



The BWTP Bulletin focuses on:

- Assessing the ability and performance of *Financial Inclusion* of Asian MFIs
- Evaluating the productivity and sustainability of Asian MFIs
- Identifying challenges and constraints, and recommending measures for improved performance of MFIs
- Promoting alliances among those working in international cooperation and development
- Informing external stakeholders of the outcomes of the Banking with the Poor Network and its members

# The BWTP Bulletin

Providing an international platform for exploring ideas and reporting findings on microfinance in Asia.

## Getting Beyond the 'Crisis' – Exploring Practitioner Perspectives on the Critique of Microfinance

### Banking With The Poor Network

*The Banking with the Poor Network (BWTP Network) is the regional microfinance network for Asia. It is an industry association that has long promoted microfinance as a vital tool in the fulfilment of policies of financial inclusion in Asia and the world. The BWTP Network is a multi-stakeholder organisation made up of 54 microfinance institutions including practitioners, associations and regulators, from 12 countries in Asia. The BWTP Network has strong links to all of Asia's national microfinance networks, and partners with microfinance support institutions globally and regionally. The article is based on the views of BWTP Network members, who provide a practitioner perspective on the current issues in the microfinance industry, in particular the recent 'crisis' reported by the media in India and Bangladesh which has led to concerns about the future of the industry. The views expressed in this article are those of the authors and are supported by contributions from members of the BWTP Network who have provided their perspectives through an online survey and interviews.*

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## Executive Summary

In the last decade, the microfinance industry has achieved worldwide acclaim. However, the industry over time has become a victim of its own success. Recently, international media attention focused on certain microfinance providers in the province of Andhra Pradesh, India, who were forcing poor households into debt, by charging exorbitant interest rates, encouraging debt beyond the income levels of households, and employing unfair collection practices. Media attention and public outcry led the government to intervene with measures aimed at closer scrutinising the practices of microfinance institutions (MFIs). The sector was feared to be on the verge of collapse in the event of political intervention and calls for loan write offs. Shortly after the crisis in India, the international media began to report on the expulsion of industry pioneer and Nobel Peace Prize awardee, Professor Mohammad Yunus from his position at the Grameen Bank. The regulatory authority cited non-compliance with regulatory norms as the reason for its actions. These two high profile cases in Asia provoked international debate about the future of the microfinance industry, and the credibility of the sector.

This article explores recent criticisms of the microfinance industry drawing on the opinion of members of the Banking with the Poor (BWTP) Network who are primarily practitioners. The article begins with a contextualisation of the microfinance industry including the diversity of stakeholders, the different development approaches and delivery models, and the broadened scope which goes beyond the provision of small loans, to include a range of credit products, deposit facilities, money transfers and insurance products, as well as the provision of non-financial services including enterprise development and social development programs.

The first criticism relates to the impact of rapid commercialisation of the microfinance industry. Commercialisation has been widely accepted as a natural progression within the industry, signifying growth and maturity. Commercialisation brings with it an increase in the scale of operations, and a focus on operational efficiency and risk management. However, rapid commercialisation can also come at the expense of continuing/growing the MFIs ability to meet the needs of its traditional client base. The BWTP Network asserts that the industry has examples of practitioners who have successfully commercialised without sacrificing social mission, by ensuring clear and viable transformation plans and leadership with vision and commitment to mission.

The second criticism is the negative impact of commercial capital, especially foreign capital, on the social mission of microfinance institutions. Inherently linked to rapid commercialisation, foreign capital is an instrumental part of the growth strategies of microfinance practitioners if there are limited local funding sources. Foreign capital is essential for ensuring adequate liquidity to support continued growth. However, microfinance institutions need to determine their priorities before forging relationships with such investors, and ensure that the social objectives and mission of the organization are protected regardless of the expectations for profit.

The third criticism of the sector is related to the long-standing concern regarding 'mission drift' among microfinance practitioners that claim social missions. The majority of the BWTP Network membership holds the opinion that there has been an unrealistic and unreasonable expectation that microfinance is 'the' solution to poverty alleviation, which has been promoted by some practitioners

and the international media. Microfinance interventions cannot substitute for essential social development programs that must be provided by national governments and social programs. At present the vast majority of MFIs, in all their forms, grapple with the challenge of maintaining a pro-poor focus while ensuring the desired level of institutional viability. Lack of social funding forces them to sacrifice essential social programs in an effort to maintain profit margins to sustain microfinance operations. Therefore, mission drift is not desired as much as imposed by the realities of financing.

Finally, the article discusses the role of regulation and supervision of the industry. Sound regulatory policies and supervision is a real need in growing microfinance markets. Even in countries with reasonably sound legal and regulatory frameworks for microfinance, there are gaps and areas of weakness, lack of effective supervision, and politicisation that all undermine the stability of the industry. The article calls for an establishment of comprehensive regulatory policy frameworks and strong supervisory mechanisms, and the establishment of separate funds for equity, debt and technical assistance. It would appear that self-regulation through commitment to a set of shared standards and principles are no longer a viable solution with increasing competition within the sector.

Furthermore, the article highlights the role of microfinance networks and associations in enforcing regulatory norms, monitoring social and financial performance with appropriate indicators, and forging strong and effective linkages between industry stakeholders.

The article concludes with a positive outlook for the future of the industry echoed by the BWTP network membership. While the brand of microfinance may have been tarnished by the recent incidents, there is no fear of long-term impact. Media focus and continuing critique of the industry is instrumental in highlighting gaps and providing warning signs. The industry as a whole must work together to ensure quality of products and services and continuing focus on alleviating poverty through financial inclusion.

## Introduction

The global microfinance industry has recently been subject to much recent criticism. While questioning the belief that the microfinance industry is in the throes of a fully blown 'crisis', the membership of the BWTP Network, interviewed and surveyed for the purpose of this article, nominated several key reasons for the current criticisms of microfinance (and more specifically micro-credit), which have only been highlighted by recent events in India and Bangladesh.

On one hand, BWTP microfinance practitioners feel they are the issues of uncontrolled growth, rapid expansion, lack of regulation (or weak regulatory mechanisms) and inadequate supervision of the sector. Furthermore, 'mission drift' has also served to shift the priorities of some microfinance institutions toward profit-making rather than achieving social impact alongside sustainable growth.

*Due to some MFIs that have been indulged in unethical practices and coercive methods in loan recovery and exorbitant interest rates charges, MFIs as a whole have been stamped like that.*

- BWTP Member/Practitioner,  
India

On the other hand, practitioners attribute recent critiques to the increasingly unrealistic expectations of investors and the international community, often due to sensationalised media accounts, a lack of understanding of the limitations of microfinance, unrealistic targets for returns on investment and a lack of a diversity of practitioner voices in the debate.

Microfinance has played a vital role in enhancing financial inclusion in Asia. As of 2009, the most reliable data indicates that microfinance institutions (MFIs) serve 64.1 million borrowers and 38 million depositors in the Asia Pacific.<sup>i</sup> However, this success has come at a price, with a minority of organisations exploiting poor people through high rates of interest and unjust recovery practices. A small number of MFIs and their management have undermined the reputation of an industry that has worked over four decades to achieve its current success, resulting in the undeserved censure of other organizations that are striving to build a client-focused and transparent industry. In some respects, the microfinance industry has been complicit in creating its own current reputational difficulties: the industry itself has not effectively countered the perpetuation of somewhat misguided assumptions of microfinance as a *single* solution for poverty in developing countries.

There is no doubt that microfinance has had an impact on millions of families worldwide, and despite some failures, overall the sector has contributed to social, human and economic development in many Asian communities. Where millions remain excluded or under-served by formal financial institutions, and while their demand for financial services is strong, governments must continue to maintain their focus on financial inclusion as a key area of policy. In such countries, microfinance will remain an indispensable tool. What must be addressed is how the sector as a whole can ensure that MFIs continue to focus on their social mission without compromising financial sustainability. To achieve this delicate balance, the industry has to learn from its mistakes, move away from emotional debates and fault-finding, and engage in constructive and inclusive dialogue. MFIs must continue to emphasize their shared mission and focus on the best interests of clients.

*The industry bodies are often aware of what is going wrong in any individual sector. It is the job of industry association and networks to advocate for microfinance in their country based on accurate research and information. Connecting with all stakeholders locally and internationally, and maintaining that voice, is the difficulty.*

- Network Representative,  
India

This article explores the issues that lie behind the so-called ‘crisis’ in the microfinance sector, drawing on insights of practitioners (i.e. those who are actually ‘doing’ microfinance, across Asia). While arguing that predictions of a widespread backlash against microfinance have been largely exaggerated, it does acknowledge certain trends and practices which, if not addressed, threaten the future of the industry. The article also aims to address the unfortunate fact that practitioner’s voices have often gone unheard amongst the current cacophony of criticism: key stakeholders – particularly the national and regional microfinance associations and networks and their MFI memberships – remain important sources

for information, research and ‘on-ground’ perspectives of the sector.<sup>ii</sup> The BWTP Network membership, as an industry association, believes strongly that networks have an essential role in providing timely and accurate information, research and analysis. The views expressed belong to the authors, but are intended to reflect the contributions of representatives of BWTP Network member organizations who have contributed through an online survey and interviews.<sup>iii</sup>

## Mapping the recent 'Crisis'

The first decade of the millennium saw unprecedented international recognition of the microfinance sector, and with this, growing expectations for the industry. The celebration of the United Nations Year of Microcredit (2005) and the Micro Credit Summit commitment to achieve significant outreach and financial inclusion in support of Millennium Development Goals helped to push microfinance to the top of national policy agendas. Microfinance became a significant part of national social and economic development strategies and was promoted by world leaders including the then US President Bill Clinton and his wife Hillary Clinton, the then UK Prime Minister Tony Blair and the royal houses of various European countries.

The industry received significant publicity with the launch of the online lending facility Kiva in 2005, which helped bring microfinance into the mainstream consciousness of the citizens of many donor countries. Annual conferences and summits, including the BWTP Network's Asia Microfinance Forums, further facilitated the rapid growth of the industry, and the sector continued to promote microfinance as an effective tool for poverty alleviation. Media attention peaked when Professor Mohammad Yunus, founder of the Grameen Bank in Bangladesh, one of the leading institutions in the sector, was awarded the Nobel Peace Prize.

Over the past decade, funding for the microfinance industry has substantially increased with funds for technical assistance, product development and innovation, and specialized funds for equity and debt instruments. With increasing financial support, microfinance institutions all over the world began to report high profits, demonstrating the potential for financial returns on investment. Microfinance promoters, including some donors, microfinance industry support organizations and media, enthusiastically promoted partnerships between community-based MFIs and global financial markets with the dual aim of achieving greater financial inclusion and social impact. In the same period, national governments, international development agencies and financial institutions that had previously distanced themselves from microfinance, as well as investors, commercial banks and individuals, began to increase financial support to the microfinance industry.

While successfully weathering several crises over the years, the industry suffered a significant setback in 2010 when a series of media articles reporting on microfinance operators in Andhra Pradesh, a southern state of India, highlighted incidences of malpractice. These included: the charging of exorbitantly high rates of interest on loans; encouraging poor households to take on large amount of debt that they would have difficulty managing given their income levels and exposure to risk; and unfair collection practices when clients were unable to repay their loans. By October 2010 the media began to report that the Andhra Pradesh state government was threatening to close down these microfinance operators alleging unfair collection practices and non-transparent pricing on interest rates.<sup>iv</sup>

The localized situation in Andhra Pradesh has grown into a protracted industry-wide debate. Among industry experts, practitioners, regulatory authorities, and government officials, there were various opinions on the appropriate responses and actions. In the meantime the international news media continued to report on the crisis, creating panic about what impact the

closure of these high-profile Indian MFIs would have on Indian, Asian and international microfinance industries.<sup>v</sup> The main concern centred on the possibility that politically-inspired decisions would be taken for wholesale write-offs of microfinance loans (which is common practice in developing countries). There was great anxiety about the impact of such decisions on the sector as a whole, in particular the spectre of mass default on microfinance loans. The sector in Andhra Pradesh accounts for a significant percentage of the Indian microfinance portfolio with substantial foreign investment, which led to concerns at the international level.

*The crisis has not hit as it has hit Andhra Pradesh but it is bound to hit if right steps are not taken.*

- BWTP Member,  
Pakistan

Over recent months, the situation in India has stabilized. The national government has been persuaded to retain its faith in the industry. However, even as media attention waned over the crisis in India, another incident hit the headlines. The international media began to report on news that the Bangladesh Bank, the central bank and financial regulatory authority, had expelled Professor Mohammad Yunus, founding Director of Grameen Bank, citing that he was above legal retirement age, but also irregularities in accounting practices and non-compliance with regulatory norms as the principal reasons for its action. Indeed, the high court has most recently upheld the decision to remove Prof Yunus from his position as Grameen. Media articles speculated on the impact of this decision on the future of Grameen Bank, and the impact on the sector as a whole, as Grameen Bank is synonymous with the 'microfinance' brand.

*Certainly in India but cannot be generalized for other countries as such. However, it is worth highlighting that attention that sector is attracting, one hopes, will lead to more transparent and regulated sector.*

- BWTP Member,  
India

Media publicity about these two incidents in Asia has provoked widespread debate about the future of the microfinance sector, mainly the perceived conflict between profit-seeking motives of microfinance practitioners and their stated social missions. In fact, mainstream media criticism has brought to the forefront issues that have been discussed and debated within the industry for years, but that have not - despite much concerted effort - been suitably resolved. Due to the actions of a few institutions, the sector as a whole has been subject to scrutiny and criticism, and

the sector has a responsibility to respond and restore its credibility.

BWTP Network members share the opinion that the situations in India and Bangladesh were exaggerated by the media primarily due to the high profile of the individuals and institutions involved. They argue that while media attention may have damaged the brand image of microfinance, this will not necessarily have lasting effects on the sector either in the specific countries or at a global level. BWTP Network members do note that the high media profile of local incidents could suggest a potential for crisis contagion, for example if responses by governments and regulators begin to influence actions of counterparts in other countries.



However, negative publicity and damage to the microfinance brand are not necessarily the main concern. Many BWTP Network members and microfinance experts feel that the media have merely highlighted valid issues which have been undermining the credibility and effectiveness of the sector for some time. Many practitioners are concerned with the underlying issues that have been brought into the spotlight; namely, how vulnerable is the microfinance industry to the threat of erosion of its original mission of poverty alleviation and claims of social justice?

*The current media scrutiny, while highlighting real risks to the microfinance sector, has amplified the potential fallout of such risk factors by 1) extending the plight of specific institutions/regions to an unproven conclusion about the industry; 2) ignoring the actions taken by other actors in the industry to mitigate the risk factors. While microfinance is by no means a perfect solution to developmental/economic problems, the coverage by the international media today may not be even-handed.*

- BWTP Member

## Understanding Contemporary Microfinance

Difficulties in making sense of recent events are often compounded by limited understanding of non-industry stakeholders about the current microfinance industry and the ways in which it has evolved. First and foremost, the sector is no longer solely focused on social development. It has evolved over the past four decades into a global industry with strong links to formal financial markets. It includes regulated institutions and links local economies to global capital markets. While media attention has focused mainly on traditional 'credit-only' providers, microfinance institutions today offer a range of essential microfinance services, including credit, savings, insurance and money transfers. Some offer enterprise development services and a few offer social development services as well.

Of these services, special attention needs to be given to the crucial role of savings as a microfinance product. In many cases, savings are a far more effective means of reducing the vulnerability of the poor to life-cycle, business and emergency risks. It is widely understood in the sector that demand for the opportunity to access appropriate savings products far outweighs demand for credit. Savings are an essential tool in building an asset base for the poor, which for many clients is a far more effective means to increasing longer term economic security than access to credit. The capacity to take and mobilize deposits also provides MFIs with the liquidity to make them less dependent on foreign capital. Regulatory restrictions in most jurisdictions however do not provide for MFIs to mobilize deposits, and this is a core issue for the sector to resolve in the future.

The industry today involves complex relationships between national governments, central banks, line ministries, international and national development organizations, banks, investors, technical support agencies and a number of other support institutions. While some microfinance markets are fully regulated, others are partially regulated with acts and charters that guide supervision of the industry, and still others – in fact, the majority of microfinance markets - are not regulated, with MFIs treated as social development organizations.

Microfinance clients include the most vulnerable segments of the community, but also low-income households who are not so poor. These 'less poor' clients are nonetheless vulnerable to external shocks, and lack access to formal financial services due to non-compliance with collateral norms or other limitations. Microfinance customers include men, women and youth, in both rural and urban communities.

MFIs have diverse sources of funding, including grants; social development funds; soft loans; and commercial loans from public and private sector banks, as well as national apex refinancing institutions. In recent years, MFIs have succeeded in attracting investments in both equity and debt from private investors. In recent years, formal financial institutions have made profits by investing in microfinance portfolios and private investors have reported significantly high returns over time, proving MFIs to be highly lucrative investment instruments.

*Microfinance is far from perfect and needs constant fine-tuning. Of course microfinance is not the only solution for solving poverty – there are many influencing factors, and many of these are also diligently worked on by microfinance institutions.*

- BWTP Member/Practitioner,  
Bangladesh

Given the diversity in the sector, it is safe to assume that there is no one model of microfinance.

*Microfinance is not perfect – stakeholders need to communicate that the industry is constantly working to make a better microfinance model.*

- Practitioner,  
Sri Lanka

Best practice standards in microfinance have largely focused on financial performance and the achievement of outreach and disbursement targets. However, given the social mission of the microfinance sector, there is an increasing focus on social performance indicators. Examples of such indicators are measures of the inclusion of the most vulnerable segments of the population; the provision of a range of financial products to meet client demand; evidence of social impact in areas such as shelter, health, asset creation, safe living conditions; and measures of other wider aspects of human development, such as political participation and participatory decision-making.<sup>vi</sup>

Although microfinance markets are multi-faceted and complex, the core commonality uniting this diverse group of microfinance stakeholders has been a commitment to a social mission: improving the quality of life of the poor through promoting and facilitating their access to sustainable financial services. It is the challenges to this mission, as well as their reaffirmation, that we now turn to.

## Commercialisation of the Sector

Critics of the microfinance industry suggest that rapid commercialization, (the provision of microfinance on commercial/for profit basis), has resulted in the corruption of the sector. At the same time, commercialization has been accepted as a necessary part of the natural evolution of the microfinance sector. To expand the number of clients they can reach, MFIs take on commercial capital. As they transform from development programs to commercially-oriented financial institutions, they experience dramatic changes in legal, ownership and capital structures, which in turn have an impact on their products, policies and practices. As organizations struggle to achieve desirable targets for financial sustainability, the primary focus is on financial efficiency determined by growth, profit, and a reduction of administrative expenses and losses. Competition in the sector, while lowering interest rates in some sectors, can also result in aggressive targets for growth, which in turn can affect the overall quality of a program. As a result, many MFIs find it difficult to balance their social

*Commercialised institutions have an impact to the activities of NGO-MFIs and cooperatives as they have been growing faster and have been expanding to other parts in Cambodia, which consequently tightens the competition.*

- Practitioner,  
Cambodia



objectives and quality of outreach with their need to achieve financial targets and assure continued access to funds from commercial sources and investors.

*On the subject of commercialisation, the industry as a whole has been in a hurry to grow and it (or its promoters) has not understood adequately the nature of its clients and that growth and impact is a slow process for which we need patience.*

- Practitioner,  
Sri Lanka

Transformation from social development programs to commercially viable microfinance institutions involves a shift in funding. Initially the sector was financed by grants from social donors and public sector financial institutions, including commercial banks and apex refinancing institutions. However, as the sector expanded and new demand was created among existing clients and new customers, MFIs had to seek financing from private financial institutions including commercial banks and investment funds. When local markets were not able, or were reluctant, to meet the demand, microfinance institutions leveraged funds from foreign markets. Initially, when the sector was financed by grants and commercial loans, MFIs earned profits that were allocated to the repayment of loans, and invested the rest in developing institutional capacity, and improving products and services to respond to the changing needs of existing and new clients. When funds were leveraged from foreign markets and investors, there was also the need to allocate funds to repay investors, based on their expectations and the formal terms and conditions.

The vast majority of MFIs that have made a successful transformation from social development organizations to regulated financial institutions have maintained their social mission by either retaining their delivery model, or adopting favourable legal structures that allow client ownership and participation in decision-making. These MFIs have clear policies and practices that reflect institutional values and mission, especially in the area of interest rate pricing, loan approvals, and collection procedures. However, during this complex transformation, some MFIs have seen dramatic changes in their ownership structure and, depending on the owners and shareholders, shifts in priorities and changes in targets. In the process of transformation MFIs have to make some tough choices. In some cases they have sought to achieve rapid growth, demonstrating no real evidence of social impact, but rather focusing on generating substantial profit for the benefit of management and investors. These institutions are the institutions that have attracted media attention and public scrutiny, but they do not represent the sector as a whole.

*Criticisms are mainly connected with governance, lending and recovery mechanisms. If these issues have been addressed by the concerned MFIs, no one will interfere in its regular business.*

- BWTP Member,  
India

BWTP Network members point to many examples of MFIs that have successfully shifted to commercial microfinance models, including regulated entities, and balanced their social mission with good financial performance. Good governance and competent management can put in place appropriate policies and requisite monitoring systems to ensure overall quality. Client-responsive products and client-focused delivery mechanisms along with effective policies regarding

*I think commercial capital comes only after an institution has well-grounded relationship with wholesale lenders and banks. Even in case of India – commercial capital was accessible only to very few top MFIs.*

- BWTP Network  
member

loan disbursement and collection procedures can ensure that clients are not subject to unnecessary risk and exploitation.

While there is widespread acceptance that MFIs must reduce dependence on grants, and begin to tap commercial funds from local and international sources, these strategies for long-term sustainability cannot be at the expense of social objectives and good practices. Financial inclusion, or increasing the number of clients reached, is an important goal, but the methods to achieve financial inclusion must focus on the quality of services and the deeper and wider impact on the clients and their communities.

## Influence of Foreign Capital

Donors and support agencies have over the years promoted socially conscious investment funds, in both Europe and the United States, to invest debt and equity in microfinance institutions all over the world. The primary objective of these social investors is social returns (i.e. demonstrable social impact) with a reasonable financial return on assets and equity. The early generation of commercial lenders, including public sector banks, learned their business over time, enabling them to cope with the level of risk, manage losses, and ensure sustainable growth with realistic profit margins. These social investors in microfinance are characterized by their realistic targets, their long-term exit strategies, understanding of the capacity of microfinance institutions, and more importantly, a real commitment to social goals and not just financial dividends.

*The expectation is that industry will collectively address challenges and opportunities - both of which abound. It would also internally need to find an answer to most fundamental question 'profit' or 'less-profit' and find concrete ways to safeguard the interest of the sector.*

- BWTP Member

Foreign investment has been crucial in driving much growth in the microfinance sector and remains an important ingredient for the success of the industry in the future. However, in recent years, with media and industry stakeholders reporting significant profits and potential for return on investments, a number of investment funds have been established with a pure profit motive. These new investors are particularly active in the Indian and Cambodian sectors, and are present in the capital and ownership structures of the institutions targeted by the media in the recent crisis. The criticism of these investors is

that they focus purely on profit, without considering the risk exposure of clients and appropriate mechanisms for risk mitigation.

A new generation of investors, with limited knowledge of microfinance and the nature of risk in the sector, tend to have short-term exit strategies. They focus terms and conditions solely from the profit-making point of view without considering the external risk factors, and the capacity of the institution and the clients to deliver desired results. Microfinance institutions may feel pressured to force clients to take larger loans, pay higher interest rates, and also subject them to unfair collection practices to meet these unrealistic targets. In such situations tension is inevitable.

Industry experts, as well as the BWTP Network membership, argue that microfinance institutions need to determine their priorities before forging relationships with such investors, and ensure that the social objectives and mission of the organization is protected regardless of the expectations for profit. BWTP Network members frequently highlighted the role that governance and management must play in taking

*While the leap to commercial capital has increased public scrutiny, indirectly leading to overreaction or unrealistic expectations, the risk factors that have resulted in the crisis today would not have been mitigated by solely relying on wholesale lenders or bank linkages*

- BWTP Member,  
Nepal

conscious steps to balance social objectives and the need to leverage capital. In addition, a large number of the BWTP Network members believe commercial capital has not necessarily been raised due to the absence of wholesale lending and bank linkages (i.e. locally sourced capital). However, in most microfinance sectors there remains a lack of wholesale facilities and a general lack of interest among the commercial banks to refinance microfinance portfolios, as they see microfinance institutions as competition as they make plans to downscale.

There is another serious problem when institutions deliberately focus on profits, not to meet investor's targets, but to compensate their senior management through handsome remuneration packages. In this case, the criticism is particularly relevant when the MFI has a mission statement that clearly states social goals, yet, in order to remunerate senior management based on profits, the institution engages in unfair practices such as non-transparent pricing of interest rates and unfair collection practices on loans, pushing their clients into greater debt.

*(IPOs) reflect acceptance of investors and proof of microfinance players as truly viable institutions.*

- BWTP Member,  
Philippines

In remedying this situation the BWTP Network membership is evenly divided on the concept of limiting profits; however it is widely believed at an industry level that any such moves are a disincentive to MFIs to reach necessary levels of growth. Transition to Initial Public Offerings (IPOs), on a case by case basis, is considered by the majority of members as a natural progression and not by any means reflective of a wrong turn in the sector. Members feel that the focus must be on assessing the goals of the investors, and ensuring that there is a shared vision and mission vis-à-vis social goals. MFIs must be careful not to attract the 'wrong' type of investors, namely those that do not have a social motive, but are interested solely in large dividends.

There is general agreement within the industry that while microfinance practitioners have succeeded in achieving significant scale and outreach due to commercialisation and foreign investment, they have been less successful in ensuring quality. The next stage in the microfinance evolution has to focus on deepening impact and achieving holistic human development. This can be achieved only by going beyond traditional minimalist credit provision, and integrating savings, insurance and relevant social development programs into microfinance intermediation.

Credit delivery mechanisms and monitoring systems must ensure overall quality and not focus solely on efficiency and productivity. Clients should be protected against unethical practices and exploitation by sound consumer protection policies and procedures. Microfinance institutions must ensure that aggressive targets for growth and profitability do not undermine fundamental social

objectives by reinforcing poverty through over-indebtedness and repayment of loans by liquidating assets or by borrowing from moneylenders.

## The Drifting Mission

A corollary of the above is the fact that over the years, despite claims of serving the poorest and most vulnerable segments of the population, many MFIs have gradually become more risk averse, resulting in the oft-cited 'mission drift'. There is no doubt that there are client groups that are credit-worthy but highly vulnerable to risk. In recent years, several MFIs have successfully developed specialized programs to work with these high risk groups, focusing on specialized credit products and investing in savings and insurance products, as well as social programs including financial education, enterprise development and human resource development initiatives. However, the vast majority of MFIs have opted to focus on credit, which limits their ability to achieve the desirable quality or scope of social impact.

The opinion of practitioner associations such as the BWTP Network is that MFIs should serve the poorest and vulnerable non-poor. MFIs are thus defined as socially oriented organizations that for the purpose of sustainability must ensure good portfolio quality. Investors in microfinance should expect returns on their investment but the emphasis should be ideally on social returns, and realistic targets for dividends. Both old generation MFIs and new generation MFIs must be willing to agree to a congruent set of principles and standards with regards to microfinance intermediation and good practices regardless of the differences in legal, ownership, and capital structures; or microfinance methodologies.

*(It) would be great if there is a common code of ethics among micro finance stakeholders in Asia*

- BWTP Member,  
Indonesia

The majority of the BWTP Network membership believes that in recent years the expectations for microfinance as 'the' solution for poverty alleviation have often been both unrealistic and unreasonable. These expectations have been established (or perpetuated) in part by vocal commentators within the industry itself and to some extent by inexperienced investors and some microfinance promoter agencies, and have been communicated widely by the media. The fact remains that at present the vast majority of MFIs, in all their forms, grapple with the constant challenge of maintaining a pro-poor focus and the pressure to sacrifice their social programs for efficiency and profit margins. Some are forced to adopt risk-averse approaches that affect their targets for social inclusion. Unless there is a conscious effort to reorient the sector's focus on holistic financial inclusion and social impact, there is a real risk of the sector falling short of its stated mission and claims for social justice.

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*Some of the corrections to sections of the industry require a recalibration with principles of simple social responsibility and awareness of social performance.*

- Network Representative, India

In recent years, as the industry has struggled to address these issues, donors, practitioners and support institutions have placed greater emphasis on social performance monitoring, client protection and transparency initiatives and developed indicators to measure social impact and help microfinance practitioners focus on both social and financial targets. There are social investors that have promoted innovation in product design and renewed the focus on social mission. Practitioners must reinforce their commitment to social mission and put in place governance and management structures, policies and practices that do more to achieve social goals.

## Regulation of the Sector

Most microfinance markets in Asia are in the process of being regulated by their central bank. Cambodia, Nepal, the Philippines and Pakistan have regulatory frameworks in place, but the frameworks have gaps and areas of weakness, particularly in the area of supervision. Regulatory frameworks are constantly in need of revision given that the industry is not static and continues to evolve at a rapid pace. Some countries like Bangladesh, India, Vietnam and Lao PDR have microfinance acts in lieu of regulatory frameworks that provide guidelines for the governance of the industry. There are other countries such as Indonesia and Sri Lanka that do not have either acts or frameworks leaving regulation and supervision to individual institutions or other stakeholders such as donors or industry associations.

The legislating of enabling policy environments to ensure sound regulation and appropriate supervision is a major concern in growing microfinance markets, especially if microfinance institutions want to mobilize deposits and attract commercial funds and foreign equity. Appropriate regulation and supervision is of particular relevance in countries where the sector is intermediating significant volumes in loans, including foreign investment. Regional and national industry associations across the region have long advocated on issues of regulatory reform and worked to inform regulators on the steps needed to create an environment conducive for a better microfinance industry.<sup>vii</sup> This has greatly contributed to the role that central banks have played allaying the fears of politicians regarding any perceived crisis in the sector, and the BWTP Network membership is reporting that regulators still generally share a positive outlook for the industry.

At the same time, political interference is an areas of concern in microfinance markets that have achieved significant outreach, particularly in communities that are popular vote banks for politicians. Good regulation does not necessarily protect MFIs from political interference. MFIs in Asia have often been targeted by politicians and political groups as they grow more influential with their client base. In addition to current events in India and Bangladesh, Thailand is a relevant example of where

populist approaches to the provision of financial services for the poor have undermined any potential for a commercial microfinance sector.

Regulators and supervisory agencies can only help to ensure that the regulated microfinance institutions comply with norms. The industry itself, with the help of support institutions, especially industry associations, must enforce standards of good practice. Institutions should also develop mechanisms for internal self-assessment, to ensure that they are in line with their organizational mission.

While self-regulation is no substitute for sound external regulation and supervision, often peer-pressure can have a positive impact on the behaviour of microfinance institutions. Indeed, some BWTP Network members have suggested that the lack of co-ordination between MFIs can undermine efforts at building industry standards and norms in their industries. However, microfinance networks and associations have been successful in influencing positive change on organizations that have drifted beyond the limits of good practice.

*There is not much politicisation happening (in Nepal) at this time since elections are still far off; but this will obviously occur during pre-campaign or election period. It has been observed in Nepal that some government officials are in favour to issue loan waiver to boost their own popularity and thus cultivate negative message to the entire industry and even to foreign stakeholders.*

- BWTP Member,  
Nepal

For instance, the microfinance association in Cambodia has had success in getting shared understanding among practitioners of the need to share client information. This was an intervention to ensure that microfinance providers competing in the same markets did not make loans to the same customer resulting in over-indebtedness and impoverishment of the client. However, in the case of India, the microfinance association was not able to control the microfinance organizations, even though they were members, and the organizations were not responding to peer-pressure.

*We think that the current performance of MFIs is OK, but we should have on alert all stakeholders, especially the Board and Management of each MFI not to be too over confident. Failure could be with us if we are not careful enough to control the evolution in the market.*

- BWTP Member,  
Laos PDR

## Learning from the crises and critiques

*There is tremendous potential in Asia (for microfinance) as there is still a huge number of the population who are in poverty; however, microfinance practitioners need to discipline themselves and stick to the basic essentials of microfinance that is a tool not for excessive profit taking but to uplift the poor in order to be able not to send wrong message to all stakeholders both local and international.*

- BWTP Member,  
Nepal

What has occurred in India and Bangladesh recently is certainly not the first crisis to hit the Asian microfinance industry. The East Asian financial meltdown in the 1990s affected the vast majority of microfinance and formal financial institutions in East Asia, especially Indonesia and Philippines. The Bangladeshi microfinance sector was affected by two major floods in 1988 and 1998, and is affected annually by floods and cyclones that result in losses. The Asian tsunami in 2004 resulted in significant losses in Sri Lanka and Tamil Nadu (South India). Finally, the 2008 Global Financial Crisis resulted in a default crisis in Cambodia and the Philippines requiring more than a year for



recovery. The main point here is that in all cases, the microfinance sectors were able to cope with the crisis, manage through the duration initial impacts and take the steps necessary to recover, regroup and return to strength.

An important aspect of the coping strategy was the existence of strong industry associations that worked with all key stakeholders to resolve the crisis. Financial crisis, natural disasters such as earthquakes, cyclones and flooding as well as conflict and political unrest take a toll on the industry, but where the sector is well regulated, and has strong microfinance institutions with visionary leadership, sound operational policies, good portfolio quality, adequate risk mitigation strategies, customer loyalty and reliable partners, including industry associations, who can enforce standards, they are as a sector able to cope with crisis and come out stronger. This challenge to the sector is no different.

Members of the BWTP Network expressed the opinion that while there are some institutions that have shown ‘mission drift’ and moved towards prioritizing financial profits over the social mission, the majority of microfinance organizations are conscious of working to maintaining their focus on social impact and consumer protection, even while ensuring financial sustainability. This includes efforts to retain client focus and institutional mission through tight control on operational policies pertaining to client-sensitive product design, delivery and recovery practices, interest rate pricing, and the negotiation of acceptable terms with investors and shareholders. They do however need to work towards achieving the goals of financial inclusion and demonstrating social impact.

*The sector should introspect on the crisis, the reasons for this and come out with clear cut solutions which should be well communicated internally and externally. Necessary policy changes should be advocated for healthy growth of the sector.*

- BWTP Network member

*The current situation has the potential to be a major crisis – other regulatory jurisdictions might take this opportunity to make political capital of the issue. However, it provides an important opportunity for some reforms to improve practices in terms of consumer protection.*

- Regulator, South East Asia

Regardless of the influence of donors or investors, and wider industry trends, microfinance institutions have the right to make choices. They can make a choice to be transparent in their pricing of interest rates, remaining competitive and achieving realistic profit margins, which are fair to the client base.

MFIs must adhere to ethical practices individually and speak out as a group, against unfair practices within the sector. While the sector will have to remunerate professionals, there must be a conscious effort to focus to allocate profits in line with the stated mission and objectives of the institution.

MFIs that state social missions regardless of legal and ownership structure, must be clear about their identity, and not compare themselves to the corporate sector. MFIs must be able to know the bottom line and have the courage to say ‘no’ rather than settle for compromise on their mission.

Last but not the least, if these institutions have a pro-poor mission, then these claims must be fulfilled through appropriate products and mechanisms. The institutions that were criticized by the media have to be judged on the basis of their stated claims and the accepted norms and standards of the industry. At this point in time, as suggested by the BWTP network members, recalcitrant MFIs are the minority; however, if norms and standards are not enforced, there is a real danger that the minority could become the majority, which will result in the distortion of the microfinance industry as we know it.

Recommendations from the BWTP Network members include:

- the establishment of comprehensive regulatory policy frameworks and strong supervisory mechanisms;
- the establishment of separate funds for equity, debt and technical assistance, to avoid distortion; and
- the need for industry standards and norms which are accepted and respected by all industry stakeholders, including practitioners, donors, investors and technical support institutions.

*(The microfinance sector requires) a realignment of social and commercial objectives. A recalibration of expectations. Stronger linkages between financial inclusion and OTHER development/social support mechanisms to bring about the social objectives of microfinance.*

- BWTP Network member

Much of the market distortion and crisis is a result of gaps in the regulatory framework and the inability of the regulatory authorities to keep up with the rapid growth in the industry. Another major failing has been the lack of success of industry associations to build a congruence of understanding between diverse types of practitioners, and enforce standards of good practice. And, some Microfinance institutions have failed to assess potential investors, accepting unrealistic terms and conditions that have put pressure on both the organization and its clients.

## Conclusion

Informed debate and discussion is critical to the growth and development of the microfinance industry, and the dialogue must reflect a good understanding of the complexity of the industry, especially the diversity of industry stakeholders, the different development approaches and delivery models, and the need for the industry to envision a wide range of services, including financial and non-financial services.

Commercialisation is an industry reality given the decline in social funding for microfinance programs. There is evidence that institutions that have good leadership can ensure a balance between social objectives and institutional performance.

Foreign capital is an instrumental part of the long-term strategies of microfinance practitioners, ensuring adequate liquidity to support continued growth. However, microfinance institutions must ensure that the social objectives and mission of the organization are well-protected regardless of the expectations of investor partners.

There is a general understanding within the sector that microfinance interventions cannot meet all development needs of the poor. Microfinance institutions with high levels of profit can design programs to reach the poorest segments of the population; however, in the current situation, lack of

social funding and inadequate profit margins will continue to result in the sacrifice of essential social programs in an effort to maintain profit margins to sustain financial services. Social performance must be monitored through a common set of indicators, but cannot be prioritized over financial performance if the primary source of funding for microfinance portfolios is from commercial sources.

Sound regulatory policies and supervision is a real need in growing microfinance markets. Regulatory frameworks must take into consideration the need for microfinance institutions to offer deposit taking services and other financial services such as money transfer and insurance.

There is no doubt that microfinance networks and associations can play an important role in building strong microfinance sectors in countries, and at the regional and international level. Networks and associations can promote practitioner-led research, networking between industry stakeholders, and contribute to quality by monitoring and reporting on social and financial performance. Effective regulation and strong networks and associations can manage the risks inherent in a rapidly evolving microfinance sector.

Overall, the BWTP Network members report a positive outlook for the future of the industry. While the brand of microfinance may have been tarnished by the recent incidents, there is no fear of long-term impact. The BWTP Network membership is confident that the crisis in India and Bangladesh will be resolved in time, and that it is time that the industry speaks out in its defence, whilst also being acknowledging the inherent weaknesses that have been recently exposed. Media focus and continuing critique of the industry is instrumental in highlighting gaps and providing warning signs. Timely and accurate information and dialogue can contribute to informed debate and relevant action by industry stakeholders, to ensure focus on alleviating poverty through financial inclusion.

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<sup>i</sup> MixMarket data for 2009 in East Asia and the Pacific and South Asia. These numbers represent the 571 institutions from that region reporting.

<sup>ii</sup> To access the websites and contact details of all national microfinance networks in Asia, visit the *Asian Microfinance Network Platform* at: <http://www.bwtp.org/platformhome.html>.

<sup>iii</sup> The BWTP Network membership consists of a diverse membership, including microfinance institutions (including NGO-MFIs, co-operatives, and rural banks), commercial banks, national microfinance networks, international NGOs, apex organisations, a central bank and a policy bank. All members were surveyed for the purpose of this article, and interviews were conducted with several key members. Complete details of the BWTP Network membership can be found at: [www.bwtp.org/membership.html](http://www.bwtp.org/membership.html). All quotes provided are from BWTP Network members, and for the purposes of this article have been labelled to ensure anonymity.

<sup>iv</sup> The situation was compounded by the increasing impact of the global economic crisis on the Indian economy with rising prices of food and fuel, increasing inflation rates, and the exposure of microfinance clients to external risk factors. The state of Andhra Pradesh was under particular stress as a result of a long and occasionally violent separatist movement and there was the threat of political interest groups and populist politics as the state prepared for elections.

<sup>v</sup> The *Microfinance Gateway* has collected a selection of international media reports and commentary on their website: [www.microfinancegateway.org](http://www.microfinancegateway.org).

<sup>vi</sup> In an important progression for the industry, the MixMarket will now report annually on Social Performance indicators developed in conjunction with the Social Performance Taskforce.

<sup>vii</sup> The BWTP Network published an update to its landmark publication 'Getting the Framework Right: Policy and Regulation for Microfinance in Asia' in March 2011 which is available on the BWTP website: [www.bwtp.org](http://www.bwtp.org).