

MARKET CREATION CASE STUDY:

How microfinance infrastructure developed to direct global capital into micro-enterprises

The global Microfinance story

1980s to present

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Overview

Microfinance started as an experiment in the 1980s to lend to people that the financial system had dismissed as unbankable. This experiment has since become a mainstream global asset class, with a financial-inclusion industry spanning credit, savings, and insurance.¹

Today, microfinance channels institutional capital through an established ecosystem of intermediaries and instruments, to hundreds of millions of borrowers and micro-enterprises.¹

Growth of the microfinance sector involved sequencing, with public money being used to build each layer, then strengthening, with concessional funds followed by commercial funds building the system out. There are strong parallels and lessons from the establishment of microfinance that can be applied to emerging Market Creation efforts, illustrating how to steer financial markets toward serving small businesses.

IN SUMMARY

- **Microfinance providers had ~200 million clients** by the early 2010s, about 137.5 million of them among the poorest.^{2,3}
- **US\$16.9bn in microfinance investment vehicles** by 2018, up from ~US\$10.4bn in 2014, as commercial money followed the public capital that came first.⁴
- **It took ~40 years** to move from business-model demonstrations to a mainstream commercial asset class by 2020, doing so without the digital infrastructure new markets can build on today.¹

How the market developed

1. Breaking ground: proving the model (1980s)

To begin, there was little evidence to convince banks that low-income micro-entrepreneurs were bankable and capable of servicing loans. Public and philanthropic funders took a risk, providing capital to emerging lenders, using grants and subsidies to experiment and prove the model, before building more tailored products. **Grameen Bank** in Bangladesh (authorised 1983) proved that micro-entrepreneurs were bankable, testing with collateral-free group lending to the rural poor as borrowers repaid the loans.³ The state-owned bank, **Bank Rakyat Indonesia (BRI)** established a model that refuted one of the largest misconceptions at the time, that there would be a lack of commercial scale. They took their Unit Desa system to market rates in 1984, withdrew subsidy by 1986, all while running thousands of rural units commercially and pairing credit with savings. From the start, its SIMPEDES deposits drew far more savers than borrowers.⁵ These are examples of the initial pipes that were being laid.

The microfinance model had been validated. Micro-enterprises were in fact bankable, and with the right structures in place, the products serving them could become commercially viable rather than subsidy-dependent.

2. Setting the conditions: establishing the support ecosystem (1990s)

By the 1990s, it had been demonstrated that microfinancing could work. However, the sector still lacked the shared infrastructure to meaningfully replicate it: common metrics, rating agencies, training systems, regulatory frameworks, and shared credit information. Early success stories were isolated and difficult to transfer across to new regions.

New institutions were created to fill this gap throughout the decade. **BancoSol** (Bolivia, 1992), created out of the PRODEM NGO, became the world's first regulated commercial bank dedicated to microfinance. It demonstrated that a pioneer NGO lender could become a deposit-taking, fiduciary institution.⁶ In 1995 ten donors founded the **Consultative Group to Assist the Poor (CGAP)**, based at the World Bank, building shared metrics, transparency standards and a common language for the sector.⁷ Then specialised rating agencies like **MicroRate** (1997), **M-CRIL** (1998), **Planet Rating** (1999), and **MicroFinanza Rating** (2000) began entering the sector and creating the necessary credit-assessment infrastructure for commercial investors to eventually price-risk.⁷

Underpinning this transition, donors were also changing their funding practices, moving from individual institutions to supporting the infrastructure and systems that connect them.⁷ Development finance institutions (DFIs) began increasingly taking on equity stakes, helping to turn NGO lenders like **PRODEM** (1986), and networks like **Accion** (1961), **Opportunity International** (1971) and **FINCA** (1984), into regulated, deposit-taking banks.^{1,8,9} Donors helped set the conditions for the new pipes and pumps, while DFIs put the funds in to develop this infrastructure.

By the end of the decade a sector was emerging. It went beyond operating as a set of organisations with a common goal, providing the institutional credibility that capital markets would later require.

3. Forging the channels: mainstreaming into global capital markets (2000s)

Providers had proven models, established credibility and were adopting shared standards globally. But they still lacked a structured way to absorb commercial capital. It was clear that additional infrastructure needed to be built for capital to flow. Public and concessional funders were the first to move towards establishing these channels, building this phase fund by fund. The **Dexia Micro-Credit Fund** (1998) is regarded as the first commercial fund designed to refinance microfinance institutions, the experimental pipes connecting capital markets to lenders. This fund was managed by the **BlueOrchard** (2001), founded on a UN initiative in 1998, and they became one of the first commercial managers of microfinance debt and established the microfinance investment vehicle (MIV) as an asset class.^{10,11} Then **Symbiotics** (2004) scaled origination and structuring so institutional capital could deploy at volume, growing MIVs to roughly US\$16.9bn by 2018.⁴

DFIs were also playing an important role in this phase, funding the ongoing development of pipes and pumps by backing new microfinance institutions. By the end of 2009, DFIs had committed ~US\$8.9bn, roughly 42% of cross-border microfinance funding. Not only did they deploy patient debt and equity, they also supplied the guarantees and first-loss capital that let commercial investors take the safer senior layers.⁹ Like the **Microfinance Enhancement Facility** (2009), a joint initiative between KfW, IFC and OeEB, which is a multi-layer fund with donor-funded first-loss shares (including €40 million from the German government via KfW) sitting beneath the senior tranches that commercial investors held. Since the facility's inception, more than US\$2bn has been channelled to 250+ microfinance institutions (MFI) in over 55 countries.¹²

The sector was now operating at scale. Capital flowed through dedicated pipes, and the public role shifted from direct provider to anchor and guarantor.

4. Mobilising flow at scale: transformation and commercialisation (2000s+)

By the late 2000s microfinance had become a mainstream product, and MFIs were transforming into regulated financial institutions as their concessional role receded. Microcredit became microfinance as licensed MFIs gradually added savings, insurance, remittances, and payments to their offerings.¹ The sector then widened into financial inclusion, with mobile money, fintechs, and commercial banks moving into the space that MFIs had opened.¹ Regulators took on consumer protection and macro-prudential mandates as the pipes and pumps built over the previous two decades now carried commercial capital to micro-enterprises across the world.

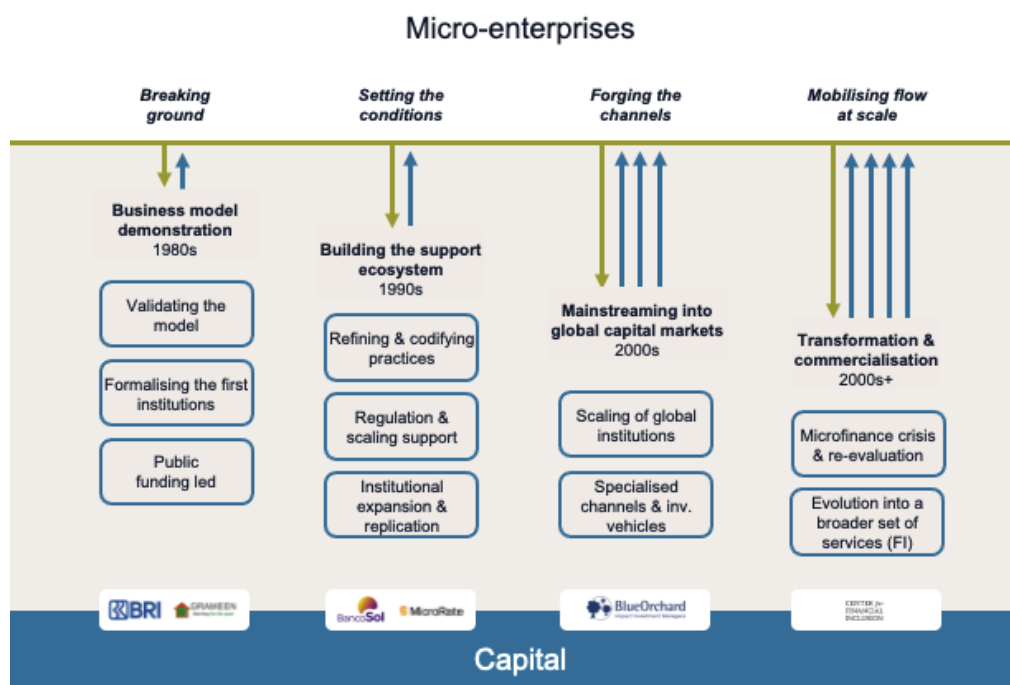
Commercial capital came quickly and its effect on the field was profound, albeit mixed. Capital was flowing at scale but controls were slipping: The **Compartamos Banco IPO** (Mexico, April 2007) proved microfinance could attract pure commercial equity, but it also started discussion on whether the mission had drifted too far, with interest rates

near 85% a year, totalling above 100% including tax.⁸ In India, the **SKS Microfinance IPO** (listed August 2010) and the **Andhra Pradesh crisis** in late 2010 broke through the chatter and bought the issue to a head. It was a celebrated for-profit listing, but immediately followed by an over-indebtedness crisis, with reported borrower suicides and a state crackdown.¹³

In response, the sector began tightening regulations and acted on the lessons learnt from the global over-indebtedness crisis. The **Reserve Bank's Malegam Committee** (2011) led to a new, federally regulated NBFC-MFI category, with caps on pricing and margins, a limit of two lenders to any single borrower, and credit-bureau reporting that was built into the resulting framework.¹⁴ Globally the **Centre for Financial Inclusion** began running the SMART Campaign in 2009, codifying client-protection principles, and credit bureaus and repayment-capacity checks becoming standard practice.¹⁵ The sector is reforming in response to tighter rules, and **Schroders'** purchase of a majority stake in BlueOrchard in 2019, marked its arrival as a recognised asset class.¹¹

The impact of microfinance has been substantial. Credit on its own does not lift people out of poverty at scale.¹⁶ But the evolution of microfinance into the financial inclusion sector, where credit can be combined alongside other savings products, has significantly strengthened household resilience.¹⁷ What remains is how regulation and responsible lending can steer commercialisation towards better outcomes. Now things have come full circle, with donors and DFIs once again leading the way as they fund the push for client protection and responsible finance under the renewed term of Financial Health.

What remains is a mature financial-inclusion market, a genuine tool for resilience under the right structures on the way to scaling credit responsibly.



Key decisions

Intentionally layering different types of capital

Each phase of the journey followed a similar sequence, starting with initial public capital, then concessional, then finally commercial funds.^{1,8} Across the sector, Government support, grants and subsidies helped to prove the model, allowing DFIs to enter with guarantees and first-loss positions to make each later investable for private actors to follow suit.⁹

Building shared infrastructure first

Funders built shared infrastructure early and intentionally, establishing critical mechanisms such as CGAP standards, ratings, regulations, and credit bureaus.⁷ These helped to connect isolated efforts into a network with the necessary infrastructure to replicate and learn from this previous success.

Transforming MFIs into financial institutions

The conversion of MFIs into financial institutions played a critical role for the development of the field. By establishing permanent players in the sector and breaking reliance on donor capital and subsidies, these institutions could begin lending on customers' deposits. Regulation also let them safeguard savings and add insurance, building further resilience,¹⁷ and gave them the standing to draw in commercial capital.

MIVs as a new pathway for capital

Before MIVs, capital only reached individual organisations, with each funder finding and monitoring their own institutions. Once MIVs were established, funders were able to begin aggregating their capital into a single fund, then disaggregate it across many institutions at once. DFIs seeded most of these early vehicles because it was more efficient than investing directly, and once the channel existed other investors could use it without building their own. By 2006, 74 MIVs held US\$2bn and reached 475 MFIs between them, compared to the 207 DFIs reached directly, and at a smaller average ticket.¹⁸

Lessons for Market Creation

Sequencing matters

Each phase depends on the one before it. Validation and stories of success create the evidence that justifies donors' investment into the system, building credibility that unlocks capital markets, which then create the pathways to commercialisation and scale. This sequencing of public, then concessional, then commercial capital, is a pattern that the Ghana and Mexico cases also demonstrate.

Convening the ecosystem is critical

A standard-setting custodian like CGAP helps make a field durable, creating the necessary conditions for advancing the market.⁷ Institutions like rating agencies, standard-setters, credit bureaus, regulators, and industry associations are the types of organisations who worked alongside government to build pathways and confidence for investors to choose microfinance. Growth Firms do not yet have these established champions who can further Market Creation

and any market starting out should consider who should and can play this role, instead of waiting for one to emerge.

Growth Firms have diverse needs

Micro-loans are small, short, and standardised, being well-suited for the specific needs of micro-entrepreneurs. In contrast, developing products for Growth Firms is not as straightforward. They range from formalizing enterprises to family owned businesses and high-growth ventures, and each one has a different growth path and financing needs, across debt, equity, and quasi-equity, with tickets from US\$20,000 to US\$2m and longer tenors.¹⁹ There is no singular product or instrument that can address the diverse needs of Growth Firms at once. Different segments need different products and institutions with the capability to deliver them. Micro-borrowers rarely graduate to SME-scale, and microcredit did not drive firm growth or jobs at scale, so the market for Growth Firms has to be built rather than grown out of microfinance.¹⁶

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This case draws on the published record listed below. It was also informed by conversations with **Nicholas Colloff** (Argidius Foundation) and **Andrew Shaw** (FMO), who generously shared their time and expertise.

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