Global microscope on the business environment for microfinance

Evaluating the legal environment for microfinance

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Economist Intelligence Unit
What is the global microscope?

- An index that assesses country-level business environment for microfinance
  - Covers 55 countries, at a national level
  - Updated annually

- Specifically, it evaluates and benchmarks countries’ legal, regulatory, and institutional frameworks for microfinance

- Focuses mainly on microcredit and microdeposits, though it also considers the regulatory framework for financial transactions through agents
Global Microscope: 2012 categories

What does it include?

- There are three index categories

- Of these, the first is devoted entirely to laws and regulations
  - Assumes that broader financial regulations are not entirely adequate to properly facilitate and oversee microfinance
  - Also accounts for the fact that some regulatory environments, while differentiated, may stifle microfinance
  - Regulatory assessments look at both institutional formalisation as well as operating requirements (reporting to the main regulator, prudential standards, etc)
  - As microfinance is largely an informal sector, the indicators do also consider the environment to allow unregulated institutions
  - Also looks at regulatory capacity for microfinance specifically, which is the main source of more nuanced laws and regulations and oversight

Regulatory framework and practice (Category 1)
Supporting institutional framework (Category 2)
Political stability adjustment factor (Category 3)
How about institutions?

- The second category is also just as important as the first

- The “Supporting institutional framework” category evaluates whether MFIs are operating in a vacuum of standards or a well-supported market
  - Assumes that although much of the sector may be informal, standards and institutions specific to microfinance (or at least accessible) are required to ensure sector health
  - Credit information, dispute resolution, accounting standards and pricing transparency all play a role here
  - Also considers regulations and use of technology for financial transactions
  - The question is how good are these are at a micro level, not just for the broader financial sector
Full indicator list

- There are a total of 12 indicators across the three categories
  - Focus is on commercial and private actors; a total of 11 are sector-specific

Microscope indicators, by category:

**Category 1**
1. Regulation and supervision of microcredit portfolios
2. Formation of regulated/supervised microcredit institutions
3. Formation/operation of non-regulated microcredit institutions
4. Regulatory and supervisory capacity for microfinance
5. Regulatory framework for deposit taking

**Category 2**
1. Accounting transparency for microfinance institutions
2. Client protection: Transparency in pricing
3. Client protection: Dispute resolution
4. Credit bureaus for microfinance
5. Policy and practice for financial transactions through agents

**Category 3**
1. Political shocks to microfinance
2. Political stability (overall country)
External evaluation which considers a variety of information and data sources

**How is it done?** It is a collection of qualitative indicators constructed using specific scoring criteria developed in consultation with expert group & benchmarking specialists.

- All information collected on a country-by-country basis, building upon previous years of data and analysis, and referring to other comparable indicators.
- Includes an important primary research component-- interviews provide depth.
- Survey provides breadth of information.
- Primary legal and policy research.

- Comprehensive evaluation
  - Laws on books and standards on paper
  - Implementation and practice
- Transparent design and scores with analysis stimulate discussion.
Indicator importance

- Analysis conducted by staff at the World Bank research department shows a significant, strong correlation between the Microscope overall score and key microfinance sector variables such as:
  - Average loan portfolio size and microcredit borrowers as a % of total population and as a % of the poor population

<table>
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<tr>
<th>Regression Framework</th>
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<td>[ \text{Penetration}_i = \alpha + \beta_1 \text{MICROSCOPE}_i + \beta_2 \text{Country}_i + \epsilon_i ]</td>
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<tr>
<td>\text{MICROSCOPE}: overall index, broad components (regulatory framework and practices and institutional framework), sub-components</td>
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<td>\text{Country}: GDP growth, inflation, institutional development, banking efficiency, overall business environment (Doing Business)</td>
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- At an indicator level, client protection sub-components related to (a) transparency in pricing and (b) dispute resolution, as well as regulatory capacity, demonstrate the strongest correlation with sector variables

- Does not yet establish causal relationships-- a good start

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1 From FOROMIC Barbados Conference Presentation, Oct 2 2012, Bob Cull, World Bank
**Client protection, Dispute Resolution: Indicator 8**

Does the regulatory and business environment provide for timely dispute-resolution at reasonable cost in the event of disagreements between microfinance lenders and borrowers?"

*Scoring:*

0 = There is no mechanism for dispute resolution;

1 = A mechanism for dispute resolution exists on paper, but few resources, if any, have been devoted to it;

2 = A mechanism for dispute resolution exists, but it does not work well in practice (for example, it is too costly, time-consuming, unfair, or is only available to a limited number of potential users);

3 = A mechanism for dispute resolution exists, and provides reasonable recourse for borrowers and lenders, but it can sometimes be slow and inefficient;

4 = A well-functioning dispute-resolution mechanism exists and is available to most borrowers and lenders
Implications: Indicator 8

- Most countries scored 25 or 50 points out of a possible 100 in 2012.
  - E.g. countries have some sort of mechanism on paper, but accessibility and effectiveness are limited or non-existent.
  - No country out of the 55 examined in the study received a perfect score, suggesting a need for new solutions to encourage the appropriate design of such mechanisms for microfinance.
  - A majority of countries have experienced no significant score change; nevertheless, more countries improved their dispute resolution score than underwent deterioration in 2012.

Bolivia, score 3

According to the Financial System Supervisory Authority (ASFI), Bolivian law provides for a clear dispute resolution mechanism for regulated institutions, the Client Complaints System (Sistema de Atención de Reclamos de Clientes, SARC). All financial institutions, including banks, Fondos Financieros Privados (FFPs, private financial funds), cooperatives and NGOs, must have personnel dedicated to dispute resolution. After submitting a dispute to an MFI, a customer may appeal to ASFI for intervention. According to an MFI informant, ASFI tends to favour clients in dispute cases. This results from high instances of age discrimination in the past, as credit was generally not extended to those over 55. This recently changed when a dispute from an older applicant was brought to ASFI, which deemed this discrimination unlawful.

NGOs and other MFIs that are not yet fully-regulated by ASFI (pending an amendment to the Banking Law), are encouraged by the authority to participate in SARC; however, this is not yet a legal requirement. (ASFI; EIU Microscope Survey 2011; personal interviews: June-July 2011)

India, score 0

There are no effective grievance-redressal systems. Sa-Dhan, an association of community-development-finance institutions, has a code of conduct that includes a commitment by members to establish an effective and efficient grievance mechanism. Indeed, it claims that it has a national-level Ethical Grievance Redressal Committee, but experts thought it to be neither fully operational nor effective. Similarly, MFIN has an enforcement committee for dealing with violations of its code of conduct. While calling the above industry-sponsored initiatives commendable, the Malegam Committee, a blueprint for future RBI regulation of the microfinance sector, including in this policy area, recommends the institution of an ombudsman to whom aggrieved borrowers could turn. As envisaged, the ombudsman could be either an employee at a lead bank in each of India’s 640 districts or a “mobile ombudsman”, who would visit each village by rotation on specified days. The committee has also recommended that every MFI establish a proper grievance-redressal procedure. (Sa-Dhan Code of Conduct, July 2011; Malegam Committee Report 2011; personal interviews, June 2011).
The Excel model contains all indicators scores and descriptions for all 55 countries

A PDF report in English and Spanish outlines the key findings and methodology

You can download both the model and report for free at:

www.eiu.com/microscope2012
LACdata.fomin.org
www.caf.com/microfinanzas
www.ifc.org/microfinance