

Microfinance in the Service of Poverty Reduction

Frankfurt, February 2007

Microfinance Reduces Poverty

Micro and small enterprises contribute significantly to people's employment and incomes in developing countries – especially for the low-income, poorer groups of the population. Typically their enterprises lack especially access to financial services; as a consequence they are excluded from many economic opportunities. This is the starting point for the microfinance engagement of KfW Entwicklungsbank, the German development bank responsible for Financial Cooperation on behalf of the Federal Ministry of Economic Cooperation and Development. The goal of its microfinance initiatives is to create and strengthen a sustainable access of disadvantaged groups to credit, savings and other financial services (e.g. payment services or money transfers, and micro-insurance). Studies show that the promotion of financial sector development, and especially microfinance, makes a significant **contribution to the achievements of the UN Millennium Development Goals** in helping to reduce poverty. Children of poorer families tend to attend school when their parents have access to savings and loans which contributes to an improved economic situation of their households. Similarly positive effects can be seen through the offer of health and nutritional advice in combination with access to savings and loans by many Microfinance Institutions (MFIs). Such services have reduced mother and child mortality rates among MFI clients, as studies confirm for instance in Bolivia and Uganda. The experience of KfW, such as in Cambodia (ACLEDA), Mongolia (Credit Mongol) and India (SEWA), also indicates that microfinance contributes to strengthening the role of women in society.

Scope of Microfinance Initiatives in Financial Cooperation

KfW Entwicklungsbank, on behalf of the German Government, currently supports **100 microfinance initiatives in 42 developing and trans-**

formation countries reaching more than 12 million people. A wide variety of complementary approaches is characteristic for the Financial Cooperation (FC) in microfinance: one approach is to establish new microfinance institutions which focus on the target group (so-called '**greenfielding**' initiatives). This involves equity investments in trust as well as at KfW's own risk and also long-term refinancing accompanied by extensive measures to build staff capacity. These microbanks have garnered international recognition and proved successful even in difficult political or economic conditions, such as in the Balkan region (e.g. Bosnia and Herzegovina, Kosovo, Albania), the Caucasus region (e.g. Georgia, Azerbaijan), and in Central and South America (e.g. Haiti, El Salvador). Due to these achievements, the International Finance Corporation (IFC), a member of the World Bank Group, has asked KfW Entwicklungsbank to participate in the establishment of microbanks also in Afghanistan and Tajikistan as well as in Angola, Mozambique and Congo.

Strengthening financial non-governmental organisations or unlicensed microfinance institutions with staff capacity building, equity investments and loans to finance the greater availability of credit to microclients is another approach. It assists these small organisations in receiving a bank licence and to then also contribute more effectively to the mobilisation of savings (so-called '**upgrading**' or '**transformation**' initiatives). Successful examples include the transformation of FEFAD into ProCredit Bank in Albania, the support of the microfinance institution and now bank ACLEDA in Cambodia and the strengthening of Credit Mongol in Mongolia.

In some cases local commercial banks can become attracted to offering microloans. KfW Entwicklungsbank supports them with credit lines in local and foreign currencies to help them

grow their microloan portfolios as well as with staff capacity building in setting up microfinance departments or branches (so-called '**down-scaling initiatives**'). This approach has been particularly successful in Southeast Europe and the Caucasus regions (e.g. through the German-Azerbaijani Fund, German-Armenian Fund, and German-Ukrainian Fund). With the European Fund for Southeast Europe (EFSE), KfW Entwicklungsbank as promoter and investor supports a globally unique **public private partnership** with, among others, Sal. Oppenheim Pramerica and Bankakademie. EFSE supports **down-scaling initiatives in Southeast Europe** in cooperation with the Governments of Germany, Switzerland and Austria, EBRD, the EU, and IFC.

In linking microfinance institutions with local as well as international financial markets (so-called '**linkage initiatives**') the results-oriented collaboration of KfW Entwicklungsbank with other implementing agencies plays a particularly important role. For instance, collaboration with GTZ and UNDP in Mali made it possible to strengthen village savings banks to the point of their acceptance as partners by larger local commercial banks in refinancing and in the payment system. The village banks thus receive funds which allow them to expand their microlending to more clients.

Another example of "linking" is the microfinance fund in Morocco, set-up by KfW with local and international shareholder partners (CDG, CDC, AFD). The Fund – unique in the Arab world - is an investment forum for local banks and further international partners as well as a forum for an intensified dialogue between donor institutions, the Moroccan state and the microfinance institutions.

Many microfinance institutions (MFIs) remain small and reach relatively few clients mainly due to a lack of equity capital and long-term financing. To reduce this gap, an investment company, ProCredit Holding AG, which contributes to the growth of MFIs with equity investments, was founded in 1998 by a like-minded group consisting of KfW Entwicklungsbank, IFC, EBRD the Netherlands Development Finance Company FMO, and the private partners Commerzbank and the Frankfurt-based consulting firm IPC, as a key initiator.

Meanwhile, this has developed into a network of microbanks called ProCredit Banks which have to date been established in 19 countries. They serve more than 2.6 million households and microenterprises with microloans, savings, and payment products. These microbanks are based mainly in Latin America and Southeast Europe with a growing number also in Sub-Sahara Africa. ACCION and FINCA, two other microfinance networks supported through KfW Entwicklungsbank, serve an almost equally large number of microclients with regional foci in Africa and Latin America.

KfW Entwicklungsbank has emerged as one of the leading stakeholders and investors in microfinance initiatives. Its current portfolio of microfinance initiatives amounts to **EUR 612 million (as of December 2006; FC portfolio outstanding)**. More than one third of the funds are invested by KfW at its own risk.

An International Leader - German Development Cooperation in Microfinance

KfW's performance in supporting microfinance and the development policy of the German Government in microfinance received a very positive rating by a peer review of CGAP in 2003. Assessed along with 17 peer institutions, KfW reached a top rating. In comparison with other donor and implementing agencies the review highlighted the following aspects as positive: (i) microfinance seen as an integral part of financial sector development; (ii) consistent implementation of international good practice standards; and (iii) high technical qualification of staff and a wide variety of microfinance support instruments.

