Of Good Intentions, and Micro-Pensions

It is often remarked that good intentions are not enough. We all know about projects and visions animated by excellent intentions that either failed completely, or inadvertently created as many problems as solutions. The role of social finance in microfinance is just such a tale.

If there is one compelling lesson I've learned from 12 years working in microfinance in nearly two dozen countries, it is that micro-savings matter -- enormously. For the bottom billion who live mostly in the rural areas at the fringes of the monetary economy, a safe, flexible savings account is a critical defining freedom that opens the door to future opportunities. These individuals and families rarely borrow from so-called 'microfinance institutions' (MFIs). Fixed biweekly repayments are simply too risky for poor households with highly seasonal and intermittent cash flows, so good household money managers steer clear. Yet few MFIs today deliver savings, and many that do, do it badly.

Even in peaceful nations, poor rural households face extraordinarily high ambient risks – floods, droughts, disease, crop failure, livestock illness, wild swings in commodity prices, etc. They save at home, for the most part in-kind – in rice, in chickens, in building materials, in gold and jewellery. Because they have very limited assets, even small events, like the loss of a month's work when the husband is bitten by a snake in his rice field, can lead to significant hunger in the family, and children being forced to leave school. The emergence of behavioral economics is finally giving us the tools to diagnose and ultimately correct this profoundly human dilemma. In their excellent book Poor Economics, Banerjee and Duflo describe poor people as 'barefoot hedge fund managers', while Portfolios of the Poor gives us the clearest insights yet into the critical issue of household portfolio management among the economically active poor.

In 1998 a large-scale evaluation of the Bangladesh microcredit sector (Fighting Poverty with Microcredit, Khandker, World Bank) found that for every $1 lent by three major MFIs into their clients' rural non-farm activities, about $2.50 came from other sources, mostly household savings. In 2000, Grameen Bank (one of the subjects of the study) introduced voluntary micro-savings and even micro-pension plans for the Bank's 2.4 million clients. By 2006 Grameen Bank had 7 million clients and was funded entirely from sources inside Bangladesh. But the aftermath of this defining moment in microfinance has been telling. Dr. Yunus and his Bank were said to have won a Nobel Peace Prize 'for micro*credit*', and very few MFIs followed Grameen's lead into micro-savings.

Table 1 outlines the capital structure for MFIs around the world that report to MIX, the premier microfinance database. It classifies MFIs based on their relative levels of financial intermediation. Nearly half in this global sample offer no savings products at all, while another 18% deliver minimal savings. In both cases the shortfall in capital is made up primarily from external borrowings, and secondarily from a gradual build-up of very high equity balances. Without savings products to offer, many MFIs recklessly encourage poor people to *borrow* to address savings goals like medical costs, or to finance long hungry periods caused by crop failures. It is notable that while the lower categories in Table 1 are dominated by NGOs and NBFIs, the 'high FI' class is much more diverse -- including 62 credit unions, 55 banks, 48 NBFIs and 39 NGOs.

Table 1: Capital Structure, MFIs Reporting to the MIX
All data for 2010, in $US millions

'Financial Intermediation' Level (MIX Rating)	No. of MFIs	%	Total Assets	Equity	Deposits	Borrowings	Deposits: assets	Borrowings: equity
Total	657	100%	54,667.2	10,198.6	25,556.5	15,027.5	47%	1.47
"High FI"	222	34%	38,789.8	5,717.8	25,082.9	5,787.0	65%	1.01
"Low FI"	115	18%	4,433.0	929.8	473.6	2,477.2	11%	2.66
"Non FI"	320	49%	11,444.4	3,551.0	0.0	6,763.3	0%	1.90

Notes:

1. Source: the Microfinance Information eXchange: http://www.themix.org
2. The universe of MFIs for which the reliability of data is rated by the MIX at 4 'diamonds' or higher.

In microfinance, the volume of voluntary deposits an MFI can mobilize offers an excellent proxy for how well it is locally trusted. So why has an entire 'microfinance asset class' emerged based on the perverse rationale that the most capital should be invested in institutions that have earned the least local trust? (The situation cannot be explained as investment in early-stage institutions: 82% of the 'non-FI' group are classified by the MIX as 'mature'.) These investments distort MFI incentives – leading them to postpone the delivery of savings products, often indefinitely. It also sends a subtle but powerful message to microfinance practitioners in the developing world. "You can't do this alone. And poor people's savings don’t matter.”

In his recent book Due Diligence: An Impertinent Inquiry into Microfinance (draft available on his blog site) David Roodman writes that the current torrent of funds flowing into microcredit “dulls the initiative to take savings as an alternative source of funds. And it encourages microfinance organizations to grow faster than they can safely manage” (pp. 275-76). Roodman tracked the financial flows that fuelled four microcredit bubbles in 2007-08 (Bosnia/Herzegovina, Morocco, Nicaragua and Pakistan). While much of the problem was caused by multilateral funds, so-called ‘microfinance investment vehicles’ (MIVs) like BlueOrchard Capital and responsAbility were also heavily implicated.

For two decades, microfinance was dominated by a kind of ‘Microcredit Summit mentality’ which went like this: “Get credit to everyone, everywhere -- *fast*. Poor people are all microentrepreneurs and all victims of moneylenders -- and they all need loans! Don’t complicate matters. Just stay focused: *exponential growth in microcredit!*” Western microcredit pioneers of the 1970s-80s viewed conventional Western capital markets as the *only* sustainable source of capital that could fund microcredit, and devoted enormous energy (and subsidies) to building an MIV sector. The lesson of institutions like BRI in Indonesia, or Europe’s co-operative banking sector – that poor people’s savings were another scalable and financially sustainable option – were not heard.

Predictably, this drumbeat now has triggered a backlash against microcredit. But it would be tragic if this backlash kills *microfinance* – the delivery of high quality savings, loans, payments and insurance to very poor people. This remains a powerful vision -- and social finance could play a transformative role in realizing it. But, just as microfinance needs re-balancing, so does the investment sector that grew up around it.

It is time to go beyond good intentions – to real financial intermediation (including micro-pensions). To reduce or eliminate MFIs’ incentives to favour the use of external borrowing over deposits as a source of capital, microfinance investors must reach an agreement on reasonable guidelines for maximum leverage thresholds. The capacity of MFIs to earn local trust should be measured and integrated into ratings. The focus of microfinance investments should shift towards greater investment in infrastructure, including mobile information systems, branch networks, rating agencies, networking institutions and technical assistance. And in countries where the law prevents NGOs or NBFIs from accepting deposits, investments should be directed to institutional types that can, such as credit unions or banks.

Canadians are very well placed to make a vital contribution to real microfinance. Our credits unions emerged in remote and rural parts of Canada in the 1930's in response to the Great Depression. These entities contain an institutional gene pool that is a global 'best practice' in rural microfinance. Toronto's Calmeadow Foundation was a pioneer of modern microcredit, and many of its alumni continue to play a vital role in the global microfinance movement. We are also global leaders in social finance. But too often the critical players are not talking to each other. For the sake the world's poor people, it is time that changed.

Perhaps it is also time for a working conference on microfinance investing?