

# MICROFINANCE BAROMETER 2018



**ZERO EXCLUSION  
CARBON  
POVERTY**

9<sup>th</sup> Edition

IN PARTNERHIP WITH



## MICROFINANCE AND PROFITABILITIES

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SPECIAL REPORT "MICROFINANCE AND PROFITABILITIES"



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### EDITORIAL

Profitability: though essential to the microfinance sector, this concept is complex to grasp in a sector that holds social impact as its rationale. Should microfinance be profitable? If so, can it be socially responsible? Can it remain true to its aspirations and contribute, through financial inclusion, to lift nearly 2 billion people without access to banking services out of poverty? Between reasonable interest rates and sufficient profitability, what is the proper balance for Microfinance Institutions (MFIs)? What resources to finance the development of the microfinance sector?

Financial sustainability is important: to fulfil their mission and develop their services to customers while ensuring their economic viability, players in the sector must not only cover their costs, but also generate profits. Profitability, however, cannot be reduced to its financial dimension. On the contrary, it is necessarily multifaceted. Actors in the microfinance sector operate not only with clients, but also within large societies and systems. The positive impact of microfinance on borrowers and on communities must therefore be taken into account, while negative externalities need to be measured and integrated into impact assessments and cost-effectiveness calculations as well.

As the sector continues to grow, the Microfinance Barometer 2018 chooses to address the issue of

profitability and its multiple aspects. From the presentation of major trends in the sector in France, Europe and the world, to the analysis of microfinance actors' business models, to a spotlight on the impact of new technologies on the profitability of microfinance, this issue questions our conceptions of profitability and mobilises investors, MFIs and experts to explore ways in which financial and social returns can be complementary and mutually beneficial.

Fighting financial exclusion must remain a priority and microfinance remains one of the tools to achieve that goal. It is neither «good» nor «bad» in itself: it responds to a real need for inclusion of the most vulnerable people. Its impact depends on how it is operated: properly implemented, microfinance can have

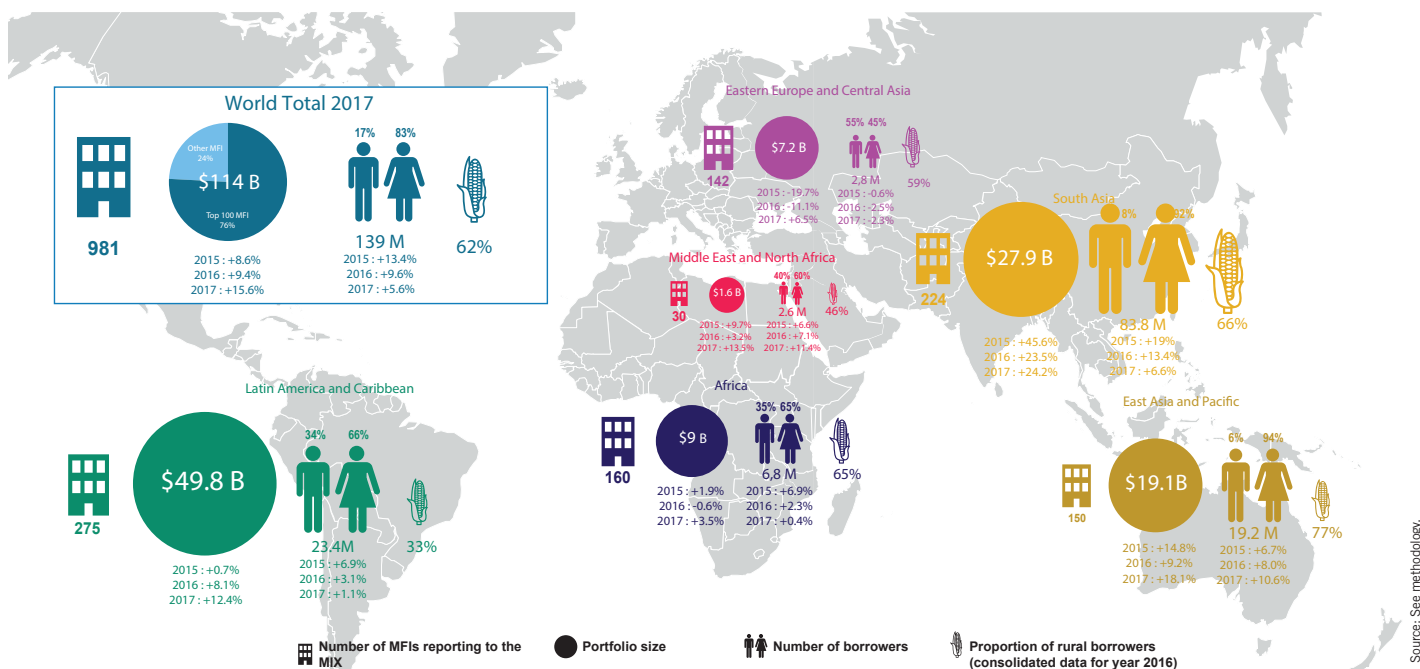
a real positive impact for the populations at the base of the pyramid. In this respect, positive examples are many, as this Barometer testifies. These initiatives demonstrate that financial profitability can be reconciled with positive social impact and, it is our hope that they can inspire traditional economic and financial actors.

We wish you a pleasant reading.



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# KEY FIGURES OF FINANCIAL INCLUSION | WORLD



Source: See methodology.

## Microfinance's global figures in 2017 : mixed picture

At the end of 2017, MFIs reached an estimated 139 million low-income and underserved clients with loans totaling an estimated 114 billion dollars. These levels represented a growth of 5.6% in total borrowers and 15.6% in loan portfolio. While the loan portfolio growth was stronger than the 2016 results (plus 6.2 points), expansion in outreach to new borrowers slowed by half in 2017 compared to the 9.6% growth experienced in 2016, representing a rising average loan balance per borrower.

The overall loan portfolio remains just as concentrated in leading global institutions as in prior years. The 100 largest institutions (ranked by loan portfolio) account for 76% of both borrowers and loan portfolio (same as 2016), putting their reach at 87 billion dollars in loans for 108 million borrowers.

Despite this slowdown in outreach to new clients, some MFIs are already positioning themselves to take advantage of an increasing digital user base with mobile money. A 2017 MIX survey of MFIs showed that 61% were deploying alternative delivery channels to reach clients, ranging from agents and ATMs to mobile phones. Of that total, 40% had already developed mobile money channels and a further 20% were in pilot testing. Additionally, according to GSMA's 2017 *State of the Industry Report on Mobile Money*, mobile money access and usage grew at double digit rates.

### Focus on regions

South Asia continues to lead global outreach, accounting for nearly two-thirds of global borrowers (60%). That being said, the region's growth in borrowers has slowed for a second year, going from 13.4% in 2016 to 6.6% in 2017. This result is overshadowed by significantly slower growth in the region's largest market, India, as fallout from the November 2016 demonetisation decree. Demonetisation withdrew over 80% of the value of currency in circulation and unsettled MFIs' cash-based disbursement and reimbursement businesses. As a result, borrower growth slowed from nearly 20% in the prior year to 5.8% in 2017.

Despite a slowdown in Cambodia, one of its lead markets, East Asia and the Pacific led regional growth in 2017 with 10.6% growth in borrowers and 18.1% in loan portfolio. Indonesia, the Philippines, and Myanmar all experienced an increase in borrowers greater than 15%. In Cambodia, on the other hand, the cooling effects of an interest rate cap from March 2017 led to an estimated 5% decline in borrowers by the end 2017.

Countries in Eastern Europe and Central Asia faced another challenging year in 2017. After a year of contraction in 2016, the loan portfolio grew in 2017 at 6.5%, an increase from the -11.1% of the previous year, but the borrower base contracted by 2.3%. The stricter regulatory norms applied in 2016 in Azerbaijan and Tajikistan that resulted in some MFIs' licenses being revoked continued to dampen outreach in 2017. While Tajikistan experienced small growth in borrowers (+2.8%), the Azerbaijani borrower base shrank by over a quarter in 2017, and the loan portfolio by 15%.

In Africa, overall outreach to borrowers remained largely flat between 2016 and 2017, growing by 0.4%, with a similar trend in the loan portfolio outstanding (+3.5%). Several countries in West Africa, such as Benin, Senegal and Mali, experienced single-digit growth in borrowers. In East Africa, Kenyan MFIs faced a challenging environment for lending in 2017, with prolonged elections contributing

to uncertainty and an interest rate cap announcement that put a brake on lending; the combination resulted in a contraction of the borrower base by over 18% during 2017.

Finally, growth in Latin American and the Caribbean, the largest regional portfolio by portfolio value (44%), slowed considerably in 2017, registering just 1.1% aggregate growth in borrowers (compared to +8.1% in 2016). Two of the largest markets, Mexico and Peru, experienced opposite trends: the total borrower outreach in Mexico shrank by 3.8% and Peruvian MFIs increased their client base by 9.5%.

## Top 10 countries by number of borrowers

| Rank | Country     | Borrower FY 2017 & growth since 2016 | Loan portfolio FY 2017(dollar) & growth since 2016 |
|------|-------------|--------------------------------------|--|
| 1    | India       | 50.9M (+5.8%)                        | 17.1B (+26.3%)                                     |
| 2    | Bangladesh  | 25.6M (+3.5%)                        | 7.8B (+17.0%)                                      |
| 3    | Vietnam     | 7.4M (+2.8%)                         | 7.9B (+18.9%)                                      |
| 4    | Mexico      | 6.8M (-3.8%)                         | 4.4B (+5.5%)                                       |
| 5    | Philippines | 5.8M (+16.3%)                        | 1.3B (+17.5%)                                      |
| 6    | Pakistan    | 5.7M (+25.9%)                        | 1.8B (+39.6%)                                      |
| 7    | Peru        | 5.1M (+9.5%)                         | 12.6B (+17.%)                                      |
| 8    | Brazil      | 3.5M (+1.1%)                         | 2.6B (+2.7%)                                       |
| 9    | Colombia    | 2.8M (-0.7%)                         | 6.3B (+5.6%)                                       |
| 10   | Cambodia    | 2.4M (-4.7%)                         | 8.1B (+21.6%)                                      |

Source: see methodology.

# KEY FIGURES OF FINANCIAL INCLUSION | WORLD

## Focus on clients

The results of the World Bank's Global Findex for 2017 highlights how the MFIs reporting through MIX Market help increase access to financial services for excluded groups, including women. According to the Global Findex data, global account access increased from 62% in 2014 to 69% in 2017, yet the gap between account access for men and women remained unchanged at 7%. This gap in access is mirrored in MIX Market data, where regional differences also appear.

South Asian MFIs remain squarely focused on serving women, as many have done since inception, with 92% female borrowers. South Asia is also the region that saw the gap in account access between men and women decrease the most, from 18% in 2014 to 11% in 2017, at the same time that overall account access went up to 70%. The women-focused outreach of the surveyed MFIs clearly contributes to that improved access.

At the other end of the spectrum, MFIs in Eastern Europe and Central Asia serve a majority of male clients: only 45% of their borrowers are women. The gender gap has increased from 3% to 6% despite overall growth in access of 7 percentage points.

Rural clients, including smallholder farmers, also constitute an important excluded segment served by MFIs. Many regions have a strong focus on rural outreach, including Africa, East Asia and the Pacific, and South Asia, which have two-thirds or more of their clients in rural areas. In contrast, MFIs in Latin America remain strong urban actors, with just a third of their borrowers in rural areas. Within the region, only countries in Central America stand out for having 50% or more of their borrowers in rural areas.

## Focus on the profitability of microfinance institutions

### Profitability of microfinance by region

Underpinning the growth in services are the business models and operating environments that shape institutional performance. As stressed out in the overall growth in 2017, MFIs faced increasingly challenging environments over the last couple of years, leading to slower growth in outreach. Reflecting this difficult context, the global portfolio at risk (PAR) exceeding 30 days increased, going from 4.7% in 2015 to 7.2% in 2016.

The contraction in loan portfolio recorded in Eastern Europe and Central Asia also appeared in business performance. On average, these MFIs generated losses (-1.1% return on assets) as delays in repayments increased by 50% compared to the prior year (15.7% PAR > 30 days). Azerbaijan and Tajikistan were particularly struck with portfolio quality problems and MFIs in both countries registered negative returns on assets, at -8.8% and -1.0% respectively.

ers impacted by the withdrawal of large quantities of cash during demonetisation. Despite these challenges, Indian MFIs managed to earn 2.6% return on assets for the year ended March 2017, down slightly from the prior year.

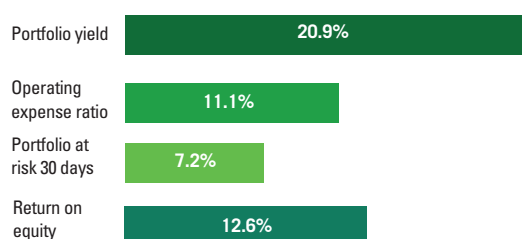
Latin America and the Caribbean, the largest region by loan portfolio base, also witnessed the most stable institutional performance. Some markets, like Mexico, experienced a small rise in portfolio risk (up to 9.4% by end 2016), due in part to its extensive exposure to consumer lending (>20%), and connected to the small contraction by MFIs from their lending portfolios in 2017. In other countries, like Bolivia, Colombia and Peru, the stable environment allowed MFIs to maintain similar portfolio risk, operating efficiency and returns as in the prior year.

### Looking ahead

After a challenging year in 2017, MFIs in many markets are revisiting their projections for growth.<sup>1</sup> In countries where borrowers outreach shrank in 2017, such as Kenya and Cambodia, MFIs that once projected optimistic growth in 2017 foresee little or no growth in 2018. Behind these projections are expectations for tougher business environment in 2018. MFIs cite both competition from other MFIs and new entrants and a more difficult macroeconomic environment as primary factors limiting their growth this year, and early data from March 2018 indicate that these projections are more realistic than in 2017.

<sup>1</sup> These projections come from MIX's Barometer Forecast surveys conducted on MFIs in 17 countries every quarter.

MFIs average performance ratios in 2016 (consolidated)



African MFIs earned overall positive returns (3.1% return on assets) with low portfolio quality (14.5% at 30 days). The positive returns were achieved, in part, from a large deposit base generating a low overall financial expense ratio (3.6%) and a portfolio earning the highest yield of any region at 26.6%.

South Asian MFIs' performance is buoyed by strong productivity and efficiency generated from a business mode which relies on group-based methodologies, allowing MFI staff to serve several clients in one setting. These MFIs spent an average 25 dollars per borrower, one-third of the operating cost of the second most efficient region and one-tenth of the most costly one. This low operating cost allowed them to clear the highest average profits (3.5% return on assets) while managing an average yield (21.2%). In addition, MFIs from the region registered the highest financial expense ratios (6.4%), resulting mainly from their dependence on external borrowers (40% of their total funding). For Indian MFIs, profits remained at regional norms despite the strong uptick in repayment delays (up to 14.5% by March 2017) from borrow-

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## Methodology

Calculations are based on data provided by financial service providers through MIX Market (<http://www.themix.org/mixmarket>). MIX makes every effort to collect the data from the dominant actors of each market to ensure visibility into each market but does not collect data on every actor in every country.

Total figures for borrowers and loan portfolio as of FY2017 are based on data provided by 981 institutions. For FY2017 data, we have considered data for all institutions that have reported through MIX Market for any period in 2017, including of March 31, 2017, June 30, 2017, July 16, 2017, September 30, 2017, and December 31, 2017. Where institutions reported annual figures for FY2016 but not for a date in 2017, those FY2016 figures were used to calculate the estimated total outreach for 2017.

Growth figures for borrower and loan portfolio values for FY2016 and FY2017 are based on a balanced panel data from the set of institutions that have provided both data fields through MIX Market for each of the fiscal years from FY2016 and FY2017.

Client segment, funding data, and institutional performance data come from MIX's *Global Outreach and Financial Performance Benchmark Report – 2016* and represent results from FY2016 for 714 institutions.

## The untapped potential of microfinance in Europe

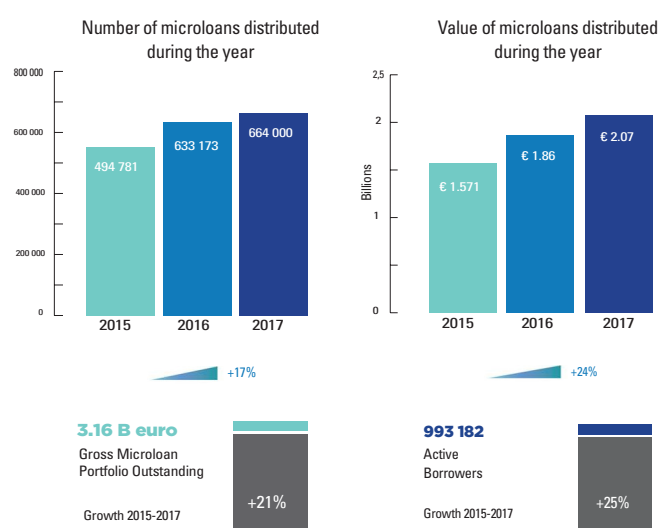
**M**icrofinance has become a growing sector of activity in Europe over the last years. It still carries an important growth potential considering the impacts of the current low economic growth on disadvantaged and impoverished populations and the need to ensure their social and financial inclusion. The rapid increase of self-employment and enterprise creation makes the role of microfinance even more important, since microenterprises – which make up 92% of the total number of European enterprises – must overcome many obstacles, first to be created, and then to find the financial resources they need. In this respect there remains a significant, yet unmet, demand from financially excluded microenterprises and self-entrepreneurs.

of institutional diversity, the range of actors that provide microloans in Europe is wide: mostly Non-Governmental Organisations (NGOs) – the most common legal type adopted – followed by Non-Bank Financial Institutions (NBFIs) and Credit Unions/Financial Cooperatives. In terms of social objectives, increased access to financial services emerges by far as the main mission pursued by MFIs across Europe. However, this trend is less pronounced in Western Europe where the job creation mission stands out as almost as important as financial inclusion (see p.6).

Preliminary results confirm that business microloans – that support self-entrepreneurs and microenterprises with loans up to 25,000 euros – are still by far the main financial product that MFIs offer in Europe, followed by personal microloans. These latter cater to critical needs of vulnerable clients such as rent, education and personal emergencies, as well as employability investments. Beyond microloans, the main financial products offered by MFIs are larger business loans (e.g. more than 25,000 euros to microenterprises and small and medium enterprises) and savings, in line with the previous survey results (2014-2015).

It is worth underlining that the scope of the microfinance sector in Europe is not limited to the provision of financial services to people excluded from the traditional financial markets. Available data show that a growing number of MFIs (almost 70%) offer much-needed non-financial support to their clients, and constitute a crucial and distinctive feature of MFIs in the European landscape. In the majority of cases, these services are internalised by MFIs and mostly delivered in the form of one-on-one coaching, consulting, mentoring or in group sessions (workshops, seminars, etc.).

Trends in microlending activity and outreach



A recent study commissioned by the European Microfinance Network (EMN) and Microfinance Centre (MFC) to evers & jung<sup>1</sup> assessed a total market potential for business microcredit of 2.7 million loan applications in EU-28 that results in a total volume of 17.4 billion euros in potential demand for microcredit in 2016. This estimate highlights the need for accessible small business loans from actors in the banking and non-banking sector, including alternative finance providers like peer-to-peer platforms or grey market lenders. The recent development of microfinance in Europe hints that this sector is increasingly addressing the needs of self-employed individuals and existing microenterprises that are still excluded from traditional banking services.

### A growing sector

As revealed by the preliminary data of the EMN-MFC Survey Report 2016-2017<sup>2</sup>, the microfinance sector has been steadily growing over recent years. In 2017, the surveyed Microfinance Institutions (MFIs) disbursed almost 700,000 microloans with a total volume of over 2 billion euros. Overall in 2017, MFIs reported almost 1 million total active borrowers, with a gross microloan portfolio outstanding of 3.1 billion euros.

When considering a six-year time span (2012-2017) these indicators reach a growth rate upwards of 50%<sup>3</sup>, confirming the dynamism of the microfinance sector in Europe.

Apart from that continuous development, the new data available confirm the persisting heterogeneity of the microfinance sector. In terms

### Support to the development of the sector

Overall, these figures depict a huge potential demand for microloans across Europe. They also show the dynamism of a sector supporting a growing number of vulnerable clients and microenterprises thanks to the combined offer of bespoke financial and non-financial services.

Despite the positive results achieved, MFIs in Europe still need adequate public and private support to ensure a wider outreach to the underserved, to constantly improve their institutional capacity and to be able to stay at the forefront of social and technological innovation. In order to deliver on its mandate to improve social and financial inclusion, the sector needs financial instruments (e.g. guarantees, senior loans, equity), grants for technical assistance and pilot projects, and subsidies to increase the accessibility of the services to the most vulnerable clients. These types of instruments are considered vital in the future of the EU support to the sector for the post 2020 period.

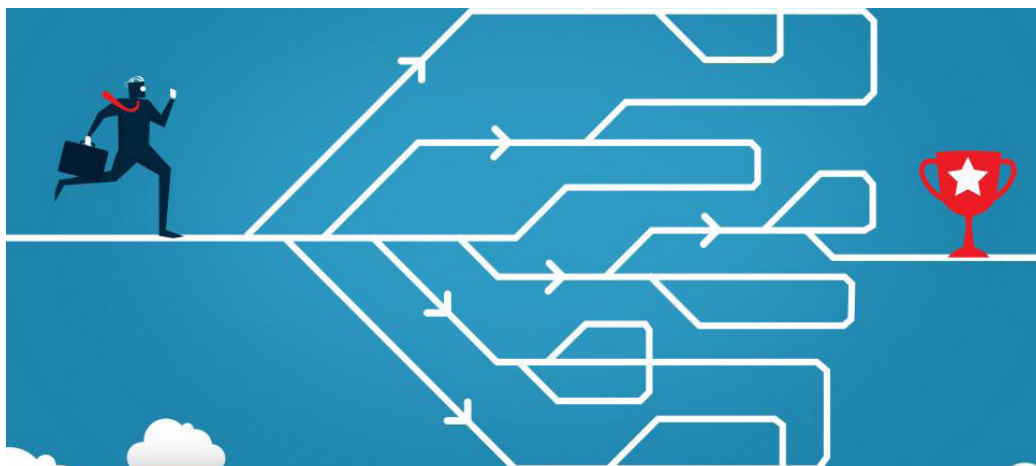
1 Assessing the European market potential of business microcredit and the associated funding needs of non-bank MFIs, evers & jung, 2017.

2 157 MFIs surveyed from 28 European countries. Full study to be released in December 2018.

3 Calculation based on a subset of 34 MFIs that replied to the last 3 waves of the survey.

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## Microfinance in Europe, a profitable sector?



Originally created in emerging countries, microfinance has strongly developed in Europe. This might be surprising, given that European countries are characterised by an efficient banking system and by generous welfare states. Yet demand continues to grow. In 2015, 747,265 European clients received microcredit for a total amount of 2.5 billion euros<sup>1</sup>. Despite this boom, microfinance institutions (MFIs) are struggling to guarantee their sustainability because of uncertain profitability (high operating costs, downward trend in interest rates, inability to collect savings, etc.).

The situation is however very different between Western and Eastern European MFIs, the latter being traditionally more profitable. After the fall of communist regimes, microfinance was introduced in Eastern Europe where the banking system was defective. Today, the microfinance sector is very dynamic and mature, to such an extent that some MFIs, pushed by private investors, have evolved towards a much more commercial than social business model. There, profitability is driven mainly by an increase in interest rates and consumer credit.

In Western Europe, the sector is younger – with the exception of France – and shows an undeniable societal return, but is also very dependent on public and private subsidies. According to a European survey by the European Microfinance Network, the average Return On Equity (ROE) in Europe rose from 2.8% in 2014 to 5.7% in 2015, but this

increase is mainly driven by Eastern Europe MFIs (3.6% in 2014 and 7.7% in 2015). In Western Europe, ROE actually remains negative (-0.4% in 2014 and -2.7% in 2015). Out of 98 MFIs analysed, 43 achieved operational self-sufficiency, of which only 7 are in Western Europe, while the best performing are based in Eastern Europe.

To evaluate this East-West gap, an analysis was carried out on some 30 MFIs, all clients of CoopEst, an investment fund dedicated to social microfinance in Central and Eastern Europe. Since 2006, and with the contribution of socially responsible investors (notably Crédit Coopératif and the European Investment Fund), CoopEst has been supporting this sector with senior and subordinated debt. The analysis is based on the average ROE of the MFIs in the portfolio and their cumulative net income over the 2013-2017 period.

By the end of 2017, the 29 MFIs in the portfolio showed an average ROE of 13% and a cumulative total net profit of 23.9 million euros. However, ROE has been decreasing since 2016, although it is still above 6%. The net

profit of the MFIs in the sample, remains positive but also demonstrates a downward trend. While the profitability of the majority of CoopEst's MFI clients remains positive, downward pressure can nonetheless be witnessed, even though their social impact is growing. By 2017, these institutions had contributed to the creation or maintenance of 67,765 jobs and the creation of 2,595 new businesses. Even in Eastern Europe, this negative correlation between profitability and social performance exists.

**The future of microcredit in Europe strongly depends on the ability of committed investors to provide affordable financial resources.**

Two of the influencing factors for this trend are the competition from "traditional" banks and low interest rates. Relying on their deposit base, these banks are seduced by MFI clients who are now considered

less risky than their traditional client base! That being said, there still are many micro and small enterprises that do not meet banks' criteria, and here lies the biggest social challenge for the sector. Yet, due to a cost structure that is totally different from that of banks, MFIs are required to offer higher rates, particularly when non-financial support is provided. To cope with this situation, MFIs must be innovative and even consider strengthening bank-MFI relationships to ensure the sustainability of their missions.

While European MFIs struggle to find a balance between social and financial performance, a decline in their profitability threatens their viability. The future of microcredit in Europe therefore strongly depends on the ability of committed investors (ethical and cooperative banks, socially responsible investment funds, public development agencies) to provide affordable financial resources to support social inclusion and job creation even in the most remote regions of the European Union, thus ensuring cohesion and development.

<sup>1</sup> Microfinance in Europe : a survey of EMN-MFC Members, Report 2014-2015, European Microfinance Network, 2016.

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Profitability and sustainability of MFIs in Western Europe and Eastern Europe

|                              | Eastern European MFIs |       | Western European MFIs |       |
|------------------------------|-----------------------|-------|-----------------------|-------|
|                              | 2014                  | 2015  | 2014                  | 2015  |
| Return on equity             | 3.6%                  | 7.7%  | -0.4%                 | -2.7% |
| Return on assets             | 3.2%                  | 3.2%  | 1.8%                  | 2.1%  |
| Operational self-sufficiency | 94.5%                 | 92.5% | 86.1%                 | 78.5% |

Source: Microfinance in Europe: a Survey of EMN-MFC Members, EMN, 2016.

# KEY FIGURES OF FINANCIAL INCLUSION | FRANCE

## Personal microcredit: a springboard to paid employment

Unlike its “professional” counterpart, the “personal” microcredit does not have a purpose directly linked to employment as it does not finance business creation. In France, the law states that it must finance projects for professional integration or social integration. In reality, the first objective has taken precedence: since 2005, 3 out of 4 microloans have been used to finance a project to access or maintain salaried employment. The main reason certainly lies in the fact that financing a vocational training project must be the most effective way to improve the precarious situation of microcredit seekers. Is this assessment justified?

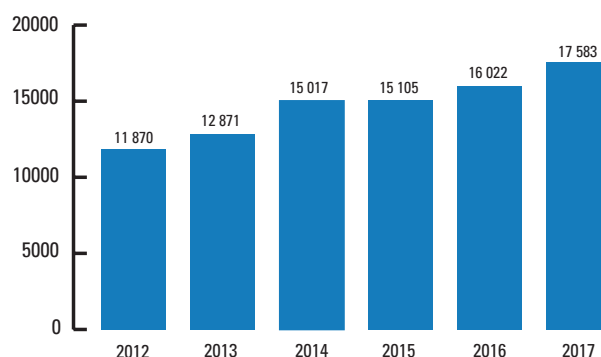
In 2013, Caisse des Dépôts conducted a study of the impact of personal microcredit. Interestingly, this study found that when borrowers pursued a professional objective, two thirds saw their situation improve or be preserved. However, the extent of the results varies according to the applicant’s initial situation: borrowers who were employed at the time of the request carried out their project in a sustainable manner in 72% of cases (keeping the current job, accessing improved professional conditions, etc.); those who were unemployed at the time of the request are only 55% more likely to have observed lasting success.

What about the impact of personal microcredit on the standard of living of borrowers? Here again, there is a positive effect: borrowers with a vocational training project see their average monthly wage rise from 771 euros when they apply for a microcredit to 881 euros at the time of the survey (the time between the two ranges from 6 months to 5 years).

Widely recognised, these positive effects of the personal microcredit in

France are dependent on the support offered by the many associations and credit institutions offering their services and counsel to borrowers. Through their advice, support and selection assistance, this ecosystem ensures that this type of loan maintains its social component. Interest rates, which range between 2.8% and 5.5% for a loan of less than 3,000 euros, also contribute to strengthening the social dimension of personal microcredit.

Number of guaranteed personal microcredit (SCF) distributed in France per year



Source: Caisse des Dépôts

## Professional microcredit

The Social Cohesion Fund’s (SCF) support to the professional credit segment is channeled towards the following mechanisms:

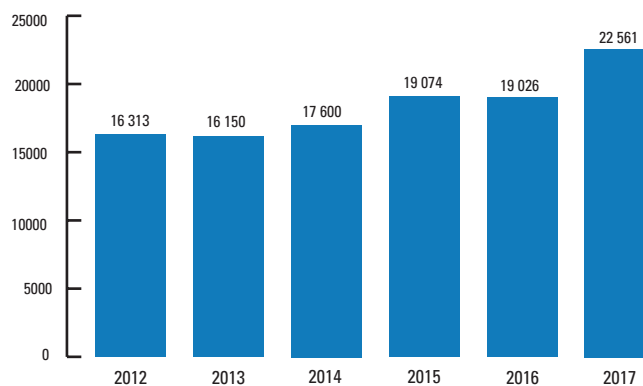
- Allocation of State funds pooled under the Guarantee Solidarity Fund for Female Entrepreneurship and Inclusion (FOGEFI)
- Support for the guarantee activity of the “Loi Galland” and territorial funds, managed by France Active
- Support for enterprise creation networks
- Interest-free loan (PTZ) since January 2017, formerly, “Nouvel accompagnement pour la création et la reprise d’entreprise” (Nacre).

In 2017, the SCF which is integrally funded by the State and the Ministry of Labour, Employment, Vocational Training and Social Dialogue, allocated 18.8 million euros to these various guarantee programmes. 9.1 million euros were allocated to the FOGEFI and “Loi Galland” guarantee lines and 1.7 million euros were used to partially cover support costs. The remaining 8 million euros was used to guarantee PTZ interest-free loan.

Through these funds, the SCF has helped finance the creation, takeover or development of nearly 24,800 very small businesses (VSBs) or social enterprises, including 21,387 beneficiaries of a bank loan guarantee (or similar). These guarantees are distributed in the following way: 20,732 VSBs, 655 social economy organisations, and 5,475 beneficiaries of PTZ.

In 2016, the impact of professional microcredits guaranteed by the SCF on employment amounted to 35,432 jobs created or consolidated in the following areas: bank or non-bank guarantees, mostly during creation for VSBs and mostly during creation and consolidation for social economy organisations. This figure is slightly down on the previous year.

Number of guaranteed professional microcredits (SCF) distributed in France per year



Source: Caisse des Dépôts

19,468 jobs were generated in the VSBs sector, including 8,662 thanks to bank guarantees (notably linked to female entrepreneurship) and 10,806 thanks to non-bank guarantees such as Adie’s. In the social economy sector, the number of created or consolidated jobs amounted to 15,964. In addition, entrepreneurs benefiting from PTZ reported a forecast of 7,492 jobs created. Taking into account a 38% coupling rate in 2017 of PTZ files with an SCF guarantee, it can be extrapolated that more than 40,000 jobs were either created or consolidated thanks to financial support from the SCF.

ECONOMIC DEVELOPMENT & SOCIAL COHESION DEPARTMENT  
CAISSE DES DÉPÔTS GROUP

# KEY FIGURES OF FINANCIAL INCLUSION | FRANCE

## Microcredit in France: social work or profitable operations?



“As opposed to developing countries, no microfinance provider in France balances its accounts solely on the basis of the financial income from this activity.”<sup>1</sup> This is the conclusion drawn up by the International Labour Office in 2015, which paraphrases the analysis made by the General Inspectorate of Finance five years earlier. As an example, and despite an operational efficiency that is undisputed, two thirds of Adie’s resources come from public funds or private generosity.<sup>2</sup>

In France, looking for financial balance would mean strongly increasing the microcredit interest rates above 30%, which would be socially unacceptable.

In France, looking for a financial balance would mean strongly increasing the microcredit interest rates above 30%<sup>3</sup>, which would be socially unacceptable. The performance of microfinance providers is not challenged. Indeed, comparative studies, and in particular the European Microfinance Network survey, show that the operational efficiency of French players is among the highest in the world.<sup>4</sup> However, the income generated by the distribution of microcredit barely covers a quarter of their expenses.

How can this imbalance be explained? Firstly, the narrow demand for such products, compared to countries like Bangladesh, limits economies of scale. Secondly, targeting clients that are excluded from employment and often in precarious situations involves an individual support and represents difficult to absorb costs. In Spain, one case stands out: Caixa Bank’s Microbank has frequently been given as an example of profitable microcredit. But it should be pointed out that Microbank’s grant awarding process is based on remote scoring of files which are processed charge free by more than 500 partner organisations. Basically, this amounts to outsourcing some of the operational costs.

Based on this analysis on the nature of microcredit in France, the Caisses d’Epargne and their partners defend a hybrid economic model based on the action of both solidarity and private operators – be they associations or banks – and on public financing able to bear part of the cost of risk, as well as the cost of borrowers’ support. In this respect, the Social Cohesion Fund (SCF), endowed by the State and managed by the Caisse des Dépôts et Consignations, plays an important role as it covers a significant proportion of microcredit in France and partly finances support networks (see p.6).

One borrower out of two claims that the granting of a personal microcredit helped improve or protect his/her professional situation.

The government’s recent decision to re-establish and sustain a grant of 20 million euros per year to the SCF, against 14 million euros in 2018, should help to boost the activity. More than an expense, the State’s allocation to the SCF is a socially profitable investment, if we refer to studies that have proven the positive impact of microcredit on borrowers and society. For example, one borrower out of two claims that the granting of a personal microcredit helped improve or protect his/her professional situation. Rather than opposing concepts of “social” and “profitable”, microcredit in France thus combines both, provided that we consider profitability beyond its strictly financial dimension.

1 Le microcrédit en France et en Europe en 2030, Bureau International du Travail, 2015.

2 Le microcrédit, Inspection générale des finances, 2009.

3 Programme d’action et budget de l’Adie, Adie, 2016.

4 Microfinance in Europe : a Survey of EMN-MFC Members, European Microfinance Network, 2016.

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### THE FRENCH MICROFINANCE PARADOX

French MFIs are among the most efficient in Europe in terms of economic and social efficiency. Yet, none have been able to become self-sufficient. Some figures behind this paradox:

**3%**

The annual interest rate of microcredit in France, the lowest in Europe<sup>1</sup>

**30%**

To reach financial balance, French MFIs should increase their interest rate up to 30% or more<sup>1</sup>

**0.17**

Each euro lent by French MFIs costs on average 17 cents in operational expenses. This number, particularly low for European MFIs, demonstrates the economic efficiency of French MFIs<sup>2</sup>

**27**

The operational self-sufficiency ratio, which evaluates MFIs’ financial independence is 27 in France. Through their activity, French MFIs therefore cover only 1/4 of their expenses<sup>2</sup>

1 Data from the 2016 study of the EMN “Microfinance in Europe : a Survey of EMN-MFC Members”

2 Data from the 2014 study of the EMN : “Overview of the microcredit sector in the European Union. Brussels: European Microfinance Network”

# SOCIAL PERFORMANCE

## The challenge of microfinance: being responsible to be sustainable, being profitable to remain responsible

We all have heard it before: “You work in microfinance? Isn’t that making profits off the backs of poor people?” The unspoken premise is that making profit in microfinance is bad. While the formulation is way too simplistic, who among us hasn’t grappled with feelings like the anti-Robin Hood at times?

Of course, we know reality is much more nuanced. Scaling up financial services that aim to reduce the vulnerability of the poor, excluded and the marginalised, calls for business models to develop, evolve and innovate. The dominant funding model is nowadays based on debt and equity (compared to subsidies of yesteryear), making profitability, or the very least operational self-sufficiency, a minimum requirement. Profits in microfinance or BoP businesses are not a bad thing, provided they are serving their social mission and their target population. Ultimately this is what makes microfinance different from other forms of finance. Robust financial performance is a means to an end, it isn’t the end itself.

Easy enough to say. But how easy is this to measure? How do you tell the difference between an institution that drives its financial performance to reach a larger goal versus one that is simply driven by numbers? What counts as “justifiable” profits? How high is too high?

Thanks to years of broad consultation, answers to these questions and to the overall responsibility of the microfinance sector towards its clients and its staff have emerged in the form of the Universal Standards for Social Performance Management. These Standards form a set of core business practices adopted in 2012

**Average SPI4 score by sub-region, from the highest to the lowest**

| Rank | Subregion                    | SPI4 score (average) |
|------|------------------------------|----------------------|
| 1    | Asia (other)                 | 74.8%                |
| 2    | South America                | 70.5%                |
| 3    | Europe and Central Asia      | 70.0%                |
| 4    | Caribbean                    | 65.2%                |
| 5    | Central America              | 64.0%                |
| 6    | Middle East and North Africa | 61.5%                |
| 7    | South East Asia              | 61.2%                |
| 8    | Sub-Saharan Africa           | 54.1%                |

Source: CERISE database - 2018

that includes the Client Protection Principles, and which provides guidance to microfinance providers on how to balance financial and social performance. By adopting the Universal Standards, microfinance providers ensure that their management systems – their policies, procedures, training, internal controls – are built to achieve their social mission. It doesn’t mean losing sight of strong financial performance and profits, but rather making sure profits serve the mission.

CERISE-SPI4 is the social audit tool that allows financial providers measure themselves against the six dimensions of the Universal Standards (and the optional “Green Index” as a seventh dimension). Used by over 300 MFIs around the world, CERISE-SPI4 assesses to which extent the social mission is integrated into strategy and operations. It measures how clients’ needs and feedback are taken into account in designing and delivering products. It looks at whether clients and staff are treated responsibly. And in dimension 6, SPI4 analyses how well the provider balances its social and financial goals.

**Microfinance should be profitable (to last), socially responsible (to make a difference in people’s lives) and environmentally aware (to build resiliency to climate change).**

The standards under this dimension explore, for example, how growth rates are set. Are they set to generate maximum returns, or do they reflect a concern for a healthy and controlled growth, to minimise the risk of over-indebting clients? Are growth rates monitored, not just to see if projections are being met, but to make sure staff are able to keep up with growth, and maintain high quality service? Evaluating a provider against these kind of indicators helps giving a clearer idea about whether growth (and by extension financial performance) is the ultimate goal or the means to an end.

When it comes to profitability, SPI4 integrates client protection standards that assess if pricing, and therefore profits – a key driver of pricing<sup>1</sup> – are responsible. Under these standards, the profitability ratio Return on Assets (ROA) is assessed against Smart Campaign-defined benchmarks: ROA above 3% is considered elevated, and over 7.5% is high. Having a ROA over

### The 6<sup>th</sup> dimension of the Universal Standards for Social Performance Management



Source : The Universal Standards for Social Performance Management Implementation Guide, SPTF, Leah Wardle

3% does not necessarily mean the provider is making excessive profits, but a credible explanation is needed for high ROA to be justified. For example, profits may be diverted to an external entity (like an affiliate NGO) that provides valuable non-financial services to clients. Profits may be shared with clients, or be used to build up equity, or expand an early stage institution. High ROA may be due to a high inflationary environment or high reserve requirements. But if profits are above levels justified by the operating context and mainly benefit shareholders, then they are not serving social goals.

Microfinance should be profitable (to last), socially responsible (to make a difference in people’s lives) and environmentally aware (to build resiliency to climate change). The Universal Standards, the Green Index and the SPI4 audits conducted all over the world guide providers and their partners in finding the right balance and progressing towards an ever more responsible financial sector to reach the bottom of the pyramid.

<sup>1</sup> Assessing price fairness in microfinance, Smart Campaign, 2016.

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## Credibility, transparency and communicability: the three challenges of the SROI approach

Inspired by the cost-benefit analysis, the Social Return on Investment (SROI) is a method coming from the United Kingdom, which aims to monetise the impact of an organisation with a social mission.

By quantifying the social return achieved by an organisation with a social mission, this specific kind of ROI is a valuable tool to convince investors that their investments are financially profitable, because they are socially impactful.

The SROI method is neither an instrument specific to microfinance nor a social impact measurement tool. It does not produce a diagnosis and does not help MFIs to optimise their organisation or their products. That being said, it proves extremely useful for structures resorting to external financing. By quantifying the social return achieved by an organisation with a social mission, this specific kind of ROI is a valuable tool to convince investors that their investments are financially profitable, because they are socially impactful. This assimilation is the core of the approach.

The implementation of the SROI approach is the logical continuation of impact measurement practices already implemented by Adie, french association which supports and provides microcredit in France. In the early stages of this process, three issues had been identified upstream: credibility, transparency and communicability.

The credibility of the SROI evaluation is assessed according to two factors: the scope used to estimate profits and costs, and monetary valuation principles. One can seek to monetise so-called "indirect" benefits, or even go as far as calculate

intangible contributions, for example the psychological benefits of creating a business. This exercise is hasardous, and this is why the approach was restricted to tangible externalities that can be clearly identified and legitimately quantified in monetary terms.

Another important issue is transparency. The SROI approach is characterised by simple-to-understand outputs that result from an elaborate process. Beyond the results, it was necessary to display the hypotheses and method that were used, without the latter appearing as an opaque and complex "black box".

Finally, communicability required a method that non-experts could understand, without obscuring the multiplicity of factors that were included, and the inherent complexity of their quantification.

### A simple principle, but complex calculations

In this context, Adie worked with KPMG in 2016. The aim of this partnership was to quantify the benefits of professional microcredit (social costs avoided and revenues generated), and to compare them to the cost borne by investors, both public and private, to ultimately measure the economic effectiveness of the action. This simple equation calls for in-depth calculations, in particular for the measurement of profits.

Four data sources were used in this SROI approach: Adie's financial accounts, customer data from its information system, public statistics (INSEE, CAF, etc.) and the latest study on the impact of professional microcredit.

This study made it possible to reconstruct typical entrepreneurial paths: business sustainability, professional integration of entrepreneurs, average lifespan of non-lasting businesses, amount of social welfare benefits received, number of jobs created, etc. Three typical situations were quantified: sustainable enterprise, non-lasting enterprise but employed entrepreneur, non-lasting enterprise and unemployed entrepreneur. The incurred social costs, the avoided costs and

the economic benefits generated were then allocated to each of these situations and for each year.

The costs avoided are essentially of two kinds. On the one hand, Adie's action prevents a number of entrepreneurs from switching to minimum social benefits once their unemployment benefits rights have been exhausted. On the other hand, income from new businesses has led to a decrease in the average amount of social benefits, particularly the Revenu de solidarité active (RSA) the french minimum welfare benefit for the unemployed.

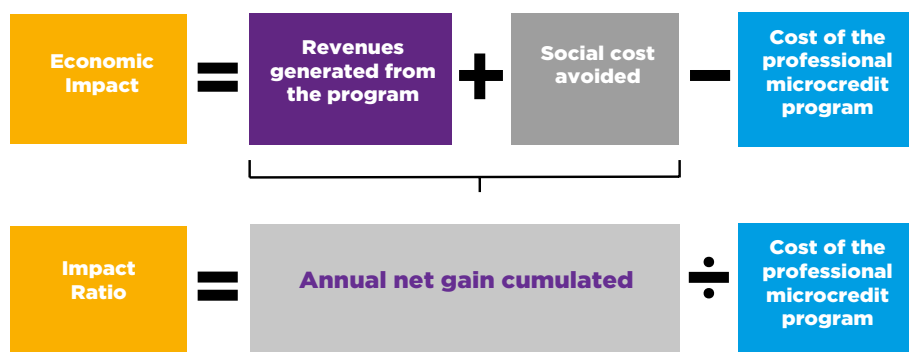
Economic benefits (value creation) are strongly associated with tax and social welfare revenues: those based on the activity of the companies created, including taxes on turnover and charges on jobs created, and those stemming from charges on the wages of entrepreneurs who have returned to employment. In addition to this direct taxation, the received income gives rise to indirect taxation which is taken into account in the calculation.

The ratio of cumulative annual net gains against the cost of the programme (after discounting to their current value the cash flows subsequently received) shows that Adie's activities are profitable at 2.38 euros per euro invested.

Over two cumulated years (2013 and 2014), the cost of the programme amounted to 24.4 million euros, and costs avoided as well as economic benefits were respectively estimated at 16.7 million euros and at 45.3 million euros. This represents a social return on investment of 37.7 million euros. The ratio of cumulative annual net gains against the cost of the programme (after discounting to their current value the cash flows subsequently received) shows that Adie's activities are profitable at 2.38 euro per euro invested and that its cost is covered in 14 months.

This very enriching experience can be transposed to other microfinance contexts. For Southern MFIs, the calculation inputs are very different, but the reasoning principle remains the same. The transparency effort of such a SROI approach can only strengthen relations with investors and bring many benefits to MFIs.

### Calculation of the social return on investment for the professional microcredit



Source: Synthèse sur l'étude Retour Social sur Investissement (SROI) de l'Adie.

THIERRY RACAUD  
RESEARCH DIRECTOR  
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### Are microfinance investments still profitable for investors?

Historically, international funding for microfinance came from donor organisations, including public development agencies and private foundations. As the sector commercialised, the need to access capital markets became crucial for the professionalisation of microfinance institutions (MFIs), thus paving the way for the development of Microfinance Investment Vehicles (MIVs).

These independent investment vehicles open to multiple investors and specialised in microfinance were created in order to channel private capital to MFIs through debt or equity. Two decades after the set-up of the first MIVs in the industry, they still remain the primary gateway for private investors looking to invest in emerging and frontier markets mainly because of their expertise over the whole value chain. As of the end of 2016, there were 127 MIVs with 13.5 billion dollars of total assets under management (AuM) globally<sup>1</sup>.

Despite the historical and crucial role of Development Finance Institutions in the growth of MIVs, these vehicles are today largely financed by private institutional investors, including among others: pension funds, banks and foundations (52%). Retail investors and high net worth individuals constitute 28% of total funding

and 20% of total capital is sourced from public investors.

Fixed-income MIVs hedged in dollars have shown a positive performance for the last ten years, without a negative year or even a negative quarter. Their net returns have averaged 3.3% over the 2006-2016 period (see graphic below), and USD-hedged MIVs are estimated to represent 75% of total MIV AuM.

Net Asset Value (NAV) per share performance was at its peak back in 2007-2008 (i.e. 6.5% and 6.2% respectively), declining dramatically following the financial crisis to reach 2% on average for the next three years (2009-2011). The pressure on credit premia was mainly due to the drop in money market rates, resulting in MFIs' demand for lower financing rates.

In addition, increased liquidity levels in local markets led to an increased competition among MIVs which put downward pressure on yields<sup>2</sup>. 2012 witnessed a short peak (3.5%) before returns declined again in 2013 (2.5%) when several emerging market currencies depreciated against the dollar resulting in a rise of hedging costs for local currency funding<sup>3</sup>. Returns in the following years continued to average 2.5% due to political and economic crisis in several emerging markets. Despite the decline in returns,

MIVs' portfolio quality remained stable with loan loss provisions averaging 2% of MIVs' microfinance portfolio while loans written-off were much lower, registering 0.5% for the period under review.

Due to the labor intensive nature of MIV business models, MIVs' total expense ratio (see "Methodology") did not decrease dramatically but rather, remained stable at 2.3% on average, naturally varying for funds with different investment strategies.

In terms of social outreach, MIVs on average financed 400,000 active borrowers at the end of 2016, with a important increase throughout the years.

Overall, MIVs witnessed stable growth and sustained profitability through several challenging periods for international capital markets, among others the financial crisis of 2007-2008, and the different microfinance crisis that followed, most notably in Nicaragua and India. MIVs have proved to be a stable and resilient channel for private investors wanting to approach financial inclusion from an investment perspective, providing a de-correlated financial return along the important social component in the context of future population growth in many emerging and frontier markets<sup>4</sup>.

Furthermore, MIVs can contribute towards the United Nations' 2030 Agenda for sustainable development by financing the current sustainable development gap estimated at 2.5 trillion dollar per year, most of which will be channeled towards emerging and frontier markets through financial inclusion schemes. MIVs thus remain catalysts in facilitating foreign private sector capital towards the Sustainable Development Goals, more so given the increasing evidence that financial inclusion has a direct impact on outcomes such as health (SDG 3), education (SDG 4) and gender equality (SDG 5) in addition to having an indirect impact on broader SDGs, in particular on growth (SDG 8), as it facilitates the financing of small and medium enterprises, as well as inequality (SDG 10) and peace (SDG 16).

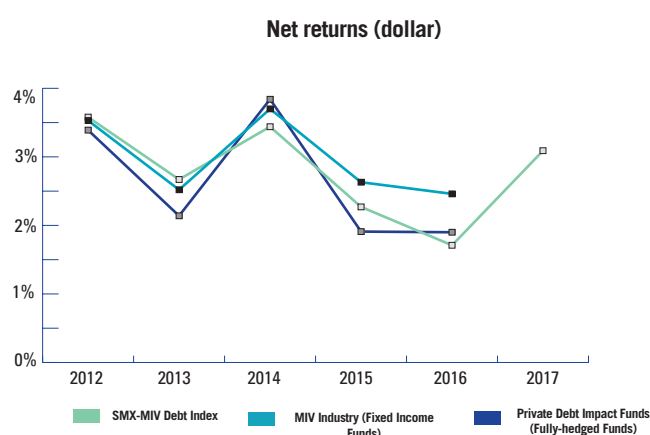
1 2017 MIV Survey 2017 – Market Data & Peer Group Analysis, Symbiotics, 2017.

2 Swiss Microfinance Investment Report, Symbiotics, 2011.

3 Microfinance Funds : 10 Years of Research and Practice, Symbiotics & CGAP, 2016.

4 Why Microfinance Matters to Investors, Symbiotics, 2017.

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Source: Microfinance Funds : 10 Years of Research and Practice, Symbiotics & CGAP, 2016 Symbiotics

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### FOCUS ON : SYMBIOTICS

As one of the leading market access platforms for impact investing, over the past decade Symbiotics, a specialised impact investing asset manager registered in Switzerland has originated and structured nearly 3460 investment transactions worth more than 4.4 billion dollars on behalf of 399 companies in 81 emerging and frontier markets, all serving measurable sustainable and inclusive finance objectives.

The company's investor clientele, concentrated in Scandinavian and Germanic countries in Europe (mostly Austria, Germany, Finland, Sweden and Switzerland), is essentially made up of large banks, asset managers and institutional investors. In addition, 2018 saw the launch of Plumseeds.com, a Symbiotics on-line platform that enables specialised emerging or sustainable professional investors and fund managers to directly purchase microfinance, impact or local green bonds on a deal-by-deal basis, having access to both social and credit ratings. This platform has contributed to the Symbiotics' origination of more than 1 billion dollar in bonds by 75 different counterparties in 32 emerging and frontiers markets since 2010.

### Methodology

This 10-year review of the microfinance offshore investment landscape is based on data collected through annual CGAP/Symbiotics MIV Surveys conducted between 2007 and 2016. The article focuses on MIVs, as defined in the disclosure guidelines – namely independent investment vehicles with more than 50% of non-cash assets invested in microfinance and open to multiple investors. Most metrics, including growth calculations, were determined using a constant dollar exchange rate as of December 2006.

### A closer look: Why invest in microfinance?

**W**hile microfinance is still a young sector, it has experienced significant annual global growth in recent years, averaging close to 9%: joint interview with Eric Campos (Head of Social and Corporate Responsibility, Crédit Agricole SA & CEO, Grameen Crédit Agricole Foundation), Alain Lévy (Head of Microfinance for Americas and Asia, BNP Paribas) and Dominique Lesaffre (CEO, SIDI) on the profitability of the sector and the best practices to combine economic and social performance.



#### What motivated your respective organisations to invest in microfinance?

**Alain Lévy (AL):** BNP Paribas has been active in the sector since 1989. Within the Group, the microfinance department does not follow a traditional commercial approach. Even if we practice a fair margin on our operations, our objective is mainly social because it requires us to finance 350,000 micro-borrowers by the end of 2018. It is an opportunity to contribute to the social development and the financial inclusion of fragile populations in countries where we work.

**Dominique Lesaffre (DL):** SIDI's mission is to support the socio-economic integration of marginalised populations by focusing on the "social return" of its action. More specifically, SIDI aims at sustaining, developing and improving the supply of financial and non-financial services, particularly in underserved areas (countries in crisis, rural areas, Sub-Saharan Africa). For this reason, we support the institutional, economic and social consolidation of local MFIs.

**Eric Campos (EC):** We are not investors but operators. The Foundation was created by Crédit Agricole in association with the Nobel Peace Prize Laureate Professor Yunus to fight poverty rather than investing in the fight against pov-

erty. This is a major difference. We were created to take part in the process of eradicating poverty alongside other actors. For this purpose, we put into place a wide range of actions all of them conceived with a common objective: the quest for impact maximisation and sustainability of our interventions.

#### How do you manage financial risks in your microfinance activities?

**EC:** There are several types of risk: the most common ones refer to the counterparty risk, the currency risk and the interest rate risk. Our approach focuses on protecting our partners by adapting the structure and nature of our financing according to their activity. We work with MFIs whose grant loans almost systematically in local currency, in order to avoid exposure to currency risk. We lend at a fixed rate to protect our clients from regular fluctuations. Regarding counterparty risk: after setting up our financing, we monitor and anticipate it by using key indicators. For this purpose, all necessary information is provided by our partners on a quarterly (sometimes even monthly) basis.

**AL:** For our part, we have conducted a lot of internal education to explain to the bank's staff that microfinance is not a philanthropic activity but a social business. We

have therefore implemented the same procedures as for the other credit lines: creation of a specific risk policy, due diligence, drafting of a credit proposal, presentation in a risk committee, quarterly monitoring... Our objective is twofold: to demonstrate that MFIs have the financial capacity to repay their loans while respecting their social mission towards their micro-borrowers. Finally, all our investments are also issued in local currency.

#### After several years of investment, what is your assessment of the microfinance sector? Has it been profitable for your organisations to invest in this sector?

**EC:** The microfinance sector is a young sector that has experienced many improvements in social and financial performance mostly driven by private actors. For instance, international standards have been enacted by practitioners gathered in the SPTF, an association in charge of encouraging the production of new standards for assessing social performance. For its part, the Foundation has recorded a positive net result. It has supported and financed more than 60 microfinance institutions with a demonstrated high level of social performance management. We currently operate in more than 30 countries and partner with local MFIs that serve approximately 3.5 million beneficiaries. Therefore, it is entirely possible for an institution to be financially sustainable at the same time that it generates a relevant social impact.

**DL:** After 35 years in the sector, SIDI is satisfied with the results of its investments on the structuring of local institutions, and therefore on the quality and sustainability of services provided to the population. For example, Amret in Cambodia, and Centenary Bank in Uganda, two MFIs that we have supported and for which we were the founding shareholder have since then become profitable and efficient leaders of their respec-

tive markets. It is also worth noting that our internal rates of return on microfinance investments, loans and equity investments combined are positive. This confirms that it is possible to fulfill a strong social mandate while being profitable.

#### How can we ensure that social performance is not sacrificed on the altar of profitability?

**AL:** Profitability is necessary in the sector given that it implies sustainability. For the MFIs in our portfolio, we ensure that the search for profitability is consistent with their social mission. During field missions, we check interest rates and visit villages to discuss MFIs' practices with micro-borrowers. We have also set up a technical assistance program by deploying CERISE's SPI4 social performance analysis tool. After training them, we send pairs of executives on the field for a week to analyse MFI's social performance.

**DL:** If social accountability is not just a shallow concept to satisfy CSR needs, and if it meets MFI's strategic objectives instead, then social performance has its rightful place and does not need to conform to the standardisation currently observed, which tends to reduce the ability of institutions to define their strategic priorities. Under this condition, social performance can even become one of the bases for financial profitability as it might lead to lower costs (customer loyalty, reduction in PAR, staff turnover, etc.).

INTERVIEW BY  
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### The illusory inevitability of Social Impact (and why trade-offs matter...)

Since the dawn of the commercialisation of microfinance nearly two decades ago, investment in microfinance has been made on a widely-accepted premise: investors will receive a “market rate” financial return, while pursuing a socially-motivated strategy. This premise is so widespread that it has taken on the allure of all groupthink, becoming an accepted truism, without necessarily being true.

The double-bottom line – the equal focus on financial and social return – can be deceptive. The dilemma is that while financial return has a clear target, social return is more nebulous. What social return is really being promised? Is serving a certain segment of clients enough? Do additional products need to be offered? What about financial education?

There are cases that call for difficult decisions and real choices. Consider: many social investors measure impact by the amount of money invested, even though their funds may often stand in competition with locally-raised deposits, which themselves are at least as socially beneficial as credit. By undermining their investee’s incentives to raise local deposits, well-meaning investment may lead to reduced – and even negative – social returns.

Or consider interest rates. Large loans tend to have lower rates than small loans, often while generating higher profits. A MFI that moves upmarket to serve wealthier customers will appear to deliver both higher financial return (bigger profits) and social return (lower interest rates). But this is specious: the “double” return is achieved by shifting away from Bottom of the pyramid populations, the precise target population that the institution was set up to serve in the first place.

A simplistic retort is to invert things – that only when investors are willing to lower their financial return targets can they be reassured of having achieved positive social return. This, too, is wrong. Countless examples show that even well-intended charity causes more harm than good.

Unsurprisingly given its dual mission, the microfinance sector has in fact been at the forefront of developing real-world social return metrics.

#### Picking the high-hanging fruit

The truth is that ensuring social return is difficult. Delivering a true double bottom line is possible, but requires dealing with the complex uncertainties hidden behind that nebulous social return. What social mission is the institution trying to pursue, and is it actually succeeding in doing so? Who are its clients? Are the institution’s services truly offering what is needed, and is the institution effective at separating cases where it does good, from those where it actually does nothing, and even causes harm?

Despite these difficulties, recent efforts to analyse and evaluate the complexity of the double bottom line are encouraging.

Unsurprisingly given its dual mission, the microfinance sector has in fact been at the forefront of developing real-world social return metrics, encapsulated by the work of the Social Performance Task Force’s around the SPI4 tool (see p.8). Such tools have contributed to the emergence of a class of committed social investors that recognises the true complexity and necessity of the double bottom line and has invested in and focused on measuring not only financial but also social “profitability” in an empirical manner.

The outcome of these efforts has been to show that financial and social returns can be complementary and mutually beneficial. Increased focus on Social Performance Management (SPM) can improve efficiency, allow for lower margins, reduce staff turnover and deepen the organisation’s understanding of its clients’ needs, giving it a competitive advantage that is difficult to duplicate. This can then support higher financial profitability.



Meanwhile, a strong social focus may lead investors to new markets that others assume unprofitable. In many ways, a strong SPM focus is reminiscent of the 1950s-60s Japanese manufacturing revolution pioneered by W. Edwards Deming: investing in a metrics-driven system can yield long-lasting returns, in this case, both social and financial.

Investors that believe in an illusory automatic link between financial profitability and social impact are more likely to take social impact for granted.

#### Humility and incentives: understanding why social impact matters

Above all, social responsibility requires humility. Setting the goal of “outreach” without recognising market capacity and realistic limits can lead to an excess of even well-designed products. Credit in particular has this risk: too much credit is often worse than no credit at all.

Humility also comprises willingness to think about demand-driven and not just “we-know-best” supply-driven solutions. But doing that requires serious, long-term investment in SPM capabilities that only committed social investors are willing to make.

Beyond humility, from a behavioural perspective it is the incentives that matter. Investors that believe in an illusory automatic link between financial profitability and social impact are more likely to take social impact for granted. This pernicious syllogism – a. I am funding microfinance; b. microfinance is Good; therefore c. I am doing Good – has dominated the narrative since the industry’s beginning. But in reality, the experience of MFIs around the world shows that financial profitability is the easier threshold to clear; it is the “doing good” that is much the harder part.

Ensuring social impact demands investment, attention, monitoring and evaluation and, sometimes, tradeoffs in financial return. That being said, the very fact the question is asked – not just in the Barometer, but in boardrooms industry-wide – illustrates how far we have come.

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# SPECIAL REPORT

## Microfinance and Profitabilities

### Under what conditions can an MFI be profitable?

At the very heart of the business model of microfinance institutions (MFIs) lies the question of their profitability. In order to be profitable and assist its clients the microfinance sector must find the right balance between financial return and social impact. This is particularly important given the nature of micro borrowers who are very often considered as economically unprofitable and too risky by traditional banks.

To enable the greatest number of entrepreneurs to have access to their services, MFIs have made an effort in terms of enhancing efficiency and rationality: the current average global cost of a microfinance loan is 120 dollars, against more than 150 dollars 10 years ago. Despite this effort, nearly half of the MFIs in the world are still not profitable. Can they become even more effective?

With an average effective annual interest rate of 25% at the end of 2017 (this rate was still 28% at the end of 2015), the price of microfinance services (cost of credit) remains significantly higher compared to traditional banks.

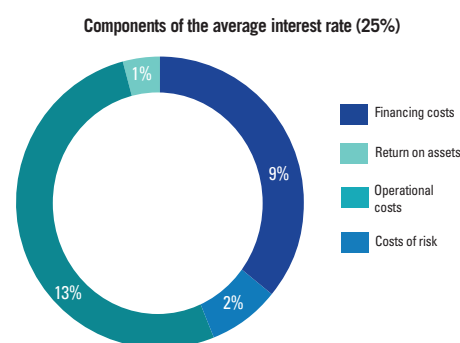
The operational costs (mostly human resources-related) are much higher in microfinance whereas the amount of each loan is usually very low. Need for intensive support of clients, modest amounts of repayment – often made in cash – and examination of credit files all lead to higher expenses. Meanwhile, central banks' demand for compliance has also increased. Together, these factors help to explain why more than two thirds of the credit cost is allocated to cover operational

expenses. Despite an excellent credit risk in the sector, the price of financing remains relatively high at more than 8.8% on average. It may even go as high as 20% in some countries due to significant currency hedging costs.

Finally, despite MFI's continuous improvements in internal processes and attention regarding the quality of their portfolio, the cost of risk in microfinance remains above 2% and has even slightly increased over the past 10 years. This is explained by the greater fragility of clients and countries where microfinance institutions operate (high risk of insecurity or high macroeconomic risk), but also by the institutions' own weaknesses, notably in terms of governance, human resources, internal control, etc. The simultaneous control of all these factors (operating expenses, refinancing expenses and cost of risk) is therefore essential to guarantee the profitability of an MFI.

However, it is interesting to note that MFIs with a good social performance tend to show good financial results as well. This demonstrates that these two approaches are not opposed, they are rather very complementary.

Being more efficient means that institutions must be able to adapt to new digital challenges in order to face the increased competition as well as the emergence of new players. In this case, efficiency may also include adapting to the new challenges of financial inclusion and the diversified needs of clients (access to improved housing, green energy, savings, etc.).



Source: Symbiotics proprietary research

These challenges require new investments – often in significant amounts – along with institutional transformation, innovation and adaptability. This must necessarily involve more professional and informed governance as well as more responsible investors. The latter must remain attentive to the needs of MFIs by offering more diversified products and supporting these institutions in their evolution, notably through technical assistance.

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SYMBIOTICS



### Ensuring the profitability of microfinance in Cote d'Ivoire: a case study from the Advans Group

How can a microfinance institution (MFI) achieve sustained profitability while continuing to responsibly serve a wide range of target clients? This is the question Advans Côte d'Ivoire, an Ivorian MFI, has faced since its creation. In 2017, after less than six years of operation, the MFI achieved a return on equity of 19%, while continuing to target Small and Medium Enterprises (SMEs), microbusinesses, farmers and village savings associations, amongst others. So, what are the barriers to profitability in the Ivorian market and what are the keys to such a success?

Despite the post-political crisis context, the Ivorian economy has flourished since 2012, benefitting small business owners, triggering a decline in poverty rates and in turn creating a dynamic microfinance market. The microfinance sector's profitability is however under pressure due to the cap on interest rates charged to microfinance clients (all-in-rate at 24%) and strong competition, especially in Abidjan. Delays in the set-up of a credit bureau to monitor client over-indebtedness have increased the level of portfolio at-risk for some players.

To face these constraints, Advans focuses on controlling all other profitability levers, particularly operating, financial and impairment expenses. Firstly, stronger penetration in the SMEs market and supporting SMEs clients in their growth has improved operating efficiency. Efforts have also been made to reduce costs through retaining satisfied clients with a good history rather than continuously renewing the client base. Coupled with close control of operating costs, this resulted in an operating expense over average total assets ratio of 9% at end-2017, which is relatively low for an MFI also serving rural clients (14% of total clients).

Secondly, mobilising retail deposits has helped to lower the cost of funds. Advans has developed a wide range of deposit products, services and delivery channels to improve deposit mobilisation and client service. In addition, thanks to its performance and the attractiveness of the Ivorian market, the institution benefits from competitive borrowing rates.

Finally, loan portfolio quality and loan-loss provision remain the main threats to the profitability of Ivori-

an MFIs. Nevertheless, the experience of Advans shows that, with a proper lending methodology, based on transparency, a comprehensive set of policies followed by all and thorough client assessment, an MFI can maintain a strong portfolio quality. Key to this quality is also the financial education of clients and staff commitment, which are essential in entrenching an on-time repayment culture.

This sustained profitability has enabled the institution to reinvest in its staff, pay dividends, and, most importantly, develop new tailored services to continue reaching un(der)served business-owners, farmers, and their families.

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### The Grameen America model: can the Bangladeshi model work in the USA?

“**W**all Street does banking for the world, but it doesn't do banking for its neighbours. We are here to show there is nothing wrong with banking with neighbours.” Moving from words to action, Professor Muhammad Yunus, the 2006 Nobel Peace Prize winner, created that same year Grameen America (GAI), a microfinance institution (MFI) built upon the success of the Grameen Bank in Bangladesh. His assumption at the time was that the Bangladeshi model could work in the United States.

Yet, one might wonder whether it is advisable to duplicate a model specifically designed to meet the needs of developing countries in a developed country. After all, how can an institution based in the United States – a high cost country – reach breakeven with lower interest rates and higher operational costs?

But this was the audacious gamble made by Pr. Yunus. The methodology applied by GAI in its 20 branches is the same one as in Bangladesh: five urban women create a group in order to get a micro-loan. They then pay back during weekly meetings and also feed personal savings accounts.

Even if there is no joint-liability by a third party, peer pressure among the members enables GAI to get high recovery rate (recent data shows that write-off, one measure for evaluating the risk of investment, stands at a low 0.2%).

The effective interest rate paid by customers is 18%: it is not that high considering the absence of hard collateral and the numerous staff required for regular meetings. Indeed, staff costs are currently slightly higher than loan income. To reduce such operational costs, GAI is resorting to technology to improve its performance.

Finally, financial sustainability is improving mainly thanks to the acquisition of new customers: the percentage of operating expenses covered by earned interest reached 62% in 2017. Their ambition is even higher, as they seek to reach breakeven by 2020, which is far from impossible to achieve, given their recent trends.

Meanwhile, and to cover their entire operational costs, GAI mobilised grants and donations, raising 64.4 million dollars in the last 7 years. This money is used as seed capital to bring GAI new branches to scale up during their first 2 years. This strategy is

one of the reason why, as of today, 8 branches are sustainable with an average of five years for MFI to reach financial equilibrium.

GAI is about to succeed in creating a sustainable MFI in the USA. Its social return is already very positive, as it has supported over 97,000 women since 2008, helping them to build their businesses, create jobs, and build a credit history, which is essential to rent apartments, buy cars, and get loans through standard commercial banks.

Last but not least, GAI borrowers develop their saving capacity, holding more than 6.85 million dollars in savings, allowing them to build the foundations for a better future. This case demonstrates forcefully that not only is MFIs' success in the South replicable in the North, but that this success is also a promising avenue for financial and social performance in developed countries.

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### Finding the right balance: the case of STEP, India



**S**hould microfinance be profitable? This question is simple, yet important: while profitability is essential for the sustainability of the sector, it should not invite various pernicious practices to gain maximum return. Offering higher amount of loans to respond to people's needs may provide a competitive advantage and better profitability, but it is not always a good option. If poorly developed, such behaviour might actually lead to more people falling into over indebtedness.

STEP sees sustainability as one of its core principles and ensuring the development and

well-being of families they work with. To be efficient, microfinance needs to be holistic. Hence, various credits and services were integrated in their microfinance practices: training, family follow-up, networking and vocational training were all developed with customers in a collaborative way, in order to accelerate and sustain the development of families.

Nowadays, MFIs are becoming highly professional in managing portfolio, and smart in utilising new technologies. They are more and more efficient in reducing cost. More than profitability, the real issue is therefore whether MFIs are directing this reduction in costs towards their social mission and the people for whom they were created in the first place.

When STEP started to become profitable, it reinvested a portion of its profits to provide new services. To respond to social issues like malnutrition, school dropout, immunisation that often are an obstacle for the development of families, family follow-up services were launched where people are counselled at home and referred to other specialised NGOs.

The introduction of Collection Centre is also in line with this approach as it is designed as an opportunity to motivate poor women in their fight against poverty rather than focusing only on repayment collection: loan officers were renamed 'Collector Motivators' and centres

started delivering training and sharing information for better management of women's businesses, health and social issues.

MFIs have proven that microfinance can help mitigate social issues, but can they solve them all? Probably not. What really matters is their ability to serve Bottom of the Pyramid population. To ensure that, solutions are double edged: on the one side, MFIs can lower operational costs thanks to new technologies. On the other side, they can take more initiative to promote skills building services to help people have more diversified business options. The later point is key, considering that due to a lack of skills, people choose businesses that can be easily started, resulting in high competition in some business sectors. This is why STEP started offering a vocational training programme. After successful completion of the course, women are taking loans to start businesses with greater hope to become successful entrepreneurs.

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### When technology enters the microfinance world



Today, a small Chinese merchant can get a loan from the e-commerce giant Alibaba. Two friends from Nairobi borrow a few euros with a text message via their telephone operator. Alternatively, they can decide to turn to an independent start-up that will use algorithms and big data to assess their creditworthiness. And tomorrow, their loan may be paid in cryptocurrency.

In just a few years, the digital world has burst into the realm of the financial services market for the Bottom of the Pyramid. Initially focused on payments, technological innovation is now gaining ground in microfinance institutions (MFIs). If competition is not (yet) head-on, the established players cannot imagine turning their backs on this phenomenon. Arnaud Ventura, founder and CEO of Microcred, renamed Baobab in 2018 to mark this change explains: “digital technologies enable us to go further in improving customer experience. That is why it is at the heart of our strategic transformation.”

The spread of phones – even smartphones – in customers’ pockets speeds up procedures and reduces friction, when comes the time for a client to renew his credit, for example. “Previously, a client had to come

back to the agency, answer the same questions and provide the same supporting documents. Today, this renewal is automatically granted to certain customers, who are notified by a text message.” explains Baobab’s founder. The repayment goes faster too. In countries where mobile money is widespread, customers pay their bills without having to travel, thanks to their phones. In China, it would be via WeChat, the electronic payment system of the Tech-giant, Tencent.

Another way to reach customers is to develop a network of correspondents, in addition to the agencies. “Late payments are often due to the fact that clients did not have time to visit the agency” says Arnaud Ventura, while deploying such a network of correspondents. The latter are equipped with biometric sensors to facilitate customer authentication and be protected against fraud.

For MFIs, it is also a question of venturing into the lands of their new competitors by developing a digital credit offer. Baobab is for instance testing it with its Taka credit, granted automatically on the basis of customers credit history and savings behavior. The latter receive a text message indicating their eligibility for a loan they can immediately disburse via a correspondent.

“It is a small, short-term and flexible credit. It is used to meet urgent needs arising from the irregular income of our customer profile. It is a product that could not exist in a traditional physical distribution model”, asserts Arnaud Ventura. The MFI claims that 100,000 Taka loans were granted during the one-year pilot in Senegal and is working to extend it to all its operating countries. It is also preparing to distribute it via partnerships with phone operators. It is a gamble: while the MFI knows its own clients perfectly, it will not know those it would attract via these partnerships. “This will be an issue for our repayment rate, but there are ways to limit the risk,” says the executive.

Such will be the challenge in the coming years: to find the right recipe so that these new technologies reinforce the social impact of microfinance, by making it accessible to the greatest number.

Digital technologies are increasingly being used to optimise MFIs’ management processes. Smartphones allow loan officers to monitor their customers’ portfolio without having to go to the agency. Tablets connected to the central information system make it possible to fill in a loan application directly and to photograph supporting documents. This reduces back-office processing time and information loss. “Technology will have a strong impact on reducing our operational costs,” predicts Arnaud Ventura. To the point of lowering microfinance interest rates while remaining profitable? “In theory, yes”, says Baobab’s founder. “But we are only at the beginning of the work. To date, it has mainly enabled product innovations in payment and emergency credit. If tomorrow it also facilitates the collection of savings, it will lower financing costs.”

Such will be the challenge in the coming years: to find the right recipe so that these new technologies reinforce the social impact of microfinance, by making it accessible to the greatest number.

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### Blockchain and microfinance: hype or promise?

In April 2018, 73 people in Sindhu-palchowk, Nepal, received 583,000 Nepali Rupees (approximately 5,500 dollars) using Sikka, an application funded and created by World Vision's Nepal Innovation Lab. This was like any other cash transfer in a disaster-stricken country, but for one invisible detail. The World Vision team developed a contract using blockchain technology<sup>1</sup> and based on the Ethereum exchange protocol, allowing users to exchange their token<sup>2</sup> on the Ethereum main network via SMS, where the user's wallet is associated to their mobile number.

Blockchain-enabled transactions for financial inclusion have attracted enormous attention by promising features such as payments tracking, low-cost secure ledgers maintaining an account holder's transactional history, and trustless systems where third-party intermediaries are no longer required. The ledger also serves as a credit reporting mechanism, but even more importantly, the system does not only connect borrowers to lenders, but in fact connects all borrowers and all lenders on the same network.

In Brasil, Moeda, a fintech company, demonstrates precisely this. It raised 20 million dollars to build a marketplace for peer-to-peer payments, microfinancing of digital loans and crowdfunding through fiat-pegged dig-

ital tokens<sup>3</sup>. Part of the funds supported a revolving fund for social impact investments, including a 50,000 dollars pilot loan to a cooperative farm in rural Brazil, one of the first denominated in a cryptocurrency – Moeda's tokens.

Most of the magic of blockchain is made possible by smart contracts<sup>4</sup>: computerised transaction protocols that execute terms of a contract. In theory, it means that there is less need for intermediaries, reducing the overall cost of financial transactions. Given that microfinance's social mission is particularly correlated with its financial cost, if this cost reduction is translated into lower interest rates (or better services), then blockchain technology and microfinance have a promising future together.

#### Putting the technology to the test

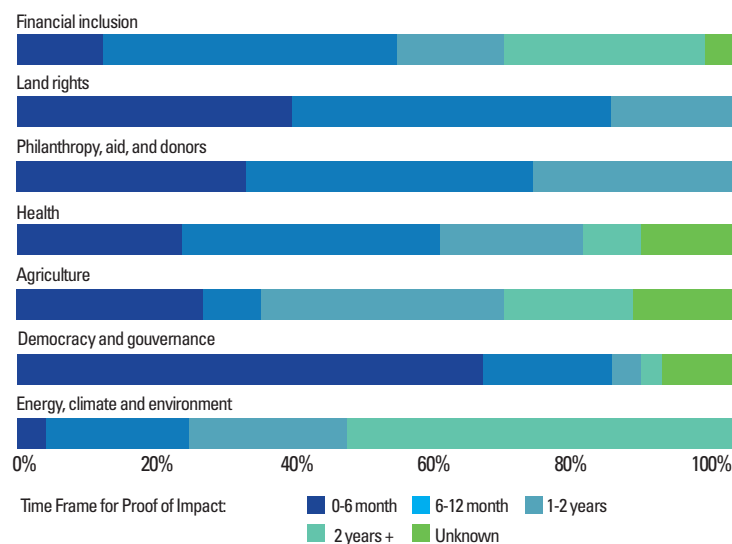
The first experimental demonstrations of a private blockchain in microfinance account data recording was in 2016. It is notable that initial experiments were developed in areas with high demand for microfinance services and for easier access to banking services such as Myanmar and Somalia, and that some of the fastest scaling projects, such as BitPesa, are from emerging countries. Today, financial inclusion is one of the most mature applications of blockchain, but – as shown in the graph below – around half of the existing

initiatives are not expected to impact their beneficiaries before 2019, and over 30% will not actually show proof of impact before two years.

The reason this process takes so long lies in blockchain's disruptive nature itself. Blockchains are extremely complex technologies with high economic barriers to entry. In addition, in this new system the blockchain code becomes law, hence, vulnerabilities and mistakes comes with a price. Despite the promise of a secure new world, early prototypes have been subjected to cyber-attacks and fraud as shown by the over 1.2 billion dollars in cryptocurrencies stolen so far<sup>5</sup>. The challenges become even more complex when data protection principles and frameworks, such as the General Data Protection Regulation 2016/679, come into play, as some core blockchain features such as immutability and lack of on-chain accountability are hardly compatible with the direction taken by European regulators<sup>6</sup>.

In conclusion, while possibly not being the long-awaited revolution for microfinance, blockchain presents fascinating innovations and creative mechanisms that could substantially improve the existing tools and strategies, given the establishment of adequate normative and ethical boundaries.

Time frame for proof of impact of the blockchain technology



Source : Doug Galen, Blockchain for Social Impact: Moving Beyond the Hype, Stanford Graduate School of Business



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