Microfinance Meets the Market

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To some, the April-2007 public stock offering of Mexico's Banco Compartamos was the promise of microfinance realized—an institution serving low-income women with small loans was also earning profits sufficient to attract outside investors on a big scale. Others, however, were scandalized by the high interest rates—nearly 100 percent per year, on an annualized basis—driving the bank's profitability. The offering sparked an intense debate about the commercialization of microfinance, illustrating the tensions and opportunities that emerge as microfinance embraces the market. This paper by Jonathan Morduch of the Financial Access Initiative and Robert Cull and Asli Demirgüç-Kunt of the World Bank clarifies what's at stake when the worlds of non-profit microfinance and commercial banking intersect. Using data on 346 of the world's leading microfinance organizations, the authors move the debate forward by showing that there are important distinctions between different types of lenders, suggesting that commercial microfinance and social businesses are complements, not substitutes.

Analyzing the Lenders

The authors look at patterns in data on 346 leading microlenders, covering nearly 18 million borrowers. They start with the finding that there are important and interesting differences in the way banks, non-bank financial institutions, and nongovernmental organizations (NGOs) do business, and in who they reach. From there, they analyze the data to find answers to eight questions: Who are the lenders? How widespread is profitability? Are loans in fact repaid at the high rates advertised? Who are the customers? Why are interest rates so high? Are profits high enough to attract profit-maximizing investors? How important are subsidies? And, how robust are the financial data?

Results

The analysis reveals that microfinance continues to be dominated by NGOs, that a large share of microfinance institutions with "non-profit" status earn steady profits which are reinvested in the organizations, and that microfinance institutions have found reliable ways to get customers to repay loans. Commercial microfinance banks make loans that on average are about four times larger than loans from NGOs, suggesting that they tend to serve a substantially better-off group of borrowers. As a group, NGOs charge interest rates that are roughly double the size of those charged by commercial microfinance banks. Thus, the poorest customers tend to pay the most for loans. Most of the institutions serving the poorest customers earn profits too small to attract profit-maximizing investors, which explains the continued importance of subsidies and noncommercial funding to NGOs. Data on the financial side of microfinance is greater in quality and quantity than data on social outreach and impacts, but current reporting practices tend to overstate profits and understate subsidies.

Policy Implications

The microfinance sector has grown tremendously, and institutions are continually reducing costs, improving quality, and expanding services. Debating about a single, correct vision for microfinance—be it a non-profit approach or a commercial model—misses the reality that microfinance flourishes thanks to a diversity of strategies. Improving and refining those strategies will require better data and continued experimentation.