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Building a Dialogue to Promote Microfinance Best Practices in South America

Mike Goldberg[a] and Eric Palladini[b]

When World Bank staff members meet with representatives of a country's microfinance sector, microfinance institution (MFI) managers assume that they can expect some kind of new financing—credit lines, guarantees, or grants—and nothing more. But, thanks to a new initiative, microfinance practitioners are learning that the Bank can also be a source of world-class expertise on a number of challenges. In addition, they have found that access to new products, innovative technologies, and additional tools in risk management can play as important a role in the success of their institutions as access to funding.

This note provides a summary of how the Bank established an eight-part distance learning series for dialogue with South American MFIs. The objectives of the dialogues were to: (1) highlight the Bank's ability to mobilize international technical expertise in microfinance; (2) strengthen MFIs by disseminating new knowledge and technological best practices; (3) promote the sharing of experiences and lessons learned; and (4) promote greater ties among the MFIs in the region. The events became an ongoing forum to provide technical assistance to microfinance networks in Bolivia, Colombia, Ecuador, and Peru. By way of example, this note summarizes the presentations of three developing areas in microfinance. The complete results of the presentations and exchanges will be published in a book-length report.

The Latin American Markets and International Trade Program (LAMIT), established by the United Kingdom's Department for International Development (DFID), and the Global Development Learning Network (GDLN) provided financing and technical support for the videoconferences. To facilitate the dialogue, the team established a collaborative online space (using the donor-supported "dGroups" platform, see www.dgroups.org). The website provided a forum for participants to share experiences and to respond to further questions. The videoconferences reached an average of more than 200 practitioners and government regulators in eight distance learning centers in the four countries. In addition, thanks to simultaneous webcasts, a group of Argentine practitioners were able to view the presentations.

The move to engage with MFIs in the four countries began in 2006—a critical year for microfinance in Latin America. In that year, the Bank recognized a need to respond to a regional trend of proposed government policies that would artificially lower microfinance interest rates and interfere with the sustainability of MFIs. Rather than expanding product menus and introducing cost saving technologies, populist governments in Bolivia and Ecuador, for example, sought to improve access to credit by mandating interest rates below the rate of inflation. In contrast, the Peruvian and Colombian governments sought to ensure the sound growth of the microfinance industry and were considering a number of regulatory and supervisory options. In all four countries, the Bank recognized a need

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to engage the policy makers and the national microfinance industries in a broad policy dialogue to promote outreach and sustainability.

The organizing team surveyed the microfinance associations to identify the most important topics in micro finance. The survey respondents identified eight issues: (1) innovative technological solutions; (2) the role of government in setting interest rates; (3) microinsurance; (4) housing; (5) leasing; (6) risk management; (7) governance; and (8) disaster preparedness.

In response, the Bank team sought out international experts and coordinated with leading regional microfinance networks and Consultative Group to Assist the Poor (CGAP) to provide the latest research, cases, and products (see www.cgap.org). Each session included an opportunity for questions and observations from the participants and follow-up questions through the dGroups website for up to two weeks. Most sessions included a presentation from one of the South American microfinance institutions. The team reviewed the draft presentations, offered technical observations, and provided translation services when needed. The consultants prepared a pre-session summary and agenda, which was distributed through the website.

Three developing issues in microfinance— insurance, technology, and housing—were of particular interest to the participants. This note broadly reviews the dialogues regarding these issues. Later *En Breve* notes will describe the discussions that took place on the other topics in the forum.

Insurance for Individuals, Households, and Businesses

Early in the dialogue, the participants heard from three experts in microinsurance: Michael McCord of the Microinsurance Centre, Carlos Arce of the World Bank, and Héctor Rivas of Financiera FINSOL in Mexico (see Box 1). The first two speakers described the policies and practices necessary for a successful micro insurance program. Hector Rivas discussed the success of FINSOL's life insurance program.

Poor households and micro enterprises require the same protection against unexpected and devastating events as the wealthy. Microinsurance protects the poor individual, household or the micro enterprise from some or all financial losses linked to an unpredictable event or risk. It does this through risk pooling and client education on coverage and benefits, in exchange for payment of a premium.

There are four groups of micro insurance products: (1) Life, (2) Disability, (3) Health, and (4) Property. Each group includes a range of potential options. Although it is not feasible to provide a comprehensive package of these services, the decision to make specific options available will depend on demand, cost, and perceived need, among other factors. For instance, in a country with a good public health infrastructure, health insurance needs will be a lower priority for potential clients. On the other hand, in a community with a strong tradition of mutual support in times of death (such as burial societies) death benefits and coverage will be lower on the priority list. Therefore, a micro insurance program must be based on an understanding of the particular priorities of the individuals, households, or businesses in a specific market. To that end, client education plays a key role in understanding the best set of services and delivery mechanisms.

Box 1 - Life Insurance: the Case of Financiera FINSOL

In 2002, a group of investors created Financiera FINSOL, a regulated limited objective financial company in Mexico. FINSOL began operations in August 2003, and by mid-2007 was serving more than 200,000 clients through 105 branches in 28 states. Microcredit methodologies included village banking, solidarity groups, and individual credit. FINSOL also serviced remittances.

As the institution evolved, FINSOL's management decided to address the lack of insurance coverage for their clients. Because of the high costs of promotion and operations and the geographic isolation of many potential clients, traditional insurance providers had ignored this market. In addition, the local MFIs did not have the specific insurance design and delivery skills. Yet, in combination, the insurance providers and the MFIs could design an appropriate insurance product that would be marginally profitable for both institutions.
Within one year of start-up, FINSOL life insurance had reached more than 180,000 of borrowers. The insurance policy includes the following:

- No medical examination required for coverage
- Policy costs kept low.
- US$3,000 coverage.
- Immediate pay-out of 30 percent for funeral expenses; remaining pay-outs made within three days.
- Coverage of individuals ages 16 to 65.
- Use of a collective policy format.
- Double coverage for accidental death.

To choose the most appropriate policies and level of coverage, the individual, household or business will need to have a complete understanding and appreciation of the benefits of the insurance products available. Given the unique needs and sheer number of the pool of uninsured households and micro enterprises, micro insurance products should be simple to understand and determined by available delivery channels. In addition, MFIs should understand and prepare for the limits and barriers to delivery of an insurance policy. For example, the MFI or the insurance agency must be able to reach large numbers of interested clients, provide appropriate incentives and respond rapidly to claims.

Even when an MFI cannot provide a complete insurance package, it can become a valuable partner with insurance companies, government agencies and other actors in the delivery of micro insurance. The MFI can play a decisive role in the design, delivery, monitoring, and evaluation of micro insurance products. To maximize the benefits to their clientele and themselves, MFI managers should; (1) leverage their intimate knowledge of their client base to encourage insurers to offer attractive products to this large market niche; (2) encourage competition by using more than one insurer, through competitive processes, and annual policy reviews; (3) improve integration of micro insurance with MFI incentives and policies; (4) recognize the value of a broad range of insurance products to MFI clients and indirectly to the MFI itself; and (5) review the cost implications and benefits of offering micro insurance.

Using Technology to Expand Outreach and Reduce Delivery Costs

One of the more popular distance learning dialogues provided the latest information on technologies that have revolutionized microfinance in other regions. Participants heard from and posed questions to three experts in the field of technology and microfinance: Hannah Siedek of Consultative Group to Assist the Poor (CGAP), Alice Liu of Development Alternatives Inc. (DAI), and Santiago Saavedra of the Red Transaccional Cooperativa in Ecuador.

Many MFIs in the Andean countries are not well-informed about the technology options available for lowering costs and expanding outreach. For example, while mobile phone-based banking (also known as "m-banking") has exploded in the Philippines, South Africa and India, there are only a few examples of this application in Latin America, despite the enormous opportunities in the region. The presentations described how new operational technologies can reduce loan processing and approval costs through faster response times and automatic review. This represents an important competitive advantage in an increasingly competitive financial services market. Efficient technologies do not require the opening of a new branch to reach clients; many interactions with an MFI involve deposits, withdrawals, payments and disbursements of credit. The decision to use new technologies has important implications for the MFI's capital investment and operating budgets, staff training, promotional activities, and other aspects of the business. For instance, opening offices in remote locations continues to be expensive for any financial entity. Low-cost alternatives could be the personal digital assistants (PDAs) for computing and information storage and retrieval, or smart cards for automated teller machines (ATMs) or m-banking. The PDAs would reduce the need for more expensive solutions by facilitating the processing of applications and reducing the time and number of documents needed. The smart card with fingerprint recognition technology accommodates the needs of members who cannot read or write or who do not speak the dominant language of the country—Quechua and Aymara speakers in Peru and Bolivia, for example. Clients appreciate these solutions because the transactions costs, including transportation and time, drop dramatically.

Providing Shelter and a Place to Work through Progressive Housing Microfinance

Another popular distance learning dialogue focused on housing microfinance, which has emerged as a key financial service to alleviate the housing needs of poor and economically vulnerable families. In addition to providing shelter, housing provides a place to work. Participants heard from Jesús Ferreyra of MiBanco in Peru (see Box 2) and Richard Schumann of the Cooperative Housing Foundation (CHF International).

The discussion focused on the most viable approach to housing finance for the poor, progressive housing microfinance. This model provides funding for building or home improvement in ways that mirror the most common approach to home building among the poor. The poor tend to build or improve existing homes, which often include microbusiness workshops, in increments that are short-term and affordable. Similarly, housing microfinance provides small, short-term loans for parts of the building process. For example, the first loan may cover the costs of one room—with the electricity and water hook-ups for the microbusiness. This approach is popular because it starts with a room with reliable utilities as a way to begin to formalize the family business. As clients become ready to add another room, or improve the existing structure, they borrow only enough for that purpose.

Box 2 - Progressive Housing in Peru: Micasa

Mibanco, Peru's first for-profit, fully regulated commercial microfinance bank (and a member of the Acción International Network), offers some of the region's leading microfinance products. Micasa, the largest of Mibanco's five progressive housing products, finances up to 100 percent of the costs to complete a house. These housing projects may also involve expanding or adding a microbusiness workshop. Loan terms include a minimum of three months and a maximum of five years for maturity. The minimum amount of the loan depends on the credit evaluation. With a few exceptions, the maximum loan amount is $US10,000. As of the end of 2007, Micasa's portfolio exceeded US$50 million.

Lessons learned by Micasa and the other progressive housing products of MiBanco include the importance of providing a demand-driven product with efficient service and ongoing follow-up. Moreover, the programs' sales plans have learned not to exaggerate the products' values: it is more effective for clients to choose from a menu of housing loans. Finally, it is important to set realistic and progressive goals and include risk management and results-based follow-up plans.

To accommodate the different characteristics and requirements of housing microfinance, MFIs will need to adapt their lending practices in such areas as collateral requirements, grace periods, loan terms, amount lent, and technical assistance. For example, one of the primary characteristics of microfinance is the lack of formal title, collateral or guarantee. Housing microfinance may allow a client without a formal land or property title to use other documents to prove ownership or at least to demonstrate a minimum period of residence. These documents might include tax receipts or public utilities service receipts. The lack of formal title also means that the client has no formal collateral to offer. Housing microfinance recognizes this constraint and offers more flexible forms of guarantee, such as a co-signer, chattel mortgages, a compensatory savings balance, and the like.

Finally, housing microfinance may include technical assistance in the loan agreement. Some MFIs view technical assistance as an integral part of their progressive housing methodology. Others view this as an additional cost, with little impact on loan repayment. Technical assistance includes help in construction design to improve the quality of the building, pre-loan inspections and help in getting low-cost construction materials, and post-loan inspections. Such programs require the MFI to train loan officers in basic construction, or to train construction specialists as loan officers. In either case, good technical assistance can improve the relationship with the client and provide improved housing.

The Work Ahead: Dissemination and Building on the New Partnerships

The dialogue's first objective—to highlight the Bank's ability to mobilize technical expertise in microfinance—has been largely achieved. The other objectives represent on-going efforts that can build on the achievements of this dialogue. A final document, in English and Spanish, will further these objectives as it is distributed to a wide audience of practitioners, supervisors, and regulators. Bank staff will benefit directly from the dialogue series, since these presentations will be integrated into staff training on microfinance and into the web-based Latin America regional microfinance toolkit currently under development.

In strategic and operational terms, the results were encouraging. First, the national associations in Ecuador and Bolivia found ways to cope with new government microfinance interest rates and lending initiatives, thanks to exchanges with experts and colleagues in neighboring countries. Second, led by Peru, the regulators in the four countries took advantage of the dialogues to share concerns and discuss ways to measure and control systemic financial risks. Finally, a number of the microfinance institutions decided to pilot new products, such as microinsurance, with support from the experts they met through the dialogues. Other benefits will be seen in the long term, as microfinance institutions prepare contingency plans for rapid responses to disasters, adjust their governance structures to meet new challenges, and adopt new technologies.

Finally, when new Bank projects include micro finance in projects for the four Andean countries, the relationships built through this dialogue will provide a strong base for operationally relevant solutions and useful policy dialogues. Such relationships will reduce the time required to reach consensus on industry needs, clients' requirements, and the most cost-effective ways to expand the microfinance revolution to the millions in Latin America who wait for reliable, affordable access to financial services.

About the Authors

a. Senior Microfinance Specialist, Finance and Private Sector, Latin America and Caribbean Region, World Bank, b. Consultant

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