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Social and Solidarity Finance in between the Failure of the Microfinance Paradigm and the Emergence of the Universal Financial Inclusion Paradigm

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As a new movement, microfinance has experienced a strong growth since the end of the 90's when its aim was to provide small loans on a large scale to unbanked people across many developing countries. In early stages of its development, the idiosyncrasy of microfinance sector was rooted in its willingness to promote proximity (either directly or through community based organizations such as SHGs in India or villages banks in Latin America). This takes in not just geographic proximity but also social proximity to overcome social and cultural barriers between potential borrowers and microfinance institution staff. Regular meetings and visits with clients and hiring local staff were strategies designed to build trust and lower social barriers between microcredit providers and potential borrowers (Servet 1996). Innovation, dynamism but also strong growth, have thus allowed microfinance institutions to scale up reaching 200 million families worldwide (Maes and Reed, 2012)[1].

Strong and unregulated growth of microfinance in terms of the number of branches and clients reached, together with market concentration and profit-seeking, however brought about strong competition and market saturation, at least in urban and peri-urban areas (Guérin *et al.,* forthcoming). This situation translated into rising financial fragility (and over-indebtedness) and several credit delinquency crises (countries, regions or microfinance institutions).

I argue that even if microfinance has been able to scale up, the microfinance industry has failed to provide financial services to underserved populations and has remained focus on the less poor, which in turn induces negative impacts on clients' well-being. Acknowledging the failure of the double-bottom line approach of commercial microfinance in democratizing access to financial services among the poorest segments (rural and low income levels in urban settings), new strategies have been implemented by governments in emerging countries. Among other strategies, this new universal financial inclusion paradigm is being implemented through existing social protection programs.

Drawing on extensive fieldwork conducted in several in the frame of a collective research project financed by the European Investment Bank[2], I will provide some key issues in the understanding of the failure of commercial microfinance. I will then highlight an emerging new approach to Financial inclusion rooted in two recent trends: 1) the Universal Financial Inclusion paradigm driven by governments, international organizations as well as private corporations and 2) the emergence of social programs targeting the poorest segments of the population. I will formulate some questions and assumptions about the potential impact these new policies may have.

I. Microfinance Missed the Social Bottom-Line

In order to ensure efficiency and profitability, commercial microfinance has mostly remained concentrated in urban and peri-urban settings in developing countries. As a consequence a large share of the poor (either in rural settings or the poorest segments of urban settings) has remained out of the scope of commercial microfinance. A second consequence is that concentration in specific regions combined with strong growth and competition among microcredit leaders negatively impacted the well being of the borrowers (i.e. financial fragility and over-indebtedness).

[1] Even if this is a small part of the total number of the 2.5 billion « unbanked » people worlwide

1 2 www.microfinance-in-crisis.org

1) Geographic concentration combined with a focus on a specific population segment.

Despite two digits annual growth in clients and portfolio that allowed for scaling-up (D'Espallier *et al*., forthcoming) many countries still face a lack of supply of financial services in rural and remote settings. For instance, according to "Encuesta Nacional de Inclusión Financiera 2012" (ENIF), 44% of the Mexican adult population (35 million people) still have no access to any formal financial institution. Of course this figure also covers better off populations such as public employees who until recently were still receiving their salary in cash. But this share reaches 80% in rural settings. At a global level, Figure 1 illustrates this situation. It highlights the shift between total number of clients' growth and the growth of poor clients number among borrowers. We can underline a clear decrease of the later while the global growth has remained quite strong (except in 2011).

Figure 1. Long-term evolution of the microfinance sector (Microcredit Summit Campaign)

Source: Microcredit summit Campaign 2014

2) Concentration on specific population segments and on credit delivery

Another central feature of commercial microfinance highlighted by Guérin et al., 2013 and Morvant-Roux et al. (forthcoming) in the context of Dominican Republic shows evidence of financial fragility (sometimes overindebtedness) among borrowers. Even if financial fragility is partly rooted in labour market characteristics (low and irregular wages) missing social protection systems and consumption patterns growth objectives (combined with incentives and pressure on loan officers) set by microfinance institutions seem to have a clear negative impact on the rise of financial fragility among borrowers.

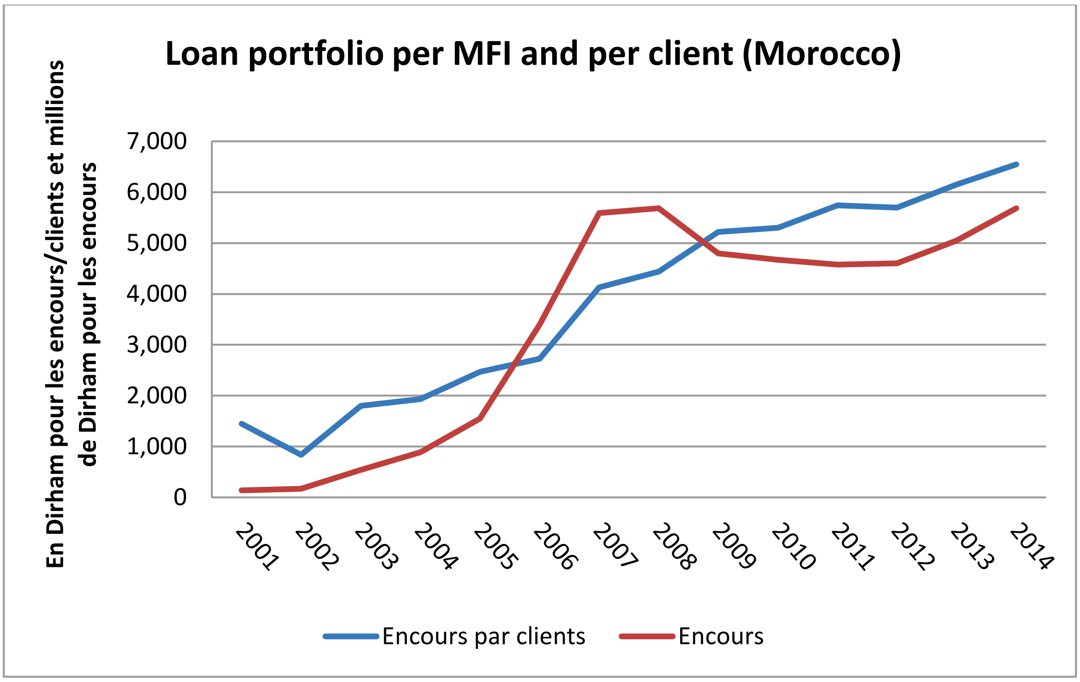
Actually, in Dominican Republic, where the microfinance sector is well developed and dominated by three main microfinance institutions, loan end up focusing on specific segments of clients (those who are creditworthy on paper), sometimes encouraging them to take on excessive risk.

As a result, Morvant-Roux et al. found " *that many clients in competitive areas of the country endure great financial hardship: they have relatively high debt/income ratios, regularly make sacrifices to keep up repayments, increase their numbers of loans and have poor prospects of getting out from under high levels of debt in the near future*". (Morvant-Roux *et al*., forthcoming)

So even in contexts where repayments performance seems under control (the leaders of the market exhibit very impressive low PAR 30 days, below 3%), borrowers repay but this doesn't mean that they don't struggle to repay. The focus on credit has induced additional financial distress for the target population, in short for a specific population segment, the scaling up of the microfinance industry has translated into facilitating "too much debt" (for a specific segment of the clientele)

Figure 2 illustrates the rise of average amount lent per borrower compared with the evolution of the total lending portfolio in the context of Morocco, similar results have been gathered in the context of India (Guérin *et al*., forthcoming).

Figure 2. Evolution of amount lent per borrower in Morocco



Source: Own elaboration, Mix-Market datasets

As a result the strong growth of the microfinance sector is concentrated on a small segment of the population. This translates into increased financial fragility, over-indebtedness and repayment defaults in some contexts.

The focus on the financial performance dimension and growth which allowed 1st tier microfinance institutions to scaling up thanks to private funding (debt and equity for some of them) has translated into exclusion of the poorest segments of the population which in turn lowers the social bottom-line of microfinance.

3) Social financial intermediaries

Outside microfinance, other actors exist but either access conditions induce exclusion of the poorest segments or the social bottom line prevents them to scale up.

I the case of financial cooperatives Bouquet et al. (2015) show evidence that access to formal financial products by savings and credit cooperatives and more specifically to credit services is restricted to people who are able to comply with membership fees, savings capacity and collateral requirements (guarantor). These requirements partly explain some exclusion processes that prevent agricultural wageworkers from accessing formal financial services.

Financial inclusion among the poorest population segments is therefore mostly driven by small-scale organizations that are out of the frame of the market economy. An in-depth analysis conducted by Crucifix and Carmona (2014) in the context of rural Mexico shows evidence that local organizations are able to survive thanks to public subsidies (J. Morduch argues that subsidies are still widespread among for-profits financial institutions)[3]. Beyond the question of scaling-up and limited outreach the qualitative study highlights that the dependence to subsidies is also a source of problems:

- Fragmentation of financial resources that poorly match their needs : amounts and flexibility and induce additional work burden;
- Constraints over medium and long-term planning
- Public funding are insecure do to political will
- Fragmentation is found to be a major impediment for a global vision

Thus, small projects face several difficulties to scale up, and diversify their support to the beneficiaries.

As already underlined, this situation explains why from the supply side, financial exclusion of poorest segments of the population has remained unsolved yet.

II. The Top-Down Universal Financial Inclusion Paradigm

Remaining strong financial exclusion due to the failure of commercial finance to serve the poorest segments of the population, the most part of marginalized populations have remained excluded from the formal financial system[4].

In that context, following the G20 commitment to improve financial access was launched, several initiatives were taken by National authorities supported by different platforms, experts groups such as Financial Inclusion Experts Group (FIEG) and action plans. The financial inclusion reference framework includes a large set of actions at

[3]Presentation at the IV European Microfinance conference, University of Geneva, 1-3 june 2015

[4] Here we don't discuss as to whether such populations have a financial needs that can be met by formal financial intermediaries (we have discussed it in the case of Agricultural wage workers see Bouquet *et al.* forthcoming). Instead, we intend to highlight the justification behind new kinds of State intervention in several developing and emerging countries (to our knowledge Mexico, India, Brazil, South Africa) towards the poorest segments of the population.

different levels: from more accurate data collection or international coordination dynamics to private sector and public sector actions.

> The UFA 2020 goal envisions that adults worldwide will be able to have access to an account or an electronic instrument to store money, send payments and receive deposits (World Bank, website)[5].

Almost 60 countries (developed and developing) have already taken part to this process. The new Universal financial inclusion paradigm offers a renewed vision of finance for the poor since it puts the emphasis on basic financial transactions (basic bank account for deposits or transactions such as withdrawals, transfers, payments) instead of focussing on « credit only ». Microcredit services are also part of the strategy but do not anymore play a central role as it was the case within the frame of the microfinance paradigm (Pande *et al.,* 2012).

The commitment to reach Universal financial Inclusion was launched by the 2012 G20 leaders in Mexico. National authorities supported by different platforms and experts groups such as Financial Inclusion Experts Group (FIEG) are committed to execute the commitment. In emerging countries such as Brazil, Columbia, Mexico, India, South Africa, one main strategy to improve financial inclusion of poor people relies on social policies targeting and reaching the poorest segments of the population (G2P programs).

As highlighted by Pickens, Porteous and Rotman (2009), around 170 million people worldwide benefit from any kind of government to person payment. This has led international organizations and governments to consider such payments as the first introduction to « modern » payment tools. While in 2010, according to the World Bank Global Payment Systems Survey, less than 30% of social benefits were delivered electronically, several emerging countries such as Brazil, Columbia, Mexico, Peru, Ecuador, India, South Africa have accelerated the movement so as to improve financial inclusion among the vulnerable segments of the population. Actually, electronic payments of G2P programs not only intend to increase efficiency by reducing transaction costs, corruption, (etc.) but also « *expand access to financial services* » (CGAP, 2011).

In Mexico, the famous Progresa-Oportunidades program born after the 1994 crisis reaches almost 6 million families -27 million individuals by 2010- of which the vast majority live in rural settings (the share is 7/10 in the poorest States such as Oaxaca or Chiapas). Direct access to a large number of poor women and their families has been viewed as the starting point of a proactive strategy led by Mexican central authorities to enhance access to a large range of formal financial services for the poor (savings, credit, insurance). In 2008 the program started to turn from cash transfers to electronic transfers while the program « jovenes con opotunidades » implemented since 2003 contains explicitly a financial inclusion component (blocked savings are made available at the end of high-school). Three main intermediaries have been used to execute the payment of social programs: the Social State bank Bansefi, Disconsa, a subsidized grocery retailer with coverage in marginalised communities and Telecom the national telecommunication company. New payment modalities involve prepaid cards (80% of beneficiaries) and savings accounts (debit cards). In 2011, the distribution network was composed by 8,000 payment points including ATMs, bank branches, telecom providers or grocery shops (disconsa).

[5]http://www.worldbank.org/en/topic/financialinclusion/brief/financial-inclusion-strategies-resource-center

In 2014 the new version of this program called Prospera launched by President Enrique Pena Nieto, intends to enlarge the services offered (savings facilities, microinsurance and credit) to beneficiaries and link it to economic development objectives:

> Inclusión Financiera. Brindando acceso a los beneficiarios del Programa, en condiciones preferenciales, a servicios financieros de educación financiera, ahorro, seguro de vida y créditos. (Reglas Prospera, Diario Oficial, 30 de diciembre del 2014)

This new component of the program is part of the massive bancarization strategy. The National Bank called Bansefi is committed to execute this financial inclusion component.
Quantitative results (accounts opened) are impressive.

At the last UFA conference in April 17 2015, The President of the World Bank group (Jim Yong Kim) was proud to highlight that:

> "More than 700 million people gained financial access between 2011 and 2014, and this gives us fresh evidence that our ambitious goal of universal access by 2020 is attainable" (WorldBank web page)[6].

In Mexico, this policy allowed for an important improvement in financial services coverage. Actually, by 2013, 1,671 (68% of Mexican municipalities) municipalities were covered by any type of financial intermediary: business correspondents, bank branch or ATM whereas the figure was around 1,242 four years ago in 2009 (World Bank, 2014). Of course some municipalities are wide and the distance to the financial services provider may complicate the use of such services. At the National level, the Findex Data registered a significant increase in the number of adults who had an account at a formal financial institution between 2011 and 2014: from 27% to 39% (Findex, 2014).

Beyond several problems related to supply and use of such services, such policies have several implications for actors involved in social finance for the poor.

In particular, while Fouillet and Morvant-Roux (forthcoming) argue that this new financial inclusion paradigm is a component of the process of state building we can wonder about potential crowding out effect between such top-down initiatives with existing financial intermediaries (socially-grounded) in these areas?

[6]http://www.worldbank.org/en/topic/financialinclusion/brief/financial-inclusion-strategies-resource-center

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