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Call for Written Evidence on Microfinance

Response to the All-Party Parliamentary
Group on Microfinance

**MAXWELL
STAMP | P L C**

Introduction

This document is in response to the call for written evidence made by the All Party Parliamentary Group on Microfinance (APPGM) towards the end of 2010. In addition to our responses to the questions posed, this document presents our company profile and outlines some of our experiences of microfinance, which we hope will provide both further insight and a practical perspective to the APPGM's thinking on the issues raised.

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BUILDING ON BRITISH EXPERTISE

RESPONSES

Qa) Of all the various products and interventions that fall under the broad heading of 'microfinance', can you be specific about which of these you will focus on in regard of the remaining questions and provide a brief description.

Aa) Microfinance can be defined as short-term, small scale lending to low-income customers, either for household needs or for informal enterprise development. However, within this broad definition, there are considerable variations in approach. At one end of the scale are 'Grameen model' lending circles of largely female entrepreneurs from the poorest level in the society. These schemes are delivered by NGOs and funded through charitable donations or by donors with a strong pro-poor remit. At the other end of the scale are commercial microfinance institutions (MFIs) serving micro entrepreneurs with growth prospects on a bilateral basis. These institutions may be pump primed using donor funds but have the remit to be self sustaining within a reasonable period of time at which time they can begin to source wholesale funds from commercial banks. MSP has experience of working with both types of model.

Recently microfinance as a term has begun to extend beyond simply micro credit. Concerns that micro lending was indebting the poor have led to a greater emphasis being put on including a savings element within micro finance programmes. In parallel, the micro insurance market has developed, albeit in selected countries with critical mass and customers that can afford to pay for it (i.e. not the very poorest).

Another innovation is in the field of student loans. We have encountered examples in Mongolia, China and South America which involve medium-term, higher education loans to poor students. The providers already have experience in other forms of micro finance and may limit the provision of loans to students in later years of study (i.e. closer to earning) and in vocational subjects (i.e. more likely to gain a job that can repay the loan).

Qb) How important do you think microfinance is for achieving the Millennium Development Goals and eradicating extreme poverty in the developing world?

Ab) Microfinance can provide a useful tool amongst a basket of other measures in reducing poverty. It is not however, a magic pill that can cure poverty on its own.

Examining each of the Millennium Development Goals in turn:

Goal 1: Eradicate extreme poverty and hunger

Microfinance can never be the prime weapon in fighting poverty but can assist in its mitigation. Taking Malawi as an example, microfinance allows entrepreneurs to develop business ventures to complement their agricultural activities, which allows them to continue to earn revenue and buy food in drought years when crops fail. Prior to the introduction of microfinance schemes, hunger was a serious problem in rural areas during years of bad harvest.

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Goal 2: Achieve universal primary education

Here again, microfinance has a role to play in supporting businesses that increases household income that then provides money to pay for primary education. A major benefit occurs when the surplus revenue produced is sufficient to allow for the education of the girls as well as the boys.

Goals 4, 5 and 6: Reduce child mortality rate; Improve maternal health; and Combat HIV/AIDS, malaria, and other diseases

In the case of NGO-managed microfinance schemes, it is often a condition of charitable funding (e.g. The Big Lottery Fund) that the programme includes classes in family healthcare, AIDS prevention etc. So although microfinance is not the main weapon in these areas, it does provide a forum for tuition in how to combat these problems, especially since the majority of microfinance borrowers are women.

Micro insurance has a role to play in the mitigation of the effects of ill health. However, as discussed above, this is only available in certain developing countries and to customers who can afford to pay for it.

Goal 7: Ensure environmental sustainability

There are various ways that financial services can be structured in order to promote environmental sustainability. However, it is unlikely that the extreme poor would be willing to borrow or pay for financial services in order to individually take measures against environmental degradation. Even in developed countries, the poorest are least likely to adopt environmentally sustainable practices, and environmentally sustainable technology often has to be subsidised to encourage its take-up.

Goal 8: Develop a global partnership for development

N/A

Qc) Should the reduction of poverty be the primary goal of all microfinance programmes?

Ac) It is understandable that where a development agency is funding the microfinance programme, they would want the reduction of poverty to be the primary goal. However, where other commercial investors are involved, their focus is likely - at least in part - to be on the return they can earn from their investment. This matters because for microfinance programmes/MFIs to be sustainable beyond the end of donor funding, they will need to attract commercial backers. However, it should be possible to reconcile both sides, as long as there is a sense of fair compromise and negotiation between the co-funders.

Qd) How can we measure whether microfinance reduces poverty?

Ad) The same way one might measure the effects of any other economic policies and interventions. The methodology of counterfactual impact evaluation is well documented and includes a range of quantitative and qualitative techniques that can be used to measure differences in economic and social circumstances between groups who have and have not received, for instance, microfinance services. Such techniques were recently applied to measure the social and economic impacts of microfinance programmes carried out under the DFID-supported Social Development Fund in Yemen.

RESPONSES

Qe) What factors make microfinance successful in alleviating poverty?

Ae) Microfinance supports the creation of small businesses that can, at the very least, generate surplus funds that improve the living conditions of the entrepreneur and their family. At its most effective, it supports the growth of micro businesses to the extent that they employ others, not only helping their living conditions too but creating the potential for beneficial spill-over effects in the wider community.

Qf) Is microfinance still valuable even if it doesn't reduce poverty directly (or if causality can't be proved)?

Af) Yes. Microfinance is valuable because it provides access to finance for business owners in the informal sector who cannot source it from banks (as they would not appear sufficiently attractive as customers). This gives them their first opportunity to grow their businesses beyond what they can self finance and in due course join the formal sector with the economic benefits that ensue (such as employment generation, tax revenue etc).

Another add-on benefit occurs in the provision of microfinance to female entrepreneurs. This can have an empowering effect on the women giving them a say in household expenditure for the first time. Female entrepreneurs can then insist on surplus funds being spent on their children's education leading to an upgrading of skills in the next generation.

Qg) Should we be concerned about the financial sustainability of microfinance models? Is achieving financial sustainability compatible with the social goal of alleviating poverty?

Ag) The experience of our colleagues in our Bangladesh office is that it can take the poor seven or eight years to rise out of poverty once alleviation measures have been applied. This timescale rises to 12-15 years for those in extreme poverty. This can be well beyond the funding timescale of many donors supporting microfinance programmes/MFIs. Thus whilst some form of grant may be appropriate to get the programme/MFI off the ground, it will have to become sustainable in due course if it is to provide any real value to its customers. The very worst scenario would be for an unsustainable programme/institution to run out of money and leave the micro entrepreneurs in the lurch.

Qh) Which groups should or should not be targeted by microfinance programmes and why?

Ah) Microfinance provision should be directed to those for whom provision is most likely to help them grow their businesses and improve their economic situation (and thus be able to repay the loan with interest thereby also strengthening the sustainability of the microfinance provider). It should be withheld from those who are unlikely to benefit from it. This is easier said than done and is something that microfinance institutions struggle with in practice. This is true even for commercially-driven MFIs, whose profit motives provide strong incentives to make such a distinction between good and bad clients. It should be noted that this approach to microfinance recognises the fact that microfinance is a solution to alleviate some but not all poverty, as it does not universally target all poor people.

RESPONSES

Qj) How can governments and donors contribute to the poverty reducing capabilities of microfinance programmes?

Ai) At the outset, governments and donors can play an essential role in providing the grant finance to help establish the programme/MFI and provide its first funding pot. Beyond that, they can help the microfinance providers to improve their financial sustainability through provision of technical assistance. This can be achieved through a number of measures:

- Improving their ability to distinguish between clients who are likely to improve their economic situation through microfinance services from those who are not, and improving their ability to offer services to them. In practice, this means strengthening the capabilities of MFIs' management in strategic planning, product development, and marketing.
- Improving their ability to manage financial risk.
- Reducing their transaction costs. Depending upon the circumstances of the MFI in question, this could involve organisational restructuring; streamlining of operational systems and administrative procedures; and strengthening of management information systems.

Governments and donors can also play a strong role in ensuring that deposit-taking MFIs are properly regulated, as this will reduce the chance of poverty exacerbation through financial crises.

Qj) What form should the UK's support for microfinance take; how should the effectiveness of UK interventions be measured?

Aj) It depends on what the UK Government is seeking to achieve. If the aim is to eliminate poverty as per the Millennium Development Goals, the UK should view microfinance as a useful weapon in a much larger arsenal with which to combat poverty. If the aim is to promote economic growth through the provision of financial services, microfinance is only one element in a much broader spectrum of measures that can be taken to promote a strong and vibrant financial sector in developing countries.

Once the policy thrust is decided, each proposed intervention should be appraised using HM Treasury 'Green Book' principles to ensure that the chosen approach is likely to be as effective as possible in achieving its goals and constitute value for money (and thus avoid the development trap of letting the heart rule the head). This process should allow a logical framework to be developed against which the intervention can be monitored and eventually evaluated.

RESPONSES

Best practice points arising from recent evaluations:

ADB (2007) Evaluation on the Effect of Microfinance on Poor Rural Households and the Status of Women

This study found that:

- The characteristics and mandate of participating microfinance institutions have important bearings on targeting poor households. The orientation of the institution or NGO needs to match the development goal in project designs.
- Planning to reach large numbers of the ultra poor with microfinance alone may not be a realistic objective. Special programmes may be needed to provide the ultra poor with a range of services, covering training, health provision, and more general social development for the disadvantaged, as well as grants of assets or credits.
- It is useful to include a gender action plan in the design of microfinance projects, which may include features to increase women's participation in, and access to, benefits of the microfinance projects.
- Involving gender specialists in project design, implementation, monitoring, and evaluation to help ensure better integration of gender/women's concerns in the project components.

Evaluation Cooperation Group (Nov 2010) Making Microfinance Work: Evidence from Evaluations

The report discusses that multilateral development banks have played an important role in the evolution of the industry, initially seeing it as an important instrument for targeting poverty and, more specifically, for targeting poor female borrowers. More recently it has become a means of expanding the access of poor households and microenterprises to a range of financial services.

The institutional modalities of microfinance have changed markedly. Grameen banking innovated group liability for dealing with asymmetric information, enforcing repayment and helping the poor. But Grameen banking itself has moved to individual lending in its subsequent lending methodology – with a special window for the very poor. This shift is based on the observation that above a certain value of loan, both lenders and borrowers have a preference for individual lending.

CASE STUDY: BANGLADESH

PROSPER Programme

Maxwell Stamp is managing a £40m grant by the UK's Department for International Development (DFID), to enable access to finance for the poor, and also for Micro-and Small-Enterprises (MSEs). Around two thirds of the funds are to be on-lent to MFI intermediaries and the remainder focused on capacity-building measures.

The aims of the project are to:

- increasing access to financial services for 20% of those in the target groups of extreme poor, and micro and small enterprises (an estimated 10 million people);
- introduction of flexible financial and support services to help eliminate the seasonal cycle of hunger; and
- the development of microcredit regulation to improve the legal protection of savings for 15 million households.

PROSPER also assists in the upgrading and capacity development of the Credit Information Bureau (CIB) of Bangladesh Bank.

CLP Programme

Maxwell Stamp is delivering the Chars Livelihood Programme (CLP), a £9m DFID-funded project to improve the livelihoods of the poor amongst the riverine community along the Jamuna River in North West Bangladesh. The development of sustainable financial services through the organisation of a network of village-level savings and loans co-operatives has been a key deliverable.

The project aims to build on that success in the future by considering how to integrate these informal institutions with the MFI community, and also to access the benefits of new technologically enabled low cost distribution channels.

Income Diversification

Begum approached one of our partner organisations (PRIME) with a view to obtaining a flexible loan for diversifying the family's agricultural production on some abandoned land adjacent to their homestead. As well as receiving a loan, Begum received counselling and training to help her make best use of the available funds. She went on to produce ginger and egg-plant crops (earning 30,000 Taka), and arrange for the agistment of beef cattle which earned a further 3,000 Taka. Her success in these ventures gave her confidence and encouraged her to undertake more intensive farm activities. She went on to plant over 100 high-yielding variety banana plants, planted some maize, and also leased a fish pond and invested 8,000 Taka in an aqua-culture venture. Through the auspices of the PROSPER programme, Begum has made huge strides in improving the value and security of her family's cash flow.



PROSPER and CLP Microfinance Programmes

CASE STUDY: TAJIKISTAN

First Microfinance Bank of Tajikistan

Under a project funded by KfW, Maxwell Stamp provided an interim management team to the First Microfinance Bank of Tajikistan (FMFB), including the COO, CFO, and Head of Internal Audit, before handing over to local counterparts. The MSP executive team supported the CEO in the execution of the FMFB's mission and vision through day-to-day management support and through a series of key strategic initiatives including:

- Development of credit policy and procedures
- Review of credit structure and organisation
- New product development and marketing
- Network expansion
- Establishment of Internal Audit function
- Development of the HR and training plan

Maxwell Stamp also co-ordinated closely with IT consultants Temenos in the integration of their eMerge system into the bank.

New Products and Markets

The Maxwell Stamp team worked with FMFB to continually innovate, in response to the market and changing customer needs. Developments included:

- Entry into the agricultural lending market and the development of a tailored agri-loan product;
- Introduction of a micro-loan protection scheme;
- Development of housing and consumer finance products;
- New leasing products for asset finance;
- Entry into the remittances market; and
- Expansion of deposit and savings product range.

FMFB-Tajikistan Among Top 100 MFIs

Rankings by the Microfinance Information Exchange (MIX), the microfinance industry's leading information source rank FMFB-Tajikistan as among the top 100 microfinance institutions out of a sample of over 650 scored on outreach, efficiency and transparency criteria. The bank has equity support from the Aga Khan Agency for Microfinance (AKAM), Aga Khan Foundation (AKF) - Tajikistan, KfW Group, International Finance Corporation (IFC), grant funds from Canadian International Development Agency (CIDA), KfW Group and credit lines from European Bank for Reconstruction and Development (EBRD) and Blue Orchard.

FMFB was profitable in less than 2 years, compared to the target of 3 years in the initial business plan. FMFB entered the top 100 of MFIs after only 3 years' operations.



First Microfinance Bank of Tajikistan

CASE STUDY: LAOS

Catalysing Microfinance for the Poor

Maxwell Stamp worked with the Bank of Laos under a project funded by the Asian Development Bank to expand microfinance outreach to the poor. The project consisted of two main components:

- the establishment of a microfinance fund management unit within the Bank of Laos to manage an ADB fund for on-lending to local MFIs; and
- the delivery of a training and consultancy programme to build capacity and expertise amongst the Laotian MFI community.

‘...feedback from the MFI community was very positive, with continual and ongoing requests...’



Catalysing Microfinance for the Poor

MFI Assessment Framework

A critical task was the development and implementation of an institutional assessment framework for local MFIs. Not only did this framework guide credit appraisal during the grant approval phase, but also outlined a high-level map for capacity building measures, including consulting and training. The framework built on our deep knowledge and understanding of MFI rating tools, but was also tailored to the unique circumstances of the Laotian environment.

Support to MFIs

Our consultants worked closely with grant applicants and recipients to build MFIs' capacity. Strengthening measures focused mainly on:

- strategic marketing;
- credit administration;
- IT/ MIS;
- finance;
- governance; and
- operations.

The feedback from the MFI community was very positive, with continual and ongoing requests for consulting support from our team and over subscription for our specialist MFI training courses.

As well as grant administration we supported our MFI portfolio through grants for technological transformation, with the purchase of MBWin (copyright GTZ-FAO). We also assisted in the implementation of the new software and provided training for staff.