ERASMUS UNIVERSITY ROTTERDAM
ERASMUS SCHOOL OF ECONOMICS

MSc Economics & Business
Master Specialization Entrepreneurship, Strategy and Economic Organization

The Microfinancial Performance of Dutch Microcredit

A double bottom line alternative?

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Finish date: JAN2010

Preface and acknowledgements

The thesis subject ‘Microcredit’ came to my attention several years ago, just before the United Nations had recognized microcredit in 2005 as a sustainable mechanism to reduce poverty. Its social bottom line of providing the poorest and underserved people in our world a chance to get out of poverty in a sustainable manner caught my interest. Since my master specialization is Entrepreneurship, Strategy and Economic Organization, the entrepreneurial aspect of microcredit was of special interest to me. Also the second bottom line of its financial attractiveness for the funders, made me decide to investigate this market by means of this thesis. I have seen the market for microfinance growing and evolving, and have experienced that the available studies, market information, the participants, and the financial involvement increased largely over the years. On the one hand this helped me to gather the necessary information needed, but it also brought along the challenge of keeping up with the developments and trends. Furthermore the current financial crisis made me investigate the background of the crisis and the effect on microfinance, but the financial crisis also brought me new insights to look at (micro)finance.

It took me quite some time to finalize this thesis, but due to the rapid and interesting market developments and the double bottom line of microcredit, I was able to keep up the motivation to keep on going. Off course, the support that I have received from my friends and family, and especially from my partner Elles, was of great importance to me and was a big motivation as well. Therefore I would like to thank them for their patience and continuous support. Also I would to thank my thesis supervisor Dr. D. Smant for his patience and constructive feedback during our meetings. I hope that the readers will enjoy reading this thesis report, and will become motivated to learn more about microcredit or microfinance in general, or even to participate in microfinance to aid the poor themselves.

Keywords:

Microcredit
Microfinance
Microfinancial performance
Performance indicators
Double bottom line measurement

Executive Summary

Thesis introduction

This thesis provides a model to measure the bank performance which is needed in order to understand the microfinance trademark of double bottom line finance for the banks. Performance theory is chosen in order to analyze the banks and MFIs for their involvement and (microfinancial) performance.

Furthermore the thesis provides an extensive overview of the current market for microcredit, the market developments and challenges as part of the microfinance literature. Next to that, an overview of the activities of the Dutch banks and some foreign banks is provided, as well as analyses of the banks' international and internal microfinancial performance and involvement. These analyses are performed based upon the following problem definition:

"What is the international and intracompany microfinancial performance of Dutch microcredit?"

Research outline

Two hypotheses are formulated to help answer the problem definition:

"Dutch microcredit is competitive with foreign microcredit by means of outreach"

"Dutch microcredit outperforms similar products Dutch banks offer"

The first hypothesis covers the social bottom line of extending microcredit. Dutch and foreign microcredit are analyzed using specific microfinance outreach indicators. These indicators are:

Worth to clients, the clients' willingness to pay for microfinance products; Cost to clients, the costs consist of interest rates; Depth of outreach, serving the underserved by financial institutions; Breadth of outreach, the number of clients served and Scope of outreach, the variety of financial services offered.

The second hypothesis covers the financial bottom line of extending microcredit and compares the position of microcredit in relation to similar mainstream products offered. Length of outreach, the sustainability of the microcredit program or microfinance institution and the intracompany financial performance indicator, the financial performance of microcredit compared to the similar financial products, are used for the analysis. The required data to perform the analyses are collected through an extensive desk research and through field research, using specific questionnaires.

Research outcomes

Based on the before mentioned analyses, it can be concluded that Dutch microcredit is not competitive with foreign microcredit by means of outreach. The indicators breadth of outreach and scope of outreach indicate that foreign microcredit has a larger outreach. The Dutch banks focus more on the clients, which is shown by their loan portfolio which is oriented at less countries, as well as by indicators such as the worth to clients, cost to clients and depth of outreach. The results of these indicators show that Dutch banks aim to serve specific client groups with a customized product. Moreover, no Dutch bank has reported that their microcredit activities serve to compete with foreign microcredit. An explanation for this could be that the number of other market players in developing countries is rather low compared to the western countries.

During the financial crisis microcredit has proven to have a low correlation with mainstream financial markets due to the high repayment rates and in some cases due to the achieved profits. Therefore one might expect that microcredit would outperform the similar mainstream products. In some cases Dutch microcredit operates on a profitable basis. These profits are achieved when microcredit is provided at a large scale through funds as part of wholesale activities. However none of the Dutch banks' confirmed that microcredit actually outperforms their similar products. This could be explained as the costs that come along when providing credit to the rural and the poor, are substantially higher than in the mainstream market, especially the retail activities. Concluding, the length of outreach of Dutch microcredit is considered to be sustainable overall. Microfinance funds are provided by the Deutsche Bank, SNS bank and Triodos Bank. These banks are considered to be the most financially involved in microcredit and have the highest microfinancial performance as well.

Dutch microcredit can be determined as having a substantial position in the global microfinance market, that is representative to their position in the mainstream financial markets. Next to the large microfinance bank funds, this is mainly due to the presence of the non-profit development organizations that provide funding such as Cordaid, FMO and Oikocredit. The financial crisis caused the microcredit activities to stabilize or to decrease, in particular the retail activities of the ING Group and the ABN Amro bank. Both the Dutch and foreign banks involved in microfinance as part of corporate social responsibility and have further integrated their microfinance activities in their mainstream activities over the past years.

Conclusion

With this thesis the microfinance market and Dutch banks are analyzed for their microfinance activities.

Both the hypotheses were refuted; the international performance of Dutch microcredit is determined as not competitive by means outreach and Dutch microcredit does not outperform the similar mainstream products the Dutch banks offer. The microfinancial performance measures used in this study are transparent and useful indicators to monitor an organization's focus and can be measured in several ways. The international performance of Dutch microcredit is mainly built upon the indicators that focus on the clients rather than upon outreach. The objective is to serve specific international client groups with a customized product, which can be a strategy to increase scope- or breadth of outreach on the long term. I believe that strategy will be *the* way towards sustainable microfinance and microcredit operations. The double bottom line benefits of microfinance have been achieved by the Dutch banks. The underserved clients benefit from customized products that enable further growth potentials of the clients. For the Dutch banks, microcredit has proven to be profitable product.

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1 Introduction

Microcredit has evolved from being a rare and idealistic product supplied by NGOs in the 70s towards a product that is recognized by the United Nations in 2005 as a sustainable mechanism to reduce poverty. Microcredit, or rather the microfinance industry as a whole, is currently going through a commercialization phase and is on its way to become a regulated, transparent and accepted financial product. Reason for this phase is that a win-win situation from two sides has evolved: commercial banks are needed to help grow the microfinance market financially, geographically and to become more mature, whereas this financial help can provide attractive risk-return profiles for commercial banks as well (Deutsche Bank Research, 2007). Although the returns of microfinance as a percentage of total returns are probably not even worth mentioning on the balance sheet of commercial banks, this involvement in microfinance does allow banks and investors to show their corporate social responsibility as part of their goal to become more social, environmentally responsible and sustainable[1]. In terms of microfinance, this double- or two bottom line[2] approach is described as alleviating poverty for clients, while also generating profits for investors.

Over the past years, the number of microcredit providers grew exponentially from several hundreds to several thousands, the number of people served with microfinance has grown from 13 to over 100 million, the foreign investments rose from 1.7 billion to several billions and the forecasted growth figures show even further growth.

During the past year we have seen that the worldwide financial system can be quite vulnerable. In the United States, (100%) home mortgages and (NINJA[3]) loans were offered to clients who had a weak credit history or little (verifiable) information on their financial situation. The property itself served as their collateral, and with rising real-estate prices, the loan providers went blind on other client information and were involved in predatory mortgage lending. With the changing economic environment, large numbers of clients (for several reasons) were not able to repay their loans anymore. This situation caused non-performing loans (NPLs)[4] in the United States to increase and finally the worldwide financial market was affected as well, because non-US banks were also (in)directly involved in subprime loans through securitization. Furthermore due to failing subprime vehicles ratings and non-existing bank capital requirements[5], huge financial deprecations were made, that are shaking the current financial world market like it ever had before.

1 These factors are also known as the “ESG-factors”.
2 Microfinance institutions are generally referred to as institutions with a double bottom line. See also publications by the Consultative Group to Assist the Poor (CGAP).
3 NINJA: No Income, No Jobs, no Assets.
4 According to the International Monetary Fund (IMF), “A loan is nonperforming when payments of interest and principal are past due by 90 days or more, or at least 90 days of interest payments have been capitalized, refinanced or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons to doubt that payments will be made in full”.
5 Kragt, 2008, De kredietcrisis.

The loan risks stemming from the western consumer clients' characteristics are actually not much different from microcredit clients in terms of their ability to repay, verifiable information and their pawn. Hulme and Arun (2009) even state that microfinance is the sub-prime market in many countries. But why is the microcredit repayment rate of > 97% (often even > 99%) in third world countries higher than that of the western commercial banks? To compare, the repayment rate on US credit cards before 2007 was 95% (Business week, 2007). Is it due to the lack of social capital in western countries or insufficient screening and monitoring of clients, which are successful tools for repayment of microcredit? Like an earlier example, the Bank Rakyat Indonesia (BRI) already showed during the Indonesian economic crisis of the late 90s that its microfinance division even stabilized, and due to that the bank was able to mitigate the risk of their commercial loans division. A 'sustainability barometer study' by Pricewaterhouse Coopers (PwC, 2007) among 260 corporate social responsibility decision makers, showed that firms that are sustainability oriented are less impacted by the current financial crisis than firms that are more focused on short-term goals and over the past years it became clear that short term profits and being "quarterly minded" in satisfying the shareholders, were more important to the western commercial banks than to build upon sustainable investments and policies.

The Fitch Ratings agency (early 2009) expected the impact of the global financial crisis on the microfinance sector to be two-fold: a funding or liquidity impact, which increases levels of refinancing risks for Microfinance Institutions (MFIs); and an economic impact, with financial performance affected by lower lending volumes, increased costs of funding, tighter net interest margins and higher volatility in foreign exchange losses/gains. Furthermore, the agency states that some MFIs are exposed to convergence risks due to the greater integration of microfinance within the banking sector. „Many MFIs would therefore revisit their strategy of commercialization and transformation" (Young, 2009). Moreover, to prevent small businesses getting squeezed out of the market and people to be pushed back into poverty as a result of financial crisis, the focus on the double bottom line benefits, the poverty reduction for the borrowers and alternative commercial benefits for the lenders, should remain *especially* during the financial crisis. The World Bank has already responded by providing credit lines for MFIs that serve the poorest people. Presidents from several countries have followed the World Bank example and have arranged funds to the microfinance market. For example the USA has freed up USD 6 million to fund microloans in 2009 and USD 24 million to market and manage microlending programs (Chalupa, 2009). Also institutions have stepped up to provide refinancing of MFIs such as the German development bank KfW that financed the initiative with USD 130 million (World Bank, 2009). Per August 2009 no failing microfinance institutions are reported. MFIs have refocused on the needs of their customers and returned to local markets as the preferred source of funding. Some MFIs have responded to a liquidity withdrawal by reducing costs and strengthening internal controls (US Banker, 2009). It is therefore relevant to know how the commercial banks are involved in the commercialization of microfinance, whether Dutch microcredit serves the double bottom line perspectives and whether it has been changed as a result of the financial crisis.

The following examples of Dutch institutions that managed well through the financial crisis with microcredit can be described. The Triodos Bank finances companies, institutions and projects that have an added value to social, environmental and cultural areas. In February 2009 the Triodos Bank published its 2008 key results, and reported a profit increase of 13%, to EUR 10.1 million. Its total value increased by 24% to EUR 2.4 billion and its client base increased with 25% to a total 190.000 clients, of which 110.000 in the Netherlands. The Triodos 'Fair Share Fund' specifically invests in microfinance institutions. This fund reported an increase in return of 7.5% and has reached 1.4 million people by providing small loans through these institutions. Triodos Bank invests in institutions that are not listed on the stock exchange markets and could therefore keep developing stably.
Another example is that of ABP, a large Dutch pension fund. ABP is one of the largest investors in microcredit of The Netherlands, mainly due to its doubling in microcredit investments in 2007 to USD 32 million. ABP considers microcredit to be an attractive long-term investment to diversify its market risk, since microcredit is hardly influenced by macro-economic developments, and next to that ABP reported a return on investment of 6%. Its microcredit portfolio is managed by BlueOrchard Finance[6] (ABP, 2007).
In an analysis of the Dutch book 'De Prooi', which covers the history of the ABN Amro bank of the last two decades, Postmus (2009) mentions lessons for the commercial microfinance industry. For example the lesson of the focus on the original (poor) clients, instead of shifting towards less poor clients. Due to the large growth figures and prospects of the microfinance market, many more investors became interested to take a share of the increasing microfinance market. However, since investors are seeking short-term financial gains, it can be expected that some investors would drop out of the microfinance sector, after they have gained enough wealth. This would endanger the sustainability that microfinance aims to offer by servicing the poor, rather than servicing the shareholders who are mainly interested in reaching short term goals. Also in reaching as many clients as possible, the goal of increasing outreach[7] merely becomes a shareholder value. In that case, a thorough analysis on the client's ability to repay could be overseen and as a result, a lot of clients might end up with debt, which is counterproductive to microfinance. Therefore it is important that the initial microfinance methods of educating the new client (groups) remain. In some cases, the MFI directors are subject to a reward system by bonus payments with options in the bank itself. Mostly those banks tend to be rather short-term profit minded, instead of being financially sustainable and supporting financially sustainable clients. Even more shocking is the fact that some of these banks or MFIs promote to support the poor, but actually enrich themselves.

[6] BlueOrchard Finance: microfinance investment managers. www.blueorchard.com
[7] Outreach is referred to as the central purpose of microfinance: to provide large numbers of poor people, including the very poor and women, access to quality financial services (CGAP, 1995).

This thesis therefore aims to understand the motive and future strategy of the commercials banks that are involved in microfinance, to find out whether commercial banks are involved in microfinance because of its bottom line of financial returns or because of its double bottom line by also servicing the poor to alleviate their poverty.

1.1 Thesis outline

In this paragraph the thesis outline is explained by describing the research constraints, the thesis contributions and thesis structure.

1.1.1 Research constraints

The main context of this thesis is constrained by analyzing Dutch banks. This prevents scope creep since nowadays there are many international banks and other institutions active in the global social financial field for microfinance. The regional (in)direct microcredit activities of the banks are therefore constrained to those parts of the world they are active at, instead of focusing on a particular part of the world or on particular social financial (non)profit organizations in the world (see chapter two for such earlier studies). The bank analysis takes out of scope the mergers, acquisitions and state interventions that have taken place since 2008.
The second constraint to focus on microcredit might sound obvious, but nowadays, as is also described in chapter two, there are other financial products available in the microfinance market besides microcredit such as savings, energy supply and insurance.

1.1.2 Thesis contribution

This thesis aims to contribute to the field of microfinance by providing a model to measure the bank performance which is needed in order to understand the microfinance trademark of double bottom line finance for the banks, as mentioned earlier in the thesis introduction. The theoretical part of the thesis consists of performance theory. Performance theory is chosen in order to analyze the banks and MFIs for their involvement and (microfinancial) performance. Therefore models that could measure the impact on the (regional) economy, due to growing entrepreneurship because of microfinance or models to analyze the (micro)financial market structure are not part of the theory used for this thesis, however related topics are covered throughout the thesis. The thesis also provides an extensive overview of the current market for microcredit, the market developments and challenges as part of the microfinance literature.
Next to that, the thesis provides an overview of the activities of the Dutch and some foreign banks involved in providing microcredit, and also provides an analysis of the banks' involvements in terms of their internal microfinance contribution and microfinancial performance. Furthermore, this thesis provides an analysis of the Dutch banks' position in terms of their microfinancial performance in the

global microfinancial market. Finally, this thesis provides insight into the internal position of microcredit at the banks compared to similar bank products, and whether their involvement in microfinance is affected by the financial crisis. Such analyses have not been performed before.

1.1.3 Thesis structure

As all of the above already described, the approach of this master thesis is from both a social and financial point of view and aims to combine these. The next chapter continues with an overview of the relevant literature on microfinance. The third chapter covers the relevant theory on financial performance indicators in the first paragraph and the social and microfinance performance in the second paragraph. Chapter four covers the research methodology and the selected microfinancial performance indicators. The second part of chapter four covers the research on the selected foreign and Dutch banks. Chapter five covers the research outcomes of the research in chapter four. The testing of the hypotheses is discussed in the final chapter six, using the research outcomes of chapter five. Chapter six concludes with a closing discussion on microfinance. This chapter continues with the problem definition and the associated hypotheses.

1.2 Problem definition and hypotheses

The definition of the investigation problem is the following:

"What is the international and intracompany microfinancial performance of Dutch microcredit?"

By 'Dutch microcredit' is meant: extending microcredit to other countries by banks that have a Dutch origin, either directly through the banks' own programs, indirectly through MFIs, or through NGOs[8]. International performance of Dutch microcredit is explained as the microfinancial performance of Dutch microcredit in the international market compared to foreign microcredit. 'Intracompany performance' is defined as the financial performance of the Dutch microcredit in relation to the Dutch banks' similar products. Performance is measured according to both social- and economic criteria: outreach and financial self-sufficiency that are part of microfinancial performance indicators. A total of seven indicators are defined to serve as means of measurement of these two criteria, as well as to support to understand the involvement in microfinance of the banks. To structure the thesis down to both the main criteria, two hypotheses are formulated to help answer the problem definition:

"Dutch microcredit is competitive with foreign microcredit by means of outreach"

"Dutch microcredit outperforms similar products Dutch banks offer"

The first hypothesis covers the social bottom line of extending microcredit. Dutch and foreign microcredit are analyzed using outreach indicators to determine the competitiveness.

[8] Large institutions funding microfinance institutions, such as Oikocredit or Cordaid, are therefore excluded from this research, however they do cooperate with the banks, see paragraph 4.5.

The second hypothesis covers the financial bottom line of extending microcredit and compares the position of microcredit in relation to the similar products offered.

The answers to the problem definition will be based on the refutation or acceptance of the hypotheses, which are discussed in chapter six. In paragraphs 4.1 and 4.2, the methodologies to test these hypotheses are explained.

2. Literature overview

This chapter provides an extensive overview of the microfinance literature, and starts with a short recap on the type of literature available. The microfinance literature starts with an introduction and proceeds with the current state and works towards the recent development of commercialization of microfinance.

Since the start of this decade, an increasing number of professional reports and academic studies became available in the field of microfinance. They describe the development of microfinance institutions, investments and/or projects and even more studies provide an overview of the development of the microfinance market by describing the outreach, interest rates, challenges, growth projections, MFI statuses, government policies, etc. These studies are performed on a country level, for example on the status of microfinance in South-Africa, on a regional level on for example the microfinance state in Africa, or at a global level with an overview on, for example total donations and investments. On the supply side, not every bank reports its microfinance involvement in detail and the information provided differs between the banks. Some theses have been written by students of the Erasmus University Rotterdam, such as 'Commercial finance to empower people' (Lansbergen, 2006), 'Organizing service for the bottom of the pyramid : a survey of organizing microfinance for the bottom of the pyramid' (Adriaanse, 2006), 'Microfinance management : the effect of management on the success of microfinance (Ferrier, 2006), 'Interrelation between microfinance and global banking : an analysis of the process of partnership between international banks and microfinance institutions (Chavez, 2007) and 'A Billion to gain, The next phase' (Bouuaert , 2008). These theses provide good overviews of the microfinance market, the governance and the success factors of microfinance. Bouuaert performed an analysis on the commercial banks as well with the aim to reveal their impact on the development of microfinance.

2.1 Microfinance literature

This section starts with an introduction on microfinance and proceeds with an extensive overview of the microfinance literature by outlining the current state, microfinance products, methodologies and (examples of) institutions. In the second half of this paragraph the future state is covered as part of the commercialization of microfinance.

2.1.1 Introduction into Microfinance

In his 'Principles of Political Economy and Taxation' (1817) David Ricardo (1781-1823) claims that countries' relative cost differences for producing goods are more important than Adam Smith's (1723-1790) absolute production cost differences (1776). According to Ricardo (1817) a country is then always better off to specialize and trade, even though a country would have the possibility to produce all goods more efficiently than another country.

Nowadays the principle of wealth separation over countries through free trade is still not taking place sufficiently. As a result, third world countries cannot benefit enough from free trade to gain wealth and elevate poverty. However, gaining wealth is considered to be possible through programs that aim to reduce poverty, starting with the poorest, such as microcredit. The poorest are described as they who are in the bottom half of those living below their nation's poverty line, or any of the nearby 1.1 billion people who live on less than one US dollar a day, adjusted for purchasing power parity (The World Bank, 2007).

In their study Beck, Büyükkarabacak, Rioja and Valev (2009) find that it is bank lending through enterprise credit rather than household credit, that drives the positive impact of financial development on economic growth and on income inequality. They also confirm earlier studies by Beck, Levine and Levkov (2007) that it is rather through enterprise credit, improved capital allocation and economic transformation than through expanding access to credit. Furthermore they state that their results are consistent with the evidence that the empirical literature has found on the effect of microcredit (World Bank, 2007). One of the main reasons why many people in developing economies remain poor is their lack of access to credit. This is because the poor have no (acceptable) collateral and/or because the costs are too high for banks to screen and monitor their poor clients and to enforce their contracts to make it profitable.

According to Ugur (2006) and Peachey and Roe (2004) state-owned banks attempted to stimulate economic growth by offering loans to agricultural banks at a lower interest rate than market rates. However they did not succeed in implementing a sustainable microfinance program. Loans were given to individual borrowers, without weighing their financial situation and disregarding their potential social network of financial support, which resulted in many NPLs. This has caused the natural selection mechanism through interest rates to be destroyed. The agency problem faced was that of adverse selection, ascertaining the potential credit risk of the borrower[9]. Since banks could not identify a safe borrower from a risky one, they had to charge the same rate to all borrowers. The rate depended on a mix of safe and risky borrowers in the population. When the proportion of risky borrowers became sufficiently large, the subsidy required was so high that the lender had to charge all borrowers a significantly high rate[10]. When the rates became sufficiently high, safe borrowers were unlikely to apply for a loan, thereby adversely affecting the composition of the borrower portfolio. This has led to a market failure where banks mostly offered loans to the risky client types that did remain in the market,

9 The likelihood that an MFI may not get its loan repayed from borrowers (plus interest) is the most common and often the most serious vulnerability in a microfinance institution, and is also referred to as credit risk.

10 The Subsidy Dependence Index (SDI) is increasingly used as a measure of the financial performance of state-owned financial institutions and of NGO's in Microfinance (Yaron, 1992). The SDI indicates how much higher the interest rates charged to borrowers would have to be in order for the institution to cover all operating costs.

which resulted in non-performing and unpaid loans. Furthermore, since these state-owned banks were continuously subsidized, there was no incentive to collect these outstanding loans and as a consequence, the chance for financial discipline had passed (Sengupta and Aubuchon, 2008). Hulme, Matin and Rutherford (2008) find that urban-biased credit allocation, higher transaction costs, interest rate restrictions and corrupt practices were further causing the market failures.

These failures stimulated innovative financial institutions in the development of the microfinance sector, which is based on the assumption that the poor posses the capacity to implement income generating activities but are limited by the before mentioned lack of access and inadequate credit facilities. This approach breaks from the directed credit strategies by reducing the government involvement and by paying close attention to the incentives that drive efficient performance (Morduch, 1999).

Microfinance is the provision of financial services to the poor on a sustainable basis. Microfinance differs from conventional finance in the fact that it serves poor people, and generally people outside the reach of the formal financial market, without perpetual skills (Churchill and Frankiewicz, 2006). Microfinance involves a large range of financial services, such as small and large credit extensions, savings, insurance portfolios and money transfers (Augsburg, 2009). The goal of microfinance is to provide a sustainable win-win scenario where the poor are actively engaged, and companies provide products profitably. Furthermore it puts minimal financial burden on the less developed country (Pralahad, 2005). Microfinance encompasses the field of microcredit since microcredit is described as programs that provide credit for self-employment to very poor persons (The Microcredit summit campaign, 2006). Another description by Rhyne (2001), states that microcredit refers to offering small loans to poor private people, groups as well as individuals.

Since the late 70s, the poor have increasingly gained access to small credit with the help of microfinance programs. The best-known example is the Grameen Bank[11] in Bangladesh established by Muhammad Yunus in 1976, with its group lending methodology. Many banks in many countries have copied this type of lending. In 2005, the United Nations (UN) declared that year to be the ”International year of Microcredit” as part of the UN Millennium Development goals (MDGs) to halve the poverty by 2015. A year later in 2006, Muhammad Yunus for his contributions received the Nobel Prize for peace. It is believed that microfinance can help people to break out of poverty, which is seen as an important prerequisite for establishing long lasting peace. In their study Setboonsarng and Parpiev (2008) in Pakistan find that microfinance institutions have been effective in contributing to the MDGs such as improving income, reducing hunger, providing children school education and training and paying for health services. They also find that women are the main beneficiaries.

[11] The Grameen Bank will be discussed later on in paragraph 2.1.5.

2.1.2 Microfinance – Current state

Asia is the home of the largest number of MFIs and MFI outreach, see figure 1 'MFIs per region'. Outreach refers to the central purpose of microfinance: to provide large numbers of poor people, including the very poor and women, access to quality financial services (CGAP[12], 1995). In China and India, an enormous demand for microfinance exists. China has an estimated poor population of 110 million people that are reached so far through the Agricultural Development Bank. In India, about 26 per cent of 1.1 billion people are still under the poverty line. Almost three-fourths of the total microfinance clients are concentrated in the four southern states of India. In Africa, Rotating Savings and Credit Associations (ROSCAs[13]) are active and an increasing number of commercial banks. Countries with a high number of MFIs in Africa include Kenya, Uganda, Ethiopia and Senegal. In the Arab world, the outreach has increased within 10 years to over one million people in 2006, although Morocco has the largest outreach in the Arab World. The majority of MFIs in the region are NGOs and mostly depend on donor funding. In many Latin American countries, there is a high concentration of microfinance programs in urban areas.

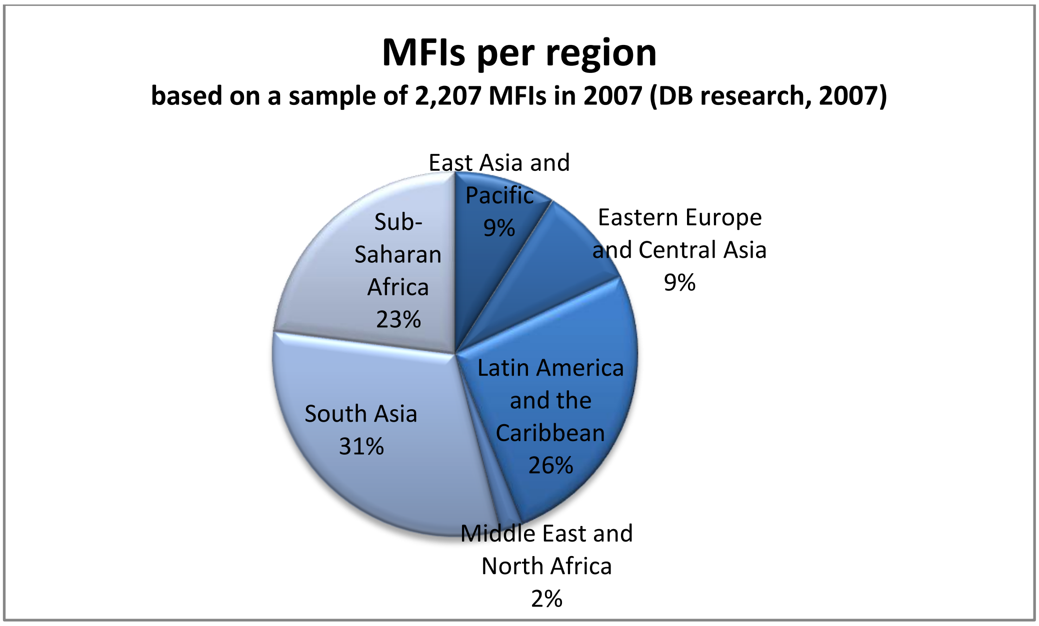

Figure 1 MFIs per region

The current microfinance providers in Latin America include NGOs, commercial banks and MFIs, which are all mostly working in urban areas. In the USA over 750 organizations provide microfinance, but its outreach is limited. Immigrants form a very large group of microloan clientele, also because many come from cultures with strong entrepreneurial skills (Harman, 2009). None of the organizations recover their costs; the best is a recovery of 70% (Latifee, 2006). The Good Faith Fund originates from the Grameen

[12] Consultative Group to Assist the Poor, (CGAP) a consortium of development agencies affiliated with the World Bank.
[13] ROSCAs are commonly referred to as merry-go-rounds, but are also known as *chit funds* in India, *susu* or *tonties* in West-Africa, *kye* in the Republic of Korea, *pasanakus* in Bolivia, *chetu* in Sri-lanka, and *ekub* in Ethiopia (Churchill and Frankiewicz 2006, Making Microfinance Work).

Bank but has failed to show similar growth figures and poverty alleviation. According to Sengupta and Aubuchon (2008) this can be clarified due to the relatively smaller percentage of those living in poverty and due to the larger safety net. Schreiner and Woller (2003) also mention that the lack of highly skilled or better-motivated workers among the poor in the United States, combined with the high entry costs and regulations (Morduch, 2009) for micro-enterprises, makes successful microfinance initiatives more difficult.

According to Christen (2004) China and India cover 65 percent of the total microfinance accounts in Asia and account for more than half of all accounts worldwide, see also figure 2 'Borrowers per region'.

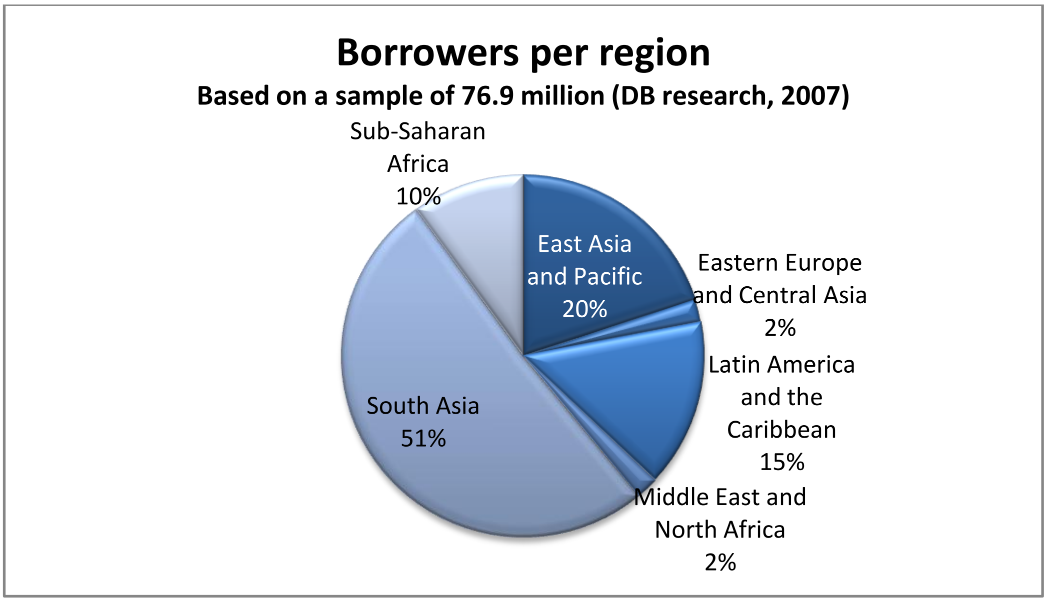

Figure 2 Borrowers per region

Between 1997 and 2005 the number of MFIs increased from 600 to 3.000, and by 2008 estimates even mention 10,000 MFIs. The number of people that have received credit from MFIs rose from 13 million to 113 million, of which approximately 84% are female clients (Daley-Harris, 2006). The funding figures by foreign investments[14] also reflect this trend: from USD 1.7 billion to around USD 4.4 billion in 2006 (CGAP, 2007).

The microcredit loans usually amount to a local currency equivalent of USD 100 and can over time reach several times this amount depending on the geographic region. For instance in Asia the average loan size amounts to around USD 150, while in Eastern Europe and Central Asia loan sizes amount to approximately USD 1.600 on average (The Microbanking Bulletin, 2006). See figure 3 'Average loan size over the world'.

[14] Foreign loans made and deposits placed in other countries are considered to be a good measure of the rapid internationalization of banking over the past decades (Rodriguez and Santiso, 2007).

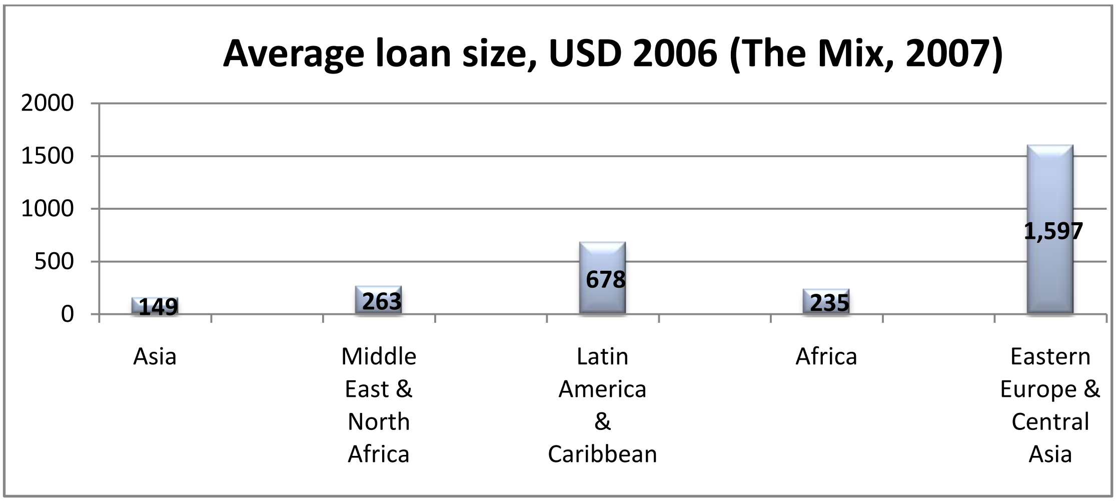

Figure 3 Average loan sizes over the world

2.1.3 Microfinance products

Not every poor person or household is an entrepreneur; however also non-entrepreneurs need financial services. By providing other financial services to the poor than microcredit, it could be beneficial to both the clients and the MFI. Several reasons apply: a broader market can be reached, that also interests non-entrepreneurs, the concentration risk of offering credit only to micro-enterprises can be mitigated by offering the possibility to clients to get access to additional loan products for, for example primary needs such as housing, could increase the incentive to repay. With this incentive, lenders face lower loan losses. Offering fee-for-service products, like remittances or insurance, can generate revenues without assuming additional risks and offering saving products could further fund the loan portfolio. By cross selling, an MFI can spread those clients' acquisition costs over different products. This could also strengthen the relationship between the MFI and the client. The impact of the social goals, such as reducing poverty or promoting economic development, can be greater by providing a more diverse product range (Churchill and Frankiewicz, 2006). However the regulatory environment, by not being allowed to offer more services, the lack of infrastructure, capacity or access to (long-term) capital, or simply business strategy may prevent the MFI to offer a (larger) range of financial services.

The traditional and most common products that many MFIs offer are Income generating loans. The intention of this loan is that borrowers put the borrowed money to productive use and with it generate a return for them and for the lender. There are different ways of providing these loans, based on the client's ability to repay and on the repayment rate; Village banking, Group lending and Individual lending are examples and are described in the next paragraph. Emergency or consumption loans are available when unexpected expenses come up. Using group guarantees, pawn items, or the borrower's credit history these loans can be provided. Housing loans are traditionally small loans offered for a relatively short period of time. The loan is then allocated for home improvements. When the improvement has been done and the loan has been repaid, clients can apply for another loan to improve another part of the house. A less common product in the microfinancial field, which allows clients to use assets without a major collateral or down payment, is leasing. Because the MFI owns the asset until the end of the lease term, the assessment process can be simple. An important part of the microfinance market, with large demands that equals the demand for microcredit, is the Savings market. However, regulatory environments may prevent MFIs to act in this market.

The main insurance that has been provided by MFIs, is to be able to repay the outstanding loan balance when borrowers disease. The last few years there has been a growing interest in insurances that manage other risks such as disability, illness and property loss. Since these products are different from savings and loans, MFIs can best cooperate with the banks or insurance companies (Churchill and Frankiewicz, 2006).

As the most important part of microfinance is to improve socio-economic performance of the clients, these services add to improvements in the fields of entrepreneurship and job-creation by providing loans and leasing products to facilitate small investments in enterprises that allow entrepreneurs to create jobs. Asset building (long-term) savings products, housing loans, insurance policies and remittances can assist poor households to build up assets. Poverty reduction through savings, emergency loans and insurance products can stabilize income levels, smooth consumption and reduce the vulnerability of people and households. Moreover, microfinance creates a sense of responsibility, leadership, strengthens social capital, empower the poor, in particular women, and creates a building block for collective actions. Of course, the combination of financial and non-financial services can enhance the aforementioned improvements.

2.1.4 Microlending methodologies

The joint liability lending approach uses groups of borrowers to which loans are made. Although only 15% of the micro lending programs use this approach, they serve approximately two thirds of all borrowers in their reach.

With joint liability lending the group of borrowers are all made responsible for the repayment of the loan. If one group member does not repay her loan, other members may have to contribute to ensure repayment. Non-repayment by the group means that all group members will be denied future access to loans from the program. In this way, group lending creates incentives for individual group members to screen and monitor other members of the group and to enforce repayment in order to reduce the risk of having to contribute to the repayment of loans of others and to ensure access to future loans. The problem of moral hazard is therefore reduced. Joint liability group lending stimulates screening, monitoring and enforcement of contracts among borrowers, reducing or erasing the agency costs of the lender. Since group members usually live close to each other and/or have social connections, also described as social capital, they are better informed on each other which contributes to the high repayment performance of such groups. This enforces adverse selection by the group members. Repayment by individual group members depends on their belief that other group members will do the same, since this will determine whether or not credit will be available to them in the next loan cycle. This belief can depend on past experiences and other social capital such as trust of the members (Hermes and Lensink, 2007). Repayment performance can be further increased when groups have written rules stating how members should behave. Another point is when groups are located in remote areas. The possibilities for acquiring credit become less, which make groups to depend more on the program they are part of. Sharma and Zeller (1997) state that groups which are formed through a self-selection process show a better repayment performance. On the other hand, when the number of family members within a group increases, the repayment performance decreases due to the fact that screening and monitoring becomes less effective. According to Paxton and Thraen (2000), a group leader has a prominent role in screening, monitoring and enforcement. Therefore the quality of the group leader can increase the repayment performance. They also show that social pressure is positively related to repayment performance. However, Paxton and Thraen (2000) find that the more homogenous the group will be in terms of ethnicity, occupation, income etc., the further the repayment performance is reduced.

Although individual-based lending, which draws the most on traditional banking practices, appears to be most vulnerable to weak enforcement and information asymmetries, a positive return on assets is shown as well. According to a study for the World Bank by Cull, Kunt and Morduch (2007), the profitability increases when interest rates increase up to 60%, however when above 60% lower profits are reached due to the increasing difficulty to repay. Investments on the workforce increase profits since the bank is not depending largely on the client for information. Furthermore, the individual-based lending covers larger loans of USD 1.220 on average, which implies lower poverty levels. More importantly, this specific method has proven to lead to self-sufficiency of MFIs. Lastly, even higher profitability is reached when borrowers become more reliable over time and receive larger loans.

Village banking is a type of group lending from the joint-liability approach, where each branch forms a single, large group and is given a degree of self-governance (Cull et al., 2007). A difference is the loan size: USD 149 on average opposed to USD 431 with group lending. Also the highest interest rates are charged with this method and the highest average costs are faced. By serving the poorest and mostly women, and being highly subsidized, (over 30%) this method is the least profitable, which confirms the common knowledge of the clear relation between high subsidies and low profitability.

2.1.5 Examples of Microfinance institutions

Many examples of successful MFIs exist in the literature; two are described in this paragraph. Table 1 shows the top 10 of MFIs by borrowers based on 2006 data.

Top 10 MFIs by borrowers in 2006		
Rank	**MFI**	**Borrowers**
1	Grameen Bank	6,287,000
2	ASA	5,163,279
3	VBSP	4,695,986
4	BRAC	4,550,855
5	BRI	3,455,894
6	Spandana	972,212
7	SHARE	826,517
8	Caja Popular	643,659
9	Compartamos	616,528
10	BANTRA	563,805
		(The Mix Market, 2007)

Table 1: Top MFIs by borrowers in 2006

The Grameen bank

The Grameen bank in 2008 had close to 7.5 million borrowers, of which 97% are women. They cover approximately 80% of the entire population of Bangladesh, and their goal is to cover 100% by 2012. The bank has a repayment rate of 98%-99% and is the countries' largest taxpayer. In 1986 Muhammed Yunus was asked by Arkansas' governor Bill Clinton to come to the United States to look for opportunities to implement his microcredit beliefs. The Grameen bank of America is now an active market player. For a presentation of his book the "Creating a World Without Poverty", Muhammed Yunus went to the Google facility in California. He explained that the target groups of the Grameen Bank are people without collateral and without experience to deal with money. These criteria are completely opposite to the traditional banking screening criteria. In terms of poverty reduction Yunus explains it with: „If someone possesses nothing, he or she will get the highest priority". An extensive group of employees explore the villages and countryside for potential clients. The incentive for clients to pay-back is the direct possibility to borrow a larger sum of money and in case when clients do not pay-back, they cannot get credit from the Grameen bank and have to turn to the so-called 'loansharks'[15] that charge very high interest rates. Morduch (1999b) challenged the Grameen bank in Bangladesh and showed that they would have to increase their interest rates substantial for a period of approximately ten years in order to become fully subsidy independent.

[15] von Stauffenberg, executive director of MicroRate, typifies loansharks as „unbelievably profitable microfinance institutions; of international investment bankers and Wall Street investors jostling for a share of those profits; of unappetizingly high interest rates"

With the same principle of no loss nor profit-making, Muhammed Yunus started several businesses such as a telephone company, internet services, solar-energy supply and water technologies to improve the quality of water, and indirectly making their clients more healthy (and capable of working (longer)) and therefore to repay their loans. A financial principle that the Grameen Bank lives by is their limit to the amount of interest that a client could pay back, which can never exceed the loan itself.

Compartamos

Compartamos (“let’s share” in Spanish), is the largest MFI in Mexico and is the acknowledged poster child for commercial MFIs (Lewis, 2008). Between 1990 and 2000, Compartamos operated as a not-for-profit NGO, receiving USD 4.3 million from international development agencies and private Mexican donors. In 2000, the MFI reached 60,000 borrowers, mostly women in rural areas. In 2000 it was converted into a for-profit MFI and six years later it served 616,000 borrowers. In 2007 the MFI even went public, raising USD 450 million with their IPO[16] (facilitated by Citigroup) which was oversubscribed 13 times and was considered a huge success by any financial market standard. Demand caused the share price, representing 30 percent ownership in the bank, to surge 22 percent in the first day of trading (CGAP, 2007). Following the IPO, the MFI was valued at more than USD 1.5 billion. This sounds like a successful start-up, however it went at the expense of its social mission, which is also shown by its APR[17] of more than 100%, compared to a worldwide average of 31%.

MFIs argue that they must charge high interest rates due to the high costs involved in borrowing to people in rural areas who have no credit history. Commercial MFIs add that they must charge high APRs to generate profits and attract private investment capital, to be able to scale up. However, the ideology and commitment to reduce poverty should remain (Lewis, 2008). In 2005, Compartamos had a 36% operating expense ratio, compared to a median MFI operating expense of 15%. This suggests poor management, but on the other hand Compartamos does have representative repayment rates of 99% that could suggest that the interest rates are fair.

Kiva.Org

Due to the increasing governmental support and popular media coverage, microfinance has received plenty of support and attention. Kiva.org. as an intermediary, connects micro-entrepreneurs to individuals that can originate their own microloan. Interest is provided by journal and progression updates, to ensure the individuals’ money has been put to a good use. With initiatives like this, the microfinance movement has become as accessible to lenders as the Grameen bank made microcredit accessible to borrowers (Sengupta and Aubuchon, 2008).

[16] IPO: Initial Public Offering

[17] APR: Annual Percentage Rate. Even Americans with bad credit histories get better terms on their credit card debt, receiving APRs that range from 22 percent to 29 percent (Business Week, December 13th 2007).

2.1.6 Microfinance institutions

Microfinance institutions can be classified into four categories according to the respective degree of commercialization. See figure 4, 'Types of MFIs'.

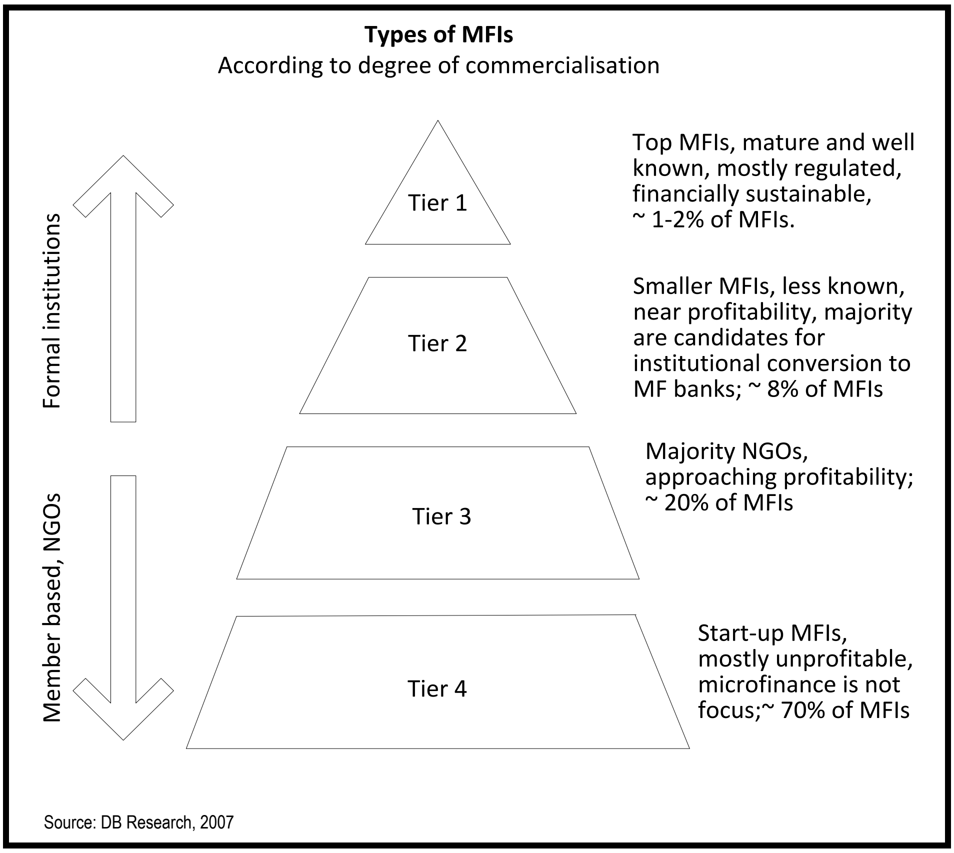

Figure 4: Types of MFIs

Formal institutions can be classified as the 'Tier 1' type and serve the vast majority of the borrowers and also hold the most assets. This first category is also the category that have entered the microfinance market most recent. These institutions can either be public or privately owned, savings or credit focused, serving a large or small number of clients in rural or urban areas. This category is characterized by institutions that are regulated and financially sustainable and are financed by deposits, commercial debt and/or private equity. Several types of institutions form this category, of which the commercial banks form the most relevant group for this thesis. There are several types of (in)direct approaches to microfinance. The methodology depends on the commercial banks' motivations for entering the microfinance market. Political pressure, pressure from the shareholders or public expectations, could have pushed large banks towards social responsible projects by making use of microfinance. To keep up their image as a public relations strategy, these banks act as downscalers since they serve lower-income clients, with either their own developed products or through the creation of subsidiaries (direct lending) that act autonomous from the main banking activities in order to respond better to a microfinance client. Through indirect lending banks can fund MFIs that serve lower-income clients.

Smaller banks also act as downscalers by entering this market with the motivation to attract new and low-income clients from this new market (CGAP, 2004). These banks are classified as 'Tier 2' MFIs.
Upscale banks are former Non-Governmental Organizations (NGOs) that have been transformed into regulated and commercial microfinance banks. The transformation made it possible to increase their outreach and to be able to offer other financial services. The need for reaching a larger number of clients by using considerable funding and to become sustainable (Labie, 2001) was the main driver for the transformation (Chowdri, 2004 and Christen and Drake, 2002). Other types are microfinance banks that have been newly created especially to serve the low-income clients. Their motivation was to become a commercial and competitive bank into this niche market that would take the advantage of having no history, unlike the incumbent commercial banks and NGO's.
State-owned banks were established in many countries, initially to serve financial underserved farmers. Due to the lack of profitability and sustainability, many of these banks went bankrupt. However some banks were transformed into commercial development banks that provide financial services to rural areas. There are only a limited number of banks that were transformed successfully, the first bank being Bank Rakyat Indonesia, which is also able to attract savings that enables the bank to become a sustainable MFI. The competitive advantages that these banks have are their extended network, ability to offer payment services and savings with government guarantees and the access to resources needed. However, these banks are characterized as having a lack of accountability for performance, political interference and low productivity. Other formal institutions are Non-Financial Bank Institutions (NFBIs), Finance banks, Savings banks and Leasing & Insurance companies. The latter two have the advantage of easy access to capital, which is needed for further growth. NGOs can serve a poorer clientele while still earning returns comparable with commercial banks and superior to NBFIs (Churchill and Frankiewicz, 2006).

Semi-formal financial institutions are registered entities that are subject to general laws, but not to a bank or finance authority. This main category consists of two main types, the credit unions and microfinance NGOs. The first types, credit unions, can be characterized by the following key points; they are savings-driven: credit unions usually have more depositors than borrowers, and therefore most of their capital is self-generated from member shares and deposits. In many countries these institutions reach more customers than other MFIs, and/or play a significant role in the provision of financial services to the poor in other countries (Ledgerwood, 1998).
The second type of semi-formal institutions, microfinance NGOs, are classified as 'Tier 3' MFIs and are the most recognized type of MFIs. These institutions have got a social mission, are subsidized by donor funding and are not for-profit oriented. The services provided can either be financial, non-financial or be a mix of both. NGOs have got a good depth of outreach and some also are innovative. However breadth, scope, length or costs of outreach are generally the fields to be improved. Most of these NGO's have

around 20,000 borrowers; some still have a long way towards these numbers and therefore cannot benefit from economies of scale. This inefficiency results in high interest rates. These NGOs are generally credit driven institutions since their legal status prohibits them from offering voluntary savings. Also their ownership structure makes it hard to raise other capital than donor funding, but some are even profitable. The main advantages of semi-formal MFIs are their ability to achieve deep outreach, the largest part of their clients are women and their loan sizes are the lowest compared to other institutions, contrary to formal MFIs. Particularly the NGOs are often offered subsidies to experiment and to reach unserved markets.

Informal microfinance service providers are typically institutions that are beyond the view and control of governments and are classified as 'Tier 4' MFIs. Instead, their members monitor them. They can be further classified in three types: Indigenous groups, such as ROSCAs, Accumulating Savings and Credit Associations (ASCAs) and burial societies. The second type are externally promoted self-help groups like village banks and financial service associations (FSAs), the third type are private entrepreneurs: pawnshops and individual moneylenders. ROSCAs are financial associations that are organized and overseen by their members, usually between 5 and 50, primarily female. Each member contributes a fixed amount to a group fund, which is awarded to one member at the end of a periodical meeting. Each member gets the opportunity to obtain the fund, at no interest costs. ASCAs have the same governance and member characteristics, but here the funds can be accumulated through internal banking. Generally, ASCAs are more flexible but also more complex and risky (Rutherford, 1999). Burial societies can consist of a few households or several thousands of people. These societies have constitutions describing the rules and regulations. Some burial societies also lend out money to generate additional money. The funds are usually kept in bank accounts and are easily accessible, unfortunately leaving room for fraud.

Self Help Groups (SHGs) are most common in India and are homogeneous groups of on average 15 poor people that voluntarily form to save small amounts. These pooled resources are forwarded to members for meeting their credit needs in the form of loans, either for consumption or income generating activities. Once the groups show mature financial behaviour, banks become encouraged to provide loans to the SHGs. Typical for microfinance loans, these bank loans are given without any collateral and at interest rates not higher than market interest rates. Peer pressures ensure timely repayments (Augsburg, 2009). The village bank gets loans from NGOs and lends them out to their members. The informal MFIs are best capable of reaching the unserved and / or in remote areas, compared to the semi-formal and formal MFIs. The worth to clients and scope of outreach are limited at the groups' knowledge and management capacity.

The results of a study by Cull et al. (2007) show that individual-based microfinance performs better in terms of profitability than group-based institutions, but that the fraction of poor borrowers and female borrowers in the loan portfolio is smaller as well. Another interesting result is when interest rates rise above a certain threshold, the quality of the portfolio in the case of the individual-based lending decreases, but not for group-based lending. The associated increased problems of moral hazard and adverse selection can be overcome by group-based lending and individual-based lending programs that drift towards wealthier clients when microfinance institutions become larger. The institutional design and adequate governance then becomes important. Furthermore, since the industry has accepted the primary goal of sustainability, increasingly MFIs are adopting commercial business models (including transformation into profit-seeking, regulated institutions) and the subsequent values.

A study by Ferrier (2006) has shown that there is no relation between the MFI structure and its financial performance. Furthermore the size, capital asset ratio, the share of loans in total assets and the percentage female borrowers are all positively related to financial performance. Differences in financial performance between a shareholder-owned model and another form of ownership seem to be driven by regional or even country-specific characteristics.

All of the before mentioned types can be summarized into a matrix using microfinance performance indicators that are outlined in paragraph 3.2.2.

		Formal microfinance instituions		Semi-formal microfinance institutions		Informal microfinance groups
Advantages, strenghts and benefits	**Length:**	Owners tend to be driven by profits, creating incentives to increase efficiences and lower costs			**Cost:**	Services are typically less expensive than alternatives
			Depth:	Semi-formal institutions can focus on serving poorer markets since profit maximization is less of a concern. Subsidies help cover the cost of reaching difficult and expensive markets.	**Depth:**	Can reach remote areas. Generally these groups reach women who may not be comfortable inter-acting with formal institutions.
	Scope:	Regulated status is often a prerequisite for offering highly valued savings services	**Scope:**	Sometimes highly innovative; semi-formal MFIs are not constrained by regulations; can access funds and technical assistance for experimentation.	**Scope:**	Free of regulation and an MFI superstructure, groups can experiment with new products
	Breadth:	Greater potential to access commercial equity or loans, and to mobilize savings, to finance large-scale growth. Able to serve more people and to offer larger loans as clients grow.			**Breadth:**	The promotion of village banks or self-help groups can achieve significant scale with relativelly little overhead costs.
	Worth:	Can upgrade staff and systems, which makes it possible to offer customized services	**Worth:**	Services are usually accessible, near the target market's home or workplace.	**Worth:**	Interest income remains with the group; products can be adapted to members' needs if groups have sufficient capacity.
Constraints, limitations, challenges	**Length:**	Interest rate ceilings can inhibit sustainability.	**Length:**	MFIs may not be transparent and the board may not provide sufficient oversight. Organizational stability is usually linked to a few key staff. Subsidies can be unreliable and often require burdensome reporting requirements.	**Length:**	Donor support may be required to promote and train groups; without ongoing external support, group longevity often is limited; groups are vulnerable to covariant risks
	Scope:	Innovation of products may be curtained if regulatoins restrict products and delivery systems.	**Scope:**	Semi-formal MFIs usually do not have the legal status to offer savings accounts or remittances.	**Scope:**	Flexibility and range of products may be severely limited by organi-zational capacity.
	Depth:	Higher costs and a wider range of services may limit deep outreach. If the financial institution has for-profit owners, they may steer it upmarket.	**Breadth:**	Without access to commercial equity or loans, capital may be insufficient to serve significant numbers.	**Breadth:**	Without linkages, the amount of group savings limits the number of borrowers.
	Cost:	Formal requirements may increase costs to clients if regulations demand more systems, staff time, reserves or taxes.	**Cost:**	Without pressure on the bottom-line, semi-formal MFIs can be inefficient.		
	Worth:	Not usually located in close proximity to the micro market.				

Table 2: Institutions matrix (Churchill and Frankiewicz, 2006)

In chapter five, where the commercial banks are evaluated for these same microfinancial performance indicators, a matrix will be presented using similar indicators to classify the commercial banks.

2.2 The commercialization of Microfinance

According to Robinson (2001) several assumptions existed for many years in the market for microfinance as to why formal institutions could not meet the demand for microfinance. These assumptions were that formal institutions could not provide microfinance profitably because of the high transaction costs the institutions would have to bear, there was a high institutional risk because of asymmetric information, moral hazard, and the adverse selection of borrowers, low income people would be uneducated and backward, and therefore unable to participate in the formal financial sector, low income people cannot afford commercial loans and would require government or donor funded credit subsidies and a final assumption was that most rural economies in developing countries do not generate a sufficient volume of business to be attractive to formal financial institutions. Robinson (2001) states that these assumptions served for decades to slow the learning curve of the formal financial sector about the profitability of the microfinance sector. However over the past years as a result of for example bank deregulations (Beck, Levine and Levkov, 2009), international attention and improved information technology, commercial banks are becoming increasingly involved in microfinance, in different ways. First, some banks directly grant microloans to the poor. Second, other banks such as Citibank, provide funding to MFIs. Third, banks distribute microfinance investment vehicles, for example Credit Suisse offers the 'Responsibility Global Microfinance Fund' and Deutsche Bank distributes 'DB microfinance Invest Nr.1'. Lastly, some banks such as Deutsche Bank or Citibank have also been active in the securitization of MFIs' loan portfolios.

Hulme and Arun (2009) recognize the shift from poverty lending to financial systems by operating on commercial lines or systematically reducing the reliance on interest rate subsidies and/or aid agency firm support. Furthermore they find that the growth of the competitive environment has put the client back at the centre of microfinance operations. They also mention the presence of formal banking institutions engaging in financial innovations such as venture capital funds, like the Dutch Hivos Triodos fund in India (The Economist, 2005).

Figure 6 has been created to visualize the financial market for microfinance. Figure 5 provides an overview of the traditional financial market and has been added for comparison purposes. The overviews also serve to visualize the literature described later on in this paragraph.

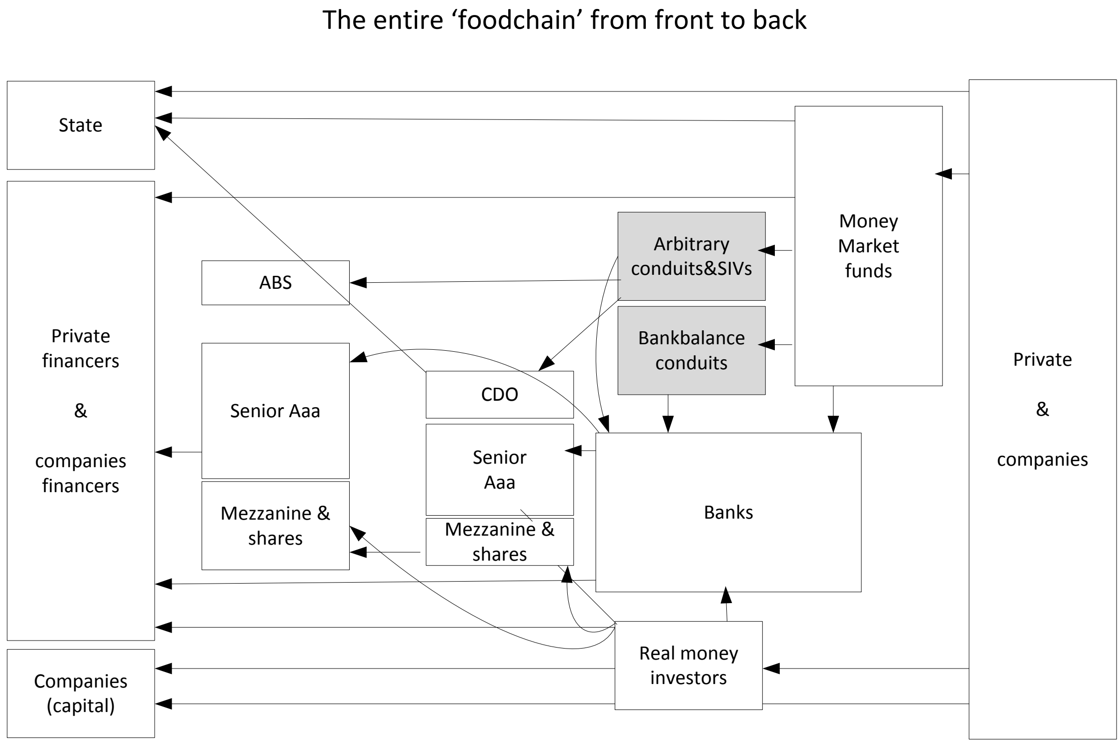

Figure 5: Market overview mainstream market (The entire 'foodchain' from front to back, Kragt, 2008)

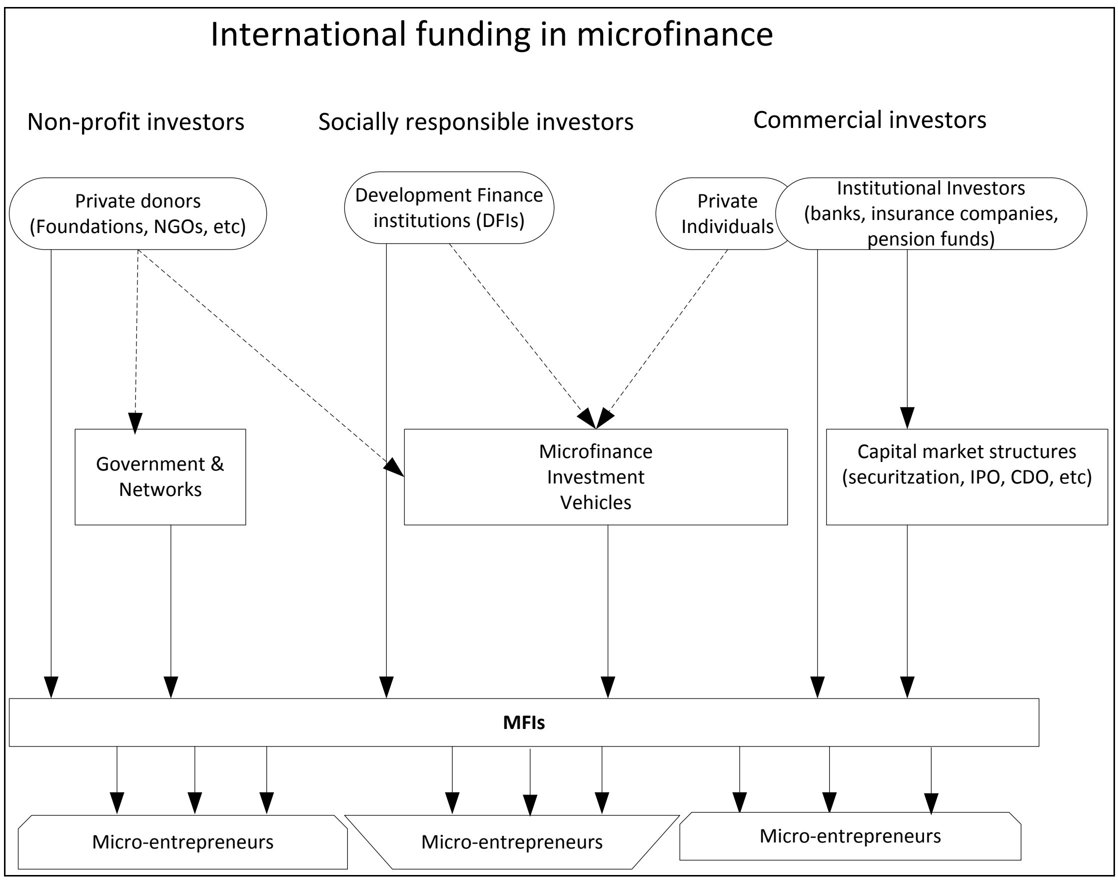

Figure 6: Overview of the international funding in microfinance (CGAP, 2007, LuxFlag, 2007)

Direct lending is mostly executed by banks that are founded to serve in the microfinance market only, such as the Grameen bank. With the creation of a microfinance subsidiary, the risk associated with lending to the poor is mitigated and creates more trust with their microfinance clients in terms of commitment to the goal of reducing poverty. Banks can partner by lending to MFIs as a type of wholesale banking. Also the technology and knowledge of lending money can be borrowed, MFIs undertake the creation, monitoring and screening of the loaned money. For MFIs partnering with banks, the opportunity for higher loans to their clients, and to use the bank's network of branches also creates opportunities for greater outreach. Banks need the cultural knowledge and the trust of the local people that the MFIs own. Jeucken (2008) states that when banks copy sustainable activities from each other, it prevents the necessary innovative processes around the banks' core activities towards sustainable development.

Providing microfinance by commercial banks can serve to diversify their capital and creates opportunities for new regular customers in the future. The banks' image can be reinforced by their engagement in the alleviation of poverty. NGOs are typically operating with a greater development, or social focus than banks. Commercial banks have significantly more borrowers than the NGOs, suggesting that there is a trade-off between social focus and scale. Commercial banks do not outperform the NGOs across the social financial performance categories. Banks earn a higher profit margin on average, but NGOs can earn a higher return on equity on average, and NGOs can prove to be better financially self-sufficient. Moreover, the commercialization of microfinance that refers to the existing, established, banks and institutions that are extending their services to the poor could make microfinance institutions redundant. Some even argue that commercialization is the only way to ensure that financial products and services are supplied efficiently (Schrevel, 2004).

According to Campion (2002), the main challenges that the commercialization of microfinance has to face include: donor subsidies, poor regulation and limited management capacity of microfinance institutions. Supervisors and enforcers need to understand the differences of the traditional, consumer finance: Lower capital requirement, ((too) high) interest rates, weighing of assets for unsecured loans, higher operational costs and requirement for a customized reporting (different type of documentation). Their limited management capacity does not overcome these challenges either, since most MFIs used to be NGO's.

An obstacle for MFIs to grow, to increase their range of services and become self-sufficient is the non-allowance to provide saving services since they are not financial regulated institutions. Bank Rakyat Indonesia (BRI) has experienced a significant growth due to its large savings mobilization and, as mentioned earlier, has also used this microfinance source to stabilize its commercial loans division during the economic crisis in Indonesia.

The general opinion of donor funding is that it should be used only in the start-up phase of MFIs and should later on be used for investments in technology, training, and information systems and should finally move away from direct subsidies. Furthermore, according to Karlan and Zinman (2007), a „pressure from policymakers, donors and investors to eliminate reliance on subsidies" has emerged. When microcredit clients are price-elastic to demand, interest rates could be a tool to wear-off subsidies by increasing interest rates. Karlan and Zinman (2007) also mention that an increasing number of MFIs face competition from other institutions, which offer interest rates substantially lower than the common microcredit rates of 15 percent to 26 prevent. According to Sengupta and Aubuchon (2008), interest rates could be raised when MFIs stop receiving subsidies before being financially independent. Standard demand theory suggests that fewer loans would be requested. Moreover, rising interest rates may exclude poorer projects, thus raising average returns. However, the moral hazard problem also increases as at higher interest rates risky borrowers apply for a loan, which increases the default rate and lowers returns. On the other hand, higher interest rates could stimulate growth and more investments, which trigger more MFIs competing for investors and customers. Clients would then have a wider range of products and providers to choose from which causes better services. When economies of scale are present, the costs of operating fall and interest would follow. However growth does not necessarily cause competition, it could also produce monopolies or cartels, as has been the case in many industry examples worldwide (Lewis, 2008). Moreover, when poor clients are geographically and educationally isolated, they are trapped when there is no marketplace present where a buyer and a seller come to a right market price. Furthermore, since many MFIs operate in a non-regulated market, the borrowers could be further disadvantaged.

Alignment on the effects of increased competition seems not to be straightforward: according to Navajas (2003), increasing competition leads to less access to credit for the poorest, i.e. less outreach. Wealthier borrowers are likely to benefit from increasing competition among microfinance institutions, but that leads to lower levels of welfare for the poorer borrowers. According to Sengupta and Aubuchon (2008), MFIs lose the leverage they gain from dynamic incentives and progressive loans (i.e., future loans are contingent on repayment, therefore not necessarily reducing the welfare for poorer borrowers), with an increase in alternative sources of credit. This latter result can even be proved by the example of an earlier MFI, the Bolivian Banco Sol, which suffered from increased competition by commercial banks in the late 1990s. However, new regulation in Bolivia has helped to promote competition, as lenders started to share more information on borrowers and by law are required to report the non-repaying borrowers.

Uncertainty in the economic environment and political environment raises a risk factor that can make (foreign) investors reluctant to provide capital and therefore MFIs to find investors. Furthermore the legal system in development countries can be weak, which makes enforcing contracts by MFIs sometimes hard. And finally credit rating in the field of microfinance is a deficiency the industry as a whole suffered from (Ugur, 2006). Nowadays several international rating agencies exist (21 per end 2007[18]), such as MicroRate, S&Ps and CGAP. These rating agencies have created rating methods to rate MFIs and they do not take into account social performance measures. In their search for funding to enable further growth, after relying on domestic funding to guard against foreign currency risk, MFIs move to the international market where MFIs face further challenges such as standard rating methods and more requirements for an international offering. Funding comes from two main sources: international financial institutions and microfinancial investments vehicles (MIVs). To access this foreign investment, MFIs are starting to use new vehicles of debt-structured finance, including collateralized debt obligations (CDOs) and securitizations. Blue Orchard Finance, Dexia Micro-Credit Fund, Oikocredit and Accion Investments[19] are large institutions active in this field of international microfinancing. See table 3 for the Top ten MIV investments in microfinance.

Name	**Country**	**Total assets (Million USD)**
1. Oikocredit	The Netherlands	201.3
2. European Fund for Southeast Europe	Luxembourg	179.9
3. Dexia Micro-Credit Fund	Luxembourg	107
4. Blue Orchard Loans for Development	Luxembourg	99.1
5. responsibility Global Microfinance Fund	Luxembourg	86
6. Blue Orchard Microfinance Securities	Luxembourg	81.3
7. Global Commercial Microfinance Consortium	USA	71
8. XXEB Microfinance Securities	USA	60
9. Triodos-Doen	The Netherlands	49.7
10. Gray Ghost Microfinance Fund	USA	44.9
Source: MicroRate, 2007	**Top 10 Total**	**980.2**

Table 3: Top 10 MIV investments in microfinance

The main difference between a CDO and securitization is that a CDO relies on the ability of the MFI to repay the loan, unlike a securitized loan that relies on the underlying borrowers to repay. A CDO is another vehicle to bring mainstream investors to microfinance, but is still limited by the ability to rate the creditworthiness of differing MFIs. To help with this issue, S&Ps released a rating methodology for microfinance in 2007, and with it sends a stronger signal to potential investors about the quality of MFI investments (Sengupta and Aubuchon, 2008).

Supported by these international rating agencies, even giving AAA ratings, microfinance evolves to the level of the mainstream financial market. Although, as described earlier, microfinance can reduce

18 Smith, I.H., Broderick, M.A. and Winsor, R.G., Accessing commercial capital markets, ESR Review.

19 Accion investment is a non-profit organization that provides loans, services and training, and works with several commercial banks. www.accion.org

portfolio volatility and has low correlation to the general market movements, the current financial crisis can affect the investors' risk appetite for more collateralized securities and whether microfinance securities will be viewed as 'subprime' loans. Therefore, as became apparent from microfinance literature and from the current lessons out of financial crisis, the common need for both financial markets is the need for further regulation and good management.

2.3 Conclusion

Microfinance has become a large market where several types of products and lending methodologies have evolved and numerous institutions are active. This chapter aims to provide an overview of the main and relevant microfinance activities, trends and challenges in order to provide an understanding of how this market has evolved, which is far beyond the 'straightforward' microcredit practices. This overview aids to understand the different types of microfinance activities that the (Dutch) banks are involved in. Furthermore this chapter is meant to support the rationale for the thesis scope, described earlier in chapter one, and the selection of the research methodology, which is described in chapter four.

The microfinance market has grown incredibly fast and will keep developing at a rapid pace as well, as long as it remains its double bottom line and is thought of being *the* tool to fight poverty and reaching the 2015 Millennium goals. Whether microfinance can live up to that goal will become clear in a couple of years. Microfinance can already prove its sustainability when the impact of the financial and economic crises on the microfinance market becomes clear during the next years. It certainly is a market that still has a huge potential in terms of outreach, fighting corruption, aiding literacy, educating people, self-deployment and profitability. Private people and banks are offered an increasing variety of services and funds to enter this market for many reasons and with the double bottom line together with keeping the risk profile low, microfinance will remain an interesting alternative to invest in. Another challenge for the microfinance market will be to prevent mission drift with the increasing competition and more attention of larger financial institutions. The next chapter aims to cover the traditional performance theory and the relatively new financial theories on microfinance, and whether microfinance theory fits into the traditional theory.

3. Theory overview

This chapter starts by covering the theory on financial performance and related topics and after that describes outreach and microfinancial performance theory. This chapter serves to provide an understanding for the selection of the research methodology, which is described in the conclusion in paragraph 3.3.

3.1 Financial performance theory

In this paragraph the financial performance measures that are related for this research context are described.

3.1.1 Performance measure groups

Verbeeten (2005) distinguishes four groups of performance measures. The first group consists of accounting performance measures that have many characteristics that help explain their prominent role in performance evaluation and compensation. They are subject to a variety of internal controls that enhance their reliability. They are easy to understand and integrate the results of organization activities into a single coherent measure. Accounting performance measures are considered backward looking and short-term focused as they do not provide any information on the creation of value (Stewart, 2002) or the realization of strategic goals (Kaplan and Norton, 2001). Common accounting performance measures include budgeted versus actual results and return on investment measures.

The second group consists of economic value measures that should improve the economic performance. Foundations for these economic value measures are residual income, internal rate of return[20], cash-flow concepts and EVA[21]. An increase in EVA should result in an increase in future cash flows. EVA is claimed to be the best predictor of future share price performance.

Non-financial performance measures is the third group and includes Balanced Scorecard concepts (Kaplan and Norton, 2001). Non-financial performance measures are defined as measures that provide information in non-monetary terms such as customer response time, productivity, market share, customer satisfaction, innovation/new product development and employee turnover (Pricewaterhouse Coopers, 2004). It is believed that many of these variables are the leading indicators of future profitability (Kaplan and Norton, 2001).

The last group of performance measures consists of subjective performance measures that may be appropriate performance measures when it is difficult to define objective performance targets or when it is difficult to measure results (Bushman et al., 1996). Subjective performance measures can be defined

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20 Von Stauffenberg et al. (2003) mention the Return on Equity (RoE) as a measure of dominant importance since it measures the return on investments in (microfinance) institutions and forms together with the Return on Assets (RoA) the two most important financial measures.

21 Economic Value Added (EVA) is developed by Stern Stewart in the 90s and is defined as the adjusted operation income minus a capital charge; managers only add value to their organization when the resulting profits exceed the cost of capital.

as measures that are based on factors other than the worker's performance (Prendergast, 2002). Subjective performance measures are able to take 'difficult to measure' and/or qualitative strategic aspects (such as employee skills and attitudes, intangible capital) into account.

Contingency-based research has a long history in the study of management control systems (Chenall, 2003). Contingency theory states that the design and use of control systems is dependent upon the context of the organizational setting (Fisher, 1998). Previous research has identified a number of variables that affect the effectiveness of a management control system, including strategy, the nature of the environment, (national) culture, size, and industry (Chenhall, 2003; Fisher, 1998). Contingency theory variables are the objectives and strategies that an organization decides to pursue, and an organization generally starts with the notion that the organizational objectives should be stated, and that strategies to achieve those goals should be adopted and implemented (Ittner and Larcker, 2001).

Subjective measures may be used to complement perceived weaknesses in quantitative performance measures (Gibbs, 2004); as such, both non-financial and subjective measures may also be related to 'stakeholder value goals' (rather than solely on shareholder value). Kaplan (2001) indicates that the balanced scorecard can be a useful tool in non-profit organizations since it provides the opportunity to measure multiple aspects of performance. Research by Cavalluzo and Ittner (2004) indicate that objective performance measures are less useful in non-profit organizations when goals are difficult to quantify, measure and interpret (for example, due to the fact that there are multiple stakeholders). Verbeeten (2005) finds that non-financial measures appear to be used most often in addition to other performance measures and are used mainly in large firms that focus on shareholder value and growth and have task cultures. Another finding of Verbeeten (2005) is that non-financial measures are to a larger extent used by financial service organizations than in other industries.

As another type of non-financial performance measure, the consultancy firm on social entrepreneurship 'Scholten and Franssen' has created a tool to analyze the future value of a social initiative. This Social Return On Investment (SROI) is an investment analysis which takes the social, ecological or cultural and economical benefits into account. By creating outcome measurement tools, social investment can be measured in order to determine the social and financial efficiency of the project. This helps the investing institution to decide on both the social and financial side. The definition of the social goals beforehand is the most important aspect of the SROI (Scholten and Franssen, 2009).

Bos, Draulans, van den Kommer and Verhoef (2006) discuss the traditional financial performance measurements of banks. According to Bos et al. (2006) „comparisons based solely on profitability do convey significant information about past performance, but provide little information about expectations for future performance".

3.1.2 Bank performance models and profit maximization

Bikker and Bos (2008) have reviewed several types of bank and market performance models and distinguish two approaches for bank production. The intermediation approach starts from the traditional core function of financial institutions and takes deposits as inputs and defines loans and investments as output. A bank provides services related to loans and deposits. Interest payments are not regarded as costs. The output components comprise loans and deposits. With the production approach, labour and physical capital are inputs and numbers of processed documents or transactions are regarded as output. This latter approach deviates in that interest payments are seen as part of the costs. According to Bikker and Bos (2008) interest rates should be a performance, not an output. Both approaches fail to incorporate the management of risk, information processing and the solution of agency problems arising due to the difference between loans and deposits and the separation between management and ownership.

One of the few common assumptions shared by the models reviewed by Bikker and Bos (2008), is the key assumption of profit maximization. The standard theory mentions the banks' shareholders as claimants for its profits and it is thereby in their interest to maximize these profits. The shareholders maximize their return on investment by maximizing revenue and by minimizing costs. Bikker and Bos (2008) consider four issues related to profit maximization: A role of diversification and risk preferences, principal agent problems between shareholders and bank management, imperfect competition and inefficient use of inputs and outputs. Looking at the microfinance models, profit maximization also raises the issue of a so-called 'mission drift', a shift from social goals towards financial goals. This will be further explained in paragraph 3.2.1, as well as the trade-offs associated with profit maximization that microfinance institutions (MFIs) face.

Bikker and Bos (2008) in their study evaluated several market power models. One of these models, the Structure-Conduct-Performance model, assumes that market structure influences bank behaviour (conduct), which in turn affects bank performance. They conclude that the stronger the loyalty of customers, the less likely a bank is to behave collusively. Intuitively, the stronger the customer loyalty, the less a bank will stand to gain by cutting prices: it does not need to do so to keep its old customers nor does it expect to gain many new customers. This behaviour and relation between clients and the bank will also prove to be important for MFIs in the last paragraph of this chapter, where the microfinancial performance measures are outlined.

Traditional bank performance is related to changes in their environment and the behaviour of their competitors and is therefore related to market power. Economic theory shows that in a perfect competitive situation, profit maximization is equivalent to cost minimization. Whereas imperfect competition causes a situation where profits are maximized at an output level where average costs are no longer minimized. It can thus be used to explain changes in profitability over time as well as between banks.

Hasan, Koetter and Wedow (2009) state that traditional measures of financial development depend on quantity proxies, which might not fully reflect the ability of financial systems to intermediate funds. They suggest an additional quality measure; economic prosperity of financial intermediaries, an efficiency effect. They find that this effect is higher than quantitative effects, since the quality of financial services spurred economic prosperity in Europe's relatively mature economic regions.
What type of performance measures can be used for this thesis will be explained later on in this thesis.

3.2 Microfinancial performance

This paragraph covers the microfinancial, social, performance theory. Sustainable development involves compensating the current generation's needs, without endangering the compensation of the future generation's needs. This development covers economic, social, governance and environmental dimensions, also called the ESG-factors (Jeucken, 2004).

3.2.1 Social (microfinancial) performance and impact
The need to measure social performance of MFIs has been recognized by developments agencies. CGAP has initiated a Social Performance Task Force in 2005, and defines social performance as "the effective translation of an institution's social mission into practice in line with accepted social values." ACCION International in 2007 published its report "Guidelines to Evaluate Social Performance", which develops a framework for MFIs of how to assess and report social performance. Some institutions already conduct social ratings, such as MicroFinanza Rating, MicroRate and Planet Rating (Augsburg, 2009)
The impact of microfinance has been described differently. Woller and Parsons (2006) state that MFIs ultimately measure their success by the impact they have on their clients, on clients' families, and on the communities in which they live. The community economic impact is defined as the direct and induced impact of the MFI on local economic activity. Calculating the community economic impact of a microfinance program is straightforward: All that would be needed are the direct expenditures of the MFI, its employees, and loan recipients (using loan proceeds) and an estimate of the relevant regional income multiplier. The income multiplier measures the increase in spending over and above the original exogenous spending increase. Since in practice the income multipliers are probably hard to estimate an alternative method is offered: the 'minimum requirements approach'. This approach requires only modest amounts of employment data available in developing countries. Minimum requirements refer to the level of employment in specific industries that is necessary to maintain the viability of a regional economy, or alternatively, it is the level of employment in specific industries required for a regional economy to be economically self-sufficient. Morduch, Khandker and Pitt (1998) express the 'consumption smoothing': no significant increases in consumption per head or educations of children,

but the diversification of labour supply across seasons and household members to mitigate the income dependencies of people, as a sustainable development for third world communities.

Woller (2007) suggests that there are still trade-offs present at MFIs between social and financial performance. Factors linking social and financial performance are likely a combination of the instrumental stakeholder theory that suggests that the satisfaction of various stakeholder groups is instrumental for organizational financial performance.

Furthermore the stakeholder-agency theory argues that the relationship between stakeholders serves as a monitoring mechanism that prevents managers from diverting attention from broad organizational financial goals. By addressing and balancing the claims of multiple stakeholders, managers can increase the efficiency of their organization's adaptation to external demands. Social performance management can help firms to establish a plausible relationship between social and financial performance. Trade-off need not to take place, social and financial performance may even be complementary. A strong social orientation need not to result in the sacrifice of financial return and a strong financial orientation need not to result in the sacrifice of social returns, it rather depends on the situation. Furthermore, scale and sustainability do not guarantee poverty outreach, but a poverty focus does not rule out scale or sustainability either. Conversely, Woller (2007) finds that a poverty focus does not guarantee poverty outreach; but scale and sustainability can promote it. Cull et al. (2007) provide additional insight on financial performance of microfinance institutions. Their study attempted to examine financial performance and outreach and specifically the assumed trade-off between depth of outreach and profitability. The assumption is that when more profitability is associated with a lower depth of outreach to the poor and whether there is a clear and deliberate move away from serving poor (individual) clients to wealthier clients in order to achieve higher financial sustainability. This is also referred to as 'mission drift'. Woller (2007) states that „Microfinance should not be expected to end poverty any time soon; there is simply no way that microfinance can live up to the lofty expectations of its more zealous advocates". Woller defines mission drift as „the quest for scale and sustainability (i.e. profitability) will invariably create pressures for MFIs to abandon their traditional clientele, to go 'up-market' and crowd out, to target easier to reach (less costly), and more well-off (i.e. less risky and more profitable) clientele". According to Woller (2007), the anti-dote to mission-drift is to keep the industry linked to its social origin.

Paxton (2003) created the Poverty Outreach index. This index shows that outreach is better at heterogeneous institutions such as banks and credit unions, since they serve a significant number of people below the poverty line.

Positive correlations between depth of outreach and reliance on subsidies are found with traditional microfinance institutions since NGOs were subsidized due to their deep outreach levels and that self-reliant MFIs with scale-economies have a hard time to reach the largest number of poor.

Woller (2007) claims that defining social performance in terms of poverty outreach is both conceptually and practically inappropriate. Social performance may include poverty outreach, but it also need not. The Social Glossary on the SEEP[22] Network's Web site, defines social performance as the effective translation of an organization's social mission into practice: „Social performance is not just about measuring the outcomes, but is also about the actions and corrective measures that are being taken to bring about those outcomes". Social performance is a broad concept of which poverty outreach is one component, however it is an important component. This thesis therefore focuses not only on the social performance in terms of outreach, which is often mentioned in literature as the leading measure for MFI performance evaluation, but also on economic performances as described earlier in this chapter.

Hermes, Lensink and Meesters (2008) discuss two views: the welfarist view and the institutionalist view. The welfarist view stresses the importance of outreach and the threat of focusing too much on sustainability and is supported by Hashemi and Rosenberg (2006). Rhyne (1998) advocates the institutionalist view, which claims that MFIs should focus on sustainability and efficiency.

In their study with 1,300 observations Hermes et al. (2008) found convincing evidence that outreach is negatively related to efficiency of MFIs. More specifically, they found that MFIs that have lower average loan balances and female borrowers, which are measures of the 'depth of outreach', are also less efficient. Some argue that commercialization and focus on efficiency can be viewed as a negative development, but Hermes et al. (2008) do not imply that a stronger focus on efficiency is bad for poverty reduction.

Zeller and Johannsen (2006) have pointed out that due to spill-over effects MFIs that strive for efficiency, and score low on outreach to the poor, may ultimately cause a higher poverty reduction at the macro level than MFIs that score high on outreach indicators. They conclude that these efficient MFIs are able to contribute to improving economic conditions at the local, regional and country level, and that these contributions ultimately are higher than the contributions to poverty alleviation made by MFIs concentrating on outreach rather than on efficiency. They did not find empirical evidence on the effects of increased efficiency of MFIs at the regional or macro level.

Commercialization of microfinance does not necessarily mean more focus on efficiency. Motives for commercial parties to invest in MFIs vary, for example to increase their social responsibility behaviour, or for portfolio risk diversification. In that case these commercial parties are necessarily looking for the most efficient MFIs. According to Lewis (2008) common business valuations, as types of both subjective and non-financial measures, by MFIs include non-balance sheet intangibles such as good will, recognition, customer satisfaction, management competence, community support and most of all, social return on investment.

[22] The Small Enterprise Education and Promotion (SEEP) Network, the leading international network and promoter of best practices in enterprise development and financial services, is a global organization whose membership is committed to reducing poverty through the power of enterprise.

The traditional performance measures described are better suited for the traditional industry and do not necessarily measure social performance but rather focus on return of investments, social conduct pricing and profit-maximization and serve the KPI monitoring goal for shareholders. The social performance measures focus on certain fields and in particular on outreach. Outreach is an important measure and can be used to measure whether MFIs are "drifting from their mission", but does not provide a satisfying indicator to measure the economic and market performance of banks. Also the MFI ratings used by the rating agencies (see page 36) do not take into account social aspects. Therefore in order to measure to double bottom line and to get behind the motive of the microfinance involvement of commercial banks, in this thesis the selected banks are analyzed for their *microfinancial performance.* Schreiner (2002) proposes a framework of six microfinancial indicators or triangles, that covers both social and economic aspects:

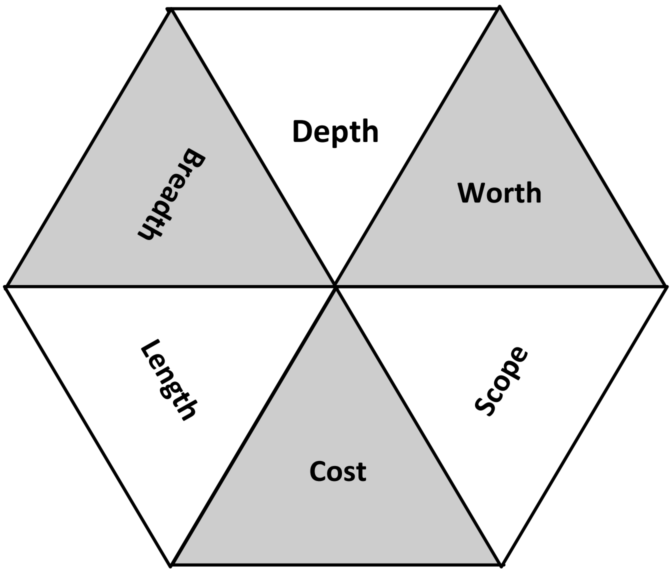

Figure 7: Six degrees of Outreach (Churchill and Frankiewicz, 2006)

3.2.2 Microfinancial performance indicators outlined

Worth to Clients. For loans, the worth to clients increases as the terms of the contract more closely match borrower demand (Churchill and Frankiewicz, 2006). Morduch (1999) describes the clients' willingness to pay for microfinance products by putting forward that clients may be sensitive to loan size, to additional transaction costs associated with borrowing from a microfinance institution (MFI) and the frequency of borrowing.

The willingness to pay can be monitored by the repayment rates: the number of clients who repay their loan within a certain period; repetitive loans: the number of clients who keep choosing the same MFI as a source for loans, over the competition; and retention rates: the number of follow-up loans divided by the number of loans paid off during the same period.

Cost to Clients. The costs consist of interest rates, fees and transaction costs. The latter includes both opportunity costs and indirect expenses for clients. The Interest rate is the main cost driver for clients. Opportunity costs are time spent meeting with for example the other villages' or group borrowers participating in the same loan or with the MFI account manager or advisor. Costs are also instalments: the amount to be disbursed each time between the instalments, and are part of the total loan size and costs (Schreiner, 2002). The provision of loans to the poor entails a different cost structure than traditional lending. There are three types of costs of MFIs: (i) financial costs (i.e. the costs of capital, (ii) the costs of default, the risk that borrowers cannot repay their loans; and (iii) operational or transaction costs. Financial costs are external to the MFI, but can be influenced by transparency and lowering default risk. The transaction costs can be directly influenced by MFIs, by close monitoring for example, which increases the costs. Operational costs are disproportional high, because loan-size and lender's costs are non-linear.

Depth of Outreach. The social measure is to serve the underserved by financial institutions. In the case of previously served clients, or when only pieces of the data can be gathered, more specific measures can be defined such as education (less is preferred), ethnicity (minorities are preferred), gender (women are preferred), location (rural is preferred), housing (small, cheap houses are preferred), access to public services (lack of access is preferred). A proxy for the depth of outreach can be determined by average loan size, as a percentage of GNP per capita.

Breadth of outreach. Breadth refers to the number of clients served. Besides that, this indicator can also be measured within certain market segments such as the number of clients served by gender, age, geographic location or type of business activity. MFIs could reach more poor people if they serve a broader market, including persons who are not poor.

Scope of outreach. With scope the variety of financial services offered is meant, which refers to both the diversity of the services and depth of the product assortment. The number of services offered can determine the scope of outreach. When measuring the diversity of the services, the actual number of clients reached per service should be considered, since some services could only reach a small number of clients. When comparing the services between the MFIs, the depth of the product assortment offered should be taken into account, since some MFIs offer specialized products, of which some can also be covered by a more general product from another MFI.

Length of outreach. Length defines the sustainability of the microcredit program or microfinance institution, and is used for the economic performance. The length of outreach in terms of net profit is calculated by taking the financial performance of MFIs corrected for income that is not generated out of the standard cash flow from their microfinance operations, and by subtracting the operational costs.

A description by Cull et al (2005), defines operating self-sufficiency as the institution's ability to generate sufficient revenues to cover its costs. Financial self-sufficiency is reached when the inflation-adjusted operating revenue, corrected for subsidies and/or donations, exceeds its inflation-adjusted costs, including funding costs (Schreiner and Woller, 2003).

Another way to look at the long-term financial performance is customer loyalty. When MFIs don't keep their customers satisfied, they will then turn to the competition or other financial service providers. Since lending activities are the primary source of income, loyal borrowers should be aimed for. Due to a combination of high costs, low income and high risks it might take several loan cycles for a new client to become profitable to a bank. Using some of the indicators, loyalty can be measured as well: then length refers to the average number of years that a customer has used a MFIs services. By analyzing the trend in distribution of the longevity, an overview of the MFIs loyalty level can be made. With breadth, the number of products that a client has with the MFI is meant. The more different products one client has with the MFI, the more loyal the client is considered. Finally, with depth, a customer's dependence on the MFI is referred to: the degree to which a customer uses an institution for all of her financial service needs.

3.3. Conclusion

Bank performance is traditionally measured by profitability, risk, market structure and efficiency, however for this thesis the microfinancial performance measures from Churchill and Frankiewicz (2006) described in paragraph 3.2.2 are used. This is because of the focus on the organizational performance from the clients' perspective, rather than from a shareholder's perspective. The different types of outreach are used, since the common outreach that is often described in literature on itself does not provide an appropriate measurement for social performance. Moreover, the microfinancial performance indicators also measure the financial impact to the clients, which in turn could be used for an organization's financial performance, combined with the length of outreach indicator.

Using these indicators to analyze banks, the overview of the main microfinance market is maintained, instead of measuring for example all of the different types of products, methodologies and institutions as described in chapter two. To structure the microfinancial performance indicators, they are divided into the groups of traditional performance measures mentioned earlier in this chapter. This will be described in the next chapter.

4 Research outline

The first two paragraphs of this chapter describe the methodologies for testing both of the hypotheses. The third paragraph outlines the research design. The fourth paragraph covers the research on finance towards developing and emerging countries and the research on the foreign banks involved in microcredit. The last paragraph covers the research on the Dutch banks involved in microcredit. At the end of both paragraphs four and five an overview is provided of the research data, which is outlined for an internal contribution level and basis key data. The conclusions from the research data are described in chapter five.

4.1 Methodology for the first hypothesis

The testing of the hypothesis *"Dutch microcredit is competitive with foreign microcredit by means of outreach"* will be based on measuring the international microfinancial performance in terms of outreach of the microcredit product(s) that Dutch banks (in)directly offer, and comparing the outcomes with the microfinancial performance of foreign banks (in)directly offering microcredit. For thesis structure purposes this first hypothesis will be covered in paragraph 6.1.

As described in the previous chapter, microfinancial outreach consists of individual indicators can also be classified as: economic, non-financial and subjective performance measures. Non-financial and subjective performance measures are used for this first hypothesis and are therefore briefly described here with their selected research method of measurement.

Due to the client focus rather than the focus on business results, the following two indicators are classified as non-financial performance measures. Firstly, 'Worth to Clients': the following methods are used to determine the worth to clients, depending on the data (a bank has) available. With the repayment rate the number of clients who repay their loan within a certain period is calculated. With repetitive loans, the number of clients who keep choosing the same MFI (as a source for increasing loan sizes) over the competition is measured. Secondly, 'Cost to clients': The interest rate level is used to measure costs.

Three measures are classified as subjective performance measures due to their qualitative nature: 'Depth of Outreach': The client location, gender, poor(est), access to public services etc. are used. Secondly, 'Breadth of Outreach': The measure of the number of clients served is used. Thirdly, 'Scope of Outreach': the number of services offered is used.

4.2 Methodology for the second hypothesis

The second hypotheses *"Dutch microcredit outperforms the similar products Dutch banks offer"* is linked to the economic performance indicators described below. The hypothesis is tested by a comparison to similar financial products Dutch banks already offer, using an additional financial performance indicator: The 'intracompany financial performance indicator' combined with the 'Length of outreach', which are described in the paragraph below. The second hypothesis will be covered in paragraph 6.2.
The outcome of the research will also be used to determine whether the Dutch banks are involved in the microfinance market for reasons such as financial returns and portfolio diversifications and/or for reasons such as corporate social responsibility and social performance, in other words, to measure both bottom lines. An internal contribution level model described in paragraph 4.3. will also be used to support that measurement.

4.2.1 The intracompany financial performance indicator

This indicator defines the financial performance of microcredit that Dutch banks ((in)directly) offer, compared to their similar financial products and can, together with the length of outreach, be described as economic value measures.
The intracompany indicator is measured by comparing the financial performance of the similar (traditional) credit activities in relation to the financial performance microcredit products and/or of MFIs (in)directly linked to the Dutch Bank. The Length of outreach indicator, as a more general measure in case not all data is available (to the banks), will be to determine whether the microcredit involvement of the MFI the Dutch bank is related to, is sustainable and/or profitable.

4.3 Research design

This paragraph describes the research types used for obtaining the required data and an additional model that is used in the questionnaires. At the end of the paragraph the selection method of the banks is described.

4.3.1. Data collection

Through an extensive desk research, using the information available through the internet, the Erasmus university library sources, newspapers and magazines, over 100 articles, academic studies, books and professional reports data are collected. Using this qualitative and quantitative data a market analysis is performed on each of the selected market players and for the indicators outlined in the previous paragraph. Several studies approximately provide intermediary information, for example at the funding level, with details on the MFIs lending from the funds, or at the country level, with data on outreach, investment sums and loan sizes. Also by investigating the linkages of the Dutch banks to the funds, other banks, or to the MFIs directly, the Dutch and foreign banks can be scored for their microfinancial performance. To test both the hypotheses and to make a comparison, further data is needed on the microfinancial indicators and the internal contribution level. Therefore primary data is needed as well. This is obtained through field research (by email and telephone) with a questionnaire for the selected Dutch banks, questioning them on:

- the banks microfinance activities and strategy
- financial involvement and performance in microcredit
- internal contribution levels of microfinance (Bouuaert, 2008. For this thesis additional levels of contribution have been added, see also below)
- main motive for the involvement in microcredit
- social performance using the microfinancial performance indicators by Churchill and Frankiewicz, 2006 (see also paragraph 3.2.2.)
- future microfinance strategy

4.3.2 Questionnaire design

The questionnaire starts with a question on the motive for the bank's initial involvement. The second question starts with a brief summary of the bank activities, which are collected during the desk research. The respondent is asked to either approve the summary or to add activities. In that way the activities are confirmed by the bank itself. The third question covers the current financial status of the bank microfinance involvement. With question four the performance indicators from paragraph 3.2.2 are used to question the banks for their social performance. In a separate text box the indicators are outlined in detail, as well as the factors used for the next question five. That question uses internal contribution factors by Bouuaert (2008), who performed a study 'A Billion to gain, The next phase'. In the report several types of microfinance contribution levels are described. For the purpose of this research two levels have been added to this model: 'Normal commercial business' and 'Commercial international business'. See below for the explanation of these types. These contribution levels are added to the questionnaire to help determine the bank microcredit involvement and internal performance. With the last question the banks are questioned for their future plans with microcredit. All questions in the questionnaire are set-up to help answer both the hypotheses.

Question four, five and six in particular help answer the first hypothesis on competition through outreach, by for example adding the option of the commercial international business level which describes a business that is characterized by microfinance products that are competitive with similar foreign bank products. The second hypothesis is supported by questions three and five, with a specific question such as *"Microfinance is more profitable than other similar mainstream credit activities, not related to microcredit"* and by adding the option of a the normal commercial business level which describes a business that is characterized by microfinance products that are more profitable the than the similar business services within the organization.

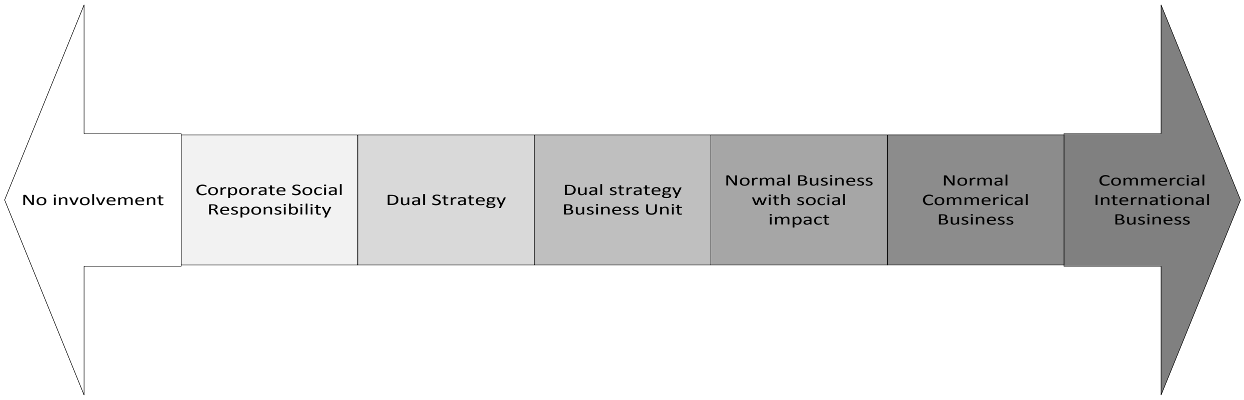

Figure 8: Levels of contribution.

• Corporate Social Responsibility

CSR is generally seen as the business contribution to sustainable development and is understood mainly as focusing on how to integrate economic, environmental, and social imperatives. The overall aim is to reduce poverty by building financial systems that work for the poor majority.

• Dual strategy

These banks look for a balance between a corporate citizenship policy (or CSR) and their commercial business targets. This approach is characterized by covering the costs, large social impact and a 'healthy' growth in total.

• Dual strategy business unit

This approach is similar to the Dual Strategy, but differs because these microfinance 'departments' are more focused on their business targets. They achieve social goals through commercial means. A well-established central team is set up that develops and coordinates all microfinance activities, mostly within a dedicated, separate unit.

• Normal business with social impact

Profit and growth are important factors in the policy. Microfinance products are approached as a normal business service. The products are fully commercial and supported by the normal businesses. In addition, they have significantly more social impact than the 'mainstream' business services.

• Normal commercial business

This type of commercial business involves the similar policy as the previous type, however this type is characterized by microfinance products that are more profitable than the similar business services within the organization, that are not related to microfinance.

• Commercial international business

With this international commercial business, the focus of the microfinance products is to be competitive with similar microfinance products that are extended by foreign banks in the same geographical region.

4.3.3 Bank selection method

The Dutch commercial banks are primarily selected based on their market share in the Netherlands and secondly for their microfinance activities, and the similar foreign commercial banks are primarily selected based on their market value and secondly for their microfinance activities. See table 4: 'The Top 20 Global financial institutions by market value per 2007' and table 7: 'Dutch banks market share' are used to select the banks. The ongoing developments and changes of the market players, as a result of the financial crisis, are not taken into account. The banks are categorized into two categories. Four banks will be selected out of each category:

- Category 1: Commercial banks with Dutch origin that (in)directly extend microcredit, by using their own defined programs or the programs of subsidiary MFIs. Paragraph 4.5 covers the Dutch banks research.
- Category 2: Commercial banks that do not have Dutch origin and that (in)directly extend microcredit, by using their own defined programs or the programs of subsidiary MFIs. The next paragraph 4.4, covers the research on the foreign banks.

4.4 Research on the foreign commercial banks in the microfinance market

In cooperation with the International Finance Corporation[23] (IFC), the top global bankers of the world have adapted the Equator principles. The goal of these principles was to address the social and environmental impact of the global projects they finance. The Equator II Principles[24] are a financial industry benchmark for determining, assessing and managing social and environmental risk in project financing. These Principles are intended to serve as a common baseline and framework for the implementation by each financial institution of its own internal social and environmental policies, procedures and standards related to its project financing activities. They will not provide loans to projects where the borrower will not or is unable to comply with the respective social and environmental policies and procedures that implement the Equator Principles.

Rodriguez and Santiso (2007) for the OECD have conducted a survey of private bank lending towards developing countries, to identify the most active private bankers in those economies. They have found an international division of bank lending that links Western banks to their historical relations with developing countries. For example UK and French banks are more active in Africa, while Spanish banks are more active in Latin America, where US banks are also heavily involved. Dutch banks are found to

[23] IFC: the World Bank's private financing arm.
[24] www.equator-principles.com

have a more global and balanced portfolio and the Netherlands are the main lender to Suriname. Over the past decades, OECD private banks have invested in and acquired major banks in developing countries, boosting the share of foreign banks credit in total domestic credit. US and Spanish banks have been the most active in developing countries between 1990 and 2003, they invested respectively USD 74 and USD 68 billion in developing countries, far ahead of UK (USD 38 billion) or French (USD 32 billion) banks (Goldberg, 2007). According to BIS[25] the total claims flowing from OECD private banks to emerging economies in 2005 reached USD 230 billion, an amount twice as large as the total OECD official aid to developing countries. Countries with the largest private bank flows towards emerging markets are the UK, Spain and the USA. According to Rodriguez and Santiso (2007), this was just the tip of the iceberg of international banking involvement in developing countries. Through acquisitions there has been an important shift towards more local activities, through branches and subsidiaries, with the subsequent implication that direct cross border activities are only part of the picture, with local lending by foreign banks in developing countries also being on the rise as underlined by the IMF (2007). For attracting funds, under the Basel I regulation micro credits are risk rated for 100%, and under the Basel II regulation have a risk rate of 75%. This caused the capital needs for MFIs to become higher and made financing microcredit more expensive (Bosman en Schrijvers, 2007). Table 4 shows the Top 20 Global financial institutions by market value, per June 2007 (EUR Billion).

Bank name	**Market value**	15. Unicredito	69.1
1. Citigroup Inc.	186.1	16. Barclays	67.6
2. Bank of America Corp.	161.4	17. AXA Group	66.9
3. HSBC Holdings	157.5	18. Goldman Sachs	66.3
4. American Intl. Group-AIG	134.8	19. Morgan Stanley	66.1
5. JPMorgan Chase	124.2	20. Intesa Sanpaolo Ord.	65.5
6. UBS	93.6	*Other:*	
7. Royal Bank of Scotland	88.9	BBVA	64.6
8. Mitsubishi UFJ Financial	87.7	Crédit Suisse	64.1
9. Wells Fargo	87.3	Société Générale	63.5
10. Grupo Santander	75.6	Deutsche Bank	55.9
11. BNP Paribas	82.4	Credit Agricole	49.7
12. Allianz	78.5	Standard Chartered	22.6
13. ING Group	72.3	Commerzbank	15.9
14. Wachovia Corp.	72.2	Rabobank Group	Not listed

Table 4: Top 20 Global financial institutions by market value (ING Profile, 2007).

[25] BIS: Bank for International Settlements in Basel. The BIS monitors foreign claims held by banks mostly from OECD countries vis-à-vis the rest of the world and defines these claims as those authorized by international banks on residents outside the country in which they are headquartered. Foreign claims may range from assets such as loans, debt securities to equities, including equity stakes in local subsidiaries (Rodriguez and Santiso, 2007).

Based on their market value and microfinance activities, the following foreign commercial banks will be analyzed:

- HBSC, United Kingdom
- CitiGroup, USA
- AIG, USA
- BNP Paribas, France
- Deutsche Bank AG, Germany

4.4.1 HBSC Group

HSBC is a large international banking network which includes 9,500 offices in 76 countries and has 110 million customers. Their total assets amounted to USD 2.3 billion in 2007.

HSBC is engaged in several microfinance activities with MFIs in Brazil, India, Mexico, Sri Lanka, China, the Philippines, USA, Turkey and Russia. Other countries such as Argentina and some Asian countries are marked by HBSC as preferred countries to engage in. These projects involve wholesale lending for USD 62.5 million to 30 MFIs per 2006 and provided an attractive infrastructure for money-transfers.

HSBC's strategy is to "engage with the microfinance sector on a commercially viable and sustainable basis…microfinance is to be viewed as a business, not philanthropy" (HSBC, 2009). HSBC aims to do so by increasing its funding to the sector through loans and securitization (Microcapital, 2006). HSBC Turkey allocated USD 5 million until 2010 as part of a CSR project. HSBC Amanah, the global Islamic Banking division of HSBC Group, has partnered with Islamic Relief to offer Islamic Microfinance in Pakistan. Islamic Relief is active in over 20 (Islamic) countries. Their Islamic microfinance provides financial service to Muslims in accordance with the Shariah, the Islamic Law. HSBC Amanah provides both training and funding for Islamic Relief's Microfinance projects (Microcapital, 2008).

In 2007, HSBC launched a rural bank in China next to their separate locally incorporated units with 40 outlets and employs around 4.000 people.

4.4.2 Citigroup

Citigroup is one of the largest financial services companies, with 200 million accounts in over 100 countries. Citigroup employed over 370.000 people end 2007.

Citigroup has a long history in working with the microfinance sector, from 1999 to 2004 it spent USD 17 million in grants to MFIs and other market players such as MIX[26]. Citigroup's Global Microfinance Group was started in 2005 to support Citigroup's strategy to "leverage its global franchise and business to extend the needed funding and to establish banking relationships with a wide range of MFIs" (Microcapital, 2006). The Citi Global Microfinance Group reaches 65 MFIs by working across Citigroup's businesses, product groups and geographies to provide leading microfinance institutions and their

[26] MIX is a not-for-profit private organization founded by CGAP, dedicated to promoting transparency and standardization throughout the microfinance industry and improving financial and social performance at the institutional level.

clients with financing, capital markets, transaction services through its Global Transaction Services, Assessment and Debt Rating Models, hedging, savings, remittance and insurance products. The Citi Network Strengthening Program advances the integration of microfinance into mainstream finance in developing countries. Citigroup is working with the SEEP network and the total network represents over 1,300 MFIs and has 19 million client members. Citigroup has worked with IFC International Finance Group of the World Bank) Compartamos on their bond, (see also 2.1.5) and Procredit holdings, a Frankfurt based network of 19 MFIs. In 2006 Citigroup announced that it will lend USD 100 million to several MFIs of which USD 70 million is guaranteed by the US government's Overseas Private Investment Corporation (OPIC). MFIs can loan up to USD 5 million and are selected based upon their size and earlier funding.

In 2008 Citigroup got approval from the China banking regulatory commission to open two microcredit firms. The Chinese approval is meant to increase competition in a rural part of China where already two non-Chinese commercial banks are active; HSBC and Standard Chartered (Microcapital, 2008). Another finance transaction for BRAC in Bangladesh, was arranged with FMO and KFW[27] and involved a six-year program of USD 180 million. BRAC is the world largest national NGO with over 5 million borrowers (mostly women). 65% of its loans are for the extremely poor who borrow from USD 50 to USD 100. This transaction has served as a benchmark for the microcredit securitization. Citigroup's Global consumer bank in India launched a saving product, using a biometric ATM.

4.4.3 AIG group

AIG is a leader in international insurance and financial services, and operates in 130 countries. In 2007 the company had assets of USD 1.1 trillion.

In 1997 AIG Uganda partnered with MFI FINCA to offer a microloan with a low-cost credit life insurance policy. Its success led to the expansion of AIG's microfinance services in Africa, Brazil, India and Central America. In India, Tata AIG launched a microfinance insurance venture with over 50 NGO's end of 2006. In Pakistan AIG provides credit protection facilities. In China AIG acquired 18 percent of the shares of MicroCred Nanchong (MNC) in 2008 by investing USD 7.4 million. MNC is jointly owned by the IFC, KfW and MicroCred S.A., and provides low income individuals and micro entrepreneurs financial products and services. KfW is one of the largest microfinancers globally and promotes some 100 microfinance projects in around 60 countries with a project portfolio of EUR 800 million per end 2007. With these projects, some 50 million people are reached all over the globe (KfW, 2009). MNC started in 2007 and offers loans with an average loan size of USD 3.600. AIG provides 1.2 million micro insurance policies in 11 countries. In 2006, AIG provided USD 5.2 million in a 3-year partnership with ACCION International, one of the largest multinational microfinance organizations. AIG also provides technical assistance to local clients. In Latin America AIG granted Pro Mujer Argentina a three year grant of USD 1 million in

[27] KfW: Kredit fuer Wiederaufbau, The German Development Bank.

2007. Pro Mujer is a MFI that started in 2005 and provides almost 6,000 clients with business loans, savings accounts, and pre-credit training sessions (Microcapital 2008).

4.4.4 BNP Paribas

BNP Paribas is one of the largest bank groups and is active in 85 countries and employs 200.000 people. Its assets totalled 1.7 trillion end 2007. In June 2006 the bank decided to create a department dedicated to Microfinance. Microfinance is an important part of BNP Paribas' corporate social responsibility strategy. BNP Paribas helped to finance 20 MFIs in France and 11 French speaking countries by partnering with the ADIE[28] program. BNP Paribas was the first commercial bank to have entered into a national partnership with the ADIE. This initiative introduces the unemployed and those on income support to microcredit, with the aim of reaching out to as many start-up businesses as possible, particularly in underprivileged neighbourhoods. This program runs since 1991, mainly in France, and since the start of the partnership in 1996, BNP Paribas indirectly provided already EUR 6.6 million to 1.400 projects per 2008. BNP Paribas contributes 10% of the cost of supporting each ADIE-assisted start-up and up to 30% of the risk coverage. In 2006, ADIE had 45.7 million in loans outstanding end 2007.

For the last 6 years, through its microfinance activity at group level, known as the “Microfi”, BNP Paribas has been working with the French Development Agency (AFD) to fund microfinance institutions that support the creation of micro businesses in developing countries. Per end 2007, the total of international microfinance loans were nearly EUR 80 million in 12 countries (Morocco, Guinea, Mali, Egypt, Madagascar, India, Philippines, Argentina, Mexico, Senegal, Tunisia and Brazil). There are 22 partners involved and more than 400,000 borrowers. Their global microfinance program has an economic and social impact on some 2 million people. In 2009, as part of their global microfinance strategy, BNP Paribas has granted its first loan to a MFI in Indonesia, MBK Ventura, totalling USD 1 million. This was MBK Ventura's first loan from an international bank, granted under commercial terms.

MBK Ventura is a MFI created in 2003, providing working capital to women from very low income households in Indonesia, to help finance their microenterprises, enabling them to increase their family's income and living standards. A unique feature of MBK Ventura is that virtually all the staff, including its CEO, are women. MBK Ventura has 134.000 female clients and is targeting 1 million clients by 2012. The average loan size provided to clients is approximately USD 100, the loan by BNP Paribas will allow lending to another 10,000 women. In December 2008, MBK Ventura was ranked No. 1 among 1,300 microfinance institutions registered with the Mixmarket, the microfinance database of the CGAP. This calculation takes MFIs targeting, profitability, and transparency into account (BNP Paribas, 2009).

[28] ADIE: Association pour le Droit à l'Initiative Economique.

4.4.5 Deutsche Bank

Deutsche Bank is a leading global investment bank with close to 80.000 employees working in over 75 countries. Deutsche Bank (DB) has been active in microcredit since 1997. It was the first bank to offer an investment fund for microfinance and embraces social investing as a specialized investment banking business with dual objectives of profitability and social return. Combining the bank's social financing expertise, investment banking skills, structuring capabilities, business resources and worldwide relationships creates financial instruments that benefit social enterprises – and in the process, transfer financial know-how among both clients and investors (Deutsche Bank, 2008).

DB manages three funds through their Community Development Finance Group per 2009:

- The Deutsche Bank Start Up Fund, which provides early-stage, commercially focused MFIs with loan capital to expand lending activities. This fund is capitalized through grants and soft funding. The fund has a loan portfolio of USD 0.4 million to 6 MFIs in 5 countries.

- The Deutsche Bank Microcredit Development Fund (DB MDF) provides catalytic financing to MFIs to attract resources on a leveraged basis from local commercial banks. DB MDF seeks to alleviate poverty worldwide by investing in the development of financial systems that serve the poor. This fund is capitalized through grants and soft funding and is a non-profit corporation. The aim of the DB MDF is to help MFIs reach scale and sustainability. DB's strategy is to encourage and establish relationships between local commercial financial institutions and MFIs by providing high-risk catalytic funds as collateral for leveraged loans from local financial institutions. The DB MDF's loans are very low-cost (1 percent to 3 percent a year) with maturities of one to five years. DB MDF loans leverage capital from local commercial financial institutions, for direct lending to the poor. Loans may not be used as working capital or as funds for direct lending to program participants. Relationships with local commercial financial institutions enable the targeted MFIs to leverage sustainable conventional debt, grow their programs to scale, and work toward the economies of scale needed to become self-sufficient. MFIs are also evaluated for DB MDF commitments based on management capacity, portfolio quality, amount leveraged through local commercial financial institutions, social impact of the DB MDF's financing and profitability and efficiency indicators. A Typical DB MDF Loan Structure: Loan size = USD 100,000 at a 2% annual interest rate. The MFI earns market interest on this USD-based deposit of the DB MDF proceeds, which helps to cover the costs of local currency loans from the commercial bank. Loans to micro-entrepreneurs have maturities that are often less than six months and typically less than one year. The fund has a loan portfolio of USD 6.5 million to 50 MFIs in 15 countries.

- DB Microfinance Invest No.1 was launched in 2007 and was the first microfinance investment fund for German investors. This fund is capitalized through investments from clients, pension funds and foundations, KfW and Deutsche Bank. The fund has a loan portfolio of USD 87 million to 21 MFIs in 15 countries.

- The Global Commercial Microfinance Consortium provided long-term, local currency funding at commercial rates to established MFIs. The fund was capitalized mainly through investments from institutional investors and was closed in 2005. The fund had a loan portfolio of USD 75 million to 38 MFIs in 22 countries and is not active anymore.

4.4.6 Overview of the microfinance activities of the foreign banks

Bank name	Involvement Structure	Contribution level	Number of people reached	Financial involvement/ Outstanding loan portfolio (USD)
HSBC	Microcredit through own bank network	Dual strategy	Over 200.000 clients	Over 62.5 million
Citigroup	Management and investment through Citigroup Microfinance Group	Dual strategy business unit	not known	Over 200 million
AIG	Loans to MFIs through partnerships	Dual strategy	Over 1 million micro insurances	Over 10 million
BNP Paribas	Loans to MFIs through BNP Microfi	Dual strategy business unit	400.000 clients	Over 100 million
Deutsche Bank	Funding through the DB Community Development Finance Group	Dual strategy business unit / Normal business w/ social impact	not known	Over 90 million

Bank name	# of MFIs reached	Countries reached	Future Strategy
HSBC	30	10	- Expand bank network in emerging markets - Increase funding
Citigroup	65	35	- Expand number of microfinance services such as remittances and insurance - Expand bank network in emerging markets
AIG	5	India, Brazil, Argentina, China, Uganda	- Expand number of microfinance services such as remittances and insurance - Expand bank network in emerging markets
BNP Paribas	22	11 (Africa, Latin America and Southeast Asia)	- A microfinance fund - Expand number of microfinance services such as remittances and insurance - Technical assistance
Deutsche Bank	75	Over 45 countries	- New microfinance funds - Multi facility microfinance investment vehicle

Table 5: Overview of the foreign banks microfinance activities

4.5 Research of the Dutch commercial banks in the Microfinance market

The Netherlands provides some of the 55 banks (per end 2008) reporting to the BIS and were among the top six countries to provide loans to developing and emerging countries. According to a study for the Dutch central bank in 2007, The Netherlands were one of the front runners in investing in microfinance and providing technical assistance to foreign financial institutions (Bosman and Schrijvers, 2007). The Dutch government yearly spends over EUR 100 Million on microcredit through development banks and social organizations[29]. The funding origins from their regular national development aid budget (DMF, 2008). The Netherlands also play a prominent role in the global microfinance market: HRM Prinses Maxima is the ambassador of microcredit for the United Nations.

In a study for International and Dutch non-profit and government organizations by Profundo (2008), Dutch commercial banks were analyzed for their 'honest' banking activities. Based on this study, the Triodos Bank was found to be the most 'honest' bank, in terms of supporting the environment, human rights, and with their credo of excluding corruption and weapon activities. From the four largest Dutch commercial banks, The Rabobank and ING Bank both scored equally high, whereas The Rabobank scores slightly higher on theme policies such as Transparency, Climate and Working rights. The ING Bank scored slightly higher than the Rabobank on divisional policies. See table 6; Overview of policy scores for the Dutch Banks.

Theme policy	**ABN Amro Bank**	**Aegon Bank**	**ASN Bank**	**DSB Bank**	**Fortis Bank**	**Friesland Bank**	**ING Bank**	**Rabobank**	**Robeco Bank**	**SNS Bank**	**SNS Regio Bank**	**Triodos Bank**
Poisonous materials and health	2	2	3	n.a.	2	1	2	2	2	2	2	4
Transparency	3	2	5	1	3	1	2	4	4	2	2	3
Working rights	3	2	5	n.a.	2	1	3	4	4	2	2	5
Biodiversity	4	2	4	n.a.	2	1	4	2	2	2	2	5
Human rights	3	2	5	n.a.	2	1	3	3	3	2	2	5
Climate	2	2	5	1	2	1	2	4	4	2	2	5
Weapons	3	1	5	n.a.	3	1	2	3	3	2	2	5
Taxes and corruption	3	1	3	n.a.	2	1	3	3	3	2	2	5
Divisional policy												
Dams	3	1	n.a.	n.a.	3	1	3	3	3	1	1	n.a.
Banking	1	1	5	1	1	1	1	1	1	1	1	3
Fishery	1	1	n.a.	n.a.	1	1	1	3	3	1	1	5
Mining	4	1	n.a.	n.a.	2	1	4	2	2	1	1	n.a.
Forresting	3	1	n.a.	n.a.	1	1	4	3	3	1	1	5
Oil & gas	3	1	n.a.	n.a.	2	1	3	2	2	1	1	n.a.
Agriculture	2	1	n.a.	n.a.	2	1	4	3	3	1	1	5
(Make)Industry	1	1	4	n.a.	1	1	3	2	2	1	1	5
Total score:	41	22	44	3	31	16	44	44	44	24	24	60

Legend:

1 = lowest score (no policy)

5 = highest score (best possible policy according this methodology)

n.a. = not active in this division, so no policy expected

Source: "Eerlijke Bankwijzer" ("Honest Bank guide") performed by Profunda for: Oxfam Novib, Amnesty International, Dutch Department of Environment and FNV Mondiaal, 2008.

Table 6: Overview of policy scores for the Dutch Banks

[29] The Ministry of Foreign Affairs also donates to the CGAP, H. van der Veen, MinBuZa / DDE.

Based on their 2007 market share of credit- and savings accounts in the Netherlands, see table 7, and their microfinance involvement, the following Dutch banks are selected:

- Rabobank
- ING Group
- ABN Amro Bank
- SNS Bank
- Triodos Bank

	Suppliers (brand names)	**Estimated savings accounts in the Netherlands (€ billion)**	**Estimated market share in the Netherlands**	**Parent company**
1	Rabobank	91	39%	Rabobank Group
2	ING Bank	82	35%	ING Group
3	ABN Amro Bank	19	8%	Dutch government
4	Fortis Bank	13	5%	Dutch government
5	SNS Bank	6,5	3%	SNS Reaal
6	Robeco Bank	4,4	1,9%	Rabobank Group
7	Aegon Bank	4,3	1,8%	Aegon
8	ASN Bank	3,6	1,3%	SNS Reaal
9	DSB Bank	2,7	1,1%	DSB
10	SNS Regio Bank	2,5	1,1%	SNS Reaal
11	Friesland Bank	1,8	0,8%	Friesland Bank
12	Triodos Bank	0,7	0,3%	Triodos
Source: "Eerlijke Bankwijzer" ("Honest Bank guide") performed by Profunda for: Oxfam Novib, Amnesty International, Dutch Department of Environment and FNV Mondiaal, Nov. 2008.				

Table 7: Dutch Banks market share

4.5.1 ABN Amro Bank

Until October 2007 the ABN Amro Bank was a large, international active Dutch bank. In 2007 all activities of the ABN Amro Bank were taken over by the RFS Holdings, a cooperation of Fortis (Belgium/Netherlands), Royal Bank of Scotland (GB) and Santander (Spain). The intention was to divide the bank divisions between the three banks, however due to the financial crisis, Fortis got into problems and one year later, in October 2008 the Dutch government took over the Fortis Bank Netherlands (Holding) NV, including the share of Fortis in RFS Holdings and the Dutch insurance activities of Fortis. RBS and Santander remained shareholders of RFS Holdings and continue to work together to cut off the activities that they acquired. The Dutch government is now responsible for cutting off ABN Amro Netherlands and ABN Amro Private Banking from the RFS Holding. The Dutch government will also merge both the remaining ABN Amro Bank and Fortis activities. After that has taken place, it becomes clear what policy the banks will pursue (Eerlijke Bankwijzer, 2008). This development does create an opportunity for the Dutch government to direct the policy further towards ESR policies, and maybe even towards (increased) microfinancing. ABN Amro Nederland will be analyzed based on their policy as was reported from their 2008 year report.

According to table 8, which lists the financial instruments that both Dutch banks and funds have used for microfinance per 2005, the ABN Amro is the largest bank.

Instruments per institution						
(EUR Million)	**Equity investment**	**Guarantee**	**Loan**	**Re-insurance**	**Donations**	**Total**
ABN AMRO	0	0	17.3	0	-	**17.30**
ASN - Novib Fonds	0	0	13.9	0	-	**13.90**
Cordaid	2.3	1	21.2	0	1.5	**26.00**
Stichting DOEN	34.6	0.06	0.9	0	1.2	**36.76**
FMO	22	16.9	20.6	0	0.1	**59.60**
Hivos	0	0	0	0	3.9	**3.90**
HTF	4.9	0.9	15.6	0	-	**21.40**
ICCO	0.8	3.2	0.4	0	3.3	**7.70**
ING Bank	4.5	-	12.1	0	0.25	**16.85**
Interpolis	0	0	0	0.24	-	**0.24**
Ministerie van BuZa	0	0	0	0	4.9	**4.90**
Novib	0.4	1.5	14.3	0	4	**20.20**
Oikocredit	14.1	0.6	93.8	0		**108.50**
Rabobank Foundation	0	0.5	6.2	0	0.77	**7.47**
SNV	0	0	0	0	0.73	**0.73**
TDOEN	5	0	23.5	0	-	**28.50**
Triodos FSF	1	0	9.3	0	-	**10.30**
Total	**89.6**	**24.66**	**249**	**0.24**	**20.65**	
Source: Facet B.V., Ministry of Foreign Affairs						

Table 8: Financial instruments per Dutch institution (2005)

4.5.1.2 Bank key data

The ABN Amro bank before the takeover by Fortis had 114.082 employees, was active in the Netherlands and 55 other countries, and had 10 million clients in the Benelux. Their balance sheet totalled: € 1.025 billion. ABN Amro has the following products for their private clients: Payment- and savings accounts, Mortgages, Insurances and Capital management.

Most important resource allocations (end 2007):

Investment in shares, bonds and derivates (33%)

Loans to domestic and foreign companies (15%)

Mortgage (loans) to private clients (12%)

Other loans (12%)

Loans to other banks (17%)

Due to the separation of the international activities of the ABN Amro Bank, it is likely that these investment shares are now different (Eerlijke Bankwijzer, 2008).

4.5.1.3 Microfinance and microcredit activities

ABN Amro was one of the leading banks to invest and expand their microfinance business. Microfinance enhanced the bank's reputation and contributed to the bank's drive for sustainable development, something that became of increasing importance to all the bank's stakeholders. ABN Amro expected that microfinance would eventually have a positive impact on their bottom line results (ABN Amro, 2006). The microfinance activities are an integral part of ABN Amro's sustainability strategy. One of the most important themes of sustainable development is to integrate the concept of triple P: "people, planet and profit" in the business of the bank. This is also the underlying philosophy of ABN Amro's microfinance activities. The microfinance activities are therefore housed in a separate charity unit. This reflects the aim to develop sustainable microfinance business, while at the same time providing access to financial services to poor people in society. The bank's involvement in microfinance is not only providing finance, direct or indirect, to poor people in certain countries, but also to provide technical assistance to local microfinance partners, for example by allowing its personnel to participate in local projects. By 2007 ABN Amro had a total microcredit loan portfolio of over 60 Million EUR reaching over 500.000 clients and their microfinance business operated profitably.

Microfinance activities are in particular focused on countries where ABN Amro had local presence. ABN Amro per 2007 was therefore involved in microcredit by means of extending credit through subsidiaries such as in Brazil with BancoReal and RealMicrocredito, a joint venture of BancoReal and Accion. In India ABN Amro works through MFIs such as CashPor and ABN Amro Foundation India (AAFI).

Banco Real (per end 2007) was the 5th largest bank of Brazil. Banco Real was perceived as being a bank exclusively for the better-off (Weizenmann, 2006) and targeted poorer clients as part of their microfinance strategy to 'Bridge the gap' between the world of finance and the poor (Mulder, 2006).

Banco Real worked together with Accion to form Real Microcredito, a joint venture with Accion where ABN Amro had 80% shares and Accion had 20%. With Real Microcredito potential micro entrepreneurs are reached directly, by working with local agents. The difficulty however was to find suitable agents, therefore several trainings were given to (potential) agents. Its Brazilian business almost reached break-even by 2006, which was in line with their strategy to be a sustainable bank (Mulder, 2006). The loan portfolio expanded to EUR 5.8 Million in 2006. Half of their customers in Brazil were under age 30, while 62% of all customers were women. Personal and group loans account respectively for about 80% and 20% of the loans. The repetitive customer rate remains at 60%, which is lower compared to other microcredit activities. By the end of 2006, 78 microcredit agents were working out of 14 service facilities.

With the start of ABN Amro India at the end of 2003, ABN Amro was the pioneer amongst foreign banks in bringing microfinance to India. The bank partners with local MFIs due to the absence of their own rural network. Clients are families rather than micro-entrepreneurs, and the loan was used to supplement the family income. By 2005, 200.000 clients were reached, and an outreach of 1 million clients by 2009 was planned. With repayment rates of over 99%, the worth to the clients is stressed. ABN Amro's Indian microfinance business achieved break-even within one year of start-up and by 2006 a modest operating profit was achieved. The microfinance portfolio had grown to EUR 26.2 million through partnerships with 26 intermediaries across six states. By 2007 ABN Amro India increased their penetration dramatically and provided financial aid to more than 540,000 households in seventeen states while still maintaining a 'nil' non-performing asset portfolio. Finding appropriate MFIs to expand their network was difficult; therefore capacity building of the current selected MFIs was pursued. The ABN Amro Foundation India (AAFI) was set up in 2006, to work closely with microfinance institutions in some of the poorest regions in India, at building their capacities for effective delivery of microfinance services. The most unique feature of AAFI is its comprehensive approach in addressing the issue of financial inclusion. It not only provides on-lending funds through the Bank to those MFIs that have strong systems in place but also helps deepen and widen the financial system. This was achieved by creating strong MFIs in underserved regions through extensive trainings, process building and hand holding. With these activities AAFI was enabled to cover 50 MFIs for the two years after 2006.

ABN Amro had successfully adopted a wholesale linkage model which implies extending a bulk loan to the MFIs for on lending to poor women. The Microfinance division initiated the commissioning of Systems and Loan Portfolio Evaluation thereby enabling active involvement in providing mentoring services to clients, including in the areas of governance and credit discipline. ABN Amro banks' microfinance program provides access to financial services to the poor in a financially sustainable and commercially viable manner, thus achieving the concept of triple P. The typical loan size is INR 6000 - 10000 (USD 120 – 200). Elaborating further on the future growth path, M. Sensarma, Head Microfinance and Sustainable Development, ABN Amro India, added, "We are constantly evolving and looking at new channel configurations and product innovation to drive scale rapidly. Going forward we are planning various initiatives to achieve our ambition of being a catalyst in making the poor self reliant while balancing our goal of revenue generation. We would like to thank our partner MFIs and acknowledge their contribution in making this possible. Our business success is a clear vindication of not only our rising competitiveness but also of our focus and conviction in providing socially responsible solutions".

In the mid-west USA, the LaSalle Bank, as part of the mandatory community investments, cooperates with independent intermediaries such as Accion. These independent intermediaries have the local

knowledge to support the microenterprises. Loans are at a western microloan-standard and are usually between USD 1,000 and USD 10,000.
ABN Amro sold its shares in BancoRegional de Paraguay to Rabo Development in 2008. ABN Amro still provides funding for FMO (ABN Amro is also the leading private sector shareholder of FMO with 22%) and ShoreCap (2.5 million) to invest in microfinance activities in third world countries.

4.5.2 ING Bank

ING Bank is part of the ING Group, a worldwide operating financial institution. ING was created in 1991 from a merger with the Nationale Nederlanden and the Postbank Group. Postbank was until end 2008 a separate brand, but is now incorporated within ING Bank.

4.5.2.1 Bank key data

ING has the following products for their private clients: Payment- and savings accounts, Mortgages, Insurances, Investment funds and Pensions. The ING Bank has 125.000 employees, and is active in the Netherlands and other countries, over 50. Balance sheet total is EUR 1.313 billion. The Bank has 8 million clients in the Netherlands and 75 million worldwide.
Most important resource allocations (end 2007):

Investments	(30%)
Loans to domestic and foreign companies	(30%)
Mortgages	(20%)
Loans to other banks	(5%)

4.5.2.2 Microfinance and microcredit activities

ING bank has a separate sustainable fund. The ING bank strives to offer their clients investments in green and social responsible products, which are profitable as well. In 2008 the sustainable fund totalled EUR 2.295 million.
With the creation of the ING Microfinance Support Program in 2004, ING actively supports the development of the microfinance industry by offering financial services to people in need and by sharing their knowledge and expertise through their employees, who are volunteering to support in many projects. These projects are coordinated with Oikocredit, Opportunity International, Women's World Banking and Microfinance Centre (ING, 2008).
ING is involved in microfinance with wholesale activities and on a retail level. In India, through the ING Vysya Bank (which is 44% owned by ING since 2002) on a retail level by reaching out both directly and indirectly to microfinance entrepreneurs in South-India. As part of the Agri and Rural Banking Unit, Self Help Groups (SHGs) consisting mainly of female entrepreneurs, are directly financed.

Per end 2008, ING Vysya served over 5.000 SHGs with loans of less than EUR 1,000, and the outstanding loan portfolio amounted to EUR 10.3 million. Microdeposits are also collected through this channel. ING Vysya in cooperation with ING Green Finance, also indirectly finances several millions of microentrepreneurs by providing wholesale loans to microfinance institutions. As of September 2008, the total value of wholesale loans outstanding amounted to EUR 42.8 million to 17 MFIs. Through these MFIs 567.000 clients have been reached in India end 2007.
Through ING Vysya Life and also by cooperating with Krushi, an Indian NGO, microinsurance products are provided to members of rural communities, including farmers, self-employed people and day labourers.

ING Bank in the Netherlands has offered its customers the opportunity to invest in a, fiscal attractive, microfinance fund that is managed by the Oikocredit Netherlands Fund (ONF), a Dutch-based non-profit organisation that was founded to stimulate the development in third world counties. Oikocredit increasingly focused on the human return on investments, besides the financial return, and therefore have included microfinance investments in their theme of sustainability (ING, 2008). Oikocredit is known for being an important ethical investment fund and leading provider of credit for development (Oikocredit, 2008). In 2005 Oikocredit had a portfolio of EUR 163 million to finance 219 microfinance institutions, spread over 48 countries. Oikocredit is the largest private financer for this sector (ING year report, 2008). During my visit at a conference on the impact of the financial crisis on the future of microfinance and the role of donors and investors in June 2009, a representative of Oikocredit mentioned that it faces a lower demand for loans, about 50% less. Of their portfolio of roughly 100 million, only 50 million was used. “This was not necessarily considered to be a bad thing, because growth is the worst enemy of MFIs”. Moreover, due to the double bottom line and relatively low risk (through a good selection process and additional trainings) “the interest in microfinance will stay”. Next to these activities, the ING Bank provides funding for and technical assistance to Oikocredit. Oikocredit, as many financial institutions active in the field of microfinance, had a positive contribution to the results of the sustainable portfolio, also during the financial crisis.

4.5.3 Rabobank

The Rabobank Group is a cooperative bank and consists of 174 independent Rabobank offices. Also a central organization exists, The Rabobank Netherlands that also has (international) subdivisions.
Rabobank is internationally specialized in mainly financing agricultural and nutrition divisions. In the Netherlands the Rabobank is active in all divisions of financial services.

4.5.3.1 Bank key data

Rabobank has the following products for their private clients: Payment- and savings accounts, Mortgages, Insurances, Investment funds, Leasing and Capital management. The Rabobank has 60.000 employees and is active in the Netherlands and 43 other countries. Their balance sheet totalled EUR 571 billion. The Rabobank has 9 million clients worldwide. Most important resource allocations (end 2007):

Real-estate Investments	(3%)
Loans to domestic and foreign companies	(20%)
Mortgages	(40%)
Loans to other banks	(10%)
Investments	(15%)

4.5.3.2 Microfinance and microcredit activities

The Rabobank is involved in microfinance through the Rabobank Foundation mainly by funding and through Rabo Development in buying shares of international (agricultural) banks.
The ambition of Rabo Development is “To replicate the success of Rabobank in the Netherlands, meaning that through providing financial services a substantial contribution will be made to the economic development of, in particular, the rural areas in selected developing countries” (Bemmel, Rabobank, 2009). Their motivation is to increase the outreach for the partnering banks and an increase of the global position of the Rabobank in the food and agricultural market (Rabobank, 2008).
Combining the knowledge of experienced Rabobank employees to help grow the bank, and helping people to achieve their ambitions through small loans, has proven to be a success and aligns with the Rabobank’s own vision to cooperate.

New (agricultural) sectors need regulations, and therefore the dialog with ministries, local governments are considered to be an important key to success. During my visit at a conference on the impact of the financial crisis on the future of microfinance and the role of donors and investors in June 2009, Rabobank mentioned that it faces more applications for loans, due to the fact that social investors retrieve from the market.

Microfinance key figures

Rabo development has shares of six cooperative banks (2008):

Zambia National Commercial Bank, Zambia	49% share
Banco Regional Paraguay, Paraguay	40% share
National Microfinance Bank (NMB), Tanzania	40% share
Banque Populaire du Rwanda, Rwanda	35% share
Banco Terra, Mozambique	30% share
United Rural Cooperative Bank of Hangzhou, China	10% share

By 2008 Rabobank had a total microcredit loan portfolio of over 30 Million EUR and reached over 72.000 clients through the NMB, Rabo India and Banco Regional Paraguay. The microfinance business operates both sustainable and profitable. Through Banque Populaire, Zambia National Commercial Bank, United Rural Cooperative Bank of Hangzhou and Banco Terra another 3 million clients are reached. Furthermore the Rabobank co-operates with banks in Vietnam, Cambodia, Peru, Malaysia, Pakistan and eastern European countries.

The Rabobank Foundation provides funding for MicroNed and Cordaid to invest in microfinance activities, mainly to women, in third world countries. The Rabobank Foundation also donates to other microfinance funds.

4.5.4 SNS Bank

SNS Bank is part of the SNS Reaal Group, a service provider in the field of banking and insurances, and is mainly active on the Dutch market, serving small- and medium sized companies. Next to that the SNS Reaal Group modestly develops real-estate financing activities outside of the Netherlands.

4.5.4.1 Bank key data

SNS Reaal has the following products for their private clients: Payment- and savings accounts, Mortgages, Insurances and Investment funds. The SNS Bank has 7.000 employees, and is active in the Netherlands and at least six other countries. Their balance sheet totalled EUR 103 billion. The SNS Bank has1.8 million savings accounts.

Most important resource allocations (end 2007):

Real-estate Investments	(10%)
Mortgages	(50%)
Loans to other banks:	(10%)
Investments	(30%)

4.5.4.2 Microfinance and microcredit activities

SNS Reaal is mainly involved in microcredit through SNS Asset Management with large funds that are financed by institutions and aims to provide funding for microfinance institutions. SNS Asset Management (SAM) is a subsidiary of SNS REAAL. The first SNS Institutional Microfinance Fund was launched in 2007, collected over EUR 125 million and had a return of eight percent in the first year. The fund solely serves a social goal through MFIs by long term investments in small enterprises in Asia, South America and Eastern Europe, which are the bottom of the society. The loan sizes vary between USD 100 and USD 1.500, for a half or a full year. 90% of its clients are women, and the number of clients served is 4 million. The SNS Institutional Microfinance Fund (SIMF) I/II are managed by SAM as Fund Manager with Developing World Markets LLC and Triple Jump B.V. as Investment Managers. DMW is considered to be the most experienced institution to select appropriate MFIs.

Triple Jump was founded by the ASN Bank, Oxfam Novib, NOTS Foundation and Stichting Doen, and also manages the ASN/Novib fund. This fund is launched by the ASN Bank (Triple Jump, 2008). The attractiveness for investors to invest is that is has little correlation with other investments. This is due to the fact that microfinancing occurs in the informal sector and/or developing countries, which are barely related to the global capital market. This was the main argument for SNS Reaal to launch a second fund in 2008: SIMF II. The fund collected another EUR 113 million by end 2008. Another argument was that during the financial crisis, commercial banks withdrawn and therefore MFIs find it harder to obtain funds. As a result, the competition was decreasing and providers of capital such as SIMF could ask higher interest rates for loans to MFIs, which is also possible due to growing demand for loans by MFIs and still acceptable credit losses (Sense, 2009 and Lubeck, SNS, 2009).

By ways of the SNS REAAL Waterfonds investments are sourced into Micro Finance Institutions specifically active in water and sanitation projects

The ASN Bank is part of the SNS Reaal group, and aims to promote a sustainable society and is guided by that aim in its economic activities. The ASN-Novib Fund invests in financial institutions that provide credit to small-scale loans entrepreneurs (Mixmarket, 2009). The majority of clients that borrow from institutions financed by ASN Novib Fonds are women. ASN Novib Fonds does not believe that credit facilities are always the best development tool, but for poor people it certainly is most useful. The ASN/Novib portfolio allocated to microfinance investments totalled 35 million by 2007 for 45 MFIs and provides loans at a market rate. The fund offers a return of 4.56% for its investors and investors also enjoy a 2.5% subsidy by the Dutch government, which makes it more attractive to invest in social funds. To reach synergy, ASN Novib Fonds works closely together with Oikocredit and Novib. The overall microfinance business operates profitable. SNS Reaal furthermore provides funding for non-commercial funds such as Oikocredit and Cordaid.

4.5.5 Triodos Bank

In the Netherlands, the Triodos Bank finances companies, institutions and projects that have an added value on social, environmental and cultural areas. They are enabled to do so by their clients who choose for a social responsible and sustainable community (Triodos 2007). The Triodos Bank was founded in 1971 as a foundation to commission donations and loans for innovative companies. In 1980 the Triodos Bank NV was founded with a starting capital of EUR 540.000. From the 90s on, several environmental and social responsible funds have been created.

4.5.5.1 Bank key data

Triodos Bank has the following products for their private clients: payment- and savings accounts, mortgages and investment funds. The Triodos Bank has 400 employees, and is active in the Netherlands and three other countries. In February 2009 the Triodos Bank published its 2008 key results, and reported a profit increase of 13%, to EUR 10.1 million. Its total value increased by 24% to EUR 2.4 billion and its client base increased with 25% to a total 190.000 clients, of which 110.000 in the Netherlands and 50% are Dutch. Most important resource allocations (end 2007):

Loans to other banks	(+/- 25%)
Loans to domestic and foreign companies	(+/- 55%)
Loans to national governments (state-bonds)	(+/- 15%)

The Triodos Bank is the front runner of financing microfinance in the Netherlands, and has several funds through which it finances MFIs: Triodos Fair Share Fund, Stichting Triodos-Doen and Stichting Hivos Triodos Fonds. The three funds are shareholder in 23 of the most prominent microfinance banks and investors. Through these three funds a total of 91 MFIs, spread over 38 countries are reached. The funds grew 29% in 2009 to a total of EUR 161 million. Triodos involves its employees by having them taking positions in the board of directors or advisory board on individual MFIs. A key contributor is the Triodos 'Fair Share Fund' that specifically invests in microfinance institutions. The Fair Share Fund is open to institutions and private clients. This fund reported at the end of 2008 an increase in equity of 62%, a return of 7.5%, excluding the 2.5% tax relief, and has reached 1.4 million people by providing small loans through these institutions. Due to the increasing demand for microfinance, a fourth fund has been launched in 2009: Triodos Microfinance Fund which collected 22 million with the first close and expects to collect over 100 million with new participating inventors by the end of 2009. The fund aims to increase the financial access to the working poor in developing countries.

In 2008 the Triodos Fair Share Fund became shareholder in the Kashf Microfinance Bank in Pakistan. This bank aims to serve women who can realize with microfinance an economic and social independence. Triodos Bank invests in institutions that are not listed on the stock exchange markets and could therefore keep developing stably. Furthermore the Triodos Bank also aims to improve the knowledge and expertise among MFIs globally. Triodos bank also organizes workshops with MFIs managers from all over the world.

4.5.6 Overview of the microfinance activities of Dutch banks

Bank name	Involvement Structure	Contribution level	Number of people reached	Financial involvement/ Outstanding loan portfolio (USD)
ABN Amro	Retail activities through: - RealMicrocredito, Brazil - ABN Amro India - LaSalle, USA	Dual strategy business unit Dual strategy business unit Dual strategy	55.000 500.000 not known	60 million
ING Group	Retail activities through: - ING Microfinance support - Green Finance Microfinance - ING Vysya Bank	Dual strategy Dual strategy business unit Normal business w/ social impact	5,692 SHGs 500.000 clients (170,000 insured clients)	55 million
Rabobank	- Equity stakes and through Rabo Financial Institutions Development - Funding through Rabobank Foundation	Dual strategy business unit Dual strategy	Over 70K direct clients 3 million through equity shares	30 million
SNS Reaal	- Wholesale funding through SNS Institutional Microfinance Funds - Retail activities through subsidiary ASN Bank	Dual strategy business unit Normal business with social impact	4 million through SNS funds 50K through ASNBank	300 million 100 million
Triodos Bank	Wholesale funding through Triodos funds	Normal commercial business	1.4 million through Triodos Fair Share fund	160 million

Bank name	# of MFIs reached	# of countries reached	Future Strategy
ABN Amro	not known	4	not known
ING Group	21	2 (India and Russia)	- Increase in number of assistance projects - Increase retail and wholesale activities - Expand geographically (to Africa) - Increase microinsurance activities
Rabobank	8	35 globally	- Increase in number of assistance projects - Target of maximum 2 new equity stakes in MFIs a year - Expand microfinance activities globally
SNS Reaal	Over 60 through SNS fund 45 through ASN Bank	Over 9 countries in Asia, South-America, Eastern Europe	- Expand microcredit to other geographical regions - Expand microfinance activities such as dedicated 'SME MFIs'
Triodos Bank	Over 90	38	- Increase fund capital - Increase fund outreach

Table 9: Overview of the Dutch bank microfinance activities

5 Research outcome

5.1 Research outcome foreign banks

Unfortunately none of the foreign banks responded to my request to fill-out the questionnaire. The data is collected through desk research and therefore conclusions drawn from the data are (partly) based on assumptions.

Matrix foreign banks

Microfinancial indicators	HSBC
Length:	sustainable
Depth:	poor clients
Scope:	microinsurance microcredit product support remittances / savings
Breadth:	200.000 clients
Worth:	increasing number of clients through customized products for multiple cultures
Cost:	rates at MFI level
Intracompany financial performance	not more profitable than similar credit activities

Microfinancial indicators	CitiGroup
Length:	sustainable
Depth:	poor clients
Scope:	microcredit / microinsurance technical assistance savings / IPO's remittances
Breadth:	65 MFIs
Worth:	increasing number of clients through wide range of customized products
Cost:	rates at MFI level
Intracompany financial performance	not more profitable than similar credit activities

Microfinancial indicators	AIG
Length:	sustainable
Depth:	poor, low-income clients
Scope:	microinsurance microcredit technical assistance
Breadth:	3 MFIs, 1 Million microinsurances
Worth:	increasing number of clients through customized insurances
Cost:	traditional market rates
Intracompany financial performance	not more profitable than similar credit activities

Microfinancial indicators	BNP Paribas
Length:	sustainable
Depth:	poor women
Scope:	microcredit remittances microinsurance technical assistance
Breadth:	400.000 clients
Worth:	increasing number of clients through customized products to support entrepreneurship
Cost:	traditional market rates
Intracompany financial performance	not more profitable than similar credit activities

Microfinancial indicators	Deutsche Bank
Length:	sustainable and profitable
Depth:	microentrepreneurs poor clients
Scope:	microcredit debt Securities microfinance funds
Breadth:	75 MFIs
Worth:	increasing number of client MFIs and loans through a high involvement to help grow small businesses and MFIs
Cost:	below market rate
Intracompany financial performance	not more profitable than similar credit activities

Table 10: Research outcome foreign banks

5.1.1 Foreign banks involvement

Foreign banks are involved in microfinance in different ways, mainly with microcredit and microinsurance activities and by acting as donors. The foreign banks selected for this research are all engaged with microfinance and microcredit activities for many years, also several years prior to the year of microcredit in 2005. Their involvement mainly started with a donor role and by working with (inter)national development agencies. The double bottom line was merely considered to be on the side of client development rather than on the bank side. The large international presence of the foreign banks is also represented by the number of countries that their microfinance activities are present. Their large market values are reflected in their financial involvement as well. After 2005 the foreign banks got more directly involved with MFIs and clients. The foreign banks mainly work with separate units through their existing network of local banks. Funds in general are considered to be part of the normal business of the DB, however due to their social focus these funds, the DB involvement can also be addressed as a dual strategy business unit.

5.1.2 Foreign banks microfinance strategy

As part of geographical expansion the foreign banks started microfinance activities in other countries, also with a future perspective of expanding their operations and to build capacity with local clients. In some countries, microfinance can provide an opportunity to enter a new market, since mainstream commercial business in some countries would less likely to be allowed to enter with, such as the examples in China. Microcredit, microfinance and providing management assistance are the main products that the foreign banks offer. With their financial involvement the foreign banks show that they consider this market to be an important one, in particular with the investment funds, however as part of their market value, their financial involvement is still rather low.

5.1.3 Impact of the financial crisis on the microfinance activities of the foreign banks

The financial crisis impacted the analyzed banks seriously, but based on their recent activities, seems not to have had a dampening effect on the funding of microfinance, expansion of their global network or direct involvement with MFIs. Reason for this could be that their financial involvement is small compared to their mainstream activities, or that they have acknowledged that microfinance remains interesting due its low correlation with mainstream financial markets and global growth opportunities. Next to that, the increased demand for microfinance by MFIs created opportunities for banks to act at a more commercial level, for example to charge higher interest rates.

5.1.4 Microfinancial performance of the foreign banks

The integration of their microfinance activities into their mainstream business seems not to have evolved, for example due to the existence of business units. However in case of new branches at new markets, the microfinance business is the only business the banks operate in, and therefore can be considered to be part of their normal business. At the country level there appears to be a more competitive environment, for example when new markets and regions are entered. This competition however is not taking place by means of microfinance products or services, but by means of length-, scope- and breadth of outreach since foreign banks have a large breadth and scope. Besides the common microfinance objectives, the worth to clients and the cost to clients appear to receive less focus by the foreign banks. Only the Deutsche bank offers loans below the traditional market rate, and most banks offer loans at the much higher MFI rate. Due to its mechanism, the Deutsche bank investment funds are probably the most profitable. Most foreign banks strive for sustainable microfinance, however none of the foreign banks are assumed to earn higher profits from microfinance than from mainstream finance.

5.2 Research outcome Dutch banks

Three Dutch banks responded to my research request by filling out the questionnaire. See appendix B for the filled-in questionnaires. The Triodos Bank information was obtained through a telephone interview. The ABN Amro bank did not respond. See appendix C for the list of respondents.

Microfinancial indicators	ABN Amro
Length:	Sustainable
Depth:	(young) women
Scope:	microcredit microinsurance savings technical assistance projects
Breadth:	500.000 clients in India 55.000 clients in Brazil
Worth:	repetitive loans of 60% and 99% and increasing loan sizes
Cost:	At market rate consistent with non-subsidized MFIs
Intracompany financial performance	Microcredit is not more profitable than mainstream banking

Microfinancial indicators	ING Group
Length:	Sustainable
Depth:	women and rural microentrepreneurs
Scope:	microcredit microinsurance technical assistance projects
Breadth:	500.000 clients and 5.692 SHG's, trough MFIs w/ large outreach
Worth:	repetitive customized loans through SHG's, MFIs and microentrepreneurs
Cost:	market rate loans or lower, specific to client
Intracompany financial performance	Microcredit is not more profitable than mainstream banking

Microfinancial indicators	Rabobank Group
Length:	Sustainable and profitable
Depth:	Rural area farmers are preferred
Scope:	microcredit focus on a wide range of retail products (including mobile banking)
Breadth:	Over 100 million Number of clients is growing
Worth:	Loan portfolios are growing
Cost:	Try to minimize costs to provide access to finance to as many people as possible
Intracompany financial performance	not more profitable than other similar mainstream credit activities

Microfinancial indicators	SNS Bank
Length:	Profits should be acceptable. RoE targets for MFIs at around 15 % are acceptable and sustainable
Depth:	Women and (rural) microentrepreneurs More depth is better, but conditional on the MFI being able to operate profitable and sustainable
Scope:	Only microcredit. Tend to stay away from higher consumer lending loans Focus and excellence in operations are more important than the variety of products.
Breadth:	4 million The number of people served is not a goal
Worth:	To value a sustainable contact with the end client. Having the right product is key.
Cost:	To value a sustainable contact with the end client. Price is an important determinant.
Intracompany financial performance	Microcredit is as profitable as mainstream banking

Microfinancial indicators	Triodos Bank
Length:	Sustainable and profitable
Depth:	women and rural microentrepreneurs
Scope:	microcredit technical and management assistance
Breadth:	1.4 million
Worth:	Growing loan portfolios out of increasing funds
Cost:	market rate loans through MFIs
Intracompany financial performance	Microcredit is mainstream profitable business

Table 11: Research outcome Dutch banks

5.2.1 Dutch banks involvement

The Dutch banks analyzed all are engaged with microfinance and microcredit activities. The banks increased their involvement after 2005, when microcredit got more international attention when it was declared to be the year of microcredit by the UN and was recognized by the UN as the tool to fight poverty. Their involvement started off from a CSR-perspective, however due to the double bottom line nature of microcredit, the increasingly interesting financial aspect also attracted banks to involve more in microfinance. The Dutch banks' international presence is also represented in the number of countries that they are active at with microfinance. On the other hand, their outstanding loan portfolio shows that they have a large financial involvement per country and is larger than their international position in terms of what their market value would suggest. The Dutch banks operate a sustainable microcredit business, and the specific microfinance funds of the SNS Reaal and the Triodos Bank operate profitable. The reason for the growing number of funds is because of the increased demand for MFIs and because of the risk diversification, since microfinance is considered to have little correlation with the mainstream financial markets.

5.2.2 Dutch banks microfinance strategy

The Dutch banks use their existing network of branches to roll-out microfinance activities and reach the poorer people. In case of new markets, the Dutch banks work through partnerships with local banks or MFIs to reach out to the poorest and to expand their geographical presence. Microcredit and providing technical assistance are the main services that the Dutch banks offer. With their financial involvement in microcredit the banks show that their involvement is substantial and to be long-term oriented. In case of the microfinance investment funds the numbers are even larger, which shows that these funds serve a high number of MFIs that reach out to a lot of clients. The Dutch banks have also indicated to see the benefits of microcredit and to expand their microfinance activities in the future for reasons such as: increase the share of the microcredit portfolio as part of the total loan portfolio, expand microcredit to other geographical regions, expand microfinance activities, and increase the profitability of extending microcredit and other microfinance activities. The integration of their microfinance activities is on its way to become part of normal mainstream business. There are no indications found of competition between other (Dutch) banks or of competition with their own similar financial products.

5.2.3 Impact of the financial crisis on the microfinance activities of the Dutch banks

The financial crisis has impacted their microfinance involvement differently. This is probably also due to the involvement of the Dutch government as a result of the financial crisis. The demand for microcredit has increased due to the financial crisis, and as a result the supply of funding by some banks has increased as well. Microcredit activities for the banks that required government support have stabilized or have decreased, also due to the sale or closure of local branches and/or banks.

5.2.4 Microfinancial performance of Dutch banks

The microfinance indicators worth to clients, cost to clients and depth of outreach receive a higher valuation by the banks than length-, scope- and breadth of outreach. This is shown by their provision of loans at rates that are specified to the clients, with the objective to achieve high a percentage of repetitive loans and to have increasing loan portfolios. Moreover most of the Dutch banks report that they aim to serve female and rural clients. Marketing poor rural and female clients with an attractive product is therefore considered to get more attention rather than to focus on the growth of the client base, building capacity or on sustainability. However this focus is expected to shift towards the other indicators such as length-, scope- and breadth of outreach on the longer term when microfinance becomes more integrated into the normal, mainstream business.

5.3 Conclusion

The microfinance activities can be divided in two groups of activities; retail- and wholesale activities. Retail activities include direct microcredit, insurance and remittances. Wholesale activities include loans to MFIs, funds and equity stakes. For most banks the retail activities form the smallest portion of their microfinancial involvement, however the number of services is larger. The foreign banks offer a wider range of services than the Dutch banks. Examples of banks that are mainly involved in retail activities are ABN Amro, ING Bank and HSBC. Loans to MFIs and funds are a substantial larger portion of the banks financial involvements. Deutsche Bank, CitiBank, SNS Bank, Triodos Bank and Rabobank are examples.

Both the Dutch and foreign banks involved in microcredit as part of corporate social responsibility and have advanced overall to the contribution level of dual strategy business units. The microcredit funds are considered to be at the normal business with social impact level. The Dutch banks have a larger financial involvement, but the foreign banks reach out to more MFIs and are active in more countries than the Dutch banks. This implies that the Dutch banks have a smaller but more intensive focus, which is understandable when the financial involvement is large.

Figure 9 shows an overview of the analyzed banks mapped for their microfinancial performance and financial involvement. The SNS bank for example has a high financial involvement and high microfinancial performance and the AIG Group has a low involvement and low microfinancial performance. (The mapping of the microfinancial performance is done according the fulfillment of the indicators).

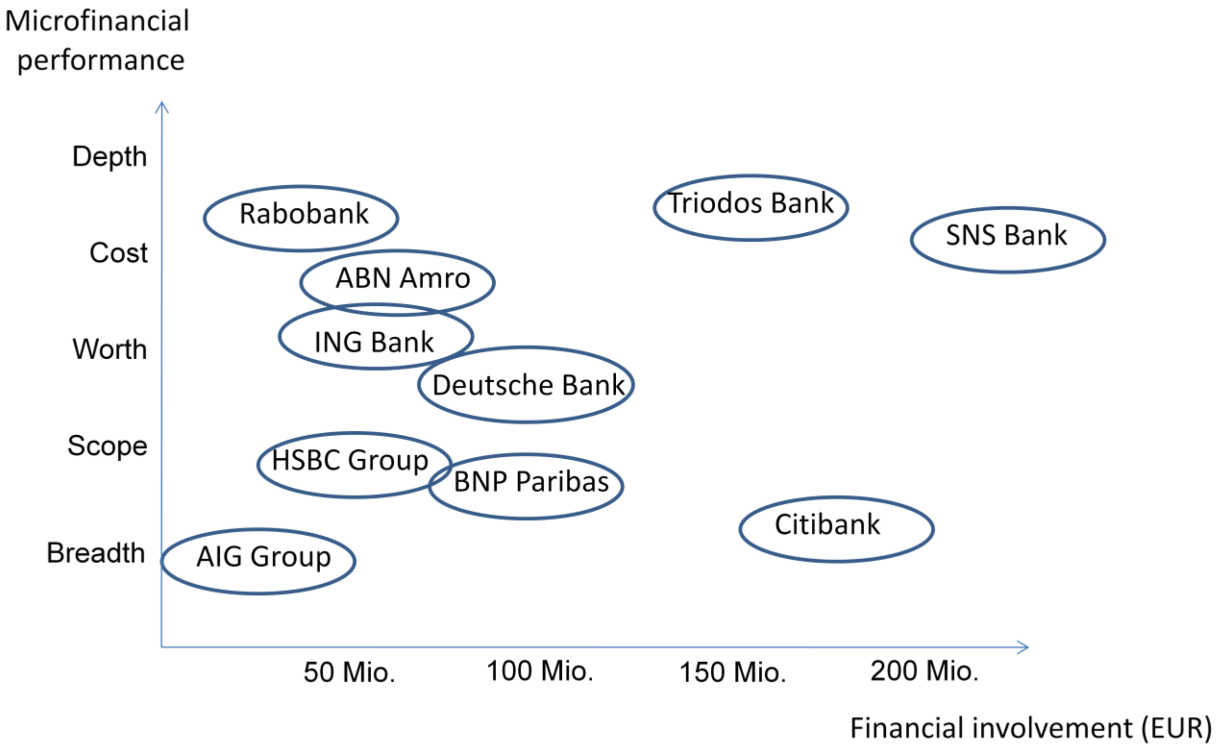

Figure 9: Microfinancial performance and involvement of all banks

6. Conclusion

This chapter summarizes the research outcomes along with the testing of the hypotheses described in chapter 4 and the problem definition formulated in chapter one. The chapter concludes with a discussion on the future of microfinance and with some concluding remarks.

6.1 Hypothesis 1: "Dutch microcredit is competitive with foreign microcredit by means of outreach"

Based on the research outcome in the previous chapter and the information collected in chapter four, it can be concluded that Dutch microcredit is not competitive with foreign microcredit by means of the outreach indicators such as breadth of outreach and scope of outreach, the number of clients and countries reached and the services offered. The reason for this is the strategy of the Dutch banks, which focuses on serving the clients in their best way, rather than on the growth opportunities and entering new markets. In terms of length of outreach, I believe that the Dutch banks' strategy to focus on the clients on the long term will be *the* way towards sustainable microfinance and microcredit operations. Clients (MFIs) who face an increasing demand will choose for products and services that have the highest worth to the clients and the lowest costs. Since foreign microcredit does not focus primarily on the worth to clients, it is likely that they would not be the first choice of clients when the microfinance supply increases. This however is largely influenced by the focus or path that the MFIs choose, and how that will be influenced by the funding banks, also in the light of the financial crisis. The MIX platform[30] therefore provides funders with information on the quality of a MFI and its level of transparency, in order for funders to analyze, select and rate MFIs. The rating agencies also play a vital role from that perspective, since their rating influences the decisions of the funding banks as well.

Furthermore no Dutch bank has reported that their microcredit activities are aimed and analyzed for their competitiveness, which confirms that Dutch banks do not actively compete with foreign microcredit. Another explanation for this passive approach is that the number of other market players in developing countries is rather low compared to the western countries, especially in rural areas such as eastern China and the north of India. Therefore the hypothesis is refuted.

[30] The MIX market analyses MFIs for their quality of providing data, their level of transparency

6.2 Hypothesis 2: *"Dutch microcredit outperforms similar products Dutch banks offer"*

Since microcredit has little correlation with the mainstream financial markets, microcredit has higher repayment rates compared to the mainstream financial markets. Also due to the lower number of non-performing loans, especially during the financial crisis, one might expect that microcredit would outperform the similar mainstream products. However none of the Dutch banks' confirmed that microcredit actually outperforms their similar products. This can be explained as the costs that come along when providing credit to the rural and the poor, are substantially higher than in the mainstream market. As a result, The length of outreach of Dutch microcredit is sustainable, in some cases Dutch microcredit even operates on a profitable basis. These profits are achieved when microcredit is provided at a large scale, however it does not have higher returns than their similar, mainstream products. Therefore the hypothesis is refuted.

Investments in information technology, selecting a low-cost method of extending microcredit and an increase in the number of clients served will lower the costs per client served, and to increase the banks profits. Whether microcredit will become more profitable than similar mainstream credit products in the future, depends mainly on these choices combined with the focus on the worth to clients to survive future potential competition, as mentioned and the previous paragraph.

6.3 Summary of the problem definition

The problem definition defined at the beginning of this thesis is:

"What is the international and intracompany performance of Dutch microcredit?"

In order to answer the problem definition the thesis provided an extensive overview of the Dutch microcredit, with microfinance literature and theory to perform an analysis of the Dutch microcredit performance based on desk research and field research. The international performance has been described in detail throughout the thesis. The problem definition is built up by the hypotheses which have been tested in the previous paragraphs. Both the hypotheses were refuted; the international performance of Dutch microcredit is determined as not competitive by means outreach and Dutch microcredit does not outperform the similar mainstream products the Dutch banks offer.

The international performance of Dutch microcredit is mainly built upon the indicators that focus on the clients rather than upon outreach. The objective is to serve specific international client groups with a customized product, which can be a strategy to increase scope- or breadth of outreach.

If the Dutch banks' microfinance involvement would not have been impacted by the financial crisis, their overall international performance would have increased. However, based on the information provided in the previous chapters, Dutch microcredit can be determined as having a substantial position in the global microfinance market, that is representative to their position in the mainstream financial markets.

Next to the large microfinance bank funds provided by the ASN-Bank, SNS Reaal and Triodos Bank, this is mainly due to the presence of the non-profit development organizations that provide funding such as Cordaid, FMO and Oikocredit. These organizations are well respected by the leading microfinance agencies, that have the objective to monitor and support the (long term) growth of microfinance worldwide. Therefore despite The Netherlands are one of the smallest countries in the world, they can be very proud of their large overall involvement in the microfinance market.

The intracompany performance of Dutch microcredit is determined as sustainable. Dutch microcredit generates profits in some cases however these profits are reported to be lower than the profits stemming from similar mainstream products. The reason why microcredit funds generate similar profits as the mainstream funds could be explained by the financial crisis, that has affected the profits of the mainstream funds.

Based on the above findings, it can be concluded that the double bottom line benefits of microfinance have been achieved by the Dutch banks. The underserved clients benefit from customized products that enable further growth potentials of the clients. For the Dutch banks, microcredit has proven to be profitable product.

6. 4 Closing discussion and remarks

The growth in competition can be seen as an increasing risk for the microfinance clients and would be driven by the appeal of microfinance to outside investors and commercial banks. Competitive pressures could move MFIs away from adhering to their standards, and could impact profitability and staffing. However increasing competition could also spur innovation and force lower prices. According to a report of MicroNed/Triodos Facet (2009) MFIs should manage these pressures, since otherwise some could fail and damage the reputation of microfinance overall. The report also refers to the financial crisis, where competition caused institutions to develop more products that had more risk, and not to develop better products. Further concerns were raised about an uncontrolled situation of the growth of salaries and bonuses and loan officers selling irresponsible loans in order to achieve their sales targets.

Karlan and Zinman (2009) in their study conclude that microfinance currently often looks more like traditional retail or small business lending: for-profit lenders, extending individual liability credit, in increasingly urban and competitive settings. They also challenge the theoretical assumption that expanding microcredit is a relatively efficient way to fight poverty and promote growth, also since formal sector access could crowd-out relatively efficient informal credit and insurance mechanisms. The often high cost of microcredit means that high returns to capital are required for microcredit to produce improvements in tangible outcomes like household or business income.

According to Hulme, et al., (2009) a current failure of not attracting the poorest by MFIs may be due to their limited understanding of the limitations of their current products and the possible innovations which could be made to make products relevant to the need of the poorest.

Innovations of ICT products such as mobile phones, lap-tops and palm pilots, the rise of connectivity through mobile phones and the internet mean that in the next decade there is an enormous potential for MFIs to develop new services: services that in the past would have been economically infeasible because of high transaction costs. These technological changes have made it easier to address two main obstacles in providing financial support to poor people – maintaining information and service delivery costs (Hulme and Arun, 2009).

From the social development point of view, a concern was raised by Augsburg (2009) that microfinance serves as a replacement for other social programs. This would be a threat in the sense that "microfinance is nowhere close to being as important as primary health care, primary education, decent nutrition and a decent infrastructure, decent government and security." However significant positive program impact is found on household income, assets and consumption categories of customers. This finding supports an earlier statement that microfinance should be seen as a "necessary but not sufficient condition for development"; that microcredit to the poor might not necessarily lift them above the poverty line, but that microcredit plays a crucial role in vital issues such as consumption smoothing, in reducing risk and uncertainty and in the ability to cope with shocks (Augsburg, 2009).

Therefore commercial banks that become more involved in the microfinance market and that further integrate microfinance into their mainstream business, need to have a constant focus on the customers; the clients in the need for microcredit. Microfinance performance measures used in this study are transparent and useful indicators to monitor this focus. The strengths of the indicators are that they can be measured in several ways, depending on the information available. Information platforms such as MIX market, but also microfinance rating agencies have an important role to gather and share information on the loan characteristics, client base data and financial performance. Further research using these indicators to measure institutional microfinance performance and compare institutional microfinance performance could be conducted on the non-profit organizations, with their large financial involvement in the microfinance market or at the MFI level within a country or geographic region. Thousands of MFIs exist and still huge potential exists for the commercial banks to expand their outreach, in terms of global position and number of clients. An opportunity to reach large numbers of MFIs is indirect: through MIVs and securitizations. The composition of these products however should be and should remain very transparent, unlike the mainstream market (before the financial crisis).

As a concluding remark I would like to state that microfinance should not be the only activities that financial institutions should invest in. Of course depending on the situation, funding other social programs remains necessary to support the development of the poor in the possible best way.

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Appendices

Appendix A: Questionnaire

<u>Survey on the involvement of Dutch banks in Microfinance</u>

Dear banker,

As part of an academic research on “Dutch Microcredit”, we kindly ask you to fill out this brief questionnaire.

The research investigates the microfinancial performance of the largest Dutch banks that are involved in microfinance. Microfinancial performance is defined as the social and financial impact, both from the perspective of the client and the bank.

The research aims to get behind the motive of banks to involve in microfinance and to determine the international position of the “Dutch microcredit”. The research specifically focuses on extending microcredit in non-western countries, which can be done either through intermediate organizations such as Microfinance Institutions (MFI’s) or directly to the clients.

The questionnaire contains six questions on the type and level of involvement and takes approximately 10 minutes to complete.

For your interest the outcome of this survey will be shared with you when the results are processed.

If you are interested in additional information on this research, please feel free to ask.

<u>Please fill in the following information:</u>

Name of organization: ……………………………………………………………………….

Department: ……………………………………………………………………….

Name of respondent: ……………………………………………………………………….

Job title of respondent: ……………………………………………………………………….

Question 1.

What were your organizations' main motives for the *initial strategic* involvement into microcredit?

- ☐ The involvement in microcredit was part of the corporate social responsibility
- ☐ The involvement in microcredit was a demand from stake- and/or shareholders
- ☐ The involvement in microcredit contributed to our loan portfolio risk diversification
- ☐ The involvement in microcredit was because of its promising financial returns
- ☐ The involvement in microcredit enabled a growth of the client base
- ☐ The involvement in microcredit enabled to grow the organization's international presence
- ☐ Other:

Rabobank specific:

Through annual reports, articles and academic papers we have understood that the Rabobank is involved in microcredit by means of extending credit through Rabobank Development with subsidiary banks such as National Microfinance Bank (NMB, Tanzania, 49%-share) and Banco Regional (Paraguay, 40%-share). The Rabobank aims at lending to the rural and agricultural poor.

By 2008 Rabobank had a total microcredit loan portfolio of over 30 Million EUR and reached over 72.000 clients through the NMB, Rabobank India and Banco Regional Paraguay. The microfinance business operates profitable.

Rabobank Development also holds shares of Banque Populaire (Rwanda, 35%-share), Zambia National Commercial Bank (Zambia, 49%-share), United Rural Cooperative Bank of Hangzhou (China, 10%-share) and Banco Terra (Mozambique, 30%-share) reaching over 3 Million clients. Furthermore the Rabobank co-operates with banks in Vietnam, Cambodia, Peru, Malaysia, Pakistan and eastern European countries. Rabobank Foundation provides funding for MicroNed and Cordaid to invest in microfinance activities mainly to women in third world countries. The Rabobank Foundation also donates to other microfinance funds. Rabobank involves its employees with microfinance activities by allowing them to participate in (local) projects to provide technical and management assistance.

ING Group specific:

Through annual reports, articles and academic papers we have understood that the ING Group is involved in microcredit by means of extending credit by partnering with MFIs, such as ING Vysya Bank (India, 44% of ING), and Mzansi SA accounts (South-Africa, originally partner of Postbank Green). ING provides funding for Oikocredit to invest in microfinance activities in third world countries. ING partners locally with MFIs and aims at lending to the rural poor (women) and self-help groups. By 2008 ING had a total microcredit loan portfolio of over 55 Million EUR and reached over 500K clients and 5.000 Self Help Groups. The microfinance business operated sustainable.

ING involves its employees with microfinance activities by allowing them to participate in local projects to provide individual their expertise and by investing in Oikocredit.

ABN Amro specific:

Through annual reports, articles and academic papers we have understood that ABN Amro was involved in microcredit by means of extending credit through subsidiaries such as in Brazil with BancoReal and RealMicrocredito, a joint venture of BancoReal and Accion. ABN Amro India works through MFIs and the ABN Amro Foundation India (AAIF). ABN Amro sold its shares in BancoRegional de Paraguay to Rabo Development in 2008. ABN Amro still partners with FMO, CashPor and ShoreCap to provide funding to invest in microfinance activities in third world countries. ABN Amro partners locally with MFIs and aims at lending to poor women, in rural areas. By 2007 ABN Amro had a total microcredit loan portfolio of over 60 Million EUR and reached over 500.000 clients, the microfinance business operated profitably. ABN Amro involves its employees with microfinance activities by allowing them to participate in local projects.

SNS Reaal specific:

Through annual reports, articles and academic papers we have understood that SNS Reaal is mainly involved in microcredit through large funds. The SNS Institutional Microfinance Fund (SIMFI/II), part of SNS Asset management, partners with the Developing World Markets (DWM) and TripleJump. Through the ASN Bank other large funds such as the ASN-Novib fund (46 Million for MF investments) are active. The funds partner with institutions and locally with MFIs and aims to loan mainly to women. By 2008 the total fund sizes are over 200 Million EUR, and reach over 4 Million people. The overall microfinance business operates profitable. SNS Reaal furthermore provides funding for non-commercial funds such as Oikocredit and Cordaid.

SNS Reaal involves its employees with microfinance activities by allowing them to participate in local projects and to donate or invest in the before mentioned funds.

Triodos Bank specific:

From articles and year reports we have understood that the Triodos Bank is a front runner in providing microfinance in the Netherlands, and is involved in microcredit through several funds. These funds are the Triodos Fair Share Fund, Stichting Triodos-Doen, and Stichting Hivos Triodos Fonds. The three funds are shareholder in 23 of the most prominent microfinance banks and investors. Through these three funds a total of 91 MFIs, spread over 38 countries, are reached. The funds grew 29% in 2009 to a total of EUR 161 million. Recently a fourth fund had started: The Triodos Microfinance Fund. Triodos involves its employees by having them taking positions in the board of directors or advisory board on individual MFIs. Through its funds, Triodos aims to serve the rural and underserved women. All of the funds operate profitable.

Deutsche Bank specific:

From several articles we have understood that the Deutsche Bank (DB) is involved in microcredit by providing funding through large funds such as 'The Deutsche Bank Start Up Fund', 'The Deutsche Bank Microcredit Development Fund (DB MDF)' and 'DB Microfinance Invest No.1'. DB invested USD 8 million themselves in these funds. 77 loans were provided to at least 50 MFIs per 2008 through these funds. DB aims to lend to poor micro-entrepreneurs in rural areas. DB works with large institutions such as Accion International, KfW, IFC, CGAP and MicroRate, etc. The microfinance business operated profitable. DB is also involved in other social funds such as Eye Fund and the Enterprise Social fund and plans to roll out other similar funds. DB involves its employees with microfinance activities by allowing them to participate in local projects to provide individual their expertise.

CitiGroup specific:

From articles we have understood that the Citigroup is involved in microcredit through the Citi Global Microfinance Group, by providing funding through large non-profit financial development institutions such as IFC, FMO, OPIC, ProCredit and KfW. Direct credit was extended to MFIs such as Accion International, BRAC in Bangladesh, Compartamos in Mexico and MFis in Hubei, China. Citibank aims to provide funding to the poor women in rural areas. The microfinance business operated profitable.

Citibank has also provided grants to several MFIs. Citibank involves its employees with microfinance to provide individual their expertise. This expertise and service covers financing, transaction services (through GTS), assessment and debt rating models, hedging, saving products, remittance and insurance products.

HSBC group specific:

From articles we have understood that the HSBC group is directly involved in microcredit by extending microcredit to MFIs in at least 11 counties, with recently added activities in Turkey. USD 62.5 million has been provided to at least 30 MFIs per 2006 and over 200.000 borrowers are reached. HSBC aims to provide funding to the poor women in rural areas. The microfinance business operated profitable. Through HSBC Amanah Islamic microfinance is provided in Pakistan.

BNP Paribas specific:

From several articles we have understood that the BNP Paribas (BNP) is involved in microcredit by providing funding directly to MFIs in 13 different development countries per 2009. BNP has an outstanding loan portfolio of EUR 81 million. Through these MFIs at least two million people are impacted and over 500.000 people are reached directly. BNP aims to lend to poor women and micro-entrepreneurs in rural areas. The microfinance business operated profitable.

Please answer the following questions while thinking of your current situation.

Question 2.

Can you confirm that your organization is involved in the above described activities?

☐ NO. Please describe your current microfinance and/or microcredit activities below:

☐ YES. Please describe any additional activities below:

What additional types of microcredit activities is your organization currently involved in?

…….

…….

What additional types of microfinance activities is your organization currently involved in?

…….

…….

Question 3.

A. How large is the current financial involvement of your organization in all of the before mentioned activities? (In EURO)

☐ 1 Mio – 5 Mio	☐ 25 Mio – 50 Mio	☐ 100 Mio or more
☐ 5 Mio - 10 Mio	☐ 50 Mio – 75 Mio	
☐ 10 Mio – 25 Mio	☐ 75 Mio – 100 Mio	

B. How would you classify your organization's current financial performance in microcredit? (Please select only one)

☐ charity: not sustainable, nor profitable

☐ sustainable

☐ profitable

☐ more profitable than other similar mainstream credit activities, not related to microcredit

☐ Other:

C. How has the financial crisis influenced your activities in microfinance?

☐ The crisis did not influence our microfinance strategy

☐ Positively, the microfinance portfolio has been increased

☐ Negatively, microfinance portfolio has been decreased

☐ Other:

Question 4.

Please first read the textbox on the next page on the different types of microfinancial performance.

Social performance can be measured through indicators such as cost and worth to clients, the scope, breadth, depth and length of outreach of the product.

What examples and numbers for each of these indicators can you mention that your organization currently aims to focus on (when selecting partners, MFI's, clients, etc.)?

☐ **Worth to clients: (**An attractive product:)

………

………

☐ **Cost to clients:** (A low cost product:)

………

………

☐ **Depth of outreach:** (To serve the underserved:)

………

………

☐ **Breadth of outreach:** (Serve a high number of clients:)

………

………

☐ **Scope of outreach:** (A variety of services:)

………

………

☐ **Length of outreach:** (Achieve high profits:)

………

………

Textbox for Question 4: Microfinancial performance indicators

(Six degrees of Outreach: Craig Churchill and Cheryl Frankiewicz, 2006)

Worth to Clients. The clients' willingness to pay for microfinance products. A bank aims to offer an attractive product.
Additional information: The willingness increases when the contract more closely matches the borrower demand. Consider that clients may be sensitive to loan size, to additional transaction costs associated with borrowing from an (microfinance) institution, and the frequency of borrowing.
Indicators for the willingness to pay are repayment rates, repetitive loans and retention rates.

Cost to Clients. The costs consist of interest rates, fees and transaction costs. A bank aims at having a low cost product. *Additional information: The interest rate is the main cost driver for clients. Transaction costs include both opportunity costs and indirect expenses for clients.*

Depth of Outreach. Serving the underserved by financial institutions. A bank aims to serve the underserved, which could be one of the following groups:
Additional information: Examples are education (less is preferred), ethnicity (minorities are preferred), gender (women are preferred), location (rural is preferred), housing (small, cheap houses are preferred), access to public services (lack of access is preferred).

Breadth of outreach. The number of clients served. A bank aims to serve a high number of clients.
Additional information: This indicator can also be measured within certain market segments such as the number of clients served by gender, age, geographic location or type of business activity.

Scope of outreach. The variety of financial services offered. A bank aims to offer a large variety of services.
Additional information: This refers to both the diversity of the services and depth of the product assortment. The number of services offered can determine the scope of outreach. For the diversity of the services, the actual number of clients reached per service should be considered.

Length of outreach. The sustainability of the microcredit program or microfinance institution. A bank aims to achieve the highest net profit.
Additional information: The length of outreach is calculated by taking the net profit of the financial performance (of MFIs), corrected for income that is not generated out of the standard cash flow from (their) microfinance operations, and by subtracting the operational costs.

Question 5.

Please take a look at the textbox below on the different levels of microfinance contribution to an organization.

How would you classify your organization's current contribution level towards microfinance?

☐ It is part of the corporate social responsibility

☐ It is part of a dual strategy

☐ It is part of a dual strategy business unit

☐ It is part of normal business with social impact

☐ It is part of the normal commercial business

☐ It is part of the commercial international business

Textbox for Question 5: Types of microfinance contribution levels

• **Corporate Social Responsibility***
CSR is generally seen as the business contribution to sustainable development and is understood mainly as focusing on how to integrate economic, environmental, and social imperatives. The overall aim is to reduce poverty by building financial systems that work for the poor majority.

• **Dual strategy***
These banks look for a balance between a corporate citizenship policy (or CSR) and their commercial business targets. This approach is characterized by covering the costs, large social impact and a 'healthy' growth in total.

• **Dual strategy business unit***
This approach is similar to the Dual Strategy, but differs because these microfinance 'departments' are more focused on their business targets. They achieve social goals through commercial means. A well-established central team is set up that develops and coordinates all microfinance activities, mostly within a dedicated, separate unit.

• **Normal business with social impact***
Profit and growth are important factors in the policy. Microfinance products are approached as a normal business service. The products are fully commercial and supported by the normal businesses. In addition, they have significantly more social impact than the 'normal' business services.

• **Normal commercial business**
This type of commercial business involves the similar policy as the previous type, however this type is characterized by microfinance products that are more profitable than the similar business services within the organization, that are not related to microfinance.

• **Commercial international business**
With this international commercial business, the focus of the microfinance products is to be competitive with similar microfinance products that are extended by foreign banks in the same geographical region.

(*M. Bouuaert, 2008)

Question 6.

What would be further opportunities for your involvement in microcredit or microfinance as a longer-term strategy?

☐ Focus on a specific client group, such as: ……………………………………………………..

☐ Increase the share of the microcredit portfolio in the total loan portfolio, to: …….%

☐ Expand microcredit to other geographical regions, such as: ……………………………….

☐ Expand microfinance activities, such as: ……………………………………………………

☐ Increase the profitability of extending microcredit, by: ……………………………………..

☐ Increase the competitiveness of microcredit internationally: ………………………………..

☐ Increase the profitability of other microfinance activities, such as: …………………………

☐ Cooperate with other organizations, such as: ………………………………………………..

☐ Other opportunity:

Any further comments:

End of the questionnaire.

Thank you very much for your time and cooperation!

Appendix B: Questionnaire responses

Rabobank

Name of organization: Rabo Development

Department: Finance & Control

Name of respondent: Amanda van Bemmel

Job title of respondent: Head of Finance & Control

Q1: Other: *The ambition of Rabo Development is "To replicate the success of Rabobank in the Netherlands, meaning that through providing financial services a substantial contribution will be made to the economic development of, in particular, the rural areas in selected developing countries".*

Q2: Rabobank confirms their microfinance situation described from public available resources.

Q3 A: More than 100 Mio.

Q3 B: Sustainable and profitable

Q3 C: The crisis did not influence our microfinance strategy

Q4:

Worth to Clients: Loan portfolios are growing

Cost to clients: Try to minimize costs to provide access to finance to as many people as possible

Depth of Outreach: Rural area is preferred

Breadth of Outreach: Number of clients is growing

Scope of Outreach: Focus on a wide range of retail products (including mobile banking)

The Length of outreach: NR

The intercompany financial performance indicator: not more profitable than other similar mainstream credit activities, no competitive strategy to compete with foreign banks.

Q5: It is part of a dual strategy business unit

Q6: no other specific opportunities than already mentioned

ING Group

Name of organization: ING
Department: ING Groenbank N.V.
Name of respondent: Auk de Boer
Job title of respondent: Manager

Q1: The involvement in microcredit was part of the corporate social responsibility

Q2: ING confirms their microfinance situation described from public available resources, and adds that their support is limited to the so-called OECD DAC countries: [List of DAC is reviewed every three years; countries are divided into income based groups based on Gross National Income (GNI) per capita as reported by the World Bank. The Development Assistance Committee (DAC) approves the list and divides the countries into four groups: Least Developed Countries, Other Low income countries (per capita GNI < USD 935 in 2007), Lower Middle income countries (per capita GNI USD 936 – USD 3,705 in 2007) and Upper middle income countries (GNI USD 3,706-USD-11,455 in 2007)].

Q3 A: More than 100 Mio.
Q3 B: Sustainable
Q3 C: Negatively, microcredit portfolio has been decreased

Q4:
Worth to Clients: 'High'
Cost to clients: 'High'
Depth of Outreach: 'High'
Breadth of Outreach: 'High'
Scope of Outreach: 'Low'
The Length of outreach: 'Low'
The intercompany financial performance indicator: not more profitable than other similar mainstream credit activities, no competitive strategy to compete with foreign banks.

Q5: It is part of the corporate social responsibility (NL), It is part of a dual strategy (ING Vysya- India)
Q6: Expand microcredit to other geographical regions, such as: Africa, Expand microfinance activities, such as Insurance

SNS Reaal

Name of organization: SNS Asset Management N.V.

Department: Development Investments

Name of respondent: Alexander Lubeck

Job title of respondent: Manager Product Structuring/Development Investments

Q 1:

☐ v The involvement in microcredit was part of the corporate social responsibility

☐v The involvement in microcredit was because of its promising financial returns

☐v The involvement in microcredit enabled a growth of the client base

☐v Other: the involvement in microcredit was motivated by the fact that 3 years ago, despite its positive characteristics, there were very few Institutional Microfinance funds available for Institutional Investors into the Microfinance market.

Q 2:

Can you confirm that your organization is involved in the above described activities?

☐ V NO. Please describe your current microfinance and/or microcredit activities below:

SNS Asset Management N.V. (SAM) is a subsidiary of SNS REAAL N.V. The SNS Institutional Microfinance Fund I/II are managed by SAM as Fund Manager with Developing World Markets LLC and Triple Jump B.V. as Investment Managers. Currently Commited Capital is around 300 mln EUR. The microfinance business is sustainable and profitable. Furthermore, through ASN Bank N.V. and its ASN-Novib Fund a further 100 mln is invested in Microfinance Institutions.

What additional types of microcredit activities is your organization currently involved in?
By ways of the SNS REAAL Waterfonds investments are sourced into Micro Finance Institutions specifically active in water and sanitation projects

Q 3: A. 250 Mio or more

Q3 B. sustainable, profitable

Q3 C. The crisis did not influence our microfinance strategy, *Although our strategy has not changed, the demand and supply forces have impacted MFI capital markets. Overall, MFI loan portfolio's are only growing slowly at best. At the same time credit losses have risen but are still acceptable. Also, Institutional demand has remained strong particularly for the higher quality MFI's*

Q 4:

Please assume scale of 1..10 with 10 being most important/highest added value in selecting MFI's to invest in (AL)

☐ Worth to clients: (An attractive product:)

7 Meaning that we value a sustainable contact with the end client. Having the right product is key in this

☐ Cost to clients: (A low cost product:)

7 Meaning that we value a sustainable contact with the end client. Price is obviously an important determinant.

☐ Depth of outreach: (To serve the underserved:)

7 From our point of view, more depth is better, but conditional on the MFI being able to operate profitable and sustainable

☐ Breadth of outreach: (Serve a high number of clients:)

5: The number of people served is not a means in itself

☐ Scope of outreach: (A variety of services:)

5: In the sense that focus and excellence in operations are more important than the variety of product as such. We tend to shy away from higher consumer lending loans

☐ Length of outreach: (Achieve high profits:)

5: in the sense that profits should be acceptable. We view returns on equity targets for MFI at around 15 % as acceptable and sustainable

Q 5:

It is part of a dual strategy business unit, It is part of normal business with social impact

Q 6:

Expand microcredit to other geographical regions, Expand microfinance activities, such as: Dedicated SME mfi's

Appendix C Respondents

- Amanda Van Bemmel, Rabobank, Rabo Development, Head of Finance&Control
- Auke de Boer, Manager ING Groen Bank N.V.
- Interview with Roy Budjhawan , ING Retail Banking, Vice-President Micro Finance
- Alexander Lubeck, SNS Asset Management N.V., Development Investments, Manager Product Structuring/Development Investments
- Interview with Hedwig Siewertsen, Deputy Director Facet/Triodos, member of Triodos Group
- Brief interview with Hans van der Veen, Ministry of foreign affairs/ development