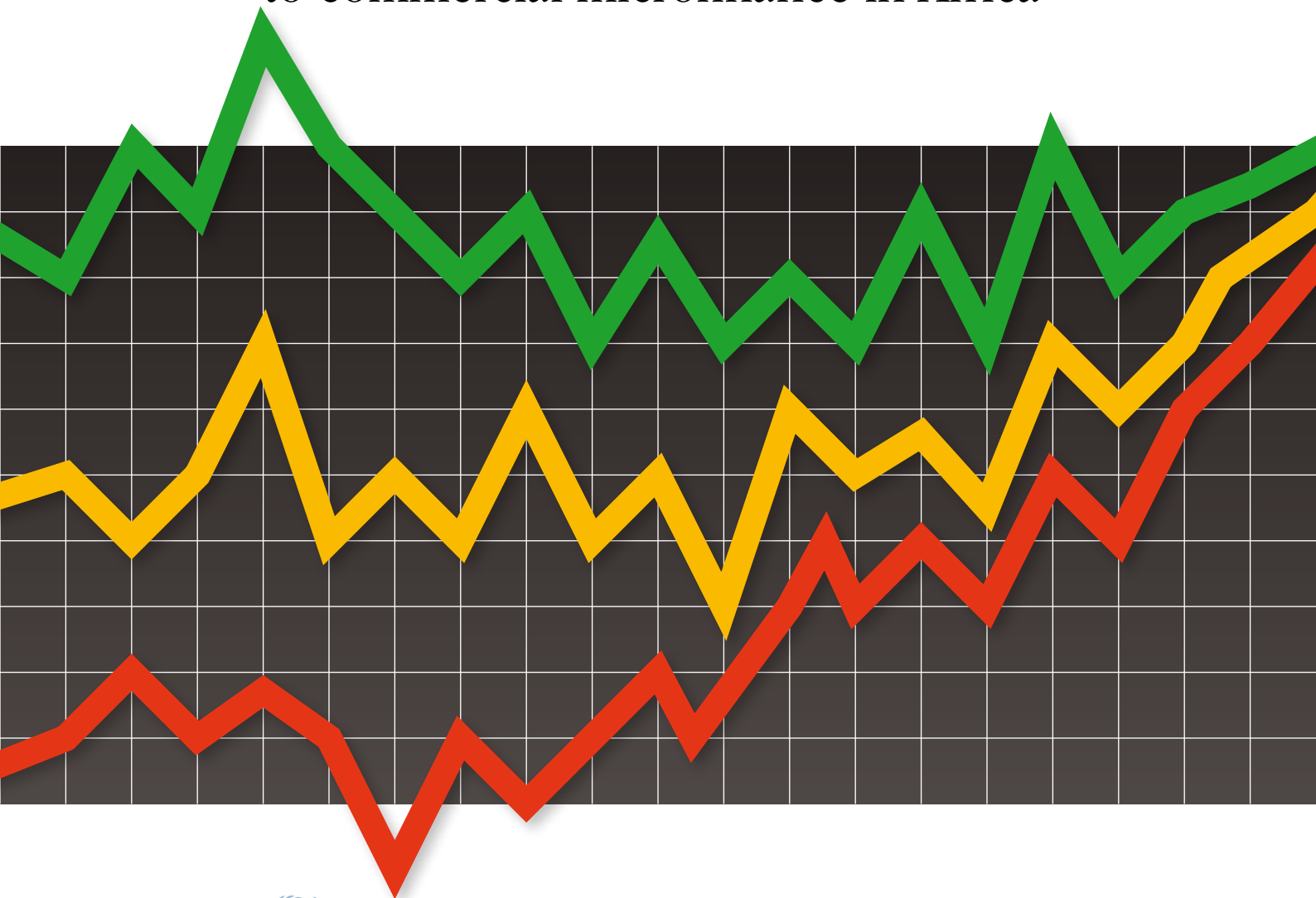


Narrowing the gap

A survey of the barriers and drivers to commercial microfinance in Africa



UNEP **Finance Initiative**
Innovative financing for sustainability

Narrowing the gap

A survey of the barriers and drivers
to commercial microfinance in Africa

A study by the United Nations Environment Programme Finance Initiative
for the Bill & Melinda Gates Foundation



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Foreword



Narrowing the gap is a most welcome addition to our collective understanding of the drivers and barriers to commercial microfinance in Africa. The survey, with input from a wide range of investors and specialists from microfinance institutions (MFIs), casts a bright light on the realities of efforts to create sustainable livelihoods across the continent. UNEP Finance Initiative is deeply indebted to those who have so generously supported development of this survey.

The background to the survey provides a fascinating insight into the centuries long effort to drive greater financial security for Africans through microfinance-like initiatives as far back as the 17th century. We are also brought right up to date in terms of the emergence of a vibrant new community since the turn of the Millennium engaged in work to accelerate the impact of MFIs in Africa and to bring microfinance to a new scale.

The challenges captured in the survey are significant and yet, the promise exists of a growing consensus across MFI stakeholders of the commonly understood drivers and barriers. Access to longer term finance and investment – on terms that work for a diverse range of African MFIs – are essential if the benefits of microfinance are to spread across the continent. Furthermore, the need to extend access to even the most basic financial services, and the supporting knowledge for effective use of such services is pivotal.

It is clear that the relatively low take up by investors willing to support commercial microfinance in Africa remains a systemic issue. This survey provides clear insights for investors, the policy community and the growing network of African MFIs determined to tackle the issues holding back scale up of microfinance.

As we prepare for the 2008 Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, later this year in Doha, *Narrowing the gap* will provide an invaluable aid for those seeking to boost the benefits of microfinance for many more millions of people across Africa.

Paul Clements-Hunt

Head
UNEP Finance Initiative
May 2008

Message from Chairs

Commercial microfinance in Africa can play a critical role in sustainable growth. The benefits of microfinance are evidenced by millions of microentrepreneurs around the world who are able to invest in their businesses and multiply their incomes for generations to come. Yet, despite this, few commercial sources are investing in the African microfinance sector.

As part of our mandate to support sustainable banking practices in Africa, the United Nations Environment Programme Finance Initiative (UNEP FI) African Task Force (ATF) commissioned this study to explore the issue of microfinance in sub-Saharan Africa. The report looks at reasons for the lack of commercial microfinance in Africa and suggests drivers that could unlock investment in this critical area. Its aim is to provide practical guidance to African microfinance institutions (MFIs), investors and supporting stakeholders to attract and facilitate an environment for sustainable commercial microfinance in Africa.

More than 30 African MFIs, investors, and other stakeholders were surveyed on barriers to microfinance and mechanisms to develop a commercial microfinance approach within the context of sustainable social and environmental development. We are convinced this report will be an important addition to the excellent efforts by numerous stakeholders to facilitate sustainable commercial microfinance in Africa. We trust this contribution will add value to the efforts of those committed to improving the livelihoods of vulnerable people in Africa and the environment they live in.



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Objectives

Note to readers: This section outlines the objectives, structure and intended audience of this report.

Africa is home to some of the lowest per capita income countries in the world, with 300 million people living on less than a dollar per day.¹ Over the last decade human development has improved across all developing country regions with the exception of sub-Saharan Africa². Many areas are affected by political instability and a severe lack of even the most basic affordable necessities: health services, education, clean water, shelter and security. In these areas access to even small amounts of capital and basic financial services in the form of microcredit³ and microfinance⁴ could support millions in their efforts to improve their livelihoods.

Microfinance is evolving from a sector dominated by non-commercial sources of finance, such as development agencies and foundations, to one increasingly attracting private sector or commercial sources of finance. Many view commercial microfinance as a unique solution to build financially sustainable microfinance institutions (MFIs)⁵ and mainstream microfinance services. Supporters argue that microfinance that is less dependent on subsidized financing could be more market-driven and efficient, and will attract further private sector actors such as local or foreign commercial banks and investors.

In Africa, commercial microfinance is a significantly less prominent trend than in Asia and Latin America. As an indicator, Africa attracts a relatively low share of foreign quasi-commercial investment for microfinance – 7% for example compared to 28% for Latin America and the Caribbean⁶. Figures for purely commercial investment in the microfinance sector in Africa are predictably lower. By 2006, MFIs on average increased commercial funds for their loan portfolios by over 70%. This holds true for MFIs globally except for sub-Saharan Africa.⁷ In an effort to promote greater access to finance, the objective of this report is to identify the barriers and drivers of commercial microfinance in Africa. In particular it seeks to answer the following questions:

- What are the current barriers to commercial investment flows to MFIs in Africa?
- What are the main reasons for these barriers?
- What are the drivers to facilitate investment flows to commercial microfinance activities in Africa?
- How to ensure the long term financial sustainability of MFIs in Africa?
- Is environmental and social sustainability a potential driver of commercial microfinance, and can these issues be integrated into commercial microfinance activities?

1 Source: The BBC News, http://news.bbc.co.uk/2/hi/uk_news/6086088.stm

2 United Nations Development Programme (UNDP): Human Development Report 2005: International cooperation at a crossroads: Aid, trade and security in an unequal world, 2005

3 Microcredit refers to a small loan to a client made by a bank or other institution. Source: The Microfinance Gateway, <http://www.microfinancegateway.com>

4 Microfinance refers to loans, savings, insurance, transfer services and other financial products targeted at low-income clients. Source: Idem

5 A microfinance institution (MFI) is an organization that offers financial services to low income populations. Almost all of these offer microcredit and only take back small amounts of savings from their own borrowers, not from the general public. Within the microfinance industry, the term MFI has come to refer to a wide range of organizations dedicated to providing these services: Non governmental organizations (NGOs), credit unions, cooperatives, private commercial banks and non-bank financial institutions. Source: Idem

6 Consultative Group to Assist the Poor (CGAP): Foreign Investment in Microfinance: Debt and Equity from Quasi-Commercial Investors, Jan. 2004

7 Microfinance Information eXchange (MIX): The MicroBanking Bulletin, Autumn 2007

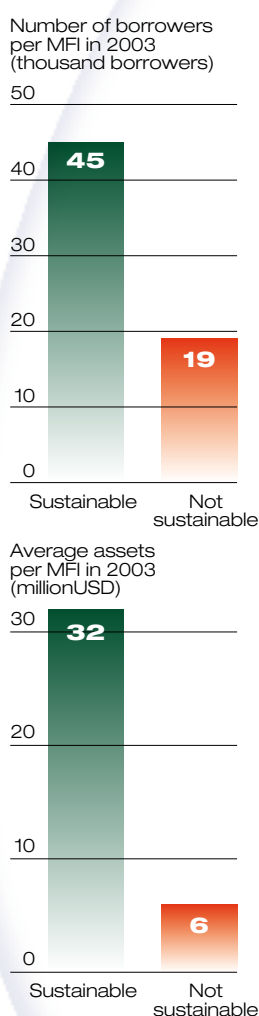
This report is intended for investors, financial institutions and policy makers, and is structured in the following manner:

- **Microfinance in Africa:** This section provides background information on the evolution and characteristics of microfinance and microfinance institutions (MFIs) in Africa. Pages 10 to 13
- **Survey Methodology:** This section details the methodology used to identify reasons for the current lack of commercial microfinance in Africa and potential drivers for more investment. Page 14
- **Survey Findings:** This section presents survey findings. Pages 15 to 26. When suitable, findings are broken down to reflect variations in stakeholder as well as regional perspectives. Findings in this section are presented under the following headings:
 - Barriers to commercial microfinance in Africa. Pages 15 to 18
 - Barriers to long term financial sustainability of MFIs in Africa. Pages 18 to 19
 - Measures to facilitate commercial microfinance in Africa. Pages 20 to 22
 - Measures to ensure long term financial sustainability of MFIs in Africa. Pages 23 to 24
 - Environmental and social sustainability. Pages 25 to 26

Microfinance in Africa

Note to readers: This section provides background information on the evolution and characteristics of microfinance and microfinance institutions (MFIs) in Africa.

Figure 1
Sustainable versus non-sustainable MFIs



Microfinance activities in Africa can be traced to informal saving and credit groups known as Tontines⁸ in the 17th Century. The first formal MFIs on the continent were established in the 1960s in West African countries like the Ivory Coast, Togo, Burkina Faso and Benin⁹. In sub-Saharan Africa, MFIs haven't been established for nearly as long and have only recently seen a growth in numbers, over half have been operating since 1998, and a number of them have doubled between 2001 and 2003. The highest concentration of MFIs in Africa can be found in countries where outreach of formal financial systems are limited¹⁰ and concentrations are often found in areas where there is a gradually stabilizing political and economic environment, a thriving informal sector, and a strong demand for access to financial services¹¹. In comparison to other regions of the world, the African microfinance sector is often referred to as middle-aged, with African MFIs having a median age of 8 years, which is younger than counterparts in Latin America and Asia, but older than those in Europe and Central Asia¹².

Traditionally, microfinance was offered by non-governmental organizations (NGOs), in which there are thousands in Africa with this status. For those with an NGO status, it takes a tremendous effort in drive and professionalism to convert into a commercially driven MFI, in which only a few have had success in doing so. Donors began to lay the groundwork for the transformation of MFIs into long term financially sustainable programs in the mid 1990s with an objective to deliver financial services to the economically active poor on a large scale through competing financially self-sufficient institutions. This initiative spurred the widely known "microfinance revolution" and has been defined by a shift from less reliable provision of subsidized finance to cost-effective and profit-making financing¹³ capable of achieving the long-term sustainability and expansion of products and services to the marginalized poor.

According to a 2006 study by the Microfinance Information eXchange, (MIX)¹⁴ MFIs not only have a high potential to become profitable and financially sustainable, but those that become so have more assets and capacity to service more borrowers than non financially sustainable ones.

The same study finds that of the newly established MFIs surveyed, half became profitable within their first three years of operation, and only a quarter took more than 6 years to become profitable. These successes not only provide an excellent business case for microfinance, but have also had positive effects of more efficiency, lower interest rates, higher levels of technology innovation, and product diversification – all factors that have defined the microfinance success stories such as found in India and Latin America today.

8 A Neapolitan banker named Lorenzo di Tonti invented this concept in France.

9 AfriCap: Financing MFI Growth in Africa through Commercial Capital: A Seminar Report, 2003

10 International Monetary Fund (IMF): Bankable Assets, 2006

11 Microfinance Information eXchange (MIX) : Overview of the Outreach and Financial Performance of Microfinance Institutions in Africa, 2005

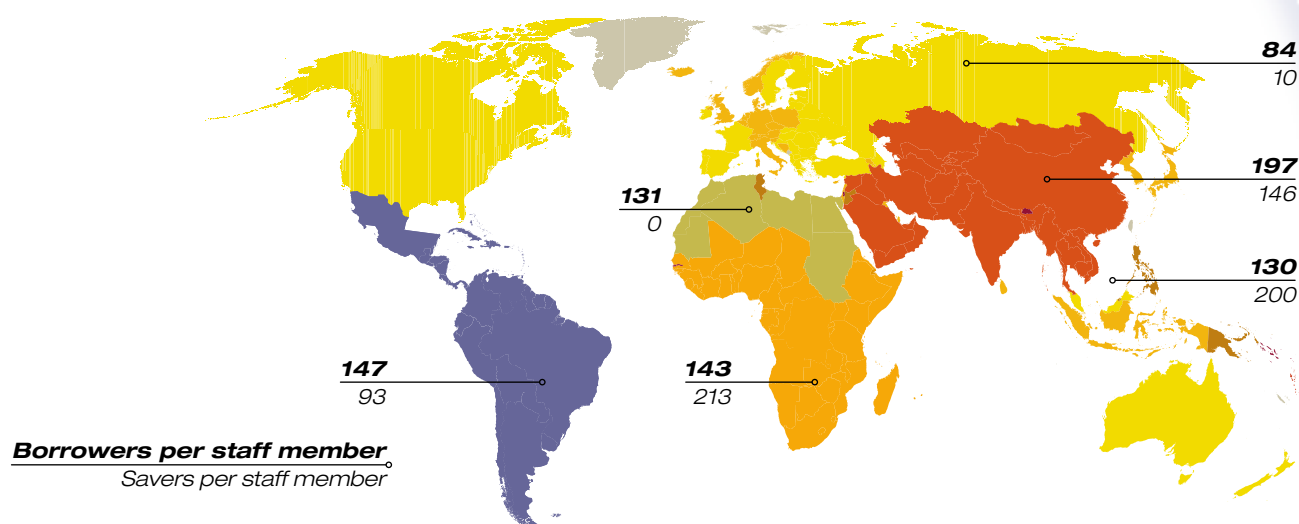
12 Microfinance Information eXchange (MIX): Benchmarking African Microfinance, 2006

13 Journal of International Development: The impact of microfinance institutions in local financial markets: a case study from Kenya, 16 (3), 467-501, Susan Johnson, 2004

14 Microfinance Information eXchange (MIX) : Microfinance Institutions in Developing Countries – A view of the Landscape, 2006

According to MIX, Africa has the potential to become a microfinance success story itself. MFIs on the continent boast a higher portfolio quality than other counterparts around the world¹⁵. In addition many have a focus on savers as opposed to borrowers, a unique feature when compared to MFIs in other continents that could potentially provide a strong capital and market base¹⁶. And finally, African MFIs are among the most productive, Figure Two below measures productivity by combining the number of borrowers per staff member, combined with outreach level, and efficiency – showing the potential to maximize services with the use of only minimal resources.

Figure 2 Borrowers and savers / Staff members



As the African microfinance industry matures, MFIs will increasingly require access to funding and investments. In the long term, it is predicted that sufficient amounts of donor funding will no longer be available to finance this sector thus highlighting the need for more commercial sources of investment in MFIs. Despite the industry's positive characteristics such as savings mobilization and high productivity, this alone will not fill the need for the financing and capital requirements needed by the African microfinance sector in the long term. While overall African MFIs are not as mature as those elsewhere, many are approaching later phases of development that are defined by a need for increasing amounts of commercial capital¹⁷.

Commercial microfinance funding is often sourced through institutional investor and high net worth individual investments in microfinance funds and broader socially responsible investment funds¹⁸. Private sector capital is often accompanied by donor grants in pooled equity or debt ventures. These ventures are more attractive to private sector investors because they offer a range of risk tranches. Private sector investors are able to finance tranches that offer acceptable levels of risk, while donors finance the other tranches. These ventures offer good opportunities to involve risk adverse private sector investors in microfinance. Another driver of the growth of the microfinance sector comes from commercial banks downscaling and extending their clients to small and medium enterprises (SMEs) or even microenterprises.

15 Microfinance Information eXchange (MIX): Overview of the Outreach and Financial Performance of Microfinance Institutions in Africa, 2005

16 Idem

17 Four broad stages of microfinance development have been identified: start-up phase, expansion phase, consolidation phase, and integration phase. It is during the latter two phases in which the MFI traditionally would seek private sources of investments. The final or integration phase is usually characterized by the disappearance of subsidies, the commercialization or transformation of MFIs into a regulated financial institution, and the ability to collect deposits from the public to finance its own growth and operations.

18 These sources have a double-bottom line expectation of both social and economic return.

Despite growth in many regions of Africa, commercial microfinance is relatively sparse and investors have adopted a “wait and see approach” to test if the microfinance sector is indeed a viable opportunity. In addition client outreach remains modest^{19 20}. In sub-Saharan Africa, less than 2 out of 100 individuals on average maintain an account with an MFI. In North Africa, only 5% of those seeking microfinance receive it, and of those that can access microcredit, only 7% of the total financing needed is actually provided²¹.

Box One and Two below illustrate examples of commercial microfinance ventures in Africa.

Box One: MicroVest and Calvert Foundation Invest in African MFI

MicroVest and Calvert Foundation announced their first investment of US\$ 1.5 million in an African MFI in July 2007. The investment was made in the Ghanaian MFI, Sinapi Aba Trust (SAT). SAT is the second-largest non-bank MFI in Ghana in terms of client outreach (52,000 clients and 18 branches) and third-largest in the country with a loan portfolio of US\$ 8.5 million (with less than 2% portfolio at risk), and a growth rate of 150%. MicroVest is a global microfinance investor in developing country MFIs with assets over US\$ 64 million. Its core fund is a private equity fund of US\$ 25million that invests in 18 MFIs in 13 developing countries. Calvert Foundation is a non-profit with an aim to remove barriers by creating investment products that blend both financial and social returns. Calvert Foundation’s US\$ 150 million in assets are used as investment capital, as opposed to subsidies, enabling MFIs to achieve sustainable scalable models.

MicroVest acts as the servicing agent for a syndicated, two-year loan of US\$ 1 million, while Calvert Foundation loaned US\$ 0.5 million directly to SAT. This is the largest loan received by SAT from international, commercial sources of funding. According to SAT CEO Anthony Fosu, the funds will help scale up outreach by providing micro-loans to an additional 50,000 disadvantaged entrepreneurs who otherwise would not have access to financial services. MicroVest have been interested in investing in Africa for a number of years and have noted several mature and financially sustainable MFIs that are ready to move on from subsidized to commercial sources of funding. The SAT opportunity presents a good risk return potential for the MicroVest portfolio and may pave the way for further future investments in Africa.

Both MicroVest and Calvert Foundation view this initial investment as a stepping stone to moving deeper into the region and hope other global investors follow suit.

Source: PRWeb: First Direct Microfinance Investment in Africa for MicroVest and Calvert Foundation, July 5, 2007

19 Client outreach refers to extending microfinance services to those who would otherwise be underserved by financial institutions. In terms of breadth, outreach can be measured by the number of clients served and the volume of services. In terms of depth, outreach can be measured by the socio-economic level of clients of which the MFI serves.

20 According to the MIX study “Overview of the Outreach and Financial Performance of Microfinance Institutions in Africa” (2005), which surveyed 163 sub-Saharan African MFIs, by the end of 2003, 57% of MFIs were conceived over the past eight years, while 45% were created over the past four years.

21 Al-Hayat: Greater Middle East Partnership, 2004.

Box Two: AfriCap Microfinance Fund The First African Private Equity Fund for MFIs

AfriCap Microfinance Fund began in 2001 when commercial microfinance started making its first appearances in Africa. At its start, the Fund was supported by development finance organisations and NGOs with the aim of paving the way for private financing, and by providing private equity, thereby promoting governance and best practices in the microfinance sector. Today, the Fund boasts a growing network of leading MFIs in their portfolio and is one of the most successful private equity funds in Africa.

With over 13 MFI investments across Africa, and an average internal rate of return (IRR) of over 30%, the Fund recently completed its second round of investment raising the company's capital to USD 50 million. An example of the Fund's success is its investment in Equity Bank Ltd., Kenya, which boasts 20% of the market share and has the most clients of any financial institution in Kenya. This MFI recently converted into a bank and is the first African MFI to have an Initial Public Offering (IPO). This was AfriCap's first investment and it still continues to grow. AfriCap would like to extend the portfolio to include other investment opportunities in Angola, Benin, Botswana, Burkina Faso, Cameroon, Ivory Coast, Kenya, South Africa, Tanzania, Uganda and Zambia. See the table below for AfriCap Investments and Shareholders at 2007:

Institution Name	Country	Instrument(s)	Status of investment
Equity Bank	Kenya	Equity	Partial exit (50%)
First Allied Savings and Loans	Ghana	Equity	Full exit
Pride Tanzania	Tanzania	Convertible Loan	Terminated at maturity
Pride Uganda	Uganda	Convertible Loan	Terminated at maturity
Access Madagascar	Madagascar	Equity	Current
CAP Microfinance	Senegal	Equity	Current
Opportunity International Bank Malawi	Malawi	Equity	Current
Quality Finance International	Egypt	Preference Shares	Current
Socremo Banco de Microfinanças	Mozambique	Equity/Convertible Loan	Current
Susu Microfinance Bank	Nigeria	Equity	Current
Union Trust Bank	Sierra Leone	Preference Shares	Current
Wizzit Bank	South Africa	Equity	Current
Women's World Banking	Ghana	Equity	Current

Shareholder	%	Shareholder	%
European Investment Bank	14.6%	AfriCap Sweden	4.2%
Nordic Microcap	12.2%	Gray Ghost Investment Fund	4.1%
Blue Orchard Private Equity Fund	10.2%	IFC	3.3%
FMO	9.6%	Hivos-Triodos	1.9%
NorFund	6.1%	Accion International	1.3%
SwedFund	6.1%	Calvert	0.4%
FinFund	6.1%	Other (including Management)	14.7%
Calmeadow	5.3%		

Aside from the Fund, AfriCap manages a grant fund, the Technical Services Facility (TSF), which complements its investments by providing technical assistance to build capacities of its portfolio companies, which is structured in the following manner:



Sources: AfriCap Microfinance Fund, <http://www.africapfund.com/site/>
AfriCap, 2004 Annual Report

Survey methodology

Note to readers: This section details the methodology used to identify reasons for the current lack of commercial microfinance in Africa and potential measures for more investment.

Our findings are survey based. In an effort to ensure an appropriate format, the survey was developed in consultation with a specially formed Advisory Board of microfinance experts. The Steering Committee also played a broader role in drafting structure and content of this report. Members of the board are listed below.

Association pour la Promotion et l'Appui au Développement de MicroEntreprises (PADME)
Blue Orchard Finance S.A.
Citi South Africa
Equity Bank Kenya
Financial Access Initiative
KfW Group
MicroVest L.P.
ResponsAbility
The Hivos-Triodos Fund

Open-ended questions were favoured in an effort to ensure the results were unbiased. Survey participants included commercial banks, African microfinance institutions (MFIs), microfinance fund managers, MFI analysts, institutional investors, development agencies and foundations. More than 30 institutions participated²². The survey aimed to capture the broadest range of relevant perspectives and included a common set of questions structured into the following key areas:

- **Barriers to commercial microfinance in Africa:** Participants were asked to describe the most important barriers that prevent African MFIs from accessing commercial investment. A list of potential barriers to long term financial sustainability was also provided and participants were asked to rate items in terms of importance.²³ The items listed included institutional issues, financial issues and other external issues.
- **Steps to overcome barriers to commercial microfinance in Africa:** Participants were asked to describe the most successful measures African MFIs can take to access commercial investment. In addition, they were asked what measures could be taken to ensure the long-term financial sustainability of African MFIs.
- **Environmental and social issues:** Participants were asked to provide perspectives on environmental and social sustainability and whether these were important issues in the context of microfinance. Participants were asked if environmental/social impacts were assessed before allocation to an MFI or client and whether or not environmental and social sustainability of operations could ensure commercial investment flows to microfinance activities in Africa.

The survey was undertaken between February and October 2007. Interviews were conducted in English and French. Individuals responding to the questionnaire answered on a personal basis, and did not necessarily represent the views of their institutions.

22 The MFIs who participated in this study include both non-profit and commercial MFIs. Most of the MFIs surveyed in the study are commercial. MFIs seeking commercial investments tend to be more mature institutions, seek to integrate a more commercial approach to business models, and are more appropriate participants in this survey than non-profit MFIs. For more information on MFIs, investors and other survey participants see "Participating Institutions" in Appendix.

23 See "Barriers and Solutions to Commercial Microfinance in Africa - Survey" in appendix to view the survey. Questions were slightly augmented to tailor each group. For example, African MFIs were asked to describe the types of commercial investments they were receiving, whether debt, equity or guarantees. Investors were asked to identify the type of investment they were issuing to African MFIs.

Survey findings

Note to readers: This section presents survey findings. When suitable, findings are broken down to reflect variations in stakeholder as well as regional perspectives.

Findings are presented under the following headings:

- Barriers to commercial microfinance in Africa
- Barriers to long-term financial sustainability of MFIs in Africa
- Measures to facilitate commercial microfinance in Africa
- Measures to ensure long term financial sustainability of microfinance institutions in Africa
- Environmental and social sustainability: The microfinance context

Barriers to commercial microfinance in Africa

Survey participants were asked to describe the most important barriers that prevent African microfinance institutions (MFIs) from accessing commercial investment. Both investor and MFI/expert perspectives are presented.

Investor perspectives

Investors were asked to provide their perspectives on the barriers which make it difficult for them to issue commercial debt to African MFIs. The most commonly cited barriers were:

1. A large presence of subsidized funding from donors which crowds out private sources of funding²⁴

Our survey finds many investors see donor funds offered at low interest rates as beneficial in the short term but distort free markets and damage long term prospects for MFI financial sustainability. Investors are frustrated because while demand for microfinance in Africa is high it is difficult to invest commercially because of lower interest rates offered to microentrepreneurs as a result of the large volume of donor subsidized funding. MFIs can access funds through grants, soft loans or free guarantees from international donors.

Many respondents felt a major problem for poor and rural clients is not the cost of credit but access to financial services. The subsidized cost of credit can actually diminish the likelihood that clients will be able to access finance in the future. In addition to the negative effect on commercial funding, crowding out can also directly damage local African MFIs. The Managing Director of an East African MFI referred to a case in which a Western non-profit was able to set up a number of MFIs in the region from a large subsidized grant, while many local MFIs had to struggle to pay back loans from Western financial institutions. This led to unfair competition that favoured Western MFIs at the expense of local MFIs.

Donor based funding however, could still be useful especially for riskier or start-up MFIs, as the cost for entry into the market for new MFIs is high. Some suggest a reorientation of the donor and international development community away from providing finance and toward providing more technical assistance that would strengthen the competencies of local MFIs. Crowding out therefore is a major problem for commercial microfinance in Africa.

²⁴ Over 50% of investors listed this in their top barriers

2. Difficulty providing loans in local currencies and finding affordable hedging instruments²⁵

Our survey finds many investors have the sentiment that MFIs in Africa are less likely to accept foreign currency loans because when exchanged to local currency the loan has a high risk of depreciating over time making it more expensive to pay back. Often the result is that while a number of credit worthy African MFIs are identified, foreign investors are unable to fund them because appropriate hedging mechanisms that make foreign currency loans affordable and protect MFIs against depreciation are not in place. As an example, one investment analyst surveyed stated that “there are several credit-worthy MFIs in West Africa but they are unable to fund them as they do not have CFA to offer and adequate (or affordable) hedging mechanisms do not exist” to offer foreign currency at an affordable rate.

MFIs in developing countries may be less likely to accept foreign currency loans as local currency in these countries have a higher risk of depreciating rather than appreciating, making it more difficult to pay back loans. A study released in 2004 that spanned five continents over the 1997-2002 period, in 23 countries with active microfinance markets found that there is an average of an 8.8% compound annual decline of the local currency’s value against the USD²⁶; the average for the African countries is higher at 9.1%²⁷. While hedging mechanisms exist in many regions of Africa, they are not widely available and are often too expensive²⁸.

3. Lack of data to assess the risk and return potentials of investments²⁹

Our survey finds many investors have more difficulty sourcing reliable information on African MFIs and markets than elsewhere. This makes it difficult to identify and reach out to the credit worthy MFIs. Investors also expressed that the problem is compounded by inefficient or absent national and regional microfinance networks that could play a role of information channelling and reporting standardization. In Africa, where political risk is arguably higher than many other developing continents, good quality and reliable information is critical for investors.

4. Weak governance

Our survey finds many investors feel a lack of good governance³⁰ is an important obstacle to issue commercial debt to African MFIs. Broken down regionally we found this was an especially important for investors issuing debt to East African MFIs. Good governance³¹ is critical in later stages of growth when MFIs seek to shift sources of capital from donors to private capital. Maintaining good governance can become increasingly difficult for MFIs as their activities expand.

MFIs confront a number of unique attributes that make governance challenging. These include the dual missions of microfinance (achieving profitability and maintaining a social objective), ownership of MFIs, the fiduciary responsibility of the board, and risk assessment³². When broken down regionally, we found that this was especially a concern for the East African region. One survey participant representing this region identified the following additional governance issues: unusual legal structures; unclear shareholder structure or difficulty tracing shareholders; government dominance in shareholder structure; unclear organization structure and division of responsibilities i.e. no supervisory board or audit committee in place; lack of good reporting standards and systems which leads to lack of transparency.

25 Over 50% of investors listed this in their top barriers

26 Cavazos, R., Abrams, J. & Miles, A.: Foreign Exchange Risk Management in Microfinance, 2004.

27 Of the 23 countries surveyed in the above study, seven were in Africa – Benin, Gambia, Ghana, Kenya, Morocco, South Africa and Uganda.

28 Women’s World Banking (WWB): Financial Products and Services Occasional Paper: Foreign Exchange Risk Management in Microfinance, 2004.

29 Over 45% of respondents listed this in their top barriers

30 Over 50% of respondents listed this in their top three barriers to commercial debt flows to MFIs in East Africa

31 Elements of good governance include: participation; transparency; accountability; consensus-building; abiding by rules, regulations, and policies; equity between shareholders; strategic and visionary leadership, etc.

32 Otero, M.: Governance and Ownership of Microfinance Institutions, 2001

Problems with accounting, financial management, internal control and operational organization are major governance issues. Although tools exist to offset these institutional shortcomings, they are not adapted to the local context. On a regional level, institutions which can help, such as auditing and computer maintenance firms are few, and those that do exist still need more capacity to make a noticeable impact.

Another investor referred to an MFI in East Africa whose initial shareholders would not let commercial investors participate in the MFI's equity due to a fear of mission drift. In many cases, this causes commercial investors to lose confidence in issuing debt. Poor governance and lack of confidence on behalf of both commercial investors and local MFIs suggest that concrete steps towards good governance are needed.

Microfinance institution/expert perspectives

African MFIs/experts were asked to provide their perspectives of the barriers that make it difficult for them to access commercial debt. The majority of this group, or more than two-thirds, felt that there will be a continued lack of commercial debt in the future. On a positive note many of their responses mirror those of investors suggesting there is at least common understanding of the barriers and future solutions can be envisaged. The most commonly cited barriers by MFIs and experts were:

1. Loan terms do not support the needs of African MFIs³³

Our survey finds many African MFIs/experts believe commercial debt is too expensive and that loan terms are not supportive to their needs. Specifically commercial debt is often only available in sums that are too large for the purposes of average MFIs, issued with strict requirements around types of hedging mechanisms used, or has too strict collateral requirements. As a result, many African MFIs continue to prefer subsidized funding from donors or development agencies. This in turn exacerbates the crowding out effect leading to competition between private and public sources of debt, the number one barrier cited by investors above. These findings suggest that if investors provide commercial debt in a manner that is more supportive of the needs of African MFIs there would be less incentive for the MFI to seek donor financing and there would subsequently be less crowding out.

2. Difficulty accessing commercial debt in local currencies³⁴

Our survey finds many African MFIs/experts view commercial debt as too expensive because of currency depreciation, currency risk and associated administrative costs. Aside from these barriers local laws may not be adapted for foreign commercial debt and equity investment. In addition many view the organizational capacity and reporting tools needed to respond to the requirements of commercial debt issuers as too costly to set up.

One investor noted that too much reliance on foreign investment lacks diversification and that overall the continent needs local initiatives to support local management and ownership. For foreign investors, it is much easier to work with internationally established firms with standardised systems, methodologies and reporting standards, therefore local initiatives could support establishing such systems and standards. This would make the local environment less risky and time consuming for the investor.

3. Commercial banks and investors in Africa are either not aware, skeptical, or risk adverse to microfinance³⁵

Our survey finds many African MFIs/experts believe there is a notable lack of information about

33 23% of respondents listed this in their top barriers

34 23% of respondents listed this in their top barriers

35 18% of respondents listed this in their top barriers

the African microfinance sector, its potential, and the kind of financial services and products it provides. Many believe commercial banks in Africa are hesitant to delve into a new niche and serve poor, rural clients. One survey participant described West Africa as dominated by credit unions that are not structured for equity investments and rely mainly on membership savings to finance their operations³⁶.

Another reason for hesitation from commercial banks may be interest rate ceilings, for example the West African Monetary Union law caps MFI interest rates at 27%³⁷. In Africa, official agricultural credit institutions have had a long history of political interference with low repayment rates again driving commercial investors and local commercial banks to be skeptical about the microfinance sector and the possible opportunity it presents. Furthermore, MFIs with solid track records are scarce.³⁸

4. Negative perceptions of political and economic stability³⁹

Our survey finds many African MFIs/experts believe perceived political and economic instability is an important obstacle to issue commercial debt to African MFIs. Broken down regionally we found this was an especially important factor for East and West African MFIs. Major macro-economic changes, with privatization developing rapidly, and the role of the state becoming much smaller are distinct features of the West and East African political and economic climate.

Barriers to long term financial sustainability of microfinance institutions in Africa

Investors and African MFIs/experts were asked to provide their perspectives on barriers to the long term financial sustainability of African MFIs. The long term financial sustainability of African MFIs is crucial for mainstreaming microfinance as well as increasing access to finance, efficiency and outreach. While donor or subsidy dependent MFIs rely on grants to sustain themselves, commercially run MFIs seek to achieve efficiency, financial independence and sustainability. Survey participants were also provided a list of potential barriers and were asked to rate items in terms of importance⁴⁰. The potential barriers encompassed institutional issues, financial issues and other external issues. Investor and MFI/expert perspectives did not vary extensively and are bundled together when presented below.

Open ended responses

The most commonly cited barriers on long-term financial sustainability of African MFIs/experts were:

1. Weak governance⁴¹

According to our survey participants, weak governance is a major detriment to long term financial

36 Consultative Group to Assist the Poor (CGAP): Foreign Investment in Microfinance: Debt and Equity from Quasi-Commercial Investors, 2004

37 Microfinance Information eXchange (MIX): Overview of the Outreach and Financial Performance of Microfinance Institutions in Africa, 2005

38 International Fund for Agricultural Development (IFAD): Regional Strategy for Rural Finance: Western and Central Africa, Feb. 2004

39 50% of respondents listed this in their top barriers

40 See "Barriers and Solutions to Commercial Microfinance in Africa - Survey" in appendix to view the survey. Questions were slightly augmented to tailor each group. For example, African MFIs were asked to describe the types of commercial investments they were receiving, whether debt, equity or guarantees. Investors were asked to identify the type of investment they were issuing to African MFIs.

41 30% of respondents listed this in their top barriers

sustainability. Weak governance was identified earlier in the survey as an important issue for investors making it difficult for them to issue commercial debt to African MFIs. This finding therefore further highlights weak governance as a prominent barrier.

2. A large presence of subsidized funding from donors which crowds out private sources of funding⁴²

According to our survey crowding out is a major detriment to long term financial sustainability. Crowding out was identified earlier in the survey as an important issue for investors making it difficult for them to issue commercial debt to African MFIs. This finding therefore further highlights crowding out as a prominent barrier.

3. High operating costs in relation to returns⁴³

As many African MFIs operate in rural, hard to reach areas, with low population density, weak infrastructure and high labour costs, their operating costs tend to be high. These factors can hinder long-term sustainability and lead to low efficiency. African MFIs are the least cost efficient in the world. In 2005 research found an African MFI will spend 35% of every dollar on operating costs. African MFI staff cost twice as much as Eastern European and Central Asian MFI staff, which is surprising given the cost of living in Africa is lower⁴⁴. Our survey finds that many view African MFI inefficiencies as a significant barrier to long term financial sustainability.

Rating of listed barriers

The survey group was provided a table listing barriers to long term financial sustainability and were asked to rate the significance of each barrier. The barriers listed below are those with the highest concentration of responses and confirm many of the open ended responses above.

Participants found the following *institutional* issues as very significant barriers to long term financial sustainability:

- Lack of operational and reporting standards
- Business model based on and thus depending on support from donors
- Microfinance industry perceived as risky

Participants found the following *financial* issues as very significant barriers to long term financial sustainability:

- Alternative means of hedging are too expensive
- MFIs unwilling to take on foreign currency debt and sources unwilling to lend in local currency
- Immature domestic debt markets
- Weak regional financial integration
- Operating costs so high that MFIs remain dependent on subsidies

Participants found the following *external* issues as very significant barriers to long term financial sustainability:

- Country risk (perceived)
- Regulatory constraints (branching requirements, interest rate caps)
- Lack of recent external rating report
- Lack of credit bureaus

42 21% of respondents listed this in their top barriers

43 21% of respondents listed this in their top barriers

44 Microfinance Information eXchange (MIX): Benchmarking African Microfinance 2005, 2006

Measures to facilitate commercial microfinance in Africa

Investors were asked to describe the most successful measures African MFIs can take to access commercial investment. In addition they were asked what measures could be taken to ensure the long-term financial sustainability of African MFIs.

Investor perspectives

Investors were asked to identify measures that can be taken to decrease the risk perception of African MFIs and make them more viable for investment. The most popular measures offered by investors were:

1. Get rated⁴⁵

Our survey finds many investors have the sentiment that securing a good score on a legitimate rating system can help MFIs attract more commercial microfinance. Investors believe ratings help inform investment decision making processes and promote professionalism, transparency, and accountability. Many believe that as the need for African MFIs to access capital becomes greater so will demand for commercial credit ratings, which in Africa was predicted to increase during 2007.⁴⁶

A major advancement in 2007 has been the launch of a global alliance between the two largest global microfinance rating agencies, MicroRate and M-CRIL, now known as MicroRating International (MRI). The organisation has rated over 400 MFIs around the globe. MRI has deployed rating teams in Africa during the second quarter of 2007. In some African countries, such as in Nigeria, ratings are obligatory for regulated MFIs. In these cases rating products must be designed in a manner that is aligned to national regulatory requirements⁴⁷.

In 2003 the African MFI Performance Evaluation Forum was established to support the widespread use of ratings and evaluations. Its founding members include some of the first rated African MFIs and professional global rating agencies.⁴⁸ Other ratings and standards agencies specifically targeted towards MFIs include ACCION CAMEL, IDB-CGAP rating fund, MIX, PlaNet Rating G.I.R.A.F.F.E., and PEARLS Monitoring System.

2. Improve governance structure and have clear ownership guidelines⁴⁹

Our survey finds many investors view that MFIs with weak governance structures often lack the commercial focus to develop into financially sustainable MFIs. Improving governance structures would decrease risk perceptions and increase flows of commercial debt. Governance is a common theme throughout this survey. It has been discussed extensively in previous sections and is viewed as both a barrier and area to improve on. Clear governance and ownership practices need to be reinforced.

3. Offer more technical assistance to improve the management structure of MFIs⁵⁰

Our survey finds many investors view management education, banking best practices and control systems as crucial elements to decrease their risk perception of African MFIs. Some believe technical assistance in these areas should go hand in hand with commercial investments. This

45 18% of respondents listed this in their top barriers

46 African MFI Performance Evaluation Forum, Newsletter No. 1, 2006.

47 ibid

48 Appui au Développement Autonome, Empowering the World's Poor, June 2007.

49 18% of respondents listed this in their top barriers

50 18% of respondents listed this in their top barriers

could be a unique and easy way for the private sector to work together with the public sector or foundations. Technical assistance of this nature could assist MFIs in accessing commercial investment.

Microfinance institution/expert perspectives

MFIs/experts were asked to identify measures which they think would increase the commercial investment viability of their institutions. The most popular measures offered by MFIs were:

1. Invest in MFI infrastructure to make them more credit worthy⁵¹

Our survey finds many MFIs/experts believe investment directed to improving infrastructure and technical capacities of MFIs would be beneficial to their commercial investment viability. In turn more viable African MFIs would have a greater capacity to reach out to the vast majority of low income people in Africa that live in rural areas. Transaction costs are higher in these areas and it is difficult to provide financial services in a profitable manner.

By investing in the technical capacities of the MFI, infrastructure such as electronic payment systems, low-cost ATMs and point-of-sale devices could be deployed in a wider manner, which would further increase access to finance and reduce transaction costs. An expert in the survey group cites the following examples of investments in African MFIs which allow the scaling-up of activities: Microfinance support organizations developing IT platforms for use by their partners, combined with capacity building support and rigorous reporting requirements; Increasing participation of private foundations such as philanthropists, with capital for investment, for research and for capacity-building.

2. Rapid establishment of appropriate legal and regulatory frameworks⁵²

Our survey finds many MFIs/experts believe the establishment of appropriate microfinance legal and regulatory frameworks in Africa would be beneficial for commercial investment viability. A number of survey participants likened the establishment of frameworks to a trial-and-error process for many governments. One investor noted that governments are increasingly realizing which regulations preclude rapid growth of the microfinance industry and are creating appropriate regulatory frameworks to support growth for the industry.

We found a number of survey participants would support the development of national strategies such as establishing investment committees to contribute to better allocation of resources, integration in financial markets, and increase in efficiency, transparency and accountability of MFIs. The creation of credit bureaus could also improve the regulatory framework. One investor noted that commercial MFIs that are adjusted to local legislation often prove very successful in their specific markets, citing Equity Bank in Kenya and First Allied Savings and Loans in Ghana as examples.

3. More senior management commitment⁵³

Our survey finds many MFIs/experts believe more senior management commitment could be beneficial for commercial investment viability. Where management realize they do not have the expertise to bring the institution to scale, management acquisitions should be considered a viable option. African MFIs believe improved management capacities through training and replacing older CEOs to instill new ideas and strategies are excellent solutions for MFIs that are plagued with systemic problems. For example, in our survey we found that building a strong global network makes senior management available to the ProCredit bank which has helped the organization secure a strong capital base and reduce dependency on donor funds.

51 55% of respondents listed this in their top barriers

52 45% of respondents listed this in their top barriers

53 18% of respondents listed this in their top barriers

4. Alternative financing instruments and making efficient use of all the stakeholders⁵⁴

Our survey finds many MFIs/experts believe alternative financing instruments would be beneficial for commercial investment viability. The creation of guarantee systems could increase the amount of loan disbursed and thus, enable the development of the MFI sector. Guarantor institutions however would need a secure and regulated environment.

The following financial tools were listed as other examples: Guarantee funds provided by governments in collaboration with development partners; local currency denominated investment provided by international financiers backed by private investors with little desire for financial returns; private foundations and international financiers to partner with a national or regional body to create a fund that targets all MFIs with potential. These bodies could then agree on a due diligence process to encourage MFIs to address the challenges they face. Finally, these actors could provide funding to cover initial administrative costs, with an agreed plan to increase internally generated revenue.

A foreign investor surveyed stated that the role of donor and development agencies should “crowd-in commercial investments through risk-sharing facilities and securitization mechanisms instead of crowding them out.” As an example of an innovative approach, the German development bank (KfW), along with the German development ministry (BMZ), and other development finance institutions and donors, set up an investment fund for Sub-Saharan Africa (REGMIFA).

REGMIFA consists of subsidized donor funding accumulated in a first loss tranche, which therefore offers more risk averse commercial investors to invest in a more protected tranche. This fund also protects its investors by ensuring diversification – KfW invests in various MFIs in various regions of Africa. As a fund containing many smaller investments in MFIs, either through credit lines and equity, in its portfolio, private investors overcome another barrier - which is that loan size demanded by MFIs are often too small to attract commercial investors. This example illustrates the use of donor funds to attract private investors as opposed to crowding them out.

Another expert suggested that donor and development agencies could “limit activities to ‘second strongest’ MFIs and credit union networks, or to provide unsubsidized funding to these, so commercial investors are able to provide competitive rates to the strongest tier organizations.” Rather than focusing on the strongest MFIs, donor and development agencies could then focus more on fostering the “new entrants so that MFIs become more efficient.” As an example of a low-cost hedging mechanism, KfW, along with other donors and investors, created a specialised fund, TCX, which allows investors in developing countries to hedge their foreign currency funding into local currency. By mixing various currencies into its portfolio, the fund itself mitigates the risk from individual currencies devaluating.

Other measures identified by the MFI/expert group include:

- Senior management commitment (i.e. through acquisitions)
- Form more strategic alliances with investors (i.e. as main shareholder)
- Long-term funding at reasonable rates
- Low cost technologies (i.e. mobile phones, hand held devices, point of sale agencies, ATMs, etc)

54 18% of respondents listed this in their top barriers

Measures to ensure long term financial sustainability of microfinance institutions in Africa

The survey group was asked to identify measures they think would ensure the long term financial sustainability of MFIs in Africa. Investor and MFI/expert perspectives did not vary extensively and are bundled together when presented below. The most popular measures offered were:

1. High-quality supervision coupled with strong management and leadership⁵⁵

Our survey finds many investors and African MFIs believe high-quality supervision coupled with strong management and leadership could ensure long term financial sustainability of MFIs in Africa. Due to ineffective governance structure, one survey participant noted that in instances where MFI management does not have the expertise to transition the institution to the formal sector, managers remain in leadership positions regardless because of their long history with the institution. To ensure that management stays focused, one expert suggested training senior managers on sound management practices and making sure that there is a change of guard in leadership. In a microfinance context strong management has been proven to have a positive impact on growth and portfolio quality.

2. Sound economic policies that promote access to financial markets⁵⁶

Our survey finds many investors and African MFIs believe sound economic policies that promote access to financial markets could ensure long term financial sustainability of MFIs in Africa. These policies would include supporting economic infrastructure and legal and regulatory frameworks. The United Nations Economic Commission for Africa (UNECA) 2005 Economic Report on Africa suggests that financial sector reforms could include “microfinance programmes, flexible collateral systems and credit reporting agencies.” Economic integration and the evolution of the microfinance sector however, seem to already be a mutually supportive process. This same report states that “indeed, formal and informal microfinance institutions are becoming more linked with formal financial institutions in some African countries.” Specific national policies that authorities could implement include the following:

- Developing a legal and regulatory framework which would allow MFIs to register, achieve self-sustainability and upgrade their services to compete in the modern financial sector. Specifically, this framework should promote deposit mobilization, adequate capitalization, good governance and independence from government; ministries and political pressure that induce rent-seeking and restricting interest rates;
- Discourage subsidies which would hinder the ability of MFIs to bridge long-term financial sustainability. Donor activities should be confined to helping MFIs achieve short-term financing gaps;
- Ensuring that management and personnel are adequately trained and competent in the microfinance sector;
- Clearly defining the mission of the MFI and identifying the assistance needed to achieve its goals before becoming full-fledged financial intermediaries;
- Training MFI staff on skills such as bookkeeping and reporting standards, strengthening internal controls and lending mechanisms, and keeping up to date with the latest technologies.⁵⁷

55 42% of respondents listed this in their top barriers

56 30% of respondents listed this in their top barriers

57 UN Economic Commission for Africa (UNECA): Economic Report on Africa 2005, Meeting the Challenges of Unemployment and Poverty in Africa

A number of survey participants also felt regulations that interest rate caps should be eliminated and a level playing field between non-profit and for-profit MFIs in terms of taxation and regulation would be a good measure towards ensuring financial sustainability of African MFIs.

3. Focus on client and ensure business model is aligned to growth by introducing a wider range of client services when appropriate⁵⁸

Our survey finds many investors and African MFIs believe a focus on providing good services to the client that extend to savings and insurance products could ensure long term financial sustainability. However survey participants also emphasized that at start-up stages MFIs should not focus on too many products but rather a few well designed and effectively delivered products that clients can use. Too many products can lead to strains on management and staff capacity that negatively affect both the MFI's performance and its client service.

Consistent high-quality delivery of a few complementary products in high demand is important⁵⁹. An ability to provide a wider range of services when appropriate is also essential. For example from 1984-1993 Equity Bank Kenya had a narrow product focus and its staff knew little about microfinance client demand. As a result, savings stagnated. In 1993 when new management was introduced Equity Bank Kenya revised its products and services to better tailor its clientele. This successful measure increased savings from US\$ 3 million in 1994 to US\$ 7 million in 1998. By 2003 Equity Bank Kenya had increased savings to US\$ 22 million⁶⁰. Today, Equity Bank is expanding in the Eastern African region and by 2008, plans to open branches in Uganda, Tanzania, Rwanda, and South Sudan. According to the CEO, "the popularity of the bank among Kenyans and its high rating by international bodies gave its management confidence that it was set for bigger things in the region."⁶¹

Other measures identified by the survey group include:

- Good internal control, management information systems (MIS) and audit
- Institution building and staff development
- Good shareholding structure (i.e. strong funding capacity for shareholders, Board of Directors, likeminded investors, clear ownership structure)
- Commercial investors to have longer-term vision (i.e. access to long-term funding with commercial rates and conditioned on strong financial standards)
- Effective support from the international community - Reorientation of donor activities (i.e. not just declarations)
- Invest heavily in IT

58 24% of respondents listed this in their top barriers

59 Q&A with Marguerite Robinson. the Microfinance Gateway. CGAP. 21 December 2007 http://www.microfinancegateway.org/resource_centers/savings/experts/_asktheexpertsno2.

60 ibid

61 [Kenya: Equity Bank goes regional](http://www.africanews.com/site/list_messages/13905). AfricaNews. 14 December 2007 http://www.africanews.com/site/list_messages/13905

Environmental and social sustainability

The survey group was asked to provide perspectives on environmental and social sustainability and whether these were important issues in the context of microfinance. Specifically they were asked if environmental and social impacts were assessed before loan allocation to MFI clients were made; and if environmental and social sustainability of operations could ensure commercial investment flows to microfinance activities in Africa. In sub-Saharan Africa especially, microentrepreneur activities seem to centre on the basic commodity services needs of those in the informal sector.

As the majority of the poor in Africa work in the informal sector, and given the importance of this sector on the African economy as a whole⁶², the question of how MFIs and investors consider environmental and social factors in their business plans or vision is relevant. In a purely environmental context microentrepreneur activities that centre on basic commodities would probably not be considered as beneficial to sustainable development. However if these types of activities can expand businesses and livelihoods socially they would be considered beneficial to sustainable development. When asked if they believed that microfinance should be leveraged to shift clients from the informal to the formal economy, 68% of survey participants replied positively. When asked if microfinance should upgrade clients from the individual to the SME level, 52% of the experts believed that it should. This supports the idea that indeed it is important that microfinance to be used for expanding businesses and livelihoods, as opposed to day-to-day consumption purposes.

However, many of the experts felt that shifting clients from the informal to the formal economy was more dependent upon macroeconomic policies, rather than an outcome of the MFI's activities. Many even supported the idea that the informal sector is indeed integral to the economy and that it should complement activities in the formal economy. According to the CEO and Managing Director of Susu Microfinance Bank Ltd in Nigeria, those clients "that are better off remaining in the informal economy should be provided with tools that will enable them to work more efficiently within the informal sector." Rather, many of the respondents felt that an MFI's role in upgrading clients from an individual to SME level or from a micro to medium-size business would be more useful.

When asked if environmental/social impacts are assessed before investing in MFIs and/or SME clients, 69% of the MFIs and experts replied that they do, 8% sometimes, and 23% do not – indicating that the environmental/social dimension of sustainability in the microfinance sector in Africa are becoming increasingly important issues. A few experts indicated that assessing for environmental and social impacts can be too cumbersome for MFIs. Therefore, it would be more feasible with a subsidized grant or with technical assistance.

As an example of technical assistance on assessing environmental/social impacts, FMO, the Netherlands Development Finance company, has developed an environmental and social risk management approach specifically aimed at MFIs⁶³. This approach is tested by FMO clients worldwide, and the experiences so far are promising. Including environmental and social checks in the MFI loan cycle in a simple and practical way appears to be worthwhile for both the MFIs and their clients⁶⁴. In Africa, already 19 participants of 8 MFIs participated in a dedicated course on the subject in Nairobi in September 2007.

62 In Africa, SMEs and the informal sector represent over 90% of business, contribute to over 50% of GDP, and account for about 63% of employment in low income countries. Annual Report 2005, UN Economic Commission for Africa (UNECA)

63 See: http://www.fmo.nl/en/publications/environmental_social_risk_management_tools_MFI.php for more information.

64 See: Environmental and Social Risk Management, The FMO Approach, by Robert Bierens, Investment Officer, FMO LAC Department, and Anton G. van Elteren, Senior Environmental Specialist, FMO Investment & Review Dept. In: The MicroBanking Bulletin, Issue No. 15, Autumn 2007.

Another example is an initiative between Triodos Bank and the Global Reporting Initiative (GRI), which is a system supported by UNEP FI. The purpose of the GRI is to develop and disseminate globally applicable Sustainability Reporting Guidelines on the economic, environmental, and social dimensions of an institution's activities, products, and services. Triodos Bank itself was the first bank to do GRI reporting. Three of Triodos Bank's African partners participate in the program: Reliance in The Gambia, K-Rep Bank in Kenya and Centenary Bank in Uganda. Through this project, Triodos Bank shares their experiences on GRI reporting with its' partners and encourages exchange of experience between leading MFIs worldwide.

Several of the experts also stated that the social impact of microfinance was more of a concern for them as opposed to the environmental impact. As reorientation of donor activities was one of the main solutions proposed, this is one area in which donors could focus on more intensively. Although almost all of the MFIs did not have a formal process in place for assessing social and environmental impacts of microfinance, one MFI, ProCredit Bank in Sierra Leone seemed to consider the environmental impacts almost as much as the social impacts. According to the General Manager, environmental policy is part of staff training - it is considered during credit committee decisions and is subject to internal auditing as well.

Appendix

Survey participants

African microfinance institutions (MFIs)

AccesBanque Madagascar
Reliance Financial Services Company Limited, The Gambia
Advans Ghana
Susu Microfinance Bank Ltd., Nigeria
ProCredit Bank Sierra Leone Limited
Marang Financial Services, South Africa
La Régionale d'Épargne et de Crédit, Cameroon
K-Rep Bank Ltd. Kenya

Investors and investment advisors

Societe Generale, France
BNP Paribas, France
Storebrand, Norway
ShoreCap International, South Africa
Swiss Investment Fund for Emerging Markets (SIFEM) AG, Switzerland
BlueOrchard, Switzerland
Symbiotics S.A., Switzerland
Access Microfinance Holding AG, Germany
MicroVest Capital, USA
La Fayette Investissement, Luxembourg
The Netherlands Development Finance Company (FMO)

Other experts

Opportunity International, USA
Women's World Banking (WWB), USA
United Nations Capital Development Fund (UNCDF), South Africa, Senegal
World Council of Credit Unions (WOCCU), USA
Metisfinance, Switzerland
ActionStream International (ASI), Italy, Tunisia
International Network of Alternative Financial Institutions (INAFI), Senegal
INAFI Africa, Kenya
Stromme Foundation, Norway
Microfinance South Africa (MFSA)
Alexandria Business Association (ABA), Egypt
World Bank, USA
Barclays PLC, UK

Survey

The below is a copy of the survey sent to African MFIs, investors and other experts.

Barriers and Solutions to Commercial Microfinance in Africa - Survey

Interviewee

Name:
Position:
Date:
Email:
Tel:
Address:

Company or organization details

- 1 Company or organisation name and country
- 2 Please describe the main areas of your company or organisation's operations (for example technical assistance, research, financial services etc)

Barriers to Commercial Microfinance in Africa

- 3 In your view, is there a lack of commercial investment available to Microfinance Institutions (MFIs) in Africa?
If yes, what do you believe are the most important three barriers that prevent access to commercial investment to African MFIs? Please expand on why you believe these three barriers to be so important?
- 4 If you believe that lack of commercial investment is not a problem for MFIs in Africa, please state why and what some of the constraints are in mobilizing these commercial investments.
- 5 Please rate the extent to which you consider the following factors as contributory barriers to receiving commercial investments for MFIs in Africa? Place a checkmark in the relevant column.
4 = Very significant barrier; 3 = Relevant barrier; 2 = Somewhat of a relevant barrier; 1 = This is not an issue in Africa; 0 = Don't know.

Institutional Issues	0	1	2	3	4
Crowding out by non-commercial sources of financing (when loans from IFIs concentrate on the strongest MFIs)					
Not enough strategic alliances with investors					
Lack of operational and reporting standards					
Investors' lack of internal expertise on microfinance					
The microfinance industry is perceived as risky					
MFIs are not structured for equity investments					
Market dominated by a few large funds investing in a small number of MFIs					
Lack of key stakeholder/shareholder interest					
Lack of senior management commitment					
Cultural divide between MFI professionals and investors – Organizational difference between MFIs and investment firms					
Business model based on and thus depending on continued support from donors					
MFIs not considered formal financial institutions					
Want to ensure local equity/stakeholder ownership					
Internal constraints i.e. investment committee, asset allocation policies, etc.					
Financial Issues	0	1	2	3	4

Limited size and liquidity of the microfinance market					
High cost of capital from private sources of investments					
Lack of collateral					
Alternative means of hedging (back to back, letter of credit) are too expensive					
MFIs unwilling to take on foreign currency debt					
Small deal size					
Low profitability					
Operating costs so high that MFIs remain dependent on subsidies					
Immature domestic debt markets					
Weak regional financial integration					
Low equity valuation					
High T-bill rates					
MFIs are undervalued on the stock exchange					
External Issues	0	1	2	3	4
Lack of credit bureaus					
Lack of recent external rating report					
Country risk					
Regulatory constraints (branching requirements, interest rate caps)					
Lack of regulatory capacity to supervise MFI activity					
Most clients located in rural areas – difficult to reach these clients					
Environmental/Social Issues	0	1	2	3	4
Little incentive for investment/asset managers to incorporate social values					
Fear of mission drift					
Insufficient environmental/social impact measurement					
Other (You may use the extra columns below to list and rate any other barriers that were not mentioned above.)	0	1	2	3	4

- 6 Of the above barriers, choose the top three that most likely hinders long-term financial sustainability of MFIs in Africa and explain why. Feel free to list any others that were not mentioned in the above table.

Opportunities for Commercial Microfinance in Africa

- 7 Of the most pertinent barriers listed above, what have been some measures used to overcome them?
- 8 What do you see as the top three measures necessary to support increased commercial microfinance investments in Africa?
- 9 In your view, what are the most successful factors that ensure long-term financial sustainability of MFIs in Africa?
- 10 In your view, is it important for commercial microfinance activities to be leveraged to help clients move from the informal to the formal economy? If so, what are the methods to do this?
- 11 In your view, is it important for commercial microfinance activities to be leveraged to help clients upgrade their businesses from individual to SME? If so, what are the methods to do this?

Environmental and social dimension

- 12 Do you assess for environmental/social impacts before investing in MFI clients? If yes, why and how. If not, why not?
- 13 Do you issue sustainability reports? If so, what kind?
- 14 Can you recommend a practical step to facilitate sustainable commercial investment flows to microfinance activities in Africa?

General comments

- 15 Is there a case study or other materials you can provide which illustrates a good example of a barrier or opportunity for commercial investment flows to microfinance activities in Africa?
- 16 Please feel free to use the extra space to discuss any issues not covered by this survey or to elaborate further on your answers.

Disclosure agreement

UNEP FI requests permission to quote from your responses to open-ended questions.

Permission to quote my name & organization name

Permission to quote, but only my position & organization name

Permission to quote, but only anonymously

No permission granted

Project partners

United Nations Environment Programme Finance Initiative (UNEP FI)

The United Nations Environment Programme Finance Initiative (UNEP FI) is a global partnership between the UNEP and the private financial sector. UNEP FI works closely with 170 financial institutions that are signatories to the UNEP FI Statements, and a range of partner organisations, to develop and promote linkages between the environment, sustainability and financial performance. Through regional activities, a comprehensive work programme, training activities and research, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

UNEP FI African Task Force (ATF)

The African Task Force is UNEP FI's platform in Africa. ATF members are financial institutions that collaborate to drive sustainable development, and address the critical environmental and social issues in Africa. The group has a mission of supporting and expanding sustainable financial practice throughout the continent. The ATF consists of the following members:

Africa Investor
African Institute for Corporate Citizenship
Citi South Africa
Development Bank of South Africa
Industrial Development Corporation
Nedbank
Standard Bank Group
Standard Chartered Bank
Societe Generale
Swaziland Development & Savings Bank
The Banking Association South Africa
The Netherlands Finance Corporation (FMO)
University of South Africa (UNISA)

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Bill & Melinda Gates Foundation

Guided by the belief that every life has equal value, the Bill & Melinda Gates Foundation works to help reduce inequities in the United States and around the world. The goal of the foundation's Financial Services for the Poor initiative is to make these services far more available so families in developing countries can survive economic setbacks, build savings, and improve the health and education of their children. Based in Seattle, the foundation is led by CEO Patty Stonesifer and co-chair William H. Gates Sr., under the direction of Bill and Melinda Gates and Warren Buffett.

For more information visit www.gatesfoundation.org

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United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a strategic public-private partnership between UNEP and the global financial sector. UNEP works with over 180 banks, insurers and investment firms, and a range of partner organisations, to understand the impacts of environmental, social and governance issues on financial performance and sustainable development. Through a comprehensive work programme encompassing research, training, events and regional activities, UNEP FI carries out its mission to identify, promote and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

