SEEP Research

Keeping an Edge

What Will It Take in the Current Microfinance Context?

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October 2013

seep Powering connections

Citi Microfinance

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Table of Contents

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The following associations completed the survey and shared their experiences for this report:

Africa Microfinance Network (AFMIN)

Associação Brasileira de Entidades Operadoras de Microcrédito e Microfinanças (ABCRED)

Associação Brasileira das Sociedades de Crédito ao Microempreendedor e à Empresa de Pequeno Porte (ABSCM)

Asociación de Instituciones de Microfinanzas del Perú (ASOMIF)

Asosciación de Organizaciones de Microfinanzas (ASOMI) - El Salvador

Association Nationale de Institution de Microfinance d'Haiti (ANIMH)

Association of Development and Support of Microfinance Organizations of Georgia

Association of Microfinance Institutions in Rwanda (AMIR)

Association of Microfinance Institutions of Kosovo (AMIK)

Association of Microfinance Institutions of Uganda (AMFIU)

Association of Microfinance Institutions–Kenya (AMFI)

Association of Microfinance Organizations of Kazakhstan (AMFOK)

Association of Microfinance Organizations of Tajikistan (AMFOT)

Association Professionnelle des Coopératives d'Epargne et de Crédit (APROCEC) - Democratic Republic of Congo

Association Professionnelle des Systèmes Financiers Décentralisés du Burkina Faso (APSFD-BF)

Azerbaijan Micro-finance Association (AMFA)

Cambodia Microfinance Association (CMA)

China Association of Microfinance (CAM)

Consorcio PROMUC - Peru

Consortium Alafia - Benin

Consorcio de Organizaciones Privadas de Promoción al Desarrollo de la Pequeña y Microempresa (COPEME) - Peru

Credit and Development Forum (CDF) - Bangladesh

Ghana Microfinance Institutions Network (GHAMFIN)

Microfinance Institutions Network (MFIN) - India

Microfinance Centre (MFC)

Microfinance Working Group for Lao PDR

National Partnership of Microfinance Market Shareholders (NAMMS) - Russia

Organismo Cooperativo Microempresarial de Colombia "EMPRENDER"

Pakistan Microfinance Network (PMN)

ProDesarollo Finanzas y Microempresa - Mexico

Red Accion

Red Centroamericana y del Caribe de Microfinanzas (REDCAMIF)

Red de Microfinanzas de Honduras (REDMICROH)

Red de Microfinanzas del Paraguay

Red Financiera Rural (RFR) - Ecuador

Red Dominicana de Microfinanzas (REDOMIF)

Sa-Dhan, The Association of Community Development Finance Institutions - India

Union of Credit Organizations of Republic of Armenia (UCORA)

Zimbabwe Association of Microfinance Institutions (ZAMFI)

Foreword

— *Sharon D'Onofrio, Executive Director, The SEEP Network*

We are at a transformative point in the evolution of the microfinance sector. Governments around the world are embracing the mandate of financial inclusion. Technological innovations are creating new efficiencies and present immeasurable opportunities to extend services to new markets. These developments, among others, are attracting a broader range of providers that will undoubtedly alter the financial landscape. This evolution prompts us to reflect about the future role of microfinance institutions and the degree to which they can respond to the emerging opportunities and challenges. While few dispute the pioneering contributions of MFIs and their member organizations to financial inclusion over the last decade and more, concern over their level of preparedness is well justified.

We are pleased to present "Keeping an Edge: What will It Take in the Current Microfinance Context." The information contained in this report represents the collective insights of 39 microfinance association leaders from 33 countries across Africa, Latin America, Eastern Europe, and Asia. These associations are member-based organizations, representing a broad spectrum of financial service providers serving the bottom of the pyramid. As seen by the report's title, we began with a question: *What will it take*? Our research sought not only to answer the question but, perhaps more importantly, to assess the degree to which industry representatives were asking this question of themselves.

Our aim with this study is to prompt meaningful deliberation about the role of MFIs in this changing landscape. We believe inquiry and debate are the source of new knowledge and fundamental to improving practice. The SEEP Network is not excluded from this line of questioning. Having served the sector for nearly three decades, we have witnessed the maturing of the industry. This process implies an evolution of roles, for SEEP itself and its members. The findings from this study clearly point to the need for a strategy embedded in partnerships. New business models capable of harnessing technology and delivering value-added products at greater scale will be a product of collaboration. This will include commercial banks, mobile network operators, agents, insurance companies, and others.

Microfinance associations, in particular, are uniquely positioned to facilitate these connections. Associations can, based on their deep knowledge and understanding, disseminate information about the market and its participants, identify incentives for market actors to take on new risks, and help build the capacity of local provider ecosystems. We view this market development role as essential to serving the needs of the industry and ensuring the future contribution of MFIs to the financial inclusion agenda in the years to come. We look forward to working alongside our members to seize these important opportunities.

In closing, we would like to express our sincere gratitude to Citi Microfinance for its essential leadership in this effort and for its partnership with SEEP. Philip Brown, managing director of Citi Microfinance, helped set the project's vision. Deborah Drake at the Council of Microfinance Equity Funds provided equally valuable support and guidance. Finally, I would like to congratulate the SEEP team and their collaborators within our membership on their efforts and extraordinary commitment.

Sponsor's Foreword

— Philip Brown, Managing Director, Citi Microfinance

The "Keeping an Edge" title and the results of this survey address some of the strategic challenges faced by SEEP, its member associations, and their MFI members. They evince a level of awareness and forward thinking that keeps them relevant to members and clients as the sector evolves. Microfinance is a financial services business. The trends listed are not new and can be seen in the long history of evolution and adaptation of the financial services industry. A record of continuity and change within regulatory boundaries continues to result in consolidation and the emergence of new and evolved business models in the face of new entrants.

The report highlights two separate and interconnected trends: a focus on diversified client needs and the importance of harnessing new technologies. Technology is key to the provision of the efficient and client-centric distribution channels required to appropriately reach underserved communities. Technology is also paramount to the collection of client data, analytics, and segmentation required to understand and to tailor product offerings to microfinance clients. Regardless of the business model and constitutive form of MFIs, clients and client outreach are at the center. Technology and partnerships with the broader financial sector and other service providers are enablers accelerating outreach and financial inclusion.

The leading microfinance service providers have become an integral part of the formal financial sector. In some markets, they have been categorized as being systemically important. For example, it is estimated that, as of May, 2013, loans to microcompanies and small enterprises represented 18% of the Peruvian financial system's total lending. Hence, the challenges facing microfinance providers are no longer isolated or exclusive to this sector. Associations are becoming more integrated into the formal financial ecosystem, which can take different forms from the sponsorship of credit bureaus to the promotion of sector funding to possible inclusion of non-MFI entrants into their membership.

Citi Microfinance is pleased to sponsor this survey as microfinance associations have played a lynchpin role in building the capacity and outreach of the microfinance sector. This survey looks at the landscape from their perspective. We are grateful to the 39 associations from 33 countries and 4 regions, representing MFIs serving 90 million clients, who contributed to this survey. We congratulate the SEEP team and especially Diana Dezso and Mariana Marinho for moving this survey from concept to report.

While the survey results are important, the value of this report will be determined by the extent to which it fosters continued engagement of the SEEP membership in the debate on strategic challenges and encourages associations to reflect upon their existing and future roles. This may stimulate greater dialogue with local banking networks and associations around common issues to the potential benefit of all financial service providers.

Executive Summary

The findings reviewed in this study are a contribution to the current debate on the development and future of the industry, fueled by a number of challenges and downturns that have affected the industry in the past few years: over-indebtedness crises and political backlash in several countries, more limited availability of donor funding for the sector, and a perceived mission drift from its original social roots. In this context, two key questions emerge: can microfinance institutions stay relevant and, if so, in what shape and form?

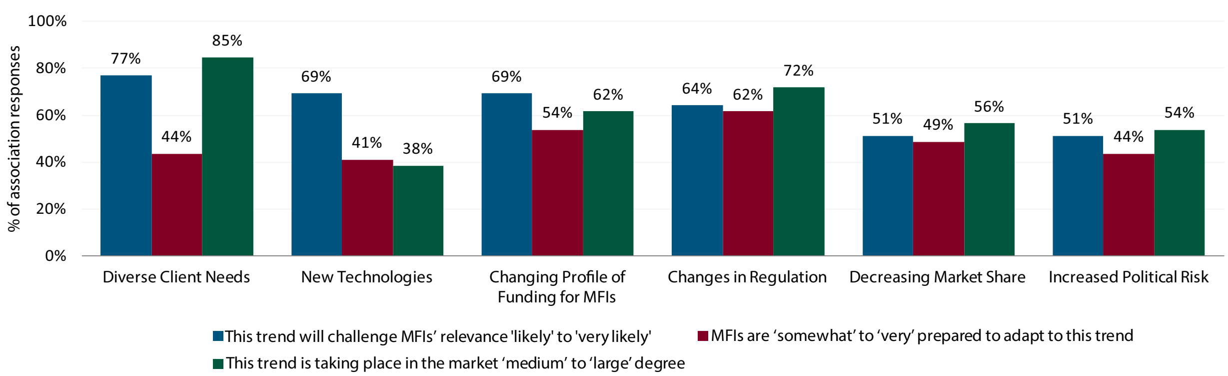
This study analyzes the most consequential trends in the microfinance industry that affect MFIs' ability to execute their strategies, achieve their business objectives, and build and protect their value. It offers a multi-country perspective gleaned from the experience of 39 association leaders from 33 countries in 4 regions: Africa (23%), Asia (18%), Eastern Europe and Central Asia (21%), and Latin America (38%). These associations represent 3,730 microfinance institutions, serving 90 million clients with approximately US$ 63 billion in loans and US $14 billion in deposits. The study emphasizes where associations see maximum impact and influence in the market, and how their members respond (or not).

Microfinance associations were generally aware of and agreed on six key trends affecting the industry:

1. Clients' increasingly diverse needs
2. Emergence of new technologies
3. Evolving profile of funding available for microfinance
4. Changes in financial regulation
5. Decreasing market share
6. Greater political interference

The associations looked at the trends in three different dimensions: 1) how likely they thought the trends will impact MFIs' ability to remain relevant, given the current business model (relevance); 2) how prepared they believed MFIs are to adapt to the trends (preparedness); and 3) how extensively they estimated each trend is already present in the market (prevalence).

Figure 1. Key Trends: Relevance, Preparedness, Prevalence



Of the six trends identified in this study, our analysis reveals that MFIs' most critical challenges stem from two fundamental issues facing the industry today: what the clients really need and how MFIs can leverage technological innovations to better provide services. This conclusion is based on the associations' responses that, in these two instances, MFIs have the largest gap between the trends' challenge to MFIs' relevancy and MFIs' level of preparedness to deal with them. In short, the larger the trend's impact and the lower the MFI preparedness, the bigger the concern. Moreover, the degree of the prevalence of these two issues in the market adds an important dimension of urgency to the discussion, intensifying the need for stakeholders to ensure that the industry as a whole is able to adapt.

An overwhelming 85% of associations indicated that clients are increasingly demanding a wider range of financial services in their markets, which poses significant challenges to MFIs' relevancy. The study also showed a lower degree of prevalence of new technologies in markets (38%), suggesting that most MFIs are not taking enough advantage of the potential of technologies to improve service delivery and scope of products, despite the activities most report are ongoing. Over half of the associations found that their members are not adequately prepared in both these areas, warranting concern that the potential negative impact of not adapting to these two trends may be significant and may alter the balance of how MFIs perform.

While associations also indicated a lower level of MFI preparedness to respond to the challenges of decreasing market share and rising political interference, these two trends did not seem to threaten MFIs' relevance as severely and their prevalence in the markets is lower. In the case of changes in sources and availability of funding as well as changes in regulation, more than half of the association leaders felt their members were better prepared to address them.

Associations also commented on strategic risks MFIs will face within the next 18–24 months, which could significantly impact MFIs' position in the market. In our survey, respondent associations specifically identified credit risk as the top risk, which may result from MFIs' limited capability to effectively identify areas of underserved demand, aggressive strategies to overserve certain segments, and responses to stiff competition from new entrants and saturated markets. Several associations mentioned the range of operational risks their members are exposed to, from lacking relevant credit management and accounting skills to managing high staff turnovers to simply not having the institutional strength and depth to deal with changing market demands and regulatory requirements.

Association leaders mentioned a number of strategies already employed by MFIs that simultaneously address the different issues described earlier: client-centric approaches (such as client segmentation, product diversification, expansion into new geographic areas), innovative partnerships, and development and implementation of supportive internal infrastructure. These are strong indications that associations believe many in the sector understand the complexity and interlinking of the six trends and perceive the necessity of responding to them. However, the ability of MFIs to respond quickly to market trends and challenges and the ability of associations to provide members with the most essential services to support them, remain important concerns.

Associations pointed to specific activities that they offer to help members with overarching challenges, notably policy advocacy for enabling financial regulations and a more favorable business environment, promotion of responsible finance practices and client protection programs, and facilitation of access to funding for their members. Despite the associations' energetic support of their members, many of their activities—with a few exceptions—do not seem fully aligned with helping MFIs deal with clients' diverse needs and the new technologies. This suggests that the associations also perhaps need to recalibrate and reprioritize what they are offering to their members.

Overall, microfinance associations observed that MFIs must seriously reflect on their business models and rethink their strategies in view of adopting more client-focused approaches. There is a growing consensus that MFIs need to diversify the products they offer and need to do it fast, not only to fend off competition, but also to be able to cater to a wider market and expand, and ultimately better withstand shocks and economic forces.

Table 1a. Summary of Association Responses

Key market trends and their impact on MFIs' relevance, MFIs' capacity to adapt, and trends' prevalence in the market

Market Trends	RELEVANCE Will this trend challenge MFIs' ability to remain relevant, given their current business model and capacity level? Very likely to likely	PREPAREDNESS How prepared are MFIs to adapt to this trend?Very to somewhat prepared Very to somewhat prepared	PREVALENCE To what degree is this trend taking place in your market? Large to medium degree
Clients' increasingly diverse needs			
Clients have increased demand for a wider range of financial services, many of which are not currently provided by the majority of MFIs. These may include insurance, remittances, savings, specialized loan products (such as for healthcare, water, and sanitation, etc.).	77%	44%	85%
Emergence of new technologies			
New technology is affecting how products are delivered and how banking is done. These include mobile pay-ments, biometric identifica-tion devices, new IT platforms, etc.	69%	41%	38%
Evolving profile of funding available for MFIs			
MFI funding sources and types of available funding are changing. Debt and equity fund-ing are still available, however generally in lower amounts for MFIs. There is an increased expectation that MFIs will be able to fund more of their operations from other sources, such as retained earnings and deposit mobilization (if permitted).	69%	54%	62%
Changes in financial regulation			
Changes in regulation and industry infrastruc-ture are affecting how MFIs operate. These may include new or changed microfinance regula-tions and supervision, new regulatory bodies, adoption of national financial inclusion strategy, etc.	64%	62%	72%
Decreasing Market Share			
New entrants seeking large scale deployment are providing financial services to a rapidly increasing number of clients, making significant gains in market share. These include consumer lenders, downscaling by commercial banks, mobile network operators, utility companies.	51%	49%	56%
Greater political interference			
MFIs are exposed to increased political interfer-ence, such as government propaganda that encourages clients not to repay loans, creation of interest-free/low interest loan funds, interest rate caps, etc.	51%	44%	54%

More Less

Table 1b. Summary of Association Responses

Actions taken by MFIs and MFAs in response to key market trends

<table>
<tr><th>What steps are MFIs taking to respond to these market changes?</th><th>What actions are associations taking to support members to respond to these market trends?</th></tr>
<tr><td>Clients' increasingly diverse needs

In most markets, there is some degree of product diversification, market segmentation, and geographic expansion. Around 60% of MFAs noted that some to most MFIs in their markets are expanding their product suite, while 25% of MFAs have seen few providers with new products. Fewer MFIs, however, are improving their market assessment practices or looking into innovative partnerships to meet client needs.</td><td rowspan="6">Policy Advocacy
Stakeholder meetings to discuss important industry issues; analysis and feedback on new regulation; lobbying for effective regulation.

Promoting Responsible Finance
Market information and financial transparency; implementation of consumer protection; financial education; social performance standards; codes of ethics.

Facilitation of access to funding
Meetings with potential investors; technical assistance to members seeking investors and becoming "investment-ready"; advocacy for the development of guarantee mechanisms; identification and attraction of special-purpose public funding (given the significant decline in donor funding).

New product development
Capacity building of members to appropriately respond to the needs of their clients; identification of products and services that can be provided using mobile technologies; facilitation of stakeholder collaborations and partnerships.

Promotion of new technologies
Researching the feasibility of mobile banking and e-money within their markets; facilitating partnerships; negotiating technology solutions on behalf of members.</td></tr>
<tr><td>Emergence of new technologies

66% of MFAs identified that few to some of their members are adopting technology for service delivery and are exploring innovative partnerships in this area. Mostly MFAs are seeing MFIs adopt technology to improve internal operations. Only a few MFIs have started training clients in technologies.</td></tr>
<tr><td>Evolving profile of funding available for MFIs

54% of MFAs reported that MFIs in their markets are building more equity. Advocacy for credit guarantee options and institutional transformations are measures taken by some MFIs members in 44% of MFAs. Only 18% of MFAs revealed that most MFI members are looking into deposit mobilization when permitted. Another 43% of MFAs mentioned that few to some of their members are exploring this possibility.</td></tr>
<tr><td>Changes in financial regulation

Over half of MFAs reported that many MFIs in their markets are developing reporting systems, changing internal operations for data collection, and working with the association on the issue.</td></tr>
<tr><td>Decreasing Market Share

Over 40% of MFAs indicated that many MFIs are diversifying their products, segmenting their clients, and changing process and accessibility to products. Some MFIs are exploring innovative partnerships, while few MFIs in 50% of the markets are merging with other providers.</td></tr>
<tr><td>Greater political interference

Almost 70% of the MFAs mentioned that some to most of member MFIs are working with the association and improving client protection practices to mitigate political risk. 54% of the MFAs indicated that many MFIs are involved in proactive engagement with government and regulators.</td></tr>
</table>

Introduction

The context in which the microfinance industry operates now challenges even the most experienced service providers. As microfinance institutions worldwide become integrated within formal financial systems, they reap such benefits as access to diverse funding sources and improved oversight and supervision by regulators. With integration, however, also comes vulnerability in this increasingly complex financial landscape: MFIs are less insulated from business and economic changes, they are more subject to government scrutiny, and they face increased competition from other financial and non-financial institutions entering the market. The 2012 Microfinance Banana Skins[1] report questioned the microfinance industry's capacity to remain relevant in the currently evolving economic and regulatory environment, prompting the industry to examine the ability of microfinance service providers to understand and adapt to these trends.

Primary Focus of Survey

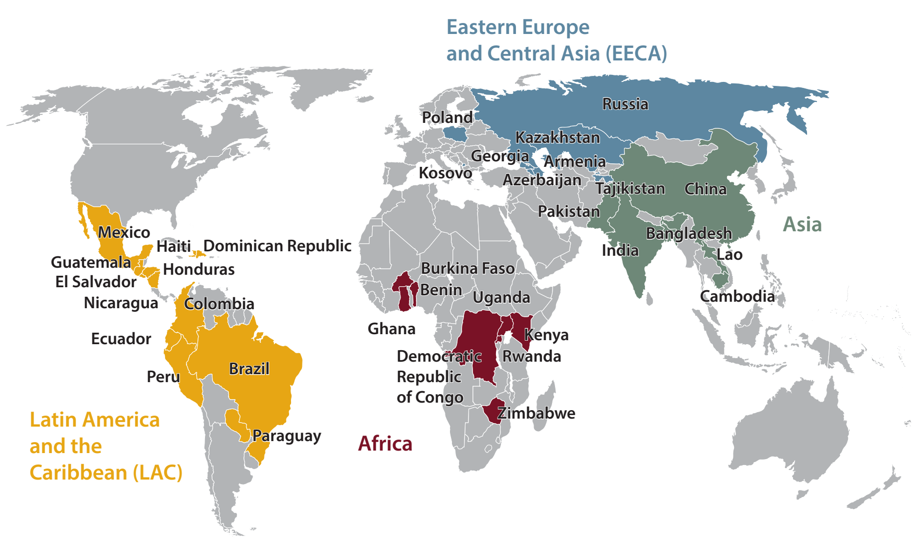
- Analysis of six key market trends (in terms of their impact on MFIs' relevance, MFIs' capacity to adapt, and prevalence in the market):
    1. Clients' increasingly diverse needs
    2. Emergence of new technologies
    3. Evolving profile of funding
    4. Changes in financial regulation
    5. Decreasing market share
    6. Greater political interference
- Analysis of strategic risks faced by MFIs
- Local market responses to trends and risks:
    - MFI level
    - Association level

Within this context, the SEEP Network, in partnership with Citi Microfinance and the Council of Microfinance Equity Funds, set out to explore the issues of perception and adaptability of microfinance providers in the changing financial services landscape, as seen through the eyes of microfinance associations around the world. To this end, SEEP surveyed microfinance association leaders about dominant trends and their potentially transformative effect on the industry and MFIs, in particular, MFI's ability to execute their strategy, achieve their business objective, and build and protect their value. The survey (annex 1) also asked association leaders to describe strategies used by their organizations and member MFIs to respond to market trends.

The report builds on existing studies and aims to contribute to the analysis of industry trends by offering a multi-country perspective gleaned from the experience of **39 association leaders from 33 countries in 4 regions**: Africa (23%), Asia (18%), Eastern Europe and Central Asia (21%) and Latin America (38%). These associations represent **3,730 microfinance institutions, serving 90 million clients with approximately US$ 63 billion in loans and US$ 14 billion in deposits**. The study emphasizes where associations see maximum impact and influence in the market, and how their members respond (or not). Associations are local member-based institutions and form a critical part of the financial ecosystem. They have a front-line view of market development through direct connections to their members, while also playing active roles in policy advocacy, relations with funders, and reporting on and interpreting industry performance. They represent a broad range of institutions serving the base of the pyramid, such as credit cooperatives, microfinance banks, non-profit organizations offering financial services, etc.

The report is structured in three main parts. The first section discusses the overall market context and presents the trends and risks identified as most prominent by microfinance associations. It discusses the ability of MFIs to stay relevant by analyzing how well prepared they are—in the view of their associations—to meet the trends and adapt accordingly. The second section describes the actions microfinance associations and MFIs took in response to these trends. Finally, a regional analysis adds perspective on the differences—and similarities—in views and insights across the four regions studied.

Figure 2. Location of MFAs surveyed, by region



1. Centre for the Study of Financial Innovation, *Microfinance Banana Skins 2012: Staying relevant* http://www.citi.com/citi/microfinance/data/news120628.pdf

I. Overall Market Context

1. Key market trends and their implications

To provide an in-depth perspective on the current business environment in which financial service providers operate across the world, we asked microfinance associations to rate six key market trends in the financial services sector that were most likely to affect how MFIs do business:

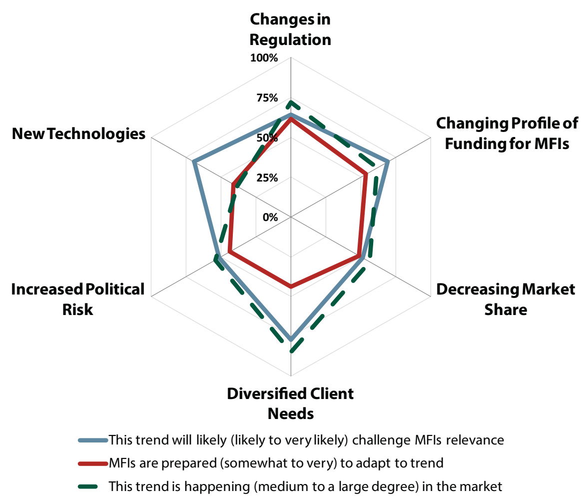
- Clients' increasingly diverse needs
- Emergence of new technologies
- Changing profile of funding available for microfinance institutions
- Changes in financial regulation
- Decreasing market share
- Greater political interference

Figure 3 illustrates associations' responses to these questions by market trend.

The most critical trends are those for which associations' responses indicate the largest gap between the trends' impact on MFIs' ability to stay relevant and the MFIs' preparedness to counter them. The degree of the trends' prevalence in the market adds an important dimension of urgency to the discussion. For most trends, a higher prevalence in the market means a greater need to ensure that the industry is prepared to adapt to the trend more quickly. With the emergence of new technologies, however, a high prevalence in the market is desirable as it means a large number of MFIs are using technology innovations to improve service delivery. Through this lens, our analysis reveals that MFIs' most critical challenges revolve around two fundamental issues facing the industry today: **what the clients really need and how MFIs can leverage technological innovations to better provide services**.

Figure 3. Market Trends: Relevance, Preparedness, Prevalence

(% of microfinance association responses)



1.1 Clients' increasingly diverse needs

Clients' increasingly diverse needs

Clients are making increased demands for a wider range of financial services, many of which are not currently provided by the majority of MFIs, such as insurance, remittances, savings, and specialized loan products for healthcare, water, and sanitation, etc.

- 77% of associations indicated that this trend will very likely to likely challenge MFI relevancy.
- Only 44% of associations reported that their members are very to somewhat prepared to address this trend.
- 85% of associations noted that this trend is present in their markets to a large to medium degree.

The landscape is changing for MFIs. Their traditional role as a provider of pure credit is generally accepted as no longer adequate for meeting the needs of their target markets. This finding is also in line with the overarching changes in the microfinance industry,[2] as identified in *The New Microfinance Handbook*, specifically the growing focus on clients and the broader range of considerations around client behavior, needs, and preferences.

A large majority of the associations (77%) identified clients' growing diverse needs as most likely to challenge the industry's relevancy: to some extent, it is already a reality in their markets. To aggravate this scenario, over half of the associations believe that MFIs are not adequately prepared to meet the challenges of this trend. Yaw Gyamfi, executive director of Ghana Microfinance Institutions Network

2. Joanna Ledgerwood, ed. (with Julie Earne and Candace Nelson), *The New Microfinance Handbook: A Financial Market System Perspective* (Washington, DC: World Bank, 2012), https://openknowledge.worldbank.org/bitstream/handle/10986/12272/9780821389270.pdf.

(GHAMFIN) agreed, saying "***the majority of MFIs lack the institutional capacity (in terms of technical and human capacity) to reach out to more clients and to develop new products and services***."

It is interesting to look at this trend as an issue of unmet demand rather than an emergence of new client needs. Research, such as in P*ortfolios of the Poor*,[3] demonstrates that poor people have been using a variety of financial instruments to smooth their cash flows, which may not necessarily represent new client needs. However, in the context of increased competition and the presence of new actors able to cater to some of these needs, meeting the demand for more diversified products becomes critical if MFIs are to keep their position in the market. Sixteen of the 39 associations surveyed did mention the presence of new products in their markets, which suggests that some MFIs are expanding their offerings. The associations recognized, nevertheless, that there is real concern in the industry about most MFIs' current ability to effectively respond to this trend.

1.2 Emergence of new technologies

New technologies

The arrival of new technology, such as mobile payments, biometric identification devices, new IT platforms, etc., is affecting how products are delivered and how banking is done.

- 69% of associations felt that the trend toward using new technology will very likely to likely challenge MFI relevancy.
- 41% of associations observed that MFIs were very to somewhat prepared.
- 38% of associations agreed that this trend is taking place in their markets to a large to medium degree.

New technologies have the potential to dramatically change the way services are provided through enhanced last-mile connectivity and the use of different delivery mechanisms, operating tools, and back-office management platforms. However, this trend has the second largest gap between relevance and preparedness: while the majority of associations remarked that the new technologies greatly challenge their members' ability to remain relevant, few MFIs are well prepared or are moving quickly to adopt them. The low prevalence of this trend suggests that, while technology opportunities may be available in the different markets, associations have not seen many of their members using them to enhance service delivery.

Nevertheless, during the survey, several associations described interesting pilot programs looking into implementing some of new technologies: in Peru, MFIs are using e-wallets to open up previously underserved markets and mobile phones to approve loans in rural areas; and in Mexico, a savings bank partnered with a telecommunications company to mobilize small rural deposits and online loans in urban areas. A few associations reported more wide-spread adoption of new technology in their markets, such as Kenya, where a majority of the association's members offer mobile banking services; and in Pakistan, Paraguay, and Ecuador, which employ widespread use of banking agent networks. Many associations also acknowledged the efforts of some regulators to promote technology to help improve costs, convenience, and efficiency.

In the current industry context, we need to consider whether MFIs are unwilling or unable to comprehend the enormity of the technological shift that is starting to occur around them. Many market observers contend that these providers should completely rethink how they engage with emerging technologies. MFIs should examine themselves to see if they are facing a "moment of truth" similar to the one IBM experienced in the early 1990s when it realized that its traditional business model was no longer working.[4]

1.3 Evolving profile of funding

The changing profile of funding—with the increased expectation that MFIs will be able to fund more of their operations from other sources, such as retained earnings and deposit mobilization (if permitted)—offered the third most significant challenge to MFI relevancy. As the profile of global microfinance has changed over the years, there is also growing engagement by the private sector as investors. A CGAP brief[5] on trends in cross-border funding in late 2012 pointed out a 12% annualized growth rate in private sector funding for the preceding five years (compared to 3% over the same period for public investors).

3. Daryl Collins et al., *Portfolios of the Poor: How the World's Poor Live on $2 a Day* (Princeton University Press, 2009), http://www.portfoliosofthepoor.com/book.asp
4. Despite a highly innovative and rapidly changing business environment, the company persisted with an entrenched business model and marketed products that quickly became obsolete, leading to its near demise.
5. Estelle LaHaye and Ralitsa Rizvamolli (with Edlira Sashi), "*Current Trends in Cross-Border Funding for Microfinance*," CGAP Brief (Washington, DC: CGAP, November 2012), http://www.cgap.org/sites/default/files/Brief-Current-Trends-in-Cross-Border-Funding-for-Microfinance-Nov-2012.pdf.

Changing profile of funding

MFI funding sources (and types of available funding) are changing. Debt and equity funding is still available, but generally in lower amounts for MFIs. Donors and financial institutions have an increased expectation that MFIs will be able to fund more of their operations from other sources, such as retained earnings and deposit mobilization (if permitted).

- 69% of associations estimated that changes in funding will likely challenge MFIs' relevancy.
- 54% of associations felt that MFIs were very to somewhat prepared.
- 62% of associations remarked that this trend is taking place in their markets to a large to medium degree.

This has implications in how MFIs themselves are expected to function, perform, and grow. The shift from public to more private sector donors in several markets has led to increased stakeholder demands for better and more transparent management of costs and funding sources. As Claudia Revilla Ostos of ProDesarollo (Mexico) commented, "***Few institutions have the strength to cope with the challenges of market conditions and their survival depends on subsidies and supports that are becoming more limited***."

Our study revealed some regional variations. In India, for example, Sa-Dhan mentions that smaller MFIs face difficulties in accessing debt financing from banks. By contrast, associations in Eastern Europe and Central Asia responded that an over-supply of funding for MFIs, prompted by over-liquid new investors, was pushing MFIs to grow, at times at unsustainable rates.

1.4 Changes in regulation

Associations also described an environment of significant changes in regulations (this trend ranked second in current prevalence in the markets) that directs the growth, performance, and presence of MFIs. The 2012 Global Microscope[6] report—which uses two umbrella parameters, regulatory framework and practices, and institutional supporting frameworks, to assign ratings to 55 microfinance markets—also cites intensifying regulatory oversight as a key development emerging from the global financial crisis. Regulators are paying more attention to the microfinance sector and struggling in many cases to find a balanced approach that responds to the needs of the industry as it serves an increasing number of low-income clients, while trying to address concerns for consumer protection, in light of the still-frequent criticism of microfinance providers' irresponsible practices.

Changes in Regulation

Changes in regulation and industry infrastructure are affecting how MFIs operate. These may include new/changed microfinance regulation and supervision, new regulatory bodies, adoption of national financial inclusion strategy, etc.

- 64% of associations reported that changes in regulation will very likely to likely challenge MFIs' relevancy.
- 62% of associations estimated that MFIs were very to somewhat prepared.
- 72% of associations said that this trend is taking place in their markets to a large to medium degree.

The regulatory environment and the regulators' responses to stakeholders' demands greatly vary among different regions and countries. Some examples of new regulations offered by the microfinance associations include new legislation on e-money, changes in licensing requirements, movements to include a greater number and range of providers under regulation, and universal access to basic saving accounts. While the expansion of regulation may help build credibility and improve market conduct among other MFIs, it also has significant cost implications for many MFIs because compliance can be particularly burdensome for smaller institutions. Perpétue Coulibaly, executive director of the Association Professionnelle des Systemes Financiers Decentralises du Burkina Faso predicted "***that some MFIs will lose their accreditation (legal status) because of their inability to adapt to the requirements of regulated institutions***."

Mikhail Mamuta, president, **National Partnership of Microfinance Market Shareholders**, offered an example of comprehensive reform in Russia, where the State Megaregulator of financial markets was recently created. It aims to provide a centralized and systematic approach to the development of financial markets and thus ensuring a more balanced support to small and medium-sized businesses. Additionally, state support is provided in four areas:

- Financial: state funding to support business start-ups and entrepreneurial projects primarily in industry, agriculture, education, development of innovative small businesses;
- Information: creation of information and telecommunication networks;
- Consulting: creation of consulting centers for small and medium entrepreneurs;
- Property: provision of state property for rental.

6. The Economist Intelligence Unit, "*Global Microscope on the Microfinance Business Environment 2012*," October 2012, https://www.eiu.com/public/topical_report.aspx?campaignid=microscope2012.

1.5 Decreasing market share

Decreasing market share

New entrants into the microfinance market, such as consumer lenders, downscaling commercial banks, mobile network operators, utility companies, etc., seeking large-scale deployment, are providing financial services to a rapidly increasing number of clients and making significant gains in market share.

- 51% of associations reported that decreasing market share will very likely to likely challenge MFIs' relevancy.
- 49% of associations estimated that MFIs were very to somewhat prepared.
- 56% of associations said that this trend is taking place in their markets to a large to medium degree.

The threat to current market shares due to the entry of newer players from the formal financial sector (e.g., commercial banks and consumer finance companies) and other types of providers, such as mobile operators, supermarkets, and utility companies, was also recognized by half of the microfinance associations. This shift is also emphasized in The New Microfinance Handbook[7] in the context of an evolving financial ecosystem where—in addition to government and regulators being much more actively involved in the sector—there are also a variety of providers in action. The unmet market demand, backed by a perception of financial viability in servicing the needs of low-income clients, has prompted many players to enter (or consider entering) the microfinance market. Understandably, this puts pressure on MFIs to figure out how to protect existing client bases or explore new markets. The responding associations indicated that their members were doing both: 60% of associations mentioned geographic expansion and product diversification as MFI strategies to address this trend. These factors have also increased opportunities for mergers and consolidation as market conditions evolve.

1.6 Greater political interference

Increased political interference

MFIs are exposed to increased political interference, such as government propaganda that encourages clients not to repay loans, creation of interest-free or low-interest loan funds, interest rate caps, etc.

- 51% of associations observed that political interference will very likely to likely challenge MFIs' relevancy.
- 44% of associations noted that MFIs were very to somewhat prepared.
- 54% of associations said that this trend is taking place in their markets to a large to medium degree.

The microfinance associations acknowledged on multiple levels that political intervention influences the playing field for MFIs. While some respondents described how governments can distort markets by providing low-interest loans, as the governments of Brazil, Pakistan, and India have done, others brought up interest rate caps and price restrictions in markets across West Africa, Eastern Europe, Central Asia, and Ecuador.

As an example, Almir Pereira, president of the Associação Brasileira de Entidades Operadoras de Microcrédito e Microfinanças described the situation in Brazil: "***The government's 'Crescer' Program is highly subsidized, offering loans at 5% per year, well below the market rate. This program competes directly with regulated and non-regulated MFIs, and puts them them in a disadvantageous position in terms of cost. The MFIs are only marginally able to compete with the big state banks with access to government subsidies. We hear that this program's portfolio at risk over 30 days in individual loans already exceeds 25%. Soon, the Crescer Program could likely be identified as another failure of the government in the area of microfinance, but until authorities accept its weaknesses, it could cause various undesirable distortions in the market***."

Political intervention also takes the form of encouraging larger formal financial sector players to enter the microfinance space, as in India. The "no-pago" [no pay] movement in several Central American countries is also a prime example of how political influence can affect the functioning and stability of MFIs in a way that is difficult to anticipate and manage.

Governments can also impact the industry in a positive way. Jorge Arias at ASOMIF Peru commented that, "***regulators can become a strength for the national microfinance sector. We have a government [that has become] much more oriented to social and financial inclusion than any previous government. They even created a new Ministry of Social Inclusion, which is very active and is led by skilled officials. Political intervention, if [the microfinance association] educates the regulators, is not perceived as a risk***."

7. Ledgerwood, *The New Microfinance Handbook*.

2. Other relevant strategic risks

In addition to a clear threat posed by these trends to the relevance of MFIs, associations commented on other strategic risks MFIs will be facing within the next 18–24 months. These risks, without adequate mitigation, could also significantly impact MFIs' position in the market.

2.1 Credit risk

Credit risk and over-indebtedness have been major issues in many markets in the last couple of years, and they remain a dominant industry concern. In our survey, half of the associations indicated credit risk as one of the top three risks in their markets, and one out of three respondents is particularly concerned with over-indebtedness. They noted the implications of this risk, which often arises from pressure to aggressively build loan volumes and/or loan sizes in the face of stiff competition and "saturated markets." However, we need to probe these issues more deeply if we want to better understand them. Considering that microfinance serves only a fraction of the estimated global unserved low-income market, it is important to consider that these worrisome conditions may reflect MFIs limited capability to effectively identify areas of unserved demand, so they aggressively compete to overserve certain segments.

Another set of associations described MFIs' insufficient understanding and expertise in credit assessments, risk, and delinquency management as factors contributing to credit risk. This also highlights the point that credit bureaus can play an important role in addressing the issues of multiple borrowing in a meaningful manner. Most microfinance associations promote credit bureaus in their markets.[8] In fact, 25% of associations mentioned credit bureaus as one of the top three most influential developments in the current provision of financial services to low-income clients in their local industries. We need further analysis of the benefits and disadvantages of developing MFI-specific infrastructure set against improved mainstream financial services infrastructure. Pakistan, for example, has a primary credit bureau that is part of the State Bank of Pakistan regulatory infrastructure, as well as a secondary credit bureau for MFIs only, but it does not exchange data with the primary credit bureau.

2.2 Operational risk

Forty-one percent of associations mentioned the range of operational risks their members are exposed to, from lacking relevant credit management and accounting skills to managing high staff turnovers, and simply not having the institutional strength and depth to deal with changing market demands and requirements. The 2012 Microfinance Banana Skins report also emphasized that this is an important challenge, given the ever-present pressures on MFIs to operate in more streamlined, efficient, and transparent ways in response to the growing visibility and perceived influence of the sector.

In addition to the risks mentioned above, some associations talked about market and environment risks (18%), but more (23%) recognized the greater liquidity and funding challenges. These are caused in part by the growing capital needs of MFIs (often from regulatory changes or from reduced donor and public funding, and the pressure to move to deposit mobilization) and sometimes by tight financial markets that result from downturns.

8. SEEP's "*2012 Microfinance Market Outlook*" reveals that 60% of associations support the implementation or the creation of credit bureaus, 40% promote the advantage of existing ones, and 37% link members with credit bureaus in their areas. http://www.seepnetwork.org/filebin/pdf/resources/Market_Outlook_web_en.pdf.

II. Industry Actions in Response to Market Trends

1. How are MFIs responding to market trends?

The associations we surveyed listed a wide range of strategies that MFIs employ in response to the market changes and risks described here (see annex 2). The associations believe that the sector generally understands the complexity of these trends and the urgent need to take action to answer them. The most frequently mentioned actions can be grouped into three categories: client-centric approaches, innovative partnerships, and the development and implementation of supportive internal infrastructure.

Across the board, MFIs strive to adapt their products to various client needs beyond credit, incorporating new internal processes that use technology and working with new kinds of partners. These partners include former competitors as commercial banks and smaller credit unions, and complementary service providers, like mobile network operators. In cases where associations rated MFIs' preparedness for meeting the challenges of a particular trend relatively high (e.g., 3 or higher on a 5-point scale), the MFIs took a wider variety of steps, indicating in part that greater awareness leads to an increased ability to take action.

1.1 Client-centric solutions

Globally there is an ever-increasing push by groups of stakeholders (investors, regulators, government, and MFI associations) for MFIs to adopt client protection practices. The most widespread definition of these comes from the Smart Campaign.[9] Not surprisingly, an overwhelming 69% of responding associations indicated that some or most of their members have concrete plans to promote greater awareness and improved practice in this area. Because the political interference in some markets sometimes influence repayment behavior and/or the operations of MFIs, many institutions are taking it upon themselves to become more transparent and responsible in how they develop and promote product offerings, and communicate costs to clients. In addition, the associations also mentioned an increased focus on financial and social transparency, and client-education programs. Although associations pointed to this response in connection to questions about increased political risk, in reality, MFIs have discovered that these are effective mechanisms for building trust and loyalty with key stakeholders and, more importantly, clients in the face of increased competition.

Extent of client-centric solutions observed by microfinance associations

Improvements in client protection practices	**69%**
Product diversification	**69%**
Client segmentation	**64%**
Geographic expansion	**59%**

According to the participating associations, MFIs have a growing awareness of the increased diversity of their current and future customer base, and the continual evolution of client demands. Thus, a successful MFI has to be able to identify the specific needs of different client subgroups in order to tailor products to them, be it offering enterprise loans to growing microenterprises or consumption-smoothing loans to cash-strapped householders. For example, rural clients may potentially have a different set of expectations (for the same product) for repayment schedules that allow for unforeseeable seasonal or agricultural delays and for loan notifications, compared to urban clients. Even though the associations indicated that MFIs are the least prepared in this area, they listed client segmentation, product diversification, and expansion into new geographic areas as three primary strategies for meeting the increased client demand for a wider range of products.

The new products most frequently mentioned by associations include agri-finance, Islamic finance, and housing finance. Savings mobilization is growing in markets where regulators allow traditional MFIs to explore this option through non-bank financial status and more countries are allowing MFIs to start providing micro-insurance. Examples also include non-financial products, such as offering access to healthcare and financial education, as well as alternate delivery channels for money transfers and payments. The increase in the use of technology-enabled services is further supporting MFIs' outreach to rural areas. MFIs are indeed realizing that credit, although traditionally the mainstay of their services, cannot be their only focus if they wish to attract and retain growing numbers of clients.

9. http://www.smartcampaign.org/index.php

1.2 Development and implementation of supportive internal infrastructure

Extent of internal infrastructure measures observed by microfinance associations

Changes to internal operations for data collection	**54%**
Development of new reporting systems	**54%**
Focus on building equity	**54%**
Adoption of new technologies for internal operations	**51%**
Transformation to regulated institution	**46%**

The microfinance associations often noted that implementation of client-centric solutions requires significant operational changes and re-alignments. These can represent different levels of change for individual MFIs, depending on their strategic outlook, size, existing staff, current product offerings, expansion plans, and funding sources. Respondents also cited operational risks as a key concern for their members, which MFIs are able to manage with only varying degrees of success. The most common strategies include changes in internal operations for data collection and the development of new reporting systems, mainly to respond to changes in regulation. Additionally, in response to the changing profile of funding, associations indicated that MFIs are focusing more on building equity, as well as exploring transformation.

1.3 Development of partnerships

One other aspect of MFI actions is noteworthy in its complexity and influence on multiple trends—developing innovative partnerships. Whether MFIs are partnering with new actors to make use of emerging technology (such as for branchless banking in Pakistan or for mobile banking in Peru) or acting as agents for larger banks (as in India), they are exploring new ways to leverage skills and advantages that other types of service providers are bringing to the microfinance field. There is a growing recognition that such collaboration is not only beneficial in terms of strengthening market access and differentiation but also can lead to superior cost management. In addition, associations listed other ways in which MFIs work more collaboratively, including proactive engagement with government and regulators and collaboration with associations.

Extent of partnership-related solutions observed by microfinance associations

Collaboration with associations	**72%**
Innovative partnerships	**59%**
Proactive engagement with government and regulators	**54%**

2. What are associations doing to support their members?

Key services that associations offer to their members

- Policy advocacy
- Promotion and implementation of responsible finance practices
- Facilitation of access to funding
- New product development
- Facilitation and implementation of new technologies

Microfinance associations, as meso-level actors, have a critical role to play in helping MFIs adapt to critical market trends. The traditional role of microfinance associations has been to support retail MFIs with services that improve their institutional performance and increase the supply of sustainable services. As environments become more complex, associations have begun to broaden their role by setting and promoting industry standards and legal frameworks that help influence market access and outcomes. Through the provision of key services to their membership and the development of formal rules in the market, microfinance associations can help create opportunities and incentives for market actors to learn from one another, pool and leverage resources, experiment with new ideas, and disseminate successful models throughout the system.

All the associations that participated in this study support their members' responses to the market trends identified here. Some provide a variety of reinforcing services and activities, while others focus on a few strategic ones.

COPEME, Peru has a long list of the various activities it undertakes for the 76 MFIs it supports:

- Implementation of innovative technology solutions
- Close relationship with the Superintendency of Banking and Insurance
- Design and product development of rural credit and savings
- Investment and loan funds management for MFIs
- Strategic information management for the microfinance sector
- Governance and risk management for MFIs
- Strengthening of middle management in MFIs
- Partnerships to implement lending products that promote care for the environment and use of renewable energy
- Support for implementation of micro-insurance
- Support for conversion of rural producers associations to credit unions
- Trainings for consultants and MFI staff

2.1 Policy advocacy

Given the dynamic regulatory and political environments, the associations often first mentioned their policy advocacy to promote an overall favorable environment to support development of the sector, when talking about their activities on behalf of their members. Advocacy is required in all markets and it evolves based on the needs of a specific sector, ranging from building basic awareness about inclusive finance and the role of microfinance in meeting this goal to more concrete and sophisticated actions, such as pushing policy reform to create fair legal and regulatory environments, engaging regulators around consumer protection, lobbying for the formation of credit bureaus, and endorsing agent banking, etc.

The **Microfinance Institutions Network** in India described the extensive advocacy work it offers their members, which includes working closely with stakeholders on multiple levels, ranging from local and state officials to central government and central bank teams, as well as other large institutional players, such as the national agricultural bank and the small industries promotion institution to foster the most supportive environment possible for their members. At the same time, they are engaged in research and advocate with regulators to enhance the scope and role of MFIs within the financial inclusion sector, especially for licensing and permissions granted to other types of financial institutions.

2.2 Promoting responsible finance practices

In the wake of political turmoil, issues of over-indebtedness and multiple loans, and increasing scrutiny of the sector, many associations have renewed their focus on ethical lending as a critical way to rebuild credibility and help the sector move beyond these challenges. They reported working actively with members on self-regulation processes, codes of conduct, capacity-building activities to promote awareness, and assistance for implementation of client-protection principles and social performance standards. Much of the learning generated around responsible finance in the areas of social performance monitoring and consumer protection is coming from regional networks in Europe and Latin America, whose markets are at the forefront of the industry.

Key association activities supporting responsible finance

- Market information and financial transparency
- Implementation of consumer protection
- Client financial education
- Promote social performance standards
- Implementation of codes of ethics

Katarzyna Pawlak, at the Microfinance Centre (regional network for Europe and Central Asia), headquarted in Poland remarked that "***we see [that MFC plays] a continuous role in promoting responsible finance standards among our members, as well as raising the issue of the whole sector responsibility (especially along the value chain to create favorable conditions). We are still very MFI-focused in the industry, but we need a more comprehensive approach [to ensure] the responsibility of suppliers (funders) and responsibility of clients to make informed decisions. This calls for standards for funders that are aligned with standards for MFIs, which in turn must to be aligned with financial education programs for consumers. And all [must be] in alignment with the regulation, which promotes responsible, inclusive access to finance***."

2.3 Facilitating access to funding

Many associations (one-third of respondents) help their members access funding through a variety of activities. They facilitate meetings with potential investors, provide technical assistance to members seeking investors and becoming investment-ready, advocate for the development of guarantee mechanisms, and identify and attract special-purpose public funding to offset the significant decline in donor funding.

The **Pakistan Microfinance Network** is undertaking several cross-cutting initiatives to help members overcome the funding challenge. These include several one-to-one meetings with commercial banks to increase their understanding of microfinance and also hear out their reasons for not lending to MFIs, holding events where bankers and MFPs are brought on the same forum to hear each other's' views, reviewing the existing guarantee programs in the country to make recommendations for their improvement, offering individual advisory to members that require assistance in approaching commercial funders through peer support, and publishing updates on funding available for the sector on a six monthly basis.

In Mexico, **ProDesarollo** worked extensively with the leading local funder to reinstate funding lines for microfinance activities while in parallel working to improve the reputation of the sector to international stakeholders; Additionally ProDesarollo is working on a project with the Inter-American Development Bank to develop a securitization mechanism.

2.4 Support for new product development

In line with the earlier discussion of key market changes, associations are increasingly helping their members better serve their clients with tailored, more appropriate products and services. It is interesting that, in SEEP's 2012 Market Outlook[10] survey, which asked associations to prioritize their activities that help members mitigate industry risks, only a few mentioned member support for product development. Among those associations that listed it, product development support was part of overall member capacity-building activities. The current, more targeted approach of supporting members in developing new products demonstrates the increased sense of urgency some associations have regarding members' need to respond to the increased demand for more diverse financial products.

Activities to build the capacity of members so they can appropriately respond to the needs of their clients include identifying products and services that can be provided using mobile technologies; facilitating stakeholder collaborations and partnerships to offer insurance and financial products for health, water, and sanitation; and assisting members with technical assistance in new product development. For example, in Ghana, GHAMFIN collaborates with external partners, such as micro-insurance agencies, institutions with expertise in health-promotion programs (e.g., Freedom from Hunger), and water and sanitation organizations (e.g., Save Water Network) so its members can diversify their products. In Azerbaijan, the association coordinates a special stakeholder working group working on developing Islamic microfinance products.

2.5 Research and promotion of new technologies

About a quarter of the associations in our survey told us that they also assist their members with identifying and implementing new technologies aimed both at improving the MFIs' internal operations and service delivery. Activities range from researching the feasibility of mobile banking and e-money within their markets to facilitating partnerships to negotiating technology solutions on behalf of members.

Red Financiera Rural in Ecuador has established a new department focused on supporting members with new product development and technology. One initiative is related to the use of PDAs for collecting rural savings. This tool allowed them to offer mobile savings services, increasing the number of customers saving with the institution and the amount of savings MFIs collected. A second initiative focused on Transactional Kiosks (satellite-connected) that were located in rural areas, to bring financial services to unbanked populations in their own communities. These kiosks could perform all traditional credit and savings transactions, and additionally can be linked to service payment networks to transact basic services such as paying taxes, utility bills, etc. A third initiative involved enabling access for members to ATMs linked to major transactional networks in the country and POS (point of services) networks in both urban and rural areas.

10. http://www.seepnetwork.org/filebin/pdf/resources/Market_Outlook_web_en.pdf.

III. Regional Analysis

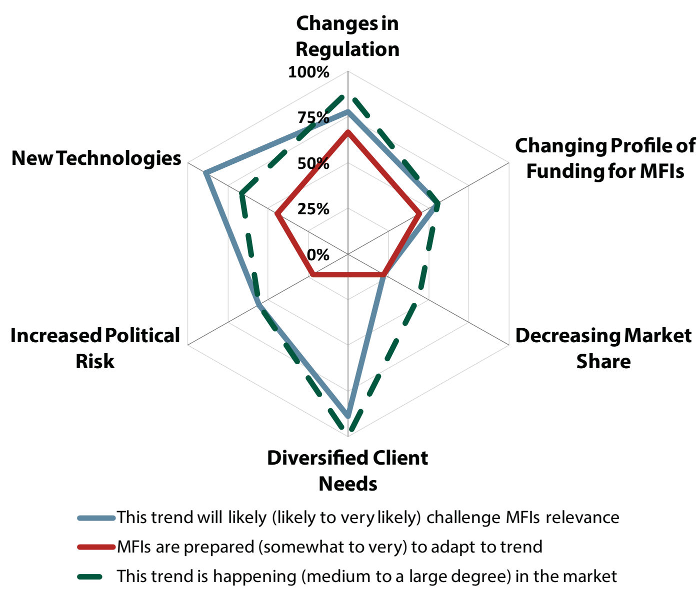
1. Africa

9 microfinance associations responses, representing 1,756 MFI members, approximately 16 million clients and a combined portfolio of US$ 3.7 billion in outstanding loans and US$ 1.5 billion in deposits.

All of the microfinance associations in Africa identified **clients' demand for diversified financial products** as a key trend prevalent in their market, and almost all believe that it will likely challenge MFIs' relevancy. They noted an increased focus on catering to the specific needs of rural clients working in agricultural sector, with many MFIs actively developing agriculture lending products for smallholder farmers. To better serve their clients' needs, their member MFIs are also exploring innovative partnerships, such as with technology providers of mobile and branchless banking. Nevertheless, only 11% of the associations indicated that their members are prepared to adapt to this trend. This was the lowest preparedness rate across all regions.

Figure 4. Market trends in Africa

(% of association responses)



Eight of the 9 associations in the Africa region recognized that not taking advantage of **new technologies** for service delivery will affect their members' ability to remain relevant. An overwhelming 67% acknowledged some adoption of new technologies to expand access to financial services, compared with 38% globally. According to their associations, African MFIs seemed most eager about technology for mobile and branchless baking, compared to any other regions. This may be due to the powerful success stories in Kenya and Uganda, where mobile payments have transformed the way financial services are provided, as well as the existence of a conducive regulatory framework for mobile banking, the West Africa Monetary Union.

As the microfinance industry continues to develop, regulators are expected to step in more. As such, **changes in regulations** are also very prevalent in the region, with 89% of the African respondents mentioning it as a current trend in their markets. For example, the Ugandan government passed a regulation that outlines the principles for regulating tier 4 institutions. A critical strategic risk is perceived in conjuncture with regulatory changes. For example, the association in Burkina Faso indicated that many MFIs will have to go through significant institutional changes to comply with the regulations and some may lose their accreditation.

Similar in the other regions, African microfinance **associations support for their members** focused primarily on advocating on behalf of their members for an enabling regulatory environment, as well as training and capacity building for members on new regulations. Several associations also mentioned educating their smaller members (in Burkina Faso, Benin, and Democratic Republic of Congo-DRC) about mergers and consolidation. In addition, associations offered a variety of activities for new product development, ranging from market research on clients' financial needs in DRC, to collaborations with international stakeholders for the development of specialized products (e.g., for healthcare) and WASH (Water, Sanitation and Hygiene) finance in Ghana, and capacity building for designing tailored client products in Uganda.

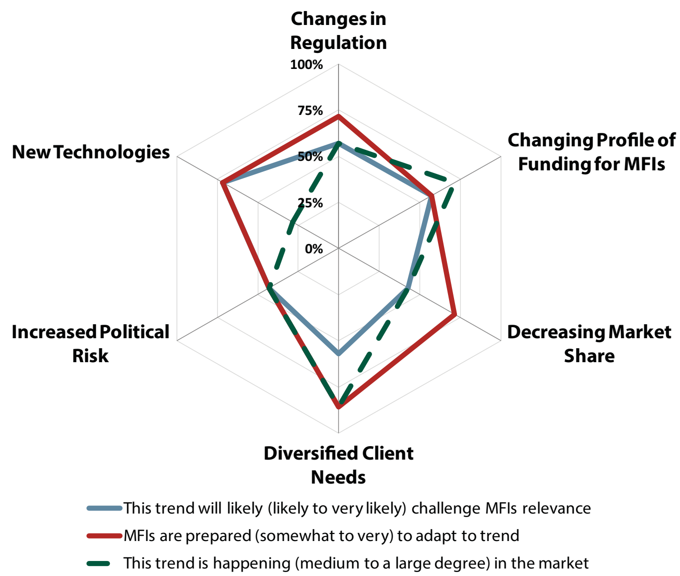
2. Asia

7 microfinance associations responses, representing 1,203 MFI members, approximately 58 million clients and a combined portfolio of US$ 38 billion in outstanding loans and US$ 2.3 billion in deposits.

Respondents most commonly (86%) identified **clients' need for diverse financial products** as prevalent in their markets. Compared to other regions, Asian associations indicated that MFIs are more likely to focus on client segmentation, developing innovative partnerships, product diversification, and increased geographic expansion. Asian MFIs are increasingly acknowledging the demand for specialized products, such as agriculture and housing finance, and are prioritizing the expansion of their outreach to remote areas and to the very poor, the disabled, and women. This focus on improving their services and developing targeted products may explain the higher level of confidence associations have regarding their members' preparedness to meet clients diversified financial needs.

Figure 5. Market trends in Asia

(% of association responses)



A majority of responding associations (71%) saw the challenges of **changing profile of funding** for MFIs and liquidity problems as a reality in Asia, particularly among smaller MFIs— higher than the global average of 62%. In India, for example, small MFIs have encountered more difficulties in accessing commercial banks credit, on which they are heavily dependent. Changes in regulation were also most commonly mentioned (57%) as a trend to manage in Asia. In several markets, regulators are increasingly focused on improving the regulatory frameworks for the microfinance industry and are concentrating on client protection issues.

Interestingly, while MFIs indicated that **new technology** is not yet widely adopted by most of their members, most of the respondent associations (71%) indicated that the ability to leverage alternative delivery channels for financial services will impact MFIs' relevancy, but also that most of them are prepared to adapt to this trend. Mobile and branchless banking users are indeed growing exponentioanlly in Asia. Some successful examples were pointed to in Pakistan, where mobile banking innitiatives have benefited from supportive regulatory environments.

The microfinance associations in Asia are overwhelmingly focusing their activity to **support their members** on government and policy advocacy (86%). In Pakistan, PMN's Policy Committee meets regularly to develop strategies to manage the risks arising from a government lending program and also mitigate the threat of interest rate caps. PMN is also a member of a steering committee that is working on the regulatory framework for non-bank MFIs to ensure interests of the industry are protected and a conducive framework is put into place. In India, MFIN is actively engaged with a range of stakeholders, including regulators, bankers, and insurance providers, as well as tax authorities, to ensure a conducive policy framework is enacted for the industry so that their members can legally provide a full range of financial services to low-income clients. In Cambodia, the association is collaborating with the central bank on new microfinance licensing requirements.

In addition to policy advocacy, associations in Asia are also very engaged in self-regulation activities and the promotion of responsible finance practices. These include the endorsement and monitoring of code of ethics in India and Cambodia, and capacity-building activities for the implementation of client protection principles in China, Cambodia, and Laos.

3. Eastern Europe and Central Asia

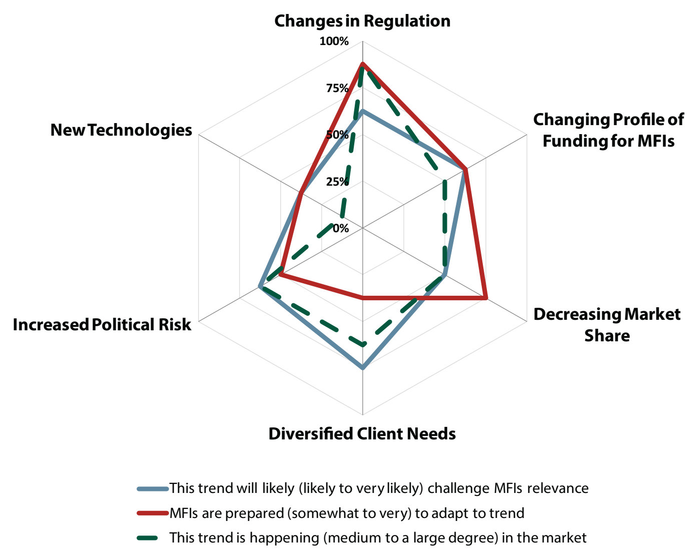
8 microfinance associations responses, representing 498 MFI members, approximately 2.2 million clients and a combined portfolio of US$ 2.5 billion in outstanding loans and US$ 637 million in deposits.

Diversified client needs and **increased political risk** were mentioned by 63% of respondents as prevalent in their markets. For these two trends, association responses reveal the largest gaps between MFI's preparedness to adapt and the trends' impact on their relevance. They did report, however, that MFIs are trying to address these trends by improving their client protection practices, researching the feasibility of new products, and increasing accessibility of their existing products. Associations in EECA, more so than other regions, indicated that political risk is the trend most likely to challenge MFIs.

Most of the microfinance associations in EECA region (88%) have identified **changes in regulation** as a prevalent trend in their market. Regulators across the region are focusing more on the microfinance industry and expect to increase regulations in most markets. In EU member countries, for example, regulators are considering mandating that financial institutions provide basic current accounts to all citizens. Also, some consolidation of regulatory functions was noticed in the region, such as in Russia. In Kazakhstan the association is concerned that MFIs may not be able to meet the new capital requirements that will be enacted in 2016.

Figure 6. Market trends in EECA

(% of association responses)



Nevertheless, associations reported that MFIs in EECA seem well prepared to adapt to the changes in regulations their countries are facing. The high level of preparedness may be explained by the proactive engagement of MFAs and other stakeholders in policy discussions and advocacy for refining current regulation to best meet the needs of the microfinance industry, as well as active outreach to increase decision-makers' and the public's awareness of the contributions of microfinance and improvements in the industry's image and positioning.

The prevalence of **new technologies** among their members scored the lowest (13%), compared to the other regions and the global trend (38%), which indicates that associations in EECA do not yet see the uptake of mobile and branchless banking as a common development. Nevertheless, they indicate that many MFIs are adopting new technologies that will improve their internal operations. Improving MIS systems scored the highest in EECA (63%), closely followed by Latin America and the Caribbean (60%), while Asia and Africa have significantly lower scores (43% and 33%, respectively).

In line with the major trends and risks highlighted in EECA, microfinance associations' **support for their members** in the region is mainly focused on government and policy advocacy (75%). Activities in this area include active engagement in policy discussions (Georgia, Tajikistan, Kazakhstan, and the Microfinance Centre at regional levels), lobbying the central bank and regulators to enable a more favorable regulatory environment in Azerbaijan and Armenia, and technical input on normative and legal regulation of the microfinance market in support of the authorities at federal and regional levels in Russia. Associations in the region also mentioned activities to facilitate members' access to funding, such as seeking public special-purpose funding (given the significant decline in donor funding in Russia), active collaboration with investors in Azerbaijan, and generally seeking new sources of funding for MFIs in Tajikistan. In addition, associations are also actively working on the promotion of ethical standards and client protection initiatives.

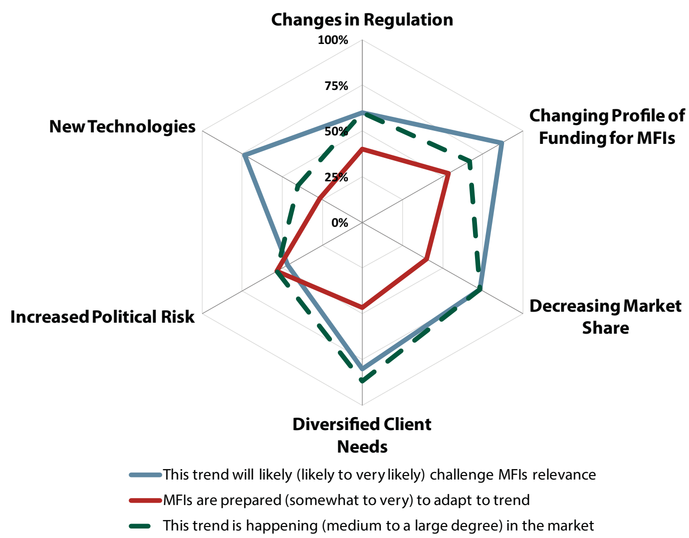
4. Latin America and the Caribbean

15 microfinance associations responses, representing 453 MFI members, approximately 13.9 million clients and a combined portfolio of US$ 18 billion in outstanding loans and US$ 10 billion in deposits.

Compared to the other regions, microfinance associations in Latin America seem to be more pessimistic about the level of preparedness of MFIs in their region to adapt to the different trends.

Figure 7. Market trends in LAC

(% of association responses)



Associations in the region rated **clients' diverse needs** (87%) and **decreasing market share** (73%) as the two most prevalent trends. Associations also indicated that these two were likely to strongly impact MFIs' ability to remain relevant and that their members seemed insufficiently prepared to deal with them. Nevertheless, 87% of the associations indicated that their members are actively exploring how to diversify their service offerings with micro-insurance, micro-pensions, and targeted products for rural clients working in agriculture.

While LAC associations indicated that the widespread use of new technologies in expanding access to finance is common in only a few countries in LAC (e.g., Peru, Bolivia, Ecuador), 73% of them felt that this trend will significantly impact MFIs' ability to stay relevant. In several other countries, they highlighted interesting pilot projects in this area, such as partnerships between a telecommunication company and a savings bank in Mexico to mobilize small deposits, online loans in urban areas in Mexico, and use of mobile phones to approve loans in rural areas in Peru.

Associations in the LAC region actively **support their members**. The most commonly mentioned services are in new product development, technology solutions, and policy advocacy, which reflect the priorities they identified in their market. For example, Red Financiera Rural in Ecuador develops new services for MFI members based on in-depth analysis of demand and has created a department of financial product development and technology. In Paraguay and across Central America, associations are also steadily engaged in helping members promote and implement client protection practices. Several of Peru's associations have wide-reaching programs underway: the Asociación de Instituciones de Microfinanzas del Perú (ASOMIF) is working closely with its members to implement alternative deliverable channels, such as mobile banking to expand access to financial services; COPEME has focused on developing innovative technology solutions; and PROMUC Network is evaluating methodologies for leveraging electronic money to support NGOs in providing microfinance services in Peru.

IV. Conclusions

Microfinance associations' responses reflected the most current concerns raised in key industry publications in the past year, specifically the pressing need for client-centric approaches by MFIs, the significant impact of regulatory changes and political interventions on MFIs, the competition from aggressive and well-resourced new entrants in the field offering financial services to clients, the impact of technological innovations in banking and provision of financial services, and the changes in funding profile.

This study's most important contribution is the identification and analysis of trends that are most consequential to MFIs' ability to execute their strategy, achieve their business objective, and build and protect their value. Our analysis reveals that MFIs' most critical challenges revolve around two of the key issues facing the industry today: **what clients really need** and **how to leverage technological innovations to better provide services**.

Associations conveyed awareness of the critical challenges and expressed urgency about the need to address them. Overall, microfinance associations observed that MFIs must seriously reflect on their business models and rethink their strategies in view of adopting more client-focused approaches. There is a growing consensus that MFIs need to diversify the products they offer and need to do it fast, not only to fend off competition, but also to be able to cater to a wider market and expand, and ultimately better withstand shocks and economic forces. The resilient MFIs are those who have adapted their business models to these changes. As the sector clamored for MFIs to provide borrowers with more products and services, those who tackled the challenges early have seen improvements, not only in their reputations, but also in their bottom line. From deposit mobilization to the provision of non-lending services to clients (such as remittances, money transfers, and insurance), these products have resulted in additional sources of income for MFIs and helped to reduce costs that ultimately improved profitability and solvency levels.

However, the ability of MFIs to respond quickly to market trends and challenges and the ability of associations to provide members with the most essential services to support them, continue to be important concerns. Associations indicated that MFIS are insufficiency prepared to proactively face the six key challenges, which is necessary to remain relevant. With the exception of microfinance associations in Asia, all others found that their members were not sufficiently equipped to meet clients' diversified needs and to adopt new technologies. (African MFIs were the least prepared.) Likewise, while associations offer a range of functions that support their members in addressing these changes, the activities most of them undertake—policy advocacy, promotion of responsible finance practices, and facilitation of access to funding—do not seem to be sufficiently aligned with the most challenging trends their members face, diversified client demand and new technologies. With a few exceptions, this suggests that associations need to recalibrate and reprioritize their service offerings.

It is, however, important to recognize that the effort "to keep the edge" does not belong to MFIs and associations alone. Other factors limit even the most resilient MFIs' ability to appropriately respond to market trends. On the supply side are barriers, such as high transaction costs and underdeveloped regulatory frameworks that hinder the development of a range of products and services tailored to meet market needs. On the demand side, environmental factors, such as gender, education, and income level, as well as limited market data and consumer protection regimes, limit uptake of services by individuals and their ability to derive benefits from these services. Therefore, only a holistic approach that engages a wide range of industry stakeholders, service providers, products, and technologies will be sufficient to address the existing supply and demand side constraints barring greater inclusion.

Annex 1: Survey used for this study

1. Overall microfinance business environment

1.1 Please describe the three most influential developments in the provision of financial services to low income clients that are currently taking place in your market.

1.2. Please describe what are the top three strategic risks MFIs will face in your market in the next 18-24 months? *Those risks which are most consequential to MFIs' ability to execute their strategy, achieve their business objectives and build and protect value. For example a government cap on interest rates or rise in client overindebtedness, etc.*

1.3. How do MFIs identify and respond to strategic threats and opportunities in the market? Please check all that apply.

❑ I don't know.

❑ No formal processes, mainly reactive action to significant risks and challenges

❑ Irregular processes, mainly based on demand from funders/regulators

❑ Based on market intelligence (collection and analysis of market data from the MFI's external environment)

❑ Based on business intelligence (tracking and analysis of internal data such as product sales, cost of capital, etc.)

❑ Routine comprehensive strategic review that includes market and business intelligence, SWOT analysis, stakeholder consultations

❑ Other, please specify:

2. Key trends in the financial services sector affecting how MFIs do business

2.1. Please provide information about the following trends in your market.

Trends	Diversified Client Needs	Decreasing Market Share	Changing Profile of Funding for MFIs
Description	*Clients have increased demand for a wider range of financial services, many of which are not currently provided by the majority of existing MFIs. These may include insurance, remittances, savings, specialized loan products such as healthcare, water and sanitation, etc.*	*New entrants seeking large scale deployment are providing financial services to a rapidly increasing number of clients, making significant gains in market share. These include: consumer lenders, commercial banks downscaling, mobile network operators, utility companies.*	*MFI funding sources and type of available funding are changing. Debt and equity funding still available, however generally in lower amounts for MFIs. There is an increased expectation that MFIs will be able to fund more of their operations from other sources such as retained earnings and deposit mobilization (if permitted).*
To what degree is this trend taking place in your market? 1- To a small degree 5- To a large degree			
Will this trend challenge MFIs ability to remain relevant given their current business model and capacity level 1- Unlikely 5- Very likely			
How prepared are MFIs to adapt to this trend? 1- Poorly prepared 5- Very prepared			
What steps are MFIs taking, if any, to respond to these market changes? *Please choose all that apply, indicating from the drop-down menu how many MFIs are taking these steps.* 1- None 2 - Very few 3 - Some of them 4 - Most of them	❑ Innovative partnerships ❑ Product diversification ❑ Client segmentation ❑ Improvements in market assessment practices ❑ Geographic expansion ❑ Other, please describe:	❑ Innovative partnerships ❑ Product diversification ❑ Client segmentation ❑ Mergers with other providers ❑ Changes in price, delivery, accessibility of products ❑ Other, please describe:	❑ Transformation to regulated institution ❑ Focus on building equity ❑ Focus on increasing deposits mobilization (if permitted) ❑ Advocate with government for creation of credit guarantee options to attract commercial funding ❑ Other, please describe:
Additional comments:			

2. Key trends in the financial services sector affecting how MFIs do business

2.1. Please provide information about the following trends in your market.

Trends	**New Technologies**	**Increased Political Risk**	**Changes in Regulation**
Description	*New technology is affecting how products are delivered and banking is done. These include mobile payments, biometric identification devices, new IT platforms, etc.*	*MFIs are exposed to increased political interference such as the creation of new types of microfinance institutions, government propaganda that encourages clients not to repay loans, creation of interest-free/low interest loan funds, interest rate caps, etc.*	*Changes in regulation and industry infrastructure are affecting how MFIs operate. These may include new/changed microfinance regulation, new regulatory bodies, adoption of national financial inclusion strategy, etc.*
To what degree is this trend taking place in your market? 1- To a small degree 5- To a large degree			
Will this trend challenge MFIs ability to remain relevant given their current business model and capacity level 1- Unlikely 5- Very likely			
How prepared are MFIs to adapt to this trend? 1- Poorly prepared 5- Very prepared			
What steps are MFIs taking, if any, to respond to these market changes? *Please choose all that apply, indicating from the drop-down menu how many MFIs are taking these steps.* 1- None 2 - Very few 3 - Some of them 4 - Most of them	❑ Innovative partnerships ❑ Adoption of new technology for internal operations ❑ Adoption of new technology for service delivery ❑ Client training on new technology ❑ Other, please describe:	❑ Collaborate with the local association on restoring the industry reputation ❑ Improvement in client protection practices ❑ Proactive engagement with government and regulators to prevent interference ❑ Other, please describe:	❑ Development of new reporting systems to comply with new laws ❑ Changes in internal operations for data collection ❑ Close collaboration with local association to respond to changes ❑ Transformation to regulated institution ❑ Other, please describe:
Additional comments:			

2.2. What actions is your association taking, if any, to support its members to respond to these market trends? *Diversified client needs, decreasing market share, changing profile of funding for MFIs, new technologies, increased political risk, changes in regulation*

3. SEEP and your association

3.1 What specific actions should SEEP take to support your association's efforts in responding to these trends in the financial services sector?

Annex 2. Range of MFIs' global and regional activities in response to market trends

Activities	%	Africa	Asia	EECA	LAC
Collaboration with the association	**72%**	56%	86%	88%	67%
Improvements in client protection practices	**69%**	44%	57%	75%	87%
Product diversification	**69%**	44%	71%	63%	87%
Client segmentation	**64%**	44%	86%	38%	80%
Geographic expansion	**59%**	56%	71%	50%	60%
Innovative partnerships	**59%**	67%	86%	38%	53%
Changes in internal operations for data collection	**54%**	44%	29%	63%	67%
Development of new reporting systems	**54%**	44%	57%	75%	47%
Focus on building equity	**54%**	33%	71%	50%	60%
Proactive engagement with government and regulators	**54%**	33%	71%	38%	67%
Adoption of new technologies for internal operations	**51%**	33%	43%	63%	60%
Transformation to regulated institution	**46%**	44%	57%	50%	40%
Advocacy for credit guarantee options	**44%**	44%	86%	25%	33%
Changes in pricing and accessibility of products	**44%**	33%	29%	63%	47%
Improvements in market assessment practices	**44%**	33%	57%	38%	47%
Focus on increasing deposits mobilization (if permitted)	**36%**	33%	43%	38%	33%
Adoption of new technologies for service delivery	**31%**	22%	43%	13%	40%
Client training in technology	**13%**	11%	29%	0%	13%
Mergers with other providers	**10%**	11%	14%	13%	7%

Note: The shades of color, dark to light, indicate which strategies are most frequently employed. For example, the higher the frequency, the darker the color.

About SEEP

The SEEP Network is a global network of over 120 international practitioner organizations dedicated to combating poverty through promoting inclusive markets and financial systems. SEEP represents the largest and most diverse network of its kind, comprised of international development organizations and global, regional, and country-level practitioner networks that promote market development and financial inclusion. Members are active in 170 countries and support nearly 100 million entrepreneurs and their families.

Powering connections

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