

A Billion to Gain?

A study on global financial institutions and microfinance



February 2006



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Buitenlandse Zaken
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samenwerking**



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A study on global financial institutions and microfinance

Executed by

EIBE
Institute of Business Ethics
Nyenrode Business Universiteit
Netherlands

Researchers

Gemma Crijns, Fennie Lansbergen, Alberic Pater,
Frans Paul van der Putten (coordinating author), Diederik Timmer

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ING Microfinance Support
Location HI 01.03
P.O. Box 1800
1000 BV Amsterdam
Netherlands
Email: ING.microfinance.support@mail.ing.nl
Telephone: +31 20 563 91 97

Contact

Kim Kiszelnik (ING) Kim.Kiszelnik@mail.ing.nl
Johan de Waard (Ministry of Foreign Affairs)
johan-de.waard@minbuza.nl
Gemma Crijns (EIBE) g.crijns@nyenrode.nl
Frans Paul van der Putten (EIBE) f.vdputten@nyenrode.nl

*The portraits in this survey represent entrepreneurs from
all over the world. Pictures by ING and Oikocredit.*





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Executive Summary

This study

Microfinance is on the rise. Since the mid-1990s domestic commercial banks have had a significant and positive influence on the access to financial services through microfinance. Only recently have international commercial banks¹ come more to the foreground. In the past year, the UN International Year of Microcredit 2005, various major international banks announced that they will initiate or expand their activities related to microfinance. The purpose of this study, commissioned by ING Microfinance Support² and the Dutch Ministry of Foreign Affairs, is to study the initiative international banks are taking, and how this relates to the activities of domestic banks. The study aims to answer the following questions:

- ◆ What are the current activities and future plans of international commercial banks with regard to microfinance?
- ◆ What can international commercial banks learn from domestic banks already involved in microfinance?
- ◆ What do international commercial banks see as a useful role for government in helping corporations to combat poverty?

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What is Microfinance?

Microfinance is widely regarded as an approach for reducing poverty in both developed and developing economies. In this report, the term 'microfinance' refers to the offering of any financial product for customers whose access to financial services is impeded by having a weak economic position. Although microfinance activities exist in every part of the world, this study relates specifically to Africa, Asia, Central & Eastern Europe and Latin America.

Involvement of commercial banks

In the 1990s, commercial banks gradually began to expand their activities into the microfinance sector. Some microfinance institutions (MFIs) also transformed from non-governmental organisations (NGOs) into licensed banks, thus becoming a part of the formally regulated financial services industry. In this hybrid sector, mainstream financial institutions and specialised microfinance institutions meet and influence each other.

1. In this report 'International (commercial) banks' includes both pure banks as well as financial institutions offering banking, insurance and asset management services that have worldwide presence and activities on national and global financial markets.

2. ING Microfinance Support is an initiative of ING Netherlands, refer to Annex 2 for more information.

Activities	Financial products	Non-financial products
Wholesale	<ul style="list-style-type: none"> • Loans to MFIs • Guarantees • Securitisation • Equity stakes • Provision of bank accounts 	<ul style="list-style-type: none"> • Technical Assistance • Credit, Risk Management and IT systems • Entry to banking networks and platforms
Retail	<ul style="list-style-type: none"> • Provision of bank accounts • Individual or group loans • Savings • Insurance • Remittances 	<ul style="list-style-type: none"> • Business services for SMEs

Table 2: Products and market orientation

The current activities of international financial institutions

The activities of international banks consist of offering financial and non-financial products. They are mainly active in offering wholesale products and services to microfinance institutions, which in turn provide financial products to end users. Typically, international banks concentrate on the larger, more established MFIs. They are also engaged to a lesser extent in the direct retail offering of microfinance products to end users, for instance to small and medium enterprises (SMEs). Table 1 summarises these activities.

Why are international banks involved?

There are two reasons for international banks to become involved in microfinance. On the one hand, they can use microfinance to advance their corporate citizenship policy. As microfinance is regarded as a positive and laudable cause by most governments, large development organisations and the general public, the involvement of banks may enhance their reputation with key stakeholders. Since helping low-income groups to gain better access to financial services is closely related to their core business and competence, microfinance is a logical object of their corporate citizenship.

On the other hand, many international banks are also involved in microfinance as a means to achieve more or less immediate business targets. Microfinance can lead to market development when banks assist small

informal-sector businesses which subsequently evolve into better-run and somewhat larger businesses. The same can be done at the level of microfinance institutions (MFIs), which grow from weak financial actors into strong ones.

Many banks seem to be following a 'dual strategy', in which they combine both types of objectives; they cannot usually rely on only one. Ignoring corporate citizenship is not sensible because in the short term microfinance is still a modest operation and the costs and risks incurred may be high compared to traditional banking activities. In addition, international banks are still lacking the necessary experience, the branch network and sometimes the specialized personnel that can turn microfinance into a major operation. At the other end of the continuum, ignoring profit figures would result in merely token forms of involvement, not in substantial investments.

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What are the main drivers for success?

According to the literature and to those interviewed – both on the financial institution side as well as on the side of the non-bankers – there are several success factors that international banks have to take into account when getting into microfinance. The most important among these are:

- ◆ Commitment from the highest levels of management;
- ◆ Access to extensive branch networks of local commercial banks or mfis;
- ◆ Absence of restrictive government regulations for microfinance activities;
- ◆ Local availability of qualified personnel;
- ◆ Offering appropriate products and services.

What can international banks learn from local commercial banks, MFIs and NGOs?

One of the most important lessons that international banks can learn from local banks and MFIs is that they have to build up or make use of local networks to penetrate a potentially lucrative market. On their own, they hardly stand a chance. In addition, an important lesson from international experts is that the main need in providing access to financial services is currently for capacity building (referring to both technical assistance as well as to retail distribution capacity), not providing hard currency. An important contribution that international banks can make is working with MFIs to help them to become more efficient. For instance, banks can support MFIs by upgrading management information systems or by making distribution of microfinance products more cost-efficient. Thus, international banks and MFIs seem to have complementary roles, while sharing a common interest in mutual collaboration.

Finally, it is suggested that international banks not only talk about microfinance and its relevance, but also take some substantial action in this regard. The actual commitment to microfinance – both on the corporate citizenship side and the commercial side – is still on the margin. At this point domestic banks and MFIs, not international banks, seem to be driving the efforts to increase access to financial services for the poor.

The role of government

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Governments can play two main roles with regard to microfinance: regulator of the financial sector and donor for microfinance initiatives. In their role as regulators, governments have an important role as facilitators, removing constraints in banking, tax and foreign investment law, or by providing minimum standards or other tools for risk evaluation at MFIs. With regard to their role as donors, governments can stimulate commercial banks to enter microfinance. They can do so through public/private partnerships, in which governments provide guarantees or otherwise limit risks for banks which lend to microfinance institutions without a strong track record. Banks generally believe that governments should not involve themselves in microfinance by creating state-owned microfinance banks. It is believed that private-sector actors can perform this role more efficiently.

Future plans

All of the banks active in microfinance stated that they intend to continue expanding their involvement in microfinance. Except for those banks that are already active in retail lending, international banks intend to continue to work at the wholesale level, through MFIs. Most banks intend to enlarge the number of partnerships with MFIs, and to increase the number of countries where they work with MFIs.

Conclusion

International banks are clearly paying much more attention to microfinance than ever before. Many microfinance experts believe that international banks have a role to play in increasing access to financial services by the poor. Combining corporate citizenship and concrete commercial objectives appears to be an effective way to make long-term investments in the microfinance sector. In the future, this strategy may enable international banks to gradually emphasise the commercial side over the corporate citizenship side, and thus increase their commitment to microfinance activities. A revolutionary shift from corporate citizenship to commerce, however, is not expected in the next five years.

Introduction

What is microfinance?

The defining characteristic of microfinance is that it applies to low value and innovative financial products for people not being served by the mainstream financial services industry. Microfinance is widely regarded as a way to reduce poverty in both developed and developing economies. Until the 1970s and 1980s, when the term ‘microcredit’ became a well-known concept in the development community, there was no term commonly used to refer to initiatives aimed at the ‘underserved’ or ‘underbanked’ segment, the so-called bottom end of the market. In the 1990s, this term was gradually replaced by ‘microfinance’, indicating that financial products other than loans and lines of credit also play a prominent role.

The 1990s were also when commercial banks began to expand their activities into the microfinance sector. Moreover, some microfinance institutions (MFIs) transformed from non-governmental organisations (NGOs) into licensed banks, thus becoming a part of the formally regulated financial services industry. In between the traditional domains of the non-commercial, non-regulated MFI and the commercial bank, a new area of activity has come into existence. In this hybrid sector, mainstream financial institutions and specialised microfinance institutions meet and influence each other. This report focuses on the activities of major international banks in this hybrid area in between the formal market and the bottom end of the market.

In this report, the term ‘microfinance’ refers to the offering of any financial product to customers whose access to financial services is impeded by having a weak economic position. Any use by banks of the term microfinance falling within this broad definition was accepted. Although microfinance activities exist in every part of the world, this study relates specifically to Africa, Asia, Central & Eastern Europe and Latin America.¹

Recent developments

Since the mid-1990s it has become clear that domestic commercial banks can have a significant influence on microfinance. Only very recently have international commercial banks come more to the foreground. In the past year, the UN International Year of Microcredit 2005, various major international banks have announced that they will initiate or expand activities related to microfinance. Existing studies on the role of commercial banks concentrate on banks in general, or on domestic banks in particular. The purpose of this study is to look specifically at what international banks are doing, and how this relates to the activities of domestic banks. Given the novelty of the involvement by international banks in microfinance, we will also pay attention to the role of government in this context.

1. In this report, the term ‘Asia’ refers to the whole of Asia including the Middle East.

Background

This report presents the results of a study performed from November 2005 to January 2006 on the attitudes and activities of global commercial banks towards microfinance.

The study was commissioned by ING Microfinance Support (ING Netherlands) and the Netherlands Ministry of Foreign Affairs, and carried out by EIBE, the Institute of Business Ethics of Nyenrode Business University.

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This report presents only a preliminary outline. The emphasis is on understanding what a small group of pioneering international commercial banks is doing and planning to do. No attempt was made to work with a full selection of banks based on clearly defined, exclusive criteria. A few international banks approached did not cooperate in this study. This may be because they have no microfinance activities, but this could not be verified as in most cases these banks did not provide an explanation for their refusal.

Many of the banks that were willing to participate in this research are still in the earliest phase of developing microfinance policies. Data, especially verifiable data, are therefore limited. Consequently, this report cannot be conclusive about how the role of international banks in microfinance is currently developing. Also, since only limited financial figures could be obtained from the respondents, this report does not make quantitative comparisons between banks. The report

identifies a number of issues that are relevant for the debate on the role of international commercial banks, and which may serve as starting points for further reflection and investigation. At the same time, this may provide financial institutions interested in microfinance with points of attention relevant to their decision making.

Methodology

The objective of this study is to answer the following questions:

- ◆ What are the current activities and future plans of international commercial banks with regard to microfinance?
- ◆ What can international commercial banks learn from domestic banks already involved in microfinance?
- ◆ What do international commercial banks see as a useful role for government in helping corporations to combat poverty?

Although some attention will be paid to savings, insurance, and money transfers, this report deals primarily with micro lending because this is by far the most important activity for most of the banks studied. Unless specified otherwise, statements on microfinance in this report relate to lending.

With regard to the first and the third research question, data was collected primarily through interviews with representatives of eleven international banks based in Europe or the US.

The representatives were asked four main questions:

- ◆ What microfinance activities their bank is currently engaged in;
- ◆ What they will do in the future regarding microfinance;
- ◆ How they view the role of international banks in microfinance;
- ◆ What role they think government should play.

Additional detailed questions were asked according to each bank's specific involvement in microfinance.

The banks involved were selected on the basis of rankings of the largest international banks and the geographical extent of their operations. However, not all banks approached participated in this study. Moreover, during selection the emphasis was put on those banks which were known, through media exposure, to be active in microfinance.

Additional interviews were held with microfinance experts from various organisations other than the large international banks. A list of people interviewed is included as Annex 1. A synopsis of the microfinance activities of the eleven banks involved in this study is included in Annex 2.

The findings for the second research question are based on research carried out by Fennie Lansbergen for her MSc thesis in Business-Society Management at Erasmus University in Rotterdam. This research was done during an internship at ING in late 2005 and early 2006. Further details on its methodology are included in Part II.

The researchers are very grateful for the help they were given by Frank Abate, Marten Brienens, Hans Dellien, Zaitoon Esmail, Harry Hummels, Kim Kiszelnik, Jacquelyn Kung, Sarah Leshner, Sonal Shah, Elsabé Willeboordse, Zhang Yi, and all those interviewed.





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Part I

International commercial banks: a dual strategy

This part of the report presents a brief and preliminary overview of current developments regarding the position of major international banks.¹ Findings are grouped according to three main points of attention:

1. Strategies employed to enter and expand into microfinance;
2. Factors influencing strategies;
- 20 3. Areas where the activities of international banks may affect the development impact of the microfinance movement.

1. Strategies

Relevant perspectives regarding the strategies of international banks towards microfinance are aims and motives, products, geographical focus and future plans.

Aims and motives

Most international banks have a DUAL PURPOSE for their microfinance activities. On the one hand their aim is to use microfinance to advance their CORPORATE CITIZENSHIP POLICY. The term corporate citizenship applies to companies' active participation in addressing societal issues. The overall aim of the microfinance movement is to reduce poverty by 'building financial systems that

work for the poor majority.'² As microfinance is regarded as a positive and laudable cause by most governments, large development organisations and the general public, the involvement of banks may enhance their reputation with key stakeholders such as employees, investors, customers, and governments. Moreover, helping low income groups to gain better access to financial services is an activity that is close to the core business and competences of banks, thus making microfinance a logical area for them to focus on.

On the other hand, many international banks are involved in microfinance also as a means to achieve more or less immediate BUSINESS TARGETS. Important aims in this respect are market development and servicing existing clients. Microfinance can lead to market development when banks assist small informal-sector businesses which subsequently evolve into better-run and somewhat larger businesses, resembling or becoming small enterprises in the formal economy. The same can be done at the level of microfinance institutions, which grow from weak into strong financial actors.³

With regard to servicing existing clients, microfinance can provide an INVESTMENT TARGET for asset management activities. Opportunities to invest in MFIs are particularly relevant as interest rates are low in major economies such as the US and the

1. While the outlines of microfinance activities per bank in Annex 1 were submitted to the interviewees for accuracy, this is not the case with the statements in Part I that relate to specific banks. These exclusively reflect the interpretation of the researchers.

2. As phrased in WWB 2005b, 3.

3. Regarding motives of commercial banks – not specifically international banks – see also Young, Robin, et al., 2005.

Microfinance Investment Funds

A number of institutions offer investment opportunities in microfinance to private persons and institutional investors, by issuing privately funded MFI-funds. Most of these funds invest in hard-currency MFI-debt. A number invest in the equity of MFIs and some funds offer local currency loans to MFIs. Apart from the Dexia/Blue Orchard and Global Commercial Microfinance Consortium (Deutsche Bank) there are large funds that are not directly linked to an international financial institution. In some cases the funds are partially guaranteed by multilateral financial institutions (such as World Bank, IFC) or national development agencies.

Table 1: Microfinance Investment Funds at the beginning of 2005

Fund	Size of MFI investments, 2004, in million US\$	Projected after 2004 in million US\$	Total in million US\$	Active since	No. of active MFI investments
Pro Credit Holding	89.2	–	89.2	1998	19
Oikocredit	80.8	39.1	119.9	1975	169
Dexia Microcredit Fund	46.3	50	96.3	1998	49
BlueOrchard Microfinance Securities I LLC	38.0	–	38.0	2004	
Triodos-Doen Foundation	30.6	3.4	34.0	1994	64
HTF Hivos Triodos Fund	20.5	6.8	27.3	1994	36
Calvert Foundation	20.0	4.0	24.0	1995	40
OTI / Opportunity Transformation Investments	19.4	5.0	24.4	2001	13
PROFUND	16.2	–	16.2	1993	10
Latin American Challenge Investment Fund (La CIF)	15.8	–	15.8	2004	
Impulse (Incofin)	15.4	–	15.4	2004	6
MicroVest I	13.5	–	13.5	2003	16
ACCION Investments	12.5	5.0	17.5	2003	5
ResponsAbility Fund	11.4	–	11.4	2003	40
ANF (ASN NOVIB)	9.5	11.5	21.0	1998	16
TFSF (Triodos Fair Share Fund)	7.0	6.8	13.7	2002	11
Global Commercial Microfinance Consortium (Deutsche Bank)	–	75.0	75.0	2005	

Source: ADA/KfW, Mixmarket, ING calculations

EU. This means that investment opportunities in the main economies are relatively unattractive, and that fund managers are more inclined to look for opportunities in less developed but more dynamic economies in other parts of the world.

22 A well-known organisation that is involved in investing in microfinance is Switzerland-based BlueOrchard Finance. This microfinance investment consultancy manages, among other funds, the Dexia Micro-Credit fund, which has existed since 1998 and which is the oldest private, worldwide, fully commercial microfinance investment fund.⁴ This fund currently finances some fifty MFIs in 24 countries, the investments totalling US\$ 77 million. In some instances development organisations promote investment in microfinance by limiting risks for commercial investors, which can strongly increase its attractiveness to asset managers.⁵ An example for this is the Deutsche Bank-led Global Commercial Microfinance Consortium. Various large commercial institutions as well as the national development agencies of the US, UK, and France participate in this US\$ 75 million fund. The latter governmental organisations bear a first loss risk of 40%. Many bank representatives interviewed for this study stressed that for their banks, microfinance necessarily combines commercial with corporate

citizenship aims. If microfinance is merely a corporate citizenship exercise, assets allocated are likely to remain relatively small compared to those generated by the banks' core activities. At the same time, under current conditions microfinance does not represent a major business case on purely commercial terms, as absolute amounts involved are still small because of the nature of the microfinance business.

If microfinance activities are tied to existing corporate citizenship policies, an opportunity exists for banks to become involved in microfinance on a step-by-step basis. Some of the largest globally operating banks foresee that microfinance can become an important niche market in the more distant future. Several of the international banks interviewed for this study have stated that they want to play a pioneering role. One bank that has consistently shown a strong ambition to be an innovator and a leader among international banks is Citigroup, which probably is the international bank with the longest track record and the widest variety of microfinance activities. Today's pioneers such as Citigroup are likely to be among the market leaders in this niche market when microfinance does become commercially competitive. But although eventually the commercial aim may overtake the corporate citizenship aim in importance, this is generally not expected to happen within the next five years or so.

Exactly how the two aims of corporate citizenship

4. <http://www.blueorchard.ch/> (17 Jan. 2006).

5. Some other tools are being developed to limit risks for asset managers investing in microfinance funds, for instance the SIRIF (Social Investment Re-Insurance Facility): Koch-Weser and Karius2005.

and commercial growth are balanced against one another is different for each bank. Some organisations may focus heavily on the corporate citizenship side, whereas others may be motivated primarily by strictly commercial considerations. For this study too few data were available to determine exactly where each bank is located on the continuum between corporate citizenship and commercial motives. Although the microfinance activities of most banks in this study combine corporate citizenship and commercial aims, a notable exception is Commerzbank.

Interestingly, Commerzbank plays an active role in microfinance without being driven by a corporate citizenship strategy. The bank is traditionally focused on servicing small and medium enterprises in Germany. As these enterprises expanded their activities to the Eastern European countries in the 1990s, Commerzbank did likewise in order to retain and further develop these client relations. In Bulgaria, Rumania, Albania, and the former Yugoslavian countries, Commerzbank found that the political and economic environment was unfavourable to establishing branch offices. As an alternative, Commerzbank decided to invest in new banks that were being set up in the region by development organisations to finance micro and small enterprises. It first did so in 2000 in Kosovo, jointly with various international development organisations. Commerzbank now has 15-20% equity interests in the 'ProCredit' MFIs with

bank status in the countries mentioned.⁶ Majority shares are held by ProCredit Holding, a micro-finance banking group based in Germany. Each national ProCredit bank has a nationwide branch office presence.

While the ProCredit banks aim to achieve a Return on Equity after tax of 15%, the main interest of Commerzbank lies in servicing German firms with activities in Southeastern Europe and in developing new business in these markets. This example shows that, under specific circumstances, microfinance can become closely tied to a bank's core business without relying heavily on corporate citizenship policies. Obviously, the resulting involvement is limited to the micro and small enterprise level in the particular part of the world where the client firms are active.

Products

Financial institutions offer a wide variety of products to provide access to financial services for the poor – either directly or indirectly. A clear distinction can be made between these products along two lines: wholesale versus retail and financial products versus non-financial products. Table 3 (see page 24) summarizes the products offered along these lines.

In the remainder of this paragraph these products and activities will be discussed in greater detail.

6. Von Leesen 2004.

Activities	Financial products	Non-financial products
Wholesale	<ul style="list-style-type: none"> • Loans to MFIs • Guarantees • Securitisation • Equity stakes • Provision of bank accounts 	<ul style="list-style-type: none"> • Technical Assistance • Credit, Risk Management and IT systems • Entry to banking networks and platforms
Retail	<ul style="list-style-type: none"> • Provision of bank accounts • Individual or group loans • Savings • Insurance • Remittances 	<ul style="list-style-type: none"> • Business services for SMEs

Table 2: Products and market orientation

Financial Products

A main distinction in product focus can be made between financial and non-financial products offered to the microfinance sector in general and to end users in particular. Banks that provide financial products offer financing (loans), savings facilities, insurance or money transfer services. By far the most important financial product offered by large international banks is financing, especially **WHOLESALE BUSINESS LOANS** and related products such as guarantees to the MFIs. Banks may also provide consumer loans, housing loans (for individuals), or securitisation (for institutions). An example of the latter activity is the 2004 issuing by Citigroup of local currency bonds for some US\$ 17 million in Mexico to finance the largest Mexican MFI, Compartamos.⁷

7. <http://www.iadb.org/sds/foromic/magazine/p12.cfm> (30 Dec. 2005).

In some instances **SAVINGS ACCOUNTS** (such as Santander in Chile or Citigroup in Mexico) or international money transfer services (such as Citigroup in Ecuador or Mexico,⁸ or HSBC in the Philippines) are also available. Savings are an important potential source of local currency funds to feed micro lending activities. However, in many countries MFIs are allowed by financial regulators only to lend money to clients – not to keep their savings. Banks can play a useful role by attracting savings from micro clients and by making these funds available for micro lending, provided they have a suitable branch office network.

INTERNATIONAL MONEY TRANSFERS are particularly relevant with regard to cross-border remittances. This term refers to the money sent by foreign migrant workers to relatives in their home countries. These remittances are an important

8. On Mexico see Kawas and Thadhani 2004.

source of income for many people in developing countries. Remittances represent relatively stable flows of money from rich countries that directly reach the individuals in developing countries. One problem, however, is that many migrant workers transfer only small amounts of money, while the fee for this service is high. Because a small number of specialised firms such as Western Union, MoneyGram and Vigo dominate this market, it is believed that an increase in competition could push retail prices down. The rapid increase in remittances in the past years and the currently high fees suggest that a considerable potential market exists for financial institutions that offer money transfers at the micro level.⁹ Internationally operating financial banks seem to be especially well positioned for this.

Whether banks also offer MICRO INSURANCE depends in the first place on whether their main business includes insurance. Rabobank Group's insurance division Interpolis is currently pioneering in supporting micro insurance organisations in various Asian countries through the not-for-profit organisation Micro Insurance Association Netherlands (MIAN).¹⁰ Another bank active in micro insurance is Citigroup's Mexican subsidiary Banamex.

An important distinction regarding WHOLESale LOANS is whether these are offered in hard

currency or in local currency. Most credit offered by international commercial institutions to local MFIs is in hard currency. This means that the currency exchange risk is normally borne by the MFI. Most MFIs cannot bear this risk and are therefore only interested in local currency financing. International banks can help the MFI to address this risk, by involving products such as forwards and swaps. These are derivatives that involve counterparties whose involvement removes the exchange risk for the MFI. Although these are fully commercial products, they are not always available (for instance, with less liquid currencies there are no counterparties available).¹¹ International banks may also provide hard currency guarantees for local currency loans, in return for which they can charge a fee to the benefiting MFI. Hard currency guarantees can be used by a microfinance institution to deposit with a local bank. The deposit serves as collateral, while the MFI earns a deposit rate. Deutsche Bank uses this approach, in which it makes sure that the fee it charges is always lower than the deposit interest earned by the MFI.

Non-financial products

Non-financial products offered refer mainly to TECHNICAL ASSISTANCE. This may cover anything from bookkeeping advice to a small entrepreneur to providing large microfinance institutions with complete credit systems. It is generally assumed that MFIs have a great need for technical support

9. Isern et al. 2005.

10. Abels and Bullens 2005.

11. Cavasos 2004.

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and capacity building and that international banks can supply it. ING is an example of an institution that provides technical assistance to MFIs. It does this in co-operation with Oikocredit and UNCDF. These institutions finance MFIs and may involve ING if technical assistance is needed by a particular MFI. Activities for RAISING AWARENESS about microfinance, such as sponsoring of events and meetings about microfinance, can also be considered as non-financial activities.

Depending on the aims of a bank's microfinance policy, financial and non-financial products can be supplied either on commercial terms or below market prices. If a bank is primarily motivated by corporate citizenship aims, it is likely to offer financing or technical assistance at a discount or even for free. However, corporate citizenship-related activities may also be undertaken under commercial conditions. For instance, banks, driven by commercial considerations as well as corporate citizenship, can offer financing at commercial rates, combined with loan guarantees or technical assistance below market prices.

**Retail microfinance:
involvement through local subsidiaries**

Microfinance products from international banks benefit the end users either directly (retail products to individuals and small businesses) or indirectly (wholesale loans to microfinance institutions, which themselves service individuals and

small businesses).¹² Commercial banks involved in retail typically target small businesses. These are usually single-person or family businesses in the informal sector, i.e., they are not legally incorporated or registered as a firm. The micro enterprises targeted include small shops, street vendors, small traders and small farmers. International banks engaged in retail microfinance tend to focus on urban rather than rural customers. A notable exception is ING Vysya. This Indian subsidiary of ING specifically targets (mainly female) client groups for its retail microfinance activities through its rural branch office network. Because of the informal status of micro businesses, the line between consumer and business financing may not always be easily drawn. Certain investments may benefit business activities as well as a micro entrepreneur's private situation. In retail financing, the customers targeted often are women. Reasons for this often cited are that women are more responsible borrowers, and that financing women contributes more directly to the economic development of entire families.

Retail microfinance can be aimed at either groups or individuals. The former approach is an established microfinance strategy for dealing with the absence of collateral (in the case of lending), or with high transaction costs (in all types of microfinance). In group lending, the group members

12. For an overview of the basic approaches open to banks – not specifically international banks – see: Isern and Porteous 2005.

are jointly responsible for each member's loan repayment. The group members' 'social capital' – their social standing – is drawn on to limit the non-repayment risk: group pressure ensures that individual members keep up their repayment obligations.

If retail microfinance is aimed at individual micro entrepreneurs, the bank needs to invest more time in building up relationships with individual micro clients. A possible advantage of this approach is that a bank can create a long-lasting relationship with specific entrepreneurs who over time may expand the size of their business and enter the formal economy. This requires that suitable customers – promising micro businesses – be selected, monitored and supported with care. Individual targeting of micro entrepreneurs usually takes place at a more 'upmarket' level, whereas group lending can reach further 'downmarket' (thus reaching poorer people).

Involvement at the retail level is closely related to whether the bank has a LOCAL SUBSIDIARY with an extensive branch office network. This applies mostly to domestic banks that at some point have become partly or wholly owned by international banks. The initiative to enter microfinance typically originates from within this subsidiary – possibly in response to local societal or governmental demands or stimuli. Since there is not always the opportunity for foreign banks to purchase controlling stakes in domestic banks,

this approach may not always be possible. Various respondents pointed out that staff involved directly in microfinance activities, especially at the retail level, should be recruited and trained separately from the regular bank staff. ABN AMRO, for instance, recruited specialised staff for its retail microfinance operation in Brazil. ABN AMRO's subsidiary Banco Real set up a separate joint venture for this purpose with ACCIÓN International, a large microfinance NGO. Traditional banking culture and reward incentives are thought to be inappropriate for microfinance work, which requires a strong awareness of social issues and which does not yield financial results to the same extent as mainstream banking does. This factor also emerged in the study on success factors for domestic banks, as will be shown in Part II.

Currently there are few international banks directly engaged in retail microfinance. One example is Grupo Santander of Spain. This bank has been active in microfinance in Chile since about 1993, through its subsidiary Banefe. In September of 2005 it was providing loans to some 63,000 Chilean micro entrepreneurs, with a total loan portfolio of US\$ 96.7 million. The bank also offers other products such as savings deposits, consumer credit and housing financing. In order to limit credit risks, Santander Banefe uses personal asset collateral and co-signatories. Moreover, the bank uses a direct sales force in the field with loan officers that do on-site loan analyses. Part of the loan portfolio is subsidised by the

	Non-financial products			Financial products			
	Technical Assistance to micro entrepreneurs	Technical Assistance to MFIs	Grants / sponsoring	Retail loans millions of US\$	Wholesale loans/ guarantees millions of US\$	Equity stakes in # of MFIs	Remittances in # of countries
ABN	x	x		4.8	14		
Barclays		x			0.27		
Citigroup		x	x	x	x		20
Commerz Bank						7	
Credit Suisse					x		
Deutsche Bank			x		x		
HSBC		x			< 62		+/- 60
ING		x	x	3.4	16.9		
Rabobank		x	x			6	
Societe General					62-125		
Standard Chartered plc				x	x	2	

Table 3: Main microfinance focus area of the financial institutions in this study (note that this offers not necessarily a complete overview of microfinance activities of the named institutions).^{12a}

Chilean government.¹³

Another bank that is active in retail microfinance is ABN AMRO through its local entity Banco Real, which provides micro loans to small entrepreneurs in Sao Paolo and other Brazilian cities. In October 2005, Banco Real had some 8,000 micro loans outstanding, amounting to a total loan portfolio of US\$ 4.8 million. The loan size ranges from US\$ 70 to US\$ 3,500 with Banco Real, and from

US\$ 200 to US\$ 7,500 with Santander Banefe.

Both Santander Banefe and Banco Real focus on individual clients.

With regard to group lending in rural areas, an example is ING in India through its subsidiary ING Vysya. In December 2005, ING was directly providing groups of Indian women with some US\$ 3.4 million worth of micro loans and attracted US\$ 2.6 million in micro savings.¹⁴

An interesting example involving international money transfers (remittances) at the micro level

12a. http://www.swwb.org/English/PDF/innovation/20brief_citigroup.pdf
<http://www.hsbc.co.in/in/corp/remittances.htm>

13. http://www.swwb.org/English/1000/address/gnbi/add_gnbi_santander.htm (30 Dec. 2005); Benavides 2005.

14. ING Vysya reached 126,000 persons with its direct and indirect activities. Micro savings data from August 2004.

is the service that Citigroup provides to Mexican migrants in the US. In 2001 Citigroup acquired Banamex, the largest domestic commercial bank in Mexico, and it subsequently developed a way to use the extensive Banamex branch office and ATM network for money transfers. Clients in the United States are offered a checkless account that requires no minimum balance and for which no social security card is needed. In return for a fee (US\$ 5 plus 2% of the transfer amount), they can use ATMs, telephone or the Internet to make a sum of money available for pick-up in Mexico. Mexican clients who purchase a special US\$ 2 card can pick up the amount at a Banamex branch office or ATM. The fee for the cash pick-up is paid by the account holder in the US.¹⁵

Fundamental factors that hamper the entry of more international banks into retail micro lending are the lack of experience, properly skilled personnel, and branch office networks required for retail microfinance. Other considerations that make wholesale activities seem more attractive than retail microfinance are the slow growth rate of clients, high transaction costs, low profitability rates, and regulatory constraints at the retail level. One factor that has been put forward by some banks as the main stumbling block to retail lending is that it involves charging high interest rates in order to compensate for the high transaction costs,¹⁶ a practice which could lead to

accusations of usury. Such criticism might reverse the improvement in public image otherwise obtained from being involved in microfinance, and thus conflicts with corporate citizenship policies.¹⁷

Wholesale microfinance: relationships with MFIs

Most international banks are active in wholesale rather than retail microfinance. They provide products to microfinance institutions, which use these to service end users. Typically they concentrate on the larger, more established MFIs, which have a better track record and can absorb more money than weaker or smaller MFIs. Examples of international banks with especially extensive relations with microfinance institutions are Citigroup (particularly in Asia and Latin America) and Société Générale (particularly in Africa and Eastern Europe).¹⁸

In comparison to retail microfinance, activities at the wholesale level are organisationally more feasible, and probably easier to integrate into

15. Kawas and Thashani 2004.

16. <http://www.prismamicrofinance.com/Downloads/Micro->

credit_Becoming_Profitable.pdf (30 Dec. 2005); Young et al. 2005, CGAP 1998.

17. In various countries the banks may also need to find a way to overcome misgivings on the part of poor people – even if high interest rates are not an issue – to approach, and enter into a financial relationship with, large companies. In Brazil, Banco Real at first approached potential clients in their own shops and opened small offices for microfinance at locations at some distance from its regular branch offices. In a later stage these microfinance branch offices were positioned as separate units within existing regular branches.

18. Exact figures regarding the total number of partner MFIs were not provided by these banks.

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a single corporate strategy. Banks may also enter into arrangements with MFIs whereby the latter act as the bank's agent in offering financial products.¹⁹ This is sometimes referred to as a type of outsourcing of retail activities. HSBC is currently engaged in pilot projects in several countries in which it makes a range of financial products, including money transfers and credit cards, available to the client networks of partnering MFIs. Another interesting development is that large domestic or international banks securitise the loan portfolios of their partner MFIs. Securitisation can be interesting also for major investment banks, that otherwise are not involved in microfinance.

Instead of supporting regular microfinance institutions, international banks may also reach end users through traditional channels in the informal sector. An interesting example is the program launched on 19 December 2005 by Barclays Bank in Ghana. Under this program Barclays provides bank accounts to 100 susu collectors.²⁰ These people collect the daily proceeds from market traders and other small business people who do not have bank accounts, and keep them for a set period of time in return for a fee. By giving the susu collectors bank accounts, Barclays Bank supports their deposit taking service, and transfers money from the informal to the formal economy.

19. See also CGAP2000, 19, n30.

20. <http://www.ghanaweb.com/GhanaHomePage/NewsArchive/artikel.php?ID=96347> (30 Dec. 2005).

Wholesale microfinance: taking an equity stake

In some instances international banks have taken minority equity stakes in MFIs, in order to have some degree of influence at the management level of the microfinance institution. This applies, for instance, to the involvement of Commerzbank in ProCredit banks in Southeastern Europe. Another example is Rabobank Group. Recently it established Rabo Financial Institutions Development (RFID) to acquire minority stakes in nationwide financial institutions in fifteen developing countries. These bank-MFIs will be supported by Rabobank through technical assistance and management support. Projects realised and under development are located in Zambia, Tanzania, Mozambique, China, Paraguay and Peru.

Another bank, Société Générale, has announced its intention to initiate an equity participation program in 2006. This development signifies a development towards more intensive and lasting ties between international banks and MFIs.

Geographical focus

Geographically, there are no limits to microfinance. International banks may be active in microfinance or closely related activities in the US or the EU, just as in any other part of the world. But countries that were mentioned in interviews with international banks and in literature as current target areas for their microfinance activities are mainly in the emerging markets, such as Mexico, Nicaragua, Brazil, Chile, Ecuador, Venezuela, Paraguay, Peru, Bosnia, Serbia-Montenegro,

Kosovo, Albania, Rumania, Bulgaria, Georgia, Russia, Morocco, Ghana, Burkina Faso, Benin, Senegal, Sierra Leone, Kenya, Tanzania, Zambia, South Africa, Madagascar, Jordan, Pakistan, India, Nepal, Bangladesh, the Philippines and China.

To some extent, historical and linguistic ties between banks' home countries and certain regions seem to affect the choice of countries where banks are initially active in microfinance. Spanish banks seem to focus to some degree on Latin America, German banks on Eastern Europe, French banks on French-speaking African countries, and British banks on English-speaking countries in Africa and on India. However, there are many exceptions, and there are no signs that their focus will not also turn to other regions. Only in the case of Commerzbank does its focus on Eastern Europe seem to be fixed. This bank's geographical choice for its microfinance strategy is tied to the particular interest its domestic clients have in this part of the world. At the same time, banks like Citigroup, Deutsche Bank, HSBC, ABN AMRO, ING and Rabobank do not seem to have a particular focus on countries with which their home countries have special ties. On the whole, India and Mexico are the two countries that perhaps attract the most attention from international banks. In India the focus often is on working through MFIs, while in Mexico working with MFIs and taking of equity stakes in or acquisitions of domestic banks are important.

Future plans

All of the banks active in microfinance and which co-operated in this study have stated that they intend to continue expanding their involvement in microfinance. The overall trend seems to be an intention to expand wholesale activities. Except for those banks already active in retail lending, international banks intend to continue to work at the wholesale level, through MFIs. Most banks want to enlarge the number of partnerships with MFIs, and to increase the number of countries where they work with MFIs.

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2. Factors influencing strategies

A relatively small group of international banks is currently actively involved in microfinance. Some started this involvement during the 1990s, while others are still in the phase of pilot projects. While it is still too early to ascertain how the international banks as a sector are going to develop their role in microfinance beyond the current pioneering phase, some preliminary insights may be derived from looking at which factors seem to be influencing the strategies of the frontrunners.

Entry phase

In the first place, there seem to be several important factors affecting whether or not an international bank will initiate microfinance pilots in the first place. International banks that enter microfinance often have ambitions to grow in under-developed or emerging economies, and are willing to invest in medium or long-term projects

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Bottom of the Pyramid

If we stop thinking of poor people as victims and start picturing them as entrepreneurs and consumers, a new potential market arises. This theory of the Bottom of the Pyramid (BoP) was developed by C.K. Prahalad in 2002. The pyramid (figure 1) depicts the distribution of purchasing power in the world, with the bottom representing the 4 billion poorest people. Of course, the purchasing power of the poor cannot be compared with that of the developed nations, but by their numbers, the poor represent a significant latent market. Prahalad states that providing products to this market in an innovative way can be a solution to poverty. Corporations play a significant role in this development. An example of selling products to the BoP is providing microfinance products in developing economies.

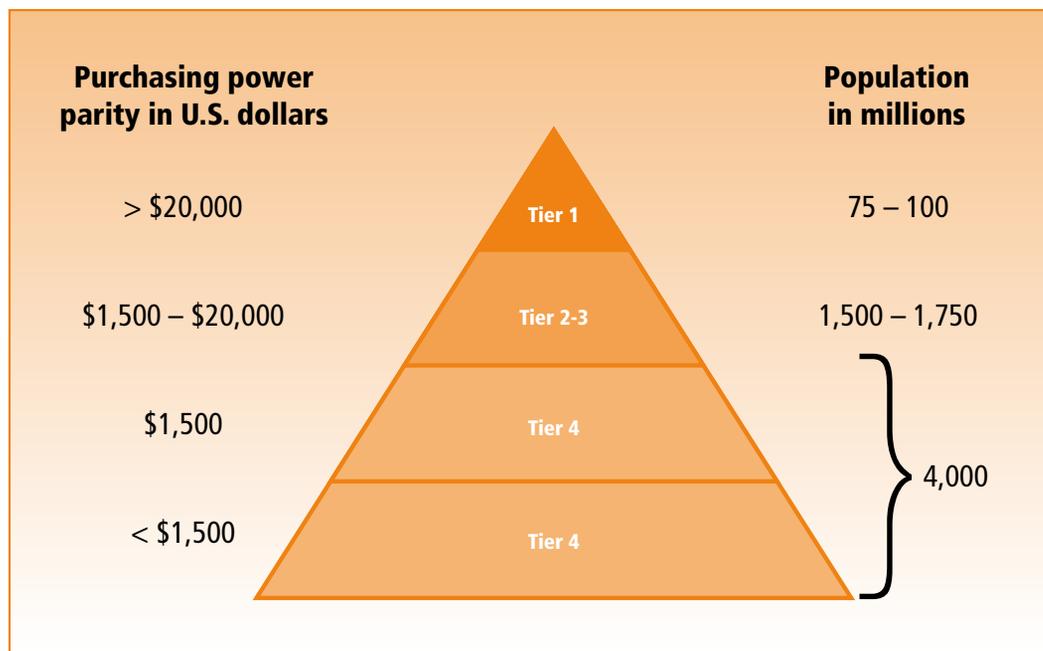


Table 4: The economic pyramid. *Source:* Prahalad, C.K., and Hart, Stuart, 2002. The Fortune at the Bottom of the Pyramid. *Strategy + Business*, Issue 2006, 2006.

to achieve this. The now-popular concept of the ‘Bottom of the Pyramid’ – entering low-end mass markets in poor regions that may bring substantial corporate growth – fuels such ambitions.²¹ Having a corporate citizenship programme partly deals with the objection that high profitability rates are lacking in the short term, because

being active in microfinance serves the corporate citizenship purpose. The relative flourishing of socially responsible investing and the widespread public demand on business to support the Millennium Development Goals further increases the influence of corporate citizenship aims.

Low profitability is also less of a problem if interest rates in the major economies are low, as is

21. C.K. Prahalad and Hart, Stuart, 2002. The Fortune at the Bottom of the Pyramid, *Strategy and Business*, issue 26, 2002.

currently the case. This means that more money is available for investment in microfinance funds. Fears of new financial crises in emerging economies appear to have receded into the background in recent years, as a result of which the effect of low interest rates is further emphasised.

The availability of risk assessment tools and rating instruments for microfinance institutions is an important requirement, given that most MFIs are young and/or unregulated institutions with short track records. Various rating agencies²² are now active in grading the creditworthiness of MFIs.

Finally, commitment from the highest management levels is cited by many of the respondents as a major precondition for a successful entry into the microfinance market. As this is a non-traditional market for bankers, firm and sustained management support is needed to overcome scepticism and to free up sufficient resources within the organisation.

Factors influencing growth

Once banks are active in microfinance, there is a further group of factors that affect their strategies. Owning local subsidiary financial institutions with extensive branch networks, or host governments allowing the acquisition of such, obviously is a direct precondition for becoming active in retail microfinance. In many countries, formal or

informal obstacles prevent foreign banks from owning local financial institutions.

The attractiveness of certain microfinance activities may be limited by restrictive regulation of the microfinance sector. For instance, a government or the central bank may set maximum interest rates or prohibit the taking of deposits by microfinance institutions. The international capital framework known as Basel II, which discourages lending by banks to less creditworthy borrowers, is also important in this respect.

The level of risk that a specific bank is prepared to take depends not only on regulatory incentives but also on how it perceives its local interests. International banks with strong historical and/or client-related ties with specific countries are more likely to maintain their presence even in times of financial or political crisis. Contrarily, banks that base their local involvement mainly on short-term gains are less likely to engage in long-term programmes with high risk.

Finally, also the corporate governance structure can have a major effect on how banks will follow up on their pilot projects. If shareholder pressure forces a bank to focus strongly on short-term profitability, there may be less likelihood of the firm and lasting commitment from upper level managers needed for sustained growth in microfinance. Shareholder pressures are not relevant for a co-operative bank such as Rabobank. On the other hand, there seems to be a good business case

22. MicroRate, M-Cril, CRISIL, Planet Rating, etc and increasingly the mainstream rating agencies.

34 for microfinance in the long term. Involvement in microfinance is a way to develop new markets, especially in emerging markets. International banks can enter market segments that are not yet served by local banks. They can also establish ties with micro entrepreneurs whose businesses may evolve into formal SME (small and medium enterprises) and as such become an attractive client base. In spite of stakeholder pressures, several international banks seem to be willing to make long-term investments. Citigroup in particular, states that it has long-term ambitions in this market.

3. Relevance to developmental issues

As mentioned above, the involvement of international commercial banks in microfinance is in many cases not purely commercially motivated, but related in part to their corporate citizenship programmes. This makes it worthwhile to focus briefly on the potential development relevance or impact on developing countries because of growing involvement in microfinance by international banks. Below are some of the areas where international bank involvement may affect developmental issues. The core issue at stake in this context is the reduction in poverty through better access to financial services for low-income groups. At this point it is too early to come up with conclusive insights. The points raised are therefore

phrased as questions.²³ WILL INTERNATIONAL BANK INVOLVEMENT in microfinance lead to a substantial increase in the availability of products at lower prices for more people at the lower end of the market? This is expected by many, but has yet to be substantiated by empirical studies. This is probably the key question regarding the developmental impact of the activities of international banks.

Other issues related – directly or indirectly – to the developmental role of international banks are:

The position of end users of microfinance products

WILL INTERNATIONAL BANK involvement in micro financing lead to more over-indebtedness by individuals and micro entrepreneurs? In some countries, the competition between micro credit providers is reported to have led to excessive lending behaviour by end users, who finance repaying one loan with another, resulting in over-indebtedness.²⁴

WILL EXISTING CRITICISM regarding group lending affect the attitude of international banks in this respect? While group lending is an important way for MFIs to reach the economically weakest, critics have pointed out that group lending has some inherent dangers. There are concerns that

23. For a list of issues relevant to commercial banks in general – not specifically international banks, see WWB 2005b, 16-17. See also FELABAN and WWB2005.

24. CGAP 2001, 10.

the microfinance industry is aimed too rigidly at the health of the financial system, rather than the well-being of the borrowers themselves. Setting up lending groups based on social capital and peer pressure brings a great social responsibility to MFIs, which not every MFI may be capable of dealing with properly. Such concerns could induce commercial banks to be extra careful in selecting which group lending MFIs they support.

WILL CHANGING RELATIONSHIPS between international and domestic banks substantially affect the position of end users of microfinance products? International and domestic banks often play complementary roles, but if economies are liberalised and opened up to foreign investment, the boundary between the two categories may fade. As domestic banks are acquired by international competitors, local branch networks may become part of multinational organisations. This has already happened in various Latin American countries, most notably in Mexico. It is unclear if this hampers or stimulates access to financial services by low-income groups.²⁵

The position of microfinance institutions

WILL COMPETITION FOR end user clients between commercial banks and MFIs grow, and if so, how will this affect the position of MFIs? This seems hardly relevant in the current situation, where

international banks in most cases do not engage in retail microfinance but rather supply or support MFIs. However, many domestic commercial banks are already active at the retail level and thus potentially compete with MFIs. An increase in acquisitions of domestic banks by international banks could bring about a greater role of international banks and reinforce the competitive strength of domestic banks at the same time. Some respondents pointed out that development organisations and NGO funding of relatively strong MFIs distorts the upper end of the microfinance market, where fully commercial initiatives may otherwise be viable.

WILL ACCESS TO funds by MFIs be affected? Access to hard currency does not seem to be a problem. The hard currency requirements of MFIs are very limited and seem more than covered by the current availability. So far international banks have had little influence on local currency availability to MFIs, but this could change if international banks increase their efforts to make local currency available for microfinance purposes. Thus, international bank involvement may help MFIs gain access to funds.

WHAT WILL BE the effect of competition between international banks for partnerships with strong MFIs? It seems that all international banks aiming at creating partnerships with MFIs are targeting the same handful of highly developed, large MFIs.

25. But it has been noted that in some cases in Mexico, foreign acquisitions were followed by a steep decline in the number of regular bank accounts: Copestake2005.

HOW WILL THE relationship between international banks and general development organisations evolve? Originally, MFIs depended largely on governmental and non-governmental development organisations for financial and technical support. Commercial banks now also provide these, especially for the stronger, larger MFIs. As a result there exists a scope for partnerships between banks and development organisations.

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WILL CLOSER RELATIONS between strong MFIs and international banks lead to ‘mission drift’ by MFIs? It is sometimes assumed that large financially and organisationally strong MFIs, who are the preferred wholesale customers of many commercial banks in microfinance, may be tempted to focus on less poor end users if they are financed primarily by commercial banks. This is thought to be possible because commercial banks may be more interested in servicing small enterprises just outside the formal economy rather than the lowest income groups. Such a shift of client focus is referred to as mission drift.²⁶

WILL THE INVOLVEMENT of international banks in microfinance lead to less economic stability for lower income groups? The concern is sometimes raised that equity investment in MFIs by foreign banks undermines their stability, as foreign investors are more likely to withdraw in times of economic crisis. While local investors may not be able to withdraw, and NGOs have a developmental

mission that keeps them from withdrawing, international banks have an obligation to their shareholders to limit financial losses. Another matter is that MFI loan portfolios are based not on collateral but on the track record of high repayment rates. Clients repay mainly because they want to retain their access to financial services in the future. Doubt from borrowers in the capacity of a given MFI to continue providing services may lead to a dramatic reversal in the repayment rate, and effectively destroy the loan portfolio.²⁷ MFIs that to a large degree come to depend on partnerships with international banks will need to be able to count on firm support from these banks during economic crises.

WILL MULTINATIONAL NON-FINANCIAL companies become an important element in the microfinance business? The entry of major telecom and IT companies into microfinance is expected by some observers. Suppliers of mass-market consumer products, such as coffee or soft drinks companies, might also play a role in microfinance. This can lead to new competition for the banking sector as a whole. But it may also supply individual banks with new partners with which to strengthen their position as suppliers of microfinance products, and increase their impact on developmental issues.

26. See also CGAP 2001.

27. CGAP 2000, 5.



Part II

Domestic banks: success and failure factors

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In addition to the study on international banks reported on in Part I, ING Microfinance Support also initiated a study on success factors in microfinance for domestic banks, i.e., banks whose activities focus predominantly on a single country or certain regions within a country. Domestic banks on the whole have been engaged in direct microfinance activities longer and more extensively than international banks. The experiences of these domestic banks may provide insights that are relevant for international banks' intent on increasing their involvement in microfinance. A study was performed on domestic banks that engage in retail microfinance, usually by providing loans and savings products. The aim of this study was to establish the main factors that determine success and failure for these banks in terms of outreach (loan portfolio and savings) and financial viability (return on equity).

Two main types of domestic banks are active in retail microfinance. The first are the downscaling domestic banks: private or state banks that originally were not active in the microfinance market. They became downscalers by either expanding from the mainstream market segments downwards to the microfinance segment, or by shifting towards microfinance completely. The second type is MFIs that have the status of a bank according to local government regulation. These are relatively large and well-organised MFIs, which started out as NGOs and eventually transformed into banks by obtaining a licence from the financial supervisory authorities.

Downscaling domestic banks

With regard to downscaling banks, a qualitative study was done on the basis of seven case studies from the following seven banks: BRI-Unit Desa (Indonesia), Banque du Caire (Egypt), Equity Building Society (Kenya), United Georgian Bank (Georgia), Agricultural Bank (Mongolia), Banco del Pichincha (Ecuador), and Banco de Crédito del Perú (Peru). All of these are downscalers, as they engage in retail microfinance. Most of these banks started their direct microfinance activities around the year 2000. The relevance of success factors could not be analysed quantitatively because insufficient statistical data were available. Instead, the relevance of a number of factors often referred to in literature was considered.

Success factors

Overall, the relevance of success factors mentioned in literature was confirmed by the case studies, to the extent that each of these successful banks paid significant attention to most of the issues. The following factors were confirmed by the case studies as particularly relevant. Firstly, a CHAMPION within the company who truly believes in the business case of microfinance seems to be crucial for the success of initiating a microfinance strategy. Most of the successful banks in the analysis had at least one strongly committed manager. The second vital issue is the ORGANISATIONAL STRUCTURE of the microfinance operations. Various researchers agree on the fact that the independence of the operations is

important and therefore a subsidiary or a service company is the best structure to use for a downscaler.¹ However, half of the banks operate with an internal unit, probably out of caution, so as not to spend too many resources on it, and to retain as much control as possible.

In the third place, a **LARGE BRANCH NETWORK** is vital. Micro clients often live in remote areas, and for microfinance to be sustainable large numbers of clients are necessary. Most of the successful banks in this research have one of the largest networks in their respective countries. A fourth factor often mentioned in literature is good **MICROFINANCE PERSONNEL**. Most researchers suggest hiring new personnel for microfinance operations, some even advise hiring personnel from outside the banking sector, because the operations, salaries and culture have to be very different when providing microfinance services. If the microfinance unit is staffed by the existing personnel, they will need extensive training and appropriate incentives. Also, staff evaluation, accountability, bonuses and promotions help to improve productivity and control arrears. Most banks, especially BRI-Unit Desa, have a strong focus on staff incentives.

As a fifth factor, **APPROPRIATE PRODUCTS** for micro clients are also very important to attract enough clients. Most of the downscalers offer several different (individual) loan products and

several savings products. Only three of the seven banks directly involved in microfinance offer products like insurance, certificates of deposit and money transfers in addition to loans and savings accounts. A sixth factor that seems to be contributing to success is **TECHNICAL ASSISTANCE**. In particular, the banks that were making a loss before they moved into microfinance (Equity, BRI, AgBank, and Banque du Caire) received a lot of 'soft' support from donors. All banks, except for Banco de Crédito, have received technical assistance.

Finally, a seventh group of relevant factors are **CLIENT REPAYMENT INCENTIVES**, an **APPROPRIATE MANAGEMENT INFORMATION SYSTEM** and **MARKETING OF THE MICROFINANCE PRODUCTS**.

Failure Factors

The most important failure factor identified by literature is the **CLASH OF THE TRADITIONAL BANKING CULTURE AND THE MICROFINANCE CULTURE**. Microfinance units differ from the bank's main organisation in areas such as operating and reporting procedures, compensation, and types of staff members. Tensions may arise between a microfinance unit and its parent bank, or microfinance operations may be done in a traditional banking style that is inappropriate to reach microfinance clients. Secondly, large banks have often **MORE PROBLEMS INCORPORATING MICROFINANCE OPERATIONS** than do smaller banks. This may be because in small banks it accounts for a larger part of the business and

1. Among others, Valenzuela 2001 and Young et al. 2005.

	Agricultural Bank	United Georgian Bank	BRI Unit Desa
Country	Mongolia	Georgia	Indonesia
Date of establishment	1991	1995	1895
Start of microfinance	2000	2002	1984
Products	<ul style="list-style-type: none"> • 6 Loan products • 5 Savings products • 3 Money transfer products • Certificates of Deposit 	<ul style="list-style-type: none"> • 1 Loan product • Savings products • Money transfers • Currency conversion 	<ul style="list-style-type: none"> • 1 Loan product • 1 Group lending product for farmers • 2 Current accounts • 4 Savings accounts • 4 Time deposits
Number of microfinance branches	379	3 branches 5 service centres	4,185
Organisational structure	Internal unit	Internal unit	Internal unit
Break-even	12 months	9 months	18 months
No. of savings accounts	377,424	n.a.	29,869,197
No. of loan accounts (direct or indirect)	128,227	1,048	3,100,358
Average loan balance per borrower	US\$ 382	US\$ 1,644	US\$ 541

Banco del Pichincha	Banco de Crédito de Perú (2002)	Banque du Caire	Equity Bank (2004)
Ecuador	Peru	Egypt	Kenya
1908 1999	1941 1995	1952 2000	1984 1994
<ul style="list-style-type: none"> • working capital credit 	<ul style="list-style-type: none"> • Consumer credit line • Micro enterprise credit • Credit card • Savings products • Insurances • Training and consulting 	<ul style="list-style-type: none"> • Micro-loans • Savings products 	<ul style="list-style-type: none"> • 6 Savings products • 6 Loan products
The most widespread branch network in Ecuador	The largest branch network in Peru	96	13 Branches plus 18 Mobile units
Service company	First specialised financial institution, later internal unit	Internal unit	Whole bank turned into specialised bank
18 months	n.a.	n.a.	12 months
0	n.a.	n.a.	295,457
34,477	81,700	50,000	75,000
US\$ 1,307	US\$ 1,007	US\$ 340	US\$ 472

Table 5: Retail microfinance activities by the relevant domestic mainstream banks included in this study (data from 2003 unless specified otherwise), refer to Lansbergen 2006.

receives enough attention and resources. Larger banks may have a stronger traditional banking culture, and be more bureaucratic, or less flexible. A third common reason why banks fail is UNCONTROLLED GROWTH; when the loan portfolio grows, it should be supported with appropriate systems and procedures that control arrears. A fourth risk, for microfinance operations within larger banks, is posed by ECONOMIC CRISES.

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MFIs with bank status

Regarding the MFIs with bank status (bank-MFIs), a group of 62 was selected based on the availability of information on MixMarket, a global web-based information platform dedicated to microfinance. These MFIs are located in Latin America, Asia, Eastern Europe, and Africa. The analysis done was a quantitative study to detect significant correlations between success measures (outreach and viability) and success factors identified on the basis of literature. The elements most often cited as success factors are management information systems and portfolio management, charging a high enough interest rate, turn around time between loan request and approval, loan terms, repayment frequency, target market, macroeconomic stability, branch networks, staff salary levels, productivity, client incentives and staff incentives. Unfortunately, it was not possible to analyse most of these factors quantitatively since there was insufficient information available. It also proved very hard to derive success factors from the quantitative data available. The research

question “what are the most important success factors?” therefore cannot be answered with this model.

However, the importance of a number of controlling factors taken into account, such as population density, GDP, and the organisation's age, was confirmed. The results do also suggest that the debt-to-equity ratio – the ability to attract capital – is important. The larger the debt-to-equity ratio, the larger the growth of the loan portfolio. A bank that is able to attract investors (increasing its debt), can disburse more loans and increase its loan portfolio. The debt-to-equity ratio also has a positive correlation with the return on equity of the MFI. This is a logical result, since the ratio is high when equity is relatively low. When equity is relatively low, the return on equity is also high. Finally, the results also indicate that a larger number of products offered will increase the loan portfolio.

Differences between downscaling banks and MFIs with bank status

Since MFIs and downscalers face different challenges, their success factors differ as well. The problems for the specialised microfinance banks concern mostly operational issues, consequently the success factors are quite specific (see above). For downscalers, most of the challenges concern the integration of microfinance within the bank. Success factors that flow from these challenges are the presence of a champion of microfinance in the organization, the organizational structure,

a large branch network, specialised microfinance personnel, staff incentives, appropriate products and technical assistance. Failure factors are the potential clash of the microfinance culture with that of the parent bank and uncontrolled growth of the loan portfolio (which is not supported by adequate management information systems).

Only three success factors are similar for both, namely the branch network, the staff incentives and appropriate products for the target clientele. The remaining success factors of downscalers all concern the process of downscaling, except for technical assistance. This is probably of more importance for downscalers since they have less expertise in the market segment.

Significance for international banks

Some preliminary conclusions can be drawn from this analysis with regard to the position of international commercial banks. If we look at which success factors are relevant to the downscaling domestic banks, it seems very likely that most of these will also apply to international banks. In most instances, international banks are similarly positioned as domestic commercial banks regarding the challenges they need to address, with one very notable exception.

Having an extensive local presence in the form of branch offices is a requirement that domestic banks are far more likely to meet than international banks. There appears from this analysis to be

no major advantage that international banks have over domestic commercial banks. Having better management information systems that limit the risk of uncontrolled growth seems an advantage of international banks, but this is likely to be shared to a sufficient extent by the larger domestic bank.

Under current conditions, domestic banks have a major competitive advantage over international banks, i.e., their local branch office presence. As we have seen in Part I, few international banks engage in retail microfinance. Those that do mainly operate through downscaling local banks that originally were domestic banks. Examples mentioned are Banco Real (ABN AMRO) in Brazil, Santander Banefe (Santander) in Chile and ING Vysya in India. There seem to be few major areas where domestic and international banks complement one another, since the challenges they need to address are so similar. However, to the extent that international banks do have significant branch office networks, their competitive advantage is very strong with regard to international money transfers. International banks seem particularly suited for this role, especially if they have local branch offices in both a sending and a receiving country. Citigroup, with major retail subsidiaries in the US (Citibank) and Mexico (Banamex) is a major example.

It can be assumed that the differences found between bank-MFIs and downscaling banks also applies to the relationship between bank-MFIs

and international banks. It is unclear if bank-MFIs have a major competitive advantage over international banks or vice versa, because their strengths and weaknesses are so diverse. However, there seems to be a clear scope for co-operation: the two groups can probably perform highly complementary roles. Indeed, most international banks choose to co-operate with MFIs instead of competing with them at the retail level. Through their partnerships with MFIs, international banks may successfully compete with downscaling domestic banks. Downscaling banks might address this competition by forming alliances with MFIs as well. The major Indian domestic bank ICICI is a major pioneer in this regard. ICICI has developed a partnership model for MFIs that separates the risk of the MFI from the risk inherent in its loan portfolio. It enters into contract-based permanent relationships with certain MFIs, that more or less act as the bank's agent for the microfinance retail market.²

In the more distant future, the differences between international banks, domestic downscalers, and bank MFIs are likely to decrease. Domestic banks will grow into international banks, and international banks are likely to purchase downscaling domestic banks or MFIs. In this regard, it is difficult to imagine that the involvement of international banks in microfinance will not increase in the long run.



2. Ananth 2005.

Part III

The role of government

For this study, we asked the bank representatives who were interviewed what they considered a useful role for governments to play with regard to microfinance and formal financial institutions. Governments can play two main roles with regard to microfinance: regulator of the financial sector and donor for microfinance initiatives. Banks generally believe that governments should not themselves be involved in microfinance by creating state-owned microfinance banks. It is believed that private actors can perform this role more efficiently.

Government as regulator

With regard to regulating, many bank representatives stated that governments should act as facilitators, primarily by removing tax or foreign investment constraints to the inflow of domestic and international capital, and by setting up common minimum standards or other tools for risk evaluation at MFIs. They also emphasised that as long as the sector is still in its infancy, regulators should be very careful with introducing new regulation. MFIs should be allowed to offer a wider range of products. One source mentioned that the solvency regulation for micro lending groups could be made less demanding, as group lending has a high repayment rate. At the international level, many banks also think their home country governments and international development banks can be useful by exerting pressure on host country governments to remove obstructing regulations.

Government as donor

With regard to their role as donors, governments can play a useful role by stimulating commercial banks to enter microfinance. They can do this by setting up public/private partnerships, in which governments provide guarantees or otherwise limit risks for banks that lend to microfinance institutions without a strong track record.¹ However, it is also stressed that donor governments should only play such a role for a short period and should step back after a few years. The role for donor governments is generally regarded to be a limited one, and largely useful for support to MFIs at the lower end, high-risk and high-transaction-cost side of the market. Donor policies aimed at transferring more hard currency capital to MFIs are thought by many to be undesirable, because much hard currency capital is already available and most MFIs cannot bear the related currency exchange risk. Finally, a role that is seen as a useful one for governments is that of bringing together actors in microfinance.² Governments can stimulate the exchange of knowledge and the formation of networks by organising conferences, supporting networks, and stimulating studies of and publications on current developments.

1. See also Mudde 2006.

2. See also CGAP 2004.





Conclusions

1. Research Questions

This study focused on three research questions:

- ◆ What are the current activities and future plans of global commercial banks with regard to microfinance?
- ◆ What can international commercial banks learn from domestic banks already involved in microfinance?
- 48 ◆ What do international commercial banks see as a useful role for government in helping corporations to combat poverty?

Current activities and plans

Currently, most international banks are still in the early phase of defining their microfinance strategy. In terms of financial resources allocated, involvement is small in comparison to banks' mainstream activities. International banks are only active in retail microfinance in a few cases. At the wholesale level, they mainly support MFIs with bank status or other well-established MFIs. This consists of offering financial products such as business loans and guarantees and to a lesser extent securitisation.

Mention must be made of various examples where equity stakes are taken in downscaling domestic banks and MFIs that turned into licensed banks. Furthermore, at the wholesale level various banks provide technical assistance which is considered a non-financial product.

According to many of the experts interviewed

for this study who do not represent international banks, the main contribution from international banks consists of hard currency loans whereas the main need in microfinance is in capacity building. Both in the sense of technical assistance as well as more local-currency-based retail capacity, aimed at clients from the lowest income groups. Compared with international banks, the current influence of domestic commercial banks is generally considered of more importance, although this varies greatly by country. However, this is obviously not true for countries where the main commercial domestic banks have been purchased by international banks.

Global banks have just started testing these (for them) uncharted waters of microfinance. The question is whether they will get out very soon or make their first serious attempt to learn to swim. Unfortunately, we could not obtain sufficient data to establish to what extent the current activities of international banks are profitable. In general, the respondents reported that their banks work out of commercial considerations, meaning that after an initial phase a break-even point is expected. However, all banks willing to discuss this topic stated that in the short term profitability from microfinance is insufficient to make the activity competitive with regard to traditional banking activities. They indicated that microfinance might perhaps become a niche market with competitive profit rates in ten years.

All of the banks participating in this study stated that they are in the process of expanding their involvement in microfinance, and all claimed they would remain active in microfinance, even in the longer term. Also, observers from outside the commercial sector expect that international banks will remain a factor in microfinance.

How fast the involvement of international banks will grow depends on too many factors to be credibly forecast.

Relevance of success factors for domestic banks

The analysis of success factors for domestic banks showed that international banks have a competitive disadvantage with regard to domestic banks. In retail microfinance, domestic banks tend to have the crucial advantage of branch networks. Compared to the large domestic banks, international banks probably do not have a particular advantage which can compensate for this. But MFIs with bank status have strengths and weaknesses that are largely complementary to those of the international banks.

Thus, whereas the scope for complementary relations between international and domestic regular banks is limited, international banks can provide many of the success factors needed by MFIs with bank status. At the same time, the MFIs can provide the local presence that international banks need to be able to compete with domestic banks.

The role of government

The role of host country and donor countries' governments is welcomed in specific areas, but is not regarded by most of the banks studied here as constituting a deciding factor for them. Generally, it is thought that governments can stimulate international bank involvement by removing regulatory constraints, and lowering transaction costs and risks associated with the weaker MFIs. Furthermore, governments can be very important in stimulating the exchange of experience and generating research. On the whole, however, many interviewees believe that governments should play a modest role and stay largely in the background.

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2. Key issues regarding the role of international banks in microfinance

Corporate citizenship versus commercial considerations

Banks' main motives stem from either corporate citizenship or commercial targets. Most banks seem to be following a 'dual strategy', in which they combine both types of targets; usually they cannot rely on one of these categories alone. Ignoring corporate citizenship is not possible because in the short term microfinance is less profitable than more traditional banking activities. Ignoring profit figures would result in merely token forms of involvement, not in substantial investments. Combining corporate citizenship and concrete commercial targets appears to be an effective way for many international banks to make long-

term investments in the microfinance sector.

In the future, this strategy may enable them to gradually emphasise the commercial side over the corporate citizenship side, and thus increase their commitment to microfinance activities.

50 However, other models also exist for banks to become actively involved in microfinance. Some banks may perceive concrete commercial advantages that are so compelling that it is not necessary for them to involve their corporate citizenship program. The main example of this in the study was provided by Commerzbank. This German bank invested in microfinance institutions in South-eastern Europe because it was the best option for that bank to establish the local banking support that its German client base needed. It seems likely, however, that this model is applicable only in very specific instances (for instance, in regions where regular banking institutions are missing, but where MFIs do exist).

Partnerships with successful MFIs

Both the interviews with bank representatives and the analysis of success factors for domestic banks suggest that international banks will be looking for ways to intensify their relations with the larger MFIs (which often have bank status). International banks may do this by taking equity participations or securitising loan portfolios. They can also engage in long-term relationships with preferred MFIs by supplying them with technical assistance on an ongoing basis or by making their staff and

systems available. It is conceivable that some MFIs may more or less evolve into micro-level agents for international banks. They will offer a range of products to the micro consumer that has been developed for them by an international bank. The bank may bear the main financial risks involved, while the MFI focuses on reaching new customers. This is likely to lead to increased competition between international banks for access to strong MFIs with significant retail capacities. It is also conceivable that large non-financial companies (such as in telecoms and IT) will play a role, as a result of which triangular relationships occur between these companies, MFIs and international banks.

Relevance for the development of the microfinance sector

The experts from other organisations who were interviewed were positive about the actions of leading international banks. Generally they thought that the international banks were making a useful contribution to the microfinance movement and they hoped that the banks would continue to increase their involvement. However, several respondents also noted that the high-profile external communications from the international banks in recent years did not match their still limited activities. Most experts think that domestic and not international banks currently play the central role in the process of commercialisation of microfinance. Domestic banks are thought to be better positioned to mobilise local

Conclusions

savings and to enter retail microfinance.

However, the experts also think that international banks are important with regard to bringing down the costs of microfinance, as they can help MFIs to work more efficiently. For instance, banks can support the upgrading of management information systems in MFIs or introduce methods to make labour-intensive distribution more efficient. Specifically with regard to money transfers, international banks can increase competition with the established companies in this business and thus bring consumer prices down. Aside from these specific tasks, respondents generally also say that international banks can be important for generating more public and financial support for the microfinance movement.

The KEY QUESTION with relation to international banks is whether their involvement in microfinance will lead to a substantial increase in the availability of products at lower prices for more people at the lower end of the market. Given the important role that corporate citizenship plays in the microfinance approach of most international banks, this question is as important for the banks themselves as it is for the development community. It will not be answered empirically until between five and ten years from now, but it seems certain that the international banks will not leave the stage easily.





Annex 1

Participating organisations

Focus banks	Person interviewed
ABN AMRO	Onno Mulder
Barclays Bank	Peter Kelly
Citigroup	Robert Annibale
Commerzbank	Eckard von Leesen
Credit Suisse	Arthur Vayloyan
Deutsche Bank	Asad Mahmood
HSBC Group	Jon Williams
	Rob Drewienkiewicz
ING Group	Richard Paardenkooper
	Gera Voorrips
Rabobank Group	Frank Bakx
	Toon Bullens
	Arnold Kuijpers
	Charles Ruys
Société Générale	Pascale Lacombrade
Standard Chartered Bank	Prashant Thakker

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Other organisations/persons consulted	Person interviewed
CGAP	Martin Holtmann
FMO	Els Boerhof
Goldman Sachs	Dawn Chirwa
Netherlands Microcredit Platform	Stijn Albregts
Netherlands Ministry of Foreign Affairs	Johan de Waard
Partos	Paul Mudde
Triodos Bank/CGAP	Marilou van Golstein Brouwers
Women's World Banking	Nancy Barry
	Mercedes Benavides
Former managing director, Oikocredit	Gert van Maanen

Annex 2
Synopsis of microfinance activities
by international banks included in this study

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ABN AMRO NV

Head office: Amsterdam, Netherlands

Geographical focus

Brazil, India

Product focus

Credit, technical assistance

Retail

Banco Real, a major Brazilian bank owned by ABN AMRO, created a joint venture with the American non-profit microlending organisation ACCION. This joint venture, Real Microcrédito, is 80% owned by Banco Real and 20% by ACCION. It provides credit to small entrepreneurs, such as shopkeepers and owners of hair salons, in poor areas of Brazil's main cities. Real Microcrédito started out in Sao Paolo in July 2002, by sending its micro credit representatives into the poor areas to visit informal sector entrepreneurs directly. Later on, small branch offices were established near – and subsequently in – existing Banco Real branches. The loan size is between US\$ 70 and 3,350, with an average first loan of US\$ 559. Loans are made available to micro entrepreneurs for business purposes only. By October 2005 the total number of clients was 8,000, amounting to a total portfolio of US\$ 4.8 million.

Wholesale

In August 2003, ABN AMRO India started providing credit to microfinance institutions in India. These supply credit to rural lending groups, composed of women considered to be the poorest of the poor. The women themselves decide who qualifies. Most operate in the south of India, some also in the north. By October 2005 the total amount involved was US\$ 14 million, which had been supplied to 16 MFIs, ultimately reaching 160,000 borrowers.

Other activities

ABN AMRO provides technical assistance to micro entrepreneurs in Brazil, via Real Microcrédito. The bank also provides financial advisory services to MFIs and development organisations in India. In 2005 ABN AMRO gave trainings on process management to 21 MFIs across India. For Indian MFIs the bank also developed a simple hand-held computer to be used in field visits.

Plans for the future

ABN AMRO aims to keep up its current rapid growth in microfinance activities. The goal in India is to reach one million borrowers by 2009 through MFIs.

Barclays

Head office: London, United Kingdom

Geographical focus

Africa

Product focus

Deposits

Retail

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Wholesale

In December 2005, Barclays launched a microfinance pilot in Ghana. The initiative will extend financial services to some of the least affluent in the country, such as market traders and micro-entrepreneurs who sell goods at the side of the road. To do this Barclays is connecting modern finance with Susu collection, one of Africa's most ancient forms of banking. Ghana's 4,000-strong Susu Collectors personally gather the income of their clients and return it at the end of each month, minus one day's pay. In exchange, the Susu Collectors provide greater security for their clients' money than they could otherwise achieve. Though each individual client's income is too small for 'high street' banking, collectively it amounts to a US\$ 137 million economy. With around 90% of the population in Ghana not banking, and 80% of the cash in the economy outside the mainstream financial services sector, Barclays has developed a solution that meets both its social and commercial objectives. It has created an account for Susu collectors to deposit their funds and will also provide

the collectors with loans of their own, which they can 'lend on' to their customers, helping them build their capital. Barclays is committing an amount of 2.4 billion cedis (US\$ 273,000) to fund the project; this will include educating the clients of the Susu collectors on basic financial issues. Barclays is starting by running a trial programme with 100 Susu collectors. If it is successful, they will look to roll the model out to other African countries where Barclays has a retail presence.

Other activities

Until recently the bank's financial inclusion efforts have been directed mainly in the UK, where it is the leading private sector support of credit unions. Barclays also operates a community Placement Programme, an innovative scheme supporting UK staff going from Barclays into roles within charities and community groups. Barclays provides funding for placements for a maximum of 75% of the salary of the role and usually for two years. A UK-based MFI involved in overseas microfinance has been a beneficiary of the scheme.

Plans for the future

A coherent, centrally co-ordinated microfinance policy for overseas countries is now being developed. The microfinance activities of Barclays will expand in the coming years. The bank will use its local presence to support MFIs through the input of local staff and grants, and by product development.

Citigroup

Head office: New York, United States of America

Geographical focus

Global, More than 20 countries.

Product focus

Capital markets, wholesale finance, individual credit, savings, remittances, insurance, technical assistance

Retail

In India, Citigroup's subsidiary Citibank provides micro loans, where it takes full credit risk, under a loan agency agreement with MFIs and, in Mexico, under its own brand name Banamex offers insurance (over 50,000 clients in Dec. 2005 and rising to 400,000 in 2006) and savings products to (approx. 40,000) microfinance clients.

Wholesale

Citigroup works with many MFIs as partners. In most countries where it has microfinance activities Citigroup offers wholesale microfinance loans to MFIs and Citigroup also lends locally with and for a number of microfinance investors, funds and networks. Citigroup also has partnership arrangements with MFIs as a result of which the MFIs act as agents for Citigroup to provide its products to end users. The MFIs use their expertise to keep costs as low as possible and retain the primary customer relationships.

Other activities

Citigroup has two MF pillars. Citigroup's Microfinance Group has a commercial focus and works with Citigroup's business, product and country organizations to provide MFIs with access to its banking and insurance services, as well as access to local capital markets. This includes foreign exchange hedging, securitisation of microfinance loans (in progress), local private placements and bond issues, direct and co-financing and cash management. Citigroup has been linking other corporate, institutional and private banking clients with the microfinance sector. Citigroup and Banco Solidario (Ecuador) have partnered on a remittance program which will extend other banking services to remitters and beneficiaries through their respective institutions.

Citigroup Foundation is a US non-profit organisation that aims to fight poverty. It has been a leading supporter of Microfinance international and national networks, as well as MFIs for over 30 years, providing grants for financial education programs, capacity and management development, etc.

The Foundation and Citigroup's Global Volunteering Program helps Citibank employees to do volunteer work for MFIs, all from a philanthropic perspective.

Commerzbank AG

Head office: Frankfurt am Main, Germany

Geographical focus

Central and South-eastern Europe

Product focus

Credit, savings, money transfers

Retail

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Other activities

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Plans for the future

The ProCredit Banks are growing very rapidly. They are proof of a successful, tried and tested public/private partnership in microfinance. Commerzbank intends to keep its involvement in these banks.

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Wholesale

Since 2000 Commerzbank has held 15-20% equity stakes in the ProCredit Banks of Kosovo, Serbia, Albania, Bulgaria, Romania, Bosnia-Herzegovina and a small stake in ProCredit Bank Georgia. Commerzbank is the only commercial German bank investing in microfinance banks. These ProCredit Banks have nation-wide branch networks and focus on providing loans to micro, small and medium-sized enterprises, which result in an average loan size of about US\$ 6,250 (depending on the country). The banks are operated on a non-subsidised, fully commercial basis by the German consulting firm IPC, and are linked to the German-based ProCredit Holding as the majority shareholder. The involvement of Commerzbank is aimed at supporting the building up of an SME sector in the respective countries and also at servicing its German clients (so-called Mittelstand or SME firms) with activities in Central and South-Eastern Europe.

Credit Suisse

Head office: Zurich, Switzerland

Geographical focus

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Product focus

Credit

Retail

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Wholesale

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Other activities

Credit Suisse is a co-founder of ResponsAbility, an organization in which several Swiss banks work together and share their microfinance activities. These activities consist of providing loans to MFIs and managing a microfinance investment fund. Partners of ResponsAbility include BlueOrchard, IPC/ ProCredit, FINCA International, Symbiotics, Opportunity International and PlaNet Finance.

Plans for the future

Credit Suisse encourages private banking clients to invest a small portion of their portfolio in microfinance funds.

Deutsche Bank AG

Head office: Frankfurt am Main, Germany

Geographical focus

Global

Product focus

Credit

Retail

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60

Wholesale

Deutsche Bank was the first global bank to start a microfinance fund eight years ago in 1998. It now has three funds that are aimed at servicing microfinance institutions globally:

1. DB Microfinance Start-Up Fund (assets US\$1 million), launched in 2005 to support MFIs in the earliest phase of their development by complementing local private sector stakeholders. Loan sizes \$25,000-100,000.
2. DB Microcredit Development Fund (assets US\$ 4 million), launched in 1998 and currently maintaining 40 relationships in 23 countries. Provides foreign currency loans for MFIs to leverage local currency loans. Loan sizes \$50,000-250,000.

3. Global Commercial Microfinance Consortium (assets US\$ 75 million), launched in 2005 in a unique partnership of 13 institutional investors and three leading development agencies and venture philanthropists. The commercial institutional investors are protected through a 40% equity and guarantee tranche provided mainly by development agencies. The fund offers financing in local currency to microfinance institutions worldwide. Products offered include co-lending with local commercial banks, deposit structures with local banks, loan guarantees, partially subordinated loans, letters of credit, and credit default swaps. Loan sizes have a range of US\$ 250,000 – 4 million.

Other activities

Deutsche Bank maintains various other activities in microfinance, such as being a member institution of the WWB Global Network for Banking Innovation in Microfinance, and a sponsor of MIX MARKET (a web-based microfinance platform).

Plans for the future

Deutsche Bank will continue to grow in microfinance and build new relationships with MFIs worldwide. It sees its role as an innovator. In the long term it wants to retain its position as a leader in microfinance among the international banks.

HSBC

Head office: London, United Kingdom

Geographical focus

Brazil, India, Indonesia, Philippines, Russia, USA

Product focus

Credit, remittances

Retail

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Wholesale

HSBC is piloting a number of approaches to microfinance around the world and is currently working with local microfinance organisations in Brazil, India, Mexico, the Philippines and Russia. These projects vary from wholesale lending to project support. The amount of capital involved is less than US\$ 62.5 million.

Other activities

In early 2005, HSBC hosted a United Nations discussion forum on microfinance to address the issues of financial services provision to people who are too poor to qualify for traditional banking services. The forum was held at the Group headquarters in London, with microfinance experts from non-governmental organisations, charities and commercial enterprises in the UK in attendance. It was one of a series of international forums organised by the UN as part of the first officially designated Year of Micro-credit. Opportunity International UK (an international microfinance body) and HSBC are piloting the Opportunity Card in partnership with three Philippine MFIs. This is a remittance product designed to help Philippine migrant workers in the USA send the money they earn abroad back to their families in the Philippines more cheaply. If this pilot is successful, the project will be rolled out in other remittance channels.

Plans for the future

The group's current approach is to engage with the microfinance sector on a commercially viable and sustainable basis, whilst not losing sight of its CSR dimension. Microfinance is to be viewed as a business, not as philanthropy. HSBC is keen to operate in areas of high social impact; although prepared for lower commercial returns, in view of favourable delinquency rates it is clear that this should be a commercially viable venture. Key to HSBC microfinance strategy will be the need to leverage their strengths and engage with partners rather than try and build expertise/capacity quickly in the short/medium term. While keen to engage in the sector, HSBC has no plans to shift its involvement in Microfinance from wholesale to retail. The Group is currently working on a business development plan for microfinance due for completion in early 2006, with a view to develop a framework for engaging more closely in the microfinance sector with a combination of capital and capacity building, incorporating remittance products and potentially microinsurance. HSBC wants to grow its microfinance activities. For 2006, HSBC is looking to increase its funding activities in the sector, both through loans and securitisation; consider offering microfinance funds to investors; expand micro remittances; and consider microinsurance. In the medium term, it is also receptive to the idea of taking small equity participations in MFIs. Furthermore they plan to engage more closely with MFIs, offering the possibility of technical support and capacity building as well as capital.

ING Group NV

Head office: Amsterdam, Netherlands

Geographical focus

Global, India, Eastern Europe

Product focus

Credit, savings, technical assistance

Retail

62

ING Vysya Bank Ltd, an Indian bank, provides loans to self-help groups in villages, reaching 43,500 persons. By December 2005, US\$ 3.4 million in loans had been distributed and US\$ 2.6 million micro deposits (August 2004 figure) were collected through this channel.

Wholesale

ING Vysya also provides loans to MFIs in India. By November 2005 the amount involved was US\$ 11.5 million, reaching 82,600 persons. ING wholesale / Green finance invested US\$ 16.9 million in microfinance institutions in Eastern Europe and India (partly through ING Vysya).

Other activities

ING has set up ING Microfinance Support, a programme based in the Netherlands and aimed at raising awareness of microfinance and giving Dutch employees of the Group

the opportunity to participate in microfinance efforts. Three thousand employees joined the special Network and may be active in awareness-raising activities for microfinance, as well as by providing technical assistance to MFIs or by investing in Microcredit funds. Since 2004, ING has had an alliance with Oikocredit, an international organisation based in the Netherlands that supports and invests in MFIs. Under this agreement, these MFIs are entitled to request technical assistance from ING. In 2004, 16 projects were executed in the Netherlands and in various emerging markets (Mexico, Montenegro, Nicaragua, Philippines, Russia, Serbia and Sierra Leone). ING also partners with the UN Capital Development Fund (UNCDF). It sponsored the 2005 United Nations Year of Microcredit and provides Technical Assistance to UNCDF microfinance partners.

Plans for the future

ING plans to increase both its retail activities in India and its wholesale activities in various countries. Moreover, the Group considers new activities in microfinance products other than credit. In 2006, ING will expand its technical assistance efforts, aiming to assist 25 MFIs. Furthermore, it will seek other partners to co-operate with besides Oikocredit and UNCDF.

Sources: authors' interview with Gera Voorrips and Richard Paardenkooper; http://www.ing.com/group/showdoc.jsp?docid=105102_EN&menopt=ivr%7Cpub%7Carf%7C004 (30 Nov. 2005); <http://www.ingvysyabank.com/> (30 Nov. 2005); ING Microfinance Support n.d.; Van Teeffelen 2005.

Since 2002, ING Group has had a 44% stake in and management control of ING Vysya Bank.

Rabobank Group

Head office: Utrecht, Netherlands

Geographical focus

Global

Product focus

Credit, savings, insurance, technical assistance

Retail

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Wholesale

Rabobank International Advisory Services (RIAS) provides management advice and technical assistance in rural banking and other financial institutions worldwide, on commercial terms.

Rabo Financial Institutions Development (RFID) has been established recently to execute a new initiative of Rabobank to acquire (minority stake) and develop nationwide financial institutions in 15 developing countries. These banks will be supported by Rabobank through technical assistance and management support. Projects realised and in the pipeline are located in Zambia, Tanzania, Mozambique, China, Paraguay and Peru.

Other activities

Rabobank Foundation provides grants, local currency financing and technical assistance to a large number of smaller MFIs and member-based organisations worldwide with a main focus on rural co-operative institutions. This programme is development-oriented, non-commercial and directed predominantly at beginning MFIs. Rabobank Foundation presently works in 45 low-income countries.

Interpolis is initiator of the not-for-profit organisation Micro Insurance Association Netherlands (MIAN). MIAN was founded in 2004 as a volunteer organisation to provide technical assistance for co-operative insurance structures in developing countries. MIAN currently has projects in the Philippines, Sri Lanka, Nepal, India and Cambodia.

Plans for the future

Under RFID, investment in rural banks will be expanded to a total of 15.

Société Générale

Head office: Paris, France

Geographical focus

Countries outside of France where Société Générale is present through retail banking activities

Product focus

Credit

Retail

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Wholesale

Société Générale is active in wholesale lending in Jordan, Morocco, Tunisia, Benin, Burkina Faso, Ghana, Madagascar, Senegal, Russia and Rumania. Société Générale is the financial partner of one or more MFI's in those countries by providing them loans on commercial terms. For example, they have 4 MFI customers in Benin and 7 in Morocco. The total amount of money involved in microfinance ranges between US\$ 62.5 and US\$ 125 million (2005).

Other activities

In July 2005, Société Générale supported the creation of MicroCred (a PlaNet Bank project) by participating in its capital with an investment of US\$ 3.75 million. MicroCred will be creating or investing in 15 MFIs over five years, through the international network of PlaNet Finance.

Plans for the future

Société Générale aims to increase its microfinance activities and will retain its focus on the countries where it maintains retail banking activities. For 2006, SG is planning to take equity participations in MFIs. If they decide to participate they will take a minority stake ranging from 10 to 20%.

Standard Chartered PLC

Head office: London, United Kingdom

Geographical focus

India, Nepal, Bangladesh, Pakistan, Ghana

Product focus

Credit

Retail

Standard Chartered Bank (SCB) in Nepal lends directly to small farmers for purchase of inputs for growing tobacco. This arrangement is backed by confirmed purchasing by the main tobacco company. Similar loans have been extended to farmers growing Lokta (traditional hand-made paper) for exports.

Wholesale

In India, Standard Chartered provides wholesale lending to three MFIs, with another four about to be added. The bank has an exposure of \$3.5 million in this country and is looking at growing this portfolio to \$10 million by early February 2006. In Bangladesh, the bank offers short-term loans and guarantee products to Bangladesh's leading MFIs. SCB also offers products to MFIs in Pakistan (Repo and PFE limits) and Africa (Cross Currency Swaps, OD facilities and FX settlements).

Other activities

In Nepal, SCB has an equity stake in the Rural Microfinance Development Centre, an apex MFI. In Pakistan, SCB has an \$830,000 stake in Khushali Bank. Khushali Bank is a pure microfinance bank and has disbursed 100,000 micro loans to date.

Plans for the future

Standard Chartered began developing a formal microfinance programme in 2004. This programme is still in preparation. The bank's microfinance initiative is an international initiative currently being piloted in four countries: India (including Nepal), Pakistan, Ghana and Bangladesh in Phase I. In Phase II, the bank may explore opportunities in the Philippines, Tanzania and Zambia. The microfinance industry in many countries is still evolving and few players have a legal structure that would permit equity participation. As the industry matures, SCB may consider equity participation if and when opportunities present themselves.

SCB hosted a day-long forum in India entitled 'Banking the Missing Middle', attended by the Finance Minister as well as senior delegates from the EU delegation. The purpose of the forum was to develop creative responses to bank a segment that exists above microfinance institutions and below SMEs.



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