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Reviewing the Progress and Charting the Path Ahead:
The Microenterprise Results and Accountability Act of 2004

Mr. Chairman, I would like to thank you for your leadership over the years in ensuring that "the least of these" thoughout the world can receive new hope and opportunity through microfinance and microenterprise programs. Thank you for your passion, commitment, and powerful concern for the world's most vulnerable. I would also like to thank Ranking Member Payne for inviting me to testify, and express my gratitude that he is so committed to microfinance and microenterprise that he is leaving straight from the hearing for the airport en route to Africa.

On the Ides of March in 1992, I arrived in El Salvador with 7 suitcases and a dream of serving the poor through microfinance. As director of the Women's Opportunity Fund of Opportunity International, I was given the most phenomenal opportunity of my life: to help make a difference in one small corner of the world. I say I was "director"—but I was also the secretary, messenger, and, most of all, loan officer. It was my privilege to spend my days meeting with very poor women, providing them with micro loans so they could invest in very small businesses, and then watching as week after week they began to take charge of their lives. Living and working among very poor women whose lives changed dramatically thanks to loans as small as $50, I learned the power of daring to think small.

Now, as Senior Vice President for Policy for Opportunity International, my view is a bit broader. And as Chair of the Microenterprise Coalition, I have learned a great deal about the explosive potential of microfinance that has been made possible through such leading organizations as ACCION International, CARE, FINCA International, Grameen Foundation, MEDA, ProMujer, Save the Children, World Council of Credit Unions, World Relief, and World Vision, among others.

Based on this experience, I have several key points I would like to make today:

1. Public funds matter. While many of us in the industry are aggressively seeking private donations and investment capital, there is an extraordinary opportunity for the U.S. Government to make an impact on economic growth and poverty if USAID, the State Department, the Millennium Challenge Corporation, and other entities play a leadership role in investing in microfinance.
2. Microfinance is a key strategy for ensuring that the poor both contribute to and benefit from economic growth.

3. Microfinance and microenterprise can be powerful tools to achieve a range of foreign assistance objectives, and can make a difference when integrated not only into economic growth objectives, but also into programs such as HIV/AIDS, natural resource management, malaria, and avian flu.
4. USAID has created powerful incentives in the past that have led the microfinance industry to achieve large-scale outreach and financial sustainability. Now, USAID has the opportunity to create incentives to ensure that the very poor and other unserved populations are included in the financial services revolution. The investment to date in the development of poverty assessment tools will truly pay off when the focus becomes innovation in products and services to reach the very poor and others who are still excluded from the world's financial systems.

<u>A Big Vision for the Future of Microfinance</u>
Here's why I think microfinance has such potential. In 1991, after 20 years in business, Opportunity International had 6,000 clients. Today, only 15 years later, Opportunity has 850,000 loan clients, along with 3 million poor people who now have basic micro insurance to protect them in the event of disaster or disease, plus a growing number of savings and remittance clients. That kind of exponential growth in numbers and in range of services is found throughout our industry.

Some would argue that microfinance is not enough—and it's certainly true that we need a range of services that reach all who are excluded from financial systems and markets, and not only the very poor and poor. But that said, it's also true that there is not enough microfinance.

Thirty to fifty million people today—mostly women—have access to microfinance services—yet 300 to 500 million people—mostly women--are still excluded from basic financial services and yet could benefit from them. What it took to get us from 0 to 50 million clients in just 3 and a half decades was the hard part. Expansion to reach 500 million has its challenges, but they can be overcome. This is a job we can finish in our lifetime. And once we've done it, it's done. With sufficient initial investment, a microfinance program can reach sustainability, and from then on can continue to provide life-changing opportunities for the poor without further grant funding.

Will USAID, the State Department and the Millennium Challenge Corporation keep up with this revolution? Will they provide global leadership to ensure that microfinance achieves its potential?

<u>The Impact of Public Funds: The Case of Opportunity International</u>
Much of what we've accomplished as an industry has been made possible through appropriate use of public funds—which, in Opportunity's case, have been leveraged through significant private support. Over the last 12 years, USAID has contributed over $75 million in grant funding to 19 Opportunity International institutions around the world. These USAID-funded institutions now serve 275,000 loan and 60,000 voluntary savings clients and have financed approximately 466,000 micro and small businesses. Just counting the businesses financed and without taking into account savings clients, that

means an average cost per business financed of $161. What's remarkable is that USAID funding is no longer needed for most of these institutions, but the work goes on. Today, these institutions operate at an average sustainability of 104% and revolve a loan portfolio of $141 million. Over the years, the total loans made, only for those of Opportunity's institutions that have received USAID funds, is conservatively over $270 million. That seems to me an excellent return on USAID's $75 million investment.

Further, Opportunity continues to leverage private funds with public funds and vice versa. In 2005, Opportunity International received $7 million in USAID funds and $23 million in support from private donors. In addition, we placed $50 million in debt, primarily from social investment funds. As a global network, we are leveraged one to one, and our leverage is growing.

<u>USAID's Impact: Opportunity International Bank Malawi</u>
Here's a specific example of the impact of USAID funds on Opportunity's work in Africa. In Malawi, one of the world's poorest countries, Opportunity's bank is a beacon for the poor. With USAID's help, Opportunity International Bank Malawi (OIBM), or "My Bank" as it's called by customers, is aggressively expanding throughout the country, including reaching the most remote rural areas with financial services using innovative products and technology. As of March 2006, OIBM was serving 5,443 loan and 39,323 savings clients with an arrears rate (>30 days) of just 1.58%.

In 2003, USAID awarded Opportunity International $2,160,918 to build the institutional capacity and outreach of its newly created microfinance bank in Malawi – OIBM – which obtained its banking license from the Central Bank in March 2002. In partnership with USAID, Opportunity has pioneered a scalable, technology-driven, low-cost approach to providing a full range of financial services to poor families living in rural Malawi.

OIBM's innovative approach includes Smart cards--ATM cards with clients' biometric identification embedded on a chip. These cards allow illiterate people with no official government identification to participate in the banking system. Other innovations include satellite branches, Point-of-Sale devices, ATMs and mobile banks that bring banking services for the first time to the rural poor in Malawi.

Opportunity has also innovated in the products it offers. Small groundnut farmers were unable to get credit from the local banks because of the high risk of drought. The World Bank contracted with Opportunity to develop a drought insurance product, and now all farmers who have purchased drought insurance are eligible for loans that are enabling them to buy higher quality seeds that have higher yields and greater disease resistance.

Building on USAID's investment, since 2003, Opportunity OIBM has secured debt and equity financing totaling $4,244,645 and has mobilized deposits of more than $3 million.

For poor people in Malawi, USAID's investment has been life-changing. Under the State Department's new foreign assistance framework, will this kind of investment continue?

The State Department's Strategy

Many of us in the microfinance community have been impressed by Ambassador Tobias's focus on measurable results and on developing coherent country strategies that do not duplicate efforts but rather ensure that all the entities of the U.S. government work together effectively on diplomatic and development goals. Yet we have questions about where economic growth and poverty alleviation will fit into the mix.

A month ago, I attended a superb Learning Conference hosted by USAID's Office of Microenterprise Development. During that conference, I learned some fascinating things about both economic growth and poverty alleviation.

Economic Freedom and Peace

In 2005, a professor from Columbia University, Erik Gartzke, did a statistical study to determine what variables lead to conflict between countries. He looked at military action correlated with such factors as economic freedom, population, democracy, total land area, arable land, and status as a major power. Professor Gartzke found that "economic freedom is about 50 times more effective than democracy in diminishing violent conflict." To be more exact, he said "economic freedom is 54 times more effective than democracy in diminishing violent conflict." In other words, "free markets appear to encourage peace" and "the best foreign policy is one that enhances and extends capitalism." If you want peace and prosperity, you need economic freedom.

Economic Growth and Poverty Alleviation

There's been a raging debate at the World Bank and within the U.S. Government about economic growth versus poverty reduction strategies—basically, which comes first. After a rigorous statistical analysis of different countries' poverty and economic growth trends, two leading economists at the World Bank, Humberto Lopez and William F. Maloney, released a report this year called "Poverty Reduction and Growth: Virtuous and Vicious Circles." They confirm what many have concluded, which is that you can have economic growth without poverty reduction, but you can't reduce poverty without economic growth. The idea is that a country can grow economically without reducing poverty—in fact, in such a way that the rich get richer and the poor get poorer. But if you're trying to reduce poverty, so-called poverty alleviation programs are simply not enough. If the pie is too small, even if you divide it equitably, you still won't have enough pie to go around. You have to grow the pie.

Microfinance matters because it is a way to grow the pie in a way that poor people can benefit. Actually, that's not quite right. Microfinance matters because it is a way for poor people to participate in growing the pie—and then participate in the benefits of the bigger pie.

How are USAID, the State Department and the Millennium Challenge Corporation ensuring that microfinance is part of their plans?

Small Loans, Big Impact: The Story of Evas

One poor woman who is doing her part is Evas Kalemeera. One of Opportunity's clients in Uganda, Evas had a thriving business raising chickens. But then, in 1999, her six-year-old daughter Margaret died of AIDS, and Evas and her husband learned they were HIV positive.

Soon, Evas became too sick and depressed to work and was bed ridden. The farm was lost. In August of 2000, her husband died as a result of AIDS. Evas struggled to care for her two remaining children and an orphan who had belonged to her sister who died of AIDS. AIDS had also taken the life of her brother, four uncles, and three siblings from her husband's side.

Yet as a mother she realized she could not afford to give up on life. With nowhere else to turn, Evas contacted Opportunity for a loan to start a new business. She was glad that Opportunity saw her as a living person and not a walking corpse like so many others did. Today, on her third loan cycle since her illness, Evas operates a thriving maize flour business with many customers.

Evas says, "These loans have … boosted my business and I am able to fend for my children and myself … paying school fees, feeding and attending to my medical requirements." She has even been able to pay for antiretroviral drug therapy to extend her life. Evas refers to her Trust Bank as her parents, her husband, and her support.

Microfinance and HIV/AIDS

The story of Evas highlights the importance of recognizing the potential for microfinance and microenterprise programs to interact with other programs such as natural resource management, AIDS, avian flu and malaria. In the case of AIDS, Opportunity is proud to have received an award in the first tranche of PEPFAR. We are not a health or AIDS organization and we are not trying to be. However, we have found that, as a microfinance organization, we can use our infrastructure to provide prevention and awareness training to our clients—mostly women who are hard to reach through other more formal channels. We have also found that people who are affected by HIV/AIDS can benefit tremendously when we adapt our financial services to meet their needs.   In Zambia, our clients' livelihoods were wiped out whenever there was a death in the family due to the high cost of funerals. We developed a funeral benefits insurance product called Ntula that has become perhaps the most valued service we provide there. And throughout sub-Saharan Africa, our micro business loans provide our clients with the means to care for AIDS orphans and to care for those who are infected.

Is our foreign assistance strategy flexible enough to allow for microfinance and microenterprise programs to be integrated into objectives such as the fight against AIDS?

Targeting the Poor and Very Poor: The Role of Poverty Assessment Tools

In 2003, Congress gave USAID a strong directive to focus at least half of its microfinance and microenterprise funds on reaching the very poor. PL108-31, the 2003 amendment to the Foreign Assistance Act, required the development of poverty assessment tools in order to measure USAID's success in achieving that mandate. In my view, USAID has sought to carry out the congressional directive with energy and intelligence, modeling a positive collaborative approach with the practitioner community. As expected, there have been glitches in the development and certification of poverty assessment tools, despite best efforts on all sides. My concern is that in the midst of the technical challenges of developing and now implementing the tools, the basic principle behind their development will be lost. Quite simply, we want to make sure that those who are excluded from financial services are not left out going forward.

It is naturally easiest to provide services to those who are better off in any society. Likewise, it is easier to provide services to those who are "poor" than to those who are "very poor". The beauty of financially sustainable institutions is that, once costs are fully covered by interest rates and loan fees, we no longer have to choose from among deserving clients. In the early days, we were often faced with a choice of giving a $1000 loan to one client or $100 loans to 10 clients—or, for that matter, $50 loans to 20 clients. Under those circumstances, I would always argue for reaching the poorest clients we possibly could. Now, however, once a microfinance institution is fully sustainable, it can fund its growth through borrowed funds. Assuming we develop the human and technological capacity—which is a great challenge for us all and one I don't mean to treat lightly--we can then provide a loan both to the $1000 client and to ten $100 clients, without needing to make draconian choices.

An organization that sets itself up with a poverty focus and intentionally tries to push the envelope to reach a lower level of poverty is likely to be able to grow with its clients and meet their growing capital needs over time, as well as to expand into easier-to-reach markets. Conversely, an organization that targets the poor and not-so-poor, as opposed to the very poor, is less likely to discover the market of the very poor and figure out how to serve it without some kind of specific intervention. Look at the history of banking around the world over time: there are not a lot of examples of downreach to reach the poor and very poor among mainstream banks, which is why the microfinance field developed in the first place.

Public Funds to Promote Downreach and Innovation

This brings me back to the question of the appropriate use of public funds for microfinance. With the increasing sophistication and capacity of the microfinance industry and greater access to private and social investment capital, the poor and less poor are more easily being served. It seems to me that it is an appropriate use of public funds, therefore, to support innovation in product development, technology, and institutional capacity-building that will lead to reaching hard-to-reach populations. This includes the very poor, those in rural areas, marginalized women, the disabled, and other unserved populations. For me one of the most useful aspects of the poverty assessment tools currently under development is what they can teach us about our clients so that we can figure out how best to serve the full range of clients, from very poor to poor to the vulnerable non-poor. The other useful aspect is how these tools can spur us to innovate—and encourage USAID to create incentives for innovation—in reaching the unserved and underserved.

Incentives can work wonders. Let me give one example of USAID providing incentives in a way that successfully encouraged downreach, including a greater focus on unserved women. According to a USAID report in fiscal year (FY) 2000, six Egyptian microfinance institutions reported a total of 72,634 clients, with an average loan size of $506. Only 17 percent of these clients were women. In FY 2002, these same institutions reported 115,345 clients (a growth of 59 percent) with an average loan size of $372 and that 54 percent of these clients were women. The secret? The USAID Mission strongly encouraged its long-time grantees to add a new group-lending product specifically designed for women, which now accounts for virtually all of their growth.

Will USAID put its technical expertise and resources behind the cause of downreach and outreach to hard-to-reach populations through these kinds of incentives and through strategic guidance for its missions?

Preserving the Social Mission

In closing, I agree with my colleague Gary Woller that the development of tools to measure and manage social performance and the encouragement of greater transparency are keys to ensuring that the social mission of microfinance is not lost in the increasing trends toward commercialization and large-scale growth. I commend USAID for its efforts to fund the research and development of these tools. This is the kind of innovation that will ensure that microfinance achieves its promise on behalf of the world's poor. With this kind of leadership, together with a healthy, collaborative relationship with the practitioner organizations that provide direct services to the poor, this very small idea—this micro idea—turns out to be a very big idea after all.