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Reclaiming Lost Ground: The Role of Microfinance Networks and Associations in Promoting Responsible and Sustainable Microfinance

This article is based on research and contributions from members of the Banking with the Poor Network, the largest regional network in Asia comprising a diverse range of microfinance stakeholders committed to improving the quality of life of the poor through promoting and facilitating their access to sustainable financial services. The views expressed in this article are those of the author.

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Executive Summary

In the wake of the crisis that hit the microfinance sector in late 2010 there has been increasing scepticism from commentators about the potential of the microfinance industry to achieve poverty reduction and social impact. The industry has been criticized for focusing primarily on financial performance and profit margins and benefit to microfinance providers and investors rather than working towards impact on the clients, primarily the most vulnerable segments of the population. External factors highlighted include the lack of comprehensive regulation, poor supervision of microfinance providers and the lack of mechanisms that can ensure consumer protection for microfinance clients. Internal shortcomings include weak governance in microfinance institutions, lack of training in customer relations for field staff, poor risk management, and the inadequacy of microfinance products and services that do not respond to the needs of clients.

One key factor contributing to recent criticism of the microfinance industry is the impact of commercialization. The commercialization of the sector is essential for long-term sustainability of institutions and the sector as a whole; however, the infusion of commercial capital also exerts tremendous pressure on microfinance institutions (MFIs) to achieve higher levels of financial performance and efficiency. MFIs in general have responded to commercialization by adopting risk-averse lending policies and practices such as excluding vulnerable population segments, limiting the level of flexibility in operations to respond to the risk exposure of microfinance clients and limiting capacity development opportunities for field staff.

The purpose of this article is to examine stakeholder responses - specifically those of networks, practitioners and service providers - to these criticisms and their perspectives on the future role of the microfinance sector in achieving poverty outreach and social impact.[1] The article is informed by a survey and individual interviews with industry networks, practitioners and service providers from Asia and other regions. These stakeholders describe the impact of the crisis on their respective work as well as the industry more broadly, identify specific challenges and constraints which the industry currently faces, and highlight areas where improvement is needed and how these issues should be prioritized.

The article concludes with stakeholders expressing the need for stronger regulation and sound supervision to ensure responsible microfinance intermediation. Financial inclusion, in particular expanding outreach to the most vulnerable segments of the population, and social impact will require greater commitment from microfinance practitioners as well as adoption of industry standards and social performance targets by stakeholders, including networks and associations, microfinance donors and investors. Global initiatives to promote social performance management, consumer protection and greater transparency and disclosure need to be promoted at the local level through microfinance networks and associations. Microfinance networks also can take on greater responsibility to ensure sector development. Most importantly, stakeholders stressed the importance of practitioners adopting responsible and ethical microfinance practices, in accordance with regulatory norms and in line with industry standards.

Going forward networks and associations face many challenges. For instance, in countries like China, Laos and Vietnam, where the industry is relatively nascent, how can networks and associations gain the recognition of central banks, microfinance

[1] Stakeholders included regulators, practitioners, donors, and support institutions. The survey was sent to all BWTP network members and associates. There were ten responses to the survey. Additionally, interviews were conducted with practitioners and other support institutions at global industry events.

donors and other key stakeholders? In markets with a range of institutional legal structures and microfinance methodologies how can a network or association put a universal Practitioner Code of Conduct into practice? In large countries which may have several active networks and associations, how can they effectively cooperate to mitigate duplication and drive impact through joint collaboration efforts? Finally, how can microfinance networks and associations achieve this and also achieve sustainability?

As the industry continues to grow and evolve, microfinance networks and associations can play a major role in promoting responsible and sustainable microfinance practices. Where the sector is emerging, networks and associations are critical for promoting industry knowhow to develop enabling regulatory environments, sharing global experiences to inform sector vision and strategy, and developing the capacity of stakeholders at all levels. In emerging markets, networks and associations can support the successful transformation of microfinance institutions into sustainable regulated entities, develop a range of support services to further institutional development, inspire innovation for client responsive products and services, and ensure sustainable refinancing from commercial sources. As markets mature, networks and associations are critical for protecting the sector and clients against unfair practices and identifying gaps in industry regulation where there is are potential risks of consumer exploitation. Microfinance networks and associations have a significant role in widening and deepening practitioner outreach, supporting innovations in products and delivery mechanisms, and providing evidence of the positive impact of microfinance practices on both poverty and social wellbeing of clients.

I. Introduction

In the wake of the crisis that hit the microfinance sector in late 2010 – a combined impact of the global financial crisis as well as specific criticisms of leading microfinance practitioners in Bangladesh and India – the BWTP Network published an article entitled *"Getting Beyond the 'Crisis' – Exploring Practitioner Perspectives on the Critique of Microfinance."* This article, which was published in 2011, explored some of the major criticisms of the microfinance industry, including the sector's failure to demonstrate social impact and reach the poorest segments of the population. The industry has also been criticized for its inability to balance financial performance with social objectives. Commercialization of the microfinance sector has enabled microfinance providers to achieve sustainability and serve clients with access to financial services. However, at the same time the focus on profit margins and institutional sustainability targets have led to risk-averse lending practices, the exclusion of the vulnerable segments of the target population, and lower level of emphasis on customer service, including client responsive products and services, with flexible terms and conditions. Industry studies and media reports have indicated that many microfinance practitioners have been engaged in practices that have been detrimental to the wellbeing of customers, including the disbursement of loans without assessing repayment capacity and risk-exposure of clients, and using force to collect on dues pushing poor households back into poverty.

The purpose of this second article is to understand the impact of the crisis on the sector in Asia and get stakeholder perspective on the criticisms of the industry from within and from beyond, including the public and media. As the sector moves forward, there are several unanswered questions regarding the potential of microfinance providers to achieve the desired social goals of full financial inclusion and substantive impact.

The content of this article is based on the responses to a survey of stakeholders (primarily networks, practitioners and service providers) from the Asian microfinance industry and interviews with stakeholders from the global industry. Stakeholders were invited to comment on the impact of the crisis in their markets and the future direction of the microfinance industry in their markets. They were also asked to provide their thoughts on the sector achieving the dual goals of sustainable and responsible microfinance, and poverty outreach and social impact. In their feedback stakeholders identified specific challenges and constraints that the industry currently faces and provided recommendations for the reform of the sector and reorientation of goals to go beyond economic development to include social and human development.

II. Background

From its origins as a movement in the early 1970s, stakeholders within the microfinance industry, including practitioners, donors and sector experts have confidently claimed that microfinance can contribute to poverty alleviation and positive social impact. Access to loans enables low-income households to establish micro and small enterprises. These businesses provide employment opportunities and leads to income sustainability resulting in better nutrition, safe housing, as well as access to health care and education. Savings and other financial services can also contribute to asset creation and build a social safety net to protect poor households from sudden shocks. While all of these factors highlight microfinance's potential benefit, a critical failure of the sector has been providing statistical data to substantiate these claims resulting in much speculation and doubt amongst microfinance critics.

The industry has been more successful in providing data that demonstrates its significant outreach; however, it has been less successful in providing evidence of the deeper impact of this outreach, such as the success in reaching the most vulnerable households, particularly in marginalized communities and remote rural areas.

While the industry has disbursed a significant volume of loans in markets all over the world, it has not been able to demonstrate impact on the stated goals, such as income enhancement, asset creation and improvement in living conditions of clients and target communities. A handful of institutions report on social performance and impact data, but the vast majority focus primarily on financial and institutional performance indicators. Other than anecdotal evidence, the industry has not produced substantiating evidence to support its claims of poverty outreach and social impact.

Additionally, the industry has witnessed the evolution of a large number of microfinance models which have collectively demonstrated the fact that the poor are bankable, i.e., that if they are provided with the opportunity and appropriate microfinance methodologies the poor can repay their loans, but they can also save. The industry has been criticized for focusing on the disbursement of credit for investment, rather than credit for meeting basic and social needs, products such as savings and insurance that can enhance social security and leasing products that can promote asset creation.

Furthermore, financial performance indicators show that individual institutions and the sector as a whole has demonstrated high levels of efficiency, productivity and profitability. However, the criticism of the industry is that there is a bias towards financial and institutional performance, with little or no emphasis on social performance. This bias is influenced by the increasing importance of commercial funding in microfinance institutions. The requirement to meet investor targets has influenced microfinance practitioners to lower the priority of meeting social goals.

In recent years, industry studies and media have reported on a number of microfinance practitioners engaging in practices resulting in the exploitation of clients and pushing vulnerable clients into greater exposure to risk. These practices have included unfair pricing of interest rates on loans, lending to poor households without risk analysis and assessment of repayment capacity, enforcing rigid collection practices and in general failing to protect consumers from risk of exploitation. These reports, along with the continued lack of evidence on poverty outreach and social impact, has led to increased scepticism and loss of faith in the industry by some.

III. Impact of the Crisis on Asian Markets

According to stakeholders consulted, the impact of the crisis in Asian markets was limited to countries where media reports resulted in public outcry and pressure for a response by the regulatory authority. Also, there has been some impact in countries where the regulator has identified the risk of microfinance customers being exploited by microfinance providers. The effect has been negligible in countries where the sector is in a nascent stage of development.

The most significant impact of the crisis was experienced in India, particularly in the southern state of Andhra Pradesh. Media reports of microfinance practitioners exploiting poor households by making loans without assessing repayment capacity, charging unfair rates of interest and using force to collect from vulnerable clients resulted in the regulatory authority closing down microfinance operations in some districts. This further led to a drop in portfolio quality, losses to microfinance institutions and forced clients to borrow from informal providers. Criticisms of the regulatory authority resulted in policy reform, tighter control and supervision of microfinance institutions and efforts by various industry stakeholders to address the problems in the sector. In response to this the local industry association, the *Micro Finance Institutions Network* (MFIN), has since worked with its members and other industry networks to develop a practitioner Code of Conduct that has been approved by the regulatory authority and will be enforced by industry stakeholders.

In some countries, such as Sri Lanka or the Philippines, poverty focused lending and social impact have always been identified as a by-product of microfinance. The Bangko Sentral Ng Philipinas (BSP), the Central Bank of the Philippines, has made efforts to identify gaps in the existing regulatory framework to avoid a similar crisis in the country both as a response to the situation in India as well as in response to media reporting on unfair pricing by some providers. There are increasing concerns in the Philippines that the dependence on commercial funding and for-profit investors are pushing microfinance institutions away from their social mission. In Sri Lanka, despite numerous efforts by donors and industry stakeholders, there has been no success in putting in place a comprehensive legal and regulatory framework for microfinance affecting financial inclusion and sustainable growth of microfinance institutions. However, the crisis has motivated the regulatory authority of Sri Lanka to draft a microfinance law to be approved by Parliament by the end of 2014.

Stakeholders report little to no impact of the global crisis in the reasonably well regulated markets of Bangladesh and Cambodia. The Credit and Development Forum (CDF) in Bangladesh and Cambodian Microfinance Association work closely with their respective central banks to ensure appropriate control and supervision exists to protect clients from exploitative practices. In both countries, there have been reports of unfair pricing and microfinance institutions causing over-indebtedness through making multiple loans to households as a result of increasing competition. However, timely action by the industry association and appropriate reform in policies and operations of practitioners has prevented a full blown crisis.

The stakeholders from the nascent markets of China, Myanmar, Laos and Vietnam report that the crisis has had no impact on the sector in their countries. However, stakeholders from China and Vietnam have raised concerns about the reluctance of regulators to take appropriate steps to strengthen the existing regulatory framework and ensure tighter control and supervision given the dynamic growth in these markets. The rapid growth of existing microfinance institutions and the diversity in microfinance models result in challenges in coordination by practitioner networks and self-regulation. Supervision and enforcement of regulation is essential to protect both the sector and clients from malpractices.

IV. Stakeholder Reactions to the Criticisms of the Microfinance Industry

Failure to achieve poverty outreach and social impact

Stakeholders who provided feedback for this paper recognize that the industry has failed to achieve the desired level of financial inclusion, particularly among the most vulnerable segments of the poor, marginalized communities and households in remote rural areas. Nonetheless, stakeholders reinforced their confidence in the potential of microfinance to contribute to poverty alleviation and social impact, provided that there is a clear definition of the target group, products are appropriately designed and delivered and necessary financing is secured.

Industry data shows that the majority of microfinance institutions do serve the poor; with a focus on the vulnerable non-poor and the not-so-poor. The poor who are on and below the poverty line in most countries remain beyond the reach of microfinance institutions as microfinance providers are unable or unwilling to take on the risk exposure and bear the costs of servicing these target groups. In most markets, the most vulnerable segments of the population are served by the informal sector and community based organizations which might implement specially designed microfinance programs made possible through external funding. Market oriented microfinance intermediation is not appropriate for serving the most vulnerable segments of the population. Specialized approaches are required, including utilizing subsidized funding for reducing the institutional costs for a range of social and human development services essential for developing the confidence and capacity of clients, and enabling them to cope with the potential risks of participating in microfinance.

Exploitation of vulnerable clients through unfair pricing of interest rates

Stakeholders who provided feedback for this paper also commented on reports against certain microfinance practitioners engaging in unfair pricing or "usury" and agreed that such cases do exist. However, they also emphasized the need for critics to understand that these reports are exceptions rather than the norm and expressed confidence in the majority of microfinance institutions in their respective markets further noting that most microfinance practitioners adhere to a common set of industry standards. Those that did express concerns of the risk of practitioners engaging in unethical or exploitive practices were primarily from nascent and developing markets, such as China, Vietnam, Laos and Myanmar. Here the lack of a universal regulatory framework and the limited influence of the practitioner association on all microfinance practitioners have resulted in individual institutions and certain microfinance models veering away from commonly accepted industry standards and practices. The lack of a universal regulatory framework is also a concern in some established markets such as the Philippines, where stakeholders expressed concern about the vulnerability of clients to unfair practices, as the current framework does not include some institutional types, such as credit unions and cooperatives.

To resolve and mitigate risks of practitioners exploiting clients, stakeholders agree that strict regulatory policies, enhanced supervision and control to enforce discipline among all providers is critical. Such actions can provide protection for both consumers as well as the sector as a whole. Collaborative efforts between the regulatory authority and industry associations have contributed to responsible practices and greater consumer protection. For instance, in Bangladesh and Cambodia, when there were reports of practitioners charging unfair rates of interest and creating over-indebtedness, the regulatory authorities in both cases allowed the industry associations, namely the Cambodian Microfinance Association (CMA) and the Credit and Development Forum (CDF Bangladesh), to work with practitioners to address these concerns by reinforcing sector standards and regulatory norms.

Reorienting the Focus on Poverty and Social Impact

Microfinance cannot be a response to all development challenges. Stakeholders emphasized the need for industry critics to understand that microfinance intermediation is a specialized economic development intervention and not a substitute for other social and human development initiatives. Microfinance clients must be able to demonstrate not only the will to repay, but also demonstrate the capacity to earn adequate income to cover basic needs and repayment, as well as the ability to cope with sudden shocks. Unless clients have the skill and capacity to optimize the access to financial services into income generation and asset creation, they cannot participate effectively in microfinance programs. This need for social development inputs requires a separate line of funding for less mature institutions in the sector, and a call for established institutions to allocate resources for client focused training in areas such as financial education, skill development, entrepreneurship development, and business development services. Another important point is that microfinance programs for the vulnerable poor must be specially financed, with a combination of social and commercial funding to ensure sustainable microfinance provision along with social development inputs.

Call for Effective Partnerships and Collaborations

Targeting the poorest of the poor is possible if microfinance providers collaborate with international and local social development organizations and government programs to combine specially designed microfinance interventions along with essential non-financial support. A key challenge is the lack of donors that are willing and able to commit to long term partnerships with microfinance institutions to provide the subsidy required for such specialized microfinance interventions. Although it is not viable for commercially funded microfinance institutions to serve the "hard-core poor", there are numerous examples of successful collaborations between social funders and commercial financial institutions in designing responsive microfinance interventions. These include the USAID ARIES rural finance project, a collaborative effort between AED, FINCA, WOCCU, MISFA and several commercial banks engaged in micro and small business lending.

Social Performance Management

Stakeholders identified the lack of focus on social performance management (SPM), monitoring and reporting as a major gap in the industry to date. The low priority attributed to social performance is due to both internal and external factors. There are a relatively small number of microfinance donors that invest in social performance management to support SPM in smaller and medium sized microfinance providers. Also, larger MFIs and banks that have the necessary resources still have to be persuaded by investors to develop social performance management initiatives. Social performance management has to be promoted and demanded by all major stakeholders, especially financing institutions, if it is to be considered relevant and important by MFIs. Over time, social performance of microfinance must be incorporated into the overall vision, strategy and operations of the MFIs, and driven by the leadership and shareholders in microfinance institutions. Unless the board and investors in the institution are committed, there will be little or no support for social performance management within a particular microfinance institution.

Also, while there has been considerable investment in developing standards, principles, indicators and practices to enforce financial and institutional performance, until recently there has been limited activity to develop the systems and mechanisms for promoting social performance. The industry has been hampered by the absence of a universal set of standards for social performance, and the lack of indicators for monitoring and reporting to stakeholders, but work is now being done to develop and promote these. However, actual results of SPM initiatives will not be achieved unless there is pressure to regularly review the progress at the individual institutional level, incentives for continuous improvement are put into place and penalties for failing to meeting stated targets are enforced.

Industry associations and networks highlighted the relevance of global initiatives such as the Imp-Act Forum and the Social Performance Task Force (SPTF), and social ratings to promote social performance. The SPTF has developed the Universal Standards for Social Performance Management (USSPM) in consultation with stakeholders from around the world, and is now working with microfinance practitioners, networks and associations to promote the principles, standards and practices among microfinance practitioners. Several industry level associations are now actively engaged in promoting USSPM among their member practitioners in Bangladesh, Nepal, Pakistan and the Philippines. However, the impact of these initiatives depends on the commitment of practitioners to implement these practices. How microfinance donors and investors value social performance indicators along with institutional and financial performance indicators is also a critical factor which impacts implementation.

The use of social performance practices and indicators will contribute to the internal monitoring by practitioners, but also result in social performance data that can be shared at the national, regional and global levels. Reporting indicators will benefit regulatory bodies, donors and investors to monitor performance and inform decision-making on specific institutions. Regular data analysis can monitor the performance of individual institutions as well as the collective impact of microfinance institutions on achieving their goals, including social impact and poverty outreach.

Industry Knowledge Management

Other areas of weakness or gaps in the industry identified by stakeholders include capacity for conducting market research, assessing demand and analyzing data on customer retention and satisfaction. Some microfinance donors have supported individual institutions in developing internal capacity for market research, with the aim to introduce appropriate institutional reform, improve and develop financial products and leverage the results of social audits and ratings to enhance their market positioning within the sector. However, to-date there has been limited impact on the sector as a whole. There is scope to leverage existing knowledge to achieve wider knowhow, particularly in the areas of widening and deepening outreach, use new technologies to reduce costs, new product design and delivery mechanisms and ways to reduce the risk and costs so that microfinance providers can serve vulnerable populations.

Regulatory reform

Strong external enforcement of good practice, especially sound regulation and supervision, is necessary as self-regulation and peer regulation do not have an impact once the industry grows to include new players that have developed without social goals. As the sector expands, industry networks and associations find it increasing difficult to enforce a shared code of conduct. In these situations, the role of external stakeholders such as the regulatory authority and microfinance investors becomes critically important. Comprehensive and universal regulation that ensures the requisite level of flexibility to include all different types of institutions is required. Cambodia's regulatory framework is one such example. Enforcement through monitoring and supervision are important in developing markets where peer-regulation is not adequate. In nascent and mature markets, a practitioner code of conduct can provide guidelines to practitioners and help a network or association ensure good practices. Industry associations in the established markets of Bangladesh, Cambodia and Pakistan have been reasonably successful in influencing good practices in their markets, including deposit mobilization, credit bureaus, and the introduction of alternative financial products such as insurance, leasing and housing finance. Their achievements have inspired the networks in the nascent markets of China, Laos and Vietnam as well as relatively more established markets of the Philippines and Nepal to explore similar approaches.

With better understanding about pricing and disclosure practices in cooperation with microfinance networks and associations, regulatory authorities will be able to reinforce the norms related to fair pricing and disclosure to consumers. Together with microfinance networks and associations, regulators will be able to take the necessary steps to protect clients against unfair practices.

Consumer Protection

Microfinance networks and associations consulted highlighted their involvement in industry initiatives to promote consumer protection and responsible microfinance including the SMART Campaign and Microfinance Transparency (MFT).

Participating in the SMART Campaign activities has enabled microfinance networks to promote consumer protection among practitioner institutions and support their efforts to become certified, which involves incorporating consumer protection policies and practices. The SMART Campaign has also had an impact on microfinance institutions and the markets in Asia. The networks in the

Philippines and Pakistan have already engaged with the SMART Campaign to promote awareness on consumer protection through training and certification of their network member practitioners. The activities involve the introduction to consumer protection principles as well as the adoption of consumer protection principles and practices. Over time, social performance reports produced by individual institutions, microfinance rating agencies with social rating tools and industry reporting by networks and associations with the MIX will serve to assess the impact of these initiatives on enhancing customer protection.

Transparency and Disclosure

There is a great degree of misunderstanding both within and beyond the sector on the pricing of microfinance loans. The pricing of microfinance loans depends on a variety of factors, including the target group, the purpose of the loan, terms and conditions and operational expenses. Products aimed at the most vulnerable segments of the population are comparatively higher in cost. The rate of interest on loans increases along with the increase in the cost of funds and operational expenses. In most microfinance markets, competition and regulation combine to maintain control on the pricing of interest rates; and microfinance institutions cope with increasing costs by ensuring higher levels of efficiency and minimizing losses. In markets which lack external pressure and have limited competition it is easy for individual institutions to develop a monopoly and take advantage of the demand supply gap by charging unfair rates of interest on loans.

In an attempt to address these issues, Microfinance Transparency has been involved with microfinance practitioners and networks globally, including stakeholders in India, the Philippines and in Pakistan which provided input into this paper. Within these markets Microfinance Transparency has provided support to their efforts to promote better understanding about pricing in interest rates and enhancing transparency and disclosure practices to protect consumers and ensure fair pricing in the industry. Furthermore, Microfinance Transparency aims to enhance the understanding on interest rate pricing and to identify fair pricing for different products that have helped to address concerns within government and regulatory authorities about pricing and to ensure that regulatory reforms on pricing do not affect sustainable growth and innovation in the industry.

Sustainable financing for the industry

Sustainable microfinance intermediation can only be accomplished by sustainable refinancing. Currently, grant funding for financing portfolios will be limited to start-up microfinance institutions in emerging markets. Only a few countries have established national level apex refinancing institutions to support the graduation of microfinance institutions from donor funded programs to independent institutions that have achieved the desired level of sustainability to access commercial funding from domestic and foreign investors.

Stakeholders expressed their concern about the lack of interest among domestic banks to refinance microfinance portfolios and the increasing costs of foreign investor funds as well as the costs associated with foreign currency loans. Microfinance products have to be appropriately priced in order to establish the lending rate of interest to clients. The cost of funds affects the pricing of interest rate on loans to clients. Reaching vulnerable populations with fairly priced loans requires lower cost funds so that over time these vulnerable clients can be graduated into the mainstream portfolio. Unfortunately, microfinance institutions rarely have access to lower cost funding from social donors or other local investors. Unless they have access to refinancing from domestic investors they are dependent on foreign investors, including for-profit investors with short exit strategies and high expectations.

Financial education

Vulnerable populations, particularly those who have limited exposure to the financial sector, and first time borrowers face the risk of exploitation. Stakeholders identified the importance of financial education as an area of focus for the financial sector and the need for microfinance providers to collaborate with relevant partners to enhance the financial capability of clients. The awareness of first time borrowers and vulnerable clients of both the advantages and the risks involved in participating in microfinance programs is important. International development organizations can play a key role in addressing this by partnering with MFIs to support financial education.

Financial education is a significant part of program activities for the microfinance networks in Pakistan, Nepal and Cambodia. In Cambodia the network has placed a particular focus on conducting regional seminars involving government and regional officials to promote awareness about the benefits and the risks involved in microfinance. Such actions help to ensure clients have the information to make informed decisions.

Human resource capacity development

The responsibility of assessing a client's understanding of loan terms such as pricing, repayment terms and conditions and the actions involved in the event of arrears or default generally rests with field staff. Stakeholders have identified the need to invest in developing human resource capacity within the field staff, including staff engaged in marketing and promotion, conducting the preliminary screening and risk analysis, loan approval, monitoring and bad debt management to ensure that they can communicate the terms and conditions with clarity.

More can be done to identify the need for client support services and the introduction of non-credit products including deposit mobilization and insurance. Additionally, stakeholders highlighted the value in reviewing operational policies and procedures; particularly those related to risk analysis, assessing repayment capacity and bad debt collection. Realistic institutional targets for disbursement and recovery and approving loans to clients based on their repayment capacity and external risks were also highlighted as important elements necessary to avoid over-indebtedness and potential for default.

VI. Stakeholder Perspectives on the Role of Industry Support Institutions

The microfinance crisis has resulted in action by regulatory authorities in several countries to review existing regulation, tighten control and improve supervision. In Cambodia, Nepal and Bangladesh, stakeholders reported that the central banks have assessed the potential for risk and taken steps to address gaps. There is an increasing focus on the implementation of a practitioner Code of Conduct that is expected to enhance self and peer-regulation to promote ethical practices and ensure consumer protection.

The crisis has also resulted in a call for action among microfinance donor agencies, especially bi-lateral agencies and international development organizations that promote microfinance. These agencies have engaged in various efforts to enhance social performance among practitioners and all major donors that are involved in the SPTF are committed to supporting monitoring and social performance reporting along with financial performance. Microfinance donors are also expected to promote awareness about consumer protection principles to protect clients and strengthen client-focused approaches by practitioners.

The dominant funders in the microfinance industry today are commercial banks and microfinance investment vehicles (MIVs) including social investors and for-profit investment funds. Stakeholders identified the need for the sector to ensure that these entities are also committed to the dual goals of social and financial performance. The success of MFIs in achieving social goals depends on the support from commercial investors.

The commercialization of the sector that began in the early part of the 1990s is now well under way in all major markets, including emerging economies. The increasing cost of funds and professionalization of the sector contribute to the cost of the microfinance loan products. Microfinance practitioners generally have demonstrated caution about the pricing of microfinance loans, particularly in competitive markets. However, the pricing policies of MFIs depend on the terms and conditions they can negotiate with their investors. While there is potential and incentives for commercial banks to meet the demand-supply gap for financing in South Asian markets, this is a challenge in countries such as Cambodia where commercial banks have retained their distance from the microfinance sector despite significant inducements. Some MFI stakeholders expressed concern about for-profit microfinance investors that do not have a particular social objective. In Cambodia, stakeholders expressed concern about some private investors that have established microfinance institutions with the intent to make profit. These institutions are less willing to comply with social performance standards.

Some stakeholders expressed concern about the challenges of meeting the expectations of commercial lenders and investors that expect high returns within short time frames. Unless microfinance practitioners are provided with alternative sources of funds to meet their financial cash flow projections, there will be an impact on the pricing of micro loans.

Interest rate pricing is also influenced by the lack of adequate efficiency and productivity of microfinance providers who then transfer the costs to their clients. Generally, competition and the increasing array of choices for consumers can effectively address this problem. However, in markets where there is a major demand-supply gap between clients and providers, the issue has to be addressed by regulation that ensures consumer protection without constraining growth and sustainability of the sector. Stakeholders cited examples such as Bangladesh and Cambodia where competition and efficient coordination amongst the practitioners led by the local microfinance network has resulted in fair pricing without affecting growth and profitability of institutions.

The media can play a critical role in rebuilding the image of the sector, and regaining the trust of stakeholders. Therefore, stakeholders acknowledged the need for industry associations and other actors to educate media and improve the quality of reporting and ensure balanced reporting with better quality data. The media can help ensure consumer protection and ethical practices by continuing to be vigilant and exert pressure on practitioners and the sector as a whole, but can also play an important role in building the trust amongst stakeholders by reporting on positive aspects of microfinance as well.

Stakeholders have prioritized the need for an enabling policy environment for sustainable and responsible microfinance. Mature markets need comprehensive regulation that covers the different microfinance methodologies and legal entities. Increasing competition and the lack of adequate supervision can lead to unethical practices by providers. This requires vigilance and effective monitoring and supervision by regulators to identify misdemeanours with timely action and penalties in the event of misconduct to deter others. In order to achieve this involves a delicate balancing act is necessary to ensure that the legal and regulatory framework still provides opportunities for product development and innovation. This is especially important for products that enhance social security of clients such as deposit mobilization and insurance.

Microfinance networks in Cambodia, Bangladesh, Pakistan, Nepal and the Philippines have been active in Social Performance Task Force activities and influenced a positive change in the attitude of members towards social performance management. Networks in the region have been active in promoting consumer protection principles in collaboration with the

SMART Campaign. Three out of the five institutions that have been certified by the SMART Campaign are MFIs from India, a country that had previously been criticized for the lack of focus on consumer protection. Microfinance Transparency has also been engaged in activities to create greater awareness on interest rate pricing, disclosure and transparency in India, Pakistan and the Philippines and is working with practitioners and industry associations in these countries. Financial education is a key activity for the industry associations in Cambodia, Philippines and Pakistan as well as for all major networks in India. In addition, the networks in Pakistan and Bangladesh have taken steps to establish an industry credit bureau.

VII. The Road Forward – The Role of Networks and Associations

The microfinance sector in most countries in the region consists of a diverse set of institutions with different microfinance models and legal and ownership structures. Included in this mix are a variety of support institutions such as donors, investors, rating agencies, research organizations and technical service providers. Greater coordination at the national level is a key role for industry networks and associations. Some Asian countries have multiple networks or associations, but generally there is one entity that is recognized both nationally and globally as primary national association.

Industry associations can play a critical role in influencing national level vision and strategy. They are seen as the principle players in coordinating the sector, representing practitioners and forging links between the different stakeholders including regulators, donors, investors and support institutions. Networks and associations are not merely member-based organizations that provide services. In most mature markets they also represent the voice of the sector and advocate for both member and non-member institutions.

By forging links with other networks at the regional and global level, national level networks facilitate information exchange. This brings global knowhow and expertise into the country and helps to promote good practices and innovations to a wider audience. They also play an important role by piloting global initiatives that promote social impact and consumer protection, such as Social Performance Management, Microfinance Transparency and the SMART Campaign.

The sustainable financing of the sector in a particular country can also be supported by country level networks and associations, as they can guide investors and donors on developing responsive strategies as well as in the identification of partners. Microfinance networks and associations play a critical role in sustainable financing for microfinance portfolios, including influencing commercial banks, the development of appropriate financial instruments such as loan guarantee funds and the development of apex refinancing funds that can enable small and medium microfinance institutions to graduate to commercial funding. This is particularly important in countries where the law prohibits the intervention of foreign investments. Microfinance donors and investors can also develop a range of financial products to support product design among practitioners along with appropriate pricing, terms and conditions which respond to a diverse set of target groups; particularly the most vulnerable population.

Networks and associations are well placed to identify gaps, especially in institutional development and human resource capacity building. They can inform donor policies and strategy on institutional development and funding strategies. Networks can also contribute to knowledge creation by promoting or engaging in market research, product design, pilot testing and providing analysis on social and financial performance data.

There is an opportunity to develop specialized non-financial inputs for both micro and small businesses and specific target groups to underpin sustainability at the household and enterprise level. Industry networks and associations play a key role in forging public-private partnerships, involving government, private sector, donor agencies, financial institutions and specialized technology providers, with the aim of expanding the array of financial and non-financial services for the target group.

Most importantly, networks and associations are essential for the development of an enabling legal and regulatory environment in nascent markets and for ongoing regulatory reform over time. The majority of stakeholders expressed a strong need to focus on regulatory reform to ensure consumer protection as well as the sustainable growth of the sector.

In conclusion, to respond to this increasingly important role of promoting responsible and sustainable microfinance in Asia, microfinance networks and associations will need to augment their own governance, management and institutional sustainability in order to rise up to the challenge.

About the Banking with the Poor (BWTP) Network

The Banking with the Poor Network (BWTP) is an Asian association of a diverse range of microfinance stakeholders committed to improving the quality of life of the poor through promoting and facilitating their access to sustainable financial services. The BWTP Network has emerged to become the largest regional microfinance network in Asia, with a total current membership of 60 institutions – comprising of 34 NGOs, 10 commercial/development banks, 10 microfinance networks, 3 non-bank financial institutions, a cooperative, a central bank and service provider. Over the years, the BWTP Network has evolved from an action research and advocacy program into an association of diverse, but like-minded microfinance stakeholders, keen to improve the quality of life of the poor by facilitating access to financial services through linkages between financial sector institutions, NGOs and Self Help Groups (SHGs). More recently, BWTP has focused on furthering its platform for cooperation and peer learning, developing capacity building training, conducting technical assistance exchanges, organizing market places (where industry players and investors meet) and providing operating support to members. Outreach, dissemination and information sharing has been achieved through various means, including workshops, webinars and conferences, the development of an online microfinance resource centre, and exchange visits.

List of Institutions Consulted

- ACCESS India
- Asian Development Bank (ADB)
- BASTOB – Initiative for People's Self-Development, Bangladesh
- Cambodia Microfinance Association (CMA)
- CARE India
- Chamroeun Microfinance Institution, Cambodia
- China Microfinance Association (CAM)
- Credit and Development Forum (CDF), Bangladesh
- Fern Software, Australia
- GM Bank of Luzon, Philippines
- Guardian MFI, India
- Hatton National Bank, Sri Lanka
- Jinnah Welfare Society (JWS), Pakistan
- M-CRIL, India
- MFC Poland
- Microfinance Council of the Philippines (MCPI)
- Microfinance Information Exchange (MIX)
- Microfinance Transparency (MFT)
- Nirdhan Utthan Bank Ltd, Nepal
- Pakistan Microfinance Network
- Rural Community Development Society (RCDS), Pakistan
- Rural Microfinance Development Centre Ltd, Nepal
- SMART Campaign
- Social Performance Task Force (SPTF)
- South Asia Microfinance Network (SAMN)
- The SEEP Network
- Vietnam Bank for Social Policies

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