

# Microfinance: The Way Ahead

## *Redesigning Microfinance Contracts to Expand Outreach*

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# 1. Outreach

# Defining outreach

Reaching the poor, both in terms of numbers and depth of poverty.

# Outreach in numbers

## Percentage of poor reached by microfinance programs

India	21%
Ethiopia	22%
Bolivia	35%
Cambodia	41%
Sri Lanka	50%
Bangladesh	65%

Notes: Uses national poverty estimates as reported in WDR 2005

Source: MIXmarket; World Bank data.

# Outreach by depth of poverty: Some evidence from India (1)

**The majority of the beneficiaries of SHG Bank Linkage are from among the poorer segments -- World Bank-NCAER Rural Finance Access Survey (RFAS)**

SHG membership by type of households						
	Marginal	Small	Medium	Large	Others	Total
<b>Andhra Pradesh</b>						
SHG member (% households)	25.3	34.3	31.1	29	29.6	28.2
% of SHG members	43.3	14	11.4	11.4	19.9	100
<b>Uttar Pradesh</b>						
SHG member (% households)	10.3	5.4	5.3	4.1	6.7	8.2
% of SHG members	72.8	8.8	7.4	4.4	6.7	100

*Marginal = landholding less than 1 acre, Small = 1-2 acres, Medium = 2-4 acres, Large = more than 4 acres. Others includes households with or without land but involved in commercial activities.*

*Source: RFAS-2003 as reported in Priya Basu et. al., Scaling up Access to Fiannce for India's Rural Poor, World Bank, Washington DC: 2004*

# Outreach by depth of poverty: Some evidence from India (2)

- How successfully are SHGs in AP targeting the poorest?
  - The two quintiles above the poorest households are more likely to receive microfinance through the SHG Bank Linkage model, while the poorest and those in the top two income quintiles are less likely to be in SHGs.

# Outreach by depth of poverty: Some evidence from India (3)

- Is SHG bank Linkage more widespread in AP's poorer villages?
  - Absence of a strong relationship between *village-level* indicators of poverty and the number of SHGs.
  - The larger the village, the greater the number of SHGs found.
  - Higher rates of illiteracy are associated with fewer SHGs in the village.
  - Villages in the interior, away from good roads, have fewer SHGs.

## 2. Issues in Contract Design

# Key features of microfinance contracts that favor outreach

- Loans are ***uncollateralized***, or use collateral substitutes
- Contracts allow for ***continuity***
- ***Repeated loans*** create dynamic incentives for borrowers to repay. Repayment rewarded by larger loans; default penalized by a loss of access to future loans.
- Opportunity for clients to make all kinds of transactions (loans and repayments, deposits and withdrawals) ***frequently***, close to the home or business, ***quickly, privately and unobtrusively.***
- ***Flexibility***

# *Credit-with-insurance* contract

- BENEFIT: Reduces borrower vulnerability to sudden shocks
- CHALLENGES:
  - Repayment insurance could burden the credibility of MFIs – particularly if they are looking to transform to banks
  - Need for re-insurance
  - Increased administrative burden: need for better accounting practices, transparency and good supervision

### 3. Beyond Contract Design: *The Challenge of expanding microfinance outreach*

# The challenge of expanding microfinance outreach

- An enabling legal and regulatory framework for microfinance
- Attention to quality and financial sustainability
- Clear targeting of clients
- Product design and interest rates
- Composite services
- Staffing