Microfinance in Africa: *opportunities for social Entrepreneurs*

By Daniel Schriber

It is undeniable that there is a large untapped microfinance market in Africa today, although constraints remain numerous. Africa, with an average loan size estimated in 2011 at USD 475, is well above the average portfolio yield of the Symbiotics worldwide microfinance index. Despite this high yield, African microfinance institutions are lagging behind in terms of profitability. However, many aspects of the microfinance business are quite promising in Africa.

Africa is often portrayed as the last growth market. After having been lagging for years, growth has finally come to Africa, mostly driven by commodities, but with immense opportunities in many more sectors. Poverty is still predominant, but entrepreneurship is taking off, with a vast portion of the population being self-employed and having no access to financial services. Microfinance is a very valuable tool for providing financial services to the bottom of the pyramid, first in the form of micro-credit to expand businesses, but also for savings, money transfers, payment services, etc. Indeed the financial inclusion is essential to creating more integrative economic development.

Microfinance as it is known today has its roots in Asia and in Latin America. In Bangladesh, the 2006 Nobel Peace prize winner Mohammed Yunus established the successful Grameen bank in the 1970's. The methodology that he used and managed to scale-up to industrial levels is that of solidarity group lending, mostly, if not exclusively, targeting women. This methodology is unique in the sense that it allows very poor self-employed women to obtain a loan without collateral. The Grameen model has been replicated in many parts of Asia and is now extensively used in Sub-Saharan Africa as well. The Latin American roots of microfinance also date back to the1970's, but this model predominantly uses an individual lending methodology, resorting to some kind of collateral, although in a limited manner, and is deeply rooted in the communities (cooperatives, community banks, NGOs). That being said, microfinance has been practiced in one way or another for centuries in different parts of the world. Typically, for decades, Ghana has known the "Susu" savings collection system, which is similar to the "Tontines" used in some French-speaking African countries. These models have progressively evolved towards established savings and credit systems. But from this traditional way of providing microfinance services, there is a need for more formalized financial inclusion and this is where modern microfinance has come into play.

Africa is the continent that has experienced the strongest growth over the last decade. Of course, there are still significant differences between its regions and countries, but there is a general positive trend that can be observed all over the continent. Democracy is progressing, wars and conflicts are decreasing, infrastructures and education are slowly but steadily improving. The vast appetite for commodities coming from the rest of the world, and particularly from Asia, represents a huge opportunity for Africa, but also brings considerable risks. One of these important risks is the growing gap between the rich and the poor and between cities and rural areas. These risks are not confined to Africa, as they are unfortunately found in many parts of the world, but as Africa's infrastructures, welfare and social mobility are still very under-developed, the risk of serious problems linked to unbalanced growth is even more evident than elsewhere.

Microfinance could well be one of the tools to address the issue of this inequitable growth. Without being the panacea to fight poverty, microfinance can be one way to spur more economic development in rural areas by giving access to financial services to micro-entrepreneurs. The rate of bankarization in Sub-Saharan Africa is estimated today at less than 15% of the population (vs. over 90% in Europe and vs. 40% in Latin America). This clearly demonstrates the necessity for more financial services addressing the needs of the lower segments of the population, particularly in rural areas.

Logically, the majority of the most advanced economies of Africa are also the ones witnessing the strongest growth of the microfinance sector. Typically, Ghana, one of the most stable and fast growing countries in Africa, has one of the largest micro-entrepreneurs bases in the continent estimated at just over 400,000 clients and a loan portfolio of above USD 300 million in a country with 25 million inhabitants. These figures show that despite being one of the largest markets in Africa, the market penetration rate remains very low in comparison to its potential. Furthermore, microfinance activities are largely concentrated in urban areas, where there is actually a risk of over-indebtedness, whereas rural areas are still poorly covered. Other African countries with large microfinance portfolios are Kenya, Nigeria, Ethiopia and Senegal, but in each of these, the market penetration rate is even lower than in Ghana. If we look at Nigeria, for example, it is has more than 1 million micro-borrowers, but the country counts for over 170 million people and has a GDP per inhabitant estimated at USD 2,700, almost 25% below that of Ghana. Again, this reveals the untouched market that predominates in the fast growing economy of Nigeria (GDP of + 7% in 2012).

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If it is undeniable that there is a large untapped microfinance market in Africa today, constraints remain numerous. First of all, financial regulation and supervision of microfinance activities are in many cases still under-developed in comparison to what has been put in place in Latin America, for instance. In particular, there is still a great deal to be accomplished on the front of centralized credit data. A well-functioning and compulsory credit bureau is a key success factor in the microfinance business. As most of the micro-loans are unsecured, knowing and evaluating the liability structure and the repayment capacity of micro-entrepreneurs is crucial to avoiding the possibility of a crisis due to over-indebtedness. This situation not only can create a social drama, as poor clients often lose all the little wealth they had and are left in a worst socio-economic situation than before becoming borrowers, but it also has very negative consequences on the microfinance sector as a whole. Indeed, if micro-lenders are affected by massive payment defaults, they will in turn not be able to honor their debt obligations towards local or international investors. This results either in liability restructuring or worse bankruptcy, which is damaging the reputation of microfinance as an asset class. Furthermore, international microfinance investors are usually very keen on the social impact aspect of microfinance and any signs of over indebtedness obviously create a tendency for them to shy away from the sector.

Apart from the prevailing lack of regulation and supervision, microfinance in Africa is still suffering from a weak governance structure at the level of the micro-lenders. There is nothing dramatic here, as this was previously experienced in Latin America or in Asia as well, but as Sub-Saharan Africa's microfinance institutions are still in early stages of their life, the problem still needs to be addressed. Often started as NGOs or cooperatives, microfinance institutions have unclear ownership structures and regularly depend heavily on a single person who simultaneously plays the role of founder, general manager and president of the Board. This type of risk factor is acute as good middle management resources are usually scarce in most of the fast growing economies like in Africa. Another constraint, especially for institutions targeting rural areas, is the weak transportation infrastructure. This usually translates into very high operating expenses at the level of micro-lenders, which in turn will either limit microfinance institutions' geographic expansion, as it is very difficult to be cost efficient when operating in rural areas, and/or cause their final lending rates to be very high. These high rates must however be put into perspective with the average loan size in Africa. The operating cost of providing, for example, a USD 2,000 loan is more or less the same as for a USD 500 loan. An institution that is lending low amounts, and therefore truly targeting the bottom of the pyramid, will have very high operating costs and consequently charge higher interest rates. Africa, with an average loan size estimated in 2011 at USD 475, shows to be well above the average portfolio yield of the Symbiotics worldwide microfinance index SYM50 (45% in Africa vs. 30% in SYM50 as of December 2012 – data from www.syminvest.com). Despite this high yield, African microfinance institutions are lagging behind in terms of profitability (average Return on Equity of 7.3 in Africa vs. 16.4% in the SYM50, as of Dec.12). This illustrates one of the main operational challenges faced by African microfinance institutions: how to achieve financial inclusion and simultaneously make efforts to gain in efficiency, this being the only way to be able to offer lower interest rates to borrowers. It should however be noted here that there are considerable differences from one country to another. For instance, among Symbiotics' invested companies, Senegal has an average portfolio yield below 22%, whereas Nigeria is around 55% and Zambia close to 80%. Those differences are also indicators of the maturity of the market: Senegal's microfinance market is much older and more mature than Zambia's which has mostly startup companies providing microcredit.

To improve efficiency, microfinance institutions have to find innovative ways to conduct operations. One example is mobile banking: Africa is clearly ahead of other regions in this field, trying to bank on the fast growing mobile networks and avoid dependency on poor transportation systems. Kenya has shown the way in mobile banking, as illustrated by the success story of the M-Pesa system launched in 2007 and which has now over 17 million registered accounts, making it by far the biggest branchless banking system in emerging markets. M-Pesa is now also in use in Tanzania, South Africa and is expanding into Asia as well.

Many aspects of the microfinance business are quite promising in Africa such as its ability to offer high quality of service with Sub-Saharan Africa being the only place in the world where there are more savers than borrowers. This has several advantages for microfinance institutions: first, savings are usually cheaper than borrowings, especially in Africa where currency hedging costs are often on the high end, making costs of funding through international providers expensive; another advantage is that offering savings provides strong roots into local communities, and as such helping developing a strong market positioning.

There is also a large untapped market in a slightly higher segment of entrepreneurs. Typically, small and medium enterprises (SMEs) are facing tremendous difficulties to finance their investment requirements. Only a few mainstream banks are offering loans to SMEs for capital such as working equipment: generators, machinery, trucks, buses, taxis, etc., despite the fact that these SMEs represent a great opportunity to create jobs and strengthen local economies. Micro-businesses are often the best option for families to survive and slightly improve their quality of life. But longer term economic development usually comes from SMEs as those businesses are the basis of a formal sector that creates permanent jobs, pays social security and taxes and forms the ground on which those emerging economies will build their future and sustainable growth. To address these new financing needs, several microfinance institutions have started up-scaling their product offering so as to cover the SME segment. Similarly, there is are a growing number of leasing companies seeing the light in Africa, with the aim to offer leasing products such as various types of working equipment required by SMEs. This trend is developing fast and represents a great opportunity for entrepreneurs in Africa.

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The strong growth in microfinance and SME activities in Africa is a unique opportunity for socially responsible investors. Financial institutions operating in these segments will indeed be in need of a large amount of equity and debt to fund their growth. As other microfinance markets, such as Latin America, are now considered mature, a fact that is evidenced by the growing number of microfinance institutions that can easily access funding through local money markets, Africa represents a still new and fast developing market for socially responsible investors. Symbiotics is at the forefront of this movement, as it is managing a debt fund specifically dedicated to microfinance in Africa. The REGMIFA fund, under management by Symbiotics and launched in 2010 as a result of a G8 agreement by 10 international development banks, has invested over USD 80 million in the last three years in 12 African countries and 30 microfinance institutions. Furthermore, Symbiotics has launched with Oxfam GB a small enterprise impact investing fund that is addressing the needs of SME lenders. More of these initiatives will certainly see the light in the coming years as Africa's economic development is picks up. This speaks for a bright future for African entrepreneurs.

About the Author:

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Symbiotics is a Swiss-based independent asset manager specialized in microfinance fixed-income transactions. Daniel joined Symbiotics in 2006 and is heading the Research & Advisory unit. Prior to that, Daniel worked at the International Committee of the Red Cross (ICRC) in various management positions in Rwanda, Sri Lanka and Afghanistan, and finally as Deputy Head of Operations for Eastern Europe. Daniel holds a master's degree in International Relations from the Graduate Institute (IHEID) in Geneva and an executive MBA in Management and Corporate Finance from the University of Lausanne.

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