

V. DEVELOPING SUSTAINABLE MICROFINANCE SYSTEMS

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Introduction

While many factors contribute to poverty, its most obvious manifestation is insufficient household income. Both the extent of income-generating opportunities and ability to respond to such opportunities are determined to a great degree by access to affordable financial services. Increasing the access of poor households to microfinance¹ is therefore being actively pursued worldwide. Once almost exclusively the domain of donors and experimental projects, microfinance has evolved during the last decade with prospects for viability, offering a broader range of services and significant opportunities for expansion.

Development practitioners, policy makers, and multilateral and bilateral lenders, recognize that providing efficient microfinance services is important for a variety of reasons. Improved access to microfinance services can enable the poor to smoothout their consumption, manage their risks better, build their assets, develop their micro-enterprises, enhance their income-earning capacity, and enjoy an improved quality of life. Microfinance services have a significant positive impact on the depth (severity) of poverty and on specific socio-economic variables such as children's schooling, household nutrition status, and women's empowerment.

Despite this, about 95 per cent of some 180 million poor households in the Asian and Pacific region still have little access to affordable institutional microfinance services. Significant resources are required to meet the potential demand. This chapter argues that on the supply side there is a need to build microfinance systems that can grow and provide microfinance services on a permanent basis to an increasing number of the poor through domestic resource mobilization. On the demand side, there is a need to invest in social intermediation² to enable the poor to optimally utilize microfinance services. The chapter analyses the status of microfinance in Asia and the Pacific, discusses means to develop microfinance systems capable of financing

¹ Microfinance is the provision of a range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and their microenterprises. Microfinance institutions (rural banks, cooperatives, NGOs etc.) are defined as institutions whose major business is the provision of microfinance services.

² Improving the condition for the excluded to access finance, for example, through grass-roots training in group formation and vocational and financial skills.

their growth for sustainable expansion, and provides an overview of the microfinance activities supported by the Asian Development Bank (ADB).

A. MICROFINANCE IN THE ASIAN AND PACIFIC REGION

Over 900 million people in about 180 million households in the region are poor, earning less than one dollar a day. More than 670 million poor people live in rural areas. Reliance on secondary occupations in rural areas is increasing as agriculture can no longer meet the income needs of the growing rural population. These occupations include paid employment, micro-enterprises, and services such as carpenters and weavers. The urban poor are engaged in self-employed businesses such as food stalls, tailoring and shoe repair. Women, who are a significant proportion of the poor and suffer disproportionately from poverty, operate many of these micro-enterprises. Corresponding to the higher rural poverty incidence, most of the microfinance institutions have a rural bias. However, the supply of microfinance to the urban poor has also markedly increased in recent years. In comparison with rural areas, microfinance service delivery in urban areas involves lower costs owing to higher population density as well as better infrastructure and economic opportunities.

1. Demand for microfinance services

The poor and low-income households as well as the micro-enterprises they undertake differ greatly in Asia and the Pacific. The collective demand of these groups for financial services is large and the types of services they demand vary across households and micro-enterprises. This large demand and the heterogeneity of services needed across households and micro-enterprises and over time have created scope for commercial financial intermediation.

Savings. Poor and low-income households and their micro-enterprises have a large demand for safe and convenient deposit services. The poor households have the capacity and willingness to save for emergencies, investment, consumption, social obligations, education of their children and other purposes. Savings are important for micro-enterprises and provide them with a major source of investment funds. Extensive use of informal savings arrangements by poor households is another indicator of their demand for savings facilities. The demand for deposit services is particularly strong among poor women in the Asian and Pacific region.

Microcredit. Demand for microcredit that originates both from households and micro-enterprises is also large. Poor households require microcredit to finance livelihood activities, for consumption smoothening, and to finance non-food expenses for purposes such as education, housing improvements and migration. Many countries in the region have numerous small farms and their operators also require microfinance services. The other source of demand is non-farm micro-enterprises, which cover a

wide array of activities such as food preparation and processing, weaving, pottery, furniture making and petty trading.

Others. The poor are the most vulnerable to economic and physical downturns. As a result, they forego potentially viable income-generating opportunities because of risk aversion. Therefore, the demand for insurance services among the poor is vast. For instance, micro-insurance products offered by microfinance institutions in Nepal have been subscribed to by most of the clients. This shows that the supply of such services creates its own demand because the real demand remains hidden in the absence of suitable products.

2. Supply of microfinance services

The microfinance market structure varies significantly across countries depending on their stage of financial development, level of economic development and policy environment. Most commercial banks do not serve the poor because of perceived high risks, high costs involved in small transactions, perceived low relative profitability, and inability of the poor to provide physical collateral. Thus, a segment of the poor households that has viable investment opportunities persists in poverty for lack of access to credit at reasonable cost. Most of the poor households also find it difficult to accumulate financial savings without easy access to safe institutions that provide deposit services.

Informal. The supply of microfinance services is dominated by informal sources. Their collective outreach, both breadth and depth, is vast in most countries. They supply mainly short-term credit and charge higher interest rates than semi-formal and formal sources. Because of the relatively greater bargaining power enjoyed by the informal suppliers in general, the terms and conditions under which services are provided do not enable the clients to fully harness economic opportunities. The informal sources operate in highly localized areas. Therefore, their contribution to financial intermediation and improvement of resource allocation is also limited.

Semi-formal. Semi-formal sources mainly comprise the NGOs. In virtually all countries NGOs have become important microfinance providers. Their involvement is important because their clients in general are poorer than those reached by many formal institutions, their services are targeted in most countries to serve poor women and services are provided largely on the basis of social collateral. The small average loan sizes of NGOs, which usually range from about \$30 to \$150 per loan account, suggest that their clients include the poorest. NGOs in some countries are trying to organize themselves into coalitions to improve microfinance standards and self-regulation. Some NGOs plan to graduate into formal financial institutions, illustrating the potential value of the NGO modality for expanding the services to a large number of poor households.

Formal. Formal refers to an organized, registered and regulated system of institutions providing microfinance services. The involvement of formal sources in microfinance has increased during the last two decades. This greater involvement has

stemmed from (a) the expansion of the scope of formal institutions into microfinance through downscaling (for example, Government Savings Bank, Thailand); (b) establishment of linkage programmes with semi-formal sources of different types (Self-help Group-Bank Linkage Programme, India); (c) the emergence of formal institutions focused on microfinance (for example, Grameen Bank of Bangladesh and Khushhalibank in Pakistan); (d) reforms of state-owned financial institutions (for example, unit desas of Bank Rakyat Indonesia); (e) the introduction of microfinance programmes by the governments through non-financial institutions (for example, Viet Nam Womens' Union); and (f) entry of private sector institutions (for example, Badan kredit-desa owned by Indonesian villagers). Cooperatives are also playing a significant role as financial intermediaries in the region, particularly in India, Sri Lanka, Thailand and Viet Nam. However, the formal operations concentrate mostly on providing credit facilities, and savings mobilization has yet to receive adequate attention, with few exceptions.

3. Major achievements in microfinance

The microfinance institutions and other microfinance providers have expanded their outreach from a few thousand clients in the 1970s to over 10 million in the late 1990s. The developments in microfinance in Asia and the Pacific have set in motion a process of change from an activity that was entirely subsidy dependent to one that can be a viable business.

- (a) The myth that poor households cannot and do not save has been shattered. Savings can be successfully mobilized from poor households.
- (b) Poor, especially poor women, have emerged as creditworthy clients, enabling microfinance service delivery at low transaction costs without relying on physical collateral.
- (c) Microfinance services have strengthened the social and human capital of the poor, particularly women, at the household, enterprise and community level.
- (d) Sustainable delivery of microfinance services on a large scale in some countries has generated positive developments in microfinance policies, practices and institutions.
- (e) Microfinance services have triggered a process toward the broadening and deepening of rural financial markets.

4. Major challenges

The achievement in microfinance in the region has been impressive relative to the status in the 1970s. However, a number of major problems remain.

(a) Policy environment

Despite general improvement in the policy environment for financial sector programmes, the policy environment for microfinance in many countries remains unfavourable for sustainable growth in microfinance operations. For example, in countries such as Viet Nam and China, ceilings on interest rates limit the ability of microfinance institutions to expand and diversify. Governments continue to intervene in

microfinance to address the perceived market failure through channelling microcredit to target groups that are considered to have been underserved by the existing institutions. Furthermore, government programmes with subsidized interest rates and poor loan collection rates undermine sustainable development of microfinance. As a result, most countries are crowded with poorly performing government microfinance programmes that distort the market, discourage private sector institutions from entering the industry, and affects the integration of microfinance into the financial sector.

(b) Inadequate financial infrastructure

Inadequate financial infrastructure (legal, information, and supervision and regulation) is another major problem. Most governments have focused on creating institutions or special programmes to disburse funds to the poor with little attention to building the financial infrastructure that supports, strengthens and ensures their sustainability. Lack of a legal framework conducive for the emergence and sustainable growth of small-scale microfinance institutions and corresponding supervisory and regulatory systems have impeded the expansion of market-based microfinance services by limiting their access to commercial sources of funding.

(c) Limited retail level institutional capacity

Most retail level institutions do not have adequate capacity to expand the scope and outreach of sustainable microfinance services. Many institutions lack the capacity to leverage funds, including public deposits, in commercial markets and are unable to provide a range of products and services compatible with client characteristics. In the absence of an adequate network and delivery mechanisms, many microfinance institutions are unable to cost-effectively reach the poorest of the poor, particularly those concentrated in resource-poor areas and areas with low population densities.

(d) Inadequate emphasis on financial viability

Inadequate emphasis on financial viability is the most serious problem of microfinance institutions in the region. This prevails among many NGOs, government-directed microcredit programmes, state-owned banks, and cooperatives providing microfinance services. As a result, only a few microfinance institutions are sustainable; most are not moving toward sustainability nor reducing subsidy dependence. Viability is important from an equity perspective because only viable institutions can leverage funds in the market to serve a significant number of clients.

(e) Inadequate investment in agriculture and rural development

Agricultural growth, which underpins much of the growth in the rural non-farm subsector, significantly influences rural financial market development. Inadequate investment in the sector is a major constraint on the development of sustainable microfinance services. The insufficient investments in physical infrastructure (especially irrigation; roads; electricity; and support services for marketing, business development and extension) continue to increase the risk and cost of microfinance and particularly discourage private investments in the provision of microfinance services on

a significant scale. In addition, in the absence of economic opportunities created by growth-inducing processes, microfinance cannot be expected to play a significant role in poverty reduction.

(f) Inadequate investment in social intermediation

The low level of social development, a distinctive characteristic of the poor in Asia and the Pacific is another major constraint. This is particularly true with respect to the poorest, women in poor households, the poor in resource-poor and remote areas, and ethnic minorities. The development of sustainable microfinance to reach a large segment of the potential market requires supporting social intermediation on a large scale. Private sector investments in social intermediation are unlikely in view of the externalities associated with such investments.

5. Lessons learned

Microfinance is a critical element of the overarching poverty reduction objective of ADB. During the period 1988-2000, ADB approved 21 microfinance projects and 24 projects with microfinance components totalling \$741 million (table 1). Over the same period, 60 technical assistance projects totalling \$31 million were also approved for social mobilization, training of clients, and institutional strengthening (table 2). Increasing attention is being given by ADB to sector analysis and policy dialogue for establishing self-financing microfinance systems, as resources required to serve the potential market are far beyond what funding agencies and governments can provide.

In general, the early microfinance projects did not make a significant poverty reduction impact because of their limited outreach. There was no mechanism to sustain the positive impact on a small number of clients beyond the project period. Poor infrastructure, sluggish agricultural growth, and limited markets imposed serious limitations on the potential for broad-based growth in rural areas and access to credit could contribute little to permanent improvements in income for clients of microfinance projects under such conditions. Thus, to maximize their development impact, it is essential to integrate microfinance services with other critical measures aimed at reducing poverty.

Other lessons learned include:

- (a) Microfinance is an effective way to assist and empower poor women, who make up a significant proportion of the poor and suffer disproportionately from poverty;
- (b) Microfinance clients are more concerned about access to services that are compatible with their requirements than about the cost of the services;
- (c) Social mobilization is necessary to introduce the poor to a market-oriented institutional environment. This is particularly true for poor women and the poorest of the poor. It is important, however, to distinguish between financial intermediation and social intermediation in designing support programmes;

Table 1. Asian development bank-financed microfinance projects, 1988-2000

<i>Project no.</i>	<i>Year of approval</i>	<i>Country</i>	<i>Project title</i>	<i>Loan amount (Millions of US dollars)</i>
I. Microfinance projects				
1L940-PHI (SF)	1988	Philippines	NGO Microcredit	8.00
2L1037-NEP (SF)	1990	Nepal	Third Small Farmers Development	30.00
4L1066-BAN(SF)	1990	Bangladesh	Rural Training	16.30
5L1067-BAN (SF)	1990	Bangladesh	Rural Women Employment	8.00
7L1137-PHI (SF)	1991	Philippines	Second NGO Microcredit	30.00
9L1213-BAN (SF)	1992	Bangladesh	Rural Poor Cooperatives	30.00
10L1237-NEP (SF)	1993	Nepal	Microcredit for Women	5.00
11L1290-MON (SF)	1993	Mongolia	Employment Generation	3.00
12L1327-INO (SF)	1994	Indonesia	Microcredit Project	25.70
13L1435-PHI (SF)	1996	Philippines	Rural Micro-enterprise Finance	18.12
14L1524-BAN (SF)	1997	Bangladesh	Participatory Livestock Development	16.58
15L1529-KGZ (SF)	1997	Kyrgyzstan	Rural Financial Institutions	11.87
16L1634-BAN(SF)	1998	Bangladesh	Rural Livelihood	42.26
17L1650-NEP(SF)	1998	Nepal	Rural Microfinance	18.66
18L1741-CAM(SF)	2000	Cambodia	Rural Credit and Savings	20.00
19L1805-PAK(SF)	2000	Pakistan	Microfinance Sector Development Programme	70.00
20L1806-PAK(SF)	2000	Pakistan	Microfinance Sector Development Project	80.00
21L1768-PNG(SF)	2000	Papua New Guinea	Microfinance and Employment	9.60
			Subtotal	443.09
II. Projects with microfinance components^a				
1971/972	1989	Philippines	Fisheries Sector Programme	30.00
21128 (SF)	1991	Sri Lanka	Southern Province Rural Development	6.40
31179 (SF)	1992	Pakistan	NWFP Barani Area Development	7.90
4L1201-SRI (SF)	1992	Sri Lanka	Fisheries Sector Programme	4.00
5L1457-VIE (SF)	1996	Viet Nam	Rural Credit Project	2.00
8L1461-NEP(SF)	1996	Nepal	Third Livestock Development	4.61
9L1531-PAK (SF)	1997	Pakistan	Dera Ghazi Khan Development	2.75
10L1549-IND(SF)	1997	India	Housing Finance	45.00
11L1550-IND(SF)	1997	India	Housing Finance	30.00
12L1551-IND	1997	India	Housing Finance	20.00
13L1583-INO	1997	Indonesia	Rural Income Generation	20.40
14L1609-NEP(SF)	1998	Nepal	Community Groundwater Irrigation Sector	12.98
15L1605-INO	1998	Indonesia	C.Sulawesi Integrated Area Dev. and Conservation	1.58
16L1672-PAK(SF)	1999	Pakistan	Malakand Rural Development	5.28
17L1771-BAN(SF)	2000	Bangladesh	Chittagong Hills Tract Rural Development	1.60
18L1758-IND	2000	India	Housing Finance II	25.00
19L1760-IND	2000	India	Housing Finance II	5.00
20L1761-IND	2000	India	Housing Finance II	10.00
21L1802-VIE(SF)	2000	Viet Nam	Rural Enterprise Finance	42.00
22L1766-INO	2000	Indonesia	Community Empowerment for Rural Development	15.00
23L1822-MON	2000	Mongolia	Agriculture Sector Project	5.50
24L1786-KGZ	2000	Kyrgyzstan	Skills and Entrepreneurship Development	0.80
			Subtotal	297.80
			Grand Total	740.89

^a Includes co-financing by other agencies.

^b The amounts refer to the size of the microfinance component.

- (d) Given the diversity of demand for financial services, a broad range of institutional types is required to expand outreach;
- (e) Expansion of the outreach of savings services can have a potentially significant impact on both institutional sustainability and poverty reduction;
- (f) Adoption of financial system development is the key to achieving sustainable results and to maximizing development impact. This approach emphasizes an enabling policy environment, financial infrastructure, and the development

Table 2. Asian development bank-financed technical assistance for microfinance 1988-2000

<i>Year</i>	<i>I. Project preparatory technical assistance</i>	<i>Amount (US dollars)</i>	<i>Year</i>	<i>II. Advisory technical assistance</i>	<i>Amount (US dollars)</i>
1989	TA 1133-NEP: Third Small Farmers	99,000	1989	TA 1092-PHI: Micro-enterprise Sector	595,000
	TA 1155-BAN: Non-Farm Employment Creation for Women	99,000			
	Subtotal	198,000			
1991	TA 1617-PHI: Rural Credit	640,000			
1993	TA 1849-INO: Microcredit	455,000	1993	TA 1871-NEP: Institutional Strengthening of ADBN	690,000
	TA 1840-MON: Employment Generation	100,000		TA 1903-NEP: Group Formation and Training of Women Beneficiaries	
	Subtotal	555,000		TA 2020-MON: Institutional Enhancement for Employment Generation	598,000
				Subtotal	1,288,000
			1994	TA 2232-BAN: Training of Cooperative and Field Staff	1,310,000
				TA 1807-BAN: Institutional Strengthening of Bangladesh Rural Development Board	600,000
				TA 2277-INO: Microcredit	1,000,000
				Subtotal	2,910,000
1995	TA 2293-BAN: Rural Livelihood	287,000	1995	TA 2449-KAZ: Study of Rural Credit and Savings	470,000
	TA 2410-BAN: Urban Poverty Alleviation	600,000			
	TA 2426-BAN: Participatory Livestock	598,000			
	TA 2453-KRY: Agriculture Credit	910,000			
	Subtotal	2,395,000			

Table 2. (Continued)

1996	TA 2700-IND: Housing Finance Facility *	100,000	1996	TA 2601-CAM: Rural Credit Review	100,000
	TA 2634-INO: Rural Income Generation	493,000		TA 2105: Country Institutional Strengthening of Agricultural Banking Services *	205,000
	TA 2604: PAK: Malakand Rural Development *	800,000		TA 2524-THA: Institutional Strengthening of Bank of Agriculture and Agricultural Cooperatives *	500,000
	TA 2624-UZB: Rural Enterprise Development	100,000		TA 2558-PHI: Strengthening Rural Micro-enterprise Finance	600,000
	Subtotal	1,493,000		Subtotal	1,405,000
1997	TA 2818-CAM: Rural Credit and Savings	600,000	1997	TA 2939-PRC: Reform of the Rural Credit Cooperative System *	997,000
	TA 2836-NEP: Rural Finance	500,000		TA 2851-NEP: Third Livestock Development *	750,000
	TA 2918-PAK: Balochistan Rural Development *	800,000		Subtotal	1,747,000
	TA 2937-PAK: Rural Microfinance	600,000			
	Subtotal	2,500,000			
1998	TA 3132-PAK: Sindh Rural Development *	800,000	1998	TA 3078-BAN: Establishment of a Framework for Sustainable Microfinance	800,000
	TA 2991-VIE: Second Rural Credit *	150,000		TA 3143-PRC: International Symposium on Microfinance and Urban Unemployment in China	150,000
	Subtotal	950,000		Subtotal	950,000
1999	TA 3213-BAN: Chittagong Hill Tracts Rural Development*	500,000	1999	TA 3270-CAM: Capacity-Building for Rural Financial Services	1,450,000
	TA 3288-IND: Housing Finance II *	405,000		TA 3344-IND: Strengthening Microfinance Institutions for Urban and Environmental Finance	500,000
	TA 3315-PNG: Microfinance and Employment	150,000		TA 2558-PHI: Strengthening Rural Micro-enterprise Finance	600,000
	TA 3254-UZB: Rural Savings and Credit Union Development	600,000		TA 3227-VIE: Strengthening Corporate Governance at Viet Nam Bank for Agriculture and Rural Development *	900,000
	TA 3206-VAN: Rural Financial Services	250,000		Subtotal	3,450,000
	Subtotal	1,905,000			

* The scope of these TAs included microfinance, among other things.

Table 2. (Continued)

2000	TA 3397-MON: Rural Finance	700,000	2000	TA 3435-ETM: Microfinance	150,000
	TA 3581-NEP: Information and Communication Technology for Improved Financial Services Provision	565,000		TA 3556-ETM: Strengthening the Microfinance Policy and Legal Framework	250,000
	Subtotal	1,265,000		TA 3480-IND: Reducing Poverty in Urban India *	300,000
				TA 3413-LAO: TA Cluster for Rural Finance Development	2,020,000
				TA 3555-TAJ: Support to Rural Financial Systems Development	150,000
				Subtotal	2,870,000
III. Regional Technical Assistance					
1992	TA 5496: Regional Workshop on Banking with the Poor	15,000			
1995	TA 5634: Review of Micro-enterprise	300,000			
1997	TA 5723: Fourth Consultative Group Forum	150,000			
	TA 5744: Economic and Policy Analyses in Pacific Developing Member Countries	600,000			
1999	TA 5836: Consultations on the Bank's Microfinance Development Strategy	400,000			
	TA 5851: Rural Financial Systems Workshop in Central Asia	360,000			
	TA 5889: Gender and Development Initiatives *	850,000			
2000	TA 5950: Financial Services for Poor Women	600,000			
	TA 5952: Commercialization of Microfinance	700,000			
2001	TA 5984: Microfinance Outreach Initiatives for the Consultative Group to Assist the Poorest				
	Total	3,875,000			
	Grand Total (I + II + III)	31,461,000			

* The scope of these TA included microfinance.

of viable microfinance institutions that can provide a variety of financial services, not just credit;

- (g) Strong retail institutions committed to outreach and sustainability are essential for extending the permanent reach of financial services and for a significant impact on poverty reduction. Thus, building the capacity of institutions with a commitment to reach the poor is vital;
- (h) Microfinance can contribute to the development of the overall financial system through the integration of financial markets.

The collective experience of ADB and other funding agencies confirms that microfinance can play an important role in poverty reduction, and the economic and social benefits can be large. The challenge is to mainstream good practice in microfinance operations and increase outreach to the poor on a sustainable basis. Experience also indicates the importance of integrating microfinance operations with the broader financial system to sustain outreach.

B. TOWARDS A SUSTAINABLE MICROFINANCE SYSTEM

To realize the poverty reduction potential of microfinance, substantial continuing resources are required to provide institutional microfinance services to the potential clients who are currently outside formal finance in the Asian and Pacific region. Efficient institutional and market mechanisms are needed whereby funds can be sourced and allocated efficiently through appropriately designed and priced services to the poor for profitable investment in agriculture and micro-enterprises. Hence, there is a need to catalyse the growth in supply of sustainable microfinance services and strengthen the capacity of the potential clients to access the services. This can be facilitated through support for the following mutually reinforcing areas:

- Creating a conducive policy environment
- Developing critical financial infrastructure
- Developing viable microfinance institutions
- Pro-poor innovations in financial technology
- Social intermediation

1. Policy environment

In many countries, the lack of an enabling policy environment for microfinance continues to be a major constraint. Relevant policy reforms include undertaking interest rate reforms for microcredit and savings, creating an environment sufficiently flexible to accommodate a wide array of microfinance service providers to meet the diverse demand, and redefining the role of the state and the central banks in microfinance development to facilitate the participation of private sector financial institutions. Given that non-financial policies such as agricultural pricing and taxation of micro-enterprises also have a critical role in the sustainable development of microfinance, the policy

reforms need to be extended to address such issues where they constitute significant constraints.

2. Financial infrastructure

Microfinance institutions can develop sustainable commercial services on a permanent basis and expand their scope of operations and outreach only if they operate within an appropriate financial infrastructure, such as information systems and training facilities. The legal framework and supervision and regulation of microfinance institutions, including self-regulation and performance standards need to be established to facilitate sound growth and improve the capacity of microfinance institutions to leverage funds in the market and provide competition. However, legal and regulatory systems should not discourage financial innovations, stunt institutional growth, and prevent the emergence of a diverse set of dynamic institutions. Legal barriers preventing banks from establishing business relationships with informal or semiformal bodies, such as community-based organizations or self-help groups, will need to be removed.

3. Developing viable microfinance institutions

Viability is critical for expanding the outreach of microfinance institutions to achieve the primary objective of poverty reduction. The institutional development support for viability needs to encompass (a) ownership and governance, (b) diversified products and services, (c) management information systems and accounting policies and practices, (d) management of portfolio quality and growth, (e) systems, procedures and financial technology for reducing transaction costs, and (f) training facilities. In countries where state-owned agricultural and rural development banks continue to undermine the development of sustainable microfinance operations, reform of such banks is necessary. In some circumstances, especially in transitional economies that lack appropriate institutions to efficiently provide microfinance, new institutions may be needed.

4. Pro-poor innovations

Those in resource-poor and low-population density areas, the poorest of the poor, and ethnic minorities often tend to be excluded by financial institutions because of risk-return considerations, although the social returns to reaching these clients may be high. Therefore, it is important to support microfinance institutions and other financial institutions to expand the services to these categories through innovative programmes, the development of financial technology that contribute to breaking these barriers through pilot projects and other measures that aim at establishing linkages between formal financial institutions and informal service providers.

5. Social intermediation

Investment in social intermediation is necessary to increase the capacity of the poor to access and productively use microfinance services. Such investments, among other things, should support (a) awareness-building programmes on a broad range of microfinance services; (b) information dissemination on service providers; (c) basic

literacy, numeracy and skills training for women, ethnic minorities, and other disadvantaged groups; and (d) social mobilization for the formation of community-based organizations and solidarity groups to actively participate in microfinance markets.

C. CONCLUSIONS

The landscape of microfinance is changing as a result of increasing understanding of how the poor use money and their diverse demands for financial services. Correspondingly, the microfinance industry is evolving into an increasingly commercial operation to serve a larger segment of the potential market. A number of challenges need to be overcome to facilitate and accelerate this process to realize the vast potential of microfinance. This calls for a comprehensive approach, as outlined above, that takes cognizance of the diversity of microfinance development issues across countries. ADB interventions in support of microfinance pursue this approach to catalyse the development of sustainable microfinance systems in the region. With a view to leveraging its support, ADB is coordinating with other funding agencies involved in microfinance and enhancing the involvement of its private sector operations in microfinance.

