GOOD PRACTICE GUIDELINES FOR FUNDERS OF MICROFINANCE

MICROFINANCE CONSENSUS GUIDELINES

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Thirty years of lessons learned, translated into operational advice for development agencies, foundations, social and commercial investors, international NGOs, and others that help build financial systems that work for poor people.

CGAP

THE KEY PRINCIPLES OF MICROFINANCE

Commitment to applying good practice in microfinance comes from the highest levels of donor countries and agencies. In June 2004, the Group of Eight (G8) endorsed the "Key Principles of Microfinance" at a meeting of heads of state in Sea Island, Georgia, USA. Developed (and endorsed) by CGAP's 28 public and private member donors, the Key Principles are translated into concrete operational guidance for staff of donors and investors in these *Good Practice Guidelines.*[*]

1. **Poor people need a variety of financial services, not just loans.** In addition to credit, they want savings, insurance, and money transfer services.
2. **Microfinance is a powerful tool to fight poverty.** Poor households use financial services to raise income, build their assets, and cushion themselves against external shocks.
3. **Microfinance means building financial systems that serve the poor.** Microfinance will reach its full potential only if it is integrated into a country's mainstream financial system.
4. **Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor people.** Unless microfinance providers charge enough to cover their costs, they will always be limited by the scarce and uncertain supply of subsidies from donors and governments.
5. **Microfinance is about building permanent local financial institutions** that can attract domestic deposits, recycle them into loans, and provide other financial services.
6. **Microcredit is not always the answer.** Other kinds of support may work better for people who are so destitute that they are without income or means of repayment.
7. **Interest rate ceilings hurt poor people by making it harder for them to get credit.** Making many small loans costs more than making a few large ones. Interest rate ceilings prevent microfinance institutions from covering their costs, and thereby choke off the supply of credit for poor people.
8. **The job of government is to enable financial services, not to provide them directly.** Governments can almost never do a good job of lending, but they can set a supporting policy environment.
9. **Donor funds should complement private capital, not compete with it.** Donors should use appropriate grant, loan, and equity instruments on a temporary basis to build the institutional capacity of financial providers, develop support infrastructure, and support experimental services and products.
10. **The key bottleneck is the shortage of strong institutions and managers.** Donors should focus their support on building capacity.
11. **Microfinance works best when it measures—and discloses—its performance.** Reporting not only helps stakeholders judge costs and benefits, but it also improves performance. MFIs need to produce accurate and comparable reporting on financial performance (e.g., loan repayment and cost recovery) as well as social performance (e.g., number and poverty level of clients being served).

[*] Since June 2004, five agencies joined CGAP. CGAP now has 33 members.

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Good Practice Guidelines for Funders of Microfinance seeks to raise awareness of good practice and improve the effectiveness of donors and investors' microfinance operations. The *Guidelines* draw on lessons learned during 30 years of support and translate them into practical, operational guidance for staff. They are based on a vision for the future of microfinance that has been defined by CGAP's members.

Vision for Inclusive Financial Systems

A world in which poor people everywhere enjoy permanent access to a wide range of quality financial services, delivered by different types of institutions through a variety of convenient mechanisms.

"The OECD's Development Assistance Committee has long argued for greater effectiveness, accountability and harmonization of aid. This excellent consensus document provides clear and practical guidance that paves the way for donors to meet these goals. It deserves to be read by everyone concerned with microfinance."—**Richard Manning, Chair of the OECD's Development Assistance Committee**

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