Microfinance through Innovation

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Abstract
The study described the evolution of microfinance in terms of its product line, methodology, outreach and means of ensuring both sustainability and viability. The study outlined the innovations undertaken by microfinance practitioners in terms of strengthening their respective institutional capabilities to provide better microfinance services that will meet the changing demands of the market. The innovations are also heavily shaped by various reconfigurations in the policy environment and trends set by the international and domestic financial system. In addition, the study provided an account of best practices formulated and adopted by microfinance institutions. It employed the method of desk review of related literature on the innovations of microfinance products and services which are important in enhancing the microfinance institutions' sustainability and responsiveness to their intended clientele. Several key issues pertinent to the innovation were discussed including: access to funding: establishment of partnerships among microfinance institutions with public or private institutions; use of technology for increasing access and provision of microfinance; introduction of new microfinance products; and the use of non-conventional delivery systems for increasing outreach. Said innovatory approaches and issues were synthesized to generate conclusions in understanding the effects of innovation on institutions and more importantly on the clientele.

Introduction

In the fields of Public Administration and Development Studies, microfinance is regarded as one of the prominent topics. This is so because microfinance is predicated on social empowerment and poverty alleviation and is likewise geared toward reducing income inequity. Thus, best practices in microfinance alleviate poverty, reduce inequity, and inevitably empower the poor because of increased access to capital. In terms of its place in the field of Public Administration, as government searches for more viable ways of bringing more accessible and sustainable credit to meet the needs of the poor, microfinance inevitably comes to the forefront of Public Administration discourses. Microfinance is a deviation from the more familiar dole-out and subsidized lending approaches undertaken by the government in facilitating credit to the poor. Microfinance targets the entrepreneurial poor, a group that has the initiative to help themselves. The entrepreneurial poor is a group with ample credit and technical skills to start up a small enterprise to generate additional income to support their basic needs. This is the empowering aspect of microfinance; it is an initial instrument to extricate the poor from the vicious cycle of poverty.

Microfinance traces its origin to the emergence of Grameen banking. Grameen Banking offers small loans – microcredit – for people too poor to qualify for traditional bank loans, to enable them to start up income generating activities. Originating in Bangladesh in 1976, the Grameen Bank has reversed conventional banking practices by removing the need for collateral, lending to groups rather than individuals, and by creating a banking system based on mutual trust accountability and participation. A key strength of the Grameen approach is its focus on community level social capital, the strong moral commitment of group leaders, the insistence on regular repayment at compulsory, weekly group meetings, and the fact that repeat loans (that can be progressively larger) are contingent upon the satisfactory repayment of previous loans. For microcredit initiatives to reach poor people in remote areas, rural banks need to experiment with the classical Grameen model. They need to adapt it to suit local needs, especially those of poor women, to tailor-fit it to those traditionally considered unbankable — with no assets, no collateral, and no savings.

Innovating microfinance is critical as it would lead to a more diverse and more accessible product line for its clients. Innovation is fuelled by competition among microfinance institutions (MFIs). Competition necessitates that MFIs innovate in their operations because if they do not, their relevance and position in the industry would be compromised both on the short and long term bases.

The study described and outlined the different strategies MFIs utilized in enhancing their products and services by improving their operational processes. Said improvements were based on the use of technology, considering market demands, taking into account the characteristics of the client, cost of implementing change in the institution and the issues encountered by the MFI during the course of innovating their respective processes. The study deemed it useful to narrate the innovations employed by MFIs because these innovations can be replicated among firms in the public and private sectors. Planners are likewise given policy alternatives to assess in terms of their viability and benefits to the general financial standing of the MFI. In addition, the full benefit of innovation is manifested when clients have more choices among microfinance products and services at prices well within their reach. A more vibrant microfinance industry is thus present when innovation is optimally utilized leading to sustainable microfinance practices.

In pursuing innovation, MFIs must consider their institutional capacity, i.e. their ability to follow through on the reforms started in a sustainable manner. Thus, MFIs must ensure that their logistics are well placed, the infrastructure present must support the changes in procedures, and more importantly, managers and subordinates must proactively support the innovatory measures. The study gave a detailed narrative of the significance of the innovations employed by the MFIs which led to empowering their clients – the end goal of microfinance.

Innovation along the perspective of microfinance

Microfinance has, throughout the years, been evolving in terms of its product line, methodology, outreach, and means of ensuring both sustainability and viability. This section of the review outlines the innovations undertaken by microfinance practitioners in terms of strengthening their respective institutional capabilities to provide

better microfinance services that will meet the changing demands of the market. The innovations are also heavily shaped by various reconfigurations in the policy environment and trends set by the international and domestic financial systems.

Reengineering Government by Michael Hammer and James Champy (as cited in Frederickson & Smith, 2003) offers some manifestations of innovation. The main tenets of reengineering that are congruent to innovation are: 1) fundamental rethinking and radical redesigning of business processes to achieve dramatic improvements in critical contemporary measures of performance such as cost, quality service and speed; 2) abandoning long established procedures and principles and inventing new approaches to process structure; 3) starting all over from scratch; and, 4) seeking breakthroughs by breaking away from ineffective antiquated ways of conducting business. Reengineering provides institutions the framework to adequately ground the justification of procedural changes in their operations. Through the tenets mentioned, administrators are guided conceptually in implementing changes in the organization.

MFIs innovate in terms of developing new techniques and methods to ensure that the services both reach the targeted clients and yield profits. They create new rules and procedures to ensure client's repayment. This includes training in policies and human resource management practices which aim at modifying financial facilities and structuring the working units to provide services. The innovative features of microfinance are: a) new methods of providing credit to the borrowers (e.g. the usage of social collateral such as group guarantee instead of personal physical collateral, progressive lending, peer pressure and peer monitoring); b) approaches to mobilizing savings from the clients and linking credit provision to savings; c) emphasis on social mobilization processes, involving awareness building and formation of self-help groups; and d) provision of other services, such as insurance, to cover risks and distress by the clients. Microcredit is probably the most prominent of the financial service innovations covered by the term microfinance. Other services that the term covers include microsavings, money transfer vehicles, and microinsurance. These services have become diversified, attracting not only family businesses and SMEs in developing countries, but also small companies in developed countries (Nugroho & Miles, 2009).

Innovations in microfinance products and services are important to increase the MFI's sustainability and its responsiveness to its intended clientele. These innovations are discussed in *Innovations in Microfinance in Southeast Asia* by Gilberto Llanto and Ryu Fukui. Llanto and Fukui (2003) defined an innovation as a production technology developed by the MFI that produces a product or service for the poor clients at the least cost possible. It could be a new way of screening and lending to clients in order to help them surmount problems of information and dispersal of clients over a geographical area, e.g. village banking. An innovation could be a product that enables the poor to smoothen their consumption and to create financial assets, e.g. micro savings (Llanto & Fukui 2003).

Along this line, Lariviere and Martin (1998) identified five categories of innovations in the area of rural microfinance: technological innovations, product innovations, strategic innovations, institutional arrangement innovations, and donor incentive innovations (Llanto & Fukui 2003).

1. Technological innovations refer to improved technologies used in delivering financial services. Examples are solidarity group lending, village banking, repayment incentive schemes such as peer group monitoring, incentives for the borrower to repay through rebates and progressive lending.
2. Product innovations refer to the financial services offered to individuals and groups. Examples are product mixes combining savings and credit services as well as farm and non farm credit.
3. Strategic innovations refer to strategies followed by MFIs to develop their clientele. Examples are risk information systems among MFIs and strategic planning for market development.
4. Institutional arrangement innovations pertain to changing legal status and the institutional arrangements to improve MFI performance. Examples are NGO transformation into a formal financial institution, downscaling strategy of commercial banks and developing new financial legislation adapted to the circumstances of MFIs like NGOs and credit unions.
5. Donor incentive innovations refer to those mechanisms that are available to donors to improve the performance of MFIs' outreach and viability.

Buchenau (1999) has a narrower characterization of innovations focusing on innovations in financial services. He categorized two types of innovations in financial services: 1) completely new products which match the characteristics of intended users, and 2) improvements or refinements in the procedures used to deliver the services or to design contracts and to achieve their enforcement.

Llanto and Fukui (2003) explained that innovations flourish where the market environment is competitive. Competitive financial markets induce innovations because microfinance institutions have to develop new products or new transaction reducing procedures or innovate on existing products in order to protect or increase their market shares. Buchenau (2003) added that financial institutions are most likely to develop and provide innovations if they have to compete. He noted that in competitive markets, institutions have to continuously improve the quality and pricing of their services to protect or increase their market shares. Otherwise, they could not cope with competition (Llanto & Fukui 2003).

Llanto and Fukui stated that the institutional innovations may be a different case in the sense that there is a tendency for the market to under produce or not to produce them. They stressed the need for public support in institutional experimentation and development of microfinance. The subsidies provided by donors and government organizations have enabled a range of experimentation and institutional development that generate social benefits. They concluded that the successful institutional innovations were not produced by market forces but through heavy reliance on financial support from the state and donors. They focus on building cost efficient MFIs that are congruent with market principles and that can reach poorer segments of the society as clients (Llanto & Fukui, 2003).

Innovating microfinance product line

The development of microfinance is seen in the products and services that MFIs offer to their clients. These products must meet the demands of the intended clientele. Also, they must be accessible, cost-effective in terms of their delivery, and most importantly, congruent to the social mission of microfinance. In several countries, MFIs have continuously embarked on the innovation of their products to serve their clients better.

One example of product innovation is the Grameen Pension Savings or GPS. Rutherford (2006) stated that the GPS is a commitment savings account for Grameen Bank's registered customers – its group members. The GPS is likewise available to Grameen staff. GPS savers agree to deposit a sum of their choosing each month for an unbroken term of 5 or 10 years. Rutherford added that at maturity they get back their deposits with interest, and they may take this accumulated lump sum in cash or leave it on deposit with the bank and take interest earnings each month as income. Should savers fail to maintain the monthly flow of deposits, the account is closed and interest is paid at a lower but still attractive rate (Rutherford, 2006).

Rutherford (2006) held that the minimum monthly deposit is 50 Bangladesh Taka (Tk), but savers may choose any multiple of Tk50, with no upper limit, and they may hold as many GPS accounts as they like. Rutherford clarified that savers usually deposit in cash on a monthly basis at one of the weekly meetings that all Grameen members are required to attend. But they may also break the payment down into easier weekly instalments into their passbook savings account and have the bank transfer it to their GPS account every six months – an arrangement which is convenient for both parties. It is argued that some GPS holders do regard their GPS as a way of saving for their old age, but many see it as a vehicle for saving toward their life cycle expenses such as home making, or the marriage, education or employment of a child, and some see it as a way of saving against unanticipated expenses such as ill health or other emergencies. Others see it as security pledged against loans taken from Grameen; some regard it in that light because of the rule that requires a GPS for a loan of a certain value. Others like the sense of security given by holding a substantial savings reserve (Rutherford, 2006).

Safesave from Bangladesh is another innovative microfinance product. Safesave was discussed by Staehle (2005) in his work entitled "Flexible Financial Services for the Poor: Experiences of Safesave, Bangladesh." Safesave was founded in 1996 by Stuart Rutherford, a microfinance enthusiast, and Rabeya Islam, a Dhaka housewife with years of experience running savings and loan clubs among her poor neighbors. The premise was that the poor people would not only use, but also pay a sufficient price for a microfinance service that incorporates the following (Staehle, 2005):

1. it is nearby and convenient to neighbors, family, employers, moneylenders and shopkeepers;
2. it provides a frequent opportunity to transact as amounts are small, and a very poor household's cash flow is large in relation to its small assets;
3. it is flexible, allowing a choice between using savings, credit, or a combination of both, to match small, frequent pay ins with larger, less frequent pay outs; and
4. above all, it is reliable.

Staehle revealed that in 1997, Safesave was registered as a cooperative with 15 members. By the end of June 2005, it had 20 shareholding members. Safesave clients were people who lived in Dhaka's slum communities. These individuals would earn their keep as day laborers, rickshaw pullers, shopkeepers, garment workers, and low-level government employees. Staehle (2005) argued that the success of Safesave depends primarily on the collectors – the front line of contract with clients. Said collectors visit an average of 180 clients door-to-door at their home or work place, 282 days per year. Staehle (2005) emphasized that there are no group meetings and clients only need to visit the branch to open an account, take loans or make big withdrawals. When collectors call, their clients are offered an opportunity to save and repay any amount they wish, starting at $0.2 and to withdraw up to $8 on the spot (Staehle, 2005).

Staehle (2005) asserted that Safesave clients are aged 16 years or older and have lived in the branch working area for one year or more. They are guaranteed the right to borrow if they follow the rules of Safesave savings and loan product. Loans are issued one at a time, within one working day of a client's request, with a value of up to their credit limit or three times their savings balance, whichever is less. There is no schedule for loans (loans can be taken for less than the credit limit) and borrowing is not required (one in five account holders never borrows at all). In addition, there is no fixed term and no fixed repayment schedule for loans. Loans are taken for an unlimited duration and only the interest payment, generally 3% of the outstanding loan balance, is due each month. Staehle (2005) maintained that clients who choose to repay quickly will earn increases in their credit limits. Increases are given for each month that a client repays at least 10% of the original loan amount, provided

that interests were never late for that loan. Clients with loan may also withdraw savings, as long as the balance does not dip below one-third of the outstanding loan amount (Staehle, 2005).

Staehle (2005) suggested that a variety of MFIs, including credit unions and building societies, can reach the very poor by viewing them as clients who can and will pay for a good financial service and then by creating products and systems that are appropriate to the very poor in the context within which these MFIs work. He identified the introduction of an incentive pay system for collectors in January 2003 wherein collectors receive 5% of the revenue they generate, regardless of performance, as instrumental to the performance of Safesave. The pay system added approximately $10 to the system. It makes revenue collection mutually beneficial for both Safesave and the collector. He, however, explained that the real performance incentive bonus is a quarterly bonus based on client numbers and portfolio quality. Said bonus ranges from a low of $8 per quarter for collectors with 120 active clients and 90% of their loans on time, to a high of $62 per quarter for collectors with 200 active clients and 96% of their loans on time (on time means that no monthly interests are overdue). Staehle (2005) stated that in April 2005, Safesave began introducing a new policy which limits loans to one per household, rather than one loan per eligible account. This change is aimed at reducing profitability, but it is seen as necessary for the long run health of the loan portfolio. The policy prevents clients from circumventing credit limits by arranging loans through multiple accounts (Staehle, 2005).

Amin (2013) discussed P9 – a savings and loan service offered to low income households by Safesave in Bangladesh that builds on Rutherford's work. P9 lends to save by advancing only a portion of the loan amount and holding the remainder (40-50%) in escrow as savings. Over time, clients pay the entire loan amount and retain the savings. For example, they want to save US$5, they borrow US$10 and immediately use US$5 to do whatever they wish. The remaining US$ is locked away as savings. The clients cannot use it until they repay the US$10 in full, at which point they have accumulated US$5 in savings. They are able to borrow increasing amounts in subsequent tranches, building up significant savings within a short amount of time. P9 has an initial registration fee of 200 takas (approximately US$3) and a disbursement fee of 3%; it has no interest and allows top ups (Ledgerwood, 2013).

MFIs have offered other microfinance products and services in relation to the educational and housing needs of their clients. For education, Opportunity Bank of Malawi offers savings accounts designed for parents and guardians of school-age children called Tsogolo Langa. The account allows parents to pay school fees and other related expenditures easily and to keep their money safe until the fees are due, ideally allowing children to go to school continuously. The account features include a minimum balance of US$1.85 and a contractual agreement between the parents and the bank to use the savings to pay for their children's education. Parents can open the account and voluntarily deposit money into it if the beneficiary child is a student at any of the bank's approved schools. There is no service charge required and payments are made directly to the school on behalf of the depositor. Interest is paid on a monthly basis (www.oibm.mw/index.php/deposit-products/62-tsogolo-langa-account).

For the housing microfinance, the study conducted by Segal, Chu and Herrero (2006) addressed the market opportunities through the Patrimonio Hoy program. The program was developed by CEMEX – a Mexican cement manufacturer which aims to reduce the Mexican housing deficit. CEMEX employees and consultants immersed themselves in the urban slum of Mesa Colorada in the state of Jalisco, where they conducted a series of learning experiments and in depth interviews. They discovered that a significant barrier to building homes was the inability to save enough money to purchase the required materials. Moreover, Patrimonio Hoy participants, when trying to purchase construction materials, had nowhere to store them. Participants pay about US$14 a week for 70 weeks and receive consultations with CEMEX architects and scheduled deliveries of materials that coincide with the building phases. Prices of all building materials are kept stable for the life of the project, which shields consumers from sudden price hikes and supply shortages that are common in free markets. And if needed, participants can store their materials in a secure CEMEX facility. Participants found that the program enabled them to build their homes more cheaply and three times faster than they could on their own (Segal, Chu & Herrero, 2006).

The use of technology is important in innovating microfinance. Said innovation is seen in the use of Personal Digital Assistants (PDAs), biometrics technology, and credit scoring in microfinance products and processes. MFIs' staff can benefit from the use of PDAs, which can

be customized to run specific programs to manage MFIs and clients' data and perform financial calculations. PDAs can help officers who are away in the field provide electronic data concerning clients which can be useful for loan applications, review, and approval. On the other hand, biometric methods of measuring individuals' unique physical characteristics, for purposes of identification, are being adopted by MFIs who have been alerted to the importance of data security. Some MFIs find low cost biometric technology preferable to passwords and PINs in accessing clients' financial data. Credit scoring systems technology analyzes the pattern of clients' historical data to predict how they will act in the future and can help in terms of strategies, marketing and client retention. The scoring technology can also be used in more advanced ways, such as pricing loans, in relation to individual client risks, and in providing against losses (Yanuar & Miles, 2009).

Microfinance has benefitted from the advancement of Internet technologies, which has meant that people are now able to take part in the microfinance movement across the world. One manifestation of said development is the creation of microfinance websites, such as www.kivaB4B.org, which acts as an online broker connecting donors and recipients (individuals, SMEs or MFIs). Another example is www.microplace.com, a for-profit subsidiary of EBay, which facilitates online peer-to-peer microlending, enabling people to invest in micro business. These websites aim to attract social investors who want a personal connection as well as a return on investments. Funds from relatively affluent people may thus become a major source of personal lending to the poor. The challenge here is in the formative years, in setting up a strong network of microfinance institutions that can effectively mobilize and deploy volumes of cash (Nugrohor & Miles, 2009).

Micro insurance is another form of innovation in terms of microfinance products which was tackled by Llanto and Fukui (2003). They cited the case of the CARD Mutual Benefit Association (MBA) micro insurance. They described that the basic infrastructure of CARD's MBA is the prevalent practice of *damayan*, a local custom in the Philippine rural areas where the members of the community, as well as relatives, contribute cash to the family of an individual who passed away. The practice is beneficial to all parties concerned since everybody expects to be treated the same way when death occurs

in the family. Ingrained in this custom is the feeling of oneness and solidarity with the bereaved. The authors stated that CARD used locally available information and the advantage of informal monitoring and enforcement system to build a solid mass of client members united in the vision that they would someday be co-owners of an insurance company (Llanto & Fukui, 2003).

Thus, CARD enabled the MBA to address a particular market niche that is not served by traditional insurance companies. It is said that ninety-eight percent of CARD clients are poor women, a large number of whom are landless coconut workers. There are three major CARD MBA products: life insurance program with total and permanent disability cover; a provident fund/retirement savings fund; and an all loans insurance package. It has successfully metamorphosed from the simple loan redemption insurance provided under the Member's Mutual Fund. CARD MBA serves to protect CARD Rural Bank and CARD NGO from loss in the event of the death of the member client. It also protects the dependents of the member who has passed away from being saddled with an outstanding loan with CARD Rural Bank. The loan redemption insurance is compulsory and the premium equivalent to 2.5% of loans above P10,000 is automatically deducted from the loan. All borrowing members are included in the scheme. An actuary computes the premiums, benefits and policies of the members. Not more than 20% of total premium collections are used for administrative, maintenance, and operating expenses. Likewise, the borrowing members have benefited from the different insurance products offered by CARD MBA (Llanto & Fukui, 2003).

Another example of microfinance innovation in products and services is reported in Hernandez and Yerina's (2003) work entitled *What works: PRODEM FFP's Multilingual Smart ATMs for Microfinance*. Hernandez and Yerina (2003) described that PRODEM Private Financial Fund's (FFP) target market includes low income communities in mainly rural areas. However, most of its target clients are illiterate, speak only the native languages of Quechua or Aymara of Bolivia, and have no familiarity with personal identification numbers or other aspects of modern financial services. Moreover, the rural areas where most of them often live have unreliable telecommunications infrastructure. The authors contended that to penetrate this market, it had to rely on new technology that would fit its target clients' needs and socio economic characteristics. FFP PRODEM addressed

this problem through technology that combined "smart cards" with digital fingerprinting recognition technology, now employed in all FFP PRODEM branch offices and smart automated teller machines (ATMs) (Hernandez & Yerina, 2003).

Hernandez and Yerina (2003) stated that the smart card stores the customer's relevant information including the account balance, five most recent transactions, and digital fingerprint. When customers approach an FFP PRODEM smart ATM, they receive audio transactions and digital fingerprint. In addition, customers receive audio instructions in Spanish, Quechua and Aymara to complete the transaction. The touch screen is color-coded to ensure that the customer can follow the audio transactions properly. The smart ATM will disburse the cash and debit the amount stored on the card. The customers do not have to fill up any form for the transaction, nor do they have to be able to read or write. Current smart ATMs cannot be used to deposit money. The smart cards can be used at any FFP PRODEM branch to withdraw or deposit funds without filing up any forms. With this technology, FFP PRODEM has been able to strengthen its outreach of deposit services significantly. At the end of August 2003, FFP PRODEM had 48,000 smart card savings accounts (Hernandez & Yerina, 2003).

Microfinance products are not limited to financial services. Morduch (2005) discussed that a different kind of time-limited, transparent, rule-bound intervention involves the delivery of non-financial services to current customers. Morduch cited the MFI - Pro Mujer, a micro lender in Latin America that is committed to improving health and economic opportunities of poor women and their families. Morduch revealed that based on the feedback from their clients, Pro Mujer's branch in Nicaragua introduced an array of health services including gynaecological exams, with a focus on cancer prevention and detection; self-help groups aimed at combating family violence; and health counselling by clients trained as health promoters. In 2005, Pro Mujer, Nicaragua began an innovative strategy to take health services straight to customers' communities. Health educators now travel by motorcycle to communities, offering pap smears and consultation services. In 2004 alone, 199 cases of cancer were detected among Pro Mujer's customers in Nicaragua, and the women were linked to treatment facilities (Morduch, 2005).

Casuga (2003) provided a summary of various innovations on basic loan products of foreign/international MFIs.

Table 1. Innovations in Loan Products of MFI's

Loan Product	Feature	Implementing MFI
Supplementary loan or "top up" loan	Replenishment of working capital loan that has been 50% paid; one year term	BURO Tangail, Bangladesh
Credit line	Used when agricultural production requires additional inputs; can be extended concurrently with other loans	Grameen Bank, Bangladesh
Enterprise/ entrepreneurship development loan	For growing micro entrepreneurs who seek to expand or diversify Additional working capital for small traders	BRAC and ASA Bangladesh
Small Entrepreneurship Development Program	For bankable borrowers who face constraints in availing of existing credit facilities; initial loans amount to Tk 20,000 with	ASA Bangladesh
Individual credit program	increments of Tk 2,000 to 3,000 per renewal	ASA Bangladesh
Housing loan	Different types depending on housing needs of the poor, with terms ranging from 1-10 years at 8% interest p.a.	Grameen Bank Bangladesh
Savings loan	Up to 80% of savings for 5% p.a.	ASA Bangladesh
Education loans	For the education of client's children	Grameen Bank Bangladesh
Sanitation wells/ loans	For tubes, wells, and latrine purchase and construction; 8% to 40% interest rate for one-year term requiring weekly repayments	BRAC, BURO Tangail and ASA Bangladesh
Disaster loan	In cases of natural disasters, Tk 500, 2-year terms, interest free	ASA Bangladesh

Sources: Mutesasira, L. (2000). "A Report of Study Tour;" Del Rosario, D. (1998). "Association for Social Advancement, AIM;" Rutherford, S., (1995). "ASA: Biography of a NGO."

Innovating systems used in microfinance

One form of innovation in microfinance products and services is manifested in the manner in which microfinance is delivered to its clients. Establishing adequate and effective delivery systems of microfinance is critical in enhancing outreach to targeted clients. Fernando (2003) explored the connection between microfinance and pawnshops in his work entitled "Pawnshops and Microlending: A fresh look is needed." It is generally presumed that pawnshops are directed at finance consumption mostly rather than productive economic activities and hence do not contribute to development. Clients in many developing countries, however, are known to use pawnshops to obtain cash for expanding their businesses and other productive activities, in addition to financing consumption. Pawnshops in Shanghai, for example, receive frequent visits from a large number of small enterprise operators in need of relatively short term and small volume loans in the city (Fernando, 2003).

Fernando (2003) explained that although pawning has its limitations, pawnshops add to the institutional diversity of the microfinance landscape, and more importantly, provide a useful service as microcredit institutions to poor and low income households in countries where there are no severe legal restrictions on their operations. It is suggested that if an appropriate legal framework exists, financial institutions add pawning loans to their menu of products and achieve significant outreach profitably. It is also argued that pawning makes microcredit markets more competitive than usual. Often institutions providing pawning services compete with informal, commercial money lenders. It is proposed that liberalizing pawning markets and introducing a conducive and enabling regulatory and legal framework enable pawnshops and other financial institutions to play a more dynamic role and provide services more efficiently (Fernando, 2003).

Another delivery mechanism of providing credit to the poor in the rural areas utilizes the post office savings bank (POSB). Nagarajan (2003) discussed this particular approach and stated that microfinance proponents exclude as MFIs those POSBs that are owned by the government and are operating from regular post offices. Nagarajan contended that POSBs offer several advantages in expanding financial services to the rural poor. It is held that POSBs are located even in

the remotest part of the country. POSBs have the ability to facilitate better financial intermediation, payment, and funds transfer services. Moreover, POSBs accept deposits, regardless of the amount and operate longer hours than most MFIs. Deposits are protected by the government and are often provided tax benefits. POSBs are readily accessible to small depositors, but are also open to all types of clients. Nagarajan (2003) noted that POSBs serve a wider clientele which may help in diversifying their portfolio and cross subsidizing cost for an efficient operation. However, human and physical resources of several POSBs are underutilized. This offers an opportunity to add new services at a lower cost compared with MFIs. Nagarajan (2003) explained that since POSBs are generally owned by the government, they can deal with shortfalls in their cash flows through budgetary allocations and therefore do not have to depend on donors.

Nagarajan (2003) suggested two points in making POSBs expand effective services for microclients. First, a clear demarcation between regular postal services and financial services is needed, so products can be priced appropriately. More importantly, governance structure and ownership issues have to be addressed. Second, financial services and products need to be diversified. Prudent cash flow management will ensure reliable payments for depositors. Cross subsidization through regular postal products is becoming increasingly difficult due to competition from private courier, parcel, and Internet service providers, especially in urban and semi-urban areas (Nagarajan, 2003).

It is believed that POSBs may find better clients than the government in channelling their investments to obtain higher revenues, as several MFIs are now searching for funding sources. It is recommended that POSBs channel some locally mobilized funds to finance flourishing local MFIs for their lending activities. Some of the locally mobilized funds may be earmarked for a centrally based apex that can intermediate nationwide. All deposits for the efficient use of deposit-mobilized POSBs need to be identified. Nagarajan clarified that engaging in such types of intermediation, POSBs may require skills to evaluate the creditworthiness of MFIs for funding (Nagarajan, 2003).

Partnerships as a form of innovation

Partnerships are emerging arrangements between institutions that provide microfinance. Establishing partnerships among microfinance institutions is crucial in its objective of maintaining and strengthening sustainability. By engaging into partnerships, microfinance institutions are given the opportunity to share innovatory approaches in their operations as well as address issues and concerns in the industry.

This particular approach was discussed by Bedson (2008) in "Microfinance Partnerships: Capacity Building." Bedson declared that partnerships are contributing greatly to the expansion and transformation of the microfinance industry. Innovative partnership approaches are opening up new streams of funding for MFIs, which translates into expanding outreach and new levels of financial sustainability (Bedson, 2008).

Bedson (2008) cited that MFIs are forging linkages with energy providers, energy suppliers or manufacturers to provide alternate, cleaner sources of energy in Bangladesh, India, Indonesia, Lao People's Democratic Republic, Nepal, Philippines and Sri Lanka. These have employed a variety of models – from partner agent engagements to fully integrated energy loans sale-service ventures. Some key examples are flagship SEWA-SELCO partnerships in India and SEEDS, which partner with various solar companies in Sri Lanka. By making microfinance loans available to pay for modern energy services, MFIs aim to overcome the problem of unfulfilled demand for safe, cheap, and income-generating sources of energy by expanding access to loans for many people living in rural areas. It is claimed that strategic partnerships are increasingly recognized as a means to overcome resource constraints and increase profits. Maintaining mutually beneficial partnerships in microfinance will require a different set of skills than currently exist in MFIs, traditional banks or private sector companies. Said skills include negotiation, management, technical knowhow, training and education, customer knowledge and product development (Bedson, 2008).

Bedson (2008) explained that the motivations of MFIs for getting into partnerships are to extend the outreach services and to broaden the range of financial and non-financial services. He reiterated that from a strategic perspective, MFIs need to grow in an increasingly competitive market, often with the difficult aim of achieving

sustainability while not compromising their original social mission. In addition, partnerships enable smaller MFIs to overcome resource and capacity constraints, while driving innovation in the sector among larger, flagship institutions (Bedson, 2008).

Bedson (2008) emphasized the importance of identifying an appropriate partner. He argued that MFIs must consider what kinds of skills and resources can reasonably be expected from a partner, what kinds of institutions might be able to provide these skills and resources, and what formal financial and other private sector institutions one may be looking for in an MFI. Partnerships, by their very nature, are a two-way process and not unidirectional – from the larger to the smaller partner. Although the contributions may not necessarily be equal, partnerships are essentially about maintaining an agreed balance between parties (Bedson, 2008).

Microfinance innovations in the Philippines

In the Philippine context, MFIs are changing their processes and products to serve their clients better. Previous sections of the review dealt with the innovations undertaken by MFIs on the services, but these accounts were taken from non-government organizations. It is equally interesting to look into the development of microfinance along the perspective of formal financial institutions that include rural, thrift, and microfinance-oriented banks.

Owens and Agabin (2006) discussed the policy interventions and innovations in terms of product line and services made by rural banks in the Philippines. It is said that one of the innovations manifested by rural banks was its support of the Microenterprise Access to Banking Services (MABS) Program of the USAID. The MABS program offered new products such as the micro agri loan product which is geared toward the needs of agricultural households. In the past, rural banks utilized traditional agricultural lending methodologies where loans, generally paid off in lump sum, focused on a projected crop yield based on the size of the farm. The new alternative product uses cash flow analysis rather than projected yields and bases payments on income streams of the entire household rather than only on income from the loan-supported investment. It should be noted that the new product has resulted in reduced risk for the banks and better yields than the previous lending methodology (Owens & Agabin, 2006).

Owens and Agabin (2006) disclosed that improvements in the management information system (MIS) of rural banks are important. In line with this, they cited the introduction of Microbanker to rural banks as one innovation for the enhancement of MIS. The MicroBanker system ensures that appropriate loan tracking reports have been incorporated to better monitor collections and provides banks with an aging report on the portfolio at risk level of their loan products so that loan account officers and bank managers could better track numerous small loans and more quickly respond to delinquent accounts (Owens & Agabin, 2006).

Another technological intervention on the operations of rural banks according to Owens and Agabin (2008) is the introduction and use of small handheld computers, or personal digital assistants, for loan collection which is helping reduce paper-based reports and improve efficiency. The authors identified another intervention made by the rural banks; this time rural banks are engaging into partnerships with telecommunication providers to expand their services. One instance is that the Rural Banks Association of the Philippines (RBAP) is working with Globe Telecommunications to offer a new money transfer service that allows clients to make transactions with their mobile phones. The service utilizes Globe G cash platform, which allows subscribers to make loan payments and send and receive money through mobile phone via text messaging. During the pilot testing in 2005, this new service was able to greatly reduce the transaction and labor costs associated with microcredit collections for both banks and borrowers. The authors described that the system can also support domestic and international money transfer services and is now being tested as a means to support remote deposit taking and withdrawals as well as ultimately supporting the development of mobile commerce opportunities for microfinance clients who can use their phones to buy and sell products and services. Cell phones could help rural banks compete with commercial banks and allow microfinance clients to use their cell phones as a debit, ATM and credit card in the near future (Owens & Agabin, 2006).

Conclusion

Microfinance as a development initiative has been recognized by the government of developing countries as a viable and responsive tool in alleviating the plight of the poor, giving them means to live their lives in their own terms, and restoring their dignity and self worth over the long term. It is, however, imperative that policy interventions be made internally and externally to make microfinance sustainable.

Internal interventions refer to changes from within the microfinance institution. These changes include the reconfigurations on the processes in which clients avail microfinance, the types of microfinance products offered by the microfinance provider, the marketing capability of the institution, the management skills of its officers, the institution's ability to source out funds both for short-and-long term needs, and more importantly, the institution's commitment to adhere to its primary social mission – that of providing accessible and sustained credit for the entrepreneurial poor. External interventions refer to government regulatory policies on the microfinance industry; market demand for microfinance; the level of poverty in a specific country; the state of the country's financial sector; and, general trends and innovations at the global and domestic microfinance market. The interplay of these external and internal factors has directly and indirectly shaped the character and operations of microfinance institutions (MFIs). The synergy of these factors has likewise influenced the manner in which managers plan the direction of the MFI for it to find its niche in the microfinance market.

Clearly, these factors have conditioned the level of sustainability of the MFI. Sustainability is indeed a very difficult concern to address as a myriad of issues must be balanced out. One such concern is the adoption of a business mindset in implementing microfinance. This approach is seen in the process of commercialization taken by some MFIs. The approach necessitates strong adherence to sound business principles, a profit-driven process in which the social component of microfinance might be compromised as the poor – the primary target clientele would be neglected in some aspects.

Measuring sustainability is important. Parameters, however, would vary as there are different MFI types – cooperatives, rural banks and NGOs with each MFI having its own peculiar characteristic,

strength and limitation. Differentiated by its institutional structure, each MFI has its own unique selling point. For instance, rural banks possess the function of savings mobilization through which they could expand their funding sources. NGOs, on the other hand, have closer links to the poor because of their outreach in remote areas. The issue on the uniform set of assessing the performance of all MFIs was resolved in 2006 when the National Credit Council came up with Portfolio, Efficiency, Sustainability and Outreach (PESO) indicators.

Replicating best practices must be anchored on sustainability. To address sustainability, MFIs must examine the market as client demography is essential. To achieve sustainability, MFIs must adjust to the dynamism of the market; more importantly, its institutional structure must have the capability to weather economic downturns and political instability which developing countries are vulnerable to. Sustainable microfinance will not happen with short-term policy interventions. It is imperative that government, private sector, and civil society adopt a strategic perspective and engage each other in utilizing their respective strengths to pave the way for a conducive policy environment leading to more sustainable MFIs. Microfinance as a development instrument can only be sustainable over the long term if MFIs reconfigure their processes to serve a larger portion of the poor, offering a spectrum of value-added products and always looking back on the rationale behind their existence – that of minimizing poverty through accessible credit.

In the Philippine context, several factors can affect microfinance sustainability. These include geographical concerns as the Philippines is archipelagic. Proponents of microfinance might have difficulty reaching remote areas that may need microfinance. The concern is aggravated by the peace and order problem brought about by secessionist and dissident groups in the countryside whereby families are displaced by frequent armed encounters between the government and rebel groups. Given such situation, it is hard for microfinance to flourish or even begin in rebel-infested areas. Another is the status of women in some rural communities, as they have less self-worth, are unable to make autonomous decisions, and are confined to doing menial household chores. With this predicament faced by some women, it will be difficult for microfinance to be accepted especially because it is anchored on women who are empowered. Finally, the financial sector is still plagued by market distortions; government still

implements direct credit programs (DCPs) which are subsidized and compete with microfinance providers. Government needs to resolve this situation by rethinking ways to level the playing field for credit providers.

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