

Appendixes

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Consultation process during preparation of the strategy

In April 1998 an interdepartmental Task Force on Microfinance at the Asian Development Bank (ADB) prepared an interim action plan on microfinance.¹ The action plan, which was approved by the President in May 1998, recommended preparation of a microfinance development strategy to provide directions for ADB's operations in microfinance. The Task Force concluded that the proposed strategy should be formulated in close consultation with ADB's developing member countries (DMCs), other funding agencies, and external experts on the subject. To facilitate such consultations, the President approved a regional technical assistance in March 1999.²

The consultation process consisted of several steps and covered a wide range of stakeholders.

First, in-country consultations were carried out during May-August 1999 in 12 DMCs (Bangladesh, People's Republic of China, India, Indonesia, Kyrgyz Republic, Nepal, Pakistan, Papua New Guinea, Philippines, Sri Lanka, Vanuatu and Viet Nam) to provide an opportunity for stakeholders in these DMCs to participate in the process of formulating the strategy and to obtain their views on microfinance development issues and initial inputs for the preparation of a draft strategy paper. Over 500 representatives of organizations such as central banks, ministries of finance, commercial banks in public and private sectors, cooperatives, nongovernment organizations, academics, and representatives of other agencies participated in these consultation workshops and meetings and provided valuable initial inputs.

Second, a regional workshop was held during 1-3 September 1999 in Manila to review and discuss the draft strategy paper with a broad group of stakeholders. Forty-six participants from 13 DMCs and 14 representatives of other funding agencies actively participated in the regional workshop. The DMC participants included policy makers, senior staff of central banks, state-owned and private regulated financial institutions providing microfinance services, NGOs and a microfinance

1 ADB. 1998. *Microfinance: An Interim Action Plan*. Manila: ADB.

2 TA 5836: *Consultations on the Bank's Microfinance Strategy*, for \$400,000, approved on 1 March 1999.

rating agency. The regional workshop included long working group sessions in addition to plenary sessions and provided participants the opportunity to concentrate and deliberate on major areas of focus included in the draft strategy paper.³

Third, the draft strategy paper was sent to over 40 external experts and organizations, such as the World Bank, the Consultative Group to Assist the Poorest, and a number of bilateral aid agencies for review and comments. In addition, the draft was placed on a web site for review and comments by any interested parties.

Internally, the draft strategy paper was circulated to the task force members and other concerned departments and offices for review and comments. The paper also benefited extensively from the work carried out in ADB's recently completed Rural Asia Study.⁴

3 ADB. 2000. *Toward an ADB Microfinance Development Strategy*. Manila: ADB.

4 ADB. 2000. *Rural Asia Study: Beyond the Green Revolution*. Manila: ADB.

Self-finance: advantages and disadvantages

Ronald McKinnon defined self-finance “as the investment within a particular enterprise (or economic unit) of savings accumulated in that enterprise.”¹ Self-finance takes place in all types of households and enterprises, from rich to poor people, and from microenterprises to the very large-scale multinational firms. However, among the poor in virtually all developing countries, self-finance is the dominant, or sole form of financing their investments. Financing from outside the household or enterprise is either unavailable or extremely limited for the poor for lack of collateral demanded by commercial banks and high transaction costs associated with borrowing from such formal sources.

Self-finance has some advantages and disadvantages.

- The main “advantage of self-finance is that, in combining the acts of saving and investing, it internalizes all the information, transaction, monitoring, and enforcement costs that would be involved if the resources were lent to someone else. No complex contracts, collateral, or other devices are required to reduce the risks inherent in lending.”²
- The main disadvantage of self-finance is that a household’s or enterprise’s resources may not match those required to harness an investment opportunity within a reasonable time frame. Thus, a household or an enterprise may not be able to take advantage of a high-productivity investment opportunity. The scale of an economic activity or an enterprise will have to be limited by the amount of self-finance.
- The shortcomings of self-finance will be more pronounced when investments are characterized by indivisibilities. A poor household may require funds to buy cattle, a sewing machine, or a bag of fertilizer. The amount of funds required may be large relative to the income of a household living at subsistence level. Hence, the

1 McKinnon, R.I. 1973. *Money and Capital in Economic Development*. The Brookings Institution: Washington DC. p. 30.

2 World Bank. 1989. “World Development Report.” World Bank: Washington DC. p.29

household may not be able to finance the investment in one lump sum but may be able to do so in installments. Poor household that is not able to self-finance discrete increases in investments will be compelled to use traditional technology and continue with low-productivity activities. Thus, McKinnon noted that

poverty and the inability to borrow can be formidable barriers to the adoption of even the simplest and most productive innovations. The important point, however, is the virtual impossibility of a poor farmer's financing from his current savings the whole of the balanced investment needed to adopt the new technology. Access to external financial resources is likely to be necessary over the one or two years when the change takes place. Without this access, the constraint of self-finance sharply biases investment strategy toward marginal variations within the traditional technology.³

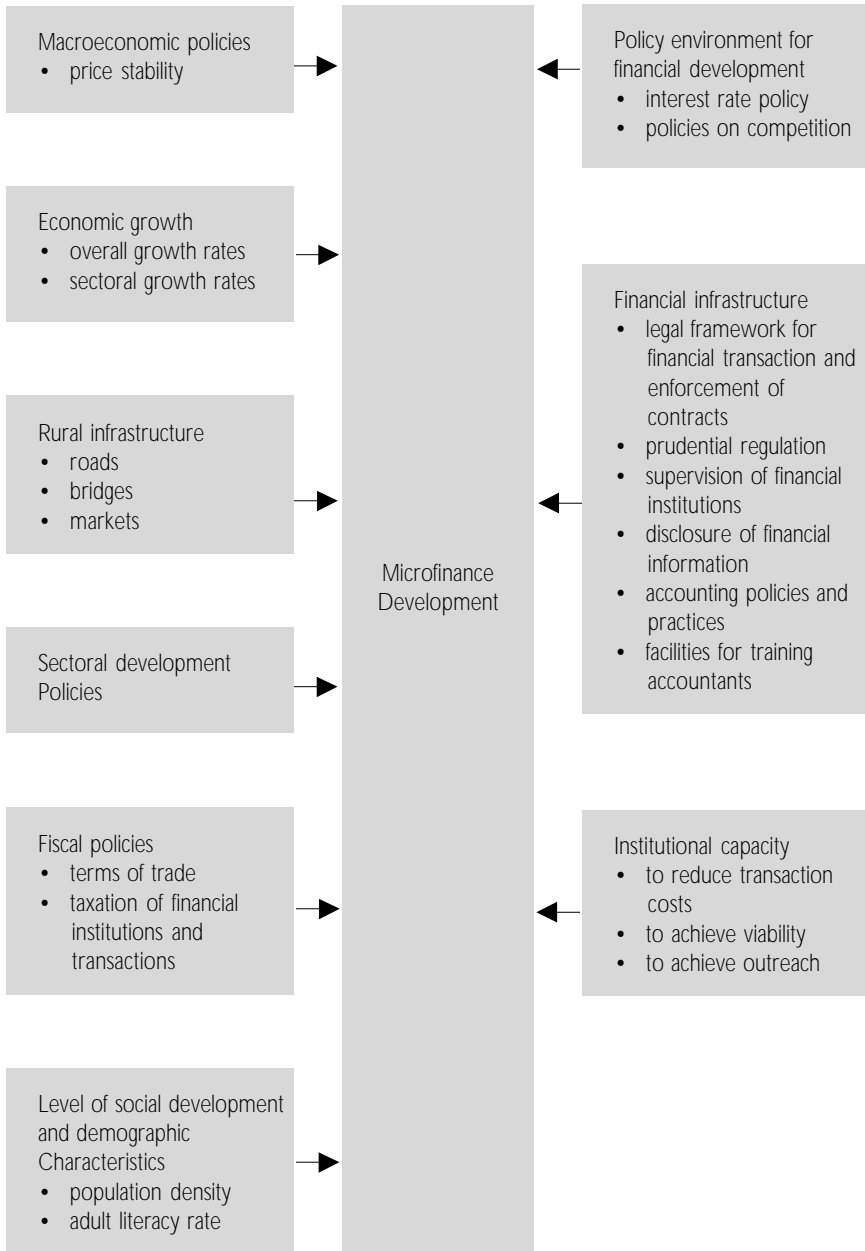
Self-finance limits specialization, adoption of better technology, growth in productivity, and thus economic growth and development.

3 McKinnon, R.I. 1973. *Money and Capital in Economic Development*. p.13

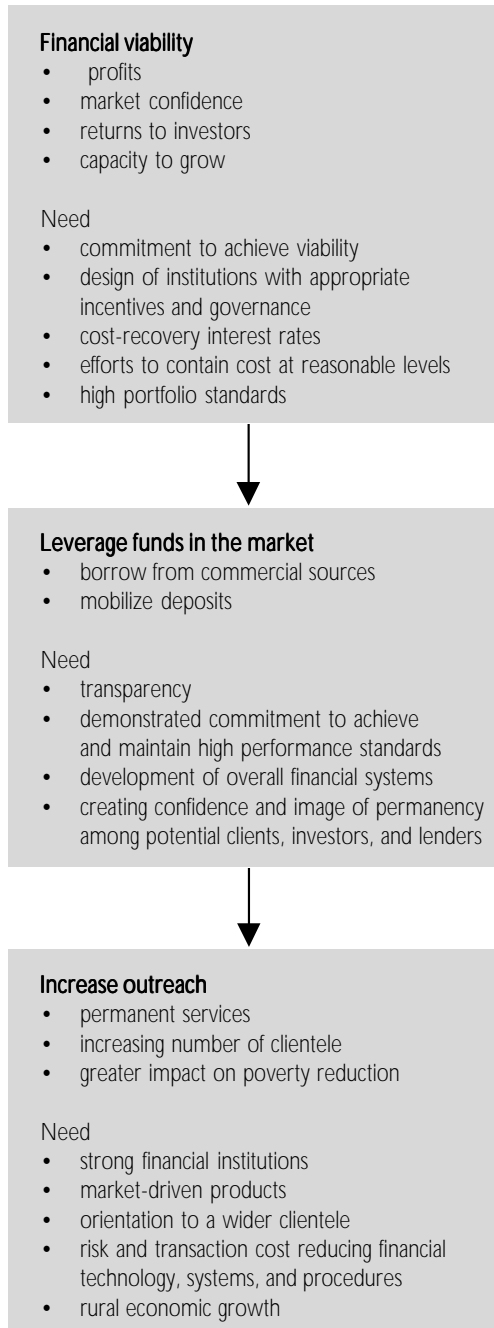
Demand for microfinance: structure and characteristics

Sources of demand	Products and services and characteristics of demand
Households Poorest (Rural and Urban)	<p>convenient access to safe and liquid deposit services</p> <p>passbook savings with unlimited withdrawal facility</p> <p>strong demand for consumption and emergency loans with no collateral</p> <p>small size loans for livelihood activities</p> <p>occasional loans to finance lumpy expenditures such as school fees</p> <p>service outlets at close proximity</p> <p>simple procedures</p> <p>low transaction costs</p>
Poor (Rural and Urban)	<p>convenient access to safe, liquid deposit facilities</p> <p>return on savings</p> <p>passbook savings with easy withdrawal facilities</p> <p>term deposits with small denominations and regular interest payments</p> <p>money transfer services, payment services</p> <p>insurance services for livestock</p> <p>consumption and emergency loans</p> <p>small loans for livelihood activities</p> <p>loans to finance lumpy expenditures</p> <p>low transaction costs</p>
Enterprises Microfarms (Rural)	<p>small loans for working capital (fertilizer, seeds)</p> <p>small loans for fixed capital (purchase of simple tools, land improvements, etc.)</p> <p>below informal market interest rates</p> <p>easy access and minimal transaction costs</p> <p>seasonal demand</p> <p>deposit facilities (safe, liquid, convenient)</p> <p>return on deposits</p>
Fisheries, Livestock and Poultry (Mainly Rural)	<p>working capital loans for feed</p> <p>fixed capital loans (for tools, purchase of chicks)</p> <p>small loan size</p> <p>substantial demand from livestock sector</p> <p>deposit services (safe, liquid, convenient)</p> <p>insurance services</p>
Nonfarm (Rural and Urban)	<p>deposit services (safe, liquid, and convenient)</p> <p>money transfer, payment services</p> <p>insurance and leasing services</p> <p>a wide range of enterprises</p> <p>demand for loan is not seasonal</p> <p>demand is large for working capital loans</p> <p>relatively large loans within the confines of microcredit</p> <p>minimal transaction costs and easy access</p>

Determinants of microfinance development



Viability-outreach relationship



Microfinance operations of other multilateral development banks

The World Bank

The World Bank has paid increasing attention to microfinance operations in recent years. The World Bank's microfinance portfolio from FY1991- FY1996 included 55 projects, with a total investment of \$713.0 million. The number of projects approved with microfinance activities grew from 6 in 1995 to 12 in 1996 for a total of \$88.0 million, indicating the growing interest. In 1997, the World Bank approved a loan of \$105 million for Bangladesh to support an apex microfinance institution (MFI). A similar microfinance loan of \$90.0 million was approved for Pakistan in 1999. The World Bank is recently showing a high level of interest in microfinance operations in very poor countries in Africa, Europe, and Central Asia.

The World Bank uses lending and nonlending modalities to support microfinance operations. The nonlending modalities include (i) technical assistance, (ii) policy dialogues, (iii) grants for pilot operations, and (iv) economic and sector work. The World Bank is also emphasizing the role of coordination among funding agencies through the Consultative Group to Assist the Poorest (CGAP).

In 1997, the CGAP reviewed the World Bank's microfinance operations, and made five strategic recommendations to improve its microfinance operations: (i) strengthen the experience and skills of staff working on microfinance; (ii) improve coordination and product development within the World Bank Group; (iii) coordinate with other funders experienced in microfinance; (iv) consider new instruments and procedures for microfinance; and (v) develop a World Bank strategy for microfinance. The CGAP also recommended that the World Bank's microfinance strategy "focus on borrower countries with appropriate financial sector policies, strong demand, and a commitment to long-term financial sustainability of retail microfinance institutions." In addition, the CGAP recommended that country departments and regions develop more coherent approaches to microfinance.¹

1 The World Bank. 1987. *A Review of the World Bank's Microfinance Portfolio FY91-FY96*, The World Bank. Washington DC. p. iv.

The World Bank is making an effort to move away from lines of credit as the primary instrument of its microfinance operations, shifting the focus to the fundamental policy framework and well-performing institutions. The World Bank also recognizes that development of a flexible enabling environment is critical to avoid overregulating MFIs. Institution-building efforts of the World Bank focus on helping MFIs develop sound commercial operations and increase outreach and sustainability. To improve the quality of its microfinance assistance, among other things, in September 1997 the World Bank created the Small Enterprise Development Unit in the Private Sector Development Department. The unit's goal is to be a center of expertise in small- and medium-scale enterprise development, microenterprise development, and microfinance.

The Inter-American Development Bank

The Inter-American Development Bank (IADB) is a pioneer and leader in microfinance and microenterprise development. IADB's support for microfinance began with the Small Projects Program in the late 1970s, and has steadily increased since that time. In recent years the microenterprise sector has constituted a significant growth area for IADB. Between 1990 and 1996, IADB approved 471 microenterprise operations totaling \$452.0 million.² IADB estimates that its microenterprise programs have reached over 600,000 microentrepreneurs, and have created and strengthened over 1.8 million employment opportunities.

To respond more effectively to the changes in the microenterprise sector, IADB prepared a microenterprise development strategy in 1997. The strategy focuses on promoting the conditions necessary for the growth and development of microenterprises in Latin America and the Caribbean. IADB launched a five-year program, MICRO 2001, to implement the strategy. This program is expected to promote policy and regulatory reform to create an enabling environment for microenterprise development on a sustainable basis. During the five years of implementation, IADB expects to increase its investments in microenterprise development to about \$500 million.³ IADB will also

² IADB. 1987. *Microenterprise Development Strategy*, IADB: Washington DC. p. 2.

³ This amount includes equity investments, loans, and TA from the Multilateral Investment Fund (a special fund established in 1992 to support new programs, innovations, and activities with demonstration value throughout Latin America and the Caribbean). The fund gives special attention to the development of small enterprises in the region.

make a concerted effort to catalyze private and other resources to microenterprise development in the region. The Microenterprise Unit in IADB's Department of Social Programs and Sustainable Development is responsible for coordinating and monitoring the MICRO 2001 program.

In 1998, IADB, with grant assistance from the Government of Norway, established the Norwegian Fund for Microenterprise Development. The purpose of this fund is to support IADB in strengthening the implementation of the microenterprise development strategy. The resources in the fund may be used, among other things, to (i) meet cost of workshops, publications, and related activities; (ii) provide technical assistance to local organizations for development of microenterprise development projects; (iii) finance activities that directly or indirectly support institutional strengthening of local organizations involved in microenterprise development; and (iv) finance applied research and information gathering and dissemination, especially best practices, that will benefit local organizations working on microenterprise development.

The African Development Bank

The African Development Bank (AfDB) has recognized the importance of microfinance for poverty reduction in recent years. To address the problems posed by the lack of access to financial services by microentrepreneurs, especially women, AfDB established a pilot program, the African Development Fund Microfinance Initiative for Africa (AMINA), in 1997. AMINA assists a wide range of MFIs including national and international nongovernment organizations to build the capacity needed to manage a growing financial services program oriented to the poor, help them acquire needed equipment, and obtain funds for on-lending to support the expanding portfolio that their additional organizational and technical capacity will make possible. AMINA focuses on capacity building because the strengthening of MFIs is crucial to their ability to expand the outreach and to limit the risks involved in their lending. AMINA provides funds for on-lending by MFIs that have demonstrated their ability to manage on-lending operations.