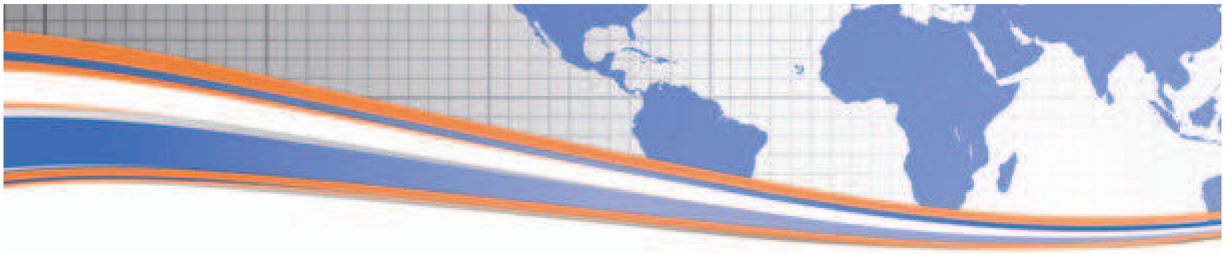

Microfinance in Africa

Policy brief no.7 - November 2011[1]

Only 12 percent of households in Sub-Saharan Africa have deposit accounts in formal financial nstitutions[2]. This is by far the lowest share of banked households in any region in the world. Yet access to savings, credit, insurance, payments and other financial services play a vital role in enabling households to cope with financial shocks and protect and build their assets. Financial inclusion is defined by the OECD as "the process of promoting affordable, timely and adequate access to a range of regulated financial products and services and broadening their use by all segments of society through the implementation of tailored existing and innovative approaches including financial awareness and education with a view to promote financial wellbeing as well as economic and social inclusion." Microfinance, which focuses specifically on poor and low income clients, is at the core of any financial inclusion strategy, but must be seen within the broader financial system. The challenge for Africa is to expand access, while ensuring that such access is accompanied by proportionate regulation, supervision and education to safeguard the security and stability of the financial system as well as protect and empower consumers and clients.

The financial sector in Africa is characterized by a number of weaknesses – small size, lack of financial depth, a high degree of informality, regulatory deficiencies – that impact negatively on the provision of microfinance services.

Continent-wide there are only 163 deposit accounts and 258 loan accounts in commercial banks per 1,000 adults compared to 737 and 258, respectively, for developing countries as a whole. On average, there are only 3 bank branches and 5 Automated Teller Machines (ATMs) available per 100,000 adults on the continent, compared to 10 branches and 29 ATMs for the developing world as a whole[3].

Table 1: Microfinance Institutions in Sub-Saharan Africa, Outreach in 2008

	Borrowers *thousands*	Loan Portfolio *Mil USD*	Depositors *thousands*	Deposits *Mil USD*
Sub-Saharan Africa	7,771	4,700	21,582	5,200
Central Africa	374		1,033	
Eastern Africa	4,519		11,806	
Southern Africa	1,121		2,171	
Western Africa	1,757		6,571	

Source: MIX and CGAP (2011): Sub-Saharan Africa 2010 Microfinance Analysis and Benchmarking Report

This document is part of a series of policy briefs produced by the United Nations Office of the Special Advisor on Africa (OSAA) and the NEPAD-OECD Africa Investment Initiative for African policymakers and their development partners. The policy briefs provide an overview of key economic and development issues affecting Africa today. The policy brief on microfinance was prepared in cooperation with the United Nations Capital Development Fund (UNCDF). The briefs are available at www.un.org/africa/osaa, and at www.oecd.org/daf/investment/Africa. For more information, please contact: David Mehdi Hamam, Chief (OSAA) at hamamm@un.org or Karim Dahou, Executive Manager (NEPAD-OECD Initiative) at karim.dahou@oecd.org.

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Notwithstanding the overall low level of penetration in the region, the region is experiencing relatively high growth rates, with the number of borrowers increasing by 20% over the previous year to 7.8 million and the number of savers increasing 30% to 21.6 million. The volume of deposits also exceeds that of borrowing, at $ 5.2 billion and $ 4.7 billion respectively. [FN: MIX and CGAP: MIX Microfinance World: Sub-Saharan Africa Microfinance Analysis and Benchmarking Report 2010. Washington, D.C. April 2011.] The robust growth in savings in the region during the economic crisis has only gained momentum and allows the region to reduce its dependence on cross-border funding and maintain a relatively low cost of funds.

The market structure in terms of financial service providers has changed substantially in recent years, with banks experiencing high growth rates in both borrowers and depositors from initially low levels. Microfinance continues to be delivered through a range of institutional types, with credit unions/cooperatives predominating in West and Central Africa, non-bank financial institutions predominating in East Africa, and banks dominating in Southern Africa. NGOs continue to play an important role throughout the region, particularly in terms of borrowers (18% of borrowers), while reaching only 8% of savers — which is not surprising given regulations regarding deposit-taking.

The dominance of savings reflects the significant role that banks and credit unions play in the microfinance sector in Africa. Non-deposit taking financial institutions reach a comparable number of clients as borrowers, but even there the average size of a loan from a non-deposit taking institution is much smaller than that of a bank or credit union. Because of the limited dependence of the sector on external and donor flows, African MFIs were less vulnerable to the global financial crisis and the temporary drought of financial flows in 2008 and weathered the storm relatively well.

An analysis of other financial services reveals a similar picture. A study by ILO found that 14.7 million Africans were covered by microinsurance, which is a mere 2.6 percent of the estimated potential target population[5]. Given that the financial risks that pose the greatest threat to household financial security as perceived by clients themselves are insurable events such as theft, fire, and destruction of property, serious illness or accident of a household member, and death and related funeral expense[6], increased access to these services could have a significant impact on the poor.

Poor people, like everyone else, also need convenient, safe, and efficient ways of making payments. Technological advances such as the use of mobile technology can facilitate transactions and lower financial, transaction, and opportunity costs, particularly to people living in more remote, less densely populated areas that are expensive to serve (see Box on M-PESA). Mobile banking services are or soon will be available in 28 countries, with Kenya and South Africa as the pioneers[4]. Much can be done to support development and extension of these services as well as ensure that regulators take an approach of "test and learn" that allows for innovation and develops regulation as tested approaches become ready for scale up and/or replication.

M-PESA and M-KESHO – The Promise of Mobile Banking

Kenya has witnessed the world's most rapid growth of the use of mobile money. The mobile-phone based payment and money transfer service known as M-PESA was launched in 2007 and has spread extremely quickly to service more than 13 million customers by the end of 2010. M-PESA's success has allowed the provider, Safaricom, to expand its range of services and offer a range of innovative financial products based on mobile phone technology. Customers can now earn moderate interest on mobile bank accounts, while farmers can insure their crops against adverse weather conditions and payouts are made directly to their phones if weather conditions indicate crop failure. Furthermore, through a partnership between Safaricom and EquityBank called M-KESHO, clients now also have access to savings accounts, using mobile transactions to deposit and withdraw savings.

Source: Jack, William and Tavneet Suri (2011): Mobile Money. NBER Working paper 16721

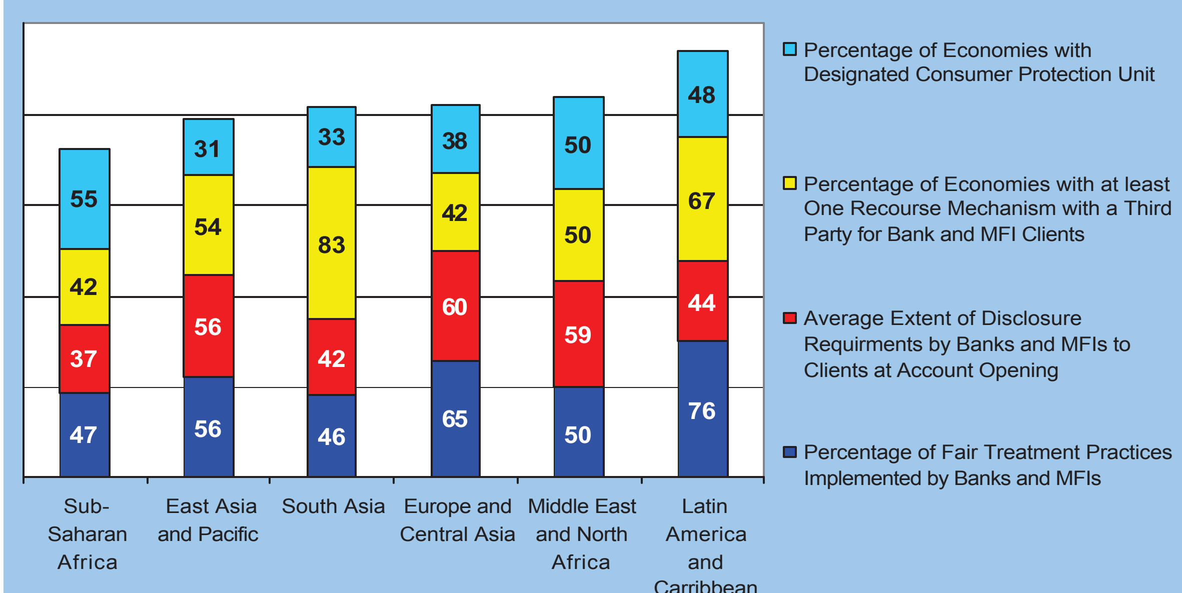
Policy Challenges and Opportunities

The triple food, fuel, and financial shocks in 2008 reminds us that financial access must be accompanied by appropriate prudential regulations and market conduct (you could make reference here to the G20 principles on financial consumer protection developed under the aegis of the OECD together with the FSB and other relevant international institutions) that can, amongst other things, mitigate the impact on the poor. African governments are increasingly including microfinance in their regulatory framework, whether as part of banking legislation, non-banking financial institution legislation, or microfinance-specific legislation[7]. Moreover, the OECD together with the FSB and other relevant financial institutions, developed principles on financial consumer protection , endorsed by the G20, which demonstrate the global trends towards increased financial consumer protection and market conduct. Despite progress in recent years, however, weaknesses and gaps remain at the micro-, industry- and macro-levels. Many countries lack regulations that adjust the regulation in proportion to the systemic risks posed by the scope and type of activities. Some countries do not adequately regulate and supervise all financial services providers, and financial cooperatives may still be regulated by generally cooperative authorities rather than by specialized financial regulators. Reporting and accounting standards are being improved, though there is a need to accelerate progress.

The capacity for supervision of the microfinance sector continues to lag behind. In order to address this capacity constraint, central banks in some countries regulate only deposit-taking institutions, while the ministry of finance or other ministries supervise non-deposit taking entities. Legal systems are often overstretched or do not have appropriate protections and recourse (such as commercial courts) to facilitate a robust financial sector. This limited supervision capacity is further strained by requirements for implementation of anti-money laundering and counter-terrorism financing (AML/CTF) requirements that have some unintended consequences of limiting access to financial services[8]. Central banks and governments should approach regulation and supervision seeking a balance between access and stability and security and taking into consideration their capacity to implement and the proportionate risks to the financial system.

Because they have fewer assets and resources and have less access to information, poor and low income clients are particularly vulnerable to financial shocks and crises, as well as inappropriate treatment by financial services providers. Policymakers and other stakeholders have seen the fallout from crises in the sector in other countries (for example, over-indebtedness in Morocco, Bosnia-Herzegovina, Pakistan and Nicaragua, and the repayment crisis in Andhra Pradesh in India). As a result, client protection is has become a central theme in industry efforts to self-regulate as well as in policy makers' actions to ensure that expanded access to finance is to fair and transparent services. Yet at present, Sub-Saharan Africa is still lagging behind other regions in both consumer protection legislation and implementation (see Figure 1).

Figure 1: Consumer Protection Legislation and Implementation



Source: CGAP / World Bank (2010): Financial Access 2010. Washington D.C.

The purpose of client protection in microfinance is to protect the interests of consumers and to promote quality services and fair competition. Governments need to attend to transparency, particularly through pricing disclosure; fair treatment, through ethical staff behavior, selling practices, and secure client data; and effective recourse through fair resolution of customer complaints. Regulations should be proportionate to the risk and should focus on protecting depositors—appropriate deposit-insurance can be one approach. The costs of complying with consumer protection rules should not make serving low income customers unattractive which may have the unintended effect of "protecting the poor out of the market."[9]

Greater financial awareness and skills on the part of clients themselves would substantially reduce their vulnerability. Clients need to be able to understand their options, make informed decisions about financial products and services, and manage the finances of their businesses and households. Higher financial literacy would empower clients to more effectively protect their own interests. Both governments and development partners can facilitate the building of client confidence and skills, e.g. by supporting the development of appropriate industry infrastructure and/or by conducting financial literacy strategieslike in the case of Ghana's National strategy for financial literacy and consumer education in microfinance[10] .

In its approval of "Key Principles of Microfinance" African Union member states signalled their commitment to promoting increased access to microfinance based on sound policies and practices, while safeguarding financial stability and protection the consumer. Actions to translate this commitment into reality at the country and regional level will be essential to expand access to financial services and thereby contribute to the achievement of the Millennium Development Goals.

Funding

In Africa, deposits represent nearly 60% of the funding structure – higher than any other region[11]. Cross-border funding is growing, but is concentrated on five countries (Ethiopia, Ghana, Kenya, Mozambique, and Uganda). Cross-border funding is dominated by donors, including bilateral and multilateral development agencies with investors including development finance institutions and institutional and individual investors and even microfinance investment vehicles on the rise.[12] Notwithstanding a strong deposit base and growing cross-border funding, "too little funding" is still perceived as an important and growing risk for the region.[13] Institutional capacity is still seen as a major constraint to the growth of and of further investments in the sector.

Outlook

The promotion of financial inclusion is of even greater importance in Africa, particularly following the global food, fuel, and financial crisis. Microfinance has already promoted poverty alleviation and contributed effectively to domestic resource mobilization. But governments and external development partners have a fundamental role to play in consolidating the development and guaranteeing the sustainability of microfinance in African countries. As recommended by the African Union, donors should support the strengthening of country systems for establishing financial sector soundness and appropriate policy, regulatory, supervisory and legal frameworks for microfinance. For more effectiveness in poverty alleviation and food security, there is scope for developing sectors like agriculture financing by enhancing market infrastructure and, by developing micro-insurance services, amongst other things. Lastly, individual consumers should reinforce their financial awareness and skills in order to enable to make savvy financial decisions for their own well being.

Notes

1. This Policy Brief is based in large part on OSAA (2011): Microfinance in Africa: Overview and Suggestions for Action by Stakeholders. New York
2. CGAP / World Bank (2010): Financial Access 2010 – The State of Financial Inclusion through the Crisis. Washington D.C.
3. Ibid.
4. MIX and CGAP (2010): Sub-Saharan Africa 2009 Microfinance Analysis and Benchmarking Report. Washington D.C.
5. ILO (2010): The Landscape of Microinsurance in Africa. Geneva.
6. FinScope Africa Surveys: Risks to household finances—a look at several African Countries." September 2007. FinScope.
7. According to information collected in CGAP's "Overview of Microfinance Related Legal and Policy Reform in Sub-Saharan Africa," all but three African countries explicitly cover microfinance in legislation or regulations
8. See the Financial Action Task Force (FAFT) 40 Principles. Examples of policies that have the effect of limiting access to poor and low-income clients include the Know Your Customer (KYC) regulations that require checking clients' identification and verifying their address.
9. Brix, Laura, and Katharine McKee. 2010. "Consumer Protection Regulation in Low-Access Environments: Opportunities to Promote Responsible Finance." Focus Note 60. Washington, D.C.: CGAP
10. For more information about financial literacy, please see www.financial-education.org
11. MIX and CGAP (2011): Sub-Saharan Africa 2010 Microfinance Analysis and Benchmarking Report. Washington D.C.
12. CGAP: 2009 Microfinance Funder Survey. Washington, D.C.
13. Microfinance Banana Skins 2011 : Losing its fairy dust. The CSFI survey of microfinance risk. Washington DC, 2011.