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APEX INSTITUTIONS IN MICROFINANCE

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Editor's Note: This study is longer and denser than CGAP's usual Occasional Paper. It was written mainly for people involved in planning, managing, or evaluating microfinance apex organizations. The less specialized reader may be content to read only the summary at the beginning of this paper and the section on conclusions at its end (pages 24 to 29).

Summary

This paper reviews the experience of national microfinance apexes—wholesale mechanisms that channel funds, with or without supporting technical services, to retail microfinance institutions (MFIs) in a single country or integrated market. The question of the effectiveness of these apex mechanisms cannot be answered categorically, because evidence is limited, national contexts vary widely, and there are legitimate differences of view as to apexes' objectives. However, some useful generalizations and lessons can be drawn. Most of these lessons would also be relevant for guarantee facilities that support commercial bank lending to MFIs in a country, even though such facilities were not studied in the research leading to this report.

- Apexes probably expand the supply of resources available for unlicensed microfinance institutions, at least in the short term.

- However, microfinance development in most countries is held back more by a shortage of strong microfinance institutions at the retail level than by a shortage of wholesale funding.

- Planning documents for apexes typically overestimate the number of retail MFIs that will be strong enough to channel the apex's funds effectively.

- Apexes for unlicensed microfinance institutions (such as NGOs) are most likely to be useful when they are created in response to the existence of a critical mass of competent retail MFIs, as was the case with PKSF in Bangladesh.

- Apexes that fund licensed institutions such as banks and finance companies have seldom been successful in encouraging these institutions to continue microlending when the apex money runs out. The only exceptions to this pattern seem to be where the apex's funds were linked to day-to-day technical assistance from a group that (a) had a track record of running sustainable microfinance itself, and (b) was able to provide the retail

institution with a fairly complete "turnkey" package of information and management systems. The number of such technical assistance providers is very small at present.

- Apexes have not been successful in building bridges between MFIs and commercial funding sources. Indeed, the incentive to seek commercial funds is weakened by the availability of easier funding from the apex.

- It may not be reasonable to require that apexes be financially sustainable themselves (after imputing a charge for the opportunity cost of their capital).

- Little evidence was found that apexes play a useful role in coordinating among donors and harmonizing their requirements.

- Management is key to an apex's effectiveness. The actual availability of managers with the necessary technical and personal qualifications should not be assumed, but rather should be investigated carefully at the planning stage.

- The most important function of apex management is probably the selection of MFIs to be funded. Because the number of qualified MFIs is usually limited, managers have trouble applying proper selection criteria when they are faced with political pressure or pressure to disburse large amounts quickly.

- In the apex's supervision of the MFIs it funds, focusing on institutional performance targets that are few in number, precisely defined, and seriously enforced is probably more effective than requiring massive reporting on detailed uses of funds.

- Political interference is a common problem in apexes, despite assurances to the contrary at the planning stage. The best protection will usually be to keep state participation in the governance of the apex to the minimum level possible.

- Donors and governments tend to create unrealistic disbursement pressure for apexes. It would usually be preferable for initial funding of an apex to be modest, with larger amounts added later in response to demonstrated demand and capacity.

I. Introduction

Despite a growing list of successful experiences, the absolute number of viable microfinance institutions remains small and, in most countries, insignificant relative to the number of potential clients[1]. One means by which governments, international financial institutions and donors[2], and in a few cases private organizations are trying to expand microfinance services is the establishment of wholesale financial mechanisms to channel financial resources to retail MFIs. These wholesale mechanisms are known variously as apexes, second-tier banks, national funds, etc. For purposes of the present paper, the term apex will refer to an institutional mechanism operating within a single country or integrated market to channel funds, with or without technical assistance or other supporting services, to a significant number of retail MFIs.[3]

International donors and NGOs are in a certain sense "wholesalers" of support to MFIs, but they are not included among the apexes examined here. Savings and loan cooperatives often form federations that provide services to the retail cooperatives, but these mechanisms will not be a central focus of this

[1] Of the MFIs tracked by *The MicroBanking Bulletin*, 60 are currently classified as financially sustainable or near-sustainable. (*The MicroBanking Bulletin*, Issue No. 4, February 2000).

[2] "Donors" as used in this paper refers to bodies other than the host-country government that provide subsidized resources to support microfinance, including official bilateral donors, multilateral lending institutions, and occasionally foundations and other private organizations.

[3] No effort is made to define "significant number." The term serves only to emphasize the obvious proposition that the multiplier effects and economies of scale that justify the creation of a wholesaler depend on the number of viable and potentially viable retailers that comprise its market.

paper because financial cooperatives typically draw most or all of their funding from their individual members, not from their federations. In some countries there are guarantee facilities that help MFIs get loans from commercial banks by guaranteeing part or all of those loans. Only one guarantee facility was included in this research, but most of the lessons reported here probably would apply to single-country guarantee facilities as well because these facilities face most of the same challenges that national wholesale funds face.

This paper reviews the experience of national apex institutions in furthering the development of microfinance. Its intended audience is mainly governments and donors considering establishment of apexes, and managers charged with running them. The paper is based primarily on available descriptions of apex institutions, many of which were written in the context of preparing, supervising, or evaluating lending operations of the international financial institutions (IFIs). In only a few cases was the intention of these documents to evaluate the role and performance of the apex institution itself.[4] These materials are, in some cases, several years old, and many of the apex institutions themselves were then young with short track records.[5] Moreover, the wide variety of institutional approaches that have been taken, the even greater differences in national contexts, and legitimately differing views about apex institutions' objectives all make broad judgments about their performance difficult. Nevertheless, some generalizations are possible, and some lessons of experience can be suggested.

A distinction is frequently made in the paper between MFIs that are licensed and subject to prudential regulation and supervision by government financial authorities, and those that are unlicensed—often non-governmental organizations (NGOs). Licensing usually brings with it, *inter alia*, the authorization to accept savings deposits, to mobilize resources from domestic capital and financial markets, and to receive liquidity support from the central bank. The apexes reviewed for this paper vary widely in the proportions of the licensed and unlicensed retailers they serve. The distinction is important. Licensed financial institutions presumably have banking skills and good access to funding, so the apex's task would be to convince and assist them to move "downstream" from their traditional clientele to serve the needs of microenterprises and poor families. By contrast, unlicensed MFIs have less access to commercial funding and are more likely to need help building financially sustainable businesses.

Apexes are created to support retail MFIs. But what precisely are apexes supposed to help MFIs do? Because any evaluation of apexes necessarily depends on an answer to this question, it is important to state transparently the assumption behind the judgments in this paper. The belief of the present author is that in almost all countries, donor and government funding will not be large or permanent enough to assure the continuing delivery of microfinance services to the millions of the poor and near-poor who need them. If this is true, then microfinance can achieve massive outreach over the long term only if it is able to tap commercial sources of funding, including the deposits of the public. To do this, MFIs must be financially self-sustainable—that is, able to cover all their costs including the cost of the commercial funding they will need to finance massive expansion. Thus, this paper asks not only whether apexes can provide money for retail on-lending to poor borrowers, but

[4] One of the few efforts in this regard was a set of studies contracted by CGAP and carried out by a team of Ohio State University researchers under the direction of Prof. Claudio González-Vega. The present study is an extension of that effort, expanding the coverage of documented experiences.

[5] A list of the institutions covered is given in Annex 1. The amount and quality of information available varied widely from one to another, explaining in large part the relative frequencies of references to them in the paper.

also whether they are likely to play a significant role in the emergence of a sustainable microfinance system in a country.

In reviewing the debates about apex institutions, several propositions are taken for granted:

- All of the participants in the debate share as a mutual objective the rapid development of microfinance as a tool for expanding economic opportunities for lower-income peoples;
- Country situations are sufficiently different that there are no one-size-fits-all answers about how best to achieve that development; and
- Even though sharing the same overriding objective, different stakeholders—e.g., governments, donors, apex managers, MFIs, final borrowers—will naturally have different perspectives and time horizons for evaluating the costs and benefits of alternative approaches.

Consequently, this paper does not set out to identify an ideal model for apex institutions. Indeed, this kind of exploration can do little more than to underline some of the practical questions and warning lights that policy-makers, institution-builders, and those that would seek to assist them will need to take into account in moving forward.

The remainder of the paper reviews the experience of microfinance apex institutions around the world and draws some useful lessons for governments, donors, and others considering to establish, enhance, or use them as vehicles for supporting the development of microfinance. Section II summarizes the benefits proponents expect from apex institutions and the criticisms expressed by skeptics. Section III looks at apexes' documented performance in delivering these expected benefits. Section IV looks briefly at sectoral issues, including macroeconomic stability and interest rates. Lessons suggested by the available experience are summarized in Section V.

II. Assumed Roles and Objectives of Apex Institutions

There is a surprising degree of polarization in the discussion of apexes and a relative scarcity of empirical analysis of the actual experience. Box 1 provides a thumbnail sketch of the positions taken on both sides with regard to the principal functions most often assigned, actually or theoretically, to apexes. The statements are direct quotes or close paraphrasings taken from formal papers and informal email exchanges among practitioners. The following overview will set the stage for the review in Section III of apexes' actual performance of the various functions that have been proposed.

Wholesale Financial Intermediation

Apex institutions receive large volumes of funding, repackage it into smaller amounts, and pass it as loans, grants, or technical assistance to retail MFIs. Most MFIs, like their poor clientele, are not taken seriously or are seen as uneconomic by domestic and international financial markets. They often are unlicensed and not permitted to mobilize savings, are unaware of or unable to implement rapidly developing microfinance technologies, and are thus limited in outreach potential and ability to achieve the economies of scale and other requisites of eventual self-sustainability. At the same time, some international donors and financial institutions find it difficult or impossible to reach retail MFIs directly—especially small ones—and to provide the tailored, hands-on assistance and supervision that may be required. Apex institutions are thus created to serve as the intermediaries between the few large sources of financing and the potentially large number of small users.

For a wholesaling institution to realize the assumed economies of scale that justify its creation, however, there must be a sufficient client base of viable retailers to serve the ultimate consumer of the goods or services. The critics of apexes do not question the

Box 1: The Two Sides of the Apex Issue		
The Function	**What the Advocates Say**	**What the Skeptics Say**
Expand MFIs' access to a greater volume of financial resources on better terms	Apexes provide a window through which governments, donors and international lenders can move larger amounts of money into microfinance than they would be able administratively to lend directly to MFIs. In some countries, access to commercial funding markets is not a realistic option for MFIs.	Money is not currently the binding constraint on the expansion of microfinancial services; the bottleneck is the lack of adequate retailing capacity. Building mechanisms to encourage lending to MFIs is simply the wrong focus; the core issue is the financial sustainability of the MFIs themselves. Easy and cheap access to apex funds undercuts MFIs' incentives to mobilize resources themselves from the market.
Build a microfinance industry by bringing financial and technical assistance resources to a larger number of MFIs	Apexes can achieve important multiplier effects by rapidly expanding the number of MFIs as well as the client-serving capacities of each.	Apexes are premised on wishful thinking about the power of the offer of money to upgrade behavior, and about the number of institutions that can be significantly upgraded. Effective coverage of a country's microfinance market does not require a large number of MFIs. There is a significant trade-off between the number of MFIs supported and the intensive institution-building support required by each.
Selection of viable and potentially viable MFIs	Because they are closer to and more familiar with the market, apexes are in a better position than external lenders/donors to identify the most capable MFIs, and they can do so at lower cost.	Apexes themselves often lack the technical capacity to appraise and monitor MFIs and are seldom able to escape the political pressures inherent in MFI selection. Moreover, they are susceptible to intense pressure from both government and donors to move the money.
Improve donor coordination	By centralizing donor activities, apexes can shield MFIs from donor pressures and bring consistency to the otherwise confusing diversity of donor approaches, standards, reporting requirements, etc.	Each donor's flexibility is tightly constrained by its own legal and political mandate and philosophy. Apexes thus end up working only with a single donor or having, at very high cost, to keep separate books and administer separate standards, credit lines, methodologies, and reporting requirements. The apex simply passes these costs down to the MFIs, adding its own cost layer in the process. To the extent that standardization of approach is achieved, the apex succeeds in dampening the initiative and innovativeness of the MFIs.
Institution building of client MFIs	As a specialized center of expertise, and with the carrot provided by its funding capacity, apexes are well placed to disseminate the philosophies, methodologies, business strategies, MIS systems, management and governance guidance, etc. needed to develop sustainable MFIs and to monitor performance.	Apexes allow donors to avoid the "hard slogging" of capacity building at the retail level. However, the development of viable microfinance capacity is a slow and costly process at both the apex and retail level. Apexes, at startup, lack the same capacities themselves, and often lack the information systems necessary for adequate monitoring and enforcement of standards. The time and costs of creating an effective apex would be better spent developing the necessary retail capacity. The effective distance of most apexes from their clients, as well as from international experience, negates their alleged informational advantages.

Box 1: The Two Sides of the Apex Issue (con't.)		
The Function	**What the Advocates Say**	**What the Skeptics Say**
Establish bridge between MFIs and financial/capital markets	By virtue of its own size, status, and access to external funds, apexes can provide information and create instruments (e.g., partial guarantees), to enable MFIs gradually to access national and international financial and capital markets.	The large and often below-market funding and weak discipline provided by apexes protect MFIs from market discipline and dampen their incentive to seek market funds. The apex's links to the market and its guarantees are of little value if the apex itself has not achieved credible financial viability. As a general rule, apexes have not in fact gained or facilitated access to commercial funding markets.
Providing monitoring and supervision of MFIs	As specialized institutions, apexes are in a better position than already overstretched central banks and bank regulators to provide oversight consistent with the special demands of sound microfinance.	Even if apexes had the skills and information systems required for prudential supervision, such a function would run into serious conflicts of interest with its lending and technical assistance activities.
Reduce costs of technical assistance, training, and back-office activities	Given their large scale, apexes can provide (or contract) technical assistance and other support activities at lower cost than can the individual MFIs, passing these savings on to their clients.	The expected economies of scale are illusory in the absence of a sufficient number of capable MFIs. Large amounts of time and money are consumed in the establishment and maintenance of the apex.

large number of potential end-users of financial services. They question rather the effective retailing capacity of existing MFIs and the latters' ability to achieve sustainability. Adequate retailing capacity, not money, is argued to be the effective constraint on expanding outreach. Indeed, the soft terms on which apexes in many countries relend to the MFIs may inhibit the sustainable expansion of outreach by undercutting the latters' incentives to become financially self-sufficient.

Building the Retail Microfinance Market

In a very few cases (PKSF in Bangladesh is the most often cited), the pre-existence of a sufficient number of viable or potentially viable MFIs may have justified the emergence of a wholesaling institution to provide economies of scale or otherwise facilitate their access to national and international funding, information, and technology. In the vast majority of countries, however, fewer than a handful, if any, viable MFIs can be identified. In several cases (e.g., K-Rep in Kenya and FondoMicro in the Dominican Republic), institutions starting out as apexes have been unable to identify and attract a sufficient nucleus of actually or potentially viable MFIs to support the wholesaling function, and have become microfinance retailers themselves. Where a critical mass of viable retailing MFIs does not exist, can apex institutions be successful in creating them? And if so, how long will it take and at what opportunity cost? These are the questions that divide the advocates and skeptics of apexes as developers of their own market—i.e., the MFIs—and their ability therefore to make microfinancial services available to a much larger proportion of the target population.

The ability of the apex to help retail MFIs become more competent depends either on its own already-acquired expertise in retail microfinance or on its

superior position, compared to the individual MFIs themselves, to draw upon that expertise wherever it may exist and make it available to the MFIs. It depends also on the quality of the relationship between the apex and the MFIs and the ability of the apex to motivate, assist, and monitor the progress of its clients toward sustainability. Advocates argue that a local apex institution is in a much stronger position than either government or international donors and lenders to select the best potential candidates for viability and to provide the necessary hands-on guidance and supervision. Skeptics, on the other hand, argue that national apexes seldom have either the expertise or the institutional independence needed for this function. Even where these qualities exist, they argue, the labor intensity of developmental work with MFIs severely limits the number of MFIs that an apex can strengthen. If the staff of the apex itself are new to microfinance, additional time and cost are needed to develop their own capacity to assist MFIs, time and resources that some critics argue would be better spent from the outset on developing a few individual MFIs directly. These critics note that serving a large microfinance market does not necessarily require a large number of MFIs: in most of the countries where the microfinance market is relatively well developed, the vast majority of the clients are served by a small subset of the countries' MFIs. Despite the small number of MFIs that dominate these markets, there is strong competition rather than oligopolistic collusion.

Bridging the Gap between MFIs and the Financial Markets

Apex institutions serve principally as financial intermediaries, receiving loan and grant resources for reallocation to microfinance retailers. However, as the MFIs move toward financial sustainability, apexes might be able to create direct bridges between MFIs and licensed financial market institutions, including commercial banks and finance companies, other savings institutions, and the bond and stock markets. They could do this in a variety of ways. In the first instance, MFI repayments of their own obligations to the apex institution might demonstrate to the market their creditworthiness and the potential profitability of lending to or investing in them. The apex could also provide the market with information and ratings regarding MFI financial performance, although rating MFIs to which the apex itself is lending presents some conflict of interest. Finally, the apex might take a lead role in creating market-bridging instruments; for example, as partial guarantors of MFI financial paper. To serve as guarantor, however, skeptics note that the apex itself must be perceived by the market as financially sustainable by virtue of either its own financial performance or higher guarantees, presumably from the state. In many cases, moreover, apex institutions have themselves sabotaged such bridges by offering the MFIs the addictive alternative of financing at below-market terms.

Donor Coordination

Advocates see apexes as useful devices for shielding MFIs from the costly and often conflicting demands of multiple donor agencies, each bringing its own program objectives and target groups, as well as its own processes and requirements. Donors, anxious to show rapid benefits to their home stakeholders, may press their client MFIs to lend out their funds more rapidly than banking prudence might advise.

In principle, the objective of reducing the heavy costs and conflicting demands that donors inflict on fragile management systems is broadly endorsed by microfinance professionals. By serving as a centralized channel for the resources flowing to the retail level, it is argued that an apex can coordinate donor programs as well as buffer donor demands, and can work with the donors to standardize their approaches and reporting

requirements, thus reducing the effective costs of their support. The skeptics, however, argue that this has rarely if ever occurred. The donors themselves, it is pointed out, may have little flexibility under their respective mandates to alter requirements. The apexes, consequently, have little alternative but to pass these requirements and their costs down to the MFIs, only interjecting themselves as another (not costless) transit point in the paper flow. Moreover, to the extent that apexes succeed in standardizing methodologies of microfinance delivery, it is argued, they will stifle initiative and innovation in the development of site-appropriate approaches.

Supervision of MFIs

Some writers have suggested that apexes, given their specialized knowledge of the particular requirements of microfinance and their close familiarity with the institutions involved, are in an excellent position to provide the close supervision that is needed for licensing, but that is outside the reach and staffing ability of the supervisory authorities of the formal financial system. The skeptics counter that most apexes still lack sufficient information access and monitoring methodologies to satisfy their own business needs, much less assure prudential oversight for the microfinance system as a whole. Even if they had such capacity, moreover, there would inevitably be questions raised about the evenhandedness with which they regulate their own clients as compared to their clients' competitors. Also ticklish would be the position of a supervisory apex facing the decision to close down one of its own clients, which may have outstanding financial obligations to the apex as well as to others. In any event, given the lack of real-life examples, this possible role of apex institutions will not be explored further in this paper.

III. How Have Existing Apexes Performed the Above Roles?

Having outlined the major issues in the apex debate, let us now see what documented experience has to say about the expectations for apex institutions.

Do Apexes Expand the Supply of Resources Available for Microfinance?

The answer to this question in the short term is most likely positive. Donors, in particular the international financial institutions (IFIs), find it exceedingly difficult to make the small loans required by individual MFIs, given their limited absorptive capacity. Without intermediating wholesale institutions, these lenders would probably not make available the volumes of resources they would otherwise channel to microfinance. In most cases, apex institutions have been created in the first instance largely to manage funds for microfinance from one or more IFIs or bilateral lenders. Examples include the apexes PKSF in Bangladesh, ACCORDE (formerly CINDE) in Costa Rica, FondoMicro in Dominican Republic, NDTF (formerly JTF) in Sri Lanka, microfinance apex units in central banks in several Latin American countries, and, more recently, RFC in Moldova and the LIDs in Bosnia-Herzegovina. In other cases, existing second-tier institutions, such as COFIDE in Peru and IFI in Colombia, have enabled external lenders to enlarge the pool of resources at the disposition of microfinance retailers. In both types of situation, case studies suggest that apex activities have been accompanied by significant growth of both the numbers of people and microenterprises receiving credit.

Nevertheless, a number of caveats are in order. The first involves the extent of *additionality* of the resources channeled through the apex institution. When the external donor contributes to the apex, is it adding to the amount of microfinance funding available, or only substituting for funds that would otherwise have been available from other sources or

Box 2: Additionality		
Level of Intermediation	**Characteristics of Recipient**	**Possibilities for Erosion of Additionality**
Donor to apex	Apex usually lacks access to commercial funding sources. Apex often established precisely to receive government and/or donor funds.	Donor funds may substitute for government contributions to apex. Donor and government support to apex may replace their direct support to MFIs. Donor and government contributions could replace market financing for creditworthy apexes.
Apex to licensed retail institution	Diversified sources of financing, of which apex resources may be a small proportion. Diversified loan portfolio, of which microfinance may be a small proportion.	Apex resources, particularly if offered on below-market terms, could reduce recipients' incentive to mobilize deposits or other market-based financing. Apex resources could substitute for monies the recipient would otherwise have onlent from own resources, thus freeing the latter for other uses.
Apex to unlicensed retail institution	Retailer typically specialized in microfinance. Retailer often considered uncreditworthy by market or legally prohibited from taking deposits or borrowing from public.	Apex fund, particularly if subsidized, could discourage MFIs from seeking financial sustainability. Could reduce incentive to transform to a licensed institution. Could reduce MFIs' motivation to seek loans from commercial banks.

through other channels? Because money is fungible there are many means of substitution, so additionality is seldom 100 percent. Box 2 outlines ways in which additionality might erode.

The case for additionality appears strongest at the level of the apex. Even at this level, one could argue that the external resources being provided to the apex might simply replace monies that donors would otherwise have channeled directly to MFIs, funds that the apex would otherwise have received from the government,[6] or monies that the apex could have raised, albeit at higher cost, in the local financial market. In counter-argument, apexes have often been created to receive external funds for microfinance programs that would not otherwise have existed. As regards non-governmental financing, few apexes have established sufficient creditworthiness to be able to tap local or international financial markets. Those few apexes that are able to borrow, such as COFIDE in Peru, are not specialized in microfinance and had not been motivated to intermediate such resources for microfinance prior to the offers of earmarked resources from external donors.

The fungibility of resources at the level of the retailing institutions is somewhat more problematic. Here, it is useful to distinguish between licensed and unlicensed retailers.

Licensed retailers, such as commercial banks, finance companies, and savings and loan associations can mobilize resources from depositors or financial markets. Moreover, they are typically multipurpose lenders, with only a small proportion of their portfolios accounted for by micro-borrowers. Evaluators in a number of the studies concluded that apex credits, particularly when offered at below-market interest rates, were undercutting the resource mobilization incentives of retailing institutions, such as BancoSol and Caja Los Andes in Bolivia, that had clearly demonstrated the ability to mobilize deposits and tap market

[6] That government monies may have been substituted and reallocated to other purposes is, of course, a possibility faced by all external aid.

funds. Similar erosions of resource mobilization incentives at the retail level have been reported in some evaluations of apexes serving credit unions, although increased outreach to poorer families or particular ethnic groups has also been reported (e.g., Ecuador). On the other hand, some private banks with significant microfinance portfolios—e.g., Hatton Bank in Sri Lanka—have refrained from drawing on apex funds, preferring to rely on their own resource mobilization.[7]

Additionality may also be reduced to the extent that retailers use the apex funds for microfinance, while diverting resources they would have allocated to microfinance activities to other uses. The InterAmerican Development Bank has mounted a number of "GlobalMicro" projects that financed micro-lending by licensed retailers—banks, finance companies, and credit unions. A 1997 evaluation of the GlobalMicro program in El Salvador, for example, noted that the participating institutions had entered the microcredit market prior to the initiation of the program, and no significant difference was found in microenterprise access to credit between institutions participating in the program and those not participating. In several evaluations of GlobalMicro programs in other countries, the IDB found that commercial banks were using the apex-intermediated resources in large part to finance their traditional customers, sometimes engaging in definitional manipulations to report those customers as being within the target group stipulated under the IDB loan. In the first three years of the program in Ecuador, the principal retailer, accounting for 60 percent of the funds used, was BNF, a state development bank, partly because of lack of interest on the part of the commercial banks. The evaluator concluded that most of the money retailed by BNF had gone to increase lending to old clients.[8]

Notable success, on the other hand, was reported in Paraguay, where evaluators found significant increases in the microfinance shares of some participating retailers' portfolios, spurred by intense competition in the sector as a whole as well as the availability of external funds. However, the decisive feature of the Paraguay case was the intensive, hands-on, and long-term nature of the technical assistance provided to both the apex and the MFIs by the German consulting firm IPC, which had years of successful microfinance experience that it could bring to bear in the Paraguayan institutions. Another positive example is found in the expanded lending to microenterprises through the Municipal Savings and Loan Associations (*Cajas Municipales*) in Peru made possible by GlobalMicro funds intermediated by Cofide. Here, again, intensive, long-term technical assistance from IPC (with support from GTZ) made a crucial contribution. The technical assistance in these cases came from someone with a strong track record in microfinance, and was substantially more intensive than the technical assistance most apexes are prepared to offer.

With some exceptions, *unlicensed retailing institutions* involved in microfinance tend to be specialized in that activity, and typically do not have access to funding from deposits or commercial resources. For them, therefore, there is less likelihood of erosion of additionality on the lending side. This is not universally the case, however. It is not readily apparent, for example, that the funds provided to large, successful NGOs by PKSF in Bangladesh, FundaPro and NAFIBO in Bolivia, and FondoMicro in the Dominican Republic are not simply substituting for resources those NGOs could have attracted from other sources, including from the very donors funding the apex. In the case of NDTF in Sri Lanka, it was reported that some client NGOs were taking NDTF funds and putting their own funds raised from deposits into commercial bank

[7] Concerns about possible political interference are reported to have inhibited both formal and informal MFIs from drawing on public apex funds.

[8] BNF also had the highest arrears rates of the participating retailers, and was barred from the program after three years.

accounts at higher interest rates. Some case studies, moreover, raise concerns about the impact of subsidized apex funds on the incentives of recipients to move toward financial viability, formalization and market access.

When all is said and done, the creation of apex institutions does facilitate amassing substantial funds for microfinance from governments, bilateral donors, and IFIs that probably would not be available in the same amounts if those sources had to transfer them directly to retail-level institutions instead. Despite "leakages" of the sort described above, it seems likely that substantial additionality is achieved through this vehicle, at least at a point in time.

The amount of money involved, however, must be put in the perspective of the total demand for financial services, on the one hand, and the administrative capacity of an apex institution, on the other. While PKSF is recognized as a relatively successful apex institution, it provided only about 15 percent of micro-loan funds in Bangladesh (not counting the microfinance activities of government banks and ministries), according to CDF data available as of this writing. Thus, in the development context one must come back to the question of *sustainability*. The resource flows provided by governments and external sources are inherently limited in amount and uncertain in duration. The shared objectives for microfinance outreach will only be reached if and when the needed resources are being generated by the microfinance system itself. Apex institutions might, in concept, be able to inject additional resources to give a "jump start" to this process, but apex financing alone will not assure a successful outcome.

Is Money the Constraining Factor?

The additional financial flows that apex institutions may facilitate are of long-term developmental consequence only if retail mechanisms are developed that assure the funds' effective use, growth, and leveraging over time. Although money may be useful for achieving some of the necessary institutional changes, money itself is not the primary factor inhibiting the development of healthy microfinance systems.

A critical constraint evident in almost all the reviewed studies is the lack of effective retailing capacity: i.e., MFIs that have achieved or are likely to achieve financial self-sustainability. A key question, therefore, is whether apex institutions contribute significantly to the development of sustainable microfinance retailing capacity. The answer to this question is far from clear.

In this regard, it is important to recognize that the objective is not to maximize the number of MFIs, but rather the effective sustainable capacity of the system. In some instances (e.g., NDTF in Sri Lanka), the number of microfinance NGOs expanded rapidly after the creation of the apex, many being formed largely to access the subsidized resources and offering little if any prospects of sustainability. Two kinds of evolution are notable in the case studies. In some cases (e.g., Fundación Covelo in Honduras), a burst of creation of new MFIs and/or the entry of existing NGOs and other institutions into microfinance activities was followed by a substantial pruning of numbers, as the institutions either failed or were dropped from the program when the apex's criteria tightened. In some other cases (e.g., K-Rep in Kenya, FondoMicro in the Dominican Republic, and Fundación Carvajal in Colombia), institutions established as apexes discovered that the number of potential qualified retailers had been seriously overestimated, and they eventually responded by going into the retailing business themselves. In contrast, one of the most successful of existing apexes, PKSF, serves an exceptionally large number of affiliated retailers (174 as of May 2000, of which 161 were active borrowers). Even so, PKSF finds itself able to work with only a small percentage of those MFIs that apply. A similarly large number of affiliates (74 at the beginning of 2000) is served by

FWWB in India, but despite enormous unmet demand, FWWB's very modest resources and its focus on the development of sound microfinance institutions will limit its intake of new MFIs to five or six per year. Ten years after FWWB commenced apex operations, its affiliated MFIs were reaching only 18,500 clients.

Given the scarcity of well-managed retail institutions in most countries, apex portfolios tend to be highly concentrated. The extreme cases may be those of FondoMicro and BMI (El Salvador). In the mid-1990s, 90 percent of their loan portfolios were accounted for, respectively, by ADEMI, one of Latin America's first sustainable MFIs, and Financiera Calpía. Clearly the retailers in these instances were more important to their apexes than their apexes were to them. Even when an apex is serving a large number of MFIs, its lending tends to be concentrated among only a few. In the GlobalMicro program in Paraguay, two retailers in 1996 accounted for 52 percent of the program, with another two accounting for an additional 31 percent. In Ecuador, BNF, a state development bank, used more than 60 percent of the funds onlent by the apex CFN and accounted for almost half of the subloans. (Very little of this money actually found its way to microfinance, however.) In 1998, Khula in South Africa was lending to 38 MFIs. The largest of these had a client base of over 18,000 borrowers, while the average for the rest was about 500. Of PKSF's 161 active borrowers, three (ASA, Proshika, and BRAC) currently account for some 56 percent of total disbursements.[9] These institutions and several other clients of PKSF are so large that their size, at least, is no obstacle to direct funding from donors.

The Development of Retailing MFIS

The improvement and expansion of sound retailing capacity is both the most important role ascribed to apexes and the one whose performance is most difficult to evaluate. As critics are quick to point out, the relatively small number of self-sustaining MFIs found around the world suggests that apexes have not contributed much in this regard. Moreover, national apexes appear to have played little role in the emergence of sustainable MFIs that do exist; indeed, in most cases their viability predates the apex and may have stimulated its creation.

Some would argue that so negative a conclusion may be premature. The achievement of financial sustainability for an unlicensed institution, previously lacking a banking philosophy and inexperienced in banking discipline, is commonly assumed to require three to five years or more. With respect to licensed financial institutions, experience has shown (see below) that the problems and gestation period needed for the adoption of the new attitudes and technologies of microfinance may be equally difficult and time consuming. Apexes themselves have required time to establish their own internal policies and systems.

On the other hand, more than half of the apexes for which information was gathered for this paper are seven or more years old—long enough to show results. In any event, where quality improvements can be seen at the retail level, it is difficult to attribute them with confidence to the activities of the apex or to other factors, and none of the examined case studies has attempted to develop a methodology for doing that.

Despite these difficulties, it is possible to make some observations about the efforts that different apexes have made to strengthen the institutional capacities and financial sustainability of their client MFIs. Again, it is useful to differentiate between licensed and unlicensed retailing institutions.

[9] In Bangladesh as of June 2000, the statistical bulletin of the Credit and Development Forum reported a membership of 12,600,000 clients served by Grameen Bank and 572 NGO MFIs. Despite this huge number of MFIs, almost three quarters of the clients were served by the top five alone, leaving 8 percent for the next five, 4 percent for the following ten, and only 14 percent divided among the remaining 552 reporting MFIs.

Capacity Building in Licensed MFIs

A number of donor agencies, most notably the IDB, have directed apex credit lines in recent years toward licensed, regulated financial institutions, most commonly commercial banks or finance companies.[10] Since these institutions are regulated and subject to the prudential supervision of official agencies, financial sustainability is not a central focus of capacity-building assistance.[11] Instead, the objective is to "open the minds" of these institutions to the potential profitability of microfinance and thereby to encourage adoption of the required technologies and the expansion of outreach to the targeted populations.

Experience in this regard must be classified as disappointing. There are few instances found in the case studies where these programs led licensed financial institutions to institutionalize and independently expand their involvement in microfinance. The most successful case, as noted above, appears to be that of Paraguay, where a number of banks and finance companies have moved energetically into microfinance with the initial encouragement of GlobalMicro financing and associated technical assistance carried out by the German consulting firm IPC. What is most notable about this example, in addition to the apparent receptivity of the retailing institutions, was the intensity and extended nature of the IPC commitment and involvement: based on its own years of experience, IPC offered the retailers a complete "turnkey" package of methodologies and systems. A similar approach, also with IPC, was attempted in Costa Rica but never took hold because of the apparent lack of interest in the participating banks.

Municipal savings and loan associations in Peru, with the long-term technical support of GTZ/IPC, and a couple of small banks already specialized in consumer finance, also responded positively in this regard. In most cases, however, according to the evaluators of IDB programs in Latin America, banks did little if anything to introduce microfinance technology and made no apparent long-term commitment to the sector. Where some positive response is seen, it was attributed more to competitive pressures in traditional markets, that forced banks to seek new lines of business, than to the availability of external funds and technical support.

Capacity Building in Unlicensed MFIs

Apex institutions in different countries have taken very different approaches to their capacity-building function, ranging from doing virtually nothing to providing extensive training, consulting services, transfer of software, etc. The incentives given MFIs to upgrade themselves in the desired directions have also varied widely, ranging from a lax, almost disinterested approach on the part of the apex to the conditioning of loan access on acceptance of prescribed technical assistance or training and the enforcement of strict performance criteria.

Eligibility criteria for participating MFIs. Many apexes have established, at least nominally, explicit criteria for the selection of partner MFIs and their continued participation in the program (see Box 3). From the point of view of many external donors, this is a primary function of apexes and frees donors from the practical as well as political difficulties of choosing among competing MFIs. In many cases, these criteria are aimed at assuring the financial soundness of the retailing institutions or motivating them in that direction. Eligibility criteria may also reflect an apex's legal mandate or philosophical inclination to assist particular economic subgroups. The target group for

[10] Several bilateral donors, such as Germany and Canada, have tended to work heavily with credit unions and credit union federations. For reasons given earlier, these experiences have not been examined in the preparation of this paper.

[11] IDB GlobalMicro loans do typically apply eligibility criteria for participating financial intermediaries beyond the prudential requirements imposed by the supervisory authorities. The point is that an FI's financial soundness is a precondition for its participation in the project, not an objective of the project.

PKSF, for example, is the rural landless; small farmers are the central concern of PCFC in the Philippines; and poor women in the case of FWWB in India. Eligibility is thus limited to retailing institutions that are similarly focused. Some apexes also limit eligibility to particular kinds of institutions, such as commercial banks (e.g., CFN in Ecuador and several other IDB GlobalMicro programs in Latin America), savings and loan institutions (e.g., RFC in Moldova), credit unions (e.g., FECECAM in Benin), or NGOs (e.g., FondoMicro in Dominican Republic). For others, all types of retailing institutions are eligible, so long as they are engaged exclusively or significantly in microfinance.

Additional criteria may be placed on the use of the funds provided by particular donors. These typically include maximum and average loan amounts in an effort to assure that the monies are directed to lower-income borrowers. Targeted sectors or economic groups may also be specified. To the extent that these criteria differ from the standard criteria of the apex institutions and the MFIs, they add to the costs and complexities of reporting and monitoring.

Most apexes working with NGOs treat financial sustainability as an outcome of the program itself, rather than an entry requirement. Initial eligibility is determined on the basis of indicators that demonstrate potential toward that end and, in some cases, an explicit business plan that sets out the path for achieving it. Continued eligibility is then monitored and determined on the basis of progress as shown by the specified indicators. There is wide variation in the degree to which financial benchmarks are rigorously specified and enforced. When FondoMicro was started in 1990, it was expected that some 200 MFIs would be served. The apex enforced its criteria seriously: by 1994, only three of the existing retail institutions were found to qualify. In many cases, apex officials enjoy considerable latitude in judging retailer performance. This does not necessarily mean weak screening, however. Even though the eligibility criteria set out by PKSF tend to be broadly defined, it is reported that little more than 10 percent of MFI applications for a first disbursement are accepted.

Evidence on capacity building. Documented progress by client MFIs toward financial viability would provide some evidence of the capacity-building contribution that apexes may make. Unfortunately, none of the available case studies gathered such data, either because it was not the focus of the study or because the data were not available from the apex itself. A recent evaluation of the CMF in Uganda does report changed behavior on the part of affiliated MFIs in the direction of greater banking orientation. Specifically, MFIs are reported to have targeted full-cost coverage as the basis for interest rates, implemented loan-tracking systems, improved their accounting systems, and greatly reduced loan arrears and loss rates as a result of CMF training and technical assistance. A demonstrated commitment to the introduction of "best practices" is one of the qualifications for accessing CMF grant funds. More than 20 grant applications were being prepared in mid-1999 by MFIs that previously received CMF-supported technical assistance. In the case of COPEME in Peru, which works with both licensed and unlicensed retailers, no loan or grant funds are involved,[12] and the principal motivation of clients is the value-added they derive from the technical services offered. Examples of these various approaches are discussed in the following paragraphs.

The Microbanking Bulletin (MBB) maintains a database on the outreach, efficiency, and finances of more than a hundred leading MFIs worldwide in order to monitor trends and analyze the key variables affecting

[12] COPEME is not, therefore, considered an apex institution under the definition adopted for this paper. It does illustrate, however, an interesting approach to the support of MFI development. In addition to its training and technical assistance support, COPEME has organized a credit bureau for the use of microlenders and a database and evaluation service on the financial performance of MFIs.

Box 3: Sample Eligibility Criteria for Access to Apex Financing		
Country	**Apex**	**Criteria for Eligibility**
Argentina	FONCAP	Exclusive dedication to microfinance Separate accounting Separate, exclusively dedicated core management team Independence from other activities, if any, of the parent institution 3-year action program for achievement of self-sustainability External audit
Bangladesh	PKSF	For initial loan: Experience in rural credit and focus on rural landless Adequate governance and management structure Good loan collection Adequate staff resources For subsequent disbursements: Satisfactory utilization of previous loan High loan recovery rate (more than 98%) from sub-borrowers Timely repayment of loans to PKSF Meeting reporting requirements Expansion potential
Bosnia-Herzegovina	LIDs	Clear vision and commitment Viable business plan Accounting system meeting international standards Adequate internal controls Average loan size below DM 10,000 Less than 5% of portfolio overdue 30 days or more Less than 3% write-off annually Less than 5% of portfolio rescheduled All costs covered by income from operations 10% of assets funded by local resources other than retained earnings
Ecuador	CFN	Licensed and supervised by Superintendency of Banks No more than 8% of portfolio overdue more than 90 days Profits equal to at least 1% of assets
El Salvador	BMI	Supervised by Superintendency of Banks Arrears over 45 days, net of provisions, not exceeding 3% of portfolio Capital is positive and above legal minimum Funds from program cannot exceed 25% of savings and time deposits
Moldova	RFC	Savings and Credit Association In compliance with prudential regulations Has received technical assistance in credit application and accounting No more than 10% of loans overdue 60 days or more
Nepal	RMDC	Minimum of 3 years experience in microcredit operations and microsavings mobilization Strict targeting of poor rural women (minimum of 80% women members) Minimum of 500 active clients Minimum of 20% balance of savings relative to outstanding loan amount Minimum 90% loan recovery rate Minimum net worth of Rs 250,000 and financial resources of Rs 500,000 Appropriate institutional and management capacity, competent Board of Directors, adequate in-house training capacity, and staff trained in microfinance, accounting, and financial management
Pakistan	PPAF	Demonstrated effectiveness in targeting poor On road to financial sustainability as demonstrated by business plan
Paraguay	Central Bank	Regulated by Superintendency of Banks Overdues more than 30 days cannot exceed 10% of portfolio Overdues more than 90 days cannot exceed 3% of portfolio Profits not less than zero Portfolio classified in categories C, D, and E cannot exceed 10 percent of portfolio Capital adequacy at least 8% of risk-weighted assets

Box 3: Sample Eligibility Criteria for Access to Apex Financing (con't.)		
Country	**Apex**	**Criteria for Eligibility**
Peru	COFIDE	Supervised by Superintendency of Banks In conformance with all prudential regulations, legal reserve requirements, and not under intervention Arrears not in excess of 12.5% of gross loans and not more than 30% above average arrears ratio for system as whole Profits not less than zero
Philippines	PCFC	At least 500 microfinance clients Ratio of capital to risk assets at least 10% (for licensed financial institutions) Positive net operating income, excluding grants (for NGOs) Collection rates above 90%

performance. COPEME has established a similar database covering its client institutions in Peru. With the approval of the individual MFIs, it will make its information available to donors and other sources of finance. Aggregated data are published for four groups of MFIs, three which are unsupervised and differentiated by lending methodology (individual, group, community banks), and the fourth consisting of regulated institutions. Like MBB, COPEME substantially adjusts the information provided by the MFIs on the basis of international accounting standards and the imputation of a market cost of funds.[13] Not surprisingly, this adjustment of accounts has an enormous impact on the assessment of sustainability, reflecting the availability of subsidized funds to the unlicensed MFIs and the failure of many of them to adequately provision against loan losses. Unadjusted data for the first quarter of 1999 show net earnings on loans covering, on average, between 77 and 116 percent of operational expenses for the four groups.[14] After the adjustments, however, the cost coverage ratios fall to between 25 and 61 percent, far short of financial sustainability.[15]

A recent World Bank study of 21 small and medium-size MFIs (of the 161 active retailing partners of PKSF) provides information on their current financial status.[16] All but three of the studied MFIs were enjoying substantial client growth and increasing average loan size, both of which were contributing to falling unit costs of operation. All but one were found to be covering all of their non-financial expenses with loan income, and 18 were also covering their costs of borrowing, including savings deposits. None would have covered financial expenses, however, if PKSF were charging market interest rates on its loans.[17] The cost of borrowing from PKSF ranged from 3.0 to 4.5 percent as compared to the 9 percent rate being charged to NGOs by one sampled commercial bank.[18]

[13] The principal adjustments made by COPEME concern the establishment of loan loss provisions in accordance with the norms of the Peruvian Superintendent of Banks, marking down loans in arrears, imputing market-interest rates to any funds received at subsidized rates, recognizing as income only interest actually received, applying an inflation correction, and excluding incomes and costs not associated with the lending activity (e.g., training or technical assistance to borrowers, programs managed for government).

[14] Financial data from the Municipal Savings and Loan Institutions (Cajas Municipales-CMACs) and from Mibanco, a fully licensed microfinance bank, are not included in the calculated average ratio for the fourth category for lack of comparable adjusted data. Their inclusion would have improved the category average because of the better-than-average performance of the CMACs.

[15] It should be noted that these averages disguise large variations among individual institutions. They also do not include the CMACs, whose microfinance portfolios have been among the better performing in Peru.

[16] Of the 21 MFIs sampled, 14 had more than 5,000 members, of which 6 had more than 10,000 members. All had been associated with PKSF for five or more years.

[17] The sample did not include ASA, one of PKSF's largest client MFIs, which is rated as financially sustainable.

[18] As discussed further below, PKSF also enforces a high minimum relending rate on the MFIs. The resultant substantial spread contributes to the growth of MFIs' capital.

The above data show financial performance at one point in time. In most instances, the apexes themselves may not have the information needed to make such evaluations and to analyze progress over time. Even when rigorous reporting requirements are set out, evaluators report that few apexes have the necessary monitoring tools to collect and analyze the information, and MFIs are often not equipped to provide it. Indeed, accounting and portfolio monitoring systems are key areas for training and technical assistance. On the other hand, fairly broad and subjectively stated eligibility criteria may be backed up by tight reporting requirements and close monitoring, including frequent site visits, and by strict contract enforcement. This is reportedly the approach of PKSF.

Most apexes require that their associated MFIs submit regular reports on fund use and portfolio performance. The accounting systems of many unlicensed MFIs are exceedingly weak, however, and definitions often do not conform to international or even national regulatory standards. Consequently, the reports that are generated may not give an accurate picture of portfolio quality, capital adequacy, or financial performance. The lack of basic, standardized financial information and accounts may itself be taken to suggest that financial sustainability has not been the primary objective of either the MFI or the apex that supports it. In some cases, however, it may simply reflect the long and arduous nature of creating both viable MFIs and strong apexes, including the institutionalization of the accounting and auditing standards, and information and control systems that are fundamental to sound financial management.

Political and other obstacles. The case studies indicate several other factors that also undercut the development and consistent application of criteria for MFI selection and monitoring on the part of apexes. One is political interference. It is typical for planning documents to assert that the proposed apex will be insulated from political pressure, but success in this regard is not nearly so typical. When established to administer state programs, apex institutions are as vulnerable as any other state agency to pressures to give favors to the government's political allies or to win the support of particular voter groups. That such problems are commonplace is indirectly reflected in the wide praise won by PKSF for the steadfast manner in which, as a majority state-owned institution, it has exercised its legal autonomy and independence of decision making. PKSF's success in this regard has been widely attributed to the commitment and the national and international prominence of individuals on its Board of Directors. Donor disbursement pressure frequently militates against rigorous selection and monitoring, by pushing disbursement rates beyond the capacities of the apex and its retailers. Still further cost and confusion are added to performance monitoring when multiple donors impose their reporting requirements with different coverages, formats, definitions, and schedules.

NDTF, the implementing agency for a World Bank poverty alleviation project in Sri Lanka, dramatically illustrates these factors. The Bank's Implementation Completion Report, written in 1998, as well as several independent commentaries, highlight the heavy-handed political intervention to which that agency's decisions were subjected. The Report also acknowledges that the project had significantly overestimated the capacity of the retailing institutions, and had vastly underestimated the complexity of developing that capacity working with so many retail partners. As a consequence of both political and disbursement pressures, eligibility and performance criteria were effectively overwhelmed, and only a handful of the 147 MFIs that drew on apex funds actually met the minimum participation criteria that had been specified.

A further factor affecting financial performance, its measurement, and the enforcement of associated standards is the frequent burdening of both MFIs and apex institutions with multiple, sometimes extraneous,

program responsibilities. Examples abound. FundaPro in Bolivia carries mandates for education and environmental protection, in addition to microfinance; CPD in Egypt carries these same mandates plus health programs and vocational training; NABARD in India manages a variety of specialized state funds and becomes involved in project implementation and the regulation of cooperatives and rural development banks; PKSF and NDTF also administer state-directed credit programs or funds in addition to their own apex activities.

Both governments and donors, including international NGOs, share culpability for this multi-tasking. The implementation of health, education and sanitation programs are all legitimate and important components in the fight against poverty, but the skills, systems, and performance criteria they require are very different from those of microfinance. When mixed together, the financial sustainability of the microfinance activity is, at best, obscured. State development banks and social funds, by their nature, support a variety of activities across sectors in their efforts to promote development and alleviate poverty. Experience provides a strong argument, however, that when such institutions enter into the support of microfinance, clear separation of accounts and management responsibilities are needed to assure the adequate supervision of MFI financial performance. FONCAP in Argentina is the single case in which we have found such separation written into the MFI eligibility criteria.

Incentives for performance improvement. Although the case studies do not provide evidence in this regard, logic suggests that the opportunity for continued access to apex funding, when conditioned on improvements in performance over time, could constitute a powerful incentive to MFIs to progress toward financial sustainability. The track record thus established could also signal growing creditworthiness to market-based sources of financing. The strength of this incentive would depend on the rigor with which the apex set and enforced performance criteria. It would depend also on the attractiveness of apex resources relative to alternative sources. If more attractive resources were available under less stringent conditions, MFIs might simply find it easier to go elsewhere. A 1997 evaluation of Fundación Covelo, for example, found that its effort to upgrade MFIs was undercut to some degree when the latter were able to access lower-cost and more loosely conditioned donor funds through other channels. Similar observations are made by evaluators of K-Rep in Kenya, Finurbano in Colombia, and ACCORDE in Costa Rica. One evaluator recommended that the apex lower its interest rate to MFIs to make its funds more competitive. The offer of subsidized funds, however, runs the danger of encouraging continued dependence, not sustainability.

Some evidence of the rigor of performance monitoring can be found in the numbers of MFIs that are, over time, dropped from eligibility for apex funding. K-Rep in Kenya was working with as many as 20 MFIs in the late 1980s, promoting an integrated package of assistance to microenterprises, including credit, business training, and management assistance. Only 12 of the MFIs qualified for funding, however, and by 1992 the number had been reduced to five.[19] At last report, the number of K-Rep retailers has fallen to four, of which two reportedly might soon be dropped for poor performance. Similarly, the 20 MFIs that were being served by Fundación Covelo in 1988 had been cut to only five, five years later. (As noted earlier, however, some of these may have been lured away by more attractive lending terms from other donors.) In a more recent example, the LIDs program in Bosnia-Herzegovina began in 1996 with 17 participating

[19] By this time, K-Rep itself had entered into retail microfinance in addition to its apex activities.

MFIs. By the end of 1999, however, despite good average performance, the decision was taken to reduce this number to eight, seven of which were reported to have achieved operational sustainability with financial sustainability expected by mid-2000.

Although continued access to apex resources may be a double-edged sword in motivating improved MFI financial performance, practitioners seem agreed that the absence of follow-up financing severely weakens an apex's ability to promote capacity building at the retail level. The most extreme negative example is probably that of the Community Development Program (CPD) in Egypt, a component of the state social fund (SFD). In this case, highly subsidized funding is being provided to NGOs on a first-come, first-served basis, and borrowers will receive second loans only after all those applying for first loans are served.

As an aside, the question of the ability of apex institutions to motivate MFI performance improvement is related to another of the issues that divides practitioners—whether the apex itself should be financially sustainable. The argument on the positive side rests, in part, on the need for MFIs to perceive the apex as a reliable source of funds and services in the future if they are to strive to meet the requirements for continued eligibility. The continued availability of apex funds and services, in turn, is argued to depend on the apex's own sustainability and future ability to tap domestic and international financial markets. In contrast, an apex may quite reasonably be viewed as a temporary institution (even if temporary may mean 15 or 20 years or more) created to play its developmental role and, in so doing, working itself out of a job.[20]

In some of the case studies, evaluators have taken MFIs' repayments on their loans from the apex institution as evidence of both the formers' overall financial performance and the latter's sustainability. A good record of repayment from MFIs to the apex, however, does not necessarily show that the MFIs themselves are doing well, given the fungibility of money. In a number of cases, evaluators noted that MFIs were increasing their indebtedness to other lenders or drawing down their capital in order to repay the apex in the face of growing arrears in their own portfolios. Examples include Finurbano, which by 1996 was experiencing no arrears from its client MFIs despite growing portfolio problems in many of the latter. A consultant's study of PKSF in 1999 reported weakening portfolio performance in a number of partner MFIs despite a continuing exemplary repayment rate to the apex.

Some apex institutions offer added inducements to good MFI performance by reducing interests rates or converting loans to capital grants when performance targets are met. This is the approach taken by, among others, Fundación Covelo in Honduras, the LIDs in Bosnia-Herzegovina, and the microfinance program of Nacional Financiera in Mexico.[21]

Technical assistance and training. In addition to funding, most apex institutions offer technical assistance and training to their client MFIs. In some cases, MFIs must take the technical support in order to qualify for financial support.[22] Almost all donor-financed programs include technical assistance and training, usually grant-financed, to both the apex and retailing institutions (and sometimes to final borrowers, as well). The form of the assistance varies widely, however. A common problem in many programs is the

[20] In only one case, that of AGEPMF in Madagascar, has a "sunset clause" been found explicitly written into an apex's terms of reference.

[21] In the case of Covelo, the principal motivation for the interest rate reduction may have been to retain some of the better clients who were being tempted away by the subsidized interest rates offered by other donor-funded programs.

[22] When training or technical assistance is required as a condition for getting finance, it becomes extremely difficult to evaluate the worth of the training. This is just as true for apex funding as it is for MFI microloans.

failure, particularly on the part of donors, to recognize that the capacity-building needs of microfinance institutions are long-term in nature, to be measured in years, and often require hands-on day-to-day assistance rather than just short courses and quick visits by consultants.

Some apex institutions, such as PKSF, provide in-house training to their own staffs and/or to the staffs and managers of MFIs. Many also directly provide consulting support for the development of management and information systems, as well as for the adoption of new microfinance methodologies. Others have played a more promotional role, encouraging retailers to acquire technical support and training from specialized suppliers of such services. The apexes in these cases will typically issue a list of certified service providers and provide either direct cash subsidies or vouchers for employing them. In the Paraguay case, a single consulting firm, IPC, was hired under the IDB's GlobalMicro program to provide these services to all participants. The LIDs program in Bosnia-Herzegovina has taken an innovative apprenticeship approach, under which MFIs initially act as agents under performance-based contracts with the apex. If the requisite lending and management skills are demonstrated, they are capitalized and put on an independent footing.

A common issue among practitioners is whether the apex should take a direct responsibility for technical support or leave that activity to external service providers. The necessary knowledge and experience is scarce in some countries. International NGOs and consulting firms have helped to bridge this gap, but their resources are also limited (and expensive), their "models" may not always fit specific country circumstances, and few have a "turnkey" capability—i.e., a tested methodology and experienced staff able to provide the intensive, hands-on operational guidance that is usually required. In Bangladesh, the existence of several large and successful MFIs, with tested "home-grown" technologies, has provided a valuable pool of knowledge and talent available both to PKSF and to other retailing institutions.

Several problems arise when the apex itself takes on technical assistance and training functions. The first is the strain on the apex's own human resources and institutional capacity. Just managing the financial side of its business, along with the close monitoring, supervision, and control functions involved, places heavy demands on staff and managers. A second problem is the potential for conflict of interest if apex staff are asked to choose among candidates for special honors (loans in this case) when some of the candidates are their own students or advisees. Although the apex may play a useful role in financing and promoting technical assistance and training and in screening service providers, there is a strong case for maintaining a clear separation of the banking and non-banking functions. In the first GlobalMicro program in Colombia, both loan collection and the provision of technical assistance were delegated to an NGO, the latter getting paid whether or not loans were collected. This arrangement left unclear the responsibility for a loan going bad and created moral hazard and conflict of interest for the NGO. For this and other reasons, loan performance deteriorated, and the arrangement was changed.

The uptake of technical assistance by MFIs has frequently lagged behind the programs initially designed by apexes and donors. Amounts allocated for technical assistance often end up being cancelled or reallocated (e.g., the World Bank loan to NDTF and the IDB loan to Finurbano). In some cases, particularly those in which commercial banks are the targeted retailers, such shortfalls appear to reflect strong disinterest in, if not active resistance to, the adoption of the new attitudes, methodologies, staff incentive systems, etc., associated with microfinance. Evaluators of a number of IDB GlobalMicro programs in Latin America concluded that little, if any, technology had been transferred after

several years of participation in the program, and bank credit managers and loan officers themselves reported that no changes had occurred in their procedures or ways of doing business. Paraguay was noted earlier as a marked exception to this pattern, though it is worth reiterating that the Paraguay case involved an intensive long-term relationship between the apex, the retailers, and highly experienced external consultants with virtually a "turnkey" transfer of proven methodology. Such expertise is still quite scarce, and will be simply unavailable in many settings.

More positive results appear to have been achieved from technical assistance and training efforts programs with unlicensed MFIs. Reports on a number of apex institutions and donor lending programs (e.g., PKSF, FondoMicro, Fundación Covelo), based in part on responses from the MFIs themselves, indicate high levels of satisfaction and report improvements in efficiency and overall performance (although these improvements could not be documented by available data.) Typical complaints from clients were that more training was needed, and that more of it needed to be hands-on and on-site rather than delivered in the classroom. Some reviewers also expressed concern that apexes and/or technical service providers sometimes pushed packaged methodologies that might or might not be appropriate to the specific circumstances and could have the effect of stifling innovation at the retail level.

Another issue that arises, and to which apexes in different countries have taken different approaches, is how nonfinancial services such as technical assistance or training for MFIs should be financed, and whether the MFIs should pay for them. Donors typically provide grant resources for these purposes, and it seems widely agreed that the subsidization of capacity building is justified by the high social returns to such investments. On the other hand, there is some evidence that nonfinancial services are better designed, more competitively priced, and taken more seriously by clients when they have to pay at least part of the costs. In a number of cases, including GlobalMicro programs in Latin America, the provision of training and technical assistance has been moved from a grant to a partially paid basis, with seemingly positive results. An approach gaining favor is to make partial funding available—for example, through vouchers—to be used at the MFI's initiative. In the case of COPEME, MFIs are required to pay fees covering the full costs of training they elect to undertake. Technical assistance, however, for which COPEME maintains a roster of local and international consulting firms, carries a starting subsidy of 50 percent, reduced progressively to 30 percent to 15 percent to zero for subsequent interventions. The demand for technical services appears to be bolstered when MFIs must meet strict performance criteria to maintain access to apex funding or to obtain the capitalization of apex loans.

Can Apexes Build Bridges to the Financial Markets?

Apexes have seldom been able to connect with financial markets. The construction of bridges between MFIs and financial markets becomes increasingly feasible as the MFIs themselves achieve or approach financial sustainability. Licensed retailers mobilize deposits and tap the financial markets quite independently of their apex relationships, and loans from the apex often represent only a small fraction of their overall funding. Although a number of unlicensed MFIs have raised funds in the market, this ability generally predates their associations with national apex institutions, and there are few examples in the literature where MFIs have gained access to the financial markets as a result of the intervention of national apex institutions.

Emprendamos is a loan guarantee program established in 1996 by the Colombian apex, Emprender. In its first 18 months, it had guaranteed more than US$10 million in loans, whose amounts ranged from $40,000

to $70,000. As of 1998, the principal acceptors of the guarantees were development banks and large credit unions. According to an evaluation done for IDB, the guarantee program had probably not resulted in additional funding to the borrowing NGOs and credit unions, but might have improved the terms on which they accessed them. The evaluator raised concern, however, about the conflict of interest involved in according Emprendamos guarantees to retailers that were almost all borrowing from Emprender. This suggests the desirability of a short-duration transition program, under which direct lending from the apex is ended and indirect support is introduced. In any event, at the end of the story, the MFI's own demonstrated financial viability will be the principal bridge to the market.

Have Apexes Been Successful in Aid Coordination?

Creators of apex institutions hope they will coordinate among microfinance donors, thereby bringing stability to disbursements, consistency to policies, and some uniformity to performance standards and reporting requirements. Little evidence can be found in the studies examined that such benefits have been realized to date. A promising exception is that of CMF in Uganda, which was reported to have had considerable success in resolving differences in approach among the several donors and in coordinating their inputs. In many cases, apexes were apparently receiving support from only one donor, with competing funds often flowing to other or even to the same MFIs through different channels. Many of the studies point to the undercutting of the quality-enhancement and sustainability efforts of the subject apex institution (e.g., FondoMicro) by competing donor and government funds, particularly when being offered at subsidized interest rates. In cases where an apex is receiving funds from multiple donors (e.g., Fundapro), the tendency has been to maintain the separateness of the programs and to onlend the respective funds on different terms to the same or different MFIs, accompanied by the different conditions and reporting requirements imposed by the various donors.

IV. Sectoral Issues

Macroeconomic Stability

Apexes provide vehicles for accumulating and channeling resources, but their creation does not solve problems of macroeconomic instability, distorted incentives, lack of legal supports for debt recovery, poor rural infrastructure, etc., all of which are crucial to the efficiency and viability of financial institutions and for financial development generally. The importance of macroeconomic stability is well recognized, and its implications for successful microfinance are not markedly different than for the rest of the financial sector. Several of the studies consulted (e.g., the GlobalMicro program in Costa Rica) recount the difficulties experienced by externally financed programs, as macroeconomic instability led to volatility of interest rates, exchange rates, and relative prices, increasing the risks faced by both borrowers and lenders. Increased risks, coupled with deteriorating portfolios, falling profits, and tightening liquidity, inhibited the expansion of loans to non-traditional clientele and reduced the uptake of apex funds. The IFIs now generally view the macroeconomic environment as a principal consideration in deciding whether or not to go forward with financial sector lending, including for microfinance.

Interest Rates

Retail Interest Rates

Among sector policy issues, perhaps none is more germane to microfinance and to the operations of apex institutions than interest rate policy, which matters at both the wholesale and retail levels. Without

retail interest rates that at least cover the operational and financial costs of providing the services, the financial sustainability of MFIs is impossible by definition. In most of the cases reviewed, interest rates at the retail level, including for microfinance, have been liberalized and are now market determined. Many if not most donors, particularly the IFIs, now insist as a condition of their support that final borrowers pay market-determined interest rates. (Note that if the "market" in question is the normal banking market, then "market" interest rates will fall far short of covering actual microlending costs.) But there are still officially sponsored credit programs that fix retail interest rates generally, or the onlending rates of MFIs specifically (e.g., CPD in Egypt, NABARD in India, Khula in South Africa), well below operational costs (and often below inflation), even without factoring in risks, the related need to maintain adequate loan loss provisions, and the opportunity cost of capital.

***The subsidization of credit for poverty alleviation purposes is a legitimate decision for governments and donors to make, but the considerable costs of doing so must be taken into account. These costs go beyond the macroeconomic strains and resource misallocations that are well documented by studies of credit subsidies around the world. Equally important in the long term are the negative impacts of credit subsidies on the very extension of outreach argued to be their principal objective. So long as MFIs are unable to cover their costs, their continued operations and any extension thereof remain dependent on a growing generosity of taxpayers and donors to pay the bill.

Where interest rates at the retail level are freely determined, an important enabling condition for financial sustainability is realized, provided that costs are also brought down to enable the requisite demand for services. PKSF imposes a *minimum* onlending interest rate of 18 percent on partner retailers with the objective of promoting their financial self-sustainability.[23] FWWB in India also set a minimum onlending rate (12 percent in 1997 as compared to inflation of around 7 percent). This policy put FWWB at a competitive disadvantage vis-à-vis the many state-financed programs that offered negative real interest rates, but FWWB nevertheless managed to steadily increase the number and value of its loans, including to some of the poorest self-help groups. FWWB's attractiveness to its MFI borrowers, despite its higher interest rate, was enhanced by its faster response time and the quality of its services.

Interest Rates to the MFIs

When interest rates charged by the apex on its loans to the MFIs are below the rates they would have to pay for market sources of funds, evaluators have found, not surprisingly, that retailers slacken in their efforts to mobilize funds from the market. Such observations are found in studies of PKSF (as regards its larger NGO partners), Fundapro and NAFIBO, and FondoMicro, among others. PKSF charges higher interest rates to the larger NGOs to cross-subsidize lower rates to the smaller ones. Both rates, however, are below market and are negative in real terms. Similar differentiations between the larger, better-established MFIs and smaller, newer ones are made by Khula in South Africa and by the newly established Center for Microfinance (CMF) in Uganda, but with very different approaches. In the case of Khula, new MFIs receive zero-interest "seed" loans, financed by external grant funds, while existing MFIs receive "concessionary business loans." In contrast, in Uganda both the new and the established MFIs will be charged market-based rates. The rate charged the larger MFIs will be fully on market terms, while the

[23] The study, cited above, of a sample of 21 of PKSF's small and medium-size partner retail institutions showed that all but one were covering their operating costs from loan incomes, and 18 were covering financial costs as well. The latter continued to depend, however, on the credit subsidy received from PKSF.

smaller ones will pay slightly above the rate on Treasury bills, thus benefiting from a lower risk premium than the market would have assigned them. In the case of Fundapro, different interest rates and loan terms apply to its various operations, depending on the original donor sources of the funds. As discussed above, any substitution of apex for market resources reduces the additionality of funds for microfinance sought by both donors and apexes.

In an increasing number of cases, particularly those financed by the IFIs, the interest rates charged to the MFIs are tied to a selected benchmark rate in the market. The CMF example is mentioned in the previous paragraph. Under the GlobalMicro program in Ecuador, the minimum rate charged the participating MFIs was set at the average interest rate on 90-day deposits for the banking system as a whole. In El Salvador, it is determined by the average rate for 180-day deposits, adjusted for the reserve requirement. In Paraguay, the benchmark is the rate on 180-day certificates of deposit, adjusted by the reserve requirement, and in Panama the minimum rate charged by the FIS to the MFIs is determined by the interbank market rate. In all of these cases, the benchmark rate is probably below what the unlicensed MFIs would have to pay to access the market directly, given the higher risk premium that would be attached to them, but the degree of subsidization is kept small. As regards the licensed MFIs, the additional administrative costs associated with joining the program (e.g., reports to apex and donors) may, in some instances, make the funds unattractive. This was reported in at least one case, that of Finurbano in Colombia.

Foreign Exchange Risk

Foreign exchange risk is an important concern when external funds are intermediated. This question is not discussed in many of the case studies reviewed, but in most instances the funds are apparently passed on to the apexes and relent by them in local currency, with the government or central bank taking the exchange risk. This is the case, for example, in the GlobalMicro programs in Paraguay and Costa Rica and under the World Bank loan to RFC in Moldova. An opposite approach, however, is taken by Cofide in Peru, which onlends to the MFIs in US dollars at an interest rate tied to the rate on 360-day dollar deposits in Peruvian banks, plus adjustment for the reserve requirement. The commercial banks participating in the program generally also onlend in dollars, passing the exchange risk on to the final borrowers.[24] The urban savings and loan institutions, on the other hand, hedged the exchange risk by depositing the Cofide funds into dollar deposit accounts in banks, against which they borrowed in local currency for onlending to their own clients.

V. Some Conclusions Suggested by Experience

The purpose of this paper is not to pass definitive judgment on whether apex institutions make important contributions to the development of microfinance. As noted at the outset, the information available from secondary sources is not sufficiently detailed or robust to support a firm answer. It seems likely that resource flows can be augmented by apex mechanisms in the short term, particularly for smaller, unlicensed MFIs more distant (in economic terms) from the market, but it is much less clear whether apexes are likely to be successful in promoting self-sustaining retail capacity and expediting the transition to market-based resources. Nor does the evidence currently available from secondary sources suggest a model that could be expected to succeed in a wide variety

[24] This strategy works for the banks, so long as the borrowers themselves earn incomes in dollars or are otherwise able to hedge their foreign exchange risks. When the borrowers receive their incomes almost entirely from the local market, however, as is typically the case with microenterprises, a depreciating exchange rate will quickly be reflected as growing credit risk in bank portfolios.

of country situations. This section will attempt to distill from the earlier discussion some of the factors that can contribute to or detract from an apex's success.

What is the criterion of success? Governments, donors, and practitioners seek to expand access to microfinance services in order to enhance economic opportunities for poor families. This objective will not be achieved simply by increasing the number of MFIs, or by providing additional financial resources. To be sure, a rapid growth of microfinance resource flows is sorely needed and desired, but the operative constraint on microfinance today appears not to be money *per se* but rather adequate, financially viable retailing capacity that could leverage the limited public resources available and provide the basis for self-sustaining growth over time. Public interventions, therefore, whether directly or through apex institutions, should be aimed at nurturing the development of sustainable MFIs.

Timing and Numbers

Nurturing the development of sustainable MFIs requires time, a rigorous selection process, close labor-intensive attention, monitoring, and a proper incentive system. Limiting selection to existing licensed financial institutions may simplify the challenge of overall financial viability, but it does not ensure the commitment and adoption of the methodologies necessary to assure microfinance outreach and the sustainable development of that market niche. By creating an apex, donors and governments can distance themselves from having to provide these inputs and the related selection decisions, but the "nitty-gritty" work has to come from somewhere. When assigning these responsibilities to an apex institution, one has to ensure that the apex has or will acquire the necessary knowledge and skills, as well as a governance structure, management and information systems, incentive structure, etc. conducive to effective functioning. That, in itself, is not a simple or costless task.

In particular, planning documents for apexes often assume without question that managers with the necessary blend of managerial and financial skill, integrity, and microfinance expertise can be found. In many settings, however, there may in fact be no such individual or group available. Thus, the question of **who will run the apex** (and who will provide technical support) needs to be addressed more directly, and at an earlier stage in the project development process.

As noted earlier, it is not possible on the basis of available secondary sources to measure the contribution of apex institutions to the efficiency, financial performance and quality of services offered by their associated MFIs. In the view of some practitioners, although nuts-and-bolts skills as well as software and hardware can be passed on through training and technical assistance, the crucial point of entry of apex institutions (or direct donors) is in the selection of the MFIs to be supported. As Dr. Ahmed, the Managing Director of PKSF has written, "Selection of the right POs (partner organizations) was the most crucial factor for PKSF's success." Or, as Richard Rosenberg of CGAP has said from a donor perspective, "Our principal role is to pick promising horses. For the most part, we are bettors, not jockeys or trainers."

The number of MFIs being served by the apex institutions reviewed for this paper range from a high of 161 for PKSF to a low of four (of which two were reportedly non-performing) in the case of K-Rep. When the number of an apex's client institutions falls to very low levels, the efficiency of setting up an apex as opposed to direct support to retailers is obviously questionable. Nevertheless, there is no optimal number of MFIs per apex; it will vary according, *inter alia*, to the size of the retail market and the maturity and quality of both the existing MFIs and the apex. The purpose of the question is to stress that the objective is not to maximize the number of retailers served, but rather to accelerate the growth of sound retailing capacity in order to, in turn, expand as rapidly as possible the

access of greater numbers of poor people to sustainable financial services. As described above, apex programs at the outset have often proven grossly overoptimistic in their expectations about the numbers of retailers they would serve. The **application of reasonable selection criteria has usually eliminated all but a small number of institutions as viable candidates for capacity building,** and not all of those have been interested in partnership with the apex.

It should be emphasized that **expanding the number of MFIs may not be the most effective way to expand the number of poor families served,** and indeed may be counterproductive in terms of taking advantage of scale economies and thus reducing intermediation costs. It is instructive in this regard that, of the 534 MFIs in Bangladesh reporting to the Credit Development Forum (CDF), the seven largest MFIs were serving almost 80 percent of clients as of the end of 1999.

Nevertheless, new project proposals continue to forecast dozens if not hundreds of MFIs participating within two or three years of program initiation. One of the clearest recommendations to emerge from this review is that apexes should start small, being highly selective and limiting their intake of MFI clients, consistent with the apex's own evolving capacity to select and support the development of promising MFIs. Donors and governments need to show patience in this process, recognizing that microfinance is another race in which the turtle may have an advantage over the hare.

Selection and Monitoring of MFIs

How does one identify the "promising horses"? For those apexes that limit their clientele to licensed financial institutions, eligibility criteria have emphasized financial performance and prudential norms, tied to or building on the regulations enforced by the national supervisory authorities. Such regulations are intended to assure the sustainability of the supervised institutions in order to protect their depositors and maintain public confidence in the financial system generally. Such criteria do not seem to have helped very much, however, to identify a retailing institution's interest in and aptitude for microfinance. Moreover, if the apex's principal role is viewed to be nurturing the development of retail capacity, it is the MFI's *potential* that must be judged. The assessment of potential is necessarily judgmental and may require more experience-based "feel" and intuition than a checklist of precise criteria.

Selecting Licensed MFIs

A number of criteria, mixing the subjective and the objective, have been emphasized by different apexes and microfinance practitioners in selecting licensed retailers as partners. One is the institution's sense of "*mission*"—i.e., the nature and strength of the MFI's interest in serving (doing business with) the targeted groups. Licensed financial institutions that have not worked previously with microenterprises are usually not very interested in that market niche. Large banks, traditionally focused on the corporate sector, have not often made a sustained "downgrading" commitment with the necessary adjustment of operational methodologies. On the other hand, smaller banks and savings and loan institutions, previously specialized in consumer credit and family services, have shown a greater interest in microfinance as an extension of existing business. On the basis of my review of the apex literature, I would venture several criteria, in addition to financial performance and prudential standards, on which apex institutions and their sponsors might judge the likely commitment of commercial banks and other licensed financial institutions (FIs) to microfinance:

- ***Previous engagement in microfinance.*** When an FI's interest in microfinance is awakened only by the availability of external resources, the interest has, with few exceptions, not outlived the availability of

those resources. (As noted in the Paraguay case, however, financial liberalization and vigorous competition for traditional clients can provide a strong motivation to seek out new market niches.)

- ***Some prior knowledge of and demonstrated management willingness to learn international "best practices" and to adopt the requisite technology.*** A readiness to explore new ways of reaching a new clientele and to commit to intensive training and technical assistance toward that end (as in the case of banks and finance companies in Paraguay) provides a strong indication of real interest in the microfinance market. Otherwise, outcomes have been disappointing.

- ***Staff skills and attitudes necessary to apply the techniques, including pay incentives, appropriate to this market niche.*** Traditional bank staff usually find it difficult to venture outside their offices to work with lower-income families, so it may often be advisable to recruit entirely new field staff for the FI's microfinance operations.

- ***Willingness to separate microfinance from traditional business activities*** (e.g., separate staff and management, cost accounting, product development, etc.).[25] Given the very different attitudes, styles, and methodologies of microfinance compared to their traditional lines of business, banks have often found it difficult to merge the two under a common administration and incentive system.

- ***Willingness to allocate a strong, well-respected manager*** to the microfinance operation. This is often the most important indicator of a bank's commitment.

Selecting Unlicensed MFIs

In most countries large numbers of informal and semi-formal organizations work with poor families and regions, and many of these offer financial services, either exclusively or as part of a package of services. Although such organizations have not proven entirely immune to corruption and opportunism, most are dedicated to improving the lives of their clients. The question of "mission", for our purposes here, has more to do with the long-term role they see financial services playing in poverty reduction and their intention to offer financial services on a sustainable basis. For an MFI eventually to achieve sustainability, its owners, managers, and staff must be able to combine social concerns with the bottom-line attitude of a banker and to relentlessly pursue the product innovations, cost reductions, loan selection and collection techniques, and internal accounting practices, information systems, and controls essential to this objective. My reading suggests the following criteria for the initial selection of NGOs and other nonformal MFIs:

- ***Management with a track record in the provision of financial services.*** Good banking is difficult under any circumstances, and the skills are not learned overnight. Few, if any, apexes will have the resources required to develop successful MFIs from whole cloth, and the interest in microfinance should clearly predate the availability of apex funds.[26]

- ***Demonstrated concern for sustainable financial performance,*** with particular attention to credit evaluation and loan recuperation efforts. The MFI's initial procedures and financial ratios are important indicators of its potential for financial sustainability, but perhaps more important is the clear existence of a "collection culture", the adoption of proven technologies, and the introduction of necessary information and control systems.

[25] An interesting case in this regard is CrediAmigo in Brazil, a microfinance program housed in a state development bank, Banco do Nordeste (BN). CrediAmigo branches share buildings with the regular branches of BN, but their retail operations have entirely separate entrances and physical spaces, as well as different staff and managers, salary incentive systems, etc.

[26] The negative example of NDTF in Sri Lanka, which witnessed the creation of numerous NGOs for the purpose of accessing the promised funding, has been cited above.

- ***Indicated willingness to charge full cost-covering interest rates,*** once reasonable scale has been achieved. The unit costs of lending services can be brought down over time, as scale grows and new methodologies are adapted and assimilated. Realistic time-bound targets, including interest rate adjustments, should be set in the business plan (see below) for achieving full cost coverage.

- ***Staff skills, attitudes, and incentives necessary to sound microbanking practices.*** Taking a "hard line" on loan recuperation and developing the credit appraisal and risk management skills necessary to financial sustainability are not easy adjustments for many NGO staff. It may sometimes be necessary to recruit and train new staff for the microfinance business.

- ***Segregation of microfinance from other activities and mandates,*** preferably in separate institutions. Once again, banking is a difficult business, demanding specialized skills, accounting systems, etc. MFIs (and their apexes) are easily overwhelmed by multiple responsibilities for social programs, training programs, etc., at the cost of properly managing their risks and financial needs.[27]

- ***An explicit business plan,*** leading over a defined period of time to financial sustainability. The plan should include explicit financial projections, based on realistic assumptions drawn from the MFI's own experience and that of similar MFIs elsewhere.

A criterion overlaying all of the factors underlined above, for both licensed and unlicensed MFIs, is the strength and quality of the **leadership** provided by directors and top managers. This is, of course, a highly subjective element in the selection decision and may be difficult to measure aside from the institution's track record. Adjectives and phrases such as dynamic, visionary, innovative, willing to experiment, clear sense of direction, resistant to pressures contrary to the institution's mission, etc., are found in the literature to explain successful MFI (and apex) leadership in Bangladesh, Bolivia, and Dominican Republic, among others. Weak leadership is invoked as a source of failure in many other cases. In appraising the potential of MFI leaders, it is very useful to have the advice of someone who has worked with a number of MFIs that have achieved sustainability, and who thus has a better feel for the kind of MFI management that is required for success. An important focus is whether a manager is willing to do the nitty-gritty things that sustainability requires. This means not just a willingness to be tough on collections, interest rate structure, and staff salaries, but also a willingness to spend his or her day the way bank managers spend their days, dealing with systems, budgets, risk analyses, and other activities that might seem less attractive to the typical NGO manager than working directly with clients.

Monitoring

Whatever the initial selection criteria, many studies underline the importance of clear, monitorable performance benchmarks for determining an MFI's continued eligibility for access to apex financing and other support services. According to reported experience, these are most effective in encouraging progress toward sustainability when the key indicators are few, precisely defined,[28] directly associated with operational efficiency and progress toward financial sustainability

[27] In addition to loading on the management of social programs, donors, including the IFIs, often make MFIs and/or apexes responsible for other social concerns, such as environmental standards, through sub-project evaluation and supervision. Such concerns are more appropriately left to national law and specialized regulation. MFIs and apexes lack the necessary expertise, and to the extent they become the vehicles for such evaluations and enforcement, the main result may be to render them uncompetitive with other lenders not so encumbered.

[28] Accounting results are obviously very sensitive to the definitions applied, as shown in the example cited above of the adjustments made by COPEME to adapt MFI financial statements and balance sheets to conform with international accounting standards.

(e.g., rate of return on assets), and incorporated into a time-bound institutional development plan. Particular emphasis should be given to portfolio quality in the assessment of progress.[29] The effectiveness of such indicators as incentives to performance depend largely on the credibility and objectivity of their enforcement when making funding decisions. Nevertheless, the apex should be allowed some flexibility in their application to permit continuity in the relationship and the taking of necessary adjustment measures in the face of shortfalls from performance targets resulting from temporary shocks (e.g., a terms of trade decline affecting a large number of final borrowers or losses related to weather).

It is worth underlining that this recommended style of monitoring, based on a few key indicators of overall institutional performance, is a radical departure from the practice of many apexes and donors who focus heavily on tracking the specific uses of their funds by the MFI, often down to the level of accounting for individual loans.

Maximizing the Apex's Chances for Success

A number of factors are important to the apex's own ability to set and enforce appropriate selection and performance standards. Many of these are obvious and analogous to the factors identified for predicting success of the MFIs. They include:

- ***A clear sense of mission,***
- ***Management with knowledge of the microfinance business and of international experience,***
- ***Strong leadership able to resist external pressures,***
- ***Segregation of microfinance from other mandates and responsibilities,***
- ***Adequate information and internal management and control systems, and***
- ***Well trained and motivated staff with appropriate incentives.***

Case studies highlight the need for apexes to enjoy **decision-making autonomy,** free of political interference. Vulnerability to interference is a particular issue, of course, in the case of apex institutions that are state owned or agencies of a government administration. The worst-case example was that of NDTF cited earlier. From the beginning, it was apparently a hotbed of partisan politics, which sabotaged its ability to uphold selection and performance standards and reportedly caused a number of MFIs, both licensed and unlicensed, to steer clear of involvement with it. In contrast, PKSF is credited with strong management and directorship, which has enabled it to exercise remarkable decision-making independence. Prudent design of apexes must be realistic in recognizing the high risk of political pressures where the government is involved. Expressions of good intentions on this point in planning documents are not enough. In most cases, a proper independence will best be promoted by limiting as much as possible government participation in, or control of, the board that governs the apex.

[29] Those apexes that do apply criteria of portfolio quality rely, like bank supervisors in most countries, on past loan performance (e.g., arrears measures) in assessing the risk of future default (see Box 3). While such indicators provide important warning signals, they often come too late to head off serious problems. A fuller and more timely appreciation of portfolio quality and risks also requires forward-looking judgments and may involve as much art as science. Such sophistication comes only with experience. Meanwhile, repayment or arrears ratios can be relied on only if they are based on very clear definitions and interpreted carefully. It is instructive in this regard to note that the 90 percent loan collection rate (amount received/amount due) considered adequate to access PCFC and RMDC funds, would imply the loss of more than a third of an MFI's portfolio every year if the portfolio is of constant size and consists of six-month loans. See "Measuring Microcredit Delinquency: Ratios Can Be Harmful to Your Health" (CGAP Occasional Paper No. 3, Washington, D.C. 1999).

Finally, and perhaps most importantly, donors and governments need to make every effort to avoid inflated expectations and **disbursement pressure,** which can make the task of a conscientious and capable apex manager exceedingly difficult. Such pressure hampers the application of sound funding criteria. It interferes with the orderly development of the apex's skills and systems. And it creates an environment in which political interference can be more likely. Donors (especially the multilateral lending institutions) and governments often have a strong preference for large rapidly-disbursing projects; thus, intelligent management of disbursement pressure will require particular discipline on their part. In situations where such discipline is not likely to prevail, an apex funding mechanism is probably not the best choice for supporting microfinance.

Except in the rare case where a large group of substantial, credit-worthy MFIs exists at the time the apex is set up, *it is strongly recommended that initial funding to an apex be small, with donor commitment that additional monies will be made available if and as progress is demonstrated in expanding outreach and improving MFIs' financial performance*. Disbursements should follow, rather than try to drive, the demand from promising MFIs and the development of the apex's own skills and systems. All parties, including the public, need to be educated to expect modest results from the apex in its initial years.

Annex 1: Apex Institutions Included in Study		
Country	**Institution**	**Year Founded**
Argentina	FONCAP Project Coordinating Unit	1997
Bangladesh	Palli Karma Sahayak Foundation (PKSF)	1990
Benin	FECECAM AGeFIB	1993
Bolivia	Funda-Pro NAFIBO	1992 1996
Bosnia-Herzegovina	various Local Initiatives Departments (LIDs)	1996
Colombia	Banco de la República—IFI/Programa de Financiamento para la Microempresa Urbana (Finurbano) Red WWB Fundación Carvajal Emprendamos	1990[30] 1993 1961[31] 1996
Costa Rica	ACCORDE (originally CINDE) Central Bank	1982 1993[32]
Dominican Republic	Fondo Micro	1990
Ecuador	Central Bank of Ecuador/Corporación Financiera Nacional (CFN)	1991[33]
Egypt	SFP/Community Development Program (CDP)	1992
El Salvador	Central Bank of El Salvador	1994[34]
Honduras	Fundación José María Covelo	1984
India	Friends of Women's World Banking (FWWB) NABARD SIDBI RMK	1982[35] 1982 1990 1993
Kenya	K-REP	1984
Madagascar	AGEPMF	1999
Mexico	FOGAIN	1953
Moldova	Rural Finance Corporation (RFC)	1998
Nepal	Rural Microfinance Development Center (RMDC) Rural Self-Reliance Fund (RSRF)	1998 1991
Pakistan	Pakistan Poverty Alleviation Fund (PPAF)	1997
Panama	Fundo de Inversiones Sociales (FIS)	1997
Paraguay	Central Bank of Paraguay	1992[36]
Peru	COFIDE	1995[37]
Philippines	PCFC	1995
South Africa	Khula	1996
Sri Lanka	JTF/NDTF	1991
Uganda	Center for Microenterprise Finance (CMF)	1997
Uruguay	Central Bank of Uruguay	1990[38]
Yemen	SFD	1997

[30] IFI was created in 1940 to promote industrial development. The GlobalMicro Program began in 1991 with the Central Bank of Colombia serving as the apex. Responsibility for Finurbano was shifted from the Central Bank to IFI in 1995.

[31] Began in 1961 as a private foundation to provide a range of community services, including municipal infrastructure, health, housing and education. Served as a second-tier lender to microenterprises through commercial banks from 1989 to 1993, after which it became a first-tier lending institution.

[32] Date of beginning of GlobalMicro Program.

[33] GlobalMicro Program began in 1991 with the Central Bank serving as apex. The program was shifted to CFN, a long-standing state development bank, in 1992.

[34] Beginning date of GlobalMicro Program in El Salvador.

[35] FWWB was originally established in 1982 but became fully operational as a second-tier institution only in 1989.

[36] Beginning date of GlobalMicro Program in Paraguay.

[37] COFIDE was created as a state development bank. It was converted to a strictly second-tier institution in 1993 and began supporting microfinance activities in 1994. It became the apex for the GlobalMicro Program in 1995.

[38] Beginning date of GlobalMicro Program in Uruguay.

Annex 2: Apex Institutions in Microfinance Partial Listing of References[39]		
Country	**Apex**	**Reference**
Argentina	FONCAP Central Bank	Ahmed, Salehuddin, "Creating Autonomous National and Sub-Regional Microcredit Funds," draft, undated. Inter-American Development Bank, Project Completion Report.
Bangladesh	PKSF	Ahmed, Salehuddin, "Creating Autonomous National and Sub-Regional Microcredit Funds," draft, undated. Credit and Development Forum, *CDF Statistics*, December 1999. Nagarajan, Geetha and González-Vega, Claudio, "The Palli Karma Sahayak Foundation (PKSF): An Apex Organization in Bangladesh," Ohio State University, January 1998. World Bank, "A Study on the Sustainability of Partner Organizations (POs) of Palli Karmsa Sahayak Foundation (PKSF)", April 22, 1999. World Bank, Project Concept Document, March 28, 2000.
Benin	Rural S&L Cooperatives FECECAM AGeFIB PADME	Turtiainen, Turto, "Rehabilitation of Rural Finance Institutions: The Case of Benin Savings and Credit Cooperatives and Lessons from Other Cases," World Bank, 1998. World Bank, "La FECECAM-Bénin: La réhabilitation réussie du réseau des caisses d'épargne et de crédit agricole mutuel, April 1997" (English version, June 1997). World Bank, Project Appraisal Document, April 22, 1998. Ouattara, Korotoumou and González-Vega, Claudio, "Microfinance Apex Organizations in West Africa: The Case of Benin", Ohio State University, March 1998.
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