

## A guide to microfinance

### Purpose of the guidance

This document seeks to help grant holders:

- Better understand the definitions and terminology surrounding microfinance
- Have a clearer idea about what microfinance is and what it involves
- Distinguish between the various microfinance services and products that are available, and by which organisations
- Understand the evidence supporting the impacts of financial inclusion
- Understand the UK Aid Match and UK Aid Direct approach to this topic.

This document is not a thorough guide and does not provide 'how to' advice. To discuss these topics, join our Microfinance Community of Practice; a dedicated space for UK Aid Match and UK Aid Direct grant holders to discuss developments and issues in the microfinance sector. To register your interest in these, contact:

- [ukaidmatch@mansiondaniels.com](mailto:ukaidmatch@mansiondaniels.com) (for UK Aid Match grant holders)
- [ukaiddirect@mansiondaniels.com](mailto:ukaiddirect@mansiondaniels.com) (for UK Aid Direct grant holders)

### The bigger picture: financial inclusion and access to finance

Financial services include credit, deposit, payment, insurance, and other risk management services. Access to finance and financial inclusion are often used interchangeably to describe the operationalisation of financial services in the development sector. Access to finance is the ability of individuals or enterprises to obtain financial services that meet their needs that are delivered in a responsible and sustainable way. Financial inclusion refers to the equitable availability of opportunities to access these financial services. The terms are similar, with financial inclusion being a description increasingly used in the development sector.

### What is microfinance?

Microfinance refers to the financial services that are made available for poor and low-income clients. It is offered by a range of different types of service providers. The term is often used more narrowly to refer to loans and other services from providers that identify themselves as microfinance institutions (MFIs). These institutions deliver very small loans to unsalaried borrowers, taking little or no collateral. Over the last 30 years new methods have been developed to do this, pioneered by Muhammad Yunis's Grameen Bank.

The overarching purpose of the microfinance sector is to ensure that low-income households have permanent access to a range of high quality and affordable financial services offered by

a range of retail providers to finance income-producing activities, build assets, stabilize consumption, and protect against risks.

### **Microfinance service providers**

Microfinance institutions (MFIs) are organisations that offer financial services to low income populations. Almost all give loans to their members, and many offer insurance, deposit and other services.

### **Formal institutions**

#### **Banks**

Includes central banks, retail and commercial banks, investment banks, internet banks, and microfinance banks. These institutions are for-profit, commercially focused and are supervised and regulated by a government agency. They may offer mobile phone banking.

#### **Non-bank financial institutions (NBF)**

Includes some microfinance organizations, insurance firms, venture capitalists. NBFIs are for-profit financial institutions without a full banking license that cannot accept deposits. They may offer mobile phone banking. They provide services that are not necessarily suited to banks.

#### **Credit unions**

Credit unions are not-for-profit organizations that exist to serve their members. Like banks, credit unions accept deposits, make loans and provide a wide array of other financial services. As member-owned and cooperative institutions, they provide a safe place to save and borrow at reasonable rates.

#### **Savings and Credit Cooperatives**

Savings and Credit Cooperatives (SACCOs) are a kind of credit union. They are private and cooperative financial institutions where membership is open and voluntary. They belong to their members who manage them democratically.

#### **Peer to peer lenders (P2P)**

P2P lenders are operational not-for-profit organisations that match lenders and borrowers via the internet. Well-known UK-based P2P lenders are [Zopa](#), [FundingCircle](#) and [RateSetter](#). P2P lending sponsors are organizations that handle loan administration for others; these include [Kiva](#) and [Zidisha](#).

### Digital Financial Service (DFS) providers

Many DFS suppliers are formal banks or non-banks that have partnered with a mobile network operator. Safaricom's M-PESA in Kenya is well known and one of the most successful examples of mobile banking, but there are many others globally.

### Micro-insurance providers

These offer products designed for low-income people. They protect the vulnerable against risks that can lead to poverty. [MicroEnsure](#) is one of the best-known UK-based providers.

### Informal institutions

#### Village savings and loans associations (VSLAs)

A VSLA is a group of people who save together and take small loans from those savings. Accumulated savings and loan profits are distributed back to members. The purpose of a VSLA is to services in a community without access to formal financial services. Care International is a pioneer of VSLAs.

#### Rotating Savings and Credit Association (ROSCA)

ROSCAs allow members to accumulate pre-specified lump sum savings amounts. Groups have a set number of members and agree to contribute a specific amount at specified intervals. At each interval, a member (rotating) will receive the entire lump sum amount from all individuals as a grant.

### Evidence - what is working

The Consultative Group to Assist the Poor (CGAP) is a global partnership of 34 leading organizations that seek to advance financial inclusion, originally set up by the World Bank. It has recently conducted a comprehensive review of the evidence regarding how financial services can lead to improved welfare outcomes for poor people. <sup>1</sup> The conclusions are summarised below:

- Financial services improve people's resilience
- Promoting access to financial services that are fully controlled and owned by women will help change women's bargaining position
- Financial inclusion can contribute to economic growth
- Financial inclusion can contribute towards reducing inequality

Beyond this, review of recent impact evidence<sup>2</sup> indicates that:

<sup>1</sup> Mayada El-Zoghbi, Nina Holle & Matthew Sourourian. 2019. "[Emerging Evidence on Financial Inclusion: Moving from Black and White to Color](#)". Washington, D.C.: CGAP.

<sup>2</sup> Cull, Robert, Tilman Ehrbeck, and Nina Holle. 2014. "Financial Inclusion and Development: Recent Impact Evidence." Washington, D.C.: CGAP.

- Microcredit benefits small businesses in supporting access credit, but the link to broader welfare is often less clear
- Savings help households manage cash-flow spikes, smooth consumption, and build working capital
- Insurance can help poor households mitigate risk and manage shocks
- Mobile money reduces households' transaction costs and seems to improve their ability to share risk.

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