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**Microfinance in Africa: Harnessing the Potential of a Continent**

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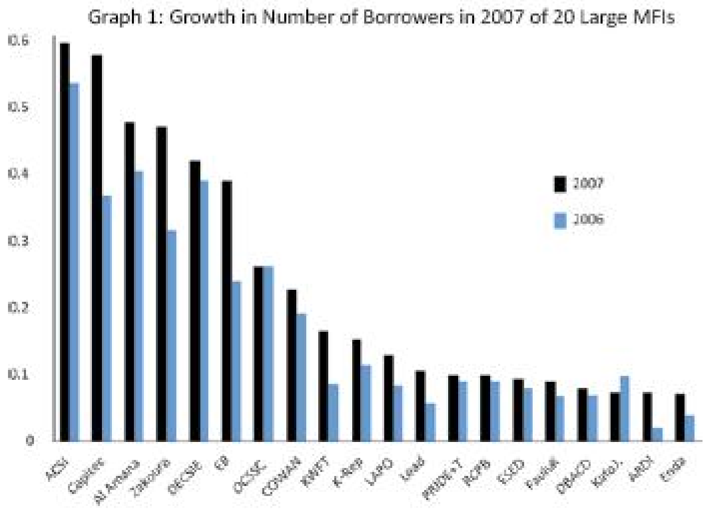
By Sarita Gupta

***In the last fifteen years, many African economies have begun to experience higher growth rates and increases in per capita income. High commodity prices, large-scale reduction in debt, Asian investment in the continent, and economic expansion of some of the non-oil exporting countries has helped drive this growth. However, there is still an alarming number of people living below the poverty line. Bringing financial services to this part of the population could break the poverty cycle. Sarita Gupta, Vice President, Communication of Women's World Banking describes the current microfinance landscape on the continent.***

In the past 30 years, microfinance has assumed increasing importance globally as a strategy for creating employment and generating wealth for low-income people. There has been a rapid increase in the number and types of institutions offering microfinance services in Africa, ranging from non-governmental organizations, savings and credit cooperatives, to commercial banks and regulated specialized providers. Yet the microfinance industry in most African countries remains largely underdeveloped.

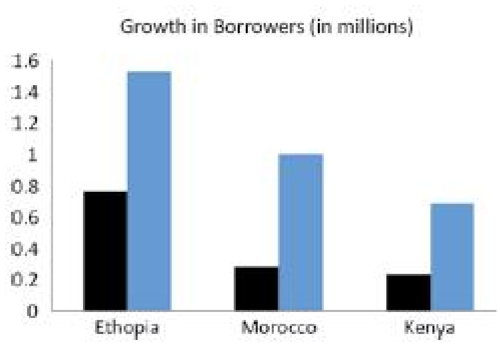
An estimated 300 million low-income Africans need microfinance services but only about 20 million currently have access. There are fewer than 20 microfinance providers (MFIs) in Africa with an outreach of 100,000 or more active clients. African MFIs primarily finance existing businesses resulting in inadequate access to credit for start-ups. Micro and small-scale manufacturing and agro-processing remain largely underdeveloped due to inappropriate technical support, financing and physical infrastructure. The apparent slow development of microfinance in Africa is further exacerbated by lack of adequate information on the extent of its provision and impact on business and employment creation.




Although the expansion of microfinance in Africa certainly faces challenges, some astounding progress has already been made and the prospects for accelerated growth are promising. A decade ago, for example, microfinance barely existed in Ethiopia and Morocco. Of the 20 large MFIs included in Graph 1, the number of borrowers grew by one million in total. Furthermore, Africa now has some veritable microfinance giants, including two organizations – Association Al Amana in Morocco and Enda Inter-Arabe in Tunisia – that made Forbes Magazine's 2007 list of the world's top 50 microfinance institutions. Perhaps most impressively, whereas the giants in Asia became so in an overall highly favorable environment for steady growth, with relatively low inflation and a notably higher population density than other regions, those on the rise in Africa are growing in very demanding macroeconomic contexts. A prime example is Kenya's Equity Bank which increased its savers by 800,000, to 1.84 million clients between 2006 and 2007.

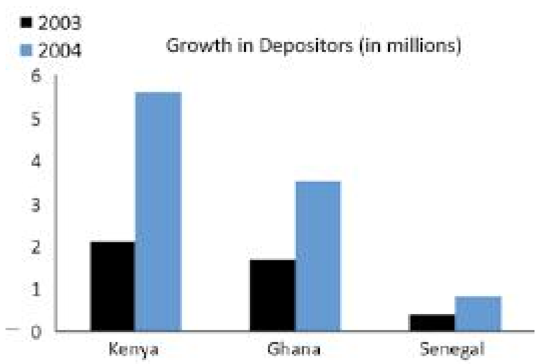
With low bank penetration and a very large informal sector, Africa is fertile ground for microfinance. In 2007, Women's World Banking and the Africa Microfinance Action Forum, a voluntary advocacy group of African leaders committed to the advancement of microfinance in Africa, undertook a diagnostic to evaluate the unique challenges and opportunities for microfinance in Africa from an African perspective. The diagnostic noted that the borders between traditional microfinance and the larger financial system have started to blur and that, although progress is uneven, we are seeing the beginnings of microfinance being integrated into larger financial systems in Africa.

**Surmountable Hurdles**



This is not to say, of course, that microfinance is the cure-all to end poverty in Africa, or that every country will be able to immediately replicate the success stories. But by taking stock of the obstacles and gleaning lessons from what has worked and what hasn't, we have the opportunity to reach more of the "unbanked poor." Among the challenges of expanding microfinance in Africa are the high costs of delivering services with poor infrastructure, regulatory and policy issues, and the need to develop institutional leadership.

The high cost environment is a major constraint to the provision of financial services in Africa. Because infrastructure and communication technology remain largely underdeveloped in Africa, it is significantly more expensive for MFIs in Africa to operate compared with their peers in other developing economies. Throughout the continent, low population densities, weak and/or expensive infrastructure and high labor and provisioning costs all contribute to high operating expenses, especially in rural areas. This results in the need for economies of scale to remain competitive and responsive to client needs. Smaller MFIs in particular are at a disadvantage, struggling to cover the industry's high operational costs and diversify their product offerings in order to compete with larger microfinance providers. The largest MFIs in Africa have been able to continuously refine their lending methodologies, and have become among the most productive in terms of both borrowers and savers per staff member. On the other hand, in spite of the challenges of competition, information has begun to emerge that in some markets, competition is pushing MFIs to innovate. Finally, the lack of sufficient funding compounds the challenges presented by the cost barriers.




One potential solution to reducing transactional costs and reaching more clients is mobile banking. Safaricom's M-Pesa service in Kenya currently transfers an average of Sh150 million (US$2m) a day mostly in small amounts averaging Sh3,800 (US$50) per transaction. So far, the system has handled over Sh36 billion (US$476m). Only 19% of Kenyans have access to formal financial services, so mobile phone money transfer services are a welcome option to the millions who cannot afford to open and operate bank accounts. However, technological innovations in Africa pose particular challenges because mobile phone usage has lower penetration than in other developing countries. More research will need to be done to determine how technology can be optimally used to alleviate poverty, and what partnerships are required to scale up technological solutions. Since one of the primary obstacles to an MFI's ability to adopt mobile banking is the lack of adequate back office systems, any scaling up of m-banking will need to take into account the MIS, operational and regulatory challenges that MFIs face, and how to best address these issues. MFIs are also working on developing ways to offer other traditionally high-cost products such as housing loans and health and crop insurance. In Ethiopia, MFIs are offering pension fund administration, in Uganda, a microinsurance product is being developed in conjunction with an NGO, and in Benin, MFIs are collaborating with commercial banks to offer remittance services.

## Through the Regulation Lens

Another challenge in Africa is policymaking and government regulations, which vary greatly by country. In many countries, the supervisory capacity of central banks, which hold the ultimate responsibility for the financial health and stability of the financial sector, is in particular need of adjustment. The countries that are able to close the microfinance demand gap most successfully will be those that improve their policy frameworks and adapt their legal and regulatory systems in line with rapidly changing industries. In short, the government regulations faced by MFIs are often ambiguous and opaque. When the rules are not clear it makes it difficult, as well as labor intensive, to create strong MFIs.

This past year, WWB network member, Kenya Women's Finance Trust (KWFT) fought for increased transparency in regulatory policy by urging government officials to approve and publish the regulations that guide Kenyan MFIs in the formalization process. WWB used its global convening power to draft an agreement with Kenya's Central Bank and the Secretary of the Ministry of Finance to ensure that the needed regulations for formalization would be approved and published. The Microfinance Act 2006 became operational on May 2, 2008 and allows MFIs that register under it to take deposits, a function that they are not currently allowed to perform. KWFT is one of two MFIs that have applied for the deposit-taking license with the aim of becoming a one-stop shop for meeting the basic financial needs of its clients.

| Largest MFIs in Africa | | | |
|---|---|---|---|
| Country | Name | Type | Outreach |
| Kenya | Equity Bank | Bank | 1,840,000 savers |
| Kenya | KPOSB | POSB | 1,280,000 savers |
| South Africa | Capitec | Bank | 783,000 savers |
| Cote d'Ivoire | FENACOOPEC-CI | Credit union | 598,000 savers |
| Ethiopia | ACSI | NBFI | 597,000 borrowers |
| Uganda | Centenary Rural Development Bank | Bank | 559,000 savers |
| Rwanda | UBPR | Credit union | 533,000 savers |
| Burkina Faso | RCPB | Credit union | 513,000 savers |
| Morocco | Al Amana | NGO | 481,000 borrowers |
| Morocco | Zakoura | NGO | 473,000 borrowers |

In a continent as diverse and vast as Africa, there are many regional differences, and our research has found regional differences in the prevalence of different types of MFIs and regulation. Yet across Africa there is increasing diversity in the composition of the sector – larger banks are entering microfinance, NGOs are regulating and becoming NBFIs –and these are signs of an industry maturing.

## Human Resources and Transparency

African MFIs, similar to most, struggle with the primary condition for success, that of sound leadership. MFI and bank leaders need both the vision and the managerial capacity to find a business model that can create efficiencies in the particular context, plan for its execution, know the risks, chart a path that overcomes the major challenges and stay the course. Related to the basic need for good leadership is the issue of information and transparency, which in microfinance has emerged as a critical element in the successful growth of MFIs. Those institutions able to produce accurate and timely reports are more likely to make appropriate decisions and mobilize commercial funds. Leading

MFIs in Africa also demonstrate an organizational culture that embraces change and is conducive to continuous improvements in service delivery.

Yet one constraint to developing institutional leadership is the scarcity of skilled manpower at the loan officer, middle management and leadership levels; this will be compounded by the massive training needs foreseen in the coming decade. Developing women's leadership in particular will be crucially important to delivering on the promise of microfinance. In Africa, as in many developing regions, the idea of women taking a leadership role goes against established cultural norms; yet increasing women's representation in microfinance, and helping women develop the leadership skills to become innovators in their sector, is key to creating a larger and better trained cadre of leaders to move microfinance forward. Women's World Banking has responded to this challenge by creating a unique training for women MFI managers to develop their individual leadership skills. Thus far women managers from Kenya, Uganda, Benin, Gambia and Burundi have been trained.

The case for a specific focus on women, however, goes beyond the leadership level. At the client level as well, there is a compelling business case for investing in women. Since women reinvest in their communities at greater rates than men – at 89 cents on the dollar versus 60 cents, respectively – a concerted focus on women is important from both a financial and a poverty alleviation perspective. As in most developing regions, women are the mainstay of African economies. The benefits of promoting women's economic empowerment spread beyond the individual woman to her children, family and out into the community – creating the long-term change that is needed to successfully alleviate poverty.

The success story of Joyce Wafukho in Kenya highlights the social and economic potential of microfinance and demonstrates the benefits a community can reap from one woman receiving a small loan. Joyce dreamed of opening a hardware store in her small village but had no access to financial resources or assistance. Turned down for loans from local commercial banks, Joyce was finally able to secure a loan through a WWB network member. Now the proud owner of a fully operational and stocked hardware store and lumberyard with 25 employees, Joyce was also able to build her family a new home and send her children to school. With the help of one small loan and a lot of hard work, Joyce succeeded in expanding opportunities for both her family and the community. All Joyce needed to get started was a small loan of less than US$100.

**Laying the Groundwork for Success**

As evidenced by the success of many MFIs in Africa, microfinance holds vast potential – still largely untapped – to spur social and economic change from the ground up. So what are the factors of success? The successful MFIs are able to rapidly spread their services through communities and change their economic landscapes. They have strong institutional leadership that is able to work closely with banks and government regulating institutions; together they work to develop tailored business models that are efficient, understand the market's specific risks and provide troubleshooting options for business owners. Successful MFIs are most often larger institutions that have enough capital and infrastructure capabilities to change lending methodologies and product offerings in order to remain competitive and attentive to their clients' needs.

| Microfinance Fund Exposure to Africa | | | |
|---|---|---|---|
| Fund | Total MFI Investments (US$ million) | Percentage in Africa | Derived Investment (US$ million) |
| AfriCap | 13.3 | 100 | 13.3 |
| CORDAID | 63.5 | 18 | 11.4 |
| Dexia | 125.9 | 2 | 2.5 |
| DOEN | 79.1 | 15 | 11.9 |
| Gray Ghost | 75.0 | 7 | 5.3 |
| HIVOS-Triodos | 28.8 | 36 | 10.4 |
| I&P | 12.7 | 22 | 2.8 |
| Impulse | 23.8 | 5 | 1.2 |
| Oikocredit | 304.2 | 15 | 45.6 |
| ProCredit | 110.9 | 6 | 6.7 |
| ResponsAbility | 96.2 | 4 | 3.9 |
| Triodos Fair Share | 18.6 | 12 | 2.3 |
| Triodos Doen | 45.2 | 15 | 6.8 |
| Unitus | 9.5 | 15 | 1.4 |

Source: www.microcapital.org; www.mixmarket.org (compiled by Opportunity International in April 2007).

It is important to take steps to ensure that women like Joyce continue to benefit from microfinance. One way is by moving beyond credit to offer insurance and savings products so that women can save to pay their children's school fees and invest in healthcare for their families. Market research done by WWB in Benin showed that clients, mostly women, save a fixed amount each day; at the end of the month the collector receives one day's savings as fees. However, while these informal savings work well generally, they are vulnerable to collapse if managers are corrupt, members are undisciplined, or a collective shock occurs. These savers need safe, secure places to save with access to their money when they need it.

At the policy level, regulators must work with MFIs – instead of against them – to improve the policy framework and adapt legal systems to changing banking and small business sectors. Financial assistance should be provided to small MFIs that are struggling, in order to allow continued access to financial services for communities. Assisting institutions in becoming regulated institutions will allow them to mobilize savings, the preferred method to raise capital. Additionally, African MFIs have not yet benefited from international and commercial funding - only 10% of the total Microfinance Investment Vehicle (MIV) portfolio is in Africa. Of course increased transparency will contribute toward the ultimate goal of integration with the global financial system.

Africa's infrastructure will need continued improvement so that access to poor, rural communities by loan officers is possible. Time and resources should be devoted to helping MFIs diversify their product offerings, implement effective marketing strategies and successfully transition from group to individual lending models.

Creating strong networks is also hugely beneficial. One of the greatest benefits of being a part of a microfinance network is the exchange of knowledge among peers. Through information and experience sharing, MFIs are able to learn best practices that they can then apply to their own institutions. For example, WWB has sent Moroccan MFIs exploring the feasibility of becoming regulated institutions to Peru, and our Kenyan affiliate to the Dominican Republic. While regional networks exist on the continent, connecting local MFIs to global best practices would lead to even greater innovations, and allow for newer organizations to benefit from the expertise of already established peers.

Overall, the African microfinance market offers sound prospects for accelerated growth, though this varies considerably from country to country. Some of the more vibrant markets will experience rapid growth in the coming years, while a number of smaller countries that have no significant microfinance services might have to revisit business models and sector-deepening strategies. Continued progress will need to be made at all levels – including client, retail, macro and regional.

Africa's complex situation calls for an Africa-driven strategy to develop home-grown solutions rather than relying on outside aid and assistance. The significant progress that has been made thus far holds great promise for microfinance's potential to expand to an even greater number of Africa's poor.

*About Women's World Banking*

*WWB is a global network of 54 microfinance providers and banks, working in 30 countries to bring financial products and services to low-income entrepreneurs, especially women. The network serves 11 million microentrepreneurs directly, and another 10 million indirectly through its bank partners and other regional networks. WWB is supported by an international team of experts based in New York that delivers expertise in product design and distribution, access to capital markets, and customer care and insight. For more information on WWB, please visit its website at www.womensworldbanking.org.*