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*The Microfinance Experience in Latin America and the Caribbean*

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## **I. Introduction**

In the first part of my talk, I will describe the evolution of microfinance in Latin America, and show how rising levels of commercialization, competition, and regulation explain many of the important trends in this industry today.

Next, I thought it would be interesting to look at some of the key performance indicators of the Latin American MFIs and compare them to their Asian counterparts, particularly since most in the audience here are likely to be much more familiar with Asian MFIs and their performance.

I will then drop back and describe the economic and social importance of the microenterprise sector in Latin America—showing you its substantial share of GDP and employment, and the fact that dealing constructively with microenterprises is a key to alleviating poverty.

Despite this last set of facts, I will then show you the unfortunate evidence that microenterprises in Latin America are poorly served by credit—leaving us much to do.

Finally, I will briefly describe the IDB's support for the microenterprise sector and for microfinance in particular.

## **II. Evolution of Microfinance in Latin America**

The story of Latin American microfinance institutions basically begins in the 1980s with the advent of socially-driven NGOs making loans to poor microentrepreneurs. The growth of these early microfinance institutions (MFIs) was funded largely by grants and soft loans from donors and governments in the region.

By the early 1990s, a few leading MFIs had reached full financial sustainability. In 1992, one of the leaders among all of these pioneering institutions—the Bolivian NGO, PRODEM—converted into the first regulated MFI in Latin America: BancoSol, a regulated commercial bank. The door was now thrown open and the regulation of many other MFIs followed in quick succession.

The *Cajas Municipales*, a group of municipally-owned MFIs in Peru became regulated in 1993. The Accion International affiliate, Corposol of Colombia, became regulated in 1994, changing its name to Finansol and failing in 1995-96 in what is still the most spectacular bankruptcy in the field of Latin American microfinance. Happily, a succession of many other NGOs went on to become regulated MFIs that grew rapidly and prospered. For example, in 1995, the IPC affiliates in Bolivia and El Salvador were licensed to accept deposits—becoming the well-known and highly-respected Caja Los Andes and Financiera Calpiá. In the Dominican Republic, also in 1995, another Accion International affiliate—the NGO, ADEMI—became the commercial bank Banco ADEMI. Many more successful cases of upgrading—or conversion into a regulated financial institution—have followed.

There have also been numerous successful cases of downscaling, in which regulated commercial banks or *financieras* (small banks) enter into the microfinance field. For example, under the auspices of an IDB Global Loan to Paraguay, the German technical assistance firm, IPC, taught 5

Paraguayan *financieras* how to adapt their consumer lending methodology in order to successfully make loans to microenterprises. Three commercial banks in Chile have also downscaled successfully into microcredit and now dominate the microfinance market in that country. More recently, the large commercial banks, Banco Solidario of Ecuador and Banco de Trabajo of Peru—as well as the giant commercial bank, Banco de Crédito of Peru—have all successfully entered into microlending on a large scale. And 2 Guatemalan banks, Bancafé and Banrural, have shown that even commercial banks can reach very poor microentrepreneurs with that most unbanker-like product: village banking—in which groups of 15-40 poor women are organized into small cooperatives and provided with credit, savings, and other services.

The rapid commercialization of microfinance is shown clearly in Table 1. These data are taken from the most comprehensive survey of MFIs in Latin America that we have. The survey was done by IDB and CGAP and covers 176 MFIs in 17 Latin American countries. The data refer to mid 2001 and clearly show the evolution from an NGO-dominated industry 10 years earlier to one in which 62 regulated MFIs provide 76% of the credit flowing to microenterprises from all MFIs (regulated and unregulated) and reach 52% of the total clients served by all MFIs.

**Table 1**  
**MFI Outreach**

Type of MFI	Number of MFIs	Number of Clients (thousands)	Portfolio (US\$ million)	Average Loan Size (US\$)
Upgrade	40	572	558	976
Downscale	22	365	343	940
Total regulated	62	937	902	962
Unregulated (NGO)	114	870	288	332
<b>TOTAL</b>	176	1806	1190	659

### *The Uneven Distribution of Microfinance in Latin America*

The geographical distribution of MFIs in Latin America has been highly uneven across countries and subregions. Table 2 shows the penetration rates of the MFIs in each of the 18 Latin American countries.

In order to derive these penetration rates we first had to analyze the household surveys of the 18 countries. We found there were a total of 59 million microenterprises in Latin America: 49 million with no employees (sole proprietorships) and 10 million with 1-5 employees. Of these 59 million microenterprises, 1.5 million had a loan from an MFI. Thus, the overall microcredit penetration rate by MFIs in Latin America was 2.6%.

As can be seen in the last column of Table 2, these penetration rates vary greatly from country to country. At the high end are Bolivia and Nicaragua, with penetration rates of 28% and 20%, respectively—the only 2 countries with penetration rates of 20% or more. At the low end are Brazil, Argentina, and Venezuela, each with penetration rates of less than 1/3 of 1%.

Regionally, the leaders in microfinance are the small and medium-size countries of Central America and the Andean region. This phenomenon is so dominant that the countries with the 8

top penetration rates all belong to these two regions.

Microfinance has been far slower to develop in the largest 4 economies in Latin America: Brazil, Mexico, Argentina, and Venezuela. These 4 countries and Uruguay are at the bottom of the list—as the only 5 countries with penetration rates of under 1%. This is a huge failing since more than half of Latin America's microentrepreneurs live in these 4 largest countries.

Unfortunately, there has simply been a lack of strong NGOs growing up in these large country markets. For various reasons, these NGOs have not been successful at achieving the kinds of scale seen in the leading microfinance markets of Central America and the Andean region. Nor have they excited the interest of many commercial banks to enter into microfinance, particularly in view of the strong presence of state development banks in the large country markets.

Nonetheless, at least 2 rising stars have emerged in the large countries. Compartamos, a Mexican NGO which became regulated in 2001, now serves over 200,000 clients—mainly using a village banking methodology. And Banco do Nordeste, a state development bank with a successful microcredit program that serves the destitute areas of Northeast Brazil, has now topped the 100,000 client mark. While these are still drops in the bucket compared to the 10 million microentrepreneurs in Mexico and the 19 million in Brazil, the rapid growth of these 2 programs gives hope that these two giant markets may finally be yielding to the microfinance revolution.

**Table 2**  
**Share of Microenterprises in Latin America with MFI Credit**

Country	Date of Household Survey	Number of Single-Person Firms	Number of Firms with 1-5 Employees <sup>a</sup>	Total Number of Microenterprises	Number of Microenterprises with MFI Credit	Share of Microenterprises with MFI Credit
Bolivia	1999	1,300,313	62,008	1,362,321	379,117	27.83%
Nicaragua	1998	377,148	40,422	417,570	84,285	20.18%
El Salvador	1998	606,569	60,617	667,186	93,808	14.06%
Honduras	1999	832,941	58,239	891,180	107,054	12.01%
Chile	1998	1,069,139	138,045	1,207,184	82,825	6.86%
Guatemala	1998	1,328,476	93,238	1,421,714	71,187	5.01%
Costa Rica	1998	232,328	78,891	311,219	12,794	4.11%
Ecuador	1998	1,396,139	298,524	1,694,663	65,719	3.88%
Dominican Republic	1998	1,315,016	77,172	1,392,188	49,437	3.55%
Colombia	1999	5,726,653	775,152	6,501,805	219,240	3.37%
Paraguay	1998	319,113	668,213	987,326	30,203	3.06%
Peru	1997	4,102,561	2,763,632	6,866,193	185,431	2.70%
Panama	1999	267,854	21,150	289,004	6,390	2.21%
Mexico	1998	8,503,552	1,770,393	10,273,945	67,249	0.65%
Uruguay	1998	314,891	27,018	341,909	1,600	0.47%
Brazil	1999	16,567,943	2,421,810	18,989,753	62,485	0.33%
Argentina	1998	1,807,615	103,555	1,911,170	4,940	0.26%
Venezuela	1999	2,906,975	340,296	3,247,271	2,364	0.07%
<b>Latin America Total Firms</b>		<b>48,975,225</b>	<b>9,798,375</b>	<b>58,773,600</b>	<b>1,526,128</b>	
<b>Latin America - Weighted Average Share<sup>b</sup></b>						<b>2.60%</b>
<b>Latin America - Unweighted Average Share<sup>c</sup></b>						<b>6.15%</b>

*Sources:* Household surveys for number of microenterprises; Christen (2000) for number of microenterprises with MFI credit, except for Panama. Christen's data refer to the second half of 1999 and cover most of the larger regulated financial institutions and NGOs lending to microenterprises, but do not cover credit unions. Data for the number of microenterprises with MFI credit for Panama are obtained from the IDB loan files, refer to December 1999, and are as follows: Multicredit Bank 3881, CrediFundes 1549, and Mi Banco 960.

<sup>a</sup> Unlike the other 15 countries in the table, in the Dominican Republic, Colombia, and Brazil, the number of firms with 1-5 employees is not counted directly, but, rather, is calculated as 83% of the total number of firms with 1 or more employees. This 83% share is the overall ratio for the other 15 countries, taken as a whole, of the number of firms with 1-5 employees divided by the total number of firms with 1 or more employees.

<sup>b</sup> Calculated as (total number of microenterprises with MFI credit)/(total number of microenterprises).

<sup>c</sup> Calculated as the unweighted average of the 18 individual-country percentages shown in the final column.

## *The Performance of Microfinance*

So far, our discussion of microfinance has excluded credit unions (CUs). We now bring in these important microfinance actors and examine their performance, along with that of the MFIs.

Credit unions in Latin America were generally established in the 1950s, 1960s, and 1970s with the strong social welfare purpose of helping the poor. Many were organized by Catholic priests, U.S. Peace Corps volunteers, and USAID. They often lacked professional management and were generally weak at loan recovery and at earning and retaining profits for future expansion. They usually kept loan rates low in order to benefit borrowing members, which meant that deposit rates were also kept low as well.

Nevertheless, with substantial grant and soft loan funds available from donors, many credit unions grew rapidly anyway in the period extending from the 1950s to the mid 1980s. With the drying up of much of these donor funds (particularly funds for on-lending) from the mid 1980s onward, the credit union movements in many Latin American countries became moribund. Donor attention then turned, properly I believe, to the provision of technical assistance money (instead of funds for on-lending) in order to strengthen the financial disciplines, systems, products (including microloans and remittances), and other aspects of credit unions.

According to a recent IDB/CGAP survey of credit unions in 17 Latin American countries, these financial intermediaries provided loans to about 1.5 million microenterpreneurs at the end of 2001, almost as many as the 1.8 million served by the MFIs in the same year. Average loan size was US\$ 1044 for the credit unions, not too different from the \$659 shown in Table 1 for the MFIs. Small and fragmentary survey evidence on the income levels of the CU and MFI clientele indicates that about 20-50% of each group is below the widely-used \$2 per day per person poverty line.

While the outreach of MFIs and CUs is broadly similar—both in terms of the number of clients served and the percentage who are poor—their recent growth rates are very different. The MFIs are growing rapidly, approximately 18% per year, versus only about 7% for credit unions (Tables 3 and 4).

There are a number of weaknesses in credit unions that explain the much slower growth of these institutions vis-à-vis the MFIs. These weaknesses have many roots, of which I will only mention two (though there are many more): 1) the free rider problems created by the cooperative form of governance (since no one has a major shareholding interest in the credit union it often happens that no one minds the store), and 2) a permissive attitude toward loan delinquency rooted in a misinterpretation of cooperativism (by not screening borrowers carefully and pushing them to repay their loans, credit unions may be driven to insolvency, harming current savers as well as future savers and borrowers).

But these and other credit union problems can be overcome. One of the key unfulfilled tasks of donors in Latin America is to clean up the credit union systems in most of the region's countries, like they have been cleaned up in Guatemala, Ecuador, and Nicaragua. In each of these 3 countries, 15-25 credit unions were greatly strengthened in the 1990s, have grown very quickly ever since (over 20% per year, not just 7%), and now dominate the credit union systems in their

respective countries, providing high quality financial services similar to those provided by the leading MFIs in the region.

**Table 3**  
**MFI Growth Has Been Rapid:**  
**Number of Microenterprise Loans and Growth**

December 1998	1,520,000
December 2000	1,914,000
June 2003	3,241,000
Total growth (1998-2003)	113%
Average annual growth	18.3%
<i>Source: IDB and CGAP surveys of 17 LA countries</i>	

**Table 4**  
**Credit Union Growth Has Been Much Slower:**  
**Microlending Portfolio in US\$ and Growth**

December 1999	\$2.41 billion
December 2003	\$3.13 billion
Total growth (1999-2003)	29.9%
Average annual growth	6.75%
<i>Source: DGRV and IDB surveys of 18 LA countries</i>	

By the late 1990s, the MFIs and CUs of Latin America had emerged as the world's leader in the key performance area of sustainability. For example, as judged by data from the *Microbanking Bulletin*, microfinance in Latin America had an adjusted ROA (after inflation) of +1.4%, versus -4.5% for all of microfinance worldwide. So, Latin America had not only achieved sustainability, but was actually turning what would be considered a reasonable profit in banking circles. For example, the after-inflation ROA of the commercial banking systems of Bolivia, Chile, and Peru in June 1999 was 0.8%, 0.6%, and 0.7%, respectively.

Moreover, this profitability of microfinance in Latin America was spread widely across different types of microfinance providers. As can be seen in Table 5 (second-to-last column), 4 out of the *Microbanking Bulletin's* 5 Latin American peer groups showed positive inflation-adjusted returns in the late 1990s.

**Table 5**  
**Returns to Microfinance in Latin America: 1996-99 vs. 2001-02 (%)**

		Adjusted ROA in 1996-99	Adjusted RO A in 2001-02
	All MFIs and CUs, worldwide	-4.5	0.1
	All MFIs and CUs, Latin America	1.4	-0.1
5 Latin American subgroups	Credit Unions (CUs)	4.2	-0.5
	MFIs: large, broad based	3.1	5.3
	MFIs: medium-sized, broad based	1.3	3.6
	MFIs: medium-sized, low end	2.3	-2.9
	MFIs: small, low end	-9.4	-12.8

*Sources:* 2nd column from Christen (2000), 3rd column from *Microbanking Bulletin* (July, 2003).

What a difference a few years makes! The final column in Table 5 shows the adjusted ROA using the data from the latest *Microbanking Bulletin*. These data refer to 2001-2002, mostly to 2002.

Latin America moves from a position of being far above the worldwide average profitability level in 1996-99 to being slightly below average in 2001-02. During the intervening time, microfinance grew rapidly in Latin America, leading to sharply increased competition levels in many of the largest microfinance markets. This eroded profit margins for the industry as a whole, turning microfinance into much more of a marginally profitable line of business.

Interestingly, the effect of these increased competitive pressures have not been felt uniformly across all types of MFIs. The adjusted ROA of the large and medium-size broad based MFIs has risen significantly while the adjusted ROA of the medium-size and small low end MFIs has taken a substantial fall. This reflects the natural evolution of a market in which there are important economies of scale. The cost advantages enjoyed by larger MFIs give them an important edge in increasingly competitive markets. These larger MFIs find themselves in the following virtuous circle:

Larger scale → Lower costs → Greater competitive advantage → Faster growth and increasing scale

Meanwhile, the smaller MFIs are caught in a vicious circle:

Smaller scale → Higher costs → Less competitive advantage → Slower growth and smaller increases in scale

### ***Responding to Increased Competition***

As MFIs have faced stiffer competition, they have increasingly turned to individual loans over solidarity group credits in order to provide loans that are better tailored to each individual

client's needs. New MFIs almost always choose to offer individual loans over solidarity group loans. And many MFIs that offered group loans in the mid and late 1990s have switched to individual loans.

In fact, this switch has been prompted both by a desire to respond to increased competition by being more client responsive and also by the realization that group loans don't work so well in bad economic times, such as those prevailing in most of Latin America during the period 1998-2002.

During difficult economic times, many group members feel that while they may be barely able to repay their own loans they certainly can't help others repay theirs. Thus, if 1 or 2 group members default, the whole group often follows, multiplying the MFI's default rates. Increasingly, MFIs offering group loans have found themselves at a competitive disadvantage vis-à-vis those offering individual loans, dragged down by the added costs of their larger portfolios of bad loans. So, again, competition has catalyzed the trend toward individual loans.

This preference for individual loans is shown in Table 6, which is based on the large survey of 176 Latin American MFIs I mentioned earlier (whose data correspond to mid 2001). As shown in Table 6, there are nearly 1 million individual loan clients, versus only 350,000 group loan clients.

Table 6 also reveals a second interesting trend in Latin America: an increased focus on poverty lending using village bank loans. The use of village banking has mushroomed since the early 1990s, until the number of microentrepreneurs with a village banking loan reached 410,000—ahead of the 350,000 served by solidarity group loans. The poverty focus of village banking can be seen in its much smaller average loan size and higher percentage of rural loan clients vis-à-vis solidarity group and individual lending

**Table 6**  
**MFI Lending by Loan Methodology and Location of Client**

Type of Loan	Number of MFIs Making These Loans	Total Number of Borrowers	Total Loan Portfolio (\$ million)	Average Loan Balance (\$)	Share of Clients in Rural Areas (%)
Individual loans	155	984,167	964	980	8
Group loans	74	350,607	115	329	17
Village bank loans	47	410,352	61	150	29
All loans (all MFIs)	176	1,745,126	1140	653	14

*Source:* All data are from the IDB/CGAP inventory of 176 MFIs in 17 Latin American countries.

Village banking too has been undergoing some rather profound changes in Latin America. As chronicled in a recent paper by Glenn Westley (Westley, 2004), faced with rapidly escalating competitive pressures, village banking institutions in Latin America have raised maximum loan sizes available to clients (often from \$300 in the mid 1990s to \$1000 or more today), lengthened loan maturities, reduced repayment frequencies, and slashed forced savings requirements. Some

have even offered individual and solidarity group loans to their village banking customers in order to improve their client retention rates.

Many other new loan products and innovative techniques for making loans have emerged from the increasingly competitive cauldron of Latin American microfinance:

- As noted in an IDB paper done last year on equipment finance in Latin America (Westley, 2003), 23 of the 25 leading MFIs and CUs surveyed offered equipment loans or leases with at least 2-year maturities. We've come a long way from those early days when a common complaint was that short-term working capital loans were the only kind of loan one could find at many MFIs.
- Lines of credit are offered by a number of the regulated Bolivian (and other) MFIs to their preferred customers, thus eliminating the need for clients to reapply for a loan when their old one expires.
- Some MFIs, such as Banco ADEMI in the Dominican Republic, even offer credit cards to qualified clients.
- A number of Accion International affiliates and others are developing credit scoring models and are also utilizing PDAs such as the Palm Pilot. Both changes are designed to cut costs and reduce client delay in accessing a loan.
- Some IPC affiliates, such as Financiera Calpiá in El Salvador and Caja Los Andes in Bolivia, are offering agricultural production loans.
- Other MFIs, such as Financiera Confia in Nicaragua and Banco ADEMI in the Dominican Republic, are branching out into housing loans.

At the same time as new loan products and methodologies are proliferating, the “forgotten half of microfinance” is really beginning to move as well. Based on data collected in 9 major microfinance markets covering the 47 MFIs that are specialized in microfinance and are licensed to mobilize deposits, Table 7 shows that total deposit-taking by these MFIs has increased from US\$ 500 million in 2000 to US\$ 1.2 billion in 2003.<sup>1</sup> While about ¾ of this \$1.2 billion is held in the form of CDs, a rising percentage is in the form of savings accounts, which are far more liquid and are typically what small savers demand. The provision of checking account services is still in its infancy in these MFIs.

By offering savings services, MFIs respond to the demand of clients for one-stop shopping. So, again, increased competition is playing an important role in driving the microsavings phenomenon. The other significant driver is that MFIs are growing so fast that they are simply outgrowing the availability of cheap donor and government funds. And so they must turn to more commercial sources of funding such as deposits and local commercial bank loans.

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<sup>1</sup> The 9 markets are Bolivia, Colombia, Ecuador, El Salvador, Honduras, Mexico, Nicaragua, Paraguay, and Peru.

**Table 7**  
**Deposit-taking in 9 Major Microfinance Markets (US\$ millions, end-of-year values)**

	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
Checking accounts	4.0	5.6	1.4	1.7
Savings accounts	118	165	254	321
Certificates of deposit	395	513	619	867
<b>TOTAL</b>	517	683	874	1190

### **III. Performance of Latin American MFIs vs. Asian MFIs**

Since most of you are probably more familiar with microfinance in Asia than in Latin America (LA), I thought it might be helpful to look at some key performance indicators for Latin American MFIs and compare them to Asian MFIs. The following data are taken from the latest issue of the *Microbanking Bulletin* (July 2003), which covers 50 Latin American MFIs and 22 Asian MFIs.

For people who work with Latin America such as myself, and who are used to pointing with pride to our region as a leader in microfinance, these numbers present a sobering picture. In some ways, it is Asia that is the leader.

While some might point to the earlier start that Asia had in microfinance as the reason for its leadership (the Grameen Bank in the 1970s, etc.), this is not a valid explanation here. The average age of the MFIs reporting to the *Microbanking Bulletin* (MBB) is 9 years for Asia and 12 for LA!

**Overall financial performance.** If I were only allowed to find out 2 things about a financial institution in order to judge its quality, I would ask to know its portfolio at risk (3<sup>rd</sup> line in Table 8) and its adjusted ROA (1<sup>st</sup> line). The portfolio at risk (PAR) tells us how well the MFI achieves its basic goal of lending money and getting it back. The adjusted ROA tells us how sustainable/profitable the MFI is, a key ingredient to its continuing survival and financial health.

On both of these scores, Asia outperforms Latin America, at least for the MFIs covered by the MBB. I don't want to over-emphasize this, however, particularly in regard to PAR. Nearly all of the MFIs reporting to the MBB have low delinquency rates (PAR). The difference between loan delinquency rates of 2% and 4% is not that significant—in both cases the MFI clearly knows what it's doing and will suffer relatively small losses from making bad loans.

**Loan outreach.** In terms of number of loan clients, the Asian MFIs have a multiple of the number of loan clients of their counterparts in LA. This is hardly surprising in view of the enormous population differences between the regions.

On the other hand, the average loan size in LA is a multiple of the average loan size in Asia. This is also hardly surprising in view of the vast numbers of extremely poor microentrepreneurs in Asia.

**Table 8**  
**Profile of the Average MFI Reporting to the *Microbanking Bulletin* (July 2003 issue)**

	All MFIs		Financially Sustainable MFIs	
	Asia	Latin America	Asia	Latin America
Adjusted ROA (%)	2.1	-0.1	5.5	4.4
Adjusted ROE (%)	10.3	1.1	16.9	16.0
Portfolio at risk (% > 30 days)	2.5	4.9	2.4	3.7
No. of active borrowers	32,915	13,755	183,171	31,010
Total loan portfolio (US\$ million)	4.9	8.6	16.5	20.8
Average loan balance (US\$)	195	816	277	900
Deposits/Loans (%)	15	29	27	36
Debt/Equity (leverage ratio)	1.6	2.7	2.4	3.4
No. of voluntary savers	18,374	2422	186,289	2961
Total voluntary savings (US\$ 1000)	816	3185	2400	9658
Average savings balance (US\$)	39	741	61	809
Operating expense/Loan portfolio (%)	22	27	16	21
Borrowers/Loan officer (%)	307	353	465	398
Borrowers/Staff member (%)	149	128	148	140
Adjusted cost per borrower (US\$)	35	195	36	171
Yield on gross loan portfolio – nominal (%)	36	44	35	41
Yield on gross loan portfolio – real (%)	30	35	29	33

The net result of these 2 conflicting pulls is that the overall loan portfolio in LA is somewhat larger than that in Asia. That is, the effect of LA's higher average loan size more than compensates for its smaller number of borrowers.

**Funding.** LA is somewhat further ahead in the funding of its loan portfolio by means of deposits, but this is still quite incipient in both regions. For example, the MFIs in LA have a deposit/loan ratio of 29%, vs. 15% in Asia.

Many MFIs start as NGOs funding their loan portfolios largely from a capital base consisting of grant money. As they develop, they begin to leverage their capital by borrowing and taking deposits. LA is further along in this process than Asia, with a leverage ratio of 2.7 for all MFIs in LA vs. 1.6 for all MFIs in Asia. Higher leverage ratios such as 8 or 10 to 1 are mainly seen, at least in LA, only among the leading MFIs.

**Savings outreach.** We turn next to a little more detail on deposits, which represent both an increasingly important MFI funding source (as we just noted) and an important service to clients in its own right.

Here the story is much the same as with loan outreach. The LA MFIs have far fewer savers but much larger average savings balances. The net result is that the total savings deposited in a typical LA MFI is much greater than the total savings deposited in a typical Asian MFI.

**Efficiency.** Average cost (=operating expense/average loan portfolio) is about 5 percentage points higher in Latin American MFIs than in Asian MFIs—for example, 27% vs. 22% for all MFIs. We know there are economies of scale in the provision of financial services. The greater numbers of loan and savings clients in the Asian MFIs may be having a beneficial impact in this regard since economies of scale in microfinance operate mainly by spreading fixed overhead and central service costs over more clients.

As further proof that economies of scale may really be operating here, look at the number of borrowers per loan officer, which is a measure of the pure productivity of loan officers and is not something much affected by economies of scale. Here the picture is mixed, with LA somewhat ahead if we look at all MFIs and somewhat behind if we look at financially sustainable MFIs. But the differences are not that great in any case—about 50 borrowers per loan officer one way or the other.

However, when we turn to the number of borrowers per staff member (where staff members include all personnel in the MFI), the Asian MFIs are clearly more efficient, despite handling far more savers than the LA MFIs. This greater Asian efficiency may reflect economies of scale in delivering both loan and deposit services. Or it could simply be due to the Asian MFIs' more productive use of its non-lending personnel for reasons other than economies of scale (better management, systems, etc.).

**Loan rates charged.** The last pair of rows in the table show that Latin American MFIs charge 5-8 percentage points more for their loans than the Asian MFIs (both before and after inflation). This effectively compensates for the higher operating expenses of LA MFIs (also about 5% of the loan portfolio).

Thus, the somewhat higher AROA in Asia vis-à-vis LA that we began with must be due to other causes besides differences in operating expenses and interest rates on loans. Leading candidates include greater LA delinquency rates and higher funding costs due to greater reliance on commercial funding sources.

**Conclusions.** All in all, apart from the obvious differences in breadth and depth of outreach—which may be largely attributed to the enormous differences in the 2 markets in the sheer number of microentrepreneurs and in the share of microentrepreneurs who are poor—the Asian and Latin American MFIs have a surprising amount in common:

- Their average costs and loan rates are quite similar, though both are lower in Asia.
- Their overall performance, as measured by AROA and PAR are not terribly different—though Asia is again somewhat ahead.
- And in both regions, deposit taking and leveraging up from capital are fairly incipient phenomena—with Latin America somewhat ahead.

#### IV. Microenterprises Are Important in the Economies of Latin America

Microenterprises are much more important in the economies of Latin America than is sometimes realized. Based on Economic Census and other reasonably reliable data, the microenterprise sector produces about 20% of GDP while micro plus small enterprises produce around 40% of GDP (Table 9). These sectors are not marginal to the economies of Latin America.

**Table 9**  
**Micro and Small Enterprise Share of GDP**

Country	Microenterprise Share (%)	Micro and Small Enterprise Share (%)
Brazil	16	43
Mexico	26	48
Dominican Republic	20	
Bolivia	24	
Peru		42
Belize		39

By extending banking services to the very substantial part of the economy composed of micro or micro plus small enterprises—which frequently lack such services—Latin American countries can obtain growth rate gains that are significant in macroeconomic terms. This assertion is backed up by a large body of Latin American and worldwide evidence that increased usage of banking services is associated with greater economic efficiency and growth. For example, King and Levine (1993) find that a 10 percentage point rise in the ratio of private banking system credit to GDP is associated with an increase in the annual GDP growth rate of about 1/3 of a percentage point. Ghani (1992) finds an even larger growth effect, approximately 2 of a

percentage point. Westley (1994) discusses several channels through which increased intermediation may result in productivity and growth rate gains.

In addition to their importance as engines of economic growth, microenterprises alone account for nearly half of all employment in Latin America (Figure 1). This suggests that extending credit to cash-constrained microenterprises could yield macroeconomically significant employment gains as well.

But we're not talking only of growth and employment benefits when we talk about microfinance. Data for Latin America suggest that microfinance may be important for poverty alleviation as well.

Recently, we analyzed household surveys from the largest 18 Latin American countries. We found that 70% of the poor earners in Latin America are connected with microenterprises—either as employees or owners. In fact, the breakdown is as follows: 35% of the poor earners in Latin America are employees of microenterprises, and another 35% are the owners of microenterprises—in almost all cases the owners of firms without any employees. With 70% of the poor earners connected with microenterprises, if we want to do something about poverty, it clearly behooves us to think about microenterprises.

## **V. Microenterprises Are Poorly-Served by Credit**

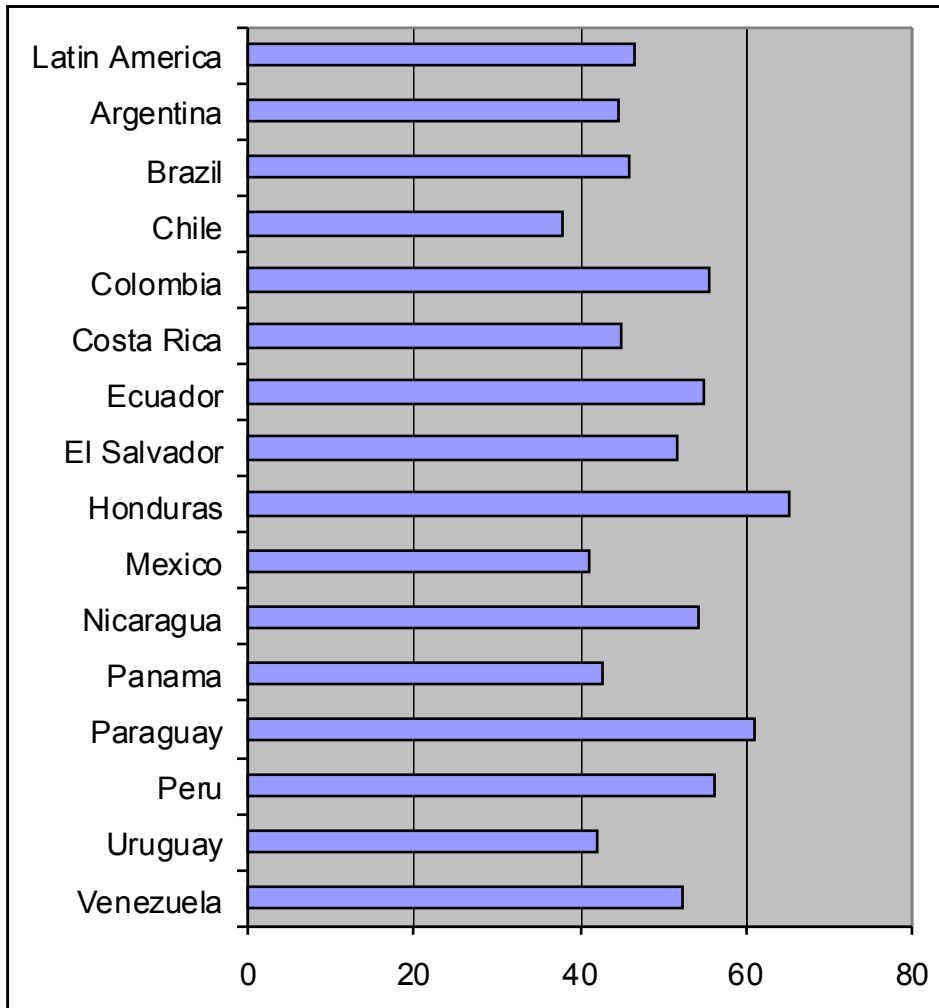
Despite their importance as a motor for growth and employment and as a means for helping to alleviate poverty, microenterprises are poorly served by credit in Latin America.

As we noted earlier, only about 2.6% of microenterprises have credit from an MFI. A slightly smaller percentage have a loan from a credit union. So, a total of only about 5% of microenterprises receive credit from any type of financial institution.

Certainly, this paltry supply of credit from financial institutions is supplemented by informal sources of credit—from relatives and friends, moneylenders, savings clubs, pawnbrokers, supplier credits, and so forth. However, the amounts available and the terms of the loans from such sources can be very limiting, and so the output and employment microenterprises can create can be severely restricted by the resulting credit constraints.

Apart from the small percentage of microenterprises with credit from a financial institution, another piece of evidence that microenterprises are greatly underserved by credit is the fact that they obviously have many high-return projects waiting in the wings, frustrated by lack of finance—as can be readily seen by the very high loan rates routinely paid by microentrepreneurs when MFI credit is finally made available to them. These MFI loan rates are often 20-30 percentage points or more above the country's inflation and deposit rates and are necessitated by the high costs the MFIs incur in extending and collecting these small credits. Despite charging high real loan rates, when good microlending programs are started up, they often attract a huge following. For example, by 1997, Banco Sol in Bolivia was only 10 years old (5 years as an NGO followed by 5 years as a bank) and already served over 1/3 of the total clients of the entire Bolivian banking system.

**Figure 1**  
**Microenterprise Share of Employment, 2002 (%)**  
(from *Panorama Laboral*, 2003, ILO)



In addition to this evidence, surveys of micro and small enterprises almost invariably find that lack of credit is the number 1 or 2 problem faced by these firms (with marketing generally the other most important problem). For example:

- In *Ecuador*, surveys show that the lack of sustained access to finance is by far the biggest problem that microenterprises face, even placing ahead of the problem of selling their goods.
- In surveys of *Honduras* and *Trinidad and Tobago*, marketing is the biggest problem microenterprises face, followed in each case by lack of finance.
- In the *Dominican Republic* a national survey of micro and small enterprises found that 42% of these enterprises would like to have credit and don't, and another 16% aren't sure. (The remaining 42% didn't want credit for a variety of reasons, including the fact that some already had it.) The impact of credit market restrictions extends even beyond this sizable group, however, as there are an unknown number of households that would like to begin their own businesses but don't for lack of credit to finance their start-up or subsequent operations.

## VI. IDB Support to Microfinance

The IDB has supported microenterprise development for more than 25 years through 3 major sources: the Social Entrepreneurship Program (previously called the Small Projects program), the Multilateral Investment Fund (or MIF), and the Global Microenterprise Credit Programs. This support has totalled more than \$830 million during the past 14 years (Table 10). I would like to briefly describe this support and also note our non-financial support to this important sector.

**Table 10**  
**IDB Support to Microfinance: 1990-2003**

<b>Instrument</b>	<b>Amount (US\$ million)</b>	<b>Share of Total (%)</b>
Social Entrepreneurship Program	190.0	23
Multilateral Investment Fund	181.9	22
- Support for financial services	70.6	8
- Loans and equity investments	34.7	4
Global Microenterprise Credit Programs	465.8	56
<b>TOTAL</b>	<b>837.7</b>	<b>100</b>
<i>Source: "IDB Group Support to the Microenterprise Sector (2000-2002): Achievements, Lessons, and Challenges," updated to 2003</i>		

### ***1. Social Entrepreneurship Program***

This program began over 25 years ago under the name “Small Projects Program.” It aims at the lower end of the microfinance market, especially NGOs and credit unions working with lower income microentrepreneurs. It also finances productive enterprises involving low income microentrepreneurs, such as storage and transport facilities for small agricultural cooperatives; credit, technical assistance and marketing help for groups of artisans; assistance to trash recyclers; and many other programs with a high social content.

### ***2. Multilateral Investment Fund***

Here, we have 2 modalities: the MIF line of activity and the regular (or larger) MIF operations. The MIF line of activity allows us to prepare a relatively short document in order to more rapidly meet the needs of individual MFIs or groups of MFIs for up to \$500,000 in technical assistance, generally for institutional strengthening. The larger MIF operations have a more involved approval process but provide more significant amounts of money (often \$1-2 million or more) for strengthening individual MFIs as well as for improving the supporting environment in which the MFIs and their clients operate (better regulation and supervision of microfinance and credit unions, faster and cheaper business formalization for small businesses, improved credit bureaus, reform of secured transactions laws, etc.).

### ***3. Global Microenterprise Credit Programs***

These provide *funds* for onlending to financial intermediaries in the beneficiary country, so that these intermediaries may, in turn, on-lend either to microenterprises (in microenterprise globals) or to all firms (in multisector globals). These operations often also provide *technical assistance* to strengthen the intermediaries in lending to such non-traditional clients as microenterprises. Typically, the financial intermediaries that participate in these Global loan programs must be regulated.

In 1997, for the first time, a Bank Global loan included credit unions among the potential beneficiaries—in the Bank’s 2<sup>nd</sup> Micro Global Loan to Paraguay. The technical assistance funds included in this 2<sup>nd</sup> Micro Global Loan were used to draft prudential regulations for credit unions, which were to come under Central Bank supervision for the first time. Substantial funds were also earmarked in the operation for credit union strengthening in order to help the credit unions meet the Central Bank’s standards.

### ***4. Policy Dialogue and Dissemination of Best Practices***

The IDB also supports microenterprises and the development of the microfinance industry through its policy dialogue and the production and dissemination of best practices studies. In our continuing policy dialogue with the countries, we emphasize the need to attend to the needs of the poor and those who are excluded from financial services.

In relation to best practices, we have recently released a comprehensive manual on best practices in the regulation and supervision of microfinance institutions and credit unions. This is now available in both English and Spanish. We have also recently completed major best practice studies on village banking, microleasing, and the role of apex financial institutions.

Last month the Bank held its 7<sup>th</sup> annual Microenterprise Forum, this time in Cartagena Colombia. With over 1200 participants this year, the Forum has become the premier event in the region for those interested in microfinance and microenterprise development. The Forum features presentations on 4 simultaneous tracks: microfinance, business development services, enabling environment, and social entrepreneurship. Plenary sessions this year included an address by the President of Colombia and the prestigious awards for excellence in Microfinance, BDS, and Social Entrepreneurship, presented by IDB president Enrique Iglesias. The next Forum will take place in Santa Cruz, Bolivia in early October 2005. We hope that you will be able to join us!

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