIBM's biometrics and smart card model overcomes the identification problem by using fingerprints, eliminating the need for clients to have PINs and making the transaction process easier for illiterate customers because they do not have to select and memorize numbers to access their accounts. The combination of the biometric system and the smart card has also eliminated the need for deposit and withdrawal slips. Consequently, the bank estimates that the productivity of its staff has increased by about 25 percent. The solution has allowed OIBM to reach rural areas cost-effectively. OIBM has partnered with local NGOs and rural retailers to help with the promotion of the service.

Keys to Success: The institution reviewed different technologies that could fill the identity card gap. Once the appropriate technology was identified, the institution worked closely with its customers to set the specifications for the solution.

In Malawi, an important challenge faced by financial institutions is the lack of a national identification system. In response, an MFI started piloting the use of biometric technologies such as fingerprints to enhance the process of client identification and data security, thereby accommodating some previously unbanked people. This speeds up the identification phase of the lending process. In combination with smart cards, improvements can also be realized at the repayment phase as clients don't have to fill in deposit slips. In Ghana, one of WWB's network MFIs has also introduced biometrically enabled Point of Sale devices at various merchants and small businesses, thereby bringing banking to the doorstep of the customer.

Uganda Microfinance Limited (UML) now offers clients the possibility of making their repayments through a network of agents. Agents are microentrepreneurs and small business owners who agree to have a so-called Remote Transaction System (RTS) at their shops. The conceptualization of the RTS model dates back to 2002, when the Hewlett Packard Foundation with support from a USAID Global Development Alliance grant created a team to seek solutions for lowering transaction costs when delivering financial services in remote areas. Through a combination of smart cards and point of sale devices, the service allows the institution to provide loan repayment and deposit services to clients who live up to 70km away from a branch. This is highly beneficial in a country like Uganda, where more than 90 percent of the population lives in small rural villages and towns that do not have the necessary banking infrastructure to support a vibrant financial sector.

Ghana has tailored introduction of e-Zwich to allow rural banks and other MFIs to issue smart cards that can be used with POS devices. This is a great step towards greater integration within the financial system and deepening the financial sector.

New technologies will require microfinance institutions to redesign their business models and educate their employees and customers to master new ways to deliver and receive services. Such changes will

not always be easy, but the benefits include greater convenience and lower costs for customers and MFIs, the ability to reach more remote customers, and increased security.

BROADER PRODUCT MENU

In Africa, microfinance has never been limited to microenterprises alone, but increasingly stakeholders are realizing that the financial needs of low-income people are potentially as wide-ranging as those of the middle class. Good practices and innovations in this area are plentiful and any example will only scratch the surface.

As mentioned, a key feature of innovation is an organizational culture that is conducive to product innovation. What is important is listening to clients, market segmentation, and thinking "beyond the box" as to potential delivery channels. Barclays in Ghana has developed an innovative delivery channel working with susu collectors.[19] In Ethiopia, there is a consensus in the microfinance industry to develop innovative lending methodologies and financial products that match the needs of rural and urban households. As a result, although Ethiopian MFIs could benefit from a more demand-driven product development process, they offer a broad range of products. Three MFIs in Ethiopia are offering a rather exceptional type of financial product for MFIs: pension fund administration. ACSI, DECSI and OCSSCO deliver the monthly pension of civil servants and military pensioners in Amhara, Tigray and Oromia regions respectively. MFIs charge a 2.5 birr service fee per pensioner. This financial product has been useful to both the MFIs and the pensioners, and shows an openness to be on the lookout for opportunities in financial service delivery.

In Uganda, an important low-income health insurance innovation has taken place—which is not the easiest type of insurance to offer. In 2000, a non-profit organization named Microcare was created out of a Community Health Financing Micro-Insurance initiative which has since grown into the largest provider of group health insurance in Uganda, servicing both formal and informal sectors and operating in urban and rural areas. Microcare provides health coverage to people who had remained excluded from the existing schemes by employing a unique approach to deliver affordable health insurance, including comprehensive information technology (IT) systems and controls. Microcare has developed a well-calibrated range of health services, integrating malaria and HIV treatment in its coverage. In 2007, Microcare became the main Ugandan insurer, with 85,000 customers. Its network covers most Ugandan districts and includes 170 approved clinics and hospitals. Malawi, Kenya and Nigeria have also been fertile ground for innovation in this regard. No one winning model has surfaced, the experience having been that each business model developed has advantages and disadvantages depending on specific contexts. What has been learned is that any microinsurance business model must acknowledge the need for reserves and reinsurance. The reinsurer's role is to focus on catastrophic risks, which are often excluded in microinsurance products; by covering these risks, reinsurance can play an important part in fortifying an emerging insurance culture. A reinsurance-like approach could also help professionalize the activities of community-based and local microinsurance programs. Involving organizations such as cooperatives and workers associations could greatly facilitate access of the poor to microinsurance (Churchill 2006). Bringing microinsurance to scale is a high impact effort in Africa because of its potential effect on both the health of clients and reduction of the large amount they spend on out-of-pocket health expenses which decreases household wealth.

Major MFIs in Benin, in response to client demand for transfer services, entered into collaboration with commercial banks to offer remittance services. Organizations such as EcoBank, which are able to detect demand for additional microfinance products, will usually manage to find a way to broaden their product offerings according to specific opportunities. More linkages of MFIs in Benin with commercial

banks and funds transfer institutions could lead to a greater penetration within the US$ 101 million market for remittance transfers in Benin.

4.3 Innovations in Depth of Outreach

Innovations in depth of outreach can be found along three main thrusts. They are reaching more rural areas, poor people—the bankable as well as almost bankable—and specific hard-to-reach groups, such as youth and pastoral communities.

RURAL FINANCE

Contrary to the general perception that microfinance in Africa has not made inroads into rural areas, the diagnostic showed that a number of interesting good practices exist. In The Gambia, the oldest MFIs started out in rural areas (see Box 10). Gambia Women's Finance Association (GAWFA) only recently introduced a loan product specifically for entrepreneurs in the Banjul urban area. Similarly, In Ethiopia, MFIs started their operations in rural areas. Only in the last few years have programs begun operating in urban areas and in order to succeed they had to develop lending methodologies that could work in the more challenging rural contexts, given the higher credit risk because of covariant risk as well as the high cost environment. The evidence from other countries is that if MFIs start out in urban areas, expanding to rural areas sometimes doesn't happen or takes a very long time. One reason for this is that most of the staff will not want to move from the capital cities.

Another example comes from Ghana, which was not among the 14 cases studies, but has been rather successful in making their financial markets more inclusive and includes some rare types of financial service providers, such as the Rural and Community Banks (RCBs) of which it has as many as 121.[20] It has introduced mobile banking in order to reach more remote communities and has also started to tackle the more difficult agricultural market segments. Increasing attention is being paid to agricultural value chains, i.e., the stages from planting to purchase: provision of inputs; crop production, weeding and harvesting; role of traders, transporters and wholesalers; sale in local, regional or overseas markets (exporting); and processing. It has, for instance, introduced inventory credit/warehouse receipt methods that enable farmers to use their crops as collateral against a loan at harvest time (Steel 2008).

Box 10: Rural Finance in The Gambia

MFIs in The Gambia manage to offer services to farmers and in rural areas, which are usually seen as the most challenging market segments. VISACAs and Gamsavings extend savings products in remote rural areas. GAWFA's main clientele are farmers and traders in rural areas. Prospective clients must be members for at least three months and open a saving account, in which they have at least 40 percent of the loan amount to benefit from a loan. The average loan size disbursed is around US$ 60—hence a good depth of outreach—with a term of six months and repayments are due on a monthly basis or at the end of the loan cycle. GAWFA has an innovative targeting methodology and a credit delivery mechanism that helps identify and attract only the poor. The percentage of agricultural loans is 53 percent of the total loan portfolio. GAWFA manages to reach a low-income group, many of whom are farmers and small traders in remote and rural areas; a group considered risky.

Mobile branches have surfaced in many countries in Africa, as a strategy to service clientele who live in areas where it is not cost-effective to open a branch. Mobile units consist of a vehicle, sometimes with a generator (for the automated process used to confirm identities) and communications equipment (if the process requires real-time confirmation of eligibility against a central database).

Banking via mobile phones not only plays a role in extending microfinance outreach as discussed in the previous section, but also in deepening its outreach. M-PESA in Kenya is a mobile phone service that allows people to transfer money available to the public, even if they do not have a bank account or a bank card (see Box 11). After a year, between 80 percent and 90 percent of M-PESA's clients used it to send money to relatives in rural Kenya. Many people living in rural areas work in Nairobi, but send much of the money that they earn back home. Others use the system to purchase mobile phone credits. Though M-PESA was also meant to be able to facilitate loan repayments, this option has not been added as yet because it proved difficult to operate when the management information system of the MFI is largely paper based. The processes would need to be replicated electronically before becoming part of M-PESA

Box 11: Mobile Phone Banking in Kenya

M-PESA is a Safaricom/Vodafone service allowing people to transfer money using a mobile phone. Entrepreneurs use M-PESA to pay their suppliers, and to receive money from customers. Kenya is one of the first countries in the world to use this service, together with the Philippines, Senegal and South Africa. M-PESA is available to all members of the public, even if you do not have a bank account or a bank card. Kenya's mobile money transfer products actually had a much simpler precursor: people who are cash strapped are usually also low on airtime. This led to the "flashing" phenomenon—also known as "beeping" and a host of other terms elsewhere—a phone call so short that the receiver will have to call back to find out what is going on. Non-bank led models have an advantage above bank-led models. The M-PESA mobile wallet service offered by Safaricom attracted 1 million registered users in 10 months (equivalent to more than a quarter in a country where fewer than 4 million people have bank accounts). M-PESA did it by building a network of 850 agent locations, which compares favorably to the 550 bank branches in total.

Keys to Success: Branding based on gaining trust.

POOREST BANKABLE

CARE is embarking on a major initiative to expand its CMLFs in Africa. Their campaign for Universal Access to Financial Services in Sub-Saharan Africa strives to lift 30 million households out of extreme poverty over the next decade by providing access to a suite of basic financial services including savings, loans, insurance, and remittances. This will be achieved by partnering with a wide variety of institutions, employing new technologies where possible and by developing linkages with banks. In addition, other NGOs, such as OXFAM and Plan International support the creation of CMLFs at a more modest scale.

Sustainable integration of microfinance and life-skills training services for very poor women—a methodology known as Credit with Education—is not an easy service, but MFIs in Africa have demonstrated it is possible to offer it profitably. The education includes critical information about nutrition, health, family planning and HIV/AIDS to help these women make better use of available resources to mitigate circumstances that threaten their daily survival and that of their children (Miamidian 2005).

ALMOST BANKABLE

BRAC in Bangladesh, has demonstrated that it is possible to move selected unbankable people to the position where they can access microfinance services (CGAP 2006). Its Income Generation for Vulnerable Groups Development program manages to graduate about two-thirds of the women enrolled in the 18-month assistance program into regular microfinance. It would be interesting if from its new operations in Africa—Sudan, Tanzania, Uganda—whether it can be replicated.

A more homegrown experience of this sort is Jamii Bora in Kenya. In 1999, its founder Ingrid Munro gave loans to 50 beggars in an extremely poor slum in Nairobi, not intending to start an organization.

At the Global Microcredit Summit meeting in 2007, she said: "We have fast climbers out of poverty and we have slow climbers, but everyone is a climber." A fast climber, one of the original 50 beggars, now has six businesses and 62 employees. By October 2007, Jamii Bora had grown to 170,000 savers and 60,000 borrowers. The program is rather unique, and in the end it may not be replicable, but provides a key lesson: doing microfinance well depends on how well you know your market and the strength of the corporate culture, not about the clients' income level.

Avenues for linking safety net programs to microfinance also need to be explored.

SPECIFIC HARD-TO-REACH GROUPS

In Kenya, KWFT has a loan specifically for youth customers who want to start their own business but do not have capital and who were previously unable to join the current KWFT lending programs. Youth clients adhere to a different set of regulations based on a group lending methodology. MFIs in Ethiopia such as Addis Credit and Saving Institution, Africa Village Financial Services S.C., DECSI, Gion MFI, and Omo provide loans to youth for equipment, mainly for those who have organized into construction cooperatives. The MFI owns the title to the equipment until its purchase cost is completely repaid with interest. The loan size varies from 5,000 to 300,000 birr (US$ 542 to 5,500). The micro-leasing products have provided new opportunities to youth that do not have the capital or the collateral to make sizable investments.

HIV/AIDS can seriously affect the wealth of many businesses, even those with enough resources. If ignored, HIV/AIDS can compromise an MFI's operations, profitability, and long-term viability. This challenge is more perceptible for African MFIs as more than 70 percent of the world's HIV/AIDS affected population is in African countries. If ignored, MFIs also miss an opportunity to increase impact by tailoring products and services in high HIV/AIDS incidence areas. The Foundation for International Community Assistance (FINCA) in Uganda is on the way to pilot testing innovations in this area both financial and non-financial. FINCA offers health insurance, saving plans, life insurance and AIDS education seminars, along with credit products.

The revolution in microfinance still has to tackle special hard-to-reach groups such as the very poor and marginalized groups residing in remote and pastoral areas in places such as Northern Kenya, Northern Mali, Ethiopia, Somalia and Sudan.

4.4 MFI Funding Sources

Many MFIs in Africa are tapping the potential of savings mobilization as a core funding strategy. Demand-driven product development and large scale deposit mobilization campaigns are potential key strategic actions.

If the domestic financial market is to respond to the funding needs of MFIs, necessary financial instruments and arrangements include domestic savings mobilization and local currency loans. As financial markets develop, there will also be a need for bond issues, securitization and local equity markets, particularly for larger MFIs. In addition, a need also exists for grants and soft loans for younger MFIs.

SAVINGS

Savings mobilization has always worked well in Africa. In many countries clients express a higher demand for savings than for loans, even without market-driven savings products. As MFIs adopt market

research and product development tools, we have seen examples of phenomenal growth. Equity Bank in Kenya increased the number of depositors from 556,000 to 1,840,000 and funds mobilized increased from US$ 58 million to US$ 168 million from 2004 to 2006. In South Africa, the "mzansi" account, a recent commercial bank driven initiative, is also mobilizing large amounts of funding.

ACCESS TO LOCAL LOANS

The successful outreach and growth of Moroccan MFIs is heavily linked to their financial structures. Over time, they have moved from relying on donations and subsidized loans to more commercial-based sources of finance. While grants and donations were essential to the Moroccan sector's initial development, they were unable to keep pace with rapid growth. As competition for scarce donor funds intensified, institutions turned to other financing alternatives, namely concessional credit lines from public entities. Large, well-managed institutions also gained access to overdraft facilities and succeeded in raising commercial debt from local banks, despite their NGO status. While initially dependent on international donor guarantees, these MFIs are increasingly relying on their performance to attract commercial investments from both local and international markets (see Table 9). With the rapid growth of the portfolio large profits have been recorded over the past three years. These profits were used to reduce pricing, passing on benefits to clients even though the Moroccan market is far from saturated by competition.

Table 9: Profitability of MFIs in Morocco (2006)

	OPERATIONAL SELF-SUFFICIENCY	RETURN ON ASSETS
Association Al Amana	126.60 %	4.08 %
Fondation Zakoura	120.63 %	4.14 %
FBPMC	186.86 %	12.43 %
Association Al Karama	126.33 %	7.24 %
FONDEP	198.41 %	19.17 %
INMAA	121.96 %	6.09 %
ATIL	79.21 %	-6.34 %
AMOS	131.22 %	6.87 %
AMSSF	106.79 %	2.21 %
ARDI	171.07 %	15.15 %

Source: Volume II - Country Reports.

In Angola, CARE has started to link the 1,500 members of its village savings and loan groups to commercial banks by opening bank accounts on their behalf. It envisions reaching three million women in Angola during the next seven years. Bank accounts can be a first step in developing relations that can lead to debt finance for more developed groups. Such linkages have been successful in countries such as Niger, and could prove an interesting means to reach lower-income women.

In The Gambia the central bank encourages linkages within the sector as a result discussions have evolved among village based credit and savings associations and Reliance Financial Services Company for possible partnerships.

CAPITAL MARKETS

AfriCap makes the point that the capital markets are "the only place where [MFIs] can access the funds needed to meet the great demand for capital that exists… Although access to capital markets will not make sense for every institution all of the time… it is a powerful tool for facilitating the provision of microfinance services" (AfriCap 2003, p3 and 6).

Corporate financing patterns in some African countries, such as South Africa and Ghana, suggest that stock markets are starting to become an important source of finance. In each of these countries, the stock markets were the single most important source of long-term external finance. It is also possible for companies to list their corporate bonds without necessarily listing their shares. Botswana has led the way in this regard, with 17 corporate bond issues, followed by Tanzania (6), Namibia (4), Ghana (3) and Swaziland (2). For MFIs, the stock markets will rarely be accessible other than to the few whose shares are listed (as detailed below). Nonetheless, MFIs may benefit in that potential lenders, such as commercial banks, can increase their access to long term funds to facilitate wholesale lending to MFIs.

As to the debt market, more than 30 African countries have introduced Treasury bill markets. The main financial market benefits are the establishment of interest rate benchmarks for other commercial paper and their use as collateral. Low-risk government debt can also help off-set the high risks of private sector lending, allowing gearing to increase within prudential limits on risk-weighted capital asset ratios. But most Treasury bill markets in Africa are immature, the instruments offered on these markets are generally short-term, and the investor base is narrow, consisting mainly of commercial banks. Secondary markets are still non-existent or small, except in Algeria, Egypt, Morocco, Nigeria, South Africa and Uganda (Christensen et al. 2007). As with the stock markets, direct access to the domestic debt markets remains beyond most MFIs in Africa. However, it is a prospect and a goal for some institutions. It is also identified by many investors and donors as a key to MFI sustainability.

The only example of an MFI equity main board listing in Africa is Equity Bank, which pursued a listing on the Kenya stock market in 2006 in an attempt "to improve its strategic position, its access to capital and to give a higher profile to its brand" (Reddy 2007 p6). The shares were sold at US$ 1.00 but reached US$ 2.50 after the initial trading, before rising to US$ 3.40 in eight months. This suggests that the shares were severely under-priced (most advisers aim for a premium on listing of just 10 to 20 percent) but this may be explained by the company's uncertainty about the likely demand for the stock.

Kenya also provides an example of a listed bond issue. Faulu Kenya issued a five-year bond for KSh500m (US$ 7.5m) in April 2005. The arranger was Stanbic and the key terms included:

- Interest rate of 91 day Treasury bill rate plus 0.5 percent (amounting to 8.94 percent in 2005), payable quarterly in arrears,
- AFD guarantee on 75 percent, at a cost of 2.0 percent p.a., payable quarterly,
- Repayable at the end of years 3 (20 percent), 4 (30 percent) and 5 (50 percent), and
- The bonds (in units of KSh1m each) are listed on the Kenyan Stock Exchange (but there have been very few trades at undisclosed prices).

Microlender Blue Financial Services is listed on the South African secondary board, called the AltX. Following a decision by the IFC in June 2007 to invest US$ 10m of equity and US$ 10m in debt, Blue Financial Services announced its intention to move to the main Johannesburg board and to dual list on the exchanges in Zambia and Botswana, two of the five countries outside South Africa in which it operates.

Finally, the point has been made that the more innovative financing methods do not usually include countries in Africa. However, there is a glimmer of light as Kenya is among the last securitizations announced before the sub-prime crisis. The Morgan Stanley and Blue Orchard US$ 110m collateralized debt obligation includes Kenya as one of the 12 developing countries whose MFIs may receive financing under the facility.

4.5 How the Meso Level Can Be in the Driver's Seat

As meso level sector building is a relatively new area, it offers fewer concrete lessons than the micro and even the macro level. However, recent years have seen some advancement in this area. So what are some of the most promising experiences? At this stage of industry development in Africa, the limited development of industry support structure forms a key gap, in the middle between the growing retail capacity and improving macro-level issues (see Figure 17).

Figure 17: The Missing Layer: the Meso Level

MICROFINANCE ASSOCIATION

A high impact microfinance association is one of the most important building blocks at the meso level as it can accelerate the building of the industry infrastructure as a whole. The Association of Ethiopian Microfinance Institutions (AEMFI) is a superb example of this. It has a strong democratic governance structure that is highly representative of its members. The leadership provided by the association—and the impressive leaders of the MFIs guiding the association—can be credited with being key drivers of the sector in Ethiopia (see Box 12). GHAMFIN in Ghana and AMFIU in Uganda are other examples of associations that have played a very important role in policy dialogue. For instance, AMFIU through constant dialogue with government managed to limit the damage of government direct involvement in the sector. In the same vein, GHAMFIN in Ghana managed to limit the distorting effect of a government subsidized direct credit intervention.

LINKING MESO-LEVEL STRUCTURES TO BANKING SUPPORT STRUCTURES

In Angola, there is an opportunity to start hosting microfinance training at the Banking Institute, after some initial support to the institute to impart the specific expertise. There is interest from all sides and

explicit demand from two commercial banks to this end. This is a low-cost way to include microfinance into an existing structure. Also, there is also an option of housing the microfinance association within the Association of Banks, which already has a voice in advocacy for the banking sector. As microfinance markets mature and begin to integrate into the financial system, bank training institutes, management consulting firms, audit firms, rating agencies and other service providers are starting to adapt to meet the needs of MFIs and instead of first setting up separate infrastructures the process can be fast tracked if an opportunity presents itself as in the case of Angola.

Box 12: AEMFI—An Example of What a High Impact Association Can Do

- *Create an environment of constant dialogue and face-to-face meetings between the MFI community and the regulators and policy makers to enhance understanding, advocate and lobby. Ethiopia has been extremely successful in dialoguing with the government to a point where the government could play its role as key supporter, instead of distorter, as in some other countries.*
- *Promote transparency and performance indicator reporting and benchmarking, which has proven to be a key driver of sectors. It is working well also in Benin, Ghana, Madagascar and Uganda.*
- *Analyze performance indicator trends to discern issues early that affect sectors at large. The networks in Benin, Cote d'Ivoire and Burundi have also begun doing this.*
- *Become a main source of information and contribute to building research capacity in microfinance*
- *Create a spirit of cooperation wherever possible; MFIs that operate in Addis Ababa, have formed a sub-network to exchange experiences and share client lists.*
- *Give direction, provide the long-term perspective, quantify the gaps, undertake projections, and set clear quantifiable goals. Most recently, AEMFI embarked on an extremely useful exercise, namely to come up with a vision for where the sector should be in ten years' time, laying out the various steps and issues to be tackled to achieve this.*

JOINT DONOR INITIATIVES

For younger institutions and nascent and growing markets, donor support to complement private capital, for capacity building, innovation, and institutional infrastructure building, can play a very important role, especially if it is coordinated. In Uganda and Mali, donors have diligently coordinated their efforts with private capital and both sectors have developed in a healthy manner. In Uganda, this history of cooperation and communication among informed stakeholders resulted in a joint reporting initiative which saved MFIs time in reporting to their various donors.

In other countries, donors have moved one step further and pooled their funding together in a facility supportive of financial sector deepening. Joint funding mechanisms can be effective, especially for agencies without technical staff on the ground, if they are structured flexibly, keep the government informed, and have conservative targets for the initial years to allow for capacity building prior to large amounts of capital injection.

In Africa, there are examples of this in Kenya, Liberia, Sierra Leone, the DRC and Tanzania. The cases of Kenya, Liberia, DRC and Tanzania are recent, but from the Sierra Leone experience, we can already draw some lessons. In 2003, UNCDF convinced UNDP and KfW, donors who were considering investments in microfinance in Sierra Leone, to develop a joint strategy to develop the sector. They built on successful efforts of the World Bank in assisting the government with training and sponsoring a conference on microfinance in Sierra Leone that laid the foundation for a national microfinance strategy approved in 2003. These donors created the Microfinance Investment and Technical Assistance Facility (MITAF) in 2003, whose goal is to accelerate microfinance sector growth through concerted support at all levels—MFIs, support institutions, Bank of Sierra Leone, government, donors/investors, and the broader microfinance community. UNCDF, UNDP and KfW pledged an initial US$ 9 million to MITAF's operations and the Dutch funding agency, Cordaid, joined in 2005.

The broad approach, donor pooling, and the resulting effective mix of technical assistance, operating grant, and loan capital funding on an annual basis according to specific MFI needs and performance indicators, created a microfinance sector that by 2007 served more than 50,000 clients—four times as many as at the outset. Furthermore, it enabled five MFIs to become transparent and reach sustainability, leveraged US$ 5 million in private equity into the sector, and attracted the interest of commercial banks. A key lesson was that while effective partnerships and collaboration are difficult in practice, they are important and possible.

REGIONAL CREDIT BUREAU INITIATIVE

Though it is too early to tell, the potential of Quest to offer private credit bureau information services in Kenya and possibly other markets in East Africa is high. Quest Risk Solutions, as one of the first private credit bureaus in Kenya, will provide valuable decision-making tools to any company or financial institution extending consumer and SME credit in Kenya. It has managed to partner with Experian®, the global information services company. Quest will use the Experian software to offer the following services to local businesses:

- Credit account information on individuals and SMEs (a very large segment of the Kenyan business population), and
- Information on previous credit applications.

RESEARCH INITIATIVES

Research initiatives, like FinScope, undertaking large scale market demand studies in Southern and now also East Africa can inform institutions on markets, and have the potential to encourage commercial investments as microfinance markets become less opaque. Financial institutions are only beginning to scratch the surface of detecting the wide ranging demand of low-income households and getting to know the costumer. The surveys provide insight into financial management behavior and specific financing needs. The repeat surveys and trend analysis also give insights into progress in expanding the frontier of finance.

In summary, a narrow and micro-level focus on building retail institutions without supporting broader meso-level activities may not create the enabling environment necessary for the sustainable long-term growth of microfinance. Some donors now combine support at the micro level with support in the area of legal and regulatory framework, but often the meso level is still overlooked. Combining investments in retail institutions with support at the meso level and education for government to stimulate an enabling environment (see next section) can both prevent misguided initiatives from starting and reinforce best practices at the broader sector level. Successes can be studied and replicated to other countries.

4.6 Policy, Legal and Regulatory Framework and the Investment Climate

Stable macroeconomic conditions and low inflation support the growth of MFIs. A government's most critical contribution to making financial sectors work for the majority is to maintain macroeconomic stability and create an environment conducive to entrepreneurial development and the flourishing of micro-, small, medium and large businesses. For instance, through its policies over the past eight years, the government of Angola managed to reduce inflation from 248 percent in 1999 to 12 percent in

2006, and saw its GNI per capita rise from US$ 390 to US$ 1,980. These developments led to a decline in lending rates from 80 percent to 19 percent. The example of DECSI in Ethiopia is also illustrative: although the region where this MFI is operating is one of the poorest regions in the country, its performance in the last 10 years has been remarkable. The increased outreach and efficiency of the MFI is partly due to political commitment and stability, a high degree of social cohesion, and traditional social structures that have facilitated the enforcement of contracts.

However, macroeconomic stability, although important, is not by itself a sufficient condition. The growth and outreach of MFIs are affected by financial sector policies and other sectoral policies, the commitment and capacity of governments at various levels, the nurturing of a range of regulated and unregulated institutions of all types to provide services on a sustainable basis, the flexibility of the MFI legal and regulatory framework, the efficiency of the judicial system and the general investment climate.

In Kenya, having overcome populist threats, the government has now created a supportive legal and regulatory framework. Furthermore, it is taking the right approach to the latest challenge: how to regulate the very fast growing mobile phone banking market, recognizing it as an area that needs to be regulated, but not rushing this as that could prevent the groundbreaking initiatives being researched, developed, piloted and launched, from reaching their full potential.

Ghana also offers lessons for other countries in Africa as it demonstrates that the responsibilities of central banks lie as much in the area of tightening to restrain excessive entry and weak performance of financial institutions as they lie in creating possibilities for new types of institutions. It first issued regulations under the Banking Law that permit Rural and Community Banks to operate as commercial banks, except that they cannot undertake foreign exchange operations, their clientele is drawn from their local catchment area, and their minimum capital requirement is significantly lower. The Financial Institutions (Non-Banking) Law of 1993 opened up the system to serving more market niches by establishing nine new categories of licensed financial institutions, including savings and loan companies and credit unions. Moreover, registered NGOs are permitted to engage in lending Likewise, individual susu collectors who gather and hold daily savings from their clients are accepted as part of the traditional, informal financial system (though they are encouraged to join the registered Ghana Cooperative Susu Collectors Association). Interestingly, and in recognition of the importance of informal finance, the Ghana MicroFinance Institutions Network (GHAMFIN) cuts across formal, semiformal, and informal institutions.

In Ethiopia, The Gambia, and Nigeria, MFIs are allowed to offer a wider range of services than in other countries. In Ethiopia, the very broad range of services includes deposits, insurance, leasing, pension management and transfers. In Nigeria, the only services that deposit taking MFIs are not allowed to engage in are foreign exchange, check clearing facilities, real estate and international money transfer. In The Gambia, MFIs can also undertake foreign exchange services. Some countries operate without too many constraints in the products MFIs can offer, which enables them to better respond to their clients' need and thereby increase the impact of their services.

An emerging area of importance, as sectors evolve, is consumer protection. Consumer protection in microfinance is a combination of consumer education and disclosure requirements. Consumer education goes beyond basic literacy in financial management to build and apply knowledge of responsibilities of both clients and financial institutions, calculation of interest rates and other costs, how to prevent over-indebting oneself. Uganda is one of the countries where some pioneering work in this field has been done. It is an important strategic alternative for governments to consider when they want to protect poor borrowers by means of imposing interest rate ceilings. This is because such restrictions generally work against access of the poor to financial services. Instead, consumer education can protect people from getting trapped in loans they can't repay, but without reducing the overall supply to lower-income

market segments. This strategy creates more informed clients and is most effective if accompanied by transparent disclosure of rates and fees, which central banks usually can require without a special legislative instrument.

Box 13: National Microfinance Strategy in Nigeria

In 2005, Nigeria formulated a national strategy. The strategy determined objectives for the sector and set specific outreach and a depth of outreach target to increase finance to women for the year 2020. It further outlined how to achieve the targets. The strategy envisages to advance microfinance through regulated deposit taking institutions using an organic growth approach with lowest minimum capital requirements for local organizations and highest minimum capital requirements for institutions seeking to operate at the state level. It is comprehensive and plans for a national consultative committee, credit bureaus, rating agencies, linkages between financial institutions and a deposit insurance scheme. It foresees tax incentives and addresses AML-CFT issues early on. Further, it reflects on the role and responsibilities of various stakeholders. Overall, the strategy is largely in-line with international standards except for being too prescriptive, which can be improved upon easily.

Source: Micro Finance Policy, Regulatory and Supervisory Framework for Nigeria, CBN, 2005..

Nigeria is an example of how younger markets can benefit from the development of national microfinance strategies (see Box 13). In combination with regulations issued at the same time, the strategy holds the promise to greatly contribute to the acceleration of microfinance in Nigeria. Microfinance is now legitimized, protects depositors, determines a national direction and sets targets, so that different stakeholders can move in the same direction with a clear timetable. The strategy is bold, but has a good chance of working. It addressed key weaknesses of under capitalization and lack of regulation. It also unifies the supervision of all deposit mobilizing institutions under the body that is best placed to do so—the central bank.

However, national microfinance strategies alone cannot guarantee the expansion of microfinance, but are one building block for a conducive sector.

4.7 Conclusions

In order to further expand the frontier of finance, good practices, some of which are discussed in this chapter, need to be documented and made available for easy access by practitioners and other stakeholders. In this way, accomplishments in one country can benefit other countries in Africa.

Chapter 5: Challenges to Financial Service Delivery to Lower-Income Markets in Africa

Overall, the African microfinance industry faces significant challenges in pursuing its activities. These include an unfavourable environment for clients and MFIs, high operating cost environments, lack of human resource capacity, lack of access to commercial funds, keeping the policy framework right, continuing to improve the legal and regulatory environment, and underdeveloped meso levels. Some markets also grapple with either too much or too little competition. This chapter will build on the findings of the previous chapter, and seeks to deepen the understanding about some of the key challenges to the provision of access to finance for all.

5.1 Unfavorable Environment

Ultimately, the health of financial institutions depends on what happens at the client level. If informal sectors are thriving and client businesses are growing, MFIs have the potential to become strong service providers and expand their operations. The more challenges encountered by their clients, the more risks this brings into the MFI serving this market.

5.1.1 The Environment in which Clients Operate

LEGAL AND REGULATORY CHALLENGES AT THE ENTERPRISE LEVEL

The legal environment poses a challenge to clients in a number of countries in Africa. Processes to register a business are lengthy and costly in most countries in Africa. Ascertaining a secure place to undertake business is equally as hard. Transport can be irregular and costly. Access to support services is limited, especially if businesses are not registered.

Moreover, women, who are the majority of the clientele for many MFIs, are treated as legal minors in some countries in Southern Africa. This implies they can only access a loan with the consent of their husband and limits their access to finance and ownership of assets that could be pledged as collateral in seeking a mortgage or other finance.

ILLITERACY AND LACK OF FINANCIAL EDUCATION

In many countries in Africa women entrepreneurs at the lower end of the income scale, especially in rural areas, lack access to education and often a higher percentage than men are illiterate. This hampers their ability to access information on support services to improve their business. It also makes it more difficult for them to participate in vocational skills training programs for self-employment or to enter the formal employment market.

As access to microfinance increases, vulnerable borrowers with limited knowledge of their rights as consumers and limited understanding of financial management issues and the dangers of borrowing beyond their means, may overextend their repayment capacity or be exposed to potentially abusive lenders.

BUSINESS SKILLS

The informal enterprises that predominate in most African economies rarely have the formal registration documents required even to open a bank account. These capacity constraints apply especially in rural areas. Informal enterprises also lack the capacity to provide the information demanded by financial institutions such as audited financial statements, business plans, sometimes utility bills to give insight into their financial position.

HEALTH

Socioeconomic indicators show that people in Africa are more prone to disease than people on other continents and once they are ill it is harder to get treated and quickly recover because of the state of the health sectors. Medical costs other than primary health care are also high. Quantitative surveys indicate that poor households spent a disproportionately large amount on health expenses. Health is a major challenge for many of the clients of MFIs, both their own health or the health of family members, including the extended family.

5.1.2 The Environment in which MFIs Operate

In a 1996 global survey of microfinance institutions (World Bank 1996), it was highlighted that MFIs in Africa face the most difficult environments. It found that lenders were challenged to provide financial services to some of the world's poorest clients, facing low population density in countries with more inflationary environments than in Asia. The first two factors increase cost and the latter has direct and indirect effects. Zimbabwe is an example of the direct effect hyperinflation can have; with inflation in the millions, microfinance activity in Zimbabwe is almost at a complete standstill.

Ten years later, the environment is still unfavourable in terms of GNI per capita and population density, and inflation in Africa is now also higher than in Latin America, where rates have gone down. But Africa outperforms other continents in terms of average GDP growth rates now, and where our generation was taught about the astounding development of the "Asian Tigers," our children will also learn about "African Tigers" as a number of economies are set to join the group of middle- or even high-income countries. For some years to come, however, the challenges of low GNI per capita, low population

density and relatively high inflation will present African MFIs with a harsh reality. More specifically, some of the main challenges faced in Africa, in addition to the macroeconomic indicators discussed above, include:

- Poor transportation, water and power infrastructure,
- Limited,though improving, telecommunications infrastructure,
- Weak property rights and contract enforcement policies,
- Commodity-driven "boom and bust" economic cycles, precluding substantial progress over time, with real income per person in Africa rising only 25 percent between 1960 and 2005, compared to a rate 34 times faster over the same period in East Asia,[21]
- Poor governance standards, with half of the bottom 32 countries in the Transparency International Corruption Perception Index[22] coming from Africa,
- Weak human resource capacity related to level and type of education, health, labor markets, etc.,
- Lengthy and violent inter-country wars, internal civil disputes and sectarian violence, and
- Difficult climate conditions, with frequent droughts and more recently floods, as well as other natural disasters.

5.2 High Costs

This unfavourable environment has resulted in high or very high costs in countries in Africa. An underlying cause of high cost is that Africa is the world's second largest continent spread over an area of 11,668,545 square miles, which makes up 20.4 percent of the total land area on the surface of the earth. It is larger than China, India, the United States and Western Europe combined (see Figure 18) and compared to its size, has a relatively small population of 936 million. This vastness translates into:

Figure 18: The Vastness of the African Continent

- Low population density, especially in rural areas. This explains why MFIs are based in urban and peri-urban areas in many countries. Among the case study countries, in Niger the population density is only 11 people per square kilometer, the lowest population density in Africa after Botswana, Central African Republic, Gabon, Libya, Mauritania and Namibia.

- Population concentration in a few major "pockets." In addition to the urban-rural divide, low population densities are compounded by another pattern we observed in a number of the case study countries, namely that population densities are de-facto very low in most parts of the country. One such country is Kenya which, as a result of very uneven microfinance development, experiences fierce competition in a few urban and peri-urban areas and limited competition in rural areas. Congo, which has one of the lowest population densities not only in Africa but worldwide, has a highly concentrated population in its two main cities of Brazzaville and Point Noire. MFIs follow the same pattern of being based in either one of those cities and hardly covering areas beyond the main population concentrations. In Niger and Sudan, the population is concentrated in a few major pockets. Most service providers are also concentrated in just a few pockets.

- Inadequate and expensive infrastructure, including communications, roads and electricity. The vast distances require enormous investments and efforts. The current limited supply limits operations and drives up the costs. The fact that many countries are landlocked increases costs of many imported items. The infrastructure gap is usually further aggravated in post-conflict countries, given their need for power generators in the absence of electricity even in the capital city and the high cost of communications. Rent and banking fees also tend to be very high in post-conflict countries.

- High labor costs are another explanatory factor driving up the costs of MFIs. Compensation for skilled employees averages 12 times GNI per capita for Central, West, East, and Southern Africa, more than twice as much as any other region in the world (MIX 2007b, p3). This is even more pronounced in oil-exporting countries, where high salaries in the oil sector have a broader impact on cost structures in the economy. Loan officers for KixiCredito in Angola are paid a minimum of US$ 700 per month. High staff turnover also greatly increases personnel costs.

- The higher portfolio at risk in Africa than other continents is another factor that currently drives up the MFI costs. This is a manageable constraint, and an area with room for improvement.

- Diseconomies of scale are another factor encountered in the smaller countries, of which Africa has quite a few: 18 countries have a population of less than five million people, 13 of those have a population of less than two million. Diseconomies of scale increase the operating costs for MFIs.

5.3 Governance and Human Resources

A recently-released report by the Centre for the Study of Financial Innovation (CSFI 2008) identified the greatest risk for microfinance to be in the area of governance and human resources. These same areas emerged as areas of major constraints in this diagnostic of microfinance in Africa. The weaknesses in human resource capacity was mentioned in most of the case study countries, nascent as well as mature markets. Not only did human resource capacity emerge as a key constraint in most countries, in 11 of the 14 countries it was listed as the most acute constraint. Governance was also brought up as a constraint, in particular in West Africa.

5.3.1 Management

The greatest risk for microfinance identified by CSFI is the uneven quality of management at MFIs at a time of rapid change. The survey reveals strong doubts about the ability of many MFIs to adapt to new demands while still retaining their social objectives. In all the regions where they operate MFIs are being stretched by hectic rates of growth, the growing complexity of their business and pressures to become more commercially-motivated. Much of the worry about management quality focused on the fact that MFIs tend to be dominated by visionaries who are strong on charisma, but less so on management skills and strategic flexibility. Several respondents felt that MFIs were not investing enough in sector-specific management skills, as the industry's philanthropic culture emphasized dedication over professionalism.

While MFI leaders are also key drivers in some countries, like in Ethiopia, this concern was echoed in other case study countries. In Angola, human resource capacity, along with the high cost of operations, is the main constraint to delivering microfinance services. Human resource capacity is limited and in high demand. The only NBFI in the country has no university graduates with the exception of its expatriate manager. This will likely limit the build up of a strong middle management, critical for any growing MFI. It will also limit the range of services that the institution can eventually offer.

In Niger, also, the lack of qualified management is a real problem for the microfinance sector. At the MFI level, one of the biggest concerns about the sector is the lack of professionalism, which is derived from inadequate training in microfinance, in a country where skilled manpower is very scarce. Qualified management is also a problem in many other countries in rural areas, such as the rural banks in Ghana.

5.3.2 Governance

Closely linked to management, is the concern identified by CSFI about the quality of corporate governance of MFIs, which was ranked the second most important risk to MFIs.

Governance was a key problem in Congo, Guinea-Bissau and Niger. In Congo, MFIs suffer from a lack of good governance, as members (of mutual organizations) and shareholders (of non-mutual organizations) are often not aware of their fiduciary responsibilities or their roles. In the case of mutual organizations, senior management is often confronted with conflict of interest issues as they are themselves members of these institutions. In Guinea-Bissau the percentage of MFIs that have gone out of business is likely unprecedented in Africa. Such occurrences further reduce confidence in a financial sector about which populations were already hesitant, and in return decreases demand for its services. Governance is a wider problem also for some MFIs in other countries in West and Central Africa.

Governance was also found to be a constraint in Angola, Ethiopia and with some of the many SACCOs in Kenya. Weak governance can lead to lack of information and transparency, low portfolio quality, lack of growth, reluctance amongst funding agencies or collapse of MFIs.

5.3.3 Staffing

Staffing emerged as an area of major constraint in this diagnostic of microfinance in Africa, almost as important as management.

Staffing is a perennial and worsening risk for most MFIs in Africa. The growth in competition, poaching of staff, lack of training and rising salaries make human resources one of the most intractable problems in the sector. Responses from all major sub-regions told a similar tale of staff shortages holding back growth and service improvements.

In Angola, the difficulty of attracting and retaining high-quality staff is an impediment to the sector's growth and sustainability. Overcoming this constraint requires a human resource development strategy with constant training. For instance, all banks have in-house and external training programs for their staff.

In Congo, human resource capacity is the primary constraints to the development of the sector. This is the number one issue raised in discussions with different actors in the microfinance sector as well as at the regulatory level. MFI staff need adequate training in how to deliver financial services to low-income households in order to deliver quality services to customers. But the problem of adequate training is one that impacts the entire private sector in Congo. It needs to be addressed by the government as well as the donor community, which need to support APEMF Congo and strengthen its internal capabilities.

In Ethiopia, there is a dire need for capacity building for staff. This includes both general training as well as more specialized training. MFI growth rates are expected to be high, so it is a demand that will be hard to meet. There probably is no precedent in Africa for the number of people that need to be trained, nor has a sector faced a challenge of this magnitude, given low education levels and the huge number of training sessions that will need to be organized.

The importance of higher levels of education and a skilled labor force for microfinance is illustrated by North Africa. For instance, in terms of transparency and timely reporting, all MFIs in Egypt and Morocco that are reporting do so regularly. Despite legal restrictions, MFIs in Morocco are showing themselves to be innovative, for example, designing housing loans and linkages with post office banks. Higher human resource capacity affects growth, sustainability and innovation.

5.4 Management Information Systems

Globally, instituting management information systems (MIS) is no longer a problem for MFIs. Both managing technology and back office operations ranked low in the CSFI survey, which noted that the MIS challenge has largely been brought under control and local support has become available.

In some of the more mature markets in Africa MIS is also no longer identified as a constraint. But in a number of markets in Africa, MFIs lack the strong management and accounting systems that are necessary to control risk and keep costs down, particularly as they expand in size and complexity. Part of this is due to the diversity of MFIs and types of services they offer for a range of specific contexts, making it is hard for affordable systems to permit all desired specifications. However, in addition to the high costs of MIS packages, one of the respondents in the CSFI survey mentioned that: "Some MFIs are not willing to pay the costs of a good MIS. The results are systems that are inferior and held together with frequent patches that create more problems." It may very well be the case that many MFIs, due to tight or negative profit margins, find themselves in the situation of being unable to invest in an adequate MIS.

The lack of MIS is the key constraint in Guinea Bissau, where there is little reliable information on even the most basic parameters. Together with lack of performance indicator use, it is the biggest constraint to the sector's development. Although MFIs in Niger have an ADBanking MIS that seems to be operating well, they appear to need a more sophisticated MIS to handle larger transaction volumes.

In The Gambia, reliable management information systems are also still rare. This is affecting the smooth operation of the MFIs, in loan disbursements as well as the crucial management of their portfolios and costs, and is affecting their ability to diversify products. In Ethiopia, it is surprising that so many products are already being offered, considering that most MFIs continue to use manual systems at the branch level. Still, for their product menu to diversify further, automated information systems will be critical to ensure timeliness of information and management decision-making. Banks getting involved in microfinance often have poorly adapted systems, unless they downscale in a systematic way.

Over the next decade, the cost of basic core systems is also expected to drop dramatically and smaller MFIs should be able to access off-the-shelf packages for a reasonable price. More advanced institutions wishing to offer automated payments will need systems that are interoperable so that they can connect to other multi-institution payment systems.

5.5 Funding Constraints and Challenges

The diagnostic, like the CSFI study, found that funding is a main constraint for MFIs in Africa, and noted also that the options for financing available to MFIs in Africa are less extensive than in other parts of the world. This poses the following challenges.

IMMEDIATE CHALLENGES

The immediate constraints to improving the availability of financing are:

- Banks are traditionally rather conservative in Africa, though this is changing,
- While the number of MFIs reporting to MIX is increasing, overall, there is limited transparency and information disclosure among African MFIs,
- There is a perception that MFI profitability and investor returns are on average not as high as on other continents. But AfriCap claims that its 12 investments have generated two exits with an average Internal Rate of Return (IRR) of 30 percent, and that its own shareholders have generated an IRR in excess of 14 percent, and
- The lack of foreign investment is also partly due to the negative stereotypes about the high risk and high cost business and investment climate in Africa.

LONG-TERM CHALLENGES

Long-term financing challenges include:

- Local bank financing costs in Africa are relatively high. As explained by MIX, "The limited supply of commercial financing by local banks in Africa remains scarce and expensive." (MIX 2007, p6).
- It remains especially difficult for MFIs to access domestic loans at longer tenures because maturities remain unavailable in most African financial markets. Therefore, any financing will ideally be complemented by measures to address these needs with a view to eventually meet the local medium- and long-term financing needs.
- More sophisticated financing methods, such as bond issues, IPOs and securitizations will only

be available to the larger MFIs due to the costs involved. Moreover, these more sophisticated methods come with other disadvantages such as fluctuations in availability due to their dependence on favourable market condition; a long lead time in preparing the documentation with a high burden on senior management; ongoing costs in terms of dividends or high interest rates; and demanding continuous disclosure obligations to the market or investors (see Table 10). While these alternative sources of funding develop, most MFIs in Africa will continue to be limited to the three primary financing methods of client deposits, borrowings and equity.

Table 10: MFI Funding Options, Advantages and Disadvantages in Africa

ITEM	DEPOSITS	LOAN	EQUITY (IPO)	BOND ISSUE	SECURITIZATION
Advantages	• Meets other demand as well • Economic stimulus is higher if interest is paid to low-income clients than to banks	• Once relationship built with bank, fast access of amount sought	• Raises MFI profile • Opportunity to set up Employee Share Plan • Liquidity for future issues or investor sell-down • No ongoing interest cost	• Raises profile but less than IPO unless listed, e.g. Faulu Kenya • Diversifies funding sources • Long-term funding • Cost may be less than debt	• Diversifies funding sources • Long-term funding • Transfers risk to variety of investors • Removes assets from balance sheet (for cap ad)
Initial Cost	Differs	>2 % (estimate)	5-7 %	2-3 % excluding any guarantee fee	Discount to book value or guarantee over first 10-15 %
Ongoing Cost	Financial and Transactions costs	Expensive in Africa	Dividends (if any)	Interest: T-bills plus margin for risk, reduced if credit enhanced	Low, due to original pricing
Future Obligations	• Annual inspections • Regular reporting	• Regular reporting	• Continuous disclosure • Regular reporting • Annual meetings	Limited reporting, unless bonds listed	Limited reporting
Disadvantages	• Though many MFIs in Africa offer deposits, for MFIs entering, this market includes high upfront cost • Debt being savings of the poor, demands ultra prudence • In Africa long-term fixed deposits don't sell	• The offering of collateral • Regular interest and repayment obligations	• Feasibility depends on state of capital markets • High public scrutiny and future focus on short-term performance • Complicates subsequent equity issues • Large burden on management	• Feasibility may also depend on state of markets • Bond markets usually less developed than equity • Large initial burden on management, e.g. prospectus	• Few or no precedents in Africa • Needs large volume of loans (in the tens of thousands or millions) • Complicated structure • Legal issues, e.g. title to assets, short-term loans, enforcement

5.6 Policy Environment

In Chapter 3 and 4 we discussed the importance and examples of a supportive government in the creation of an enabling environment for microfinance. The heightened government interest in microfinance, however, brings not only opportunities, but also risks, such as politicization. Some governments around the world are turning back the clock and calling for interest rate ceilings, the launching of new government microfinance banks, and/or bringing bank supervision back into the orbit of the political leadership. The next ten years will see at least some other countries go down that path, to the detriment of their low-income populations (Otero 2007). A danger of too much government involvement in microfinance is that political criteria, rather than sound credit administration, could drive decisions as to who gets credit and where branch operations are located (Helms 2007). This was the case throughout the 1960s and 1970s, and it resurfaced in some countries, with disturbing developments in Benin, Kenya and Uganda.

In Kenya, we came across an example of a nearly complete reversal on what is considered the most fundamental condition for financial institutions to serve lower-income markets—liberalized interest rates. Throughout the early 2000s, the so-called "Donde Bill" (introduced by Member of Parliament Joe Donde) caused considerable concern, although it was not specifically directed at MFIs. The Bill sought to drastically control the interest rates of banks and other financial institutions specified by the Central Bank. It was passed by a large cross-party majority of Parliament and presented to then-President Moi. After due consideration, Moi announced that he would not give assent on the basis of contradictions between the bill and existing legislation. Even the threat of the bill, however, was sufficient for at least one bank, the Cooperative Bank of Kenya, to put on hold its plans for a major activity expansion into microfinance. Since then, the Treasury bill rate, which was the fundamental reason for the high interest rates at that time, has decreased significantly. Following discussions with the Bankers' Association, the Ministry of Finance has also introduced a number of administrative changes (as proposed in the Donde Bill) throughout the budget. This includes, for example, the requirement that banks must publish the full details of their rates and any fees charged on loans. The Donde Bill is now in abeyance, but remains a background threat especially perhaps to the MFIs (Wright 2004). We see some parallels with Ethiopia, where a draconian draft banking law was recently proposed. If passed, it could indirectly influence microfinance sector development and its full integration into the formal financial system.

Benin, another case study country, is currently plagued by myriad challenges which started since the economic downturn in 2004 (see AMAF, WWB (2008), *Diagnostic to Action: Microfinance in Africa, Volume II: Case Studies*, New York, USA, soon to be published on the website of Women's World Banking). The loan portfolio dropped by 22 percent and the PaR jumped to 11 percent from 6 percent. Furthermore, to grasp the complete depth of the portfolio degradation, one must integrate the volume of loans written off and their impact on surpluses. Table 11 below presents the impact of loan losses recorded in 2006 on selected networks and MFIs in Benin.

Table 11: Loan Losses and Impact on Results for Selected MFIs in 2006 (Amount in 000 FCFA)

	FECECAM	FINADEV	PAPME	PADME
Provision for doubtful accounts	1,091,943	284,689	1,961,427	656,816
Loan written off (a)	2,744,850	675,975	3,890,964	3,053,348
Accumulated provision on loan written off (b)	890,912	319,319	856,955	889,279
Loan losses (a) – (b)	1,853,938	356,656	3,034,009	2,164,068
Total impact on result	2,945,881	960,665	4,995,436	2,820,884
Result (loss) in 2006	(2,932,768)	(364,066)	(3,144,587)	(1,504,167)

Sources: Interview with concerned MFIs.

The evidence suggests that, regardless of their legal structure, only MFIs with quality management and institutional organization have managed to limit the loss. Few leading MFIs, with the exception of PADME, have risk management units in place despite their size. On top of the cost of delinquency, MFIs are facing an even graver risk of government policymaking—which ironically was once credited for the sector's successful take-off. The expansion of government-initiated subsidized direct lending damages the credit culture and undermines the efforts of MFIs.

Though the case of Benin is quite dramatic, bad government policymaking was found in other case study countries, as well. With their many players at national, regional and local levels, Ethiopia and Nigeria are not yet free from direct subsidized lending. Moreover, in both Malawi and Sudan, the government is heavily involved in the sector. In Malawi, the government has shaped the industry from the outset and still owns the two major institutions that have benefited from subsidies as long as they have existed. The Sudanese government uses microfinance as a social service offered to the poor and also as an electoral propaganda tool.

Ironically, some of the reversals in government policymaking have emerged in the more developed markets, perhaps because of the higher profile that the sector has gained. "Particularly because scale and success bring high visibility, actions to restrain or interfere with microfinance are more likely to appear in exactly those countries where microfinance grows fastest" (Rhyne and Otero 2006). Uganda is another of the more developed markets in Africa experiencing some government direct lending interventions that threaten the sustainability of MFIs. This is because their subsidized interest rates pose unfair competition to the MFI, but the usual low loan repayment of such programs has an additional distorting effect on the credit culture. In an odd twist for Uganda, after years of working to develop the capacity to deliver services to lower-income markets, government actions could impede the sector from reaching the next phase of high penetration of the microfinance market which could improve the lives of millions of the country's poor.

Aside from developing microfinance strategies and avoiding direct lending, another area where government can add significant value in the creation of an enabling environment for microfinance in Africa is in improving the judicial systems. This domain has been a key constraint for all of the case study countries. Weak property rights and inadequate legal environments make foreclosing a very lengthy process. In Congo and Malawi, procedures to recover the debt on average cost more than the value of the debt itself. In Central Africa, progress is being made in this domain through the Organization for the Harmonization of Business Law in Africa (OHADA), but currently the environment is still constraining. In East and Southern Africa, where the Common Law tradition prevails, judicial systems are functioning a bit more smoothly, though the utility of land title deeds in rural areas can often be limited. In Benin, the majority of borrowers have no title deeds because there is no transparent system to acquire and exchange land titles. This limits their capacity to pledge collateral when they seek to access larger loans.

5.7 Rigid Legal and Regulatory Frameworks for MFIs

Though the creation of legal and regulatory frameworks has been a major reason for sector growth in a number of countries, in others excessively restrictive approaches may constrain innovation and expansion of finance at the lower-end of the market. Generally speaking, the legal and regulatory environment has not been a major obstacle in Africa. At the same time, at this juncture and stage of sector development globally and in much of Africa, this area is critical for the industry's advancement. The regulatory and policy environment will play a role in determining which regions and countries will close the demand gap most successfully.

This section seeks to highlight key constraints in legal and regulatory frameworks for MFIs that, if addressed, could have a major impact on advancing microfinance in Africa. They include:

i. Price controls,

ii. Lack of diversity of institutions,

iii. Limitations in product offering,

iv. Micromanagement by regulators, and

v. What to regulate and what not.

PRICE CONTROLS

The greatest constraint to the development of microfinance is the imposition of business parameters that impede the MFI from growing. The emergence of the PARMEC law elevated the status of the microfinance industry and strongly influenced the emergence and growth of the sector in the UEMOA region, and it has since become an essential sub-sector of the region's formal financial system. But, even though improvements were recently passed (see AMAF, WWB (2008), *Diagnostic to Action: Microfinance in Africa, Volume II: Case Studies*, New York, USA, soon to be published on the website of Women's World Banking), the framework continues to control interest rates on lending. Addressing this is of ultimate importance in order to reach more remote areas. The authorities have pushed MFIs to operate with very tight margins. The revenues are so low in some countries that though MFIs have sought and succeeded in offering their services sustainably, no buffers exist against uncertain times and minimal resources are available for innovation. In Benin, studies have been undertaken that show that an interest rate above the PARMEC cap of 27 percent is needed to ensure the viability of MFIs and that the rate does not take into account the realities confronting MFIs (Azokli et al. 2007). The forced low margins do not allow them to expand through growth in retained earnings, and any slow years can result in not only decreased returns on assets, but can push them into the negative.

DIVERSITY OF INSTITUTIONS

Ideally, financial regulations distinguish among various types of institutions through the types of services permitted and related financial and human capacity to offer them. However, this scenario is a reality in very few countries; whereas many countries have a relatively limited range of institutional types permitted, which impede the sector's capacity to grow and diversify. The limitations are most pronounced in North Africa where in Morocco, for instance, the only type of MFI is an NGO MFI. In Egypt, only NGO MFIs and some banks offer microfinance services. In Sudan, the autonomous government of the South has chosen to limit its intervention in issuing permits for microfinance activities, but for the other parts of Sudan, the law stipulates that only banks can offer microfinance products. In UEMOA countries, a long-standing constraint (rectified in September 2007) had been that commercial entities were able to acquire only temporary authorizations to operate. In Ethiopia all MFIs are NBFIs and savings and loan cooperatives. In Nigeria, a specific law has been passed for (deposit taking) MFIs so, whether from NGO or community bank origin, all deposit taking microfinance institutions now have to comply with the new law. In The Gambia, Malawi, Kenya, South Africa and the COBAC countries we see more diversity permitted in terms of institutional charters. There can also be constraints in the permitted type of entity. For example, in Ethiopia, financial institutions, including MFIs, have to be established as share companies and wholly owned by Ethiopian nationals; NGOs are not permitted to offer microcredit. It has also resulted in somewhat artificial ownership and governance structures, as international NGOs have identified trusted nationals to take on ownership of their institutions, but with limited rights in terms of sale or transfer.

High minimum capital requirements can also limit the diversity of MFIs in certain situations. In Nigeria, the minimum capital for deposit taking institutions was set quite high, but it is a prudent measure in an effort to ensure that the central bank could supervise all deposit-taking institutions, and has proven manageable as most former community banks were able to mobilize the additional capital.

Restrictions on the diversity of institutions has not always negatively impacted sector growth—as can be seen in Morocco and Ethiopia—but it has proven a serious impediment in countries like the Democratic Republic of Congo, where new entrants have been discouraged, while the central bank focuses significant efforts on relatively small, licensed institutions. To the extent that the law permits a healthy diversity, it enables regulation to occur in regard to those institutions for which supervision is necessary, without impeding growth of those which require less or no supervision.

PRODUCT OFFERINGS

In a number of countries, only banks can capture savings or other deposits, while insurance companies offer life insurance and NGO MFIs exclusively microcredit. For instance, in Angola, the financial institutions law defined microcredit companies as institutions engaged in operations of money and credit. It prohibits activity in any other type of financial operation, such as savings or insurance. As most microfinance actors in Angola are commercial banks, the banking law also impacts the sector. Banks are currently unable to offer life insurance on loan balances as is common with many microfinance operations. Similarly, in Morocco, due to legal restrictions, NGO MFIs can not offer savings products, and none of the commercial banks have downscaled in savings. In other markets in North Africa there are similar constraints and, in addition to a limited product range, this also limits innovation, which is inherently related to the domain of delivering financial services to lower-income market segments.

Further, legal changes are needed in many countries to allow a broad product offering and eventually respond to all financial needs of lower-income market segments.

MICROMANAGEMENT

Some MFI legal frameworks, which are generally conducive to the development of a flourishing microfinance sector, could be improved further by removing overly prescriptive clauses. In Ethiopia, despite an overall conducive role, improvements can be made in MFI legal and regulatory frameworks. For instance, in urban settings, the individual loan is in highest demand but MFIs can only provide individual loans up to 1 percent of their capital, and this has to be secured by mostly immovable property. Another issue raised was the requirement of re-registration when an MFI mobilizes savings above the 1 million birr threshold. This adds unnecessary uncertainty and an extra administrative burden on the regulator and MFI.

In Morocco, although the microfinance law has supported the development of the industry by offering a clear framework, it is too prescriptive. Even though the law has also evolved over the last several years to permit housing loans and by increasing the maximum loan size, a loan ceiling of 50,000 Moroccan Dirham (US$ 6,500) remains in the current regulations. This inhibits MFIs from growing with their clients from micro- to small- and medium-sized enterprises. In Nigeria, although the new law for deposit taking institutions is a prudent initiative that could facilitate sector take-off, it is currently too regimented. For example, a microfinance client should be between 18 years and 60 years of age, cannot be a formal sector salaried employee, and the maximum loan cannot exceed N500,000 (US$ 4,500). Furthermore, the loan term is prescribed at six months, with an exception for agriculture, and collateral is defined as a joint or several guarantee. Overly prescriptive policies limit MFIs in refining their business models, adapting or innovating, and they limit the market segments in which MFIs could potentially deliver services. Additionally, they take time and resources for supervision from frequently under-staffed departments.

THE BALANCING ACT OF WHAT TO REGULATE AND WHAT NOT

The objective of building inclusive financial sectors does not mean that all MFIs need to be regulated. The aim is to build strong regulated and unregulated institutions of all types to provide services on a sustainable basis.

A failure to regulate this market segment can be disastrous, but so is the attempt to regulate too much. Overregulation not only suppresses innovation but results in overburdening the central bank and, sometimes, in limiting its capacity to approve licenses; not only does it delay microfinance sector

growth, it can also create situations where large deposit-taking institutions do not receive sufficient supervision to guarantee their soundness. Effectively supervising hundreds of MFIs is in most cases neither possible nor necessary.

In some countries there is a time lag between effecting MFI legislation and the issuance of regulations, which creates a vacuum and prevents the supervisory authorities to take on their roles. In Kenya, the delay in drafting regulations for the sector has left MFIs uncertain about their operating requirement. In Angola, since the development of the financial institutions law in 2005, no regulations have been developed, thus microcredit companies function in a legal limbo. This makes them hesitant to pro actively seek commercial funds and limits growth. On the contrary, Nigeria issued regulations when it also laid out its policy and legal framework, so MFIs are very clear about what is expected from them and can adapt their reporting systems and standard operating procedures accordingly.

A new challenge comes from the pressures of addressing AML-CFT (anti-money-laundering and combating the financing of terrorism) efforts, which are demanded by more and more countries. Especially in post-conflict countries, where perceived laundering risks are high, procedures will have to be put in place relatively soon in order to re-establish the country's banking links with international correspondents. This drives up the costs for MFIs. At the same time, MFIs that are unable to invest in compliance expose themselves to other risks, such as sudden closure.

In summary, as microfinance service providers have started to become major players in some financial sectors, regulatory bodies have increasingly taken on initiatives to accommodate them in the legal and regulatory frameworks. We have seen in Africa that those countries which permit a diversity of institutional types, while allowing regulated institutions to offer a wide product range have seen growth in their sectors. As MFIs mature, overly prescriptive rules can and have impeded innovation and growth. To the extent that regulators focus on prudential norms, and avoid becoming too involved in questions of methodology, pricing and client profiles, they will enable MFIs to create, innovate and grow. At the same time, adequate and appropriate supervision is needed for deposit-taking MFIs in order to ensure confidence in the financial sector.

5.8 Underdeveloped Industry Infrastructure

In more than half of the case study countries, the absence of key building blocks at the meso level was found to be a key constraint to the advancement of microfinance services and eventual integration into the formal financial system. The gap at this level was most acute in Congo, The Gambia, Guinea-Bissau, Malawi, Morocco, Nigeria, South Africa and Sudan.

In the case of Congo, though there is an association, employment of industry standards is limited and information is still scarce. Though three MFIs have attempted to start reporting to MIX, they seem to be struggling with their MIS and lack of trained staff. The limited amount of donor funding is apparent in Congo and there are no local technical service providers.

In the case of The Gambia, the single most important constraint to sector development is the lack of industry infrastructure. There is a microfinance association, the Gambia Microfinance Network (GAMFINET), but it has not been able to bolster the sector. There is very little information available on the sector and the use of internationally recognized performance indicators remains limited. If GAMFINET followed the example of other countries such as Ethiopia, the resulting improved information at the MFI and sector level, and utilization of key performance indicators, would be bound to spur sector development. There are no local technical service providers, though nearby Ghana has some capacity and there are also English speaking microfinance specialists in Senegal.

In the case of Malawi, the principal challenge to the development of the microfinance industry lies not in changing or amending the existing law but in adopting the best practices. The industry must become more customer-oriented to design demand-driven products as client drop-out rates are currently very high, which is very costly. The absence of a strong association further impedes swift addressing of these weaknesses.

In the case of Morocco, where the retail level is well developed, the current key constraint is the legal and regulatory framework. During such a period of dialogue on potential changes at this level, and the subsequent potential transformation of MFIs into deposit-taking institutions, microfinance associations play an important role. The weakness at the industry association level in regard to advocacy represents a constraint for the sector.

In Nigeria, the absence of a strong microfinance association has impeded the development of the sector. There is an acute need for dissemination of best practices, advocacy with the many actors at the various levels of government and stimulating and coordinating capacity building initiatives. It is urgent that the country hastens the development of a strong industry infrastructure. Nigeria home to one-fifth of Africa's population, and though the MFI retail capacity is still extremely low, the industry is growing very fast. An active microfinance association with leverage would provide much-needed support to members, including providing the performance indicators, tools, and advocacy and government dialogue. States with governments falling behind could be exposed to others and MFIs could be supported in their efforts to advocate for enabling environments.

In the case of South Africa, a strong network is important to leverage learning and to continuously assess the progress being made in the market. The country seems to have reached a stage in which microfinance has become integrated into the broader financial sector. Presently, the NGO MFIs have an association, while NBFI microlenders have a separate association, and banks are joined in the banking council without specific support in microfinance services. Significant cross learning and sector development could be increased, as well as potential linkages developed with a strong network serving all institutional types.

In Sudan, an association for the MFIs in the North has been formed but it has not yet found its proper strategic positioning in the financial landscape of Sudan. There is not a lot of information available. The local technical service provider capacity is limited.

The lack of information in many countries can be directly attributed to the absence of functioning microfinance associations, whose fundamental roles are those of information broker and advocate for the microfinance industry. The resulting void at an industry level constrains the development of retail capacity and hinders strategic planning for sector development.

In principle, regional networks could play a role in promoting and assisting national ones. However, though they exist, so far this has not resulted in significantly stronger national associations. AFMIN can play this role if it expands its operations to represent all countries, and if supported enough financially and technically; or another entity could seek to represent all 53 countries. More focus on exchange among countries could have an important impact on sector development. UMEAO countries, for example, experience significant exchange among themselves through CAPAF and CIF, but remain relatively isolated from the innovations and commercialization being experienced in East and Southern Africa. Africa needs a strong network to represent the industry and make sure that the African voices are well heard by the international community.

Generally, high quality local technical service providers are also still rare and the lack of a microfinance talent pool generated from local or nearby universities is another constraint at the meso level in many countries.

The absence of a credit bureau is being felt across Africa, as is the lack of research capacity in microfinance matters.

5.9 Too Much or Too Little Competition

Even though competition has the power to force MFIs to rethink and reform, the problem of fierce competition is that it can undermine operating standards and erode profitability of MFIs with small margins. It also results in competition for limited human resource.

In Africa, there are many countries where competition is not yet a significant issue. On the contrary, at least ten monopolistic markets were identified that actually need more competition, from the perspectives of both consumers and financial authorities. Competition is usually an effective way to reduce microcredit costs, which has been identified as a key obstacle in almost all microfinance markets in Africa. Without new entrants or significant strengthening of some of the current players in these markets, it will be hard to elevate the sector to the next stage and realize the potential of finance for all. Moreover, not only is there a systemic risk if individual institutions continue to dominate national markets in the microfinance sector, but in some countries they could imperil the financial sector at large.

Social investors in these markets would have a greater impact if they not only picked the winners, but also took a long-term perspective and invested in due diligence on the second and third-most successful MFIs in such markets, in seeking to create a level playing field.

5.10 Conclusions

To conclude, we identified nine major constraints in this diagnostic of microfinance in Africa. An unfavorable environment can lead to high cost and volatility, and when the policy environment and the legal and regulatory framework present constraints, it can hinder growth and put at risk existing successful structures. At the MFI level, a key impediment is the scarcity of skilled manpower, which combined with funding constraints, limits the growth in microfinance retail capacity. Moreover, there are some general early growth industry matters—such as an underdeveloped industry infrastructure and, in some countries, a monopolistic industry—that can harm sector development and create systemic risk.

PART III: THE ROAD AHEAD

Chapter 6: Access to Finance for All in Africa

The African microfinance market offers sound prospects for accelerated growth, though this varies considerably among the different countries. Some of the more vibrant markets will experience rapid growth in the coming years, while a number of countries have no significant microfinance services. Diversity is increasingly pronounced, as more and more formal financial institutions as well as other types of institutions—telecommunication firms, one-to-one banking initiatives like Kiva and in some countries supermarket chains—enter the market. The number of MFIs transforming is likely to continue to rise in the years to come. Throughout the continent, the frontier of finance is moving towards unserved markets, to poorer, rural and very remote segments of the population. Microfinance has already become an established part of the financial system in some countries.

AMAF's vision of seeking and promoting effective microfinance solutions that are anchored in the realities of the African continent lies at the base of the proposed areas of major concern outlined in this chapter. As a group of leaders in the field, many of whom have managed or are running major MFIs, the value proposition is evident. It sheds light on, analyzes and suggests major areas that need to be addressed in order to accelerate microfinance and the eventual access to finance for all in Africa. The continent has many unknown success stories, and many specific solutions, some of which can be replicated in other countries.

Growth of microfinance in Africa could be optimized if countries build on what works (such as diversity of institutions and savings mobilization), increase the number of efficient retailers, look for opportunities beyond the traditional microfinance domain, work rigorously to build an industry infrastructure, keep the policy framework right, and exchange information with similar countries when strategizing for growth.

6.1 Bringing Clients to the Forefront

6.1.1 Empower Clients in Matters of Financial Management

As financial institutions are only as strong as their clients, partnerships with organizations that can provide training in financial literacy and consumer education are important.

FINANCIAL LITERACY

Financial literacy is equally important for existing clients as well as for the category of "almost bankable" in the course of trying to expand the frontier (see Chapter 4). Experience has shown that basic financial literacy training is important to prepare the ground and educate potential clients about savings, credit, and money management (especially women, who tends to be the targets and most successful clients of microfinance institutions) and a key ingredient to graduating people from almost bankable to bankable microfinance. Experience with such training of women in villages in Ghana shows that they appreciate and are able to apply the knowledge gained, and to spread it to others in their communities either directly or through the demonstration effect of seeing the improvement in their livelihoods and access to finance. Hence an important strategic element is support for financial literacy training in underserved areas (Steel 2008).

Box 14: What Clients Want

Clients seem to value two aspects of the service most highly: convenience, and their interactions with a particular individual. Convenience relates to: the ability to deposit daily or on a schedule that suits the client; the fact that the collector comes to the client; and the speed of transactions (three minutes on average). Clients appreciate that savings collectors come from the area, speak the local language, and demonstrate "the qualities of a good person."

Source: CGAP, Country Level Savings Assessment, 2005.

CONSUMER PROTECTION AND EDUCATION

As the industry is maturing, equally important is consumer education aimed at creating more informed clients, preferably accompanied by transparent disclosure of rates and fees. Consumer education goes beyond basic literacy in financial management to build and apply knowledge as to responsibilities of both clients and financial institutions, calculation of interest rates and other costs (Steel 2005). In the long run, having informed consumers is in the interest of responsible MFIs, and it would be desirable for microfinance associations and sector support facilities to encourage MFIs to participate in and adopt consumer education programs, perhaps by setting codes of conduct for their segment or for the industry as a whole. For codes of conduct to be effective they need to have buy in from a large number of stakeholders. A code of conduct for Africa could be helpful, so that country level initiatives have a starting point, but in the end such continent-wide document can be provide input but not replace national exercises in this regard.

IMPROVE THE BUSINESS ENVIRONMENT

Though the business environment is improving in many countries, more progress needs to be made in this area in the coming years, to enable Africa's private sector to become competitive and small enterprises to thrive. A secure and supportive business environment is important both for enterprises operating in the informal sector, as well as for SMEs and other enterprises operating in the formal

sector. Hawkers form an essential part of the economy in many countries in Africa, and they should be assisted as much as possible, never evicted. For formal SMEs, reforms need to be introduced to reduce the costs of and barriers to business registration and operation.

6.1.2 Receptiveness to Listen to Clients

Empowering women to understand issues of financial management and express their needs in this regard is one thing. Being heard by the financial service provider is another. In order to bring clients to the forefront, the relation and interaction with MFIs needs to be reversed from the traditional top-down supply-driven approach. Some generalizations can be made (see Box 14), but ultimately, every context is different and MFIs need to master the client feedback loop and build-in the capacity to detect client wishes at every point in the business process. For this, toolkits exist and more consultants are accredited to train MFI staff, imparting market research and product development skills and offering demand-driven products and services. However, what is most important is the overall orientation of MFIs and how they look at clients.

Recommendation: Create a more secure and supportive business environment for informal sector enterprises, including consumer protection initiatives. Introduce reforms to reduce the costs of and barriers to business registration for formal SMEs.

- MFIs: Promote client empowerment and continuously increase MFI capacity to listen to clients and adapt products accordingly.
- Microfinance Associations: Continuous lobbying and communication or contact with policymakers. Consider the introduction of consumer protection and education initiativse as in Uganda and Ghana.
- Government: Support consumer protection initiatives. Demand transparency and disclosure of rates charged to customers. Introduce reforms to reduce the costs of and barriers to business registration for formal SMEs.
- Donors: Consumer protection issues are a public good which could be sponsored by donors to encourage governments during the initial phases/introduction of these type of programs.
- Researchers: Document cost-effective success stories of making clients informed decision makers.

6.2 The Bottom Line: Efficient Retailers

The most critical strategic element for the next five years will continue to be building retail capacity to deliver financial services to low-income households and to do so more efficiently and on a greater scale.

6.2.1 The Economics of Microfinance in Africa

In order to achieve the goal of access to finance for all in Africa, MFIs will need to build on what works and innovate. Successes in Ethiopia and Morocco, which managed to build a sizeable industry with large, profitable retailers within a decade, can be replicated if stakeholders jointly analyze the

key constraints and strategize on how to overcome obstacles with clear, quantitative target-setting. Microfinance is already becoming an established part of the financial system in some countries. But, it will not be feasible for this retail capacity to develop unless it is well-planned.

It is more difficult in Africa than in some other regions to be a successful MFI, and MFI strategies have to be smarter. As underscored in this report, Africa is a challenging market for microfinance. In fact, as mentioned, one of its greatest disadvantages is that the continent counts 53 separate markets, many of which are too small to allow for many viable MFIs. Low population densities, high salaries, and communication and transportation infrastructure beset with deficiencies further drive up costs. It is critical to analyze the particular context and determine if there is a window of opportunity to start a viable microfinance operation. The question is: how can this best be done? Below, we outline strategies that can lead to overcoming this fundamental hurdle.

Aim for Economics of Scale. Know not only the break-even point, but the volume of operations where MFIs are likely to start to experience a crucial increase in efficiency. In Chapter 3, we emphasized that there is a point where the loan portfolio is large enough to generate significant efficiencies (See Figure 8). This differs in each country and by lending methodology. In Sudan and Angola, where relatively high costs of doing business are influenced by oil, significant investments are needed to achieve profitability and the portfolio size where significant efficiency gains will start to set in is very high; Kixi Credito in Angola only broke even at US$ 2.8 million. A clear direction on where to go, which focuses not only on locations and break-even points but on efficiencies necessary to keep operations affordable, is bound to lead to more MFIs that achieve economies of scale more rapidly. An alternative approach for small institutions which may struggle to grow to a large scale is to merge with likeminded MFIs or with complementary financial service providers. It should be noted that reaching scale does not necessarily imply moving up-market; several MFIs in Egypt, Ethiopia, Kenya, and Morocco were able to reach significant scale while maintaining average loan sizes as a ratio of GNI per capita below the average in Africa.

Create Efficiency Gains through Technology. MFIs will need to continue to decrease their cost of operation by means of automation and making use of new technologies (Azokli 2007). Microfinance clients in some countries in Africa already have access to cashless banking through cell phone payments, ATMs, and card products, providing them with greater security and convenience at a lower cost. Latest trends are demonstrating that Africa is not falling behind in this area. With the advent of mobile phone technology the telecommunications wave has taken Africa by storm, due to specific necessities and opportunities that exist on the continent, such as the many countries that skipped the phase of having fixed "landline" communication structures altogether. A number of countries in Africa have become fertile ground for pioneering technologies. Magnetic strip and chip (smart) cards, point-of-sale devices and biometric recognition are just some of the potential options that MFIs have already started to consider as a means to reduce their costs. In addition, credit decisions can be automated using lessons from consumer lending and credit scoring.

Despite high costs being a key constraint in Africa, the new opportunities on the continent are perhaps even more important. For example, the efficiency gains and cost reductions that are being realized through new technologies can be significant and could even provide MFIs with the chance to get ahead.

Create Efficiency Gains through Distributed Financial System Architecture. A number of business models have emerged that are particularly suitable for rural areas because they managed to develop efficient operations, adapted to the realities in rural areas. The credit union, CVECA, FSA and CMLF business models are playing a major role in moving the frontier forward. In combination with advances in technology, efficiencies can be further reinforced.

Retaining Clients. As MFIs are better able to respond to what clients want, thereby increasing client retention and decreasing turnover in their loan portfolios, they can significantly improve efficiency. The cost of bringing in new clients is higher, as typically first-time borrowers take out smaller amounts. Return borrowers are less expensive to serve, and borrow more making it a more efficient use of loan officer and staff time. In addition, the impact of designing products which meet borrowers' needs is greater. Strong client retention is often a sign of greater satisfaction and can result in higher impact.

Improve Portfolio Quality. As to poor portfolio quality, while some of this is due to economic factors, MFIs can act to improve client credit culture, lending methodology and product design, loan recovery mechanisms and staff training. We believe efficiencies could improve at least a few percentage points if MFIs can improve their portfolio quality. Moreover, setting up or improving the incentives so that energies are focused towards this goal of portfolio quality improvement has proven highly effective.

Create Regional Operating Groups. To address the issue of scale and share in research and development costs, there has been an expansion of regional banks with affiliates in many African countries. For example, there are now banking groups based in Ghana, Nigeria and South Africa that have operations in more than 10 countries. A similar phenomenon is also occurring in microfinance, in which holding companies such as ProCredit, Opportunity International, Financial Bank/Finadev, AccessHolding, Advans, FINCA, EBL and UML have established MFIs and/or banks in a number of African countries. This regional approach brings efficiency benefits in areas such as technology, management and risk diversification (Christensen et al 2007, p5). By the same token, these MFIs become more attractive to investors and lenders.

Diversify Product Offerings. Another way to achieve scale is by ensuring that a broader product menu can increase the profit margin per client and reduce unit costs. This is not self-evident, as often a broader product menu will increase the cost structure of MFIs; to achieve the desired result, the offerings have to be carefully planned. In this regard, MFIs can benefit from membership in pan-African networks, with a greater critical mass allowing for lower per-client cost coverage and spreading of the research and development or product development costs.

Nurture Institutional Diversity. Building on what works, the diversity of institutions is a key area in the acceleration of microfinance in Africa as well as elsewhere and, though the trend towards regulated financial institutions seems inevitable, this does not and should not lead to a universal type of financial service delivery model. A wide range of financial and other institutions will boost innovation required to serve the many needs of hard-to-reach poor people. Different types of institutions will have different risk perceptions, missions and organizational structures which optimize the potential for innovation. Smaller organizations can respond more rapidly to potential new innovations with less formal research and development processes, while some NGOs allow themselves to develop and pilot products and refine products through incremental learning over long periods of time, through operations in many different countries and settings.

In many African financial markets, new entrants will be the drivers of change. New entrants in microfinance may include commercial entrants, including commercial banks, non-financial retailers, including technology companies, as well as established MFIs from other parts of the world. Some commercial banks will develop retail capacities, while others will purchase successful MFIs. New entrants will also include so-called greenfields as well as downscaling of some large-scale financial intermediaries like Post Office Savings Banks. The next decade of microfinance will see the creation of alliances among what were considered before to be unlikely partners, who will continue to reinvent microfinance together. Major insurance companies and banking groups, telecommunication companies and retailers are already partnering and contributing to the advancement of the sector.

Include the Best of the Rest. Most discussions of microfinance—and databases reporting microfinance performance—focus on NGOs, NBFIs, and commercial banks that specialize in microfinance, as well as microfinance programmes in full-service commercial banks. However, as discussed, there are some other types of financial institutions with a double bottom-line which may deserve more attention than they receive, both from microfinance proponents and from central banks and finance ministries.

At present, these other institutions, POSBs and credit unions have most of the outreach, as well as most of the infrastructure. Even though many of their clients are not poor, they are more likely than commercial banks to have branches in areas where poor people reside and where account and transaction sizes tend to be quite small. In particular, government-owned institutions, such as POSBs or other savings banks account for a significant share—sometimes the majority—of financial system customers in many developing countries where banking system development is still low. These alternative financial institutions combined (including credit unions) reached 65 percent of total accounts in Cote d'Ivoire, 77 percent in Burkina Faso and 98 percent in Niger.

This is also one of the findings of this diagnostic: the outreach, infrastructure and opportunities are significantly higher if you include these other types of financial service providers. Currently in some countries they are included in typical microfinance statistics and in some they are not. There would be significant value-added if promotional campaigns and brainstorming sessions were conducted about how to systematically incorporate these types of mammoth institutions into statistics and initiate discussions about how to create the desired financial architecture that will enable access to finance for all.

Any strategizing about how to accelerate microfinance has to include the credit unions and savings banks, as well, even though detailed information might be hard to find. These institutions often have outreach and infrastructure that may offer great opportunities to expand microfinance, while some of them also have plenty of room for improvement. In view of this situation, donors, governments and other stakeholders interested in fostering financial services for poor and nearly poor clients should be looking closely at the opportunities and challenges presented. Many savings banks provide quite respectable savings services, and many others should be able to improve their savings performance and tailor them to the particular needs of poorer clients. Poor clients, including the very poor, highly value good formal savings opportunities. Some MFIs are newcomers when it comes to deposit services and may benefit by learning from—and partnering with—established savings-based institutions.

Zakoura Foundation, a Moroccan NGO MFI, developed a partnership with the Moroccan postal service to open savings accounts for Zakoura's clients, as the law does not allow the NGO to collect savings. This service was an extraordinary success. POSBs can play an important role in remitting money, which reaches large numbers of poor in Africa and elsewhere. Another opportunity would be to complement the savings and payments or transfers with the highly successful microlending techniques developed by MFIs during the past two decades.

As a start, it would be helpful to the acceleration of microfinance to systematically include credit unions and POSBs in any microfinance data sources, except when it is very clear that their target market are high-income clients. Including the rural SACCOs and not the urban SACCOs will in some countries be a good proxy to including low-income access without overestimation.

Once the cost hurdle is overcome, there are two other key areas to advance in order to have the retail capacity needed to deliver financial services at the scale required to provide access to finance for all. The other key ingredients are human resources and funds, two areas identified as key constraints across many markets in Africa.

Recommendation: A clear focus on economics of scale, retaining loan clients, keeping delinquency rates low and innovative savings and lending methodologies are important factors in optimizing efficiency, as its importance is multiplied in high-cost Africa.

- MFIs: Plan for scale (possible regional operating groups), retain loan clients through demand driven product development, zero tolerance for delinquency, innovate savings and lending methodologies.
- Microfinance Associations: Emphasize efficiency and solutions to get to scale in best practice dissemination, study tours, tool development, training, and seminar topics (how to plan for scale, what is needed to get to scale, and successful mergers and acquisitions).
- Government: Improve the macroeconomic environment to reduce infrastructure costs and build infrastructure, in particular rural infrastructure.
- Donors and Socially Responsible Investors: Need deep enough pockets to commit the high initial investment capital needed and to working with longer time frames in Africa as breaking-even takes longer. Assist Tier 2 and 3 MFIs in their efforts to innovate.
- Venture Capitalists: Convergence of interest for the piloting of high tech innovations in particular.
- Researchers: Researchers play a very important role in advancing this area.

6.2.2 Governance and Human Resources

In order to achieve and operate at scale, MFIs need good governance, exceptional management and a sizeable, committed and skilled workforce. This is not an easily achieved hurdle unless the issue is systematically addressed at MFI, meso and macro levels. This key area must be addressed at all levels: the MFI itself, local industry infrastructure, and national and continent levels.

GOOD GOVERNANCE

The first step toward a strong microfinance sector is a strong board of directors at the MFI level. Successful MFIs on the continent have a strong board of directors and others can build on these experiences to promote governance best practices. However, there is a real need for training and support to African boards of directors.

EXCEPTIONAL MANAGEMENT

It is widely recognized that more high-quality professional management is needed because microfinance is a complex financial activity combining both banking and social goals, which is technically difficult and costly (European Investment Bank 2005, p2.). In other contexts, a diligent manager could come a long way by implementing a proven business model, in Africa, the number of challenges and complexities are so overwhelming, that exceptional leaders are needed that can create opportunities, know the risks, chart a path that overcomes the major challenges and stay the course.

DEVELOP HUMAN RESOURCE STRATEGIES

The gap between the demand and supply of skilled and trained labor is presently high and the workforce in this sector is expected to grow fast over the coming decade, with MFI growth rates of around 25 percent in Africa. Human resource strategies are one of the most critical aspects of microfinance service delivery. It starts from defining the sought-after front office personnel profile that has the right mix of local intelligence and minimum education levels. Most MFIs have induction as well as other in-house

training. In some countries, including post-conflict, training has to be broad and investment in training will have to be high. Retaining personnel can be a challenge and needs to be addressed in the human resource strategy. In Angola, BPC puts into its contract that if an employee leaves in the first three years, he/she must pay back all training received. This seems like a good incentive to decrease turnover.

Some of the pressures for skilled manpower will be exacerbated by the employment of technology mentioned above. With faster and better technologies being invented every day that have already begun to transform microfinance, the only constant for MFIs that seek to remain competitive will be that change is going to be the order of the day in order to capitalize on any new and more appropriate or more affordable inventions. MFIs will need to refine and redesign their business models and must continue to educate both their employees and customers about new ways to deliver and receive services.

MICROFINANCE ASSOCIATION WORKSHOPS AND TRAINING INITIATIVES

In addition to in-house training, MFIs can often benefit from working with microfinance associations that offer the full CGAP training modules. Other associations manage donor funds to this end with international trainers. Many associations organize workshops on issues of common interest. AEMFI, in Ethiopia, in seeking to prepare for the future and build sustainability, has proposed that MFIs and staff should cover part of the costs of the training themselves, even when these costs are ostensibly covered by donors. AEMFI has proposed to use this contribution to establish an endowment fund to meet future training needs.

TECHNICAL SERVICE PROVIDERS

In addition to standard best practice training provided by the MFIs and the local association, specialist consulting firms will have to be called upon for MFI-specific training needs. In some countries, this will initially need to be offered by sub-regional, regional or international firms, as local firms either do not exist or have insufficient capacity to meet the needs of fast-growing MFIs.

REGIONAL ACADEMY

There are a few specialized microfinance training institutions that can provide trained manpower for the industry. In Benin, Cameroon, Kenya, South Africa, and Uganda it is now possible to be trained specifically in microfinance.

INVESTMENTS IN EDUCATION SECTOR

Moreover, in countries like Ethiopia, with very low education levels, and in post-conflict countries, where the skilled manpower base is very narrow, large-scale government investments in the education sector, especially secondary and tertiary education and banking academies, will ease the strain put on fast-growing MFIs, among other businesses, to ensure their manpower bases are trained and confident in implementing their duties.

Recommendation: A strong focus on leadership development and training through encouraging long-term, medium- term and short-term leadership training (inclusion in curricula and agendas, addition of Master Classes to relevant conferences, and making funding available). Find sustainable solutions to strengthen governance. Build local and/or sub-regional training infrastructure. Promote and employ affordable in-house training methods, performance-based salaries, efficient recruitment and clear career paths.

- MFIs: Spend time in seeking to invite strong board members, develop affordable in-house training methods, recruit efficiently, offer performance-based salaries, and clear career paths and succession planning.
- Microfinance Associations: Based on a calculation of the number of MFI staff to be trained in five years, plan for the medium- and long-term local and/or sub-regional training capacity. Offer existing training modules in the short term. Organize study tours to MFIs with high ratings for governance and create an award for the best MFI board of directors in Africa.
- Government: Increase investment in the education sector, including secondary and tertiary education and banking academies. Don't fund things the private sector could fund.
- Donors: While direct investments into MFIs will gradually diminish over the coming years, donors still have an important role to play in this area in funding leadership development, exposure trips for board of members to other African MFIs, initiatives to find sustainable solutions to strengthen governance, and the building of high quality local training infrastructure.
- Researchers: Undertake research on sustainable solutions to strengthen governance.

6.2.3 Management of Information

Another key condition to being able to manage a high scale of operations is developing capacity in the MIS. Better information in combination with a transparent corporate culture will not only attract funders but also enhance the decision-making capacity at all levels of the MFI.

Recommendation: All stakeholders promote and support the information management capacity of MFIs and the benefits of information sharing.

- MFIs: Consult not only internet resources but also MFIs that have been successful in overcoming the MIS bottleneck, prior to developing a software application.
- Microfinance Associations: Consult countries where MIS is not a problem to chart a path on how to tackle MIS issues at home. Test off-the-shelf packages for appropriateness to country conditions.
- Government: Provide tax breaks and/or reduce entry barriers for MIS companies.
- Donors: Take note of the need for sustainable MIS solutions at the country level.

6.2.4 Ensuring Better Access to Funding

MFIs in Africa have been constrained by a shortage of funding. In order to achieve scale, MFIs need not only a business model that will produce lasting results, leaders and a skilled workforce, but also funds to fuel that growth. MFIs will need to do even better in savings mobilization, increase access to domestic commercial borrowing, make more serious headway in terms of medium term and long term finance, and access private equity (for non-credit unions) and other forms of commercial capital. The ultimate aim is for MFIs to have the broadest possible set of choices as to sources of financing.

As outlined in this report, MFIs in Africa are confronted by a unique combination of hurdles at both the environmental and operational levels. If MFIs in Africa are to have access to the largest array of potential financing sources, there are a range of things that they can do. At the same time, there are improvements that could be made in the funding environment.

MFI IMPROVEMENTS

Improvements that should be considered by African MFIs seeking financing include:

Professional Management. This was identified as the most important MFI criteria in a survey conducted both of local office staff and senior regional managers at three of the MIVs with the greatest exposure to Africa as a whole and with other stakeholders.[23] It was discussed in the previous section. Moreover, in seeking to access more funding, some MFIs will have to improve their capacity to negotiate funding.

Ownership Structure. A clear ownership structure is regarded as important for investors and lenders because it clarifies the issues of ownership and accountability for any loans and any related security taken. Converting to an entity constituted by shares can occur regardless of the licensing category that the MFI wishes to attain but in some countries (e.g., DRC), it will also be required by the licensing body.

Success Stories. African MFIs need to share their success stories and increase the number of profitable MFIs. The issues that must be confronted by MFIs in this regard include ways to reduce costs through economies of scale (mergers or regional bank groups) or through the employment of new technologies with improved efficiencies. Demand-driven products, changes in the client credit culture and better recovery mechanisms will contribute to increasing income (and reducing costs). MFIs in some countries can also increase revenues by a calculated balance so as to enlarge their product menus profitably.

Savings Mobilization. Build on what works by enhancing the savings mobilization capacities of deposit taking MFIs, and combining this with deposit protection. As many MFIs in Africa are savings-based institutions for which members have primarily joined because they want to keep their money in a safe, accessible place, the institutional orientation is there. Capacity has also been built in Africa over decades in mobilizing and managing savings accounts of large numbers of small savers in a very efficient manner. However, market penetration is still low in most countries (see Chapter 3) and while there is high demand, it has not been strategically tapped—there is room for improvement. Furthermore, in both East Africa and North Africa, a series of MFIs are transforming or starting to transform into deposit taking institutions, which will need to be accompanied by properly designed technical assistance packages.

The solution to enhancing the savings mobilization capacity is twofold: First, massively increase the training and technical assistance in this area. Basic savings mobilization principles are known (see Box 15) and training material on how to define and target various market segments with a demand driven product mix is also available. Secondly, organize exchange visit to the MFIs in Africa that have been highly successful in mobilizing large amounts of funds from low-income households, as well as from

lower-middle, middle- and even high-income groups. We believe that, with aggressive savings mobilization target setting, in terms of numbers and volume, the volumes mobilized could drastically increase.

Box 15: Basic Principles for MFIs Mobilizing Savings from the Public

- *Poor people save. The job of the MFI is to provide products and services appropriate for their needs.*
- *For savings it is the client who selects the institution.*
- *MFIs that succeed as intermediaries are those that understand that they can service larger numbers of poor if they mobilize deposits from other clients as well.*
- *Staff incentives should be set in line with targets set for savings mobilization.*
- *Growth should be sequenced, not rushed.*

Source: Adapted from Robinson, M., SPEED, 2004.

The other side of the coin would be to introduce deposit insurance, as in Kenya, where the Deposit Protection Fund Board (DPFB) plays the role of protecting depositors, especially small depositors, against loss of their deposits in case of a bank failure, by providing payments of insured deposits thereby ensuring depositors remain confident enough to continue keeping their savings within the banking and payments system. The fund was established in response to challenges presented by banking crises and bank failures in the country and has proved its worth during 20 years of existence.

FUNDING ENVIRONMENT

Certain improvement can also be made in the general funding sector that would be of benefit to MFIs in Africa seeking access to financing:

Bank Finance. Any MFI, even those that are very successful at savings mobilization, needs to be able to call upon local banks in case of any liquidity constraints, and long-term funding sources to enable growth and product diversification. The experience of Benin, Morocco and Uganda, among others, in lending to MFIs should be shared (see Chapter 4). Banks in countries with reluctance to lend to MFIs need to be linked to banks experienced in lending to MFIs with local banks in some manner to increase the latters' understanding of the market and to encourage them to start wholesaling to MFIs.

Long-Term Finance. Whereas funding is a major constraint faced by MFIs, long-term finance is even scarcer, as is the case in many African financial markets. International lenders should be aware that this is an area where they can add value.

International Investors to Help Create Level Playing Field. International investors could greatly boost sector development by being conscious of not just investing in the winners. This creates an unfair competitive advantage and increases the systemic risks in monopolistic or oligopolistic markets.

Information about MFIs. Independent sources of data on the MFI sector will encourage local and international lenders and investors, particularly in smaller countries where information is not always available. National microfinance associations are one source for this. MIX is also a good example of an independent source of information on MFIs, which sets standards and seeks regular reporting. MFI networks, such as Opportunity International and Women's World Banking, also demand transparency from their member organizations to the level of independent prudential and/or internal network evaluation standards.

Data on Funding Sources. By the same token, providing information about the various sources of financing can also be of assistance to MFIs weighing the funding alternatives. This may be going too far. It may be better if information is made available through MFI associations, marketing by funding or lending bodies, or third parties such as Microcapital.[24]

Investor Coordination. International funders should strive to co-invest with local investors or bank financing to leverage Microfinance Investment Vehicles (MIV) investments as much as possible. Funding agencies, especially in younger markets, should also be encouraged to assist MFIs in other ways, such as through technical assistance and governance. Where one funder does not provide everything that an MFI needs, it should link with others. For example, MIVs provide commercial finance, international financial institutions could take on higher levels of risk funding, and granting organizations, such as bilateral and multilateral agencies, could offer technical assistance (Latortue et al. 2007, p23). Investors could also coordinate with joint donor facilities. Moreover, while they are often focused on their own approval and disbursement pressures, funding agencies should also pay attention to the absorptive capacity of the MFIs and their particular needs for different types of financing at any given time.

Secondary Markets. Equity investors in MFIs will usually be keen to ensure that there is an exit strategy for their holdings. While trade buyers, IPOs and even management buyouts may be feasible in some situations, it is also crucial that other institutions are ready to step up when initial investors wish to liquidate their investments. Grey Ghost has established a secondary market for MFI shares in other parts of the world. Something similar needs to occur in Africa.

Stock Market Integration. Stock markets integration at different levels would increase the market size and, hence, the appeal to participants. One example would be the linking of African stock exchanges. This would promote cost efficiency and improve liquidity and price discovery. Even where the exchanges themselves cannot physically be linked, financial instruments can be established that provide a regional exposure. For example, Merrill Lynch is listing its Africa Lions Index certificates, which track shares in 15 African countries, on several European exchanges.[25] Such offerings will further improve the general perception of investment opportunities in Africa with a positive impact on the ability of MFIs to access financing.

Integration with Global Financial System. This should be the ultimate goal (Christensen et al. 2007, p6). Apart from the policy aspects of minimizing administrative and regulatory restrictions, governments can seek to develop longer-range financial instruments and secondary markets linked with full capital account liberalization. Finding solutions to the high transaction costs of selling bonds in local capital markets is an area that, if tackled, could greatly contribute to meeting financial needs of leading MFIs.

Recently, there has been a substantial increase in general investment into African economies as was discussed earlier. With more integration and an enhanced flow of financing benefiting MFIs, this should create a virtuous circle, where access to greater funding increases the efficiency and numbers of poor clients reached by microfinance services, in turn improving the profitability of the MFIs and making them more attractive to growing sources of financing.

Recommendation: Drastically increase the flow from banks to MFIs. Promote aggressive savings mobilization target-setting, in terms of numbers and volume from the various market segments. Social investors should take a long-term perspective and invest in due diligence on the second and third-most successful MFIs in such markets, in seeking to create a level playing field.

- **MFIs:** Start the dialogue with banks early through sending them regular reports so they can start to familiarize themselves with this segment of financial institutions and its performance indicators. Increase savings mobilization through more demand-driven products, a broader savings product menu and access to new market segments. Learn how to negotiate with banks and private equity investors.

- **Microfinance Associations:** Reach out to countries where access to banks is not an issue. Organize a series of training sessions in savings mobilization.

- Investors: Investors should be encouraged to coordinate their efforts and pay attention to their role and the absorptive capacity of the MFIs and their needs for different types of financing at any given time (avoid over borrowing of the top MFIs). For example, commercial investors finance the top MFIs whereas social responsible investors and International Financial Institutions could take on higher levels of risk funding, medium and long term funding in local currency, while employing innovative forex solutions. They should also strive to co-invest with local investors or bank financing to leverage foreign investments as much as possible.

- Donors: Make funding available to conduct workshops and study tours on lending to MFIs, with a view to encouraging banks to wholesale to MFIs. Offer technical assistance complementing the investor capital.

- Analysts: Independent sources of data on the MFI sector will encourage local and international lenders and investors. By the same token, providing information about the various sources of financing can also be of assistance to MFIs weighing the funding alternatives.

- Governments: Approach donors and investors to develop sector facilities benefiting from pooling of donor/investor resources.

6.3 Strengthening the Meso Level

To provide everyone with access to finance, the meso level needs significant strengthening. It is underdeveloped in most African countries and there are few industries in the world that can function without an industry infrastructure. The meso level of the financial system—the service providers that support the work of those directly offering financial services to the poor—is comprised of a complex and varied set of actors. In view of the range of constraints faced by MFIs in Africa, they need all the help that can possibly be made available, and require an industry infrastructure, unless they are among the few that have already managed to reach gigantic proportions. The following measures should be taken at the meso level to accelerate microfinance:

Set Goals to (Re)Activate Microfinance Associations. National microfinance associations can play critical roles in the advancement of microfinance. It is safe to say, that Ethiopia would be on the same level as Nigeria had it not been for the existence of a strong network. Associations play important roles in the policy dialogue with governments, information dissemination and standard-setting, functioning as an industry information depository, providing a vision and strategy for sector advancement and strategies for human resource capacity building. But they can also play an important role in the application of technologies for microfinance and ensuring IT platforms. Functioning associations are indispensable in countries where developments at the policy level are not conducive to microfinance. More needs to be done than ad-hoc funding for associations by certain donors that happen to be supporting the sector in a particular country. Associations can visit successful peers from Benin, Cote d'Ivoire, Ethiopia, Ghana, Madagascar and Uganda to learn from them for a small fee, donor exchange program or the creation of sister organizations to build up the younger ones, possibly with donors that see the importance of the spread of associations continent-wide. By 2010, the six strong associations should grow to at least 15. A continental association, like Sanabel could perhaps spur national association development. AFMIN could be expanded to include all countries. A feasibility study would have to be done to determine how to make it a sustainable organization.

Dissemination of Microfinance Standards at MFI, Policy, Donor and Investor Levels. Transparency and employment of key performance indicators are key drivers of MFI success and in the same vein can strengthen sectors at-large. Many stakeholders can play a role in furthering this important aspect of an

industry support infrastructure, but MFI associations can play a critical role, as in Ethiopia and Benin. Investors can be generous in making information available to the general public. Donors can stimulate transparency and key performance indicator initiatives through awards, funding of resource centres and wide distribution of publications and tools. MFIs can start to report to their national microfinance associations and to MIX. The specific targets to be achieved can be spelled out in national microfinance strategies or their implementation plans.

External Auditors with Microfinance Expertise. More external auditors trained and experienced in auditing MFIs will advance the industry, as the level of analysis will be richer. Moreover, management letters could then be more valuable as tools for management to improve in specific areas of organizational development within a certain time frame.

Local Rating Capacity. Greater access to ratings for MFIs may also act to encourage certain investors and lenders on the local and international level to broaden their exposure to investment in the microfinance asset class in Africa, which would ease the funding constraints. Some MFIs are not yet willing to pay for a rating, now that initial subsidies of the CGAP rating fund have come to an end: for smaller ones the price might indeed be relatively high. For smaller MFIs, cost-sharing of ratings could still be justified. This will help the rating agencies operate at higher sales levels so that they can reduce their prices, which again will increase their turnover. The microfinance association in Congo suggested a sub-regional rating agency, which would seem a very good idea.

Credit Bureaus. These are a must in the more mature markets although it has proven difficult so far to extend such data collection and exchanges down to the level of small borrowers. The absence of credit bureaus covering the lower-end of the market is a major deterrent for banks to downscale and has been delaying the industry from moving towards more standardization and more high-tech business models, such as credit scoring.

Local Research and Analysis. Examples would be demand studies (see below), the analyses of different products and impact studies, notably, on more recent products like microleasing and transfers. It is also important to promote the success stories among MFIs in Africa, some of which have already been documented in this report.

More Demand Studies. Financial markets come in many shapes and sizes, and the interplay and lessons to be learned from the informal markets are multifold. MicroSave, and now FinMark started to shed some light on the demand side, including the range of demand for specific products and services, preferences and magnitude. However, this type of information is only available for a dozen of the 53 countries so far. It is critical to understand the needs of different customers and why markets fail to meet these needs.

Technical Service Providers. Service providers will ideally become available at the local level. The most important type in this category are local consulting firms capable of delivering the wide range of capacity building services MFIs need. Basic technical capacity can be built at local levels if donors who fund technical assistance begin to consistently top-up their budgets, which would enable international firms to work hand-in-hand with local firms in local capacity building. For more specialized types of service delivery, key markets in a particular region could come together to promote training, technical assistance and other services at the sub-regional level.

Joint Donor Facilities. The establishment of wholesale funding facilities, which provide loanable funds and technical support to MFIs, has already been mentioned as one way to support the expansion of microfinance at different stages. Normally, these funds would be provided in local currencies, thereby avoiding foreign exchange risks.

Partnerships with Business Development Service Providers. With the goals of access to finance well underway and the boundaries between micro- and small enterprise blurring, there will be greater focus on enterprise development for clients of MFIs, microfranchising, value chain interventions and vocational training. Morocco has advanced quickly in creating effective linkages in this field.

Other Complementary Client Services. With substantial progress on access to basic finance behind it, and having turned over much of the service provision to the commercial sector, socially-motivated MFIs, especially NGOs, can focus on ensuring that clients who are receiving microfinance services also have access to social and economic opportunities. The next decade will see the emergence of new institutional models for combining commercially-oriented microfinance with social and enterprise development activities. Quality of life issues to be addressed include health, education, environment and shelter (Otero and Rhyne 2007).

Generally, a more rigorous approach to building the industry infrastructure could accelerate microfinance in many markets.

Recommendation: Continue information dissemination (especially in younger markets), develop and strengthen microfinance associations, promote credit bureau launch and sub-regional rating agencies; make funding available for training of external auditors in the microfinance subject matter; build local and sub-regional training and research capacity; R&D on how to reach very poor, rural and hard-to-reach clients. As national microfinance associations play a key role in sector development, more attention is to be paid to ensure their proper functioning in an increasing number of countries.

- **MFIs:** Be an active player in the microfinance association and its meso level initiatives for their own growth as well as confidence in the sector as a whole.
- **Microfinance Associations:** Find a sustainable business model to ensure a firm and lasting role (merge with another structure, generate income to sustain operations or secure a permanent subsidy). Promote the other building blocks of the industry support structure such as credit bureaus, sub-regional rating agencies, specialist external auditors, research capacity, and development of other service providers to the industry.
- **Regional Microfinance Association:** One option to monitor and support the creation of strong national association is the development of an Africa-wide Association. This could be in the form of the expansion of AFMIN to include all countries or creating a new network to this end, as long as it has a lasting business model.
- **Government:** Make it legally obligatory to be member of a microfinance association. Promote the development of private credit bureaus, not public ones.
- **Donors:** The meso level is the area where donors can make their mark in the coming five to ten years in: information dissemination (especially in younger markets), support to microfinance associations, research and development on how to reach very poor, rural and remote clients and developing industry infrastructure such as credit bureaus; making funding available for training of external auditors in the microfinance subject matter; building local research and technical service provider capacity; and stimulating particular areas of weakness can help sectors overcome hurdles, as donors did in Kenya, where the sector had stagnated and a focus—funded by donors—on product development helped the sector to take off.

6.4 Keeping the Policy Framework Right and Regulating Where it is Due

The performance of microfinance in countries like Ethiopia, Egypt, Ghana, Kenya, Morocco, South Africa and Uganda will contribute to reaching the first of the Millennium Development Goals: halving poverty by the year 2015. Meeting this goal is not a distant dream anymore, though it will likely not be possible in all countries in Africa. It will require governments to make the right choices in their stances towards the overall financial sector and microfinance in particular, like so many governments in Africa have already done. The Dakar Declaration is guiding in this regard and its implementation critical.

Creating and maintaining the right legal space for MFIs to operate in, is an area that requires dialogue between the range of microfinance stakeholders and education of the policymakers on the realities of financial service provision to low-income markets. Continuous dialogue by the microfinance association with national and sometimes regional authorities is critical. In mature microfinance markets investors, both local as well as international, are often well placed to step-up the dialogue efforts. Even more than donors, with primarily funding, investors have a vested interest and will be there to stay. Consequently, they can ensure appropriate follow-through and help with high-level discussions. In younger markets, broad knowledge building can help in making the right choices and donors could provide funding for government officials to take part in specific microfinance training, attend workshops or global conferences.

Importantly, in some countries, such as Ghana, Kenya, Nigeria, and some of the UEOMA countries, the most important regulatory issue in the years to come is not the legal framework itself, where significant achievements have already been made, but the supervisory capacity. With hundreds of MFIs with more than 1,000 outlets, the burden of inspection (especially the on-site inspection visits) threatens to absorb a disproportionate share of the resources of central banks. Central banks that have defined what they should and could realistically regulate and supervise, have been the most successful in supporting healthy sector development. Central banks that are trying to supervise hundreds of village-based savings and lending institutions will never be able to do so effectively; it will be to the detriment of the larger institutions that need their oversight. Alternately, it could be limited to only the largest village-based institutions, as in Tanzania where only SACCOs that have mobilized deposits above a certain level are being supervised. Furthermore, what is needed in addition to a framework recognizing different tiers—regulated, less regulated or not regulated—are robust strategies to finance and build the staff capacity, skills and systems to undertake these supervisory responsibilities, including delegation of supervision for some categories. In the UEOMA countries a support facility has been launched, but support is needed for other regions as well.

Specifically, in many African countries, the following items need to be addressed in the realm of MFI legal and regulatory frameworks if their potential is to be realized:

- Low-income markets are a market segment of the financial sector, and the earlier any policymaking entities or functions—just as the support industry bodies discussed in the previous sections—can have their home in structures apt to execute those functions, the better,
- Full interest rate liberalization,
- Laws to regulate activities other than the intermediation of public deposits into loans can be disproportionately restrictive and unmanageable,
- Legislation open to a variety of institutional charters and institutional charters permitted to offer a range of savers,

- Exchange trips for decision makers to other countries to expose them how things could be organized differently and what can be achieved,
- In the area of transfers, regulatory and competitive environments that allow for smaller money transfers, in particular local fund transfers,
- In the area of micro-leasing, legal and regulatory framework that encourages the provision of leasing services to SMEs and microenterprises,
- Strengthened supervisory capacity for formal deposit taking institutions, and an MFI association as watchdog for less formal financial service providers, and
- Minimizing the vacuum that sometimes emerges when governments pass bills related to microfinance but don't immediately follow-up with regulations.

Given the rate of change under which the industry is still developing—like the financial sector at large—even the more seasoned central banks will need to continue to learn and be flexible when appropriate. Regulatory authorities must adapt to new technologies that are often outside existing regulatory frameworks, such as deciding whether cell phone and correspondent banking innovations meet minimum standards for safety and security.

In addition, regulation of MFIs should be accompanied by complementary modifications of related business laws and regulations, especially in the areas of taxation, contract enforcement, collateral registration and enforcement, securities regulations and consumer protection as loan transactions and the legal status of borrowers differ markedly from those in conventional commercial banking and finance (Gallardo et al. 2005). Moreover, and court systems must be strengthened and uphold secured transactions. Governments should also play their role as an enabler by improving the legal and regulatory environment at the enterprise level, which still falls far behind other regions.

Governments could also contribute to financial sector deepening by investing in rural infrastructure such as roads, water, electricity, and information communication technology, which would attract MFIs to locate and provide financial services in these remote areas.

Adhering to high standards of consumer protection and education as discussed above will also serve to avoid painful episodes of government intervention that could subsequently lead to much heavier regulation.

Recommendation: Countries should create a good investment climate, formulate and implement national microfinance strategies and continue to improve and adapt their legal and regulatory systems as the industry evolves.

- MFIs: Actively participate in any microfinance association to help them lobby for an enabling environment.
- Microfinance Associations: Continue to lobby and communicatewith policymakers. Consider the introduction of a consumer protection/education initiative.
- Government: Take an active interest in policymaking rather than project implementation. Be supportive of financial service delivery to low-income markets, but don't budget things the private sector could fund. Create and keep the right legal space for MFIs. Keep legal and regulatory framework flexible to accommodate the specifics of MFIs and open to a variety of institutional charters for MFIs, including those permitted to offer a range of services. Regulation

of MFIs to be accompanied by complementary modifications of related business laws and regulations, especially in the areas of taxation, contract enforcement, collateral registration and enforcement; and court systems to be strengthened and uphold secured transactions.

- Investors: Even more than donors, with primarily funding, local as well as international investors have a vested interest in sound sector development and are therefore well placed to back the association in policy dialogue and high-level discussions.
- Donors: Make funding available to familiarize and educate policymakers with financial service delivery to low-income households and best practices in this regard.
- Researchers: Continue building the information base for each country and update research and information for countries for which information is already publicly available.

6.5 Optimizing Impact: Innovative Linkages and Growth Oriented Strategies

The coming decade should be one of partnerships for the microfinance sector. There are more socially responsible funding sources available than ever before. The current generation will pass on US$ 41 trillion in the next 50 years in the US alone, with 1 percent of the population holding 60 percent of wealth and US$ 2 to 4 trillion of this estimated to go to social sectors (Wood 2007). Successful development strategies have also emerged after almost half a decade of experience. The past five years has also seen walls break down between widely differing entities, that have begun to speak each others' language, see each others' value, and have come up with win-win solutions in a wide range of areas. This section explores some innovative linkages which could become promising models.

COFFEE AND BANANA FARMERS RECEIVING BUSINESS DEVELOPMENT SUPPORT AND LOANS

In Angola, Banco Sol has teamed up with the Cooperative League of the U.S.A. (CLUSA) to finance cooperatives with a loan product that offers coffee farmers US$ 500 for their first loan, and from US$ 300 to 1500 for horticulture loans. Banco de Fomento de Angola (BFA) has also demonstrated an interest in agricultural lending—through teaming up with CLUSA for medium and large businesses. It targets producers and agricultural business firms in the same value chains with loan sizes in the order of US$ 50,000 to 100,000. In this coordination CLUSA performs the pre-selection, training, business planning and support with loan applications. The bank then lends. Such cooperation has enabled the banks to reach rural productive sectors that they would otherwise be unable to serve. At the same time, CLUSA supported farmers, some of whom sell to Chiquita, with the required access to finance in order to achieve the project's goals. This cooperation will facilitate the outreach in rural markets, and could set the stage for sustainable access to finance.

MICROFINANCE IN AREAS WITH INCREASED CASHEW NUT PROCESSING

In Guinea-Bissau, little of the value added to the country's main export products stays in-country because cashews are exported in raw form. However, a project like the USAID initiative to support enterprise development in cashew nut processing for large- and small–scale cashew growers is highly complementary and could greatly enhance the impact of microfinance initiatives.

PRESENTING MFI CLIENTS WITH VARIOUS OTHER SERVICES THROUGH DEVELOPMENT OF PARTNERSHIPS

NGOs in Morocco have been successful in the creation of win-win partnerships to complement the loan products they offer. The clients of one MFI benefit from the support of the Office de la Formation Professionnel et la Promotion du Travail (OFPPT) for vocational training that will help them better manage their projects. In another partnership with Office National de l'Eau Potable (ONEP), a semi-state owned organization, ONEP provides support to young people with the creation of enterprises that seek to extend the provision of drinking water to remote villages, which will then be financed by the MFI.

PARTNERING WITH HEALTH SECTOR SUPPORT ORGANIZATIONS

Malaria and HIV/AIDS are two important areas for linkages between MFIs and other organizations. In Benin, one of the leading MFIs, PADME, has signed an agreement with Population Services International (PSI) to distribute subsidized insecticide-treated mosquito nets to its microfinance clients. Opportunity International works with partners to disseminate AIDS prevention information to its clients in many countries: the AIDS Information Centre in Uganda; Planned Parenthood of Ghana; Family AIDS Caring Trust in Zimbabwe; Society for Family Health in Zambia; and AID for AIDS of Scripture Union throughout Africa. These organizations provide health education through peer education at weekly meetings that clients are required to attend. Partnerships make sense in such areas because, while MFIs are experienced in giving out loans and working in poor communities, it is unrealistic for loan officers to develop this kind of specialized knowledge.

SOLAR PARTNERSHIP

In Kenya, a number of the market leaders introduced a loan product for renewable energy technologies such as solar panels (Faulu Kenya, K-Rep Bank, KWFT and KUSCCO). Faulu Kenya's lending model demonstrates that service delivery can be strong if both the MFI and energy company work within their expertise: the MFI carries out credit provision and management (including accounts record keeping, loan approvals, assessment of collateral, loan collection, etc.) and the energy company focuses on the technical issues related to supplying, installing, and providing maintenance and repair of the energy systems. Access to modern energy services can increase income by improving productivity, providing access to markets, adding value to agricultural crops, and creating employment. KUSCCO and Faulu Kenya have experienced institutional growth and some measurable impact on their clients' well-being when they added energy lending.

In Angola, there was an interesting example of a public-private sector endeavour financed by Chevron and UNDP entitled the Angolan Enterprise Program with the mission to contribute to the development of a conducive private enterprise sector, which initially had a microfinance component. However, in 2006 the project shifted focus to business development.

These examples are just some innovative partnerships, of which more are surfacing. Partnerships with MFIs can increase the impact of financial services on the poor, while allowing for the most efficient service delivery through specialist entities.

Partnerships to stimulate diversification and productive sector growth would also be highly valuable. As outlined in the Commission for Africa and latest ECA reports, in order for Africa to land on a sustainable growth track that can alleviate poverty, rather than addressing punctual concerns, the

economies need to diversify and transform. This implies a massive effort at all levels. As microfinance becomes increasingly sophisticated and capable of financing activities other than working capital, and as the divisions between MFIs and SME lenders begin to blur, attention to the economy's productive sectors will align efforts with those of other sectors in Africa.

Recommendation: Be on the lookout for linkages with other organizations that address other key constraints of clients.

- MFIs: Once operationally self-sufficient, invest some time in the creation of linkages that could make a difference in the life of their clients.
- Donors: Make funding available to pilot, document and where possible replicate innovative linkage programs.
- Researchers: Consider research and development and/or action research in innovative linkages programs with MFIs. Document and analyze innovative partnerships for lessons learned and to evidence results.
- Complementary Service Providers (whether government or NGO): Be flexible where possible with extension services or health education service delivery to serve villages where MFIs ask for such intervention.

6.6 Management of Systemic Risk

Benin, a leading microfinance sector in Africa is going through a turbulent time (see Chapter 3). In seeking to accelerate microfinance on the continent we have to understand how growth can come to a standstill or decline. In Benin, the microfinance industry in its aggregate provides as much as 15 to 20 percent of the amount of loans granted by the banking system to the private economy. What can be learned from this experience? Is it only due to the economic downturn that hit the country in 2004, or are other factors at play as well (see AMAF, WWB (2008), *Diagnostic to Action: Microfinance in Africa, Volume II: Case Studies*, New York, USA, soon to be published on the website of Women's World Banking, for full case study). What risk mitigation strategies could microfinance stakeholders consider—at macro-, meso- and MFI-level—to guard themselves against situations like this?

The situation in Benin demonstrates that, although the microfinance has proved resilient in economic crises, such as in 1997 following the crisis in the Asian financial markets, because it is relatively uncorrelated, it is not immune to economic downturns. MFIs and their investors need to be better prepared for volatile economic cycles to be able to anticipate some of its negative effects.

The experience in Benin also underscores the importance of solid capacity to supervise and the need to further strengthen national supervisory bodies. Major MFIs had problems long before the economic downturn, but were only placed under statutory management once they were approaching crisis. Had problems been addressed earlier, perhaps the effect of the crisis on the MFIs would have been less dramatic. In Benin, stakeholders need to seek ways to reinforce the capacity of the Direction Générale de la Surveillance du Secteur de la Microfinance (DGSSMF) so that it effectively supervises all licensed MFIs.

In other countries this should be done as a preventive measure. Unregistered MFIs in a number of countries in West Africa should be supported to comply with the regulatory and legal framework. This will require a stronger involvement of the central bank. Maybe the option of sub-contracting the audit services to external sources, such as licensed audit firms and consultants, ought to be seriously considered.

Finally, MFIs are cautioned against moving into new market segments as emergency measures without undertaking proper market research and institution building measures aligned with the changed operations. This is especially the case if the new market segment is one with larger business that can be much riskier and typically require a very different type of risk analysis. Emergency technical assistance funding is a possibility for donors to assist in these types of situations.

Recommendation: Reduce systemic risks in monopolistic markets.

- MFIs: Establish risk management unit and practice risk management strategies.
- Socially Responsible Investors: Take a long-term perspective and invest in due diligence on the second and third-most successful MFIs in such markets, in seeking to create a level playing field and as such reduce the systemic risk of one mammoth player dominating the sector.
- Government: Budget adequately for the ongoing expanded supervisory capacity costs that comes with supervision of MFIs.
- Donors: Provide funds to help enhance supervisory capacity.

6.7 One Size Does Not Fit All

We believe the issues outlined in the previous sections apply to all countries in Africa. But, in addition, some countries have such specific contexts, which warrant a separate section highlighting some of those additional features. Africa is home to a large number of exceptionally small countries, a few very large economies, some sub-regional blocks, and has been faced with a number of conflicts.

6.7.1 The Big and the Small

Grouping and strategizing countries according to their size is probably an even more significant exercise than looking through a regional lens. For instance large countries are faced with impediments in terms of the large bureaucracies, whereas small countries face market impediments.

AFRICA'S MOST POPULOUS COUNTRIES

The countries in Africa with more than 50 million inhabitants are Nigeria, Egypt, Ethiopia and the Democratic Republic of Congo (DRC). Big countries are endowed with ample opportunities. The most significant opportunity is that the demand for microfinance is not an issue; markets are unlimited. So, for MFIs, the high cost hurdle, which is pertinent throughout Africa, is easier to overcome as MFIs can quickly reach the volume needed where efficiency gains have reached significant levels. There also is room for a diversity of players. A specific constraint for big countries is the fact they also have big governments, and sometimes several layers of government.

An important constraint that must be taken into account is the sheer size of operations. MFIs will need to plan for branch roll-outs and clients in the hundreds of thousands, which will put their back-offices and human resources building capacities to the test early on. In Ethiopia, the microfinance industry has created employment opportunities for 5,000 staff, of which about 3,500 are loan officers. A growth of 20 percent implies that at least 1,000 new personnel need to be trained per year, and growth is expected to be much higher. In Nigeria, the numbers are even higher. The community banks, of which over 600 were recently licensed as so-called Microfinance Banks, have wide-ranging staff capacity, but many staff need intensive training for longer periods of time.

The DRC has a large population but faces many other hurdles, such as: a dire lack of infrastructure, including internal transportation; an unwieldy and imprecise tax system; and enormous bureaucratic obstacles, including that MFIs can wait more than two years for approval for the corporate structure needed to operate as a deposit-taking MFI. The country is now being assisted by a sector support facility but still has a long way to go.

Egypt has a larger educated workforce and some 3,000 staff employed in microfinance. In order to advance sectors in countries of this size, two requirements stand out: the need for scale and the need for coherence. Piecemeal support to MFIs will be like a drop in the ocean. It also merely amplifies the potentially chaotic situation where each actor, state or province works only along its own objectives. Ethiopia realized this early on and embarked on an intensive process of dialogue with a wide range of actors to not only get people to speak with each other and break down walls of distrust, but also to familiarize a critical mass of people with the importance of building domestic financial markets that work for the poor. For this to happen there is a need for determined leaders, good planning, the requisite funding to implement the plan and expertise to assist in its sound implementation.

MFIs in Ethiopia took a leadership role that did not alienate other parties, but enabled them to impart knowledge about microfinance. In Ethiopia, the microfinance community is also thinking ahead and is preparing a strategic vision for the coming ten years. This lays out the magnitude of the tasks ahead and the machinery needed to get there. For Nigeria, Egypt, Ethiopia and the DRC, they cannot just emulate programs from other countries, they instead need a sort of Marshall Plan to invest in structures that can get to scale.

Though some of the big countries have initially not met expectations, Ethiopia is evidence that big countries are not bound to be without microfinance. And although it will be a mammoth task, with the appropriate investment in technical assistance, Nigeria could also build a high performing sector. Egypt already has a maturing market. DRC is slowly growing into a young industry, but faces additional constraints and opportunities as a post-conflict country.

It is recommended the microfinance associations of Africa's most populated countries, Ethiopia, Nigeria and Egypt, as well as potentially the DRC, form a committee to exchange experiences and strategize. This could be under the leadership of Ethiopia. It could start as an African initiative and focus extensively on analyzing the issues among the African big countries, and later extend to include India and possibly Brazil.

SMALL COUNTRIES

Of the 53 countries in Africa, 13 (26 percent) have a population of less than 2 million (Botswana, Cape Verde, Comoros, Djibouti, Equatorial Guinea, Gabon, The Gambia, Guinea-Bissau, Lesotho, Mauritius, São Tomé and Principe, Seychelles and Swaziland). If one adds countries with a population of between 3 and 5 million (CAR, Congo, Eritrea, Liberia and Mauritania), the number increases to 18 (36 percent). Taking this into consideration, a strategy can be developed that matches the particular context of each country. Small countries need some way of overcoming the diseconomies of insufficient scale and the lack of competition among different financial service providers.

In such small markets the inability to exploit economies of scale calls for one of two things. The first is a regional perspective, where the local operation would be a branch of a multi-country financial institution like Financial Bank/Finadev in West and Central Africa. Secondly, MFIs could vertically integrate, such as GAWFA in The Gambia has done, by adding SME loans for enterprising women in Banjul, so that the sales volume can be increased. Alternately, MFIs will need to increase income

through a significantly broad product menu that will allow for cost-effective horizontal expansion. Going through the same process of industry-building as in other countries would not make sense, simply because the market is too limited to accommodate a large number of financially healthy players.

In some of the small island states, notably the middle-income ones, formidable investment in IT by their existing credit unions, for instance, would seem to be the more cost-effective and sustainable way to go. Another option would be an emphasis on bank downscaling, including imparting techniques to provide financial services to SMEs.

As mentioned, the issues outlined in the previous sections of this chapter apply generally to all countries in Africa, whether small, large, or medium. The remarks in this section are meant to add on to the general insights because the contexts are so specific in very small and very large countries respectively that we wanted to bring them to the attention of the reader.

Recommendation: Stakeholders are encouraged to work together with other similar countries. For instance large countries are faced with impediments in terms of the large bureaucracies and massive capacity building needs, whereas small countries face market impediments.

- MFIs: Approach MFIs in similar sized countries.
- Microfinance Association: Develop the industry infrastructure based on lessons learned in similar sized countries.
- Government: Organize seminars and working groups on microfinance with similar sized countries to prepare for strategy development.
- Donors: No blueprint sector support in very small or very big countries, but fund brainstorming and strategy development seminars.

6.7.2 Regional Priorities

CENTRAL AFRICA: STRATEGIZE AND DISSEMINATE

Central Africa is the least developed region in terms of creating domestic financial markets that work for the poor, and Cameroon and Rwanda are the only two countries with developed microfinance markets. At first glance, accelerating microfinance in the region would seem a mammoth task. The region is also very diverse in terms of population. At one end of the spectrum are smaller countries with very low population densities, such as Congo, CAR, Chad, Equatorial Guinea, Gabon and São Tomé and Principe. To the other extreme are Burundi and Rwanda, which have extremely high population densities (only exceeded by the island economy of Mauritius).

Except for Cameroon, Rwanda and perhaps Burundi, the region lacks the dissemination of best practices and has few market leaders that could have a demonstration effect on others. Consequently, there should be a massive effort to invest at the meso level (see Section 6.4). With the exceptions of Cameroon and Chad, costs are also very high in most countries, and so it is hard for MFIs to operate and find a winning business model.

This is one of the reasons that Congo has had difficulty taking off; it is facing very high costs as an extremely small market whose population is concentrated in two main cities. In a situation like this, any sector growth beyond the dominant market player MUCUDEC, which holds 80 percent of the market

share, would require other MFIs to differentiate themselves sufficiently and achieve scale. This could come from a number of institutions merging or from the introduction of new technologies by a new or smaller player that could take market share through the first mover advantage. One MFI is already at an advanced stage of piloting mobile phone banking.

As some banking groups have started to do, more regional operations, information exchanges, study visits and support infrastructure, beginning with the CEMAC countries, would seem to offer an opportunity for advancing the sector in the region. Burundi, Cameroon, DRC and Rwanda could also benefit from exchanges among them.

EAST AFRICA: FINANCE FOR ALL IS IN SIGHT

East Africa is home to three markets that surpassed the one million client milestone by 2006. Ethiopia and Kenya are among the top three in terms of borrowers, and Kenya and Uganda are the top two for savers. Ethiopia grew fast from the outset in 1996 and Uganda has been growing gradually since the 1990s. Kenya's first MFI dates back to the 1980s, but the sector truly started to take off in the past five years. Moreover, Tanzania is growing fast, as well. Three of the four countries are already attracting commercial investors, which could provide the large amounts of funding needed to fuel future growth; the fourth could easily do so, as well, if it were to open to this. In order to speculate about the future, it is important to understand what have been these drivers of growth.

In Ethiopia, the key drivers for the fast growth have been: a strong network and dialogue with the government; strong leaders that embraced a culture of transparency and the employment of performance indicators; and committed staff, low salaries and an unlimited market. In Kenya, a key driver has been product development and solving the problems with MIS. In Uganda, the central bank showed understanding about the issues at play in the domain of microfinance and sought to create an environment where the range of entities delivering microfinance could flourish. Donors joined hands and provided coherence in their support. In both Kenya and Uganda, competition started to push the main actors to innovate.

There is no reason to believe this trend in these leading sectors will not continue, because the underlying reasons for growth are still valid, except the dampening of economic growth in Kenya because of the civil unrest following the 2007 elections. This has set the industry back, but hopefully its MFIs can recover quickly. Ugandan MFIs are under a lot of strain from both the government, which is turning back the clock in terms of regulation, as well as from the aggressive entry of commercial banks that are endowed with a large support infrastructure. But MFIs in Kenya and Uganda have become strong enough to weather some storms and have gotten used to competition and the need to constantly innovate and, as a result, are likely to start forming partnerships with non-financial institutions to offer more services to clients.

Nonetheless, all these countries in East Africa will be faced with a much higher magnitude of demand for growth. Ethiopia alone already needs to train tens of thousands of new staff in microfinance in the decade to come. The coming five years will still see more piloting of high-tech applications and some intensive organizational changes as the institutions transform into deposit-taking institutions and that process is not an easy one. But thereafter, true growth will set in and the market penetration could well reach 50 percent of the poor.

NORTH AFRICA: LEVERAGE ACCOMPLISHMENTS TO OTHER KEY DOMAINS OF MICROFINANCE

Though Morocco is one of the leading markets in Africa, and Egypt is also in the top five, the region needs to leverage these accomplishments to effect a broad product offering and acceleration of microfinance beyond these countries.

A significant constraint in North African microfinance is that MFIs can not offer savings services. The only option for a MFI wishing to mobilize deposits is to become a commercial bank, which would require large amounts of resources. To address this shortcoming, short-term and medium- term strategies can be employed by MFIs, supported by meso level actions. A short-term strategy could establish linkages with deposit-taking institutions, similar to Zakoura Foundation partnering with the Moroccan postal service to open savings accounts for Zakoura's clients. This service was an extraordinary success. The outreach of postal office savings banks is enormous in other North African countries, as well. Egypt has been successful in this model with as many as 11 million accounts, followed by Algeria with 7.1 million and Tunisia with 2.2 million accounts.

A medium-term strategy could be for investors to support the advocacy efforts of associations in terms of allowing deposit mobilization and diversification into other products for MFIs. North Africa is the least developed region within Africa in terms of product diversification and has a long way to go in this respect. MFIs would also require assistance to impart new skills and transition from NGO and changing ownership structure; this implies a change of mindset and substantial efforts at the governance level.

In some markets in North Africa, such as Algeria and Tunisia, microfinance might not take root the way we have seen it in other African markets. The microfinance sector may never develop independently, but rather existing formal financial institutions would enter this market directly; postal banks with streamlined operations are better equipped to increase their market share in lower-income markets and commercial banks are downscaling as well. In Egypt, two of the major commercial banks already target the microfinance market. This experience could hopefully travel to other countries.

There is a lot of cross-continental learning that could take place. Countries in Central and Southern Africa could benefit from being exposed to North African operations based on best practices. Countries in West Africa, for instance, could benefit from seeing the ways in which MFIs in Morocco gained the confidence of commercial banks for large amounts of funding. Conversely, policymakers in North Africa, would benefit from visiting countries where MFIs are allowed to offer a wide range of services to allow regulators to see which services would make sense to add to MFI product menus in their countries.

SOUTHERN AFRICA: BANKS AND NEW ENTRANTS ARE DRIVING FORCES

Southern Africa is home to more middle-income countries than other regions, which brings with it both special constraints and opportunities. Accelerating microfinance in Southern Africa has to take into account the following specific features: banks are driving the sector; there is a developed consumer finance industry; and costs are high.

In Southern Africa, microfinance is evolving in a different way to other markets. NGO MFI initiatives have not fared very well and, possibly, the NGO-driven phase will be skipped in some countries that go straight to existing financial institutions that have worked their way down. Government-driven initiatives have not been very successful, although the recent initiatives for a Financial Sector Charter in South Africa and Namibia can fast-track the deepening of the financial sector.

There are also interesting examples coming out of the region in the areas of mobile phone banking and innovative delivery channels. But, with a view towards optimizing the gains and replications feasible in these new areas, information collection, presentation, sharing and knowledge-building has to be enhanced. Information is at the heart of understanding markets and creating domestic financial systems that work for the poor.

Some countries in this region, or areas within countries struggling with how to operate in sparsely populated areas, could learn from countries like Mali in West Africa that have created decentralized financial systems operating so efficiently that they can deliver services in very harsh and remote areas.

The Mwanzi account experience from South Africa—a debit card based, low cost transactional and savings account—could be shared with other countries, first in the Southern Africa region and possibly beyond.

WEST AFRICA: LIBERALIZE INTEREST RATES, IMPROVE GOVERNANCE

As mentioned, the key issue in the UEOMA region in West Africa is the ability to charge higher interest rates. On the cost side, MFIs have reached levels of efficiency that are hard to improve further with the current business models. At some point, countries will be faced with economic downturns or the informal sector could be particularly hard hit through other developments, like border closings, and MFIs need to have enough room to operate and withstand external shocks.

An area that needs to be fortified is governance, in UEOMA as well as other West African countries. Across a number of countries in West Africa, MFI governance issues have come to the fore as key constraints. One way to improve the situation is to not issue loans to board members of MFIs or to tie them to the MFI equity base. In this way, even though the duties of board members are largely voluntary, there will be extra incentives to spend time with the institutions and ensure their proper functioning. More training of board members is required and it is an area where donor funds would still be well spent.

The skilled manpower base is also scarce, especially in a number of UEOMA countries like Mali and Niger and post-conflict countries like Liberia and Sierra Leone, so strategies to constantly provide training at all levels, and to attract people for top positions need to be developed.

For sparsely populated countries like Niger, Mali, Mauritania electronic retail payments and mobile telephony offer great opportunities.

In West Africa, in particular, attention needs to be paid to the formulation of growth-oriented portfolio strategies and the establishment of linkages to offer complementary services to clients, as economies are in dire need of more local processing and added value across the value chain.

Experiences from West Africa in savings mobilization can be shared with East and possibly North Africa. It may also be interesting for some MFIs operating in certain countries in Southern Africa to see the efficient models operating in West Africa.

Recommendation: Each sub-region also has specific priorities. Key in Central Africa is to strategize and disseminate; in East Africa finance for all is within reach; in North Africa accomplishments need to be leveraged to advance in other key domains like product diversification; in Southern Africa banks and new entrants are the driving forces; and in West Africa there is a need to liberalize interest rates in the UEMOA zone and strengthen MFI governance.

- MFIs: Develop regional operating models in high cost environments or small countries.
- Microfinance Association: Cooperate with associations in the sub-region.

- **Government:** In West Africa and North Africa government can play a key role in the acceleration of finance for low-income households by further improving the enabling environment.

- **Donors:** Consider funding projects at sub-regional or regional level.

6.7.3 Post-Conflict and Oil-Rich Countries

POST-CONFLICT: BE RESPONSIVE TO CONTEXT

Post-conflict countries generally suffer from weak governments, a scarcity of qualified and experienced human resources, fragile financial systems with a lack of client confidence, limited infrastructure such as roads and telecommunications networks, and very high costs.

The informal sector is the main source of livelihood for the majority of people in many countries in Africa, and the number of people seeking to survive and make a living in the informal sector tends to grow further in post-conflict situations. This is because large parts of the country's infrastructure have been destroyed. A large proportion of the workforce lacks higher education and there will be a shortage of vocational training institutes. Usually unemployment soars, as major corporations close operations. One often sees many former full-time employees, some of whom are both highly skilled and educated, resorting to the informal sector to earn a living. But this large reservoir of potential services and creativity operating in the informal sector, whose markets are very vibrant and have huge turnovers, is faced with a lack of working capital for restocking or to make business investments. Finance is either outside the reach of micro and small businesses, or formal banking services don't exist at all in the country anymore.

In post-conflict settings, the effective range of the formal financial sector typically shrinks to a limited geographic zone, as up-country bank branches are abandoned. Most banks indeed collapse altogether or teeter on the brink of insolvency, their liquidity dependent on financing of the government's deficit. The domestic payments system is likely to require reconstruction from the bottom up. If security is still questionable in rural areas and no bank branches yet exist, the government will have difficulty in making payments, including to its employees. AML-CFT (anti-money-laundering and combating the financing of terrorism) procedures will have to be put in place early (Honohan 2007).

Another challenge in post-conflict situations is the lack of or confused credit culture. Years of hand-outs and relief MFIs having ventured in the area of income generation and microcredit sometimes without enough specialist knowledge, can have a distorting influence. In such a situation, it might be critical to develop guiding principles for the use of loans and grants as was done in the case of Liberia (USAID 2006) and circulate those to all stakeholders, including MFIs, donors, government and support programs.

But, besides these challenges, there are also unique opportunities, as countries starting from a clean slate may be able to avoid the mistakes made elsewhere. The challenge will be to harness the lessons, energy, and expertise from more rapidly-growing economies to help make financial systems work for the poor, who are the majority in these fledgling countries (Helms 2007a). For instance, it may prove feasible at a relatively early date for them to use electronic payments via mobile-phone technologies—one of the first services reaching a wide geographic coverage—along with points of sale in a handful of stores in the larger towns. For example, mobile phone banking is starting in Sudan and Angola.

Strategies in post-conflict countries have to be broad, address the basics, and at the same time work at the high–end, as the post-conflict environment also offers specific opportunities. In view of the special

context, it may in some cases be necessary for MFIs to take special measures such as the deliberate provision of services in the areas home to both formerly fighting parties. One has to realize that it can take time for the normalization and reconciliation process to set in, yet initiatives like this could be considered to help move the process forward.

Creating a sense of normalcy, even in situations that are still far from normal, is important. One such example of credit programs in refugee settings is to give certificates for clients with good repayment records. When clients return home after the war, they don't have to start from scratch. It sends the right signal and gives weight to an important performance indicator and clients can proudly show their achievement.

OIL RICH COUNTRIES: PARTNER AND SEEK TO ALLEVIATE ACUTE POVERTY

Some oil-rich countries—Angola, Congo, Equatorial Guinea, Gabon, Libya, Nigeria, Chad and Sudan—also face specific constraints and opportunities.

The oil can be an unexpected challenge as it often inhibits the development of a local, diversified industrial base and a flourishing well-integrated domestic economy. This is because a lot of resources are flowing into the country anyway, government has ample revenue, and many people can earn a living by being civil servants. As a result, the entrepreneurial culture could be suppressed, as occurred in South Africa during apartheid or in (former) planned economies. Further, it also creates an artificially high cost structure, meaning that life becomes extremely expensive for those not benefiting from oil money. The wealth is usually very concentrated so contrary to what one would expect the lower income market is still large and poverty levels can be shockingly high.

Financial sector policies can have a role, as a mechanism for channelling some of these resources into the financing of productive investment, which in turn can help increase productivity and output in the non-oil sector.

Building domestic financial markets that work for the poor in such contexts is opportune because of the following reasons:

- Funding is less of a problem,
- Public-private partnerships can add value,
- Microfinance businesses can grow faster into small- and medium-sized businesses because of higher education levels,
- At least in the short-term, the economies will be growing, and
- Partnering with other agencies can further alleviate the acute poverty in which most citizens find themselves.

Recommendation: Post-conflict countries face specific challenges of credit culture and human resource capacity but can rise quickly if proven models are studied and largely followed. Sharing of the growth is possible in oil-rich countries, if public-private partnerships are formed to fund financial sector deepening, and if the management of such facilities is left to experienced private sector entities.

- MFIs: Seek funding to gain international exposure as the home sector is likely in very rudimentary state.
- Government: Promote financial sector deepening to effect shared growth. Clarify from the

outside in a national strategy or code of conduct how grants are different from loans and how income generation can complement microfinance.

- Private Sector: Assist in the form of technical assistance or grants for MIS and study tours.
- Donors: Follow the pooled funding model to optimize resource use and impact.

6.8 Special Areas of Attention

6.8.1 Gender

An appreciation of gender issues is important when seeking to provide access to finance for all in Africa. There are four main reasons why gender matters. First, women own the majority of businesses in the informal sector in African countries and also play a major role in farming systems in Africa. Second, within households in many countries income generated by women is more directly related to the nutritional intake of the family. Third, the ability of women to formalize and grow their businesses, to create jobs, and to enhance productivity is hampered where legal and institutional barriers exist that affect men's and women's enterprises differently. Fourth, there is evidence to indicate that gender disparities—inequality in education as well as unequal access to land and productive inputs—not only disadvantage women but also reduce the growth potential of the region as a whole. The existence of gender-related barriers can thwart the economic potential of women as entrepreneurs and workers, and such barriers have an adverse impact on enterprise development (Bardasi 2006).

A gender sensitive approach does not mean that all efforts should be exclusively focused on women, though in microfinance quite a number of MFIs by mandate exclusively serve women. A gender specific approach means the gender specific demand should be revealed and addressed, for instance in responsive financial products. It also means that extra efforts will be made to ensure that women are at least equally represented as men even though they generally face more obstacles to participating in the economy, at the client level as well as in broader society. Dr Cecilia Ibru, CEO of Ocean Bank in Nigeria who won the first African Banker of the Year Award from African Banker; Ms Linah Mohohlo from the Bank of Botswana who is the first female Governor; and President Johnson-Sirleaf in Liberia, the first female president in Africa will open the door for many more women to rise to the occasion, make their mark and contribute their skills in more influential positions.

Microfinance has the potential to empower women economically. Consequently, addressing gender-specific barriers to entrepreneurship and leveraging the full participation of both men and women in the development of Africa's private sector represent a significant opportunity to unleash Africa's productive potential and to strengthen economic growth. At the high end, the rise of women in high positions needs to be further promoted.

Recommendation: Many markets warrant segmentation of the market along gender lines. Understand the specific gender based constraints and the differences in demand for financial products and services from men and women.

- MFIs: As needed segment the market for men and women, undertake market research in both segments and develop products accordingly. Put extra efforts into increasing the percentage of women among its clientele and leaders.
- Government: Address gender-based constraints in the legal and regulatory framework. Ensure a secure environment.

- Donors: Fund technical assistance in new lending methodologies particularly suitable to women.

- Social responsible investors: Demand reporting along gender lines.

6.8.2 Health and HIV / AIDS

HIV/AIDS has a devastating effect in many countries on the African continent and is most widespread in Southern Africa. The HIV/AIDS incidence has reached such high levels that it changed not only the demographics but also the economics and social structures, especially in countries with a high flux of migratory population. It causes a shortage of teachers and health personnel, difficulty in recruiting other skilled labor, the emergence of child-headed households and orphans. Every day 6,000 people die of the disease in Africa and it has reached such proportions that MFIs can't ignore it, but need strategies to mitigate its various effects.

Direct measures MFIs can take include the introduction of life insurance, partnering with an entity that can offer health insurance, partnering with institutions that can raise awareness about the disease and the preventive measures people can take, close monitoring so that the chance of default can be minimized in case a borrower him/herself or one of his family members gets sick, and workplace programs for the MFI itself.

Recommendation: In some areas in Africa the HIV/AIDS epidemic is of such a significant scale that the expected impacts are significant as well and ignoring this reality would threaten MFI viability.

- MFIs: Seek information on changing financial needs in HIV/AIDS affected communities to respond rapidly in terms of products, increase customer loyalty, attract new customers and reduce its risks (Partners and Action 2006). Partner with complementary institutions.

- Government: Provide large scale health education and ensure a budget to advertise to educate the public.

- Donors: Possibly fund linkage programs for health education to clients and MFI workplace programs.

- Private Sector: Engage the private sector in social marketing campaigns and workplace programs.

6.8.3 Islamic Finance

Many Muslim countries (and recently also some non-Muslim countries) adopt totally or partially the concepts of Islam in their financial systems. But how different is the Islamic financial system from the conventional financial system and how will it impact microfinance institutions and their clients?

PRINCIPLES OF AN ISLAMIC FINANCIAL SYSTEM

Prohibition of interest. This is a central component of the Islamic finance system. More precisely, any positive, fixed, predetermined rate tied to the amount of the principal is prohibited. This prohibition is based on arguments of social justice, equality and property rights. Islam encourages the earning of profits but forbids the charging of interest because profits that are determined afterwards, symbolize successful entrepreneurship and creation of additional wealth. If the interest is determined prior to the success of the project, this is a cost that is accrued irrespective of outcome of business operations.

Risk sharing. Because interest is prohibited, suppliers of funds become investors instead of creditors. The provider of financial capital and the entrepreneur share business risks and in return they share the profit.

Money as potential capital. Money is treated as potential capital. It becomes actual capital only when it joins hands with other resources to undertake a productive activity.

ISLAMIC MICROFINANCE

As the evolution of the microfinance industry has taken place, and in order to respond to the needs of different clients, microfinance has adopted the Islamic principles in some cases. Many elements of microfinance could be considered consistent with Islamic banking as entrepreneurship advocacy and risk sharing. Islamic microfinance is more a response to the needs of a portion of the population who because of religious beliefs can not benefit from traditional financial products. This trend is clearly established in countries that have introduced Islamic financial products after a long period of conventional products. A large proportion of the population, mostly poor, had chosen not to use products based on interest rates (Riba), but has naturally accepted Islamic products.

THE ROAD AHEAD

Combining microfinance and Islamic law can be useful to serve a portion of the target population who refuses for religious reasons to take out traditional microfinance products. This is a vast reservoir of people on the African continent, which hosts a Muslim population of more than 400 million, the second largest continent, after Asia.[26]

Recommendation: Studies on the design and launch of such products should not be limited to Muslim countries, but should have the support of the microfinance community at the international level.

- **MFIs:** MFIs in Muslim countries or countries which have a minority of Muslims should realize the importance of introducing products based on Islamic law.
- **Donors and Investors:** Encourage this type of product because they meet a real need.
- **Researchers:** Find ways to decrease the costs of Islamic finance.

6.8.4 Environment

A food crisis, depleted soils and a looming water shortage are matters of concern at the global level and also in Africa. Higher food prices push poor households to cultivate more frequently, on less fertile ground, further depleting soils if soil and water conservation techniques are not used. The smaller the enterprise, the bigger the impact of higher food prices as it leaves very little investment capital. Scarcity of water has its impact on health and thereby also reduces income generated.

The energy crisis is hitting countries in Africa in particular and results in the use of other, costly, less clean energy sources. The lack of access to modern energy services severely limits the potential for economic and social development. It also affects low-income households as it will interrupt their business processes and this effects the output of their business, with many hours lost. Rural energy programs launched to date are mostly publicly funded, whereas it is essential to engage the private sector as well.

Meanwhile, there are emerging business opportunities for lending for household water supply and energy services to offset the high upfront costs. The price of solar panels has finally dropped to within affordable range, especially when they can be financed by a specifically designed loan product. Access to a simple solar lantern can extend business hours into the evening. Households switching from open fire cooking to an LPG burner for cooking save time, improve health, reduce household energy expenditures and cutting of trees. Some MFIs have also partnered with clean water providers bringing a product with potential very high impact on the household well being, within reach of low-income households.

Recommendation: Financially self-sufficient MFIs could investigate partnering with water and sanitation or energy service firms to see if solutions can be found that will meet needs of their clientele (The SEEP Network 2007).

- MFIs: Track energy loans separately to assess their performance.
- Private Sector: Partner with local energy service providers. Ensure a clear understanding of the roles and responsibilities and the model of service delivery (for instance in a Memorandum of Understanding). User training is important to success.
- Donors and Investors: Seek funders among traditional donor or foundations like the Shell Foundation who provided funding to strengthen and scale-up energy lending in Kenya.

6.8.5 Social Impact

Most MFIs have their own social mission. They may seek to broaden access to financial services to reduce poverty, to build community solidarity, or empower women. Social performance refers to their success in meeting these goals. The social performance measurement systems reflect and enable a response to client needs as well as the priorities of MFIs. Social performance assessments can inform decisions that affect both the social and financial performance of the MFI. It helps MFIs understand their clients' needs.

The development of simple, routine and self-directed methods of social performance assessment by MFIs can improve the social return to microfinance. This is not only important for clients and MFIs, but a clearer articulation of the social returns in addition to the financial returns of MFIs will also help socially responsible investors in raising more money.

The Small Enterprise Foundation (SEF) in South Africa developed an explicitly poverty-focused program alongside its more orthodox microfinance program. Through its social performance assessment, SEF can now monitor the effectiveness of its microfinance program in reaching and serving poor and very poor clients. This resulted in falling drop-out rates, which led to increased revenue by far exceeding the annual costs of roughly US$ 20,000 of running the social performance system.

Recommendation: For MFIs that are interested, Social Performance Monitoring (SPM) is a simple and cost-effective tool to better serve their clients, report to stakeholders and, through better products, improve operational performance.

- MFIs: Poverty focused MFIs can greatly improve their effectiveness in reducing financial exclusion and poverty. More generally, the success of an MFI is closely linked to the success of its clients so there is a long term benefit to perfecting products with a view to the highest possible social impact.
- Microfinance Associations: Invite regional networks MCF from Poland or Sanabel from Egypt to introduce the SPM methodology in the country so that interested MFIs can become familiar with it.
- Donors: Donors can provide funding for systems development and training and will often be able to support social performance monitoring through MFI networks
- Socially Responsible Investors: SPM is a simple, low-cost tool that can provide stakeholders with regular information about the MFI's social performance.

6.9 Conclusions

To release the energies of the many low-income households in Africa that currently can not access finance, financial service providers serving these markets need to boost their retail capacities through two parallel focuses:

1. Building on what works and getting the basics right, and
2. Innovating to seize market share.

The importance of getting the basics right cannot be understated. It is of ultimate importance in mastering the challenges of delivering financial services in a high-operating cost environment like Africa. There are still many institutions that do not grow because they are unfamiliar with, or unable to adopt, good practices which could ensure institutional health and opportunities for growth. The primary consideration appears to be related to leadership. Senior MFI and bank managers need both the vision, as well as the managerial capacity, to find a business model that can create efficiencies in the particular context, plan for its execution, know the risks, chart a path that overcomes the major challenges and stay the course. A strong focus on leadership development and training could have an important impact in this area. Given the high cost environment, the importance of efficiency is multiplied in Africa. A clear focus on minimizing costs, retaining loan clients and keeping delinquency rates low are important factors in optimizing efficiency. Efficiency gains are not only important for the sustainability and service quality of the MFI, but also for the clients, who will reap the benefits through more competitive prices and, thereby, more opportunities to grow their businesses.

Related to the basic need for good leadership is the issue of transparency, which in this industry has emerged as a critical element in the successful growth of MFIs. Those institutions able to produce

accurate and timely reports are more likely to make appropriate decisions and mobilize commercial funds. The absence of an appropriate MIS remains a problem, though decreasingly so. A second critical element is a strong human resource management capacity. Human resources is repeatedly highlighted as one of the greatest challenges in African microfinance. Therefore, affordable in-house training methods, as well as ensuring performance-based repayment, efficient recruitment and clear career paths are all important elements in managing a successful institution in the face of this challenge.

In terms of innovation, leading MFIs in Africa demonstrate an organizational culture which embraces change and is conducive to continuous improvements in service delivery. This is usually complemented with very clear procedures for introducing new systems and piloting new services. Most successful microfinance providers are increasingly able to ensure that products are adapted to clients needs through research and/or mechanisms such as exit interviews. Also, those institutions which have been able to introduce distribution channels via mobile phones or POS technology have seen rapid growth in client numbers over the past few years. Innovation, coupled with increasing use of linkages among complementary institutions, can enable the sector to reach many unbanked people. The microfinance sector could expand quickly by taking note of the forgotten half of formal financial institutions, such as POSBs, and in case they have potential to downscale in a particular country, including them more systematically in strategic planning. Finally, new products lines, such as life, health, crop and weather insurance, may significantly increase sector impact by mitigating areas that dramatically reduce the coping capacities of people in Africa, especially as the continent remains more volatile and its people more vulnerable than others.

Though fierce competition among MFIs and erosion of standards is an increasing risk globally, in Africa, there are close to a dozen monopolistic markets that are in need of more competition, both from the perspective of consumers as well as from financial authorities. Without new entrants or significant strengthening of some of the smaller players in these markets, it will be hard to elevate the sectors to the next stage and realize the potential of diversified and affordable finance for all. Moreover, not only is there a systemic risk if individual institutions continue to dominate national markets in the microfinance sector, but in some countries they could imperil the financial sector at large. Social investors particularly in these markets would have a greater impact if they not only picked the winners, but also took a long-term perspective and invested in due diligence on the second and third-most successful MFIs in such markets, in seeking to create a level playing field.

Any industry needs an infrastructure, and microfinance is no different. Industry infrastructure is equally important for nascent, growing and mature industries, though the elements of support will vary. We have already seen the extremely positive effect of microfinance networks in enabling MFIs to adapt to best practices and, on the other hand, felt the impact of the lack of a credit bureau in areas with increasing competition. Given that efficiency is critical for MFI success, industry infrastructure will become increasingly important to open doors for the next levels of efficiency gains. Where possible, microfinance infrastructure should be built within the mainstream financial sector.

An additional element necessary for the growth of microfinance in Africa is the improvement of the enabling environment. Many countries are already benefiting from better macroeconomic policies, moving away from planned economy foundations, with improvements in the performance of the public sector institutions, better regulation and more investments in human resource development. In others, however, the investment climate is not yet conducive to flourishing businesses creation and expansion. Some countries also need to continue to improve policy frameworks and adapt their legal and regulatory systems as the industry evolves.

Specific insights have been, and can continue to be, gained from a number of country groupings, and stakeholders are encouraged to work together with other similar countries. There is a lot to learn from

microfinance in Africa, and countries on the continent are the first ones who could greatly benefit from both information exchange and cross learning at other levels. This knowledge building, knowledge management and information exchange is important at the country level to strategize about growing the sector at large, but also at the MFI level, for individual MFIs to learn from other MFIs directly on how to become a leading institution.

NOTES

1. *The most complete data set on this indicator was found to be from "African Economic Outlook, 2007/2008," OECD/AfDB. The figure does not include the following five countries for which no data is available: Comoros, Seychelles, Mauritius, Somalia, and Sudan (together accounting for 48 million inhabitants).*
2. *NEPAD is an Africa-owned and –led process that reflects African leaders' common vision and shared commitment to poverty alleviation and to placing their countries on the path to sustainable growth and development.*
3. *All six CEMAC countries are also part of the Economic Community of Central African States, along with Angola, Burundi, the Democratic Republic of Congo, Rwanda, and Sao Tomé and Principe.*
4. *Definition from Foster, S. Greene, S., Pytkowska, J. (2006), "The State of Microfinance in Central and Eastern Europe and the New Independent States" CGAP, Washington DC.*
5. *www.accessholding.com*
6. *www.advansgroup.com, www.microcred.org*
7. *As of December, 2007.*
8. *In Ethiopia, MFIs have one legal form: private company known as microfinance institution.*
9. *Defined as one player serving more than 80 percent of the market.*
10. *As per industry standards a small MFI is an MFI with an outstanding loan balance of less than US$ 2 million and a medium sized one has more than US$ 2 million, but less than US$ 8 million outstanding .*
11. *Though we used a different data set with MFIs reporting to the MIX in 2005 and 2006, and used averages instead of medians, these results are by and large in line with the MIX, which reports on the Sub-Sahara sub-region only.*
12. *World Bank, as quoted in the Economist, December 15, 2007.*
13. *This does not include the average loan size of the CMLFs.*
14. *Outliers, such as a small MFI in Benin with average loan size of 22,000, were removed as not being representative of what is going on in lower-income markets in Benin.*
15. *Courtesy of Xavier Reille.*
16. *POS terminals are devices that handle disbursal payments by reading debit or credit cards or barcodes and communicating transaction information via a telecommunications connection.*
17. *http://www.microfinancegateway.org/content/article/detail/19524*
18. *http://www.bobsguide.com/guide/news/2008/Feb/27/New_Report_from_Aite_Group_Considers_Mobile_Banking_Models_from_Africa_for_the_United_States.html*
19. *The Economist, December 15, 2007.*
20. *The only other country in Africa with widespread existence of this type of institution is Nigeria, with over 700 community banks, though they were recently re-registered and are now adhering to the Microfinance Bank charter.*
21. *The Economist, June 24, 2006, p 53-54.*
22. *http://www.transparency.org/policy_research/surveys_indices/cpi/2007*
23. *Discussions were held in Kenya (Oikocredit, Jitegemee, MicroSave and the Financial Sector Deepening Fund) and in Tanzania (Oikocredit, Unit Trust of Tanzania and the Financial Sector Deepening Trust), and at the regional level with AfriCap, CORDAID and ACCION.*
24. *www.microcapital.org*
25. *The Economist, "African Financial Markets: On Safari," December 15, 2007.*
26. *Africa Banking Congress, July, 2008.*

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