Guest Editorial: Does 'microfinance' mean what it used to?

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What does 'microfinance' really mean in these days of financial inclusion and digital financial services? Is 'financial inclusion' simply a rebranding of 'microfinance', that is itself a rebranding of 'microenterprise credit'?

In the 1990s, microfinance became recognized as a set of methodologies that can make provision of financial services to the lower-income, 'unbanked' population viable and affordable. 'Banking for the poor' involved managing the costs and risks that made commercial banks avoid small financial transactions and informal enterprises – largely by passing them on to clients via solidarity groups and by using dynamic incentives such as short repayment periods and gradually increasing loan sizes. Initially, 'microfinance' and 'microfinance institutions' (MFIs) were virtually synonymous – both implying outside the formal financial system.

As methodologies improved and scaled up in the late 1990s and early 2000s, costs came down. Microfinance became potentially profitable, some MFIs transformed into licensed banks or non-bank financial institutions, and countries began introducing laws and regulations giving MFIs a niche in the formal financial system. Such MFIs often served non-poor as well as poor customers. Some purists, focused on the social mission of serving the poor, considered this 'mission drift' from the original concept of microfinance. Others were more willing to extend the concept of microfinance to include cross-subsidizing poor clients from profits on the 'entrepreneurial poor' and not-so-poor, perhaps even to using these methodologies to address the so-called 'missing middle' of small enterprise finance.

In this context, practitioners, researchers, and policy-makers became increasingly concerned with issues of the 'financial sustainability of microfinance institutions' and the potential 'trade-off between outreach and sustainability of MFIs' (see articles by those titles in this issue by Sydney Chikalipah and by Abdulai Adams and Devi Datt Tewari, respectively). At the same time, people were wondering whether the apparent miracle of microfinance methodologies could be extended to other difficult areas of finance, such as agriculture, youth, and even private schools (see articles on 'Six myths of farmer finance' by Rick Van der Kamp and 'Youth savings groups in Africa' by Justin Flynn and James Sumberg). 'Microfinance' and 'MFIs' took on a wider range of meanings and legal definitions, and could no longer be considered synonymous.

As microfinance methodologies and institutions became increasingly included in formal financial systems in the 2010s, attention of researchers and donors shifted toward the ability of previously excluded populations to access financial services – informal as well as formal. 'Financial inclusion' became the new buzzword – though the meaning often differs between, on the one hand, central bank signatories to the Maya Declaration on Financial Inclusion, who tend to focus on the suppliers

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of financial services (i.e. on regulating MFIs), and, on the other hand, ministries of finance and development partners, who are more concerned with policies, programmes, and surveys targeted at the demand side of the 'financially excluded' (who need financial literacy and consumer protection to negotiate the burgeoning array of financial services available through different channels).

Which brings us to channels such as agent banking, e-money, and digital financial services (DFS). These methods are being used to reach previously underserved market segments, including (but by no means limited to or even focused upon) rural areas and the poor. Should we consider these as new microfinance methodologies? What if they charge the poor 20 per cent commission on small money transfers or over 100 per cent effective annual percentage rate on consumer loans? Microfinance purists might consider some licensed MFIs and DFS providers as exploiting rather than serving the poor. Others may consider them as expanding access and making finance more inclusive – and let the buyer beware (or, better: be educated). If the current reality of 'microfinance' has moved away from its poverty-focused origins, does 'financial inclusion', broadly conceived, take us even further away? One might ask to what extent financial inclusion per se is necessarily a tool for sustainable development and poverty reduction (see the article titled 'Financial inclusion and the 2030 Agenda for Sustainable Development' by Jahel Queralt et al.). Also in this issue sustainable development of the cocoa sector is discussed from perspectives other than financial in the article by Judith Krauss titled 'What is cocoa sustainability?'.

To go back to basics, we might define 'microfinance' literally as 'small financial transactions' (which are particularly, but not exclusively relevant to the poor), and thereby applicable to any methodology that seeks to lower the costs and risks of 'micro' transactions. Besides traditional microfinance methodologies, this definition would include branchless banking, DFS, and other innovations. These methodologies are all instruments of increasing 'financial inclusion' – which can be taken broadly to include any measures that facilitate previously underserved groups to gain access to and be able to use effectively a growing range of financial services and channels. Thus, opening up and regulating new tiers of MFIs, applying digital and mobile phone technologies, financial literacy campaigns, consumer protection, and education – all are means to the end of financial inclusion.

One bottom line is that 'microfinance' and 'MFIs' mean different things to different people and in different contexts. Another bottom line is that poverty focus is not necessarily implied, and needs to be made explicit, if desired. So let the user beware and heed Humpty Dumpty's practice of using 'a word [to] mean just what I choose it to mean – neither more nor less'. That is, clarify your particular definition and usage.

Nevertheless, like Alice, I can't help wondering what happens to communication and clarity when people 'make words mean so many different things …' (Carroll, 2007)

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Reference

Carroll, L. (2007) *Through the Looking Glass,* London, UK: Penguin Classics.