

**AFRICAN DEVELOPMENT BANK
AFRICAN DEVELOPMENT FUND**



**MICROFINANCE
POLICY AND STRATEGY FOR THE BANK GROUP**

**OPERATIONS POLICIES AND REVIEW DEPARTMENT
(POPR)**

May 2006

TABLE OF CONTENTS

	<u>Page</u>
Abbreviations and Acronyms, Definitions, Executive Summary	(i-x)
I. INTRODUCTION	1
1.1 Microfinance in the Context of Development	1
II. BACKGROUND	1
2.1 The Evolution Microfinance.....	1
2.2 State of Microfinance in Africa.....	2
2.3 Demand for Microfinance Service in Africa.....	3
2.4 Supply of Microfinance Services in Africa	4
2.5 Constraints of Microfinance in Africa	5
2.6 Major Achievements-----	5
2.7 Rural Financial Markets	6
2.8 The Financial Sector.....	7
2.9 The Informal Sector.....	8
2.10 Gender and Microfinance-----	8
III BANK EXPERIENCE IN MICROFINANCE.....	10
3.1 Background.....	10
3.2 Portfolio Clean up Exercise.	10
3.3 ADF Microfinance Initiative for Africa (AMINA).....	11
3.4 The Donor Peer Reviews	11
3.5 Mainstreaming Microfinance into Bank Operations...	12
3.6 The Microfinance Business Plan.....	12
3.7 Development Impact.....	13
3.8 Lessons Learned.....	13
3.9 Development Partners in Microfinance	14
IV. BANK GROUP POLICY ON MICROFINANCE	14
4.1 Rationale for the Policy	14
4.2 Goal and Outcomes of the Policy.....	15
4.3 Guiding Principles of the Policy.....	15
4.4 The Policy.....	16
4.5 Policy Levels and Areas of Focus in Microfinance....	17
4.6 Eligible Countries.....	18

TABLE OF CONTENTS (Continued)

	<u>Page</u>
V. BANK MICROFINANCE DEVELOPMENT STRATEGY	18
5.1 Strategic Vision and Orientations for Policy Implementation	18
5.2 Strategic Orientation No. 1: Enhancing Key Stakeholders Capacity and Investment in Microfinance in RMCs	18
5.3 Strategic Orientation No. 2: Creating an Enabling Environment that Promotes Building Inclusive Financial Systems ...	19
5.4 Strategic Orientation No. 3: Enhancing Strategic Partnership	19
5.5 <i>Strategic Orientation No. 4: Knowledge Management - Research, Information Collection and Dissemination</i>	<i>20</i>
5.6 <i>Strategic Institutional Partners in Microfinance</i>	<i>20</i>
5.7 <i>Instruments: Financial and Policy Frameworks</i>	<i>22</i>
VI. IMPLEMENTATION ARRANGEMENTS	23
6.1 Introduction	23
6.2 <i>Microfinance Business Plan</i>	<i>24</i>
6.3 Organizational Arrangements	24
6.4 Progress Reporting	25
VII. CONCLUSIONS	25
BOX 1: The Eleven Principles of Microfinance	16
ANNEXES	
1. RESULTS-BASED FRAMEWORK	
2. ACTIVE COLLABORATIVE PARTNERS OF THE BANK IN MICROFINANCE	
3. BEST PRACTICE INDICATORS FOR MICROFINANCE	
4. OPTIONS FOR RURAL FINANCE FOR POVERTY	
5. REDUCTION KEY PERFORMANCE STATISTICS OF A SAMPLE OF THE LARGEST AFRICAN MFIS	
6. PROCESS OF DEVELOPMENT AND VALIDATION OF THE POLICY AND STRATEGY	
7. LIST OF EXTERNAL STAKEHOLDER WORKSHOP PARTICIPANTS	

ABBREVIATIONS AND ACRONYMS

ADB	African Development Bank
ADF	African Development Fund
AFMIN	African Microfinance Network
AMINA	ADF Microfinance Initiative for Africa
APPR	Annual Portfolio Performance Review
BDS	Business Development Services
CEMAC	Central African Monetary Union (for francophone countries)
CGAP	The Consultative Group to Assist the Poor
CSP	Country Strategy Paper
DFI	Development Finance Institution
DFID	Department for International Development (UK)
DPRs	Donor Peer Reviews
EU	European Union
FAO	The Food and Agricultural Organization
FSAs	Financial sector assessments
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
GIABA	Groupe Inter-gouvernemental d'Action contre le Blanchiment en Afrique
IADB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development, or the World Bank
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation, World Bank Group
IMF	International Monetary Fund
ILO	International Labour Organization
MSC	Microcredit Summit Campaign
MDGs	Millennium Development Goals
MFI	Microfinance institution
MIS	Management Information Systems
MIX	The Microfinance Information Exchange Market
MMD	<i>Mata Masu Dubara</i> , or “Women on the Move”, Niger
NEPAD	New Partnership for Africa’s Development
NGO	Nongovernmental organization
NTF	Nigeria Trust Fund
OCMU	Former Central Microfinance Unit (of the Bank)
OCVP	Vice Presidency, Central and West (of the Bank)
ONVP	Vice Presidency, North, East and South (of the Bank)
OPEV	Evaluation Department (of the Bank)
OPSD	Private Sector Department (of the Bank Group)
PADME	Association pour la Promotion et l'Appui au Développement de Microentreprises / Bénin
PAR	Projects at risk
PBL	Policy-Based Loan
PDRE	Policy Research and Development (of the Bank Group)
POPR	Operations Policy and Review Department
PRSP	Poverty Reduction Strategy Paper
RMC	Regional member country

SACCO	Savings and Credit Cooperative
SADCC	The Southern African Development Coordination Conference
SME	Small and Medium Enterprise
TSP	Technical Service Provider
UA	Unit of Account
UEMOA	West African Monetary Union (for francophone countries)
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Program
USAID	United States Agency for International Development
WOCCU	World Council of Credit Unions

DEFINITIONS

Business Development Services: Support services that contribute to the growth of enterprises (eg. business planning, client training, networking, marketing technical support). *Source: Calmeadow*

Depth of Outreach: Extent to which financial services reach the relatively poor. *Source: Schreiner 1998.*

Financial Sector: The sector of the economy that comprises financial institutions and financial markets. *Source:*

Financial Sector Deepening: The extent to which the financial sector serves a population in a country. Monetary assets to GDP ratio are the major indicator of financial sector deepening. *Source: Pakistan Journal of Public Administration*

Financial Self-Sufficiency: Total operating revenues divided by total administrative and financial expenses, adjusted for low-interest loans and inflation. In a microfinance context, an institution is financially self-sufficient when it has enough revenue to pay for all administrative costs, loan losses, potential losses and funds. *Source: ACCION*

Informal Sector: A term usually denoting workers and businesses for private gain that are not formally registered or recognized by the economic or administrative systems governing the areas in which they operate. The term can include home-based workers, informal subcontractors to formalized businesses, self-employed, paid workers in informal enterprises, unpaid workers in family businesses, casual workers without fixed employer, sub-contract workers linked to informal enterprises, and sub-contract workers linked to formal enterprises. Additional characteristics include:

- (i) In general, firms and workers in the informal sector do not pay fees or taxes and the administrative procedures are simplified.
- (ii) It is difficult to protect the rights of the agents employed, as the informal sector does not always comply with the rule of law. *Source: SOAS/ London University*

Market Rate: The rate of interest borrowers must pay to borrow funds commercially. Program-related investments generally are offered at below market rates or at no interest rate. *Source: Renz and Massarsky*

Microcredit: A part of the field of microfinance, microcredit is the provision of credit services to low-income entrepreneurs. Microcredit can also refer to the actual microloan. *Source: ACCION*

Microfinance: Banking and/or financial services targeted to low-and-moderate income businesses or households, including the provision of credit. Microfinance is part of the financial sector. *Source: ACCION.*

Microfinance Institution: A financial institution - can be a nonprofit organization, regulated financial institution or commercial bank - that provides microfinance products and services to low-income clients. *Source: ACCION*

Outreach: The number of clients that an institution serves. *Source: ACCION*

Poor: For microfinance, the poor include those living below the poverty line defined for any given RMC. The poor can include households whose income levels are lower than the average for any given RMC, the working poor, micro enterprises usually working in the informal sector, the destitute, and the victims of conflict. Those who are destitute and/or considered very poor are those who live on less than U.S.\$1 per day. Those who do not have the resources to meet the basic needs for healthy living. They do not have the income to provide the food, shelter and clothing needed to preserve health. *Source: University of Fairfield, Connecticut*

Private Sector: The part of a nation's economy that is not controlled by the government. *Source: investorwords.com*

Rural Finance: Financial institutions and their services that target those who live and work in non-urban areas and who are generally involved in agricultural-related activities. **Rural finance can be a part of microfinance, while microfinance can also be a part of rural finance at the same time.** *Source: The MIX Market*

Executive Summary

1. Background

1.1 In response to the need by the international community to address development effectiveness, the African Development Bank adopted the following vision: to be the leading development finance institution in Africa, dedicated to providing quality assistance to its Regional Member Countries (RMCs) in poverty alleviation. In line with this vision, one of the *priorities* of the Bank's strategic plan is improve the effectiveness of Bank activities and achieve productivity growth and poverty reduction in Africa. Microfinance plays a critical role in achieving the Millennium Development Goals (MDGs) and enhancing development effectiveness by contributing to

- poverty reduction,
- increased political, social, and economic development,
- social empowerment,
- community participation,
- school attendance of children, and
- Economic prosperity (especially for women).

The role of microfinance in realizing Bank goals is based on a key lesson learned by the Bank and its development partners: The full potential of microfinance can be achieved, if microfinance institutions become linked to, or integrated with the formal financial sector in building inclusive financial systems that works for the poor. .

2. The Evolution of Microfinance

2.1 Microfinance has existed for centuries in Africa and around the world. Everyone, no matter how poor, needs and uses financial services all the time. Many people use moneylenders that usually charge high interest rates on loans. There are many global examples of the history of microfinance, ranging from informal, small-scale, rotating savings-and-loans clubs in England, Ireland, and Germany during the eighteenth century to savings and credit cooperatives in Indonesia in the nineteenth century. In Nigeria, microfinance goes back to the fifteenth century and was carried from there to the Caribbean by slaves. The original Yoruba term, *susu*, for the practice is still **in use** today. In Africa, mainstreaming, formalization, and recognition of microfinance as part of the formal financial sector began to gain momentum in the late 1990s.

3. State of Microfinance in Africa

3.1 The African microfinance industry is as diverse as the continent itself and geographically dispersed. An array of approaches has been used ranging from traditional group based- systems to specialised lending by banks, non-governmental organizations (NGOs), non-bank financial institutions, cooperatives, rural banks, savings and postal financial institutions and increasing number of banks. The Community-Based approach in MFI development that is commonly followed in African countries has been to rely on local communities to support the development of MFIs, outside the formal banking sector. As MFIs operating outside the formal banking sector had to find their own source of funds, the development of innovative saving vehicles was important and supported by participatory efforts in local communities to form cooperatives. Consequently, traditional community based cooperative

groups such as local clubs and village bank associations have played a central role in the savings mobilization effort and the expansion of other microfinance services in Africa.

4. Demand for Microfinance in Africa

4.1 The demand for microfinance in the Africa is large and the types of services the poor and low income client's demand vary across the board. This large demand and the diversity of the microfinance clients created the need for building inclusive financial systems that work for the poor. Poor and low-income people need and want a range of financial products and services to build income and wealth, smooth expenditure patterns, and reduce risk (e.g, deposits, loans, payment services, leasing, money and remittance transfers, pensions, and insurance).

5. Supply of Microfinance Services in Africa

5.1 The market structure in microfinance in the Africa region varies significantly depending on member countries stage of financial sector development, policy environment etc. However, the bigger gap on the supply side is lack of information on what institutions are actually accomplishing versus what they could be accomplishing. Microfinance institutions must be aware that microfinance service delivery is more complex than one could think originally, especially in a competitive environment where clients are more and more demanding and educated. As a result microfinance institutions should endeavour to understand what clients want and how to deliver services and products that their clients want instead of just assuming that potential clients will avail themselves of what the institutions may be willing to offer.

5.2 Microfinance has two long-term global goals. The first is to build inclusive financial systems to ensure that all people can access the services provided by formal financial institutions and the private sector. The Bank will help its RMCs to build such inclusive financial systems in Africa. The second is to assist micro entrepreneurs working in the vast informal sector to expand their businesses into registered, licensed small- and medium-scale enterprises (SMEs).

5.3 Some 320 million people living on less than USD 1 per day represent the potential demand for microfinance services in Africa alone. These people can effectively use microfinance to lift themselves out of poverty, reduce their vulnerability to external shocks, and become prosperous. Although microfinance is not a panacea for poverty, access to financial services for all people underpins the attainment of the MDGs.

5.4 This Policy and Strategy on Microfinance is intended to further guide Bank Group Operations in supporting the RMCs to develop microfinance and mainstream it into their formal financial and private sectors. It capitalizes on the lessons learned by the Bank and its development partners concerning the appropriate approaches to microfinance, including the assurance that no harm will be done to existing financial markets and that a financial sector approach will be used. The Bank document, "Business Plan: Mainstreaming Microfinance into Bank Group Operations,"¹ made explicit provision for the development of this Policy and Strategy.

¹ ADF/BD/WP/2003/157. Approved November 11,2003.

5.5 The Microfinance Policy and Strategy for the Bank Group has three purposes, namely, to:

- provide strategic direction to the Bank as it extends more significant support to its RMCs to build inclusive financial systems, which will provide a wider range of financial products and services to a large part of their respective populations;
- provide the Bank a means of focusing its microfinance activities in order to achieve the greatest impact within the shortest period of time, given the 2015 deadline for meeting the MDGs; and
- Clarify for the RMCs what they can expect from the Bank in terms of support for building inclusive financial systems.

6. Constraints of Microfinance in Africa

6.1 Among the microfinance challenges that RMCs continue to face are: the absence of strong retail capacity in microfinance institutions (this challenge is the single biggest constraint to expanding the outreach of financial services to the poor in Africa)

- extending access to financial services to the remotest of rural areas in a cost-effective manner
- the pervasive impression that microfinance is a social system of resource transfers to “beneficiaries” at subsidized interest rates, rather than a part of the financial sector (this impression explains in large part why national enabling environments still restrict MFIs from mobilizing savings and prevent them from achieving financial self-sufficiency due to interest rate ceilings)
- institutional infrastructure is needed for microfinance, including service providers such as training institutes, accountancy, credit bureaus, and information technologies

7 Gender and Microfinance

7.1 Microfinance has the potential to have a powerful impact on women’s empowerment. Although microfinance is not always empowering for all women, most women do experience some degree of empowerment as a result. Empowerment is a complex process of change that is experienced by all individuals some what differently. Women need, want, and profit from credit and other financial services.

7.2 Strengthening women’s financial base and economic contribution to their families and communities play a role in empowering. Simply earning small amount of money, through access to capital to start a small business can increase women’s confidence and empower them through greater economic independence and security. Women’s financial contributions to family can earn them more respect from their husbands, children, in-laws and extended families.

8. Bank Experience in Microfinance

8.1 The Bank has been involved in microfinance since the 1970s, mostly by financing microcredit components within larger investment projects. During the 1990s, the Bank started funding operations that applied microfinance best practices. To consolidate these efforts, in 1999 it established the African Development Fund Microfinance Initiative for Africa (AMINA) on a pilot basis. Through AMINA, the Bank Group was able to contribute to building the capacity of microfinance institutions (MFIs), expanding the outreach of 70 MFIs in ten countries to hundreds of thousands of additional clients. These institutions improved their self-sufficiency and contributed to the development of better enabling environments in their respective RMCs, especially Ethiopia, Mauritania, and Tanzania. Implementing the AMINA initiative generated a number of lessons, the most important of which led to

the current microfinance mainstreaming process within the Bank. In other words, financial intermediation designed to serve low-income groups must be addressed from a financial sector perspective and rely on best practice standards in order to succeed.

8.2 The Bank also learned that supporting the development of microfinance through components of larger investment projects was not as effective as using a direct support approach (i.e., the strategy used by the AMINA project). The limited effectiveness of component projects is demonstrated by the inferior performance of 73 ongoing mainstream operations that were designed as microcredit components. Pursuant to the Microfinance Business Plan, a portfolio clean-up process is underway to align these operations with best practice standards so that they support the objectives of the RMCs and the Bank in mainstreaming microfinance.²

8.3 The experience of AMINA also helped Bank staff understand the role microfinance plays in development effectiveness and achieving the MDGs. In early 2002, when the AMINA initiative ended, the Bank approved the Microfinance Business Plan, which was followed by the current mainstreaming process. Also of note, the Donor Peer Reviews coordinated by CGAP in 2002 recruited peers from 17 development partners to review one another's microfinance operations. The results of these reviews provided further direction to the Bank in mainstreaming microfinance. The Peer Review of the Bank, for example, recommended that a strong centralized microfinance unit be attached to the Private Sector Department and that the Bank develop a clear strategic vision for this unit.

8.4 Policy documents of the Bank that relate to microfinance include the Strategic Plan, 2003–2008; the Microfinance Business Plan, 2003; the Financial Sector Policy, 2002; the Private Sector Development Strategy, 2005; the Agricultural and Rural Development Sector Policy, 2000; and the Rural Finance Guidelines, 2002.

9. Bank Group Policy on Microfinance

9.1 The rationale for the Bank Group Policy on microfinance is anchored in:

- the global and African history of microfinance, as well as direct link of microfinance with development effectiveness,
- universal principles and standards of microfinance best practice,
- the extensive experience of the Bank in microfinance, including lessons learned to date,
- the high level of political consideration given to microfinance, as reflected in the endorsement of Eleven Key Principles of Microfinance by the 2004 Summit of the Group of Eight (G8) Heads of State, and
- the direct linkage between development effectiveness and microfinance that was established by the Donor Peer Reviews.

The rationale for the policy is further anchored in the Bank's comparative advantage and recognized success in building retail MFI capacity.

² Best-practice standards are operational criteria by which microfinance should abide. The basic standard is the outreach of quality financial services to as many poor people as possible while maintaining the financial self-sufficiency of institutional intermediaries.

9.2 The principles on which the Bank's microfinance Policy is based are the abovementioned Eleven Key Principles of Microfinance. The more significant of these principles, which are elaborated in the body of this document, are that:

- the poor need a variety of financial services'
- microfinance intends to build financial systems that include the poor
- interest rate ceilings debilitate the poor's access to financial services
- Governments should act only as enablers, not as direct microfinance *providers*.

9.3 The goal of the policy is to reduce poverty and increase prosperity in the RMCs by supporting their efforts to build inclusive financial systems. The objective is to increase microfinance investments in the RMCs.

9.4 The microfinance policy of the Bank Group is to support the RMCs to build sustainable systems of financial intermediation to serve people who do not have access to quality financial services. The policy seeks to integrate and mainstream microfinance into the formal financial and private sectors of Bank RMCs so that microfinance can achieve its potential of reaching millions of RMC citizens. The role of the Bank is that of a catalyst and facilitator, linking those with resources (e.g., private investors) with those who need resources especially retail MFIs that serve the poor in remote areas.

9.5 The modalities and focus of the policy include the three institutional and/or systemic levels of financial systems development: the micro level, where the Bank seeks to promote strong retail institutions; the meso level, where the Banks seeks to support industry infrastructure; and the macro level, where the Bank seeks to foster a conducive enabling environment and assure an appropriate role for RMC governments.

10. Strategy on Microfinance

10.1 The Policy and Strategy has four strategic areas of orientation for serving all RMCs:

- enhancing key stakeholder capacity in microfinance, including investment in new and existing microfinance institutions (MFIs);
- creating an enabling environment that promotes building financial systems inclusive of the poor;
- enhancing strategic partnerships; and
- Knowledge management (i.e., ensuring effective research, information collection, and dissemination).

These four areas, especially enhancing stakeholder capacity, respond to the major constraint facing microfinance in Africa: the need to build the capacity of sustainable, retail-level institutions.

10.2 The Bank will collaborate with its strategic institutional partners to ensure that the goals and objectives of this Policy are met. These partners will include retail intermediaries; RMC governments; associations and professional networks of MFIs; private-sector funds, including commercial banks, foundations, and investment funds; other development agencies (most of which are CGAP members); and technical service providers.

10.3 To make this Policy operational, the Bank will use the following financial instruments and policy frameworks:

- loans
- grants
- equity investments
- guarantees
- financial sector assessments
- PRSPs and CSPs
- promotional dialogue with the RMCs on microfinance

10.4 The choice of instruments and policy framework will be determined according to standard rules and regulations for availing resources to the RMCs. This Policy will remain in effect for five years. Operations under the Policy will be designed in line with a new microfinance Business Plan to be developed.

10.5 This Policy will maintain the organizational structure approved in the Microfinance Business Plan. Enhancements to the structure will be made to bring it into line with the provisions of the Policy, as well as to accommodate additional required activities. The Private Sector Department (OPSD), the public sector Operations Departments, and the Microfinance Division of the Operations Policy and Review Department (POPR), will be involved in the operational implementation of this Policy. A revised Microfinance Business Plan and Microfinance Guidelines (to be developed) will describe in greater detail how each of the three organizational structures will be used and enhanced, and outline additional funding and staffing resources that are needed.

11. Progress Reporting

Management will regularly monitor progress in the implementation of this Policy and Strategy, including the preparation of annual reports. There will be a midterm review at the end of Year 3 and a final report at the end of Year 5, to be submitted to the Boards of the Bank.

12. Conclusion

12.1 The African Development Bank has concluded that building inclusive financial systems, or microfinance, in its Regional Member Countries is one of the most effective strategies to achieve its vision of poverty reduction and the creation of prosperity. This conclusion is based on the proven linkage between microfinance and development effectiveness. This document outlines the Bank's microfinance Policy and Strategy, which are to provide direction in supporting its RMCs more meaningfully in microfinance, define a means of achieving greater impact with its interventions, and clarify for RMCs what they can expect from the Bank in terms of support for building inclusive financial systems.

12.2 The Boards are therefore requested to approve the Microfinance Policy and Strategy of the African Development Bank Group.

I. INTRODUCTION

1.1 Microfinance in the Context of Development

1.1.1 In response to the need by the international community to address development effectiveness, the Bank adopted the following vision: to be the leading development finance institution in Africa, dedicated to providing quality assistance to its Regional Member Countries (RMCs) in poverty alleviation. In line with this vision, one of the *priorities* of the Bank's strategic plan is to improve the effectiveness of Bank activities and achieve the goals of productivity growth and poverty reduction in Africa. Microfinance plays a critical role in achieving the Millennium Development Goals (MDGs) and development effectiveness by contributing to:

- poverty reduction
- increased political, social and economic development
- social empowerment
- community participation
- school attendance of children
- economic prosperity (especially for women)

1.1.2 The Bank's vision statement on poverty reduction makes explicit reference to microfinance as an intervention to reduce poverty. Reference to microfinance is also made in other Bank policies and strategies, including the Strategic Plan, 2003–2007. Therefore, the new Microfinance Policy and Strategic Orientation shall be implemented on a complimentary basis with the Financial Sector Policy, 2002; Policy on Poverty Reduction, 2002; Private Sector Development Strategy, 2005; Agriculture and Rural Sector Development Policy, 2000; and the Rural Finance Guidelines, 2002.

The role of microfinance in realizing Bank goals is based on a key lesson learned by the Bank and its development partners that microfinance can achieve its full potential, if microfinance institutions become linked to, or integrated with the formal financial sector in building inclusive financial systems that work for the poor. .

II. BACKGROUND

2.1 The Evolution of Microfinance

2.1.1 Microfinance has existed for centuries in Africa and around the world. Everyone, no matter how poor, needs and uses financial services all the time. Many people use moneylenders that usually charge high interest rates on loans. There are many global examples of the history of microfinance, ranging from informal, small-scale, rotating savings-and-loans clubs in England, Ireland, and Germany during the eighteenth century to savings and credit cooperatives in Indonesia in the nineteenth century. In Nigeria, microfinance goes back to the fifteenth century and was carried from there to the Caribbean by slaves. The original Yoruba term, *susu*, for the practice is still in use today. In Africa, mainstreaming, formalization, and recognition of microfinance as part of the formal financial sector began to gain momentum in the late 1990s.

2.1.2 In the twentieth century, microfinance underwent four distinct phases of evolution before arriving at its present phase of building sound, inclusive financial systems. The *first phase* of microfinance in the previous century began in the 1950s and consisted of directed, subsidized credit, often targeting individuals who did not have the means to reimburse loans. These schemes assumed that the lack of money was the main obstacle to eliminating poverty. The *second phase*, starting in the 1970s, consisted of microcredit offered mostly through NGOs, beginning with the Grameen Bank in Bangladesh and followed by a great number of NGOs that attempted to provide of microcredit to the poor. At this time, financial self-sufficiency was not as important to such NGOs as were donated resources. Development agencies provided subsidized funds, and the common belief was that the supply of such resources would remain reliable. NGOs were intermediaries, largely functioning as income transfer agents for social purposes rather than serious financial intermediaries.

2.1.3 The *third phase* of microfinance in the twentieth century was the formalization of microfinance institutions in the 1990s. In response to demand, MFIs began offering more financial services, such as savings and insurance. Microfinance also demonstrated that it could improve the socioeconomic well-being of its clients and their families. The poor were experienced positive changes in attitude as microfinance helping them believe that they could lift themselves out of poverty. Finally, a sustainable credit culture was created. The *fourth phase*, which began in the mid-1990s, is the mainstreaming of microfinance and its institutions into the formal financial sector. Microfinance is evolving to where the term itself is becoming obsolete. *Building inclusive financial systems for the poor* is the term that is increasingly used as microfinance becomes part of the formal financial sector without losing its focus on serving the poor. Mainstreaming requires that MFIs and other intermediaries operate according to the same standards of accountability, transparency, performance, and profitability as do commercial banks and other formal financial institutions.

2.2 State of Microfinance in Africa

2.2.1 The African microfinance industry is diversely and geographically dispersed. An array of approaches has been used ranging from traditional group based- systems to specialised lending by banks, non-governmental organizations (NGOs), non-bank financial institutions, cooperatives, rural banks, savings and postal financial institutions and increasing number of banks. The Community-Based approach in MFI development that is commonly followed in African countries has been to rely on local communities to support the development of MFIs, outside the formal banking sector. As MFIs operating outside the formal banking sector had to find their own source of funds, the development of innovative saving vehicles was important and supported by participatory efforts in local communities to form cooperatives. Consequently, traditional community based cooperative groups such as local clubs and village bank associations have played a central role in the savings mobilization effort and the expansion of other microfinance services in Africa³.

2.2.2 According to a recent survey conducted by CGAP (April 2005) MFIs in Africa are dynamic and perform favourably compared with their counterparts in other global regions. Indeed African MFIs lead the world in savings mobilizations, in both the number of clients served and the absolute volume of savings on deposit. Never the less, African MFIs still face several challenges. Many MFIs work in rural areas, where low population density and weak infrastructure result in high operating costs. However, institutions continue to seek ways to increase efficiency through better communication, improved lending products and new technology.

³ Microfinance in Africa : experience and lessons learned(A.Basu, R. Blavy and M. Yulek September 2004)

2.3 Demand for microfinance services in Africa

2.3.1 The demand for microfinance in Africa is large and the types of services the poor and low income client's demand vary across the board. This large demand and the diversity of the microfinance clients created the need for building inclusive financial systems that work for the poor. Poor and low-income people need and want a range of financial products and services to build income and wealth, smooth expenditure patterns, and reduce risk (e.g, deposits, loans, payment services, leasing, money and remittance transfers, pensions, and insurance). In Africa, savings services are in greater demand than loans.⁴ Microfinance allows microenterprises to grow and evolve into small- and medium-sized enterprises (SMEs). Remittance flows and their end use are improved by measures that reduce fees, build assets, and help channel and regulate such flows into the formal financial sector.

2.3.2 Microfinance has the worldwide potential of serving 3 billion people who are not currently served or otherwise excluded by institutions in the formal financial sector. Of these 3 billion people, some 1.2 billion live on less than USD 1 per day, including 320 million Africans. Globally, there is a large gap between the potential demand for microfinance services and the supply of these services—*less than three percent* of estimated demand is currently being met. As of 2004, almost 3,000 MFIs reported reaching about 81 million clients, among whom 58 million were among the poorest of the poor when they accessed their first loan.⁵ It has been proven that even the poorest of the poor—those considered destitute—will save. In addition to working in developing countries, MFIs also work in impoverished areas of certain developed countries, such as the United States.

2.3.3 The potential for developing microfinance in Africa is substantial. Demand is estimated to reach **USD 10 billion** among micro- and small businesses alone over the next several years. Women represent 61 percent of the clientele of major African MFIs, with an outstanding loan per client of USD 307. There are relatively few successful institutional models in Africa. Microfinance, however, can help modernize banking systems, make them more hospitable to those who do not use banks, and mobilize idle capital for investment in economic and social development.

2.3.4 The majority of microfinance efforts and institutions in Africa operate in the informal sector. Only in the 1990s, with the intervention of international cooperative movements and specialized NGOs, was microfinance able to reach more clients in Africa, such as the one million clients now in Ethiopia. Strong efforts have also been made toward the institutional transformation of microfinance in Africa, mostly NGOs that have become MFIs that meet best-practice standards. A major example of this trend is K-Rep Bank in Kenya, which transformed from an NGO into a licensed commercial bank.

2.3.5 African microfinance institutions are increasingly integrating and joining forces via such mechanisms as networks, cross-border cooperation in institutional development and addressing policy issues of the enabling environment. National associations and networks of retail MFIs, called microfinance associations (MFAs), are being established to assist members to improve their professional performance and harmonize the criteria against which MFIs should report. These associations provide services and engage in activities in support of their MFI members. National MFAs are increasingly grouping themselves into regional and sub-regional “networks of networks,” such as AFMIN (the African Microfinance Network) and SANABEL (Microfinance Network for

⁴Anne-Lucie Lafourcade, Jennifer Isern, Patricia Mwangi, and Matthew Brown, “Overview of the Outreach and Financial Performance of MFIs in Africa,” The Mix Market, Washington, DC, April 2005; http://www.mixmarket.org/medialibrary/mixmarket/Africa_Data_Study.pdf.

⁵ Microcredit Summit Campaign, *Annual Report : Microcredit Summit Campaign*, 2004).

North African and Middle Eastern countries). In addition to microfinance networks, (NEPAD) is working with microfinance as part of its support of the regional financial sector, economic integration, and the harmonization of standards.

2.4 Supply of Microfinance Services in Africa

2.4.1 The market structure in microfinance in Africa varies significantly depending on member countries stage of financial sector development, policy environment etc. However, the bigger gap on the supply side is lack of information on what institutions are actually accomplishing versus what they could be accomplishing. Microfinance institutions must be aware that microfinance service delivery is more complex than one could think originally, especially in a competitive environment where clients are more and more demanding and educated. As a result microfinance institutions should endeavour to understand what clients want and how to deliver services and products that their clients want instead of just assuming that potential clients will avail themselves of what the institutions may be willing to offer.

2.4.2 There are three basic levels of MFIs in Africa, categorized according to their stage of institutional evolution, from emerging MFIs to expanding MFIs to formal financial sector institutions. This categorization is further defined in terms of RMC enabling environments, service coverage, and the levels of MFI institutional development, competence, and experience. This categorization helps classify the stage that microfinance has reached in individual RMCs, and thus design appropriate interventions by sequencing the type of support that they provide.

- *Category I: MFIs* in the emerging stages consist of thousands of NGOs, informal-sector intermediaries (especially those working in rural areas), and even individuals who provide financial services on a largely artisanal basis. These MFIs operate spontaneously to fill market niches and charge very high rates of interest on loans to meet the demand of mostly poor people who work and do business in the informal sector. They operate largely without formal recognition in terms of licensing or registration. RMCs generally do not have the ability to recognize these institutions due to the absence or inappropriateness of existing legislation and regulations on microfinance. By virtue of their informal nature and non-legal status, MFIs operating in this category have few opportunities to grow and expand. Examples include the *susus* of Ghana, which operate in urban and peri-urban markets; the wool and mohair associations operating in the Lesotho Highlands; (SACCOs) operating in East Africa; and informal associations such as the (MMDs) in Niger.
- *Category II MFIs* : are institutions that are in a full growth and expansion phase, becoming financially self-sufficient, and increasing their outreach to thousands of people who previously had no access to quality financial services. RMCs are increasingly adapting existing and creating new legislation and regulations to govern such MFIs. These MFIs, however, have yet to become fully mainstreamed into the financial sectors of their respective RMCs. Examples include the larger SACCOs of East Africa and the *susus* of Ghana, which have won a level of legal recognition in individual countries, as well as NGOs such as PADME in Benin, which are profitable, but have yet to be fully integrated into the formal financial sector.
- *Category III MFIs*: are fully mature financial institutions that are integrated into the formal financial sectors of their respective countries. They are licensed and registered as financial service entities, such as commercial banks. Their respective legislative environments fully address microfinance, as is the case of savings and credit cooperatives in Tanzania and the countries of francophone West Africa (or UEMOA). The most prominent examples of MFIs that have become

commercial banks include K-Rep Bank and Equity Building Society in Kenya, together with Centenary Bank in Uganda.

2.4.3 While unregulated MFIs are reaching poorer clients, they have higher transaction costs and smaller operation volume. These institutions will need to scale up, transform or merge with other institutions to achieve levels of efficiency that can guarantee their continued operations. Cooperatives compare favourably for savings mobilization even though, on average, they do not lend as much as other MFI types. Commercial banks are entering the market and competition is increasing in many countries, especially in Benin, Cameroon, Ghana, Kenya, Madagascar, Mali, Senegal, South Africa and Uganda. MFIs will need to innovate and provide high quality services to retain clients and remain competitive in their local financial service market.

2.5 Constraints of microfinance in Africa

2.5.1 Among the microfinance challenges that RMCs continue to face are: the absence of retail MFI capacity (this challenge is the single biggest constraint to expanding the outreach of financial services to the poor in Africa)

- extending access to financial services to the remotest of rural areas in a cost-effective manner
- the pervasive impression that microfinance is a social system of resource transfers to “beneficiaries” at subsidized interest rates, rather than a part of the financial sector (this impression explains in large part why national enabling environments still restrict MFIs from mobilizing savings and prevent them from achieving financial self-sufficiency due to interest rate ceilings)
- institutional infrastructure is needed for microfinance, including service providers such as training institutes, accountancy, credit bureaus, and information technologies
- the ability to serve the “missing middle,” that is, small- and medium-scale enterprises that grow beyond the capacity of an MFI to serve, but are still unable to access financial services from formal financial institutions
- despite general improvement in the policy environment for financial sector programs, the policy environment in many countries remains unfavourable for sustainable growth in microfinance operations.

2.6 Major achievements in microfinance

2.6.1 The microfinance sector in Africa is quickly expanding, and institutions have increased their activities according to CGAP’s Microfinance Information Exchange (MIX). The African MFIs are among the most productive globally, as measured by the number of borrowers and savers per staff member. MFIs in Africa also demonstrate higher levels of portfolio quality with average portfolio at risk over 30 days of only (four) percent. The developments in microfinance in the region have set in motion a process of change from an activity that was entirely subsidy dependent to one that can be a viable business.

2.6.2 Characteristics of successful MFIs, many of which are derived from lessons learned over the past decade, include: (a) adherence to financial-sector discipline; (b) evolving in a manner that enables MFIs to follow best practice principles and standards and operate as professional, business-oriented financial institutions; (c) access to seed capital, such as grants that support start-up operations and expansion; and (d) providing quality financial services that are in demand among the poor.

2.6.3 Successful African MFIs that have these characteristics include PADME in Benin (45,000 clients), Credit Rural in Guinea (110,000 clients), Farmers Development Union (FADU) in Nigeria (135,000 clients), and Amhara Credit and Savings Institution (ACSI) in Ethiopia (288,000 clients). Annex 5 illustrates key performance figures from some of the largest African MFIs in more detail.

2.7 Rural Financial Markets

2.7.1 The cost of lending in rural areas is relatively high as a result of low population densities combined with low loan volume, poor transportation and communication facilities, which make unit delivery costs very high for small financial transaction and for many larger institutions, which often operate in urban areas, it is not worth the substantial investment required to move into rural areas. For this reason in many African countries the providers of rural finance are smaller, locally based institutions.

2.7.2 Thus, the development of rural markets in Africa is hindered by several natural factors to include, the high risk associated with the main economic activity-rain fed agriculture – and the difficulties in diversifying away this risk because of segmented markets caused by the above difficulties ; and the absence of traditional physical collateral normally required by the banking system. Thus, the cost and risks associated with the delivery of lending services in rural areas is likely to be high, with negative consequence for the outreach and quality of portfolio. These problems overlap with those of microenterprise finance, but the above factors are special problems associated with providing sustainable financial services in rural areas.

2.7.3 However, successful models of savings and credit cooperatives and village banks for poor populations have been developed, and are being implemented in remote areas of Niger, Tanzania, and Uganda. Other examples of successful rural microfinance in Africa include the increasing use of autonomous savings-and-credit groups; the introduction and use of modern telecommunications technology, including cellular telephones and satellites, which open access to financial services even to the remotest rural populations; and rural MFIs offering demand-driven services to all who seek them. Crop insurance is, for example, currently offered in Malawi. (See Annex 4) for an illustration of the policy choices that must be made when determining how funding agencies such as the Bank should time their financial support of rural financial initiatives.)

2.7.4 Rural microfinance cannot, however, address all challenges facing rural economies that prevent these economies from becoming more prosperous. Among such challenges the absence of competent financial intermediaries to provide demand-driven rural microfinance, the general subsistence nature of agriculture in these areas (leading to poor loan repayment rates), lack of land tenure, poor infrastructure (which limits market access), widespread poverty, and highly seasonal income. Microfinance has important role to play in expanding the reach of the financial system to clients who need small loans and lack collateralized assets but other challenges need to be addressed by other development interventions in addition to microfinance institutions.

2.8 The Financial Sector

2.8.1 The financial sector, of which microfinance is a part, is defined for the purposes of this Microfinance Policy and Strategy as having three components:

- **financial policies** (monetary policy, public sector financing, external sector policy, and policy on the provision of financial services),
- **financial infrastructure** (the legal and regulatory framework, audit systems, accounting and financial disclosure standards, payment systems, credit bureaus), and
- **financial institutions** (banks, non-bank financial institutions, money and capital markets, microfinance institutions).

2.8.2 The financial sector plays a critical role in economic growth and poverty reduction. Theoretical and empirical research has shown a positive correlation between a sound financial sector and economic development.⁶ The financial sector's contribution to development and poverty reduction is realized in several ways. **First**, it provides the facilities and instruments for mobilizing savings and allocating them for consumption and investment purposes. **Second**, a well-developed financial system enhances the effectiveness of macroeconomic policies that promote price stability, which itself is conducive to development and superior economic performance.⁷ **Third**, the financial sector is the main channel through which countries enter the mainstream of globalization and gain benefits via increased trade, capital flows, and access to technological know-how.

2.8.3 The **fourth** way in which the financial sector contributes to economic growth and poverty reduction is as a provider of financial services are used as inputs in other productive sectors. In fact, the financial sector helps to economize on the cost of financial transactions. By providing access to a variety of domestic and foreign financial instruments, it enables economic agents to pool, price, and exchange risks, thereby increasing the efficient use of resources and the rate of growth. **Fifth**, the financial sector has the ability to contribute directly to poverty reduction through such channels as microfinance institutions and the informal sector, which provide savings and loan facilities to micro-, small- and medium-scale enterprises (MSMEs), as well as the urban and rural poor, on a sustainable basis.

2.8.4 The unfinished agenda for financial sector reforms in Africa consists of filling three gaps: the **financial intermediation gap**, represented by the fragility of the financial system; **the development gap**, reflected in the shortage of long-term finance for investment; and **the poverty reduction gap**, represented by the unmet demand for financial services by SMEs, the economically active poor, and the disadvantaged, especially women. The long-term trend of financial sector development is to build inclusive financial markets that comprise a wide spectrum of financial markets, instruments, infrastructure support, and institutions.

⁶ See Carl-Johan Lindgren, Gillian Garcia, and Matthew I. Saal, *Bank Soundness and Macroeconomic Policy* (Washington, DC: IMF, 1996).

⁷ "A banking system that is in distress can distort allocative efficiency and macroeconomic policy implementation, even though it can continue to function as long as it remains liquid. In addition to complicating monetary management, banking system unsoundness can also impose high costs in the form of fiscal obligations and other macroeconomic distortions" (Ibid., 57).

2.9 The Informal Sector

2.9.1 The informal sector is an oxymoron- on one hand it is an unorganized ‘nuisance’ sector whose members, for example, do not pay any form of tax; on the other, it provides jobs and increases incomes of the most vulnerable groups in a city- the very low-income group and there is love-hate relationship with formal agencies. So what kinds of policies best foster the informal sector to mainstream without losing its inherent advantages? There are no easy answers. However, the Bank will support its RMCs to remove institutional barriers and ignorance about the rights of the informal sector to enable smooth interaction between informal sector and institutions. Moreover, the Bank will work together with institutional partners to facilitate the development and empowerment of the informal sector in strengthening groups and network and empower them to address their own needs.

2.9.2 A key characteristic of African economies is the large size of their informal sectors compared to that of the formal business and financial sectors, which are regulated and legally recognized. Microfinance largely exists to assist this sector to reduce poverty. This informal, or “shadow,” economy has its own financing channels, which are equally informal. The informal sector can be considered the nascent private sector, in that the activities pursued by participants in this sector are for private gain. Its contribution to the overall economy, although significant, cannot be easily measured in terms of financial-sector deepening, labor force numbers, or the gross national product.

2.9.3 The informal sector exists to fill a vacuum characterized by an absence of formal economic activity and labor-market opportunities. People have to find ways to survive and earn a living, whether or not the formal sector economy exists and is functioning. In most sub-Saharan RMCs, the majority of economic activity takes place in the informal sector, with countries such as Togo reporting that the informal sector accounts for over 90 percent of total economic activity. Generally, the larger an informal sector, the more people who live in poverty, and the lower the economic performance of a country. The enabling environments for microfinance in RMCs with large informal sectors are non-existent or ill adapted to promote the growth and sustainability of formal-sector economic and financial intermediaries.

2.9.4 Numerous informal financial systems meet the financial service needs of the informal sector. Such systems take the form of small-scale, rotating savings-and-loan clubs; private lenders, such as traders and shopkeepers; different types of loan systems based on social proximity and informal systems for money transfers and remittances. Among many examples of informal financial service systems are: the tontines and “banques ambulantes” of francophone West and Central Africa, such as those in Cameroon; susus in Ghana and Nigeria; wool and mohair associations in the Lesotho Highlands; burial societies in South Africa and Lesotho; and the “hawala” systems in North Africa.

2.10 Gender and Microfinance

2.10.1 There is ample evidence to demonstrate that women experience extreme socio-cultural constraints in participating and benefiting from microfinance⁸. This can be attributed, among other reasons to: i) unequal access to productive resources, given the inequalities within the household and lack of property especially land that can be offered as collateral for loans and for generating capital; ii) low levels of education which make it difficult for women to participate in training that requires a specific literacy level or vocational skills; iii) low self confidence and inability to deal with formal

⁸ OECD Gender Tipsheets ‘Enterprise Development: Micro-Credit and Equality between men and women.
www.oecd.org/tipsheet

banking institutions; iv) time poverty and the unequal gender division of labour that prevent women from starting economic businesses; and v) limited mobility due to cultural factors and lack of access to appropriate means of transportation which constrain their ability to conduct businesses, attend training and search for markets and possible suppliers.

2.10.2 Microfinance has transformative capacity in that it has the potential to provide women with the opportunity to build a pathway to empowerment. It can strengthen a series of interlinked and mutually reinforcing “virtuous spirals”⁹ of empowerment through which women can own and control incomes and assets and contribute to household incomes. This in turn could increase their role in economic decision making in the household leading to greater well being for women and children as well as men. Furthermore their increased economic role may lead to change in gender roles and increased status within households and communities.

2.10.3 These positive outcomes notwithstanding, existing research and anecdotal evidence suggest that direct relationship between access to microfinance and an increase in women empowerment and their status within households and communities cannot be assumed and is certainly not automatic¹⁰. It has been observed first, that many aspects of gender inequality such as discriminatory land laws and policies, the unequal division of domestic responsibilities, and educational biases cannot be dealt with through microfinance. Secondly, while participation in microfinance programmes can increase income, they can also exacerbate women’s time poverty through increased overall workload, as there is no respite from their domestic responsibilities. Thirdly, due to women’s unequal position within the family, women’s incomes from microfinance activities may be ultimately controlled by male family members. Fourthly, unless a gender-balanced approach is applied, women’s access to microfinance could exacerbate gender related tensions within household and the incidence of domestic violence.

2.10.4 In order to enhance the inclusion of gender dimensions in all stages of the project cycle, guidelines and checklists will be included in the new microfinance operational guidelines under preparation. Moreover, during the design of microfinance stand alone projects or components, the following strategies will be adopted in order to ensure that appropriate actions are included for gender mainstreaming: (i) projects should define sub-objectives related to gender; (ii) propose gender targets (iii) include amounts in the cost table to promote high impact gender – specific interventions (iv) apply gender analysis in the project logical framework and propose actions verifiable impact indicators related to gender; (v) supervision reports will assess the effectiveness of the adopted gender strategy and indicate progress in achieving gender objectives and targets as set out in the project.

2.10.5 The Bank will provide support to RMCs under the Strategic Orientation No. 2: Creating an Enabling Environment that Promotes Building Inclusive Financial Systems. Specifically support under this pillar will include: legislation, legal and policy reforms that would contribute to the elimination of gender inequalities in education, employment, information, property rights, advocacy and women’s access to and control of resources.

⁹ Mayoux, Linda. 2001. “Microfinance and Women Empowerment: Rethinking Best Practice” Development Bulletin, no 57

¹⁰ Hunt, Juliet. 2002. “Reflections on microfinance and women empowerment” Development Bulletin, no 57 pp 71-75

III. BANK EXPERIENCE IN MICROFINANCE

3.1 Background

3.1.1 The Bank has had microfinance operations since the 1970s ranging from financing microcredit components attached to agricultural and social service projects, to the current mainstreaming of microfinance into Bank operations in line with the principles and best practice standards. One of the key challenges for the Bank into the late 1990s was finding ways to make its microfinance interventions more effective. In 1999, the Bank recognized that its microfinance operations had to be designed and implemented according to internationally acceptable best practice standards so as to effectively integrate them into the formal financial sector of its RMCs. To achieve this, the Bank embarked on mainstreaming microfinance into its operations. This process continues, highlighting and underscoring the need for the development of this Policy and Strategy, which is intended to enhance and strengthen the incorporation of microfinance in Bank operations in line with best practices. The Bank is increasingly focusing its efforts on improving the capacity of institutions in order to develop financial intermediation that is sustainable and serves the poor rather than promoting one-off, unsustainable credit components at below-market interest rates that only act as temporary income transfers.

3.2 Portfolio Clean Up Exercise

3.2.1 The exercise identified the following as microfinance/micro credit portfolio deficiencies that characterized most of the 73 projects with credit components: (a) designs did not adequately assess the ability of those targeted for loans to absorb, invest and repay them at market rates of interest; (b) few competent financial intermediaries identified to manage credit funds; (c) little to no assessment of the enabling environments in the countries in which these components are to operate; (d) little to no determination on whether other agencies had microfinance interventions in the same areas; and (e) little to no data available to measure performance in self-sufficiency and outreach, and portfolio recovery rates.

3.2.2 The clean up exercise defined four criteria to help determine the future of each project and form the basis for key lessons learnt, including: (a) determining in advance the ability of those targeted to invest and repay loans; (b) existence of competent and willing financial intermediaries such as MFIs to manage credit funds targeting poor clients; (c) governments allowing MFIs to mobilize savings deposits and charge interest rates on loans sufficient to cover costs; and (d) compatibility of Bank operations with development partners supporting microfinance in the same areas by assuring that no harm is done to existing financial markets.

3.2.3 The Operations Departments are implementing these recommendations and expected to complete the exercise in December 2006. The departments are committed to complete the Bank's portfolio clean-up, however, it has been noted that cancellation of projects/components that are not disbursing encounter opposition from the Bank staff (Task managers) and officials in the RMCs who prefer readjustment measures rather than cancellation. The Bank is working on incentives for staff and the RMCs to develop a mutually acceptable action plan to address the issue. More over, the portfolio "quality at entry" for all new projects with microfinance components or stand alone projects has significantly improved and adheres to the microfinance best practices.

3.3 The ADF Microfinance Initiative for Africa (AMINA)

3.3.1 In 1999, the Bank began integrating microfinance based on best practice standards to its operations at which time it created the ADF Microfinance Initiative for Africa (AMINA) program. AMINA was proposed by the ADF VII Deputies as an independent unit reporting to the Operations Vice President to operate on a pilot basis to determine the viability and effectiveness of building institutional capacity of MFIs.

3.3.2 The achievements of AMINA were mixed. For the **three-year** period the program existed, achievements included: (a) increased institutional capacity of about 30 MFIs in Ethiopia, Mozambique, Burkina Faso, Ghana and Mauritania to expand the outreach of improved quality financial services to low income groups, with collective increases of about 200,000 clients; (b) contributing to the design and implementation of legislation and regulations to govern microfinance in Tanzania and Mauritania; (c) increased understanding, knowledge and awareness of microfinance based on best practices among Bank staff, including Operations Task Managers; and (d) enhancement of the overall image of Bank performance in microfinance with key external stakeholders. To build capacity at the design stage, UA 20 million was allocated primarily to build and improve the institutional capacity of 70 MFIs through training of personnel, holding conferences, and undertaking exchange visits. There were also over 1,000 microfinance experts and other participants from RMCs who received training to provide quality financial services to increased numbers of clients especially women. The implementation of the program was constrained from achieving its full potential by a number of factors, including its temporary nature, isolation from the rest of the Bank, and having only one regular professional staff. This affected its ability to more fully deliver on its mandate and invest all of the resources allocated to it, with a considerable balance of these resources remaining.

3.3.3 One of the key lessons drawn from AMINA was that focused support to build the capacity of MFIs through a dedicated unit improves their performance in offering and providing quality financial services to those in Africa, usually the poor, excluded from traditional finance institutions such as commercial banks. Other lessons include the fact that facilitating contacts and seminars among continental stakeholders promote more favorable enabling environments for microfinance, and that significant amounts of resources are leveraged when collaborating with other partners in capacity building and investment activities. These lessons have developed comparative advantages for the Bank in microfinance. The Bank concluded that it was necessary to employ microfinance experts to take charge of its microfinance operations to collaborate with others especially in Operations to assure that all microfinance operations are in line with best practice standards and principles.

3.4 The Donor Peer Reviews

3.4.1 In line with the microfinance mainstreaming process, the Bank in 2002, along with 16 other funding agencies, participated in the “Donor Peer Reviews (DPRs): Tackling Aid Effectiveness from the Top: Microfinance as a Test Case.” The DPRs established the link between performance in microfinance and development effectiveness and made recommendations that informed the Bank’s microfinance mainstreaming process and the development of this Policy and Strategy. The DPR recommendations to the Bank included: instituting an immediate clean-up of the Bank’s existing portfolio of projects with microcredit components; strengthening the organizational unit for microfinance by adding more specialist staff and giving it a greater private-sector orientation; and developing a clear, strategic vision of what microfinance means to the Bank

3.5 Mainstreaming Microfinance into Bank Group Operations

3.5.1 At the end of AMINA in early 2002, the Bank approved two measures to mainstream microfinance into its operations to serve all RMCs. The initiative to mainstream microfinance was based on the realization that all RMCs, not just the ten pilot countries served by AMINA, needed to develop microfinance in line with microfinance best practices. Moreover, microfinance needs to be treated as an integral part of the financial sector. The Bank has used the lessons learned from AMINA to focus its efforts on developing the institutional capacity of retail MFIs. The first effort in this direction was the adoption of the “ADF Strategy and Assistance in Microfinance to Regional Member Countries” in 2002.⁸ The second effort was the development of a Microfinance Business Plan. Both measures were intended to assure *quality design and implementation* of microfinance operations by aligning them with best practices.

3.5.2 Two standalone microfinance operations were subsequently approved, each targeting the institutional development needs of rural financial intermediaries. The Bank Private Sector Department (OPSD) also became involved in microfinance. OPSD has made a USD 1 million equity investment in one of the few African MFIs to become a commercial bank, K-Rep Bank of Kenya. As these standalone operations remain ongoing, no conclusive lessons have yet been drawn from them. Nevertheless, indications are that their outcomes will be more effective and in line with best practices than those of microfinance components of projects designed for other sectors.

3.6 The Microfinance Business Plan

3.6.1 The “Business Plan: Mainstreaming Microfinance into Bank Group Operations,” or the Microfinance Business Plan, is the instrument by which current microfinance mainstreaming is taking place in both the Bank and the RMCs. The three-year Plan, approved in late 2003, provides measures that assure Bank microfinance operations are based on best practice standards. The Plan established the Bank’s vision for microfinance, which is to reduce poverty through increased access of poor people to quality financial services by enhancing conditions for viable and sustainable Bank microfinance operations. It established that microfinance operations would take place in the following areas: capacity building, strategic planning and project cycle activities, policy formulation, information dissemination.

3.6.2 Progress to date in implementing the Plan includes creation of the Microfinance Division in the Operations Policies and Review Department (POPR Microfinance Division) out of the former Central Microfinance Unit (OCMU); recruiting four microfinance specialists in 2005; more effective screening of microfinance projects and components to assure best practices; progress on cleaning up the existing 75 projects with microfinance components; and the development of this Policy and Strategy for Microfinance. However, the main constraints to Plan implementation include the absence of operational guidelines for microfinance, which need to be developed following approval of this Policy, and delays in completing microfinance specialist staff recruitment because existing staff vacancies have not been identified to fill these positions.

⁸ ADF/BD/WP/2001/97/Add.5. Approved March 1, 2002.

3.7 Development Impact

3.7.1 Although it is difficult to accurately measure the development impact of the Bank's microfinance investments, the portfolio clean-up exercise identified some important insights on the development impact of the Bank's microfinance investments and the results were mixed. The 73 projects reviewed reveal that early project designs did not adequately assess the ability of targeted populations to absorb, invest, or repay loans at market rates of interest; little to no assessment of the enabling environments was conducted in countries in which these components were to operate, little to no determination was made as to whether other agencies had microfinance interventions in the same areas; little to no data was made available to measure the performance of financial intermediaries in self-sufficiency, outreach, and portfolio recovery rates

3.8 Lessons Learned

3.8.1 Together with its development partners, the Bank has learned key lessons in how to work more effectively to support microfinance in the RMCs and to link microfinance to development effectiveness. Lessons learned include the need to focus on building inclusive and sustainable financial systems for all. Further, the most effective way to approach microfinance is from a financial-sector perspective, based on sound principles and best practices, and to assist institutions rather than individuals. A focus on assisting institutions ensures that financial services will be provided to all in perpetuity in a given area, with the institutions increasingly able to mobilize resources from domestic savings and commercial capital for on-lending. Providing assistance to individuals via directed lines of credit at below-market interest rates, without institutional development or support, simply represents temporary relief and income transfers. Such directed lines of credit also distort existing sustainable financial markets and credit culture discipline in targeted areas.

3.8.2 Funding agencies such as the Bank can function more effectively as catalysts or facilitators, that is, by linking resources with those who need these resources. On one hand, financial actors who *have* resources, such as domestic savings depositors, investment funds, and commercial banks, may want to invest in microfinance, but lack knowledge of viable MFIs in which they could invest with confidence. On the other hand, MFIs that *need* capital also need to *leverage* their capacity to attract potential investors. The Bank can selectively use its own resources as *leverage* between investors and MFIs, bringing confidence to the former while helping to improve the capacity of the latter.

3.8.3 The Bank and its development partners have also learned that the most effective areas of support to microfinance include:

- funding MFIs with loans and grants while requiring a high degree of accountability for results
- promoting enabling environments and support services for microfinance in the areas of policy, regulation, and law
- leveraging private capital and domestic savings for MFIs without distorting local markets
- financing and supporting capacity building for MFIs and their professional networks and associations at different stages, including networks that offer technical assistance and training
- standardizing the use and reporting of all performance indicators for MFIs, leading to positive credit ratings
- promoting knowledge development, research, and exchange among all key stakeholders in microfinance through such Internet-based platforms as the MIX Market

3.9 Development Partners in Microfinance

3.9.1 Existing and potential microfinance partners of the Bank include multilateral and bilateral funding agencies, such as the European Union, the U.K. Department for International Development (DFID), *USAID*, the German Die Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), the World Bank, the United Nations Development Programme (UNDP), the Consultative Group to Assist the Poor (CGAP) and (NEPAD). The Bank and these partners have developed consensus guidelines and criteria for best practice standards to which all donors, including the Bank, have agreed to adhere. The consensus guidelines for funding agencies define three different levels of support to microfinance that complement, but do not replace, private capital and international social capital. This support seeks to find market solutions to achieve greater microfinance outreach to the poor. Basic lessons learned from the cumulative experience of the funding agency community in microfinance informed the definition of these three categories of support: micro level, meso, and macro (see Annex 3&4) for these policy levels and description of leading individual development partners):

IV BANK GROUP POLICY AND STRATEGY ON MICROFINANCE

4.1 Rationale for the Policy

4.1.1 Poverty is a pervasive, enduring problem in the RMCs. *Many development interventions* by well-intentioned funding agencies have *not achieved their development objectives*. One key to solving poverty is to empower the poor to solve their own problems. Microfinance provides that empowerment. Microfinance is commercially viable, which means that it can be scaled up to reach poor RMC families on a mass scale by building linkages with formal capital markets. The Bank will help RMCs reduce poverty by supporting their ability to harness the power of financial markets through well-run MFIs.

4.1.2 The key reasons for the Bank to be involved in microfinance include:

- the direct linkage of microfinance to development effectiveness and achieving the MDGs (by reducing poverty and increasing the prosperity of the majority of people it serves)
- the RMCs have expressly identified microfinance as a development need and seek the Bank's support in developing it
- working with the RMCs in microfinance leverages Bank activities to achieve greater development effectiveness (the Bank has the comparative advantage of being proximate to, having the confidence of, and being owned by RMCs)
- Bank involvement in microfinance gives confidence and comfort to other investors, thereby increasing the potential that greater numbers of people can access quality financial services
- microfinance is a profitable investment opportunity for the Bank

4.1.3 The Microfinance Policy and Strategy of the Bank Group has three purposes, namely, to:

- provide strategic direction to the Bank as it extends more significant support to its RMCs in building inclusive financial systems, which will provide a wider range of financial products and services to a large part of their respective populations;
- to provide the Bank a means of focusing its microfinance activities in order to achieve the greatest impact within the shortest period of time, given the 2015 deadline for meeting the MDGs; and

- Clarify for the RMCs what they can expect from the Bank in terms of support for building inclusive financial systems.⁹

4.2 Goal and Outcomes of the Policy

4.2.1 The goal of the Microfinance Policy is to reduce poverty and increase the conditions for socioeconomic development and prosperity by helping RMCs build inclusive financial systems. It intends to increase the number of people that can access financial services, particularly people in rural areas, as well as the volume of investments and interventions in microfinance in the RMCs.

4.2.2 The medium-term outcome of this Policy will be more inclusive financial sectors and the provision by diverse institutions of a range of financial services and products adapted to the needs of end-user clients. In addition, the mobilization of domestic savings will increase, as will the mobilization of resources from commercial sources, both of which will reduce subsidy dependence of microfinance intermediaries; micro and small enterprises will develop; and remittances will become more efficient and used more productively.

4.2.3 The long-term outcome will be reduced poverty and broad-based economic growth that benefits the poor, as indicated by rising levels of per capita GNP among the extremely poor and their increased participation in formal private and financial sectors.

4.3 Guiding Principles of the Policy

4.3.1 The establishment of microfinance principles and best practice standards, as well as the global determination that microfinance is part of the financial sector and concerns building inclusive financial systems form the basis of the Eleven Key Principles of Microfinance sanctioned by the G8 Summit in 2004. The Principles provide definitive terms of reference that can guide the Bank and other development agencies when developing and implementing microfinance policies and strategies. The Principles define microfinance as a development intervention based on a financial-sector approach. Box 1 summarizes the Principles and how the Bank Policy and Strategy (and microfinance operations) will support them.

⁹ The RMCs are increasingly requesting Bank support in building inclusive, sustainable financial systems that provide a wider range of financial products to a large part of the population such requests have been made at such events as “Celebrating the International Year of Microcredit 2005” seminar on “The Status and Perspectives of Microcredit in Africa,” Cotonou April 2005; “International High-level Conference on Microfinance,” Paris, June 2005; the “African Microfinance Conference,” Cape Town, South Africa, September 2005; and other international events.

Box 1. The Eleven Principles of Microfinance

1. **The poor need a variety of financial services:** The Bank will support demand-driven microfinance interventions that develop and provide financial services.
2. **Microfinance is a powerful instrument against poverty:** The Bank will ensure that its operations support initiatives that increase the access of people in RMCs who are presently excluded from accessing quality financial services.
3. Microfinance means building financial systems that serve the poor: The Bank will support its RMCs to build such systems.
4. **Financial sustainability is necessary to reach significant numbers of poor people:** The Bank will support initiatives that help suitable intermediaries achieve financial self-sufficiency.
5. **Microfinance is about building permanent local financial institutions:** Dependence on concessional funding from such agencies as the Bank will only be temporary and diminish over time. The support of microfinance by the Bank will be contingent on intermediaries that are progressing toward, if they have not already attained, financial self-sufficiency.
6. **Microcredit is not the only answer:** In supporting microfinance in it's the RMCs, the Bank will consistently establish that any resources applied to target groups and identified as credit will be extended through a viable institutional intermediary with a clear means of repayment at market rates of interest.
7. **Interest rate ceilings debilitate the ability of all, but especially the poor, to access financial services:** The Bank will support the ability of all RMC financial intermediaries to charge market rates of interest on loans. The Bank will further support the elimination of interest rate ceilings and the creation of more operational efficiencies to reduce MFI costs, thereby allowing them to reduce the rates of interest charged on loans.
8. **Governments are to act as enablers, not as direct providers of financial services:** The Bank will support RMC governments in defining the elements of the enabling environment necessary to mainstream microfinance into the formal financial sector. At the same time, the Bank will discourage RMC governments from directly funding people targeted by MFIs.
9. **Funding agencies should complement, not compete with, private-sector capital:** The Bank will provide selective support for initiatives with the objective of building inclusive financial systems. The Bank will, however, require a defined exit strategy at the outset of such support.
10. **The absence of institutional and human resource capacity is the key constraint:** The Bank will support building the institutional capacity of financial intermediaries to provide financial services in demand among people who do not have access to formal financial services.
11. **Transparency in financial and outreach matters is important:** Bank support to microfinance in the RMCs will help ensure transparency at all levels and by all institutions.

4.4 The Policy

4.4.1 The Bank Group will support the RMCs to build sustainable systems of financial intermediation and mainstream them into their formal financial sectors. These financial systems will be built to serve poor, low-income RMC populations, especially those located in rural areas, which otherwise would have little to no access to quality financial services, such as savings, loans, and insurance. The Bank will adopt a catalytic and facilitating role in microfinance, leveraging its own resources with those of other partners to develop institutions and other activities that will build sustainable, inclusive financial systems in the RMCs. Bank support to microfinance projects will be conditioned on their conformity with internationally accepted best practice principles and standards. The Bank will also intervene to ensure that RMC enabling environments, allow MFIs to mobilize savings and extend secure land tenure to rural populations. Bank goals in this sphere include the elimination of interest rate ceilings.

4.4.2 Bank support of microfinance in the RMCs is a strategic priority. Support will be anchored on the premise that microfinance is an integral part of RMC financial sectors, into which it will be mainstreamed. Microfinance will help the large informal sectors in the RMCs better integrate into the formal economy by allowing micro entrepreneurs to access quality financial services. These goals represent the most effective ways in which microfinance can achieve outreach to mostly poor people and people located in rural areas (who would otherwise have no access to the financial services needed to lift themselves out of poverty).

4.5 Policy Levels and Areas of Focus in Microfinance

4.5.1 Bank support to RMCs in microfinance will address the three policy levels: the micro level (retail financial institutions); meso-level (financial industry infrastructure); and macro level (policy environment).¹⁰

4.5.2 ***The micro-level: promoting and investing in strong retail institutions.*** The Bank will primarily support investments in building the capacity of retail intermediaries to increase their sustainability and outreach to people who do not have access to quality financial services, improve the quality ***and increase the variety*** of their services, make them ratable by competent rating agencies, and assure their financial self-sufficiency. ***A special focus will be placed on assisting rural MFIs to meet best practice standards, including expanding their outreach to rural populations.*** Interventions will include ***assistance for*** starting new and expanding existing microfinance operations, whether standalone institutions or parts of other institutions (e.g., commercial banks). Intervention will also help transform existing institutions, such as NGOs and informal-sector organizations into competent MFIs that are mainstreamed into the formal financial sector. Bank support will be extended for defined time periods and made contingent on such institutions demonstrating their competency, vision, capacity, and interest in providing quality financial services to the poor while making progress towards financial self-sufficiency.

4.5.3 ***The meso-level: supporting industry infrastructure.*** The Bank will support its RMCs to develop industry infrastructure that facilitates the building of inclusive financial systems. Bank support for meso-level infrastructure will be selective and undertaken in collaboration with development partners. In order to reduce transaction costs and harmonize the delivery of funds and/or technical assistance to the sector, apex institutions may be created to provide refinancing or technical assistance to retail MFIs, ***especially those located in or serving rural areas.*** Emerging infrastructure services includes domestic and international financial and capital markets, investment funds, bond issues, and securitization. ***In addition,*** the Bank will support both the work of professional MFI associations and networks and the capacity building of such organizations, given the economies of scale obtained by working with such associations. (Networks have the ability to transfer skills to their MFI members on a more individual basis).

4.5.4 ***The macro level: fostering a conducive enabling environment and assuring an appropriate role for government in the development of microfinance services.*** This goal will be an important focus for Bank support of the RMCs. The role of the Bank at the macro level is to support RMC governments to develop and implement legislation, regulations, and other enabling environment attributes that reflect the true needs of retail financial intermediaries (MFIs) and their clients, ***particularly those located in rural areas.*** Policy dialogue must be pursued with governmental

¹⁰ See CGAP, *Building Inclusive Financial Systems – Donor Guidelines on Good Practice in Microfinance* (Washington, DC: CGAP).

authorities to orient their microfinance initiatives towards best practices. Dialogue also must be pursued to encourage governments from directly offering microfinance services themselves, as well as to discourage them from imposing politically motivated lending decisions on MFIs.

4.6 Eligible Countries

All RMCs will be eligible for microfinance-related support provided by the Bank Group under this Policy. Priority will be given to RMCs that have solid intentions and plans to make their enabling environments more conducive to the building of inclusive, sustainable financial systems and the expansion of the private sector.

V. BANK MICROFINANCE DEVELOPMENT STRATEGY

5.1 Strategic Vision and Orientations for Policy Implementation

5.1.1 The strategic vision of the Bank in microfinance is that a *majority* of RMC citizens should gain access to quality, sustainable financial services, and that RMCs should integrate microfinance into their respective formal financial sectors. The strategic vision and its four orientations (see section 5.1.2 below) cut across sectors and include Bank support to the microfinance industry at the three policy levels of the financial sector: micro, meso, and macro.

5.1.2 The Strategy will focus on the following four orientations:

- enhancing key stakeholder capacity and investment in microfinance in the RMCs;
- creating an enabling environment that promotes the building of inclusive financial systems;
- enhancing strategic partnerships to leverage Bank expertise and resources; and
- Knowledge management (i.e., research, information collection, and dissemination).

5.2 Strategic Orientation No. 1: Enhancing Key Stakeholders Capacity and Investment in Microfinance in RMCs

5.2.1 The key strategic orientation of the Bank will be to invest, provide technical assistance, and support capacity-building efforts, at the retail (micro) level of microfinance intermediaries in both the informal and formal sectors. Priority will be given to building institutional capacity that expands the outreach of quality financial services to the remotest of rural areas. The institutions supported must agree to implement their operations in accordance with recognized principles and standards of microfinance best practice. The Bank will assist intermediaries that agree to follow these principles and have a solid plan to adhere to them. The Bank will support institutions in all three categories of institutional development described earlier in this document (i.e., the emerging, expanding and mature stages).

5.2.2 The Bank will finance portfolio diversification, the costs of expanding and/or deepening outreach, as well as research and development costs to facilitate:

- expansion of existing microfinance retail institutions transformation of institutions such as NGOs into financially viable MFIs
- commercial bank expansion into microfinance operations and/or their creation of separate financing windows for microfinance
- diversification of products, with a special focus on microenterprise and SME financing to address the “missing middle,” remittances integration, and rural finance

- replication of successful models, such as the K-Rep Bank/Kenya, to other RMCs

5.2.3 The Bank will support such institutions as rural savings and credit cooperatives, RMC MFIs, commercial banks, finance companies, cooperatives, remittance money transfer agents, credit unions, and postal savings banks, among others, that are involved in providing financial services to the poor. Innovative microfinance strategies, approaches, and products will also be supported, especially those that reduce operational costs and pass the savings on to clients in the form of lower interest rates and improved service quality. The Bank will additionally provide assistance to and target the increasing number of MFI professional associations and networks. Economies of scale are derived from this approach because of the membership nature of associations and their consequent ability to disseminate knowledge, skills, and other institutional capacity-building efforts to individual MFI members. The Bank will also support meso-level actors to provide quality technical assistance in priority areas. Capacity building in this area could include, but is not limited to, new product development, strategic planning, management and information systems and computerization, internal controls, savings mobilization, and improving access to remittances.

5.3 Strategic Orientation No. 2: Creating an Enabling Environment that Promotes Building Inclusive Financial Systems

5.3.1 RMCs will be supported to create enabling environments at the macro level that promote the growth of financial intermediaries such as MFIs. Depending on the RMC, areas of focus will include enacting legislation, laws, and regulations that support microfinance; cultivating respect for the rule of law, particularly laws concerning the enforcement of loan contracts and collateral; eliminating interest rate ceilings; allowing MFIs to mobilize savings while protecting the fiduciary interests of depositors; and helping institutions to manage and invest savings with due diligence and to control fraud. A conducive environment will also help the informal-sector clientele of financial intermediaries to expand their entrepreneurial activities into more profitable ventures, such as SMEs. The primary targets of this strategy are RMC governments, through their ministries and central banking authorities, as well as legislative bodies such as national assemblies and parliaments. Enabling environment initiatives to regulate microfinance and promote integration at regional levels, such as those of multi-country central banks, will also be supported.

5.4 Strategic Orientation No. 3: Enhancing Strategic Partnerships

5.4.1 The Bank will work together with key institutional partners to facilitate the development of coordinated, complementary approaches to microfinance in the RMCs. This strategy will leverage the amount of resources and expertise offered by the Bank, complementing them with other resources available to support the development of microfinance. It will also help harmonize and coordinate interventions so that Bank actions mutually reinforce the interventions of other agencies to the benefit of the RMCs, ensuring that limited resources are used more effectively.

5.4.2 Efforts will be made to ensure collaboration with NEPAD; the African Union; sub-regional bodies such as (SADC), (CEMAC), and the (UEMOA); and other organizations to enhance dialogue on enabling environments for microfinance. For rural finance, particular efforts will be made to collaborate with the Food and Agriculture Organization (FAO) and its Rural Finance Center, as well as the International Fund for Agricultural Development (IFAD). The Bank will also ensure collaboration with strategic public- and private-sector institutions, such as traditional development partners, commercial banks, investment funds, and information and telecommunications technology companies such as Nokia, Microsoft, and Hewlett Packard. Partnerships will be sought to leverage resources and

seek common solutions to overcoming the challenges of providing remote rural populations quality financial services on a sustainable basis. Joint or syndicated investments and guarantees will be made to expand service and resource outreach to the poor, particularly in rural areas.

5.5 Strategic Orientation No. 4: Knowledge Management—Research, Information Collection, and Dissemination

5.5.1 Microfinance is an ever-evolving field with new research, findings, and data becoming available on a regular basis. There is a critical need to manage knowledge in the sector; that is, to gather, analyze, and disseminate information on research findings, innovative products, processes, and technologies. The Bank will fully integrate microfinance and microfinance appraisal procedures by adapting existing operations and information systems, such as the Operations Manual and (SAP), to adequately capture and present performance data.

5.5.2 Such data will be researched, analyzed, and used as a database for the preparation and appraisal of microfinance investments and other interventions. It will also be used to measure the effectiveness of the Bank's support of microfinance. The Bank will disseminate key findings from its work in microfinance to interested stakeholders, both external and internal, in conformity with existing and future information disclosure policies and guidelines. Such data, research findings, and recommendations will be harmonized with Bank development partners according to internationally recognized criteria, guidelines, and microfinance best practice standards and principles.

5.6 Strategic Institutional Partners in Microfinance

5.6.1 *The Bank's support of microfinance will ensure collaboration with and service to a broad number of stakeholders. Bank relationships with these stakeholders will assure that the goal, objective, and purpose of this Policy are achieved. These strategic relationships will reflect the role and fit of individual stakeholders in the four orientations of the Bank's work in microfinance (see section 5.1.2). Financial and non-financial instruments, such as those listed in Section 5.7 below, will be used for support. The principal stakeholder categories with which the Bank will work are described in the paragraphs that follow.*

5.6.2 **Retail intermediaries.** *The priority target of Bank support to microfinance is the majority of poor people who are usually excluded from access to quality financial services. The Bank will serve these people by supporting retail intermediaries that actually offer and provide such services to the poor. These intermediaries may be targeted directly by the Bank for support in terms of capitalization and institutionalization, using the instruments listed in Section 5.7 below, depending on such criteria as their institutional size, number of clients, and orientation towards microfinance best practice principles and standards. Intermediaries that receive Bank support may be at any of the three development stages: emerging, expanding, or mature, each has different set of needs and would require a different intervention from the Bank. Support of these institutions responds to the dearth of financial intermediaries that are sufficiently capitalized, professionally competent, and financially self-sufficient to achieve significant outreach to the poor. Section 2.4.2 lists the kinds of retail intermediaries that the Bank will support. The Bank may also indirectly support smaller intermediaries through professional associations and networks of MFIs that operate regionally and nationally (in individual RMCs).*

5.6.3 ***Regional member country (RMC) governments.*** The Bank will support RMC governments to create enabling environments needed to facilitate the building of inclusive financial systems. This work will include support for:

- budget support and policy-based lending to assist in the development of updated, appropriate legislation, regulations, and means of supervising MFIs
- creating new or revising existing laws and regulations that govern enterprise registration and licensing, land tenure, property rights, labour laws, rights of inheritance, and contracts and collateral (i.e., their use and enforcement)
- loans and grants for technical assistance to and capacity building of RMC government agencies in such areas as microfinance, bookkeeping and reporting, establishment of accounting standards, and improving technology and human resources in the microfinance sector.
- Develop monitoring frameworks for MF, similar to what central banks already do for formal sector financial institutions.

5.6.4 ***Associations and networks of MFIs.*** From the perspective of the Bank, microfinance associations (MFAs) will be both funding targets and collaborative partners in its microfinance work.

As targets, the Bank will support MFAs to improve their capacity to better represent retail MFIs before RMC governments to lobby for favorable changes to country enabling environments. The Bank will also use MFAs as collaborators and technical service providers, depending on their competence and experience in delivering institutional development support and training services to retail MFIs. Economies of scale will be derived by supporting MFAs because in supporting one MFA, the Bank will simultaneously support its entire membership of retail MFIs.

5.6.5 ***Private sector funds: commercial banks, foundations, and investment funds.*** Microfinance represents an emerging investment opportunity for private-sector commercial funds and foundations with philanthropic purposes. The amount of these types of funds is vast, while the number of competent institutional intermediaries (i.e., MFIs) that qualify for investment is small. Bank support of microfinance will increase the confidence of such entities to invest in microfinance. Together with commercial investors, the Bank will collaborate, co-invest, and syndicate the financing of financial intermediaries. The Bank will also provide grants for technical assistance to and capacity building of those MFIs in which commercial entities may invest. The Bank may also invest in specialized funds dedicated to microfinance in Africa.

5.6.6 ***Development partners.*** Traditional multilateral and bilateral funding agency partners of the Bank are potential collaborators in microfinance. The Bank will seek to work with regional organizations such as the African Union, CEMAC, UEMOA, Groupe inter-gouvernemental d'action contre le blanchiment en Afrique (GIABA), and NEPAD, as well as the sub-regional development banks for East Africa, West Africa, and Southern Africa, to assure that microfinance is mainstreamed into the formal financial sectors of the RMCs. In addition, the Bank will collaborate with bilateral initiatives, such as the U.S. Middle East Partnership Initiative (MEPI, which covers the North African RMCs) to facilitate dialogue on the enabling environment for microfinance.

5.6.7 The Bank will also continue to work with such agencies as the International Monetary Fund (IMF), the International Labor Organization (ILO), the European Union, the United Nations Capital Development Fund (UNCDF) and the UNDP to jointly fund MFI capacity building. The Bank has already jointly funded capacity building initiatives with the UNCDF and UNDP in Ghana and Mozambique through the Microstart program. In a similar manner, the Bank intends to collaborate

with development partners to invest in financial intermediaries via loans, equity, guarantees, and lines of credit. The Bank will also collaborate with the World Bank to conduct financial sector assessments and co-fund MFI capacity building through seminars, training courses, conferences, and consultants.

5.6.8 *Technical service providers (TSPs)*. TSPs are organizations and individuals, both private and public, that have expertise in areas of microfinance that are needed to improve the institutional capacity of financial intermediaries such as MFIs. TSPs can include private consulting firms and individuals; rating agencies; educational institutions such as schools, universities, training centers, external audit firms, and individuals; and information technology firms and experts, among others. When international TSPs are used in Bank-funded projects, particularly if they are from non-regional member countries, an attempt will be made to partner these TSPs with RMC-based TSPs so that the latter benefit from the transfer of skills and experience.

5.7 *Instruments: Financial and Policy Frameworks*

5.7.1 *The Bank will support the development of microfinance in the RMCs using a variety of instruments, including both financial and policy instruments, on a selective basis. Financial instruments will include, among others, those of the ADF and ADB, together with technical assistance and trust funds. These instruments will be used to support the development of microfinance at the three levels of the financial sector: micro, meso, and macro. Instruments will be selected according to the purposes for which they will be used and how well they achieve intervention goals and the objectives of private- and public-sector operations. All financial instruments will be used in accordance with the rules and regulations of the Bank and other funding sources.*

5.7.2 *Regardless of the type of instrument used, any institution supported by the Bank will be required to demonstrate that it has an adequate orientation toward microfinance best practices and performs in accordance with best practice standards. This requirement will be a condition of extending additional, repeat, and/or future Bank assistance. The following paragraphs list the kinds of instruments that the Bank will use to support microfinance in the RMCs.*

5.7.3 *Loans*. *Financial intermediaries such as MFIs, commercial banks, development banks, and other institutions will be targeted for Bank support via lending instruments. Loans will be used in all RMCs and may be sovereign or non-sovereign guaranteed. Public-sector loans will be used for such purposes as macroeconomic reform, budget support, policy-based regulatory reform, and capacity building of relevant government and private-sector authorities. Loans for the private sector will be used to capitalize loan funds and support the institutionalization of financial intermediaries and other qualified institutions. Lending for these purposes will support improvements in MFI performance, change management, governance, business development, and management information systems.*

5.7.4 *Grants*. *Grants will primarily be used by the Bank to support the technical assistance and capacity-building needs of RMC stakeholder institutions, both start-up and existing institutions engaged in or supporting the building of inclusive financial systems. Grants may be used for the same purposes for which Bank loans are used. For ADF RMCs, grant resources remaining from the AMINA program will be used, together with those from other sources, such as the Japanese Government initiative entitled “Enhanced Private Sector Assistance for Africa.”*

5.7.5 *Equity*. *The Bank will also support microfinance by making limited, selective equity investments in financial intermediaries that have substantially evolved into recognized microfinance industry leaders. Equity will be invested in those institutions that have considerable capitalization and*

experience in microfinance, are capable of replicating or franchising their operations in other regions and countries, and are at the threshold of achieving mass outreach in providing quality financial services to the poor. Equity investments will allow the Bank to further support microfinance and enhance its image by serving on the governing Boards of the entities in which it invests. (Board membership will be a prerequisite of all such investments.)

5.7.6 Guarantees. *Guarantees are a financial instrument that requires the greatest number of conditions and selectivity in use, as they can incur the greatest losses to the Bank. Guarantees will be used with such entities as commercial banks that lend to MFIs and microentrepreneurs. They will be structured in ways that make microfinance a profitable business opportunity for commercial financial institutions. Institutions to which the Bank extends guarantees will be required to demonstrate their willingness to share the risk of default and perform due diligence in lending decisions.*

5.7.7 Financial sector assessments (FSAs). *FSAs will be conducted by the Bank to determine whether certain regions, RMCs, and local areas offer conditions conducive to financial intermediary institutions such as MFIs, while also meeting best practice standards, particularly that of financial self-sufficiency. The Bank will selectively participate in and support FSAs that assess policy environments and the suitability of local, regional, and/or national conditions for microfinance. FSAs will be undertaken in conjunction with Country Strategy Papers (CSPs) and collaboration with such development partners as the World Bank.*

5.7.8 Poverty Reduction Strategy Papers (PRSPs) and Country Strategy Papers (CSPs). *All PRSPs and CSPs in which the Bank is involved will undertake adequate assessments of RMC financial systems and make recommendations for interventions that support the building of inclusive financial systems. Bank support in developing these PRSPs and CSPs will assure that microfinance is adequately analyzed and that prescriptions for financial, non-financial, and policy framework interventions are made. In particular, the Bank will engage in full coordination with RMC governments to develop PRSPs.*

5.7.9 Promotional dialogue with RMCs on microfinance. *Certain needs of microfinance and its mainstreaming within the formal financial sectors of the RMCs can only be met through promotional dialogue. Such dialogue, conducted via meetings, seminars, conferences, and other forums, promotes enabling environments favorable to the development and integration of microfinance into RMC financial and private sectors. Such dialogue will also promote respect for the rule of law, land tenure, business licensing, and other issues that help microfinance clients expand their micro-businesses into SMEs.*

VI. IMPLEMENTATION ARRANGEMENTS

6.1.1 The Bank recognizes the need for increased in-house expertise to effectively implement the Microfinance Policy and Strategy as well as the priority areas of intervention, namely (i) financial intermediation (ii) creating of an enabling environment and (iii) knowledge management. The Bank will strengthen its internal capacity and skill mix by recruiting highly competent microfinance experts and by enhancing technical partnerships with other development partners (national or international). Particularly, in the area of knowledge management, the Bank will build its capacity in order to accelerate the development and dissemination of know-how both internally to staff and externally to partners and stakeholders.

6.2 Microfinance Business Plan

6.2.1 The Policy and Strategy on Microfinance will be implemented initially over a five-year period. The existing three-year Business Plan, ends in 2006 and will be revised, so that it appropriately reflect the current Policy Statements and Strategic focus of the Bank . The revised Business Plan will outline the process by which microfinance will be operationalized and mainstreamed into Bank operations. Specifically, the plan will address the following: (i) mainstreaming microfinance into Bank Group operations; (ii) the required resources, activities, outputs and measurement indicators presented in a results-based framework; (iii) functions and activities of organizational units in microfinance mainstreaming; (iv) the human and financial resources required; (v) the necessary organizational arrangements to implement the plan and (vi) critical assumptions

6.3 Organizational Arrangements

6.3.1 In line with the new organizational structure approved by the Bank's Board of Directors in April 2006, the microfinance operations will be located in the *Financial Intermediation & Microfinance Division* of the Private Sector Department (OPSD). The Division will provide leadership in the area of private-sector-oriented investment and other operational activities under this Policy and Strategy, given that MFIs are private financial intermediaries. Under the Financial Sector Policy of the Bank Group, the Bank advocates private-sector leadership in the development of sound financial intermediary institutions in terms of ownership, risk-taking investment, and operational decisions. In support of the first strategic orientation, enhancing stakeholder capacity via well-targeted investments, OPSD will use the full array of financing instruments and investment modalities available to it—including individual loans, lines of credit to apex institutions, equity and quasi-equity investments, and guarantees to build a reasonably sound and self-sustaining portfolio of microfinance operations.

6.3.2 The new Division will provide technical input to and collaborate with the public-sector Operations Departments in their support of RMCs under the second strategic orientation, which involves participating in Bank dialogue with governments and other authorities in the microfinance sector development. In particular, the Division will focus on the elements needed to increasingly integrate MFIs and their clientele into the formal private and financial sectors of the RMCs. Under the third strategic orientation, developing partnerships, OPSD will syndicate co-financing arrangements, including suitably structured and targeted venture capital funds, to support capital investment in MFIs and other intermediaries with microfinance operations. Within reasonable ethical and industry-practice limitations, OPSD will also provide relevant performance data and information on its operations to the Microfinance Division, based on best-practice indicators.

6.3.3 The Financial Intermediation and Microfinance Division will undertake internal and external advocacy activities for development effectiveness. This will involve organizing of workshops, seminars, attending conferences, and exchange visits. It will also ensure effective Bank-wide internal coordination in the implementation of the four strategic orientations of this Microfinance Policy and Strategy (see section 5.1.2). Moreover, the Division will support outreach to and the professional development of the microfinance specialists in the Bank through internal and external training and coordination under the Bank Microfinance Network to facilitate internal and external information sharing.

6.3.4 Under the third strategic orientation of the Microfinance Policy and Strategy, enhancing strategic partnerships, the Financial Intermediation and Microfinance Division will develop partnership agreements to co-finance and collaborate on capacity building and investment initiatives with such key

stakeholders and development partners such as CGAP, UNDP, DFID, *USAID*, the World Bank, the Economic Commission for Africa (UN-ECA), the African Union Commission/NEPAD Secretariat, and regional economic communities (RECs). With respect to the fourth strategic orientation, knowledge management, the Division will oversee the implementation arrangements for the acquisition, analysis, archiving, and dissemination of research and performance data generated by the Bank Group's operational activities in microfinance.

6.3.5 The new Division will also develop a plan for the utilization of the balance of the Technical Assistance Fund resources of the AMINA program. The use of these funds was frozen by the Board pending on the development of this Policy and Strategy.

6.3.6 ***Public Sector Operations.*** Public Sector Operations Departments (ODs), will take the lead in the implementation of the second strategic orientation of this Policy and Strategy: enhancing the enabling environment to promote the building of inclusive financial systems. The ODs will support RMCs to put in place or reinforce elements of establishing an enabling environment. With technical support from the Financial Intermediation & Microfinance Division, the ODs will maintain effective dialogue on macroeconomic issues with senior-level RMC officials. An important mandate of the ODs is to ensure that microfinance goals, objectives, and strategies are given serious consideration in individual country PRSPs and that the results-based CSPs are linked to them. Operational modalities and financing instruments at the disposal of the ODs in implementing this second strategic orientation include macroeconomic or structural adjustment operations, such as policy-based loans (PBLs) in the case of ADB-only countries and ADF countries capable of sustaining concessional loans; policy-based grants (PBGs) in the case of ADF grant only countries.

6.3.7 ODs will also be responsible for realigning existing operations with microfinance components and standalone interventions to ensure that such operations come into line with best practice standards and implement the first strategic orientation of enhancing institutional capacity. They will ensure that any new operations, whether credit components or standalone initiatives, must incorporate microfinance best practice principles and standards, particularly with regard to the contribution that value-added components or projects make towards sustainable financial sector development.

6.3.8 In addition, one or two staff members specialized in microfinance will be placed in the Operations Policy and Compliance Department and will be responsible for assuring quality in microfinance operations quality assurance and compliance, policy formulation and the preparation of guidelines.

6.4 Progress Reporting

Management will regularly monitor progress in implementing this Policy and Strategy, including the preparation of annual reports. There will be a midterm review at the end of Year 3, and a final report at the end of Year 5, which will be submitted to the Boards.

VII. CONCLUSIONS

7.1 The African Development Bank has concluded that building inclusive financial systems, or microfinance, in its Regional Member Countries is one of the most effective strategies to achieve its vision of poverty reduction and the creation of conditions for prosperity. This conclusion is based on the proven linkage between microfinance and development effectiveness.

7.2 This document outlines the policy and strategy of the Bank in microfinance, which is to support the RMCs to build sustainable systems of financial intermediation and mainstream them into their formal financial sectors. This Policy and the Bank's strategy to implement it incorporates lessons learned from microfinance based on internationally recognized standards of best practice, the experience of Bank partners in the sector, and the Bank's own experience in the sector since the 1980s. This document outlines four specific strategic areas of orientation and intervention for the Bank's work in microfinance:

- enhancing key stakeholder capacity in microfinance, including financing the expansion of microfinance institutions (MFIs)
- creating an enabling environment that promotes the building of inclusive financial systems that serve the poor
- enhancing strategic partnerships
- facilitating knowledge management to ensure effective research, information collection, and dissemination

7.3 The Boards are therefore requested to approve this Microfinance Policy and Strategy of the African Development Bank Group.

BANK GROUP POLICY AND STRATEGY FOR MICROFINANCE: Results-Based Framework

<u>Goal</u>	<u>Long term Outcomes</u>	<u>Targets Persons</u>	<u>Indicators</u>	<u>Targets</u>	<u>Assumptions, Risks</u>
<p>Reduced poverty and increased prosperity in RMCs</p> <p>Building inclusive financial systems</p> <p>Financial sector deepening</p>	<p>Rising levels of per capita GNP in RMCs among the 300 million +/- in extreme poverty</p> <p>Economic growth that includes the poor</p> <p>Greater involvement of the poor in the formal private & financial sectors</p>	<p>The African poor, especially on < U.S.\$1/day, and women</p>	<p>RMC poverty rates decrease (national statistics)</p> <p>Size of informal sector in RMCs decreases (national statistics)</p> <p>Increase in income for micro entrepreneurs (surveys)</p> <p>More inclusive financial systems measured by the % of clientele among total population (surveys)</p>	<p>MDG targets for poverty met</p> <p>Minimum 5% reduction in size of informal sector</p> <p>15% increase in income, wealth and employment from baseline in 2005 of micro entrepreneurs served by MFIs</p> <p>15% increase from baseline survey in 2005</p>	<p>RMCs accept to have their enabling environments improved/adapted to accommodate the mainstreaming of MF into their formal financial sectors & client entrepreneurs to integrate into the formal private sector</p>
<u>Objective</u>	<u>Medium Term Outcomes</u>	<u>Targets Sectors</u>	<u>Indicators</u> (Midterm & five-year reports)	<u>Targets</u> (Five-year progress report)	<u>Assumptions, Risks</u>
<p>Increase in number people accessing quality financial services, especially in rural areas, and volume of best practice Bank MF interventions</p>	<p>Inclusive financial sectors providing a range of financial services & products adapted to their clientele through diverse institutions</p>	<p>MF sector in selected African countries</p>	<p>- No. of RMCs with improved enabling environments for MF</p> <p>- No. of sustainable MFIs</p> <p>- No. of MFI clients</p> <p>- No. of female clients of MFIs</p> <p>- No. of MFIs members of MF networks</p> <p>- No. of commercial banks engaging in MF</p> <p>- Volume & portfolio-at-risk quality of outstanding MFI loan portfolios</p>	<p>- 50% of countries for whom Bank CSPs have targeted enabling environment for MF have improved the environment</p> <p>- 15% increase in number of profitable MFIs</p> <p>- 20% increase in clientele over baseline</p> <p>- 20% increase in female clientele over baseline</p> <p>- 10% increase in number of MFI members of African networks</p> <p>- 10% increase in commercial banks doing MF over baseline</p> <p>- 15% increase in portfolios of MF partners over baseline</p>	<p>An increasing number of commercial banks invest in MF</p> <p>Resource availability</p> <p>Bank MF activities are harmonized and complementary to those of other development partners</p> <p>Inflation is under control in targeted countries</p>

	<u>Activities and Inputs According to Strategic Areas of MF Policy Orientation</u>	<u>Sector/Theme; Short term outputs</u>	<u>Target People & Institutions</u>	<u>Indicators:</u> (Midterm and at five-year reports)	<u>Targets:</u> (Five-year progress report)	<u>Risks, Mitigating Strategies, Assumptions</u>
1. Enhance Key External Stakeholder Capacity in Microfinance						
Dissemination	- Summary of the new MF Policy disseminated - MF Policy dissemination workshops for Bank staff held	Bank projects with MF components designed and implemented according to best practice MFIs performing according to performance contracts Regional MF initiatives supported	Bank staff MFIs in Bank projects RMCs in Bank projects with MF components targeting the enabling environment for MF	- % of Bank staff knowledgeable of & implementing the MF Policy - No. of MF Policy dissemination workshop held for Bank staff - No. of Bank staff who attended a Policy dissemination workshop - No. of RMC officials who have read and are familiar w/ the key elements of the MF Policy	- 90 % of Bank staff knowledgeable of the new MF Policy & implementing it - 4 MF Policy dissemination workshop held for Bank staff - at least 100 Bank staff have attended workshop - At least randomly sampled 25 RMC officials who have read & are familiar w/ key Policy elements	All MF staff are hired Resources are made available Development partners will work with the Bank
Guidelines, Indicators, and Instruments	- MF Consultant hired for two months to develop guidelines for the Bank Operations Manual - Guidelines developed - Capacity building fund established - Instruments adapted or created - Training given to staff in guidelines and instruments		MF clients and families	- % Guidelines adapted or created for MF - % microfinance projects being monitored with Indicators - No. of microfinance trust funds in existence - No. of instruments developed for microfinance - No. of trainings given to Bank staff in MF guidelines and instruments - No. of Bank staff having attended a training on new guidelines, indicators, and instruments	- 90% of all Bank guidelines adapted to MF & part of Bank Operations Manual - 1 Operational Guideline developed for MF trust fund and instruments - 1 MF Trust fund in existence - 100% MF projects being monitored with best practice indicators - At least 2 funding instruments developed for MF - Up to 5 trainings given to Bank staff - Up to 150 Bank staff have attended training	
Build Bank Capacity	- MF training workshops for Bank headquarters & field office staff held - MF operational notes disseminated - Microfinance publications disseminated - OPD MF officer, & 2 MF Officer for Country Depts. Recruited - Bank MF Network meetings held	9.Workshops 9.Operational notes 9.MF Officers recruited	Bank staff	- No. of MF training workshops held for Bank staff - Number of operational notes disseminated - Number of MF publ. disseminated - No. of Job descriptions for OPD MF Officers - No. of network meetings among MF Officers	- 5 MF training workshops held for 150 Bank staff - 4 job descriptions - 1 functional MF office/unit in OPD - 10 network meetings among MF Officers - 15 informal discussion groups held among Bank staff	- Same as above

	<u>Activities and Inputs According to Strategic Areas of MF Policy Orientation</u>	<u>Sector/Theme: Short term outputs</u>	<u>Target People & Institutions</u>	<u>Indicators:</u> (Midterm and at five year progress reports)	<u>Targets:</u> (Five year progress report)	<u>Risks, Mitigating Strategies, Assumptions</u>
1. Enhance Key External Stakeholder Capacity in Microfinance (continued)						
Building MFI Capacity	<ul style="list-style-type: none"> - MF Officers hired in OPSD - Public sector operations MF officers hired - MF officers in monitor and publicize MF portfolio performance - Board criteria for approval of MF projects publicized - Performance contract template for MF components developed - OPSD MF Officers participate in project identification and design - OPSD MF Officers identify projects - Public sector epts.. Identify and design sector projects for capacity building - MF officers identify networks and design projects to assist them - POPR.4 continues to assure the quality at entry & implementation according to best practices 	<ul style="list-style-type: none"> - MFIs improving their performance in outreach & financial self-sufficiency 	<ul style="list-style-type: none"> - MFIs - MFI professional networks & associations - Commercial banks & other private sector entities - "down marketing" - Bank Operations 	<ul style="list-style-type: none"> - % projects designed with best practice MF standards - % projects monitored with new indicators - % of MF partners performing according to performance contracts - No. of national, sub-regional & regional networks supported - No. of projects approved in OPSD - No. of projects within OPSD done in collaboration with other donors - No. of microfinance projects in the 2010 APPR problematic portfolio - All projects w/ MF are quality controlled 	<ul style="list-style-type: none"> - 90% projects with microfinance components designed with best practice standards - 100% projects monitored with new indicators by end of year 5 - 75% MF partners performing according to contract - 5 networks supported - 55 MF investments/projects approved in OPSD - 0 MF projects in the 2010 APPR problematic portfolio 	<ul style="list-style-type: none"> - Same as above <li style="text-align: center;">+ - RMC MFIs able to maintain their autonomy from governments
2. Create an Enabling Environment that Promotes Building Financial Systems that Include the Poor						
RMC Dialogue on Microfinance	<ul style="list-style-type: none"> - Country Departments design effective projects to assist RMCs with enabling environments with OPSD input 	<ul style="list-style-type: none"> - PRSPs, CSPs & FSAs 	<ul style="list-style-type: none"> - RMC governments: relevant ministries dealing with finance, the economy, planning - Central banks & monetary authorities 	<ul style="list-style-type: none"> - % countries whose CSP identified enabling environment strategies have received support - % FSAs featuring MF - No. of RMC officials trained in MF enabling env. Issues 	<ul style="list-style-type: none"> - 60% of RMCs whose enabling environments for MF have improved - 60% of RMCs with effective microfinance & other legislation that enforces respect for the rule of law, contracts, collateral, rights of inheritance, land tenure, especially for women - 60% of relevant RMC officials w/ increased knowledge of enabling MF environmental issues 	<ul style="list-style-type: none"> - Degree to which RMC governments are willing to upgrade enabling environment elements e.g. legislation
3. Enhance Strategic Partnerships						

Partnership Agreements/ Co Financing Arrangements Made	- Bank collaborates with development partners in joint funding and use of TSPs for MFI capacity building	- Collaboration/ funding agreements w/ strategic partners	- Development partners - TSPs	- % Bank MF investment activities done in collaboration w/others - Amount of funds leverage relative to Bank investment - No. of TSPs dealt with	- 60% of MF investment activities in collaboration w/ partners - Bank financial investment input leveraged five times - Local RMC TSP capacity improved	Willingness and capacity of partners to collaborate
---	--	---	----------------------------------	--	---	---

	<u>Activities and Inputs According to Strategic Areas of MF Policy Orientation</u>	<u>Sector/Theme: Short term outputs</u>	<u>Target People & Institutions</u>	<u>Indicators:</u> (Midterm and at five year progress reports)	<u>Targets:</u> (Five year progress report)	<u>Risks, Mitigating Strategies, Assumptions</u>
4. Knowledge Management: Ensuring Effective Research, Information Collection and Dissemination						
MFI Perf. Data Acquired, Stdzd. & Reported	<ul style="list-style-type: none"> - Assure that all MFIs with whom the Bank deals report their performance according to the standard best practice criteria: no. of loans, clients (% women), rate of MFI self-sufficiency, etc. - Bi annual African workshop to assess MF industry status & progress 	<ul style="list-style-type: none"> - MFI data - Bank web site for MF - RMC sector data generated & conclusions made to improve industry performance 	<ul style="list-style-type: none"> - All MFIs w/ whom the Bank deals - The public at large 9. RMC officials, MFIs, Bank staff, other relevant stakeholders 	<ul style="list-style-type: none"> - Growing trend of Bank-supported MFIs report best practice performance information & upload data to such platforms as MIX Market - % same MFIs are rated - 50% growth in no. of MFIs w/ improved outreach & financial sustainability 	<ul style="list-style-type: none"> - All MFIs the Bank supports report best practice performance data via The MIX Market - 60% of same MFIs are rated by one of the reputable MFI rating agencies 	SAP adaptability to MF
	<ul style="list-style-type: none"> - Bank MIS systems adapted to accommodate performance data of MFIs 	<ul style="list-style-type: none"> - SAP MF friendly 	<ul style="list-style-type: none"> - The Bank - The public at large 	<ul style="list-style-type: none"> - No. of MF newsletters published 	<ul style="list-style-type: none"> - 10 newsletters - 10 MF newsletters issued & disseminated - 6 publications disseminated - Dynamic Internet web site for MF 	

Active Collaborative Partners of the Bank in Microfinance

1. *Consultative Group to Assist the Poor (CGAP).*

1.1 The Bank will continue to benefit and learn from its membership in CGAP, while also contributing to the CGAP agenda. Among the many activities from which the Bank has and will continue to benefit include: the DPRs on development effectiveness; briefing and training Bank Board members and staff on current developments in microfinance; maintaining an extensive research library and microfinance database; and input and advice on such initiatives as the portfolio clean-up and this Policy and Strategy document. The Bank will also continue to participate in CGAP Annual Meetings and provide feedback on CGAP publications, such as the revised *Donor Guidelines on Microfinance*.

1.2 Established in 1995, CGAP is a member organization owned by multilateral and bilateral funding agencies. The Bank was one of its nine founding members. CGAP was founded based on the conviction that microfinance had enormous potential to evolve into a full-fledged financial industry that could serve the poor. CGAP consortium members work together to build sustainable financial services for the poor. CGAP has become a recognized center of excellence, providing services and information to an array of industry actors engaged in building inclusive financial systems. In Africa, CGAP initiated the CAPAF program based in Dakar, which facilitates capacity building of microfinance institutions in francophone African countries. CGAP has also directly invested in African MFI capacity building.

2. *The Microcredit Summit Campaign (MSC).*

2.1 The Bank will continue to work with the MSC in advocating best-practice microfinance for all. Involvement in MSC advocacy efforts to date has included responding to the petitions of 700 parliamentarians from five developed countries on what the Bank was doing in support of microfinance and microenterprise development.

2.2 The MSC is a global campaign and advocacy group that seeks to reach 100 million of the world's poorest families with quality financial services by the end of 2005. It has since renewed its mandate to reach 175 million poor families by 2015. The MSC is committed to development of sustainable institutions that assist the unbanked to work their way out of poverty with dignity. The MSC's focus on Africa has led it to conduct two regional summits there since 1997, together with an additional summit (in 2004) that also included the Middle East.

9. *Inter-American Development Bank (IADB).* The Bank can adapt IADB practices to its own direct operational investments in MFIs and remittance studies. Among regional development banks, the IADB is considered a pioneer in direct support of microfinance institutions. Since 1979, the IADB has largely funded local intermediaries through 570 projects (collectively valued at USD 302 million) that have assisted 530,000 clients who had no previous recourse to commercial banks.

IADB interventions have supported such microfinance flagships as Banco Sol and Prodem in Bolivia and Mi Banco in Peru, all of which are commercial banks that primarily offer microfinance services. The IADB is also doing pioneering research work on remittances, the total transfer of which to Latin America in 2004 was valued at USD 40 billion.

4. ***Asian Development Bank (AsDB)***. The Bank will learn from and adopt approaches similar to those of the AsDB, such as direct investments in MFIs, leading strategic dialogue on enabling environments, and facilitating information management. Since 1988, the AsDB has taken an active, multi-perspective approach to the development of microfinance in its vast and varied Asian region. It promotes and develops its knowledge in microfinance so that its financial interventions, even if limited, are implemented selectively. In 2000, AsDB approved a microfinance policy that supports sustainable microfinance and guides its operations and policy dialogue with regional member countries. Since the policy was adopted, AsDB has sponsored ten microfinance loan projects valued at USD 350.8 million, 16 microfinance components worth USD 131 million, seven microfinance preparation facilities, and 21 technical assistance projects in 12 countries.

5. ***The World Bank/ International Bank for Reconstruction and Development (IBRD)***.

5.1 When AMINA was still in existence, the IBRD ceded the lead in microfinance in Africa to the African Development Bank. In implementing this Policy and Strategy, the Bank will leverage the work done by the IBRD on financial sector assessments with a focus on microfinance and remittances, as well as on developing harmonized policy approaches through PRSPs and CSPs. The IBRD approach to financial sector development includes microfinance, which it terms “banking services for the poor.” In recent years, the IBRD has increased its emphasis on the enabling environment for financial sector development. The Bank participated in the IADB-sponsored “Financial Sector Development for Africa Retreat” held in March 2005, which approached microfinance from the broader perspective of financial sector development.

5.2 The IBRD also supports capacity building, which it sees as critical. Instead of focusing on building NGO microfinance institutions, however, the IBRD works primarily with existing financial infrastructure institutions, such as commercial banks, postal savings banks, cooperative networks, and reformed development finance institutions (DFIs). In Africa, the IBRD has invested in numerous programs and projects in support of microfinance. Among its notable successes are PADME and PAPME in Benin, and non-lending technical assistance to microfinance institutions in Uganda.

6. ***International Finance Corporation (IFC)***. The IFC, the IBRD’s private-sector arm, invests in professionally managed, profitable microfinance entities, such as retail outlets and commercial banks, using wholesale intermediaries and equity funds. The IFC has invested USD 245 million to date in microfinance institutions. The MFIs supported by it have a combined outstanding loan portfolio of over USD 1.2 billion. The Bank can learn from and work with the IFC to coordinate and leverage their respective resources to invest in best-practice MFIs, such as K-Rep Bank/Kenya. In Africa, the IFC is a co-investor with the Bank in K-Rep Bank. It has also extended loans to and equity investments in Moroccan MFIs.

7. ***U.N. Development Programme (UNDP) and the U.N. Capital Development Fund (UNCDF)***. As was the case with the AMINA-supported MicroStart initiative, the Bank will continue to leverage its resources for building retail MFI capacity with those of the UNDP and UNCDF. These two organizations, which often partner with each other and work as one organization, are active in microfinance in the Least Developed Countries of Africa. They have, for example, worked with the Bank in Ghana and Mozambique in its Microstart program, and in Sierra Leone in the Social Action and Poverty Alleviation (SAPA) program. The Bank has also collaborated and co-funded the Upstream Initiative in Mozambique with these two agencies. UNCDF's new strategy for microfinance is to bring all stakeholders together for a financial sector assessment before jointly designing interventions. (Its niche is funding start-up microfinance institutions.)

8. ***GTZ (German Gesellschaft für Technische Zusammenarbeit)***. GTZ is the agency with which the Bank most closely collaborated on capacity building in the AMINA program, through which the two organizations funded national microfinance networks and associations. The Bank anticipates that it will continue to collaborate with and learn lessons from GTZ, which is an international cooperation enterprise for sustainable development with worldwide operations. GTZ carries out microfinance projects in more than 20 countries on behalf of the German Federal Ministry for Economic Cooperation and Development (BMZ). Its work in microfinance contributes to achieving its goal of developing financial systems that improve the poor's access to financial services. GTZ has supported numerous programs in Africa, most notably, the regional MFI network, AFMIN.

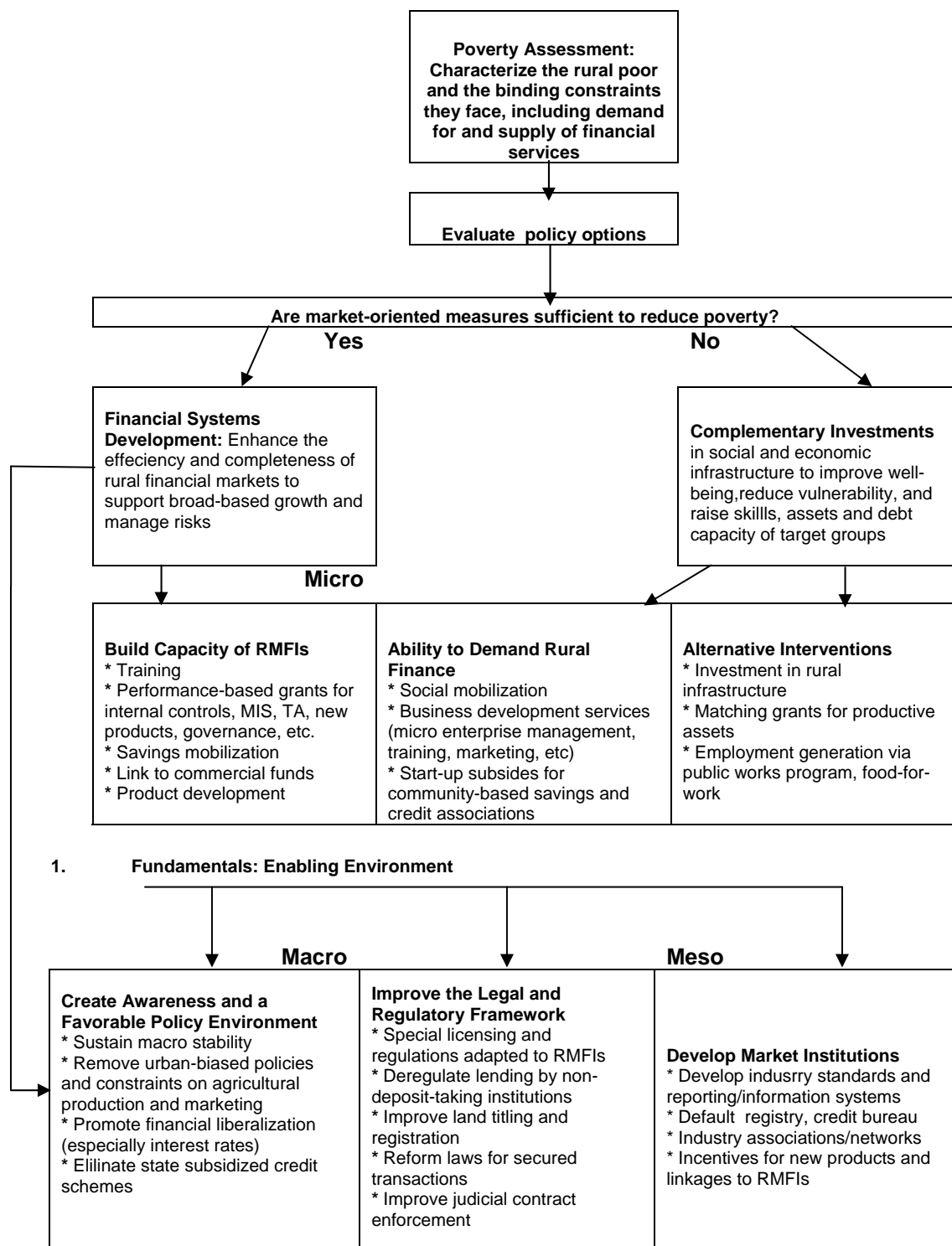
9. ***Private investment funds and commercial capital***. Bank support of MFI capacity building will encourage private investment funds and commercial investors to invest in promising MFIs capable of expanding their outreach to the poor. The Bank may also invest in microfinance through such funds. The Bank's work with such funds will generate multiplier effects that benefit all parties concerned, as the ample resources of private investment funds can help capitalize MFIs. An increasing number of investors are looking for opportunities to invest and participate in microfinance. According to CGAP in 2005, 53 such funds exist, including the Ford Foundation, the Shell Foundation, Planet Finance, Oikocredit, and the Monsanto Fund. Africap Microfinance Fund, for example, a USD 15 million fund, invests in microfinance institutions (MFIs) across the African continent. Commercial banks such as Citigroup of the United States, HSBC of the United Kingdom, and Commerzbank of Germany, are also becoming active investors in and lenders to the sector.

BEST PRACTICE INDICATORS FOR MICROFINANCE¹¹

<p>1. Outreach: How many clients are being served?</p> <p>Indicator: Number of active clients or accounts</p>
<p>2. Depth of outreach: How poor are the clients?</p> <p>Indicator: Average outstanding balance per client OR account as a proportion of gross national income (GNI) per capita</p>
<p>3. Portfolio quality: How well is the financial institution collecting its loans?</p> <p>Indicator: Portfolio at risk > 30 days (PAR) and write-off ratio OR annual loan-loss rate</p>
<p>4. Financial sustainability: Is the financial institution profitable enough to maintain and expand its services without continued injections of subsidized donor funds?</p> <p>Indicator for unsubsidised institutions: Return on assets (ROA) OR return on equity</p> <p>Indicator for subsidized institutions: Adjusted return on assets (AROA) OR financial self-sufficiency</p>
<p>5. Efficiency: Is the financial institution providing services at the lowest possible cost to clients?</p> <p>Indicator: Cost per client OR operating expense ratio</p>

¹¹ CGAP/The World Bank. Building Inclusive Financial Systems: donor Guidelines on Good Practice in Microfinance Washington: December 2004; page 33

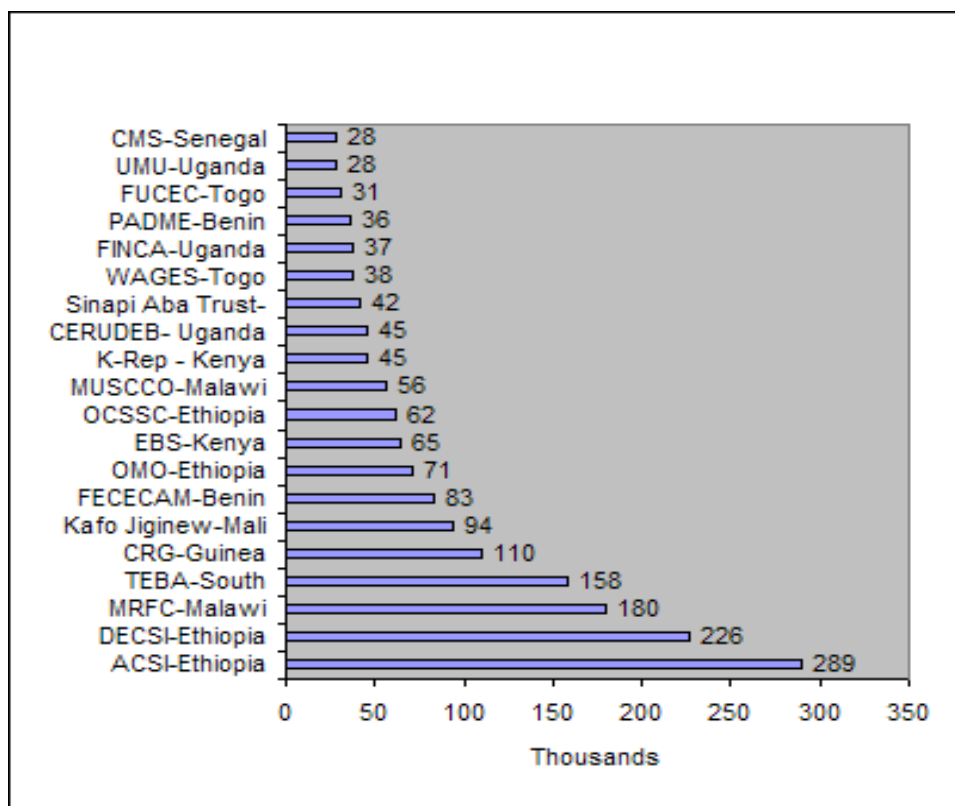
Options for Rural Finance for Poverty Reduction



Source: Adapted from Yaron, Jacob; Benjamin; and Piprek. Rural Financial Services. World Bank, 1997.

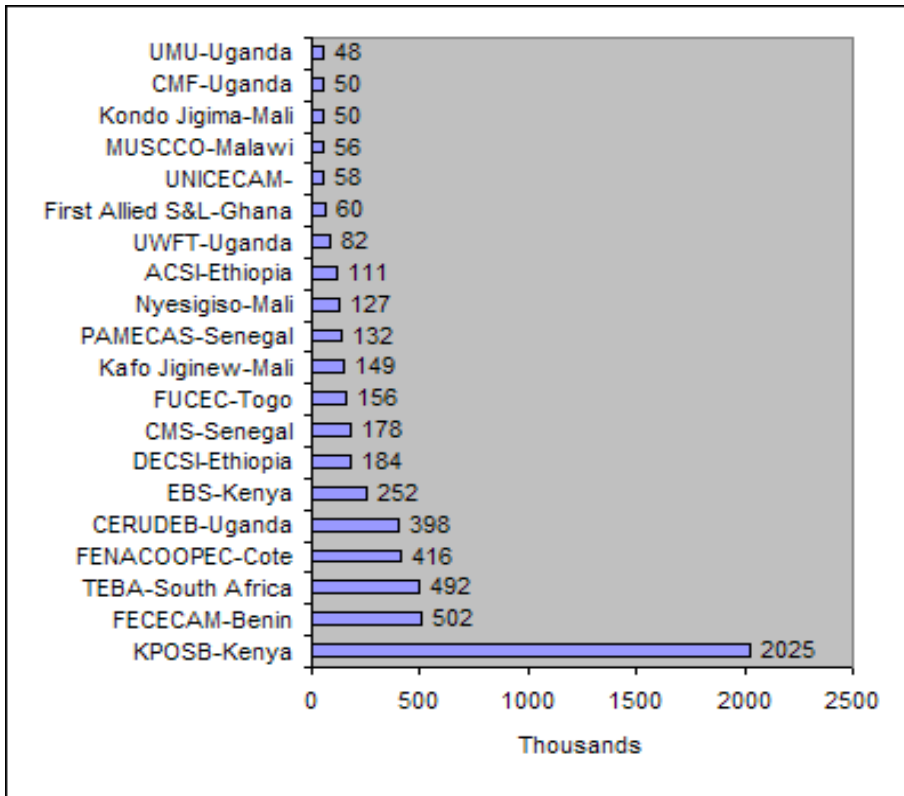
KEY PERFORMANCE STATISTICS OF A SAMPLE OF THE LARGEST AFRICAN MFIs

Numbers of Borrowers



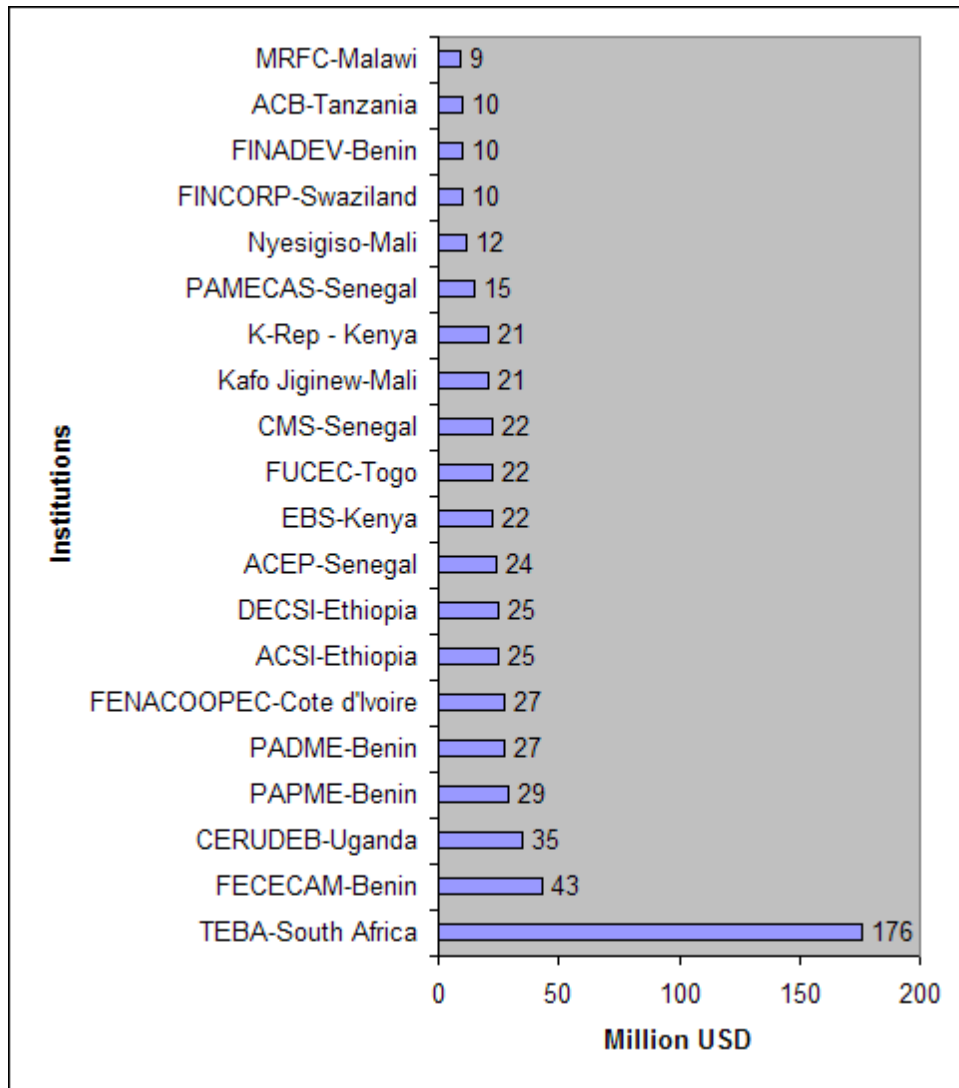
Total: 1,724,000 Borrowers

Number of Savers



Total: 1,250,000 Savers

Amounts Lent



Total: USD 586 million

The Process of Developing and Validating the Policy and Strategy

This Policy and Strategy has been developed, informed, and validated on the basis of past experience, inputs, reviews, and consultations. The most prominent inputs to this document included:

- lessons learned by the Bank that direct credit components embedded in larger projects, such as those designed for agriculture, are largely ineffective
- lessons learned from six years of Bank experience in working in microfinance on the basis of best practices, starting with the implementation of AMINA in 1999
- the Bank's work to mainstream microfinance since 2002
- advice from Bank development partners
- an independent consultant's report for this Policy and Strategy document, completed in early 2005
- extensive document review, stakeholder interviews, and Internet research
- internal, peer, and Bank management and operations staff review, as well as discussion at all management and professional levels
- consultation and validation with numerous microfinance experts at conferences and meetings

The 2005 conference and meetings on microfinance included the participation of RMC heads of state and other senior officials, underscoring the importance and need of agencies such as the Bank to meaningfully support microfinance development in these countries.

Microfinance Policy External stakeholder's Review Workshop - 15th December 2005			
List of Participants			
	Name	Title	Organization
1.	Rene Azokli	Director	PADME
2.	Abdoul Anziz Atoumane	Secretary General	AFMIN (African Microfinance Network)
3.	Essma Ben Hamida	Co-director	ENDA Inter Arab
4.	Dondo ChristoAleke	Managing Director	K-REP
5.	Dorothy Nduku Kitundu	Program Coordinator	African Rural and Agricultural Credit Association (AFRACA)
6.	Francis Beinpuo	Chairperson	GHAFFMIN (Ghana Microfinance Institutions Association)
7.	Felistas Coutunho	Managing Director	FINCA
8.	Sylvester Kadzola	CEO	MFI Malawi Union of Savings and Credit Cooperatives MUSSCO
9.	Lutombi M. Kawana	CEO	Pride Zambia
10.	Mekonnen Yelewumwosen	General Manager	Amhara Credit and savings Institutions
11.	Meltus Rwsa	Manager	Akiba Commercial Bank Ltd
12.	Monsieur Charlot RAZAKAHARIVELO	Director	Vola Mahassoa
13.	Charles K. Byanyima	Executive Director	Microfinance Support centerLtd
14.	Amasi Okone	Group Executive Chairman	Mutual Alliance Savings & Loans Ltd

15.	Mohamed El Haitamy	Chef departement comptabilité et contrôle de gestion	Alamana
16.	François Mutemberezi	Président du Conseil d'administration	Microfinance Inking S.A
17.	Scott Bellows	Managing Director	URWEGO Commity Banking SS
18.	Roroge Paulino	Head of Microfinance	GAPI. SARL
19.	Maurice O. Danje.	Manager Business Development Department	Kenya Post Office Savings Bank
20.	Eric Ekue	Directeur Services Financiers Décentralisés.	BCEAO
21.	Lebughe N.Marie Marthe	Directeur Adjoint Chargée de la Microfinance	Democratic Republic of Congo Central Bank
22.	Gladys Ghartey	Coordinator	Ministry of Finance and Economic Planning microfinance Unit
23.	Kamya Agnes	Deputy Director	Bank of Uganda
24.	Gerhard Coetzee	Professor	University of Pretoria
25.	Mady Koanda	Directeur General	Centre Africain d'Etudes Superieurs en Gestion (CESAG)