MICROFINANCE

YESTERDAY, TODAY AND TOMORROW

SIMONA SAPIENZA

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Ms Sapienza has held various academic positions in Italy and has been legal counsel for the Italian Institute of Research for the international protection of human and civil rights. She has been actively engaged in supporting NGOs projects associated with the Department of Public Information of the UN and in inter-cultural projects promoted by the EU Commission.

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→| FUTURES

> ***"Probable impossibilities are to be preferred to improbable possibilities."***
>
> ARISTOTLE

"MICROFINANCE IS *ANOTHER term for microcredit,* (1) which is defined as *the lending of small amounts of money to low interest to new business in the developing world,*" this the official definition[1].

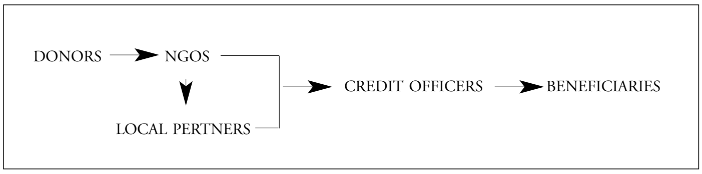
Although clear, this definition may need some revision in particular in the light of the socio-demographic changes which over the last decades have significantly altered the world economic scenario. Actually, for microfinance the new context has meant different potential beneficiaries with different financial needs and a greater involvement of financial intermediaries.

Traditionally microfinance has been associated with programmes that benefit people with serious subsistence problems in developing countries. This is why microfinance may overlap easily with microcredit: small loans, often without traditional guarantees, aimed at improving the lives of the beneficiaries and their families or at sustaining micro-economic activities. The resources, coming mainly from funds donated by states and supranational organisations or by individuals and foundations, are channelled to their recipients usually through NGOs and local partners. In this scenario NGOs and donor countries have been operating together with other locally-based organisations, such as municipalities or governments or other entities from the third sector helping to facilitate the screening and management of credit positions. In order to reduce the often cultural gap between lenders providing credit and the beneficiaries of the microloans many organisations have relied to networks of local partners visiting potential beneficiaries to gather information during the selection and monitoring phase and later to collect the different installments related to the micro-loans granted.

The traditional beneficiaries of traditional microfinance therefore have been citizens of developing countries sadly known as the "poorest of the poor". Within this category, women have been of particular importance as the group most affected by financial exclusion and, at the same time, more capable than men to repay and manage the funding received in small income initiatives [SEE GRAPH 1].

In the last few years microfinance has served a group of beneficiaries largely distinct from the one traditionally associated with microcredit. More recently microfinance has open up to self employed workers and individuals in charge of small, often family owned business, which are simply not able to access credit from banks. For micro-entrepreneurs, microfinance has become an alternative to credit given by informal lenders and a way out of the money lending system. Furthermore, actual potential microfinance beneficiaries include individuals who, although not living in poverty, may have general difficulty in gaining access to the financial system.

As a matter of fact today exclusion from the traditional credit system includes millions of people and it can be the consequence of other forms of exclusion, primarily from the socio-political system. Immigrants or ex-convicts may be, for instance, the victims of such social and political exclusion and be among the *unbankable* ones. Furthermore, a form of financial exclusion can be the one affecting customers, mainly small-scale entrepreneurs, considered marginal by credit institutions as they represent a low-value target compared with the traditional customer evaluation models. Although it may well sound a paradox, it is this very group of *unbankable* people that, despite their common distance from the credit system, are usually characterised by increasing levels of professional and managerial ability, and increasing levels of creditworthiness.



GRAPH 1 - Standard microfinance structure.

Up to yesterday the financial system regarded microfinance with suspicion. Traditional finance considered offering credit to individuals seen as *un-bankable* when not backed up by guarantees, as a too risky business. Moreover, the process of supplying small loans incurs excessive costs owing to the significant operating cost needed to deal with each loan in relation to the amount of credit supplied.

In recent microfinance experience, however, we are witnessing a cross-over movement, which is seeing a greater involvement of banks and microfinance financial intermediaries in programmes destined for the poorest of the poor, the poor and the *unbankables*, and a parallel involvement of NGOs and microfinance financial intermediaries in programmes aimed towards marginalized beneficiaries.

The continuous increase of un-bankable and marginalized people in the world is determining a greater complexity of the financial structures in microfinance programmes and, therefore, a more significant move away from the traditional patterns of microcredit.

Microfinance is no longer just a financial technique mainly offered by the non-profit sector as part of development programmes to sustain the poor in developing countries. It has become something different. Despite the challenges which remain in attracting private capital, lowering costs and interest rates and developing regulation, it has slowly become an established part of the global capital structure.

The modern microfinance market is characterised by a complex demand for financial and technical services and a complex supply, owing to a growing interaction and interest on the part of institutional donors, the non-profit sector and the financial markets.

The increasing participation in microfinance programmes of regulated financial intermediaries brings microfinance closer and closer to traditional finance. The presence of intermediaries oriented towards profit, and the use of private funds, can represent a risk of departure from the ethical nature of the social and humanitarian objectives behind traditional microfinance and of the channelling of funds through non-profit organisations lines. To prevent this and to facilitate the development of a microfinance of tomorrow linked to the values of ethical finance, the non-profit sector will still play a crucial role. NGOs especially will have the important task of safeguarding the original features of microfinance, in particular the ethicality of the business, the flexibility of the process and the proximity to the beneficiaries. They will still be the best organisations to interact with microfinance financial institutions and local governments to propose projects linked to national and local development policies.

To lower intermediation costs to manage the risks associated with microfinance project effectively, the entry in the microfinance market of non-bank financial intermediaries such as Ethical Investment Funds and Ethical Pension Funds will also be crucial. They may be an important source of low cost funding for microfinance, still much unexploited. Actually, savings collected from ethical investors could find market investment alternatives in microfinance that meet the ethical feature required. In addition, ethical savings do not incorporate a risk-return relation similar to traditional savings and, therefore, can be dedicated to investments that ensure rate of returns lower than market ones'.

NGOs are in the position to select the most appropriate beneficiaries for each project. They can offer the human resources necessary to provide technical assistance and training from the starting up of the project until the exit strategy. They will have to cooperate with financial intermediaries to implement an efficient credit process that reduces to the minimum the different costs that may arise from asymmetric information and risk management models. NGOs are already on the path and made important contributions to poverty alleviation by addressing quality of life issues such as health, education, environment and shelter, and by providing new opportunities to beneficiaries.

For the future, it is possible to foresee that microfinance programmes will be increasingly characterised by stronger cooperation among stakeholders – international donors, governmental bodies, financial intermediaries, NGOs, technology companies – using respective skills and institutional objectives to foster the effectiveness of microfinance programmes and support ethical sustainability [SEE GRAPH 2].

The next decades of microfinance will bring new players to the field and will create alliances among entities that would have been difficult to consider partners a decade ago and who together will continue to reinvent microfinance.

INSTITUTIONS	SERVICES	BENEFICIARIES	
		POOREST AND POOR	UNBANKABLES-MARGINALIZED
GOVERNMENTS	GRANTS	X	
DONORS	GIFTS	X	
NON-PROFIT NGOS	DONATIONS	X	
FINANCIAL NGOS	LOANS		X
BANKS	CREDIT/TECHNICAL SERVICES		X
MICROFINANCE INVESTORS	CREDIT/TECHNICAL SERVICES		X
FINANCIAL INTERMEDIARIES	CREDIT/TECHNICAL SERVICES		X

GRAPH 2

NGOs that gave birth to this sector, have already started to reinvent themselves, some have transformed themselves into regulated financial entities which operate principally by offering microcredit as part of development projects, often combined

with the offer of technical assistance and social intervention for beneficiaries.

Microfinance fits well in the context of the Millennium Development Goals (MDGs). Among the many important tasks that constitute the agenda for poverty eradication the UN Millennium Declaration calls for "microfinance projects which meet the local community priorities". From this point of view, the new microfinance model becomes an important component to meeting the MDGs of 2015. This places greater pressure on the new actors of microfinance to address the challenges and to seize the opportunities of the next years so that in 2016 microfinance will have realised the vision, assuring access to financial services to the world's majority ▣

[1] *Oxford English Dictionary*, 2009.