

The Moroccan association Al Amana was set up in 1997. It employs 2 000 people, has a portfolio of 500 000 clients, and has now become the biggest microfinance institution in North Africa. In this article, its CEO, Fouad Abdelmoumni, makes a review of the different sources of financing that need to be mobilized – and the challenges that this implies – in order to ensure growth in the microfinance sector.

# What resources to finance the development of the microfinance sector?

*Microfinance is booming and requires considerable additional funds. The equity of microfinance institutions (MFIs) needs to be strengthened; private investors – that invest when certain conditions are met – can play a key role in this development. In terms of borrowed funds, although recourse to global markets may not be a solution, it is essential to mobilize public deposits and bank debt in order to meet current needs. To a lesser extent, donors must also support growth in the sector. In order to mobilize all these sources of financing, MFIs must hybridize themselves and strike the best possible balance between social mission and profitability targets.*

**By Fouad Abdelmoumni, Economist and Chief Executive Officer of Al Amana**

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Microfinance has earned its wings by underscoring – via its promoters – its mission to combat poverty and support economic and social inclusion. But its worldwide appeal lies first and foremost in the fact that it can claim to actually fulfill this mission. It has been built on an economic model based on the *credo* that those who are excluded from classic financing systems are very often self-employed workers that need long-term financing, and that they can repay their debts and pay the entire cost of the service. The economic dimension of microfinance is consequently the cornerstone for the implementation of its social mission.

The rates actually charged for microfinance loans are generally well above those of banks financing due to their very nature (small amounts, short maturity, fragility of guarantees and other recourse, etc.). Clients are much less sensitive to interest rates than they are to opportunity and transaction costs; they are mainly concerned about the profits that microfinance will allow them to earn via their activity. Opportunity costs relate to the lack of access to financial services and the fact that the amounts allocated, loan maturities, repayment frequencies and waiting periods do not match demand, and products and methodologies are not adapted. Transaction costs concern, among other things, the quality of the service and the constraints of guarantees and travel. Unlike MFIs, banks cannot reduce transaction costs and opportunity costs. Poor populations consequently con-

tinue to prefer microfinance, despite high nominal rates and both apparent and real costs. According to Rosenberg (2008), the median value of overall effective interest rates in 2007 stood at 35% and ranged from 60% in Mexico to under 20% in Sri Lanka; these rates are historically on a downward trend. According to Gonzalez *et alii* (2009), the global average stood at 26.4% at the end of 2008. A third of so-called profitable institutions are of a capitalist nature, the other two thirds include NGOs, cooperatives, public banks and non-profit organizations. The fall in rates can be explained by the maturation of the sector, underpinned by competition and economies of scale, the increase in average outstanding debt and a better control over operating expenses. For example, the Moroccan MFI Al Amana has lowered the overall effective rate it charges its clients. It was over 40% in 2000 and fell to below 20% in 2008. Yet it is still well above bank rates which have an official ceiling of below 15%. In Bolivia, the average microfinance interest rates fell from 60% in 1992 to 18% in 2007.

Studies concerning the need for additional funds are in their infancy and do not always tend toward the same conclusions. They do however converge on some hypotheses that make it possible to estimate these needs: client base multiplied by 10 (from 100 millions to a billion people) and average loan amount multiplied by 3 or 7 depending on the period considered. In order to face their need to grow, MFIs can rely on grants and subsi-

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dies, capitalized operating surpluses, bank loans, recourse to financial markets, public deposits and equity investments.

Although national and international development aid – both public and private – is the main provider of start-up funds for MFIs, it is not destined to bear operating and development costs. Those that are better organized have managed to include the cost of their refinancing in the fees charged to their clients. A lot of ink has been spilled over the development strategy of Compartamos<sup>1</sup>; by applying extremely high interest rates (up to 100%), it has built up a very comfortable endogenous growth fund that allows it to attract commercial funds. Many other institutions have, over long periods, managed to achieve margins of over 20 or 30% for annual return on equity, thus doubling their equity every three years on average. Others have intentionally ceded the operating margins to their clients when they have gone over a certain limit; in line with their mission, they consider that they must finance their expansion via an alternative to charging their clients non-essential fees.

## MFIs attract bank financing

Operating surpluses may not have been sufficient to meet all the growth requirements of the sector, but their levels have persuaded the local and international banking sector to grant loans at favorable conditions – bringing debt up to impressive levels (over 10 times the value of equity in the case of India). When institutions demonstrate their stability, commercial players such as banks are willing to consider them as a “credible risk”, assessed on the basis of the scale and quality of their assets, institutional soundness and growth prospects. They may be using their involvement in the sector to strengthen their “social marketing”, but they only envisage sizeable financing when they are confident in its security and profitability. The multiplier effect that MFIs can obtain from bank financing varies enormously; it is very high in India for example – where the State obliges the banking sector to be heavily involved in this type of financing – but is however inexistent (or even negative) in Egypt where the profusion of funds from USAID has allowed MFIs and banks to comfortably benefit from an “economic rent”. In the case of Morocco, the banking sector, in an over-liquid situation, extends loans to MFIs – reputed to be among the best in the world – that can be up to seven times

their total equity. Thanks to financing from banks or financial markets (bond issues or debt securitization), MFIs have been able to consider diversifying their resources and means of refinancing. This has also attracted investors motivated by the coexistence of social and economic objectives, but it has especially led public authorities to give them the capacity to raise deposits from the public. MFIs have consequently become fully-fledged financial intermediaries.

Michael Chu considers that “the only way to mobilize the money needed to meet the credit needs of the poor is to connect to the ocean of commercial money”. On the other hand, Muhammad Yunus, founder of Grameen Bank, considers that “there is plenty of money in the locality – money is not the problem”. The problem for many MFIs stems more from the legal framework they operate in; they should make it evolve so that they can become local microfinance banks with a capacity to mobilize deposits. Connecting institutions to the global financial market is not a satisfactory solution to meet their financing needs; on the contrary, it is necessary to reduce institutions’ dependence on external financing as it can limit sector development and its capacity to satisfy the expectations of its clients. Mobilizing public deposits is all the more attractive for microfinance banks as it allows the poorest to benefit from an institutional service to manage their savings. Yet public authorities and national banking supervision authorities are reluctant to authorize the collection of public deposits as MFIs do not benefit from the supervision, governance, financial standing, possibilities of recourse, organizational base and tools required to secure deposits and guarantee access to them. It is consequently a question of establishing conditions for the capacity to collect based on legal, governance, capitalization and organizational requirements. But small-scale institutions rarely have the capacity to meet these conditions: this incapacity creates a divide between institutions destined to specialize in credit in a “professional” manner and those destined to focus on providing banking services to the excluded.

## A period of change

Microfinance is gradually consolidating its basic services and organization, and is diversifying its range of services and making them widely available. It is firmly anchored into its social mis-

<sup>1</sup> *Compartamos Banco was founded in 1990 in the form of an association and became a commercial bank in 2006. It is the largest debt issuer on the Mexican financial market.*

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sion and uses tools and organizations inspired by a liberal market approach. Those who uphold the “social mission” dogma know that they cannot make microfinance sound, sustainable and of good quality if they do not accept to face the market. MFIs will generally resort to financing that will allow them to achieve their mission; the most “social” of them will have no problem counting hard-line capitalists among their funders if they consider that this strengthens their action. Those that are first and foremost

motivated by maximizing their profits will ensure they do not “kill the goose that lays golden eggs” by adopting unsustainable processes and reflexes. The institutions that will manage to come through this period of change will be hybrid institutions meaning with a better combination between social vocation and economic approach, a mission of service and profitability targets. Once everyone’s expectations have been clarified and everyone is satisfied, they will be viable and strong institutions. ●

## How to meet the financing needs of microfinance?

Swanson (2007) estimates the current portfolio of MFIs is worth 17 billion dollars, but estimates that 200 billion dollars of financing will be needed for microfinance in the long term. For their part, Chu and Yunus (2008) only count 500 million clients in the long term and expect total outstanding amounts in the sector to reach between 250 and 500 billion dollars. Whatever the case, we can imagine a reasonable scenario for 2020 whereby microfinance worldwide would rise from 100 million active clients to half a billion, with unit outstanding amounts in the region of 200 to 500 dollars – i.e. a total portfolio of 20 to 250 billion dollars, or an annual average growth rate of 25%. Grants are expected to make little contribution to the mobilization of the re-

quired amounts; they will be increasingly earmarked for intangible capital or development which is not part of the permanent portfolio. It is estimated that “intrinsic” equity will rise to 15 billion, made up of current equity (roughly 5 billion) and the surpluses that would be capitalized (10 billion). “Extrinsic” equity provided by national investors is also expected to be in the region of 15 billion. Total equity is expected to triple as a result of public deposits, i.e. 90 billion; 60 billion could be raised from loans from the banking system and issuances on the domestic financial market. The remaining 60 billion would have to be raised from international finance institutions (15 billion) and individual investors and foreign institutions (45 billion).

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