MICROFINANCE IN AFRICA

The United Nations (UN) has paid close attention to and recognised the important role of microfinance in the socio-economic advancement of communities. This has included the declaration of the year 2005 as the year of microfinance, conducting studies and producing publications on the subject, and strengthening activities of its specialized fund for small-scale investment (UNCDF). More recently, the UN Secretary General has designated a Special Advocate for Inclusive Finance, to champion the microfinance agenda.

The report describes Africa's economic growth since the mid-1990s, generated through improved macroeconomic management and governance, economic and regulatory reforms that have provided a more conducive environment for private sector development and substantially opened up economies, and a favorable external environment that has followed a prolonged period of higher commodity export prices.

Despite this growth, however, the report reveals that the continent's private sector remains small, dominated by small enterprises that are engaged in largely informal activities, their growth hampered by limited access to formal financial services, such as deposit and credit facilities and other financial services.

This UN's intense interest is in recognition of the emerging importance of microfinance as a tool for poverty reduction in African. Although the recent financial and economic crises adversely affected many African economies, microfinance grew on the continent at a remarkable pace even at the height of the crisis in 2008.
At the end of 2008, Microfinance Institutions (MFIs) in SSA reported reaching 16.5 million depositors and 6.5 million borrowers. Moreover, even when the region witnessed a slowed growth in borrowers in 2008, there was a continued and strengthened uptake for depositors, as their growth rate increased by 10 per cent to reach 40 per cent, which is more than for any other region.

Evidence shows that microfinance in Africa is developing at all the three levels of the financial system – the micro (financial service providers), meso (support service providers), and macro (policy, regulatory framework and supervision). At the micro level, there are many stakeholders and growing interest from banks and private investors. Microfinance institutions (MFIs) are having a predominant role, with a strong credit unions membership, although the bulk of savings is still mobilized through the banks. At the meso level, MFIs have scaled up provision of services such as training or auditing, and indications are that some associations are active in coordinating the activities of MFIs. At the macro level, countries are increasingly shifting to a conducive paradigm of market based policies, while also putting in place regulatory and supervisory frameworks.

The report notes that most African countries are undertaking economic reforms, including the establishment of sound macroeconomic conditions, market-based economic policies and improvements of the business environment all of which support growth of micro-enterprises in which clients of MFIs are involved. As a result, the continent's microfinance industry is diverse and geographically dispersed. An array of approaches has been used ranging from the use of agent and village community banks and traditional group based- systems to specialised lending by various institutions. The report highlights various ways in which continent's economic environment for microfinance has improved, including through strengthened regional arrangements and benefit from bilateral trade preferences, as well as the rise of emerging markets as fertile ground for entrepreneurs.

However, microfinance in Africa still faces challenges, which conceal the strengths and opportunities at the various levels. These challenges have inhibited its capacity to unleash its potential to better contribute to the fight against poverty. At the micro level, African MFIs have structural weaknesses at several levels: governance, portfolio management, internal control, human resources, and financial sustainability. At the meso level, microfinance support services are rare and of unequal quality. Also, although the Consultative Group to Assist the Poor / Microfinance Information Exchange Market (CGAP/MIX) compiles information on financial performance, the data is still limited, reflecting reporting gaps. At the macro level, the supervisory and coordinating bodies have limited resources, while more effort is needed to strengthen the legal framework. This is especially so for many low-income African countries, where the legal system is too overstretched and is not sufficiently reliable to help develop the financial sector further.

These weaknesses call for governments and external development partners to play a leading role in consolidating the development gains achieved so far and in guaranteeing the sustainability of microfinance in African countries. This should involve facilitating and consolidating partnerships between the government and other domestic stakeholders.

This report puts forward the following recommendations, which the table below has summarized.

- At the micro level, governments and donors should help MFIs adopt appropriate practices towards building retail capacity and reducing transactions costs, including through payments and clearing systems, information infrastructure, financing infrastructure, technical support, capacity building and education services. In this regard, as donors operate in various countries, they have access to good practices in microfinance across the globe and should promote or help adapt them in African countries. In particular, it is essential that donors help well-performing MFIs tailor their services better, while supporting the weaker ones to clean up their portfolios by introducing sound management practices. The study also recommends that, generally, governments and donors should help MFIs improve governance, while promoting the diversification of institutions and approaches in microfinance.
- At the meso level, governments and donors should support capacity building by promoting the availability of local training that is clear, accessible, and sustainable. Governments and donors should also support the development of financial infrastructure, including the strengthening of professional associations, which can be strategic in advancing microfinance at country and regional levels; the establishment of sustainable systems for refinancing MFIs, which can help MFIs access resources and expand their capacity; and deposit insurance, which helps to protect clients and build confidence in the system.
- At the macro level, governments should maintain environments that are conducive to micro-finance and clarify the role that various ministries have to play in advancing microfinance at national levels. In this regard, the report

supports the very pertinent recommendations that the African Union has made, which include that

I. Governments should
   - Set policies that stimulate financial services for poor people at the same time as protecting deposits;
   - Maintain macroeconomic stability;
   - Clamp down on corruption;
   - Improve the environment for micro-businesses, including access to markets and infrastructure;
   - Avoid interest rate caps to keep the cost of credit affordable by low income communities; and
   - Refrain from distorting markets with subsidized, high-default loan programs that cannot be sustained.

II. In line with best practices, Donors should work within country systems, which should support the strengthening of country systems for establishing financial sector soundness and appropriate policy, regulatory, supervisory and legal frameworks for microfinance. In this regard, this report supports the CGAP recommendations that donor grants, loans, and equity for microfinance should be temporary and used to:
   - Build the capacity of microfinance providers
   - Develop supporting infrastructure at the micro and meso levels
   - Support experimentation

III. Donors should:
   - - Integrate microfinance with the rest of the financial system
   - - Use experts when designing and implementing projects
   - - Set clear performance targets tied to future funding
   - - Set a realistic exit strategy from the beginning

These recommendations underscore the UN's strong view that the microfinance agenda can advanced best if carried out in a partnership – a partnership in which governments provide the enabling environment; external development partners (Donors) provide financing and technical support; and the MFIs and meso-level players take maximum advantage of the enabling environment and the support of development partners to develop and deliver services and industries. This partnership should be built on the principles of the Paris Declaration and the Accra Agenda for Action.

SUMMARY TABLE OF SWOT ANALYSIS RECOMMENDATIONS OF STUDY

<table>
<tr><th colspan="2">MICRO SWOT</th></tr>
<tr><th>STRENGTHS</th><th>WEAKNESSES</th></tr>
<tr><td>• Strong savings growth
• Desire of coops and MFIs to adapt structure to environment (for more efficiency)
• Increased ability to service rural areas (costs, technology)
• Suitability for support to MEs and PS development (to enhance risk management, enterprise development, money management)</td><td>• Structural fragility of most MFIs: Governance problems (volunteer led not ideal, some mgrs lack training and skills, favoritism in coops); Poor portfolio management (high PAR in region); Lack of internal systems and controls (poor MIS, misappropriation of funds); Scarcity of HR
• Supply of credit not meeting demand (lack of guarantees, treasury bills more attractive, no incentive for med/long term loans since deposits are mostly short term)
• Limited ability to meet demand from enterprises (only 15% of SMEs in Africa have access)</td></tr>
<tr><th>OPPPORTUNITIES</th><th>THREATS</th></tr>
<tr><td>• Large number of points of service
• Increased linkages among the banking sector, private sector and microfinance
• Technological advances
• Development of innovative financial products</td><td>• Unfavorable environment and situation of clients (biz environment costly and corrupt; limited legal rights especially for women; vulnerable clients with limited knowledge of rights and financial management; more prone to disease than in other regions; informal enterprises without right docs to access fin products)
• Unfavorable environment and situation of MFIs (high costs; poor and uneven quality of management; poor quality of corporate governance; poor quality of staff)</td></tr>
<tr><th colspan="2">MICRO RECOMMENDATIONS</th></tr>
<tr><td colspan="2">1. Strengthen institutional capacity to deliver range of financial services at a reasonable cost to those with limited or no access to financial services.
MFIs: clarify vision/goals/action to enhance sustainability and expand capacity through</td></tr>
</table>

• Improve operational management and portfolio quality by improving MIS and adopting international standards in portfolio management • Improving financial management , and structure fees and interest rates appropriately • Improve internal governance, including clarifying role of board members and technical staff and improve transparency and accountability • Strengthen HR capacity **Development Partners:** Support MFIs to improve governance, operational management and portfolio quality (MIS, client due diligence, credit risk analysis, credit scoring) **Governments:** set policies at macro level and support development at meso level that enable MFIs to strengthen institutional capacity and set standards to ensure that they do
2. Promote development of range of services to meet needs of those with little or no access **MFIs:** learn from experiences elsewhere, conduct demand-side focused market research, invest in product innovation, reduce costs, scale distribution. **Development Partners:** disseminate knowledge from elsewhere, support research and innovation. **Government**: develop policies and regulations that support product diversification and sustainable delivery.
3. Facilitate participation of diverse institutional types to enhance competition, improve range and quality of services, and reduce costs. **MFIs:** reduce costs by investing in technology; build inter-institutional linkages to enhance access to finance; forge ties with other stakeholders. **Development Partners:** finance fora; disseminate good practices; subsidize expansion of providers into hard-to-reach areas. **Government:** remove policy barriers to profitable provision of financial services.

MESO SWOT	
STRENGTHS	**WEAKNESSES**
• Start of microfinance refinancing by banking sector. • Existence of professional associations • Initial supply of specialized training • Interest shown in microfinance by audit firms and consultants.	• Fragility of services provided to MFIs (limited number of skilled services providers; problems with accessing trainings; risk of unfair competition in training and other technical support areas; limited transfer of skills; local rating capacity and costs; uneven quality of audit and other service providers and perception of high costs) • Low capacity of national microfinance associations • Unavailability and unreliability of information in a few countries (lack of comprehensive, standardized, and regular statistics; lack of national identification systems and client information)
OPPPORTUNITIES	**THREATS**
• Growing interest in mobile phone industry • Several ongoing and upcoming capacity building initiatives	• Unfavorable environment and situation of service providers • Funding challenge (high cost/short-term tenor of financing; wrong perception that MFI profitability is low; negative stereotypes of foreign investors re investment climate; high cost of accessing capital markets)
MESO RECOMMENDATIONS	
Government: encourage involvement of private sector and donors in building capacity of MFIs (by encouraging use of existing training facilities); advance MFI transparency (by fostering adoption of standards and disclosure and build capacity to implement); support development of industry infrastructure collaboratively (establish payment infrastructure; sustainable refinancing systems; helping to establish guarantee funds; encouraging MFIs to submit to ratings and audits; deposit insurance schemes; private credit bureaus; ensure adequate data collection and analysis on supply and demand side); accompany entrance of new players and develop enabling regulation appropriately.	

MACRO SWOT	
STRENGTHS	**WEAKNESSES**
• Positive change in general environment (adoption of national mf policies consistent with good practices; proper assignment of mf within overall financial system and clarification of supervisory responsibilities)	• Fragilities of the general economic environment • Supervision remains weak • Questions about involvement and role of other ministries • Ineffective legal system (no fast track or small claims) • Low levels of financial literacy
OPPPORTUNITIES	**THREATS**
• Expanded range of institutions • Agreement on key performance	• Risk of politicization in policymaking • Risk of market distortions from

<table>
<tr><td>• Increased interest of donors
• Opportunity for establishing national identification through voter registration
• More interest from standard setting bodies</td><td>• Risk of rigid legal and regulatory frameworks (interest rate controls; overly restrictive regulations)</td></tr>
<tr><th colspan="2">MACRO RECOMMENDATIONS</th></tr>
<tr><td colspan="2">1. Formulate national visions and action plans and clarify roles of various stakeholders
Governments: clarify national vision and strategy through streamlined and time-bound process; convene stakeholders; adopt good practice; develop and implement plan of action and assess progress.
Development Partners: enhance dialogue and collaborate with other development partners under leadership of country government, share good practice experience; encourage governments to have Min of Finance/Central Bank take lead; involve other ministries in planning and coordination; include MF in development projects.</td></tr>
<tr><td colspan="2">2. Strengthen country systems for managing financial sector soundness
Governments: ensure financial sector soundness (through appropriate monetary and fiscal policies, sound macroeconomic management and alignment between financial sector policy and budget management)
Development Partners: BWIs and other donors to help design appropriate financial sector programs; BWIs to undertake financial sector assessments—FSAPs and assist with translating assessments into recommendations and strategies; build capacity for data gathering and analysis.</td></tr>
<tr><td colspan="2">3. Reform and implement financial sector regulations that take into account range of financial services (individuals and households, micro, small and medium enterprises, and so on) and range of providers (bank, MFI, cooperative, NBFI, other non-traditional)
Governments: formulate financial sector regulation that includes range of services and range of users and communicate changes.
Development Partners: assist in formulating regulation and designing regulatory and supervisory structures; build capacity of central bank to regulate.</td></tr>
<tr><td colspan="2">4. Build supervisory capacity
Governments: establish efficient supervisory systems to protect savings; develop supervisory structure focused on protecting the financial system and public resources; build capacity of central banks to adequately supervise and maintain integrity of financial system.
Development Partners: provide support to governments in drafting instructions on regulations; help build capacity of supervisory agencies (TA and equipment and lateral learning)</td></tr>
<tr><td colspan="2">5. Increase efforts towards client protection

MFIs should adopt client protection principles and translate them into practices throughout their institution. Investors should consider client protection in their investment agreements with retail institutions and in their own practices.

Governments and Development Partners should promote transparency and disclosure, promote redress mechanisms for complaints, and should consider facilitating building client capabilities. Governments should also ensure that they adequately supervise the industry. Governments and development partners could also support the development of industry infrastructure towards enhancing client protection.</td></tr>
<tr><td colspan="2">6. Reform the business environment
Governments: establish right investment climate; ensure appropriate institutions</td></tr>
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established and functioning; establish sound legal framework (collateral, creditor rights, non-restrictive labor laws) **Development Partners:** capacity building towards better business environment, including modifying laws and regulations; judiciary reform.
PARTNERSHIP FOR PROGRESS
In summary, in the coming years, agenda for financial inclusion in Africa should include: • Reducing industry fragility and building retail capacity in Microfinance • Building domestic financial markets for microfinance • Utilizing technology to cut costs and expand outreach • Building industry infrastructure to enhance depth and diversity of product offerings • Formulate country strategies and reform country mf policies, regulatory and supervisory frameworks
RECOMMENDATION ON ROLE OF GOVERNMENTS (FROM CGAP)
• Maintain macroeconomic stability through appropriate monetary and fiscal policies • Involve the private sector in formulating poverty reduction strategies • Adjust regulatory frameworks as needed, to permit range of financial institutions and prudential regulation focused on savings • Invest in supervisory capacity.
GOVERNMENTS SHOULD AVOID (FROM CGAP)
• Interest rate ceilings • Provision of credit at retail level • Subsidized lending programs • Political interference
ENSURING EFFECTIVENESS OF DONORS' SUPPORT: IMPLICATIONS OF THE PARIS DECLARATION PRINCIPLES AND THE ACCRA AGENDA FOR ACTION
• African countries have the primary responsibility for leading microfinance development to accelerate the fight against poverty. • Donors should strengthen country systems, rather than bypass them. • Donor support to microfinance development will be tailored to country circumstances. • Donors consider weaknesses in microfinance development as symptoms of broader financial sector challenges • Donors should pursue strategies of constructive and systemic engagement, including in high-risk environments. • Donors should strengthen transparency in their own operations and in the programs they support through enhanced information disclosure. • Each donor's activities in support of microfinance must be focused on delivering results, demonstrating impact and adding value compared to other donors. • Donors should build strategic partnerships with each other to achieve common objectives.
MFIs: strengthen national and regional associations (to help establish and uphold standards in performance, responsible finance, client protection, etc.; provide members with training and support services; advocate with government and policymakers); participate in credit bureaus and utilize rating and audit services; generate and submit quality data. Provide beneficiaries with 'basics' of fund management.
Development Partners: support institutional capacity building (subsidize/finance quality trainings; make skill transfer sustainable through ToTs); promote MFI transparency (standards, disclosure, client protection, cofinancing of ratings and

audits—including these in finance agreements); support development of industry infrastructure (incl. guarantee funds, rating agencies, deposit insurance, credit bureaus, associations); promote engagement of private sector players to develop and deploy low-cost distribution channels (through use of agent banking and technology amongst other strategies).

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