



ICADE BUSINESS SCHOOL

**FINANCE FOR DEVELOPMENT. MICROFINANCE
AND ITS IMPORTANCE ON ECONOMIC
DEVELOPMENT**

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1. ABSTRACT

The aim of this document is to focus on the concept of microcredit and its relevance on social and economic development. Microcredit is linked to the expression “responsible productive finance” and they are part of the social inclusion framework. I am going to focus the paper on the general characteristics and on the current situation in Latin America with the specific example of the BBVA Microfinance Foundation and its six microfinance institutions. On the other hand, we will deepen in interest rates problems, administrative costs handicaps, guarantees issues, risk evaluation problems, idiosyncratic characteristics, credit for women, problems of economy informality, sector diversification, products development, client treatment and new models developed (banking correspondents). The paper also shows some main improvements and risks such as the concept of overindebtedness of low-income people or the lack of impact valuation.

Key word: microcredit, microcredit institutions, social exclusion, responsible productive finance, Grameen bank, BBVAMF, banking correspondents, Latin America development.

2. INTRODUCTION

The main objective of this paper is to study and deepen in the microfinance world. The main goal is to provide the reader with a general overview about what microfinance is and its implications in order to understand more clearly why microfinance is necessary. Consequently, this paper tries to study what the social role of microfinance is and why it is worthy to maintain microfinance institutions. According to some authors (Gonzalez, 2015) only around 10% of total microenterprises in the region have access to financial services. However, it is precisely this group of entrepreneurs who needs more financial support. But, as they do not have many resources, assets or guarantees to provide, they are riskier than other segments. Consequently, traditional banks do not usually are available to provide them with credits and are excluded from the formal financial sector. This fact is limiting their future possibilities and depleting their possibilities to develop productive activities to improve their life standards. On the other hand, it has been totally proved that around 77% of poor people overcome poverty thanks to entrepreneurship (BBVAMF¹).

Then, an effective way to help people to improve their standard of life and auto-generate incomes is to provide them with economic resources that let them generate incomes in the future becoming independent. For doing that, we need institutions fully dedicated to provide poor people with credit, only targeted to develop productive activities (mainly entrepreneurs) that allow them generate incomes by themselves. I am talking about institutions specialized on credits with social objectives, not credits for just consumption. Then, we focus on institutions really aware of and worry about clients’ needs. Then, microfinance institutions are different from traditional banking. Microfinance institutions play a social role than traditional banks do not play for reasons we are going to study. Moreover, microfinance institutions create products adapted to the specific clients’ needs, are based on the trust and direct

¹ Informe de Desempeño Social BBVAMF 2016

knowledge of the client (Grameen bank and other authors such as Flores 2007 or Lacalle Calderón 2001) and monitoring them correctly. The final goal is that low-income people can have access to basic financial products and benefit from them developing their own businesses. They also try to provide them with financial education that they usually do not have.

In this way, I decided to firstly provide the reader with the definition of microcredit, the origin and evolution. Then, I am going to talk about the main characteristics of microcredits and microfinance institutions and their goals in the society. I am going to highlight one of the relevant problems of this kind of institutions: how to manage with administrative and transaction costs and what kind of interest rates they should ask for. In this case, we have asked some specialists of BBVAMF (BBVA Microfinance Foundation) about its point of view and the main solutions. Later, we focus on Latin America, and I will provide some basic characteristics there. On the other hand, I will focus on one specific example of microfinance institutions in Latin America studying the way in which the BBVAMF is working through its six microfinance institutions. I am going to deepen in two of them and their activities (Bancamia in Colombia and Adopem Bank in Republican Dominican). Moreover, I have interviewed two experts from the foundation in order to deepen and know its activities and obtain data about projects that they are developing now in Latin America. Then, I have included this data in the paper and I have shown a BBVAMF new project: the banking correspondents' system and how they are working on it, the role and the goals. Besides, I have included some improvements and aspects that are necessary to do in this sector from the foundation's point of view. Finally, I have elaborated some final conclusions about the topic and the current situation.

3. DEFINITION OF MICROFINANCE. MAIN PURPOSES. WHO ARE THE MAIN RECEIVERS?

In this first part of the document, we are going to talk about the definition, the purposes and origin and history of microfinance.

Microfinance is very connected to the concept of microcredit and both have to do with the economic development. Many authors (Calderón et al 2013, Flores 2007) based the original definition of microcredit in the International Conference about Microfinance, in Washington, D.C, 2-4th February 1997 (Microcredit Summit, 1997). According to that Summit the microcredits are “granting programs of small credits led to the poorest people, so that these poor people could set up new small businesses generating incomes that let them improve their life quality and living standards of their families”.

The microcredit is a good instrument of solidarity; it allows poor people the access to capital and boost savings among the most vulnerable individuals (Calderón et al 2013). The microcredit wants to improve the ability to generate wealth, reducing the level of poverty (Flores, 2007). For that reason, the main objective of microcredits is the social and financial exclusion reduction providing better well-being to families all over the world. According to the specialists from BBVAMF (Microfinance BBVA Foundation)², microfinance are not only credits,

² Interviews to two specialists (Commercial Innovation and Development Area) from BBVAMF. Carmen Zaragoza Correa (Channels distribution) and Paloma Pérez Castañares (Microinsurances and microsavings). BBVAMF is one of the most relevant Spanish institutions specialised on microfinance in Latin America. We will deepen on it later.

but also other financial services and financial education. Microfinance allows sectors typically excluded to access to finance. Furthermore, microfinance let boost the entrepreneurship and then, the economic independence. In addition to that, the specialists from BBVAMF (their point of view) highlight that microfinance affects positively to the country and its economy because generate employment and have a clear multiplier effect. Then, it cannot be compared with traditional banking. This last one generates less multiplier effect than microfinance institutions because traditional banking is focused on profitability (as its first purpose). However, microfinance institutions need to be profitable to survive in the long term, but they are focused on making possible that vulnerable people have access to basic financial products and developing a specific institutional culture trusting on a population segment that traditional banks are not interested in and do not offer products.

More specifically, financial exclusion means the lack of access to the products and services of the formal financial system. This is a phenomenon that involves the individuals or families who cannot have access to products such as credit, savings, insurances or other payments instruments (Calderón et al 2013). This lack of financing is allocated in the lowest income people segments and microenterprises in the developing countries (Calderón 2001), mainly in Latin America, Asia and Africa. These microenterprises or “small businesses” are called the “informal sector” in the economy.

The origin of microcredit practices is in Asia, although, nowadays, it has been developed in most developing countries (Flores, 2007). According to Calderón 2001, microcredits appeared almost at the same time in Asia with the Grameen Bank and in Latin America with ACCIÓN Internacional. Both institutions have been independent each other but curiously, they are developed the same business model in order to reduce the poverty in Asia and Latin America respectively. Besides, both are shared experiences and learn between each other. Another relevant institution is the Rakyat Bank in Indonesia. These three institutions have demonstrated clearly that a bank dedicated to providing microcredits is also profitable. In any case, the specialists from BBVAMF says that poverty is different in each country, for that reason, microfinance is not exactly the same in Asia, Africa and Latin America.

It is worthy to highlight why financial inclusion is important in the economy and then, why microfinance plays a key role. As reported by the II Report of Financial Inclusion, 2016 by Felaban³, the financial inclusion is needed because it is positively connected to GDP increase (when structural restrictions of credit are reduced -example: more flexible or intangible guarantees-), and total productivity of factors increase. Moreover, it can affect positively to the GINI coefficient and reduce the level of asymmetric information. Lastly, they also show that simplified processes and credit applications in the formal financial system is another key point that financial inclusion does and that is causing positive effects in population standard of life.

On the other hand, as reported by some specialist from the BBVAMF⁴, it is proved, by several research from the World Bank, that almost the 77% of poor people achieve to overcome poverty through own entrepreneurship because it is a good way to become independent. The microfinance is part of the support that entrepreneurs need to success.

³ Federación Latinoamericana de Bancos in Spanish.

⁴ Paloma Pérez Castañares, BBVAMF

4. ORIGIN AND EVOLUTION. GRAMEEN BANK

In the next pages, we are going to explain what the evolution was in India, Bangladesh, where the first bank specialized only in microcredit for low-income people was set up by the well-known Muhamad Yunus.

According to M. Yunus (Yunus, 2003) the concept “microcredit” did not exist before the seventies and the term could be confusing because there are several types of microcredits such as traditional informal microcredit (moneylender’s credit, pawn shops, loans from friends and relatives), microcredit based on traditional informal groups (tontines...), activity-based microcredit through conventional or specialized banks (agricultural credit, fisheries credit...); rural credit through specialized banks; cooperative microcredit or consumer microcredit, NGO microcredits. In this way, authors attribute the microcredit creation and foundation to Muhamad Yunus. So, Yunus created this new concept in 1976 in Bangladesh and founded the most famous microcredit bank, Grameen Bank. 20 years later, in 1996, the Grameen Bank and copycat organizations had “3.5 million women borrowers; adding their dependents, that amounts to about 20 percent of Bangladesh’s population” (Jolis, 1997).

It is clear that people can have and develop microbusiness ideas, but the problem is always the same: so that individuals can carry out its businesses and take advantages of the economic opportunities, they need access to financing resources (Calderón 2001). So, the key word here is “capital”. People need capital to acquire raw materials and other inputs in order to produce output and sell them. The lack of capital is, in this case, their main obstacle (Calderón 2001).

Calderón 2001 highlights the main barriers that the poorest people find when they want to develop a small business. According to this author, the traditional commercial banking (official banking) is not focused on providing financial resources to poor people. This kind of banking denies granting loans or credits to people who cannot provide guarantees, as it is the case of poor people. Moreover, the author affirms that “the official banking motto has always been: the poor women and men do not have enough resources to survive, therefore, credit cannot be granted to them”. This is because, traditionally, when people do not have resources and guarantees, it is said that the possibility of default in the repayment is higher and banks usually do not want to assume this risk.

Knowing that commercial banks are not available for very-low or low-income people, the single opportunity for them is what is called “informal resources” according to this author. Informal resources involve either asking for money to their relatives (in many occasions their relatives do not have the money needed) or asking for the money to “usurers” through “predatory loans”. These predatory loans are characterized by high and unfair interest rates. These unfair interests’ rates do not allow them to develop because they have to save a lot of money just to repay the interests of those loans. As other author⁵ points out they are trapped and doomed to give almost all their profits to the usurers. Consequently, there was not any fair and available financial resource for poor people, when this segment of the population is the most needed and require more attention so that they can improve their living standard. According to Calderón 2001 some data provided for the World Bank in 1996 ensured that

⁵ Teka Aregau, G. (1997): El papel del crédito agrícola en el desarrollo agrario en Etiopía, Tesis Doctoral presentada en la Universidad Autónoma de Madrid el 3 de julio de 1997.

there were 500 million of microentrepreneurs in the world, and less than 2% had access to financial services. It is obvious that in those years, most finance specialists believed that financing the poorest people is too risky and very expensive, then not profitable. However, in some places efforts have been done in order to develop the new concept of microcredit targeted to low-income people.

Considering the crucial importance and the great contribution of Muhamad Yunus to the microcredits expansion, it is worthy to point out how he decided to set up this concept.

Muhamad Yunus was an economy professor of the Chittagong (Bangladesh), who had done his PhDs in the United States and came back to his country. There, he noticed that the poorest people were in a situation that does not let them improve although they worked a lot of hours. They couldn't save money so; they need capital access despite getting it in small quantities (Jolis, 1996). In this way, in 1976, Yunus decided to lend the money to some families, just small amount of money so as to invest it in productive activities such as bamboo. Thanks to the money lent by him, these families could acquire raw materials, produce bamboo and sell it (Flores 2007). Then, they had to pay the money back (notional plus interests) in small weekly installments to Yunus. Little by little he increased the number of families to whom he lent money.

In 1979, Yunus decided to ask commercial banks for lending the money directly and he guaranteed the operation, if any family could not pay the money back, he acted as a guarantor. Then, in 1982, he created the Grameen Bank, specialized in providing small quantities of credit to poor people, and only to poor people in fair conditions, without guaranties or guarantors. The Grameen Bank has a 16% of State participation (Flores, 2007). The rest of the bank is currently owned by the borrowers (most women). In this origin Grameen Bank was a rural bank since it was considered that the poorest people were in rural areas in Bangladesh and more than 90% of borrowers are women.

The main objective of the Grameen Bank is to provide very-low income people, excluded of traditional commercial banking, with access to financial resources, granting small loans to a lot of entrepreneurs (instead of huge quantity of money to few people) so that they can improve their life and reduce the gap between rich and poor individuals regarding financial opportunities. Calderon 2001 said that the final target was "to let small entrepreneurs, from the most disadvantaged social sectors, have money in beneficial conditions". In fact, Yunus wanted to reduce the level of global poverty with this method.

The main objectives of Grameen Bank are as follow (Flores, 2007):

- Provide the poorest people with loans. Specifically, those individuals who do not have savings and guarantees and do not have loans or credit available from traditional banking. Grameen Bank tends to allocate in rural areas.
- Avoid that poor people are under pressure due to predatory loans from usurers avoiding people exploitation. Sometimes the interest rates were almost 100%.
- Create employment and self-employment. In Bangladesh setting up a business was very complicated.
- Avoid the vicious circle that the poor people suffer. They do not have savings, so, no investments and no profits. Then, they cannot save. Grameen bank wants to break this circle.
- Grameen Bank is really focused on women. In Bangladesh women have a very vulnerable situation: they are considered inferior than men and, many times, they are

abandoned by their husbands. Grameen Bank wants to change the social traditions in this sense.

In 2000, the Grameen Bank introduced some changes. From the implementation of these changes, the Grameen Bank is known as Grameen Bank II. The main features are that they gave more flexibility to repayments and the possibility to renegotiate terms and amounts individually (Flores 2005). So, in general terms, the grameen system was improved to adapt the conditions to the client's needs.

Consequently, microcredits have several advantages such as the increase of poor people's incomes and savings, improving confidence's people and self-esteem when they discover that they are able to acquire the loan, invest and give the money back (Calderón 2001).

4. A) Credit Lending Models according to Grameen Bank

Microfinance institutions are using several models around the world, but according to Grameen Bank (grameen.com) the most relevant are as follow:

Associations: they are a group of people who join since they want to develop some activities all together. These activities can include savings and these could be associations of young people, women for instance in order to promote activities. They usually have in common political, cultural or religious issues. In this way, they joint to generate microenterprises and manage some microcredits. Sometimes, these organizations are legal entities that can collect fees and have tax advantages. Some examples are NGOs or community groups.

Bank guarantees: it is used to get a loan or credit from a conventional commercial bank. In this way, the guarantee can be obtained from an external donation or government agency or internally from members' savings. When loan is obtained can be given to a person or to a group. A bank guarantee is defined as "capital guarantee scheme" or guaranteed fund used for several purposes. For instance, the Grameen Bank says that a lot of international and UN organizations have formed international guarantee funds in which banks and NGO's can subscribe to with the purpose of promoting or starting microcredit programs.

Community Banking: the community banking model is, according to Grameen Bank, based on the treatment of the community as a unit. In this case, the microfinance is given through the use of semi-formal and formal institutions. These institutions are usually helped by NGOs. These NGOs also provides the community with skills, knowledge and basic training in finance. In many cases, community banks are participating in larger community development programs and use finance in order to boost activities and development of the community.

Cooperatives: according to Grameen Bank a cooperative is "an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise". Some cooperatives have also financing of its members and savings activities.

Credit Unions: it is a "unique member-driven, self-help financial institution". They are composed an organized by members of a group or institution. The main objective is to save

their money all together and to grant loans among all the members inside the credit union at a “reasonable rates of interest”. So, it has two part: the savings part (from its members) and the financing activity to its members. The members of these organizations usually share things in common such being part of the same community, from the same church or labor union, working in the same company... A credit union is a “democratic, not-for-profit financial cooperative”. One important feature is that each member has the right to vote in the elections of the representatives and each member “is owned and governed by its members”.

Grameen: it is the specific methodology of microfinance applied by the Grameen Bank in Bangladesh and created directly by Yunus. The methodology is the following: a bank unit is formed by one manager and a number of bank workers. This bank unit is going to cover between 15 to 22 villages. The managers and workers have to visit each village, knowing the people and explaining its purpose, function and methodology to the local people. Then, groups of five “prospective” borrowers are created. In a first stage, the bank is going to choose only two of them as “eligible” to receive a loan. Then, the group is follow for some weeks in order to check if they are able to accomplish with the Grameen rules. So, only if the two first borrowers are able to repay the notional plus the interest over a period of fifty weeks the rest of the member could access to the financing as “eligible”. There is a group pressure to maintain clear goals and records, therefore, there is a “collective responsibility” of the group and that acts as a collateral. Although there is no any kind of real collateral.

Individual: this is another model to provide micro loans, in this case, directly to the borrower without groups’ formation or any kind of “peer pressures” to ensure repayments. It is usually that, this kind of “individual model”, is part of a greater “credit plus program” where the person also receives socio-economic services, training and knowledge development in order to improve its situation.

Intermediaries: intermediary model is a model where there are three parts: the borrowers, the lenders and the intermediaries. Consequently, intermediaries are organizations that bring together borrowers and lenders. They play a “critical role” since they have to generate credit awareness and education among borrowers. Sometimes, they carry out savings programs. The main objective of intermediaries is to make possible that borrowers that need loans can obtain them from lenders. To achieve that, intermediaries create and develop different kind of programs based on training, education, saving plans and research. It is a way to improve the borrowers’ situation so that lenders want to grant loans to them. In this way, intermediaries improve the “credit worthiness” of the borrowers to a level enough to make them attractive to the lenders” as Grameen Bank points out. These activities take place at individual, local, regional, national and international levels. Some examples of intermediaries according to Graamen Bank are: “individual lenders, NGOs, microenterprise/microcredit programs, and commercial banks (for government financed programs), government agencies, commercial banks, international donors....”.

Non-Governmental Organizations (NGOs): currently, NGOs play an important role in the microfinance world. They usually act as intermediaries, as I have explained previously. Their main function is their active participation in microcredit programs:

- Creating awareness of the importance of microcredit within the community, as well as various national and international donor agencies.
- Development of resources and tools for communities and microcredit organizations to monitor progress and identify good practices.

- Development of publications, workshops, seminars, and training programs.

Peer Pressure: peer pressure is based on the use of moral and other linkages between borrowers and project participants. The objective is to ensure the repayment and participation. Peers could be other members in the group, community leaders (these leaders usually come from NGOs), NGOs themselves, banks etc.... this peer pressure function as collateral because other members can only receive a loan if the initial chosen members repay its loan. The technique is to visit to the defaulter, try to help him/her, prepare community meetings where they are identified and requested to comply etc.

Rotating Savings and Credit Associations (ROSCAs): they are a group of people who join together and “make regular cyclical contributions to a common fund”. Then a lump sum is given to a member of the group in each cycle. For instance, the Grameen Bank shows the following example: a group of 12 people contribute with \$33 (per person) per month for 12 months. Then, all the money collected during this period of time is given to one of the members. So, this lump sum acts as a loan for the member. He/she has to pay back the money in regular/further monthly contributions. The group continues to contribute to the fund in order to get another amount of money to be lent to another member. The decision about who is going to receive the money is decided by consensus, by lottery, by bidding or other methods.

Small Business: microcredits are also being granted to micro and small companies who need financing so as to keep their activities. So, nowadays, an important part of the microfinance is the microcredits granted directly to micro and small businesses. Sometimes, this financing is channeled by a larger enterprise development program for instance.

Village Banking: they are defined as “community-based credit and savings associations”. They consist of 25 to 50 low-income people who want to improve their lives through self-employment activities. The initial loan capital for the village bank usually come from external sources, but the purpose is to run their own bank (the members run the bank). Therefore, they choose their members, rules, officers and grant and distribute loans to individuals and collect savings. As it is usually in microfinance, there are no real collaterals in this business, only the moral collateral: “the promise that the group stands behind each individual loan”.

4. B) Aspects considered by Grameen bank to grant a credit

Three features of credit according to Grameen Bank (Grameen bank website). They are three main aspects that Grameen Bank takes in to account when granting a loan:

- 1) **Character**: the bank mainly studies the general history or background of each client in order to know if that person repaid debts in the past. They want to measure the reliability and the truthfulness of that person.
- 2) **Capacity**: they carefully study the level of debt that each person can manage in a good way. They analyze the income flows and try to adapt the level of credit granted to that person.
- 3) **Capital**: referred to the current level of assets that the borrower has. Some examples are: own savings, investments or real estate. The purpose is to analyze them in order to know the capacity of that person to repay if the income flows stop being available. Although, guarantees are not needed.

4. C) Grameen Bank Methodology

As it has been defined in the past section, the Grameen methodology is based on the voluntary formation of small groups of five people to provide “mutual, morally binding group guarantees”⁶ instead of requiring collateral. They assume that if they provide credit to individual borrowers, they will be able to identify how to manage it and invest it in profitable activities (“Income-generating activities”). Another key point in the methodology is that women are also eligible for loans. And not only they treat women equal to other borrowers but also do they completely support the idea that women are “astute entrepreneurs”. Consequently, women started to have credit access and they definitively improve their status with stronger independence on their husbands and more possibilities to provide basic needs to their children. In fact, as we have already commented, more than 90 percent of Grameen’s borrowers are women.

The main characteristics of Grameen bank methodology are that they are based on the intensive discipline, the follow-up of their clients and try to personalize the services provided. They are based on the branches creation and the independence among them. Each branch needs to have enough “delegated authority” so that they can carry out their own purposes.

They have developed a meticulous selection of borrowers and projects (based on the three features of credits previously commented). The denominated “peer pressure” and the repayment model based on 50 weekly installments are the key points.

Some interesting results that show how well this system has been working through time are as follow (according to Grameen Bank):

- A) There are some estimations that show that members of Grameen Bank have, on average, 50 percent more household incomes than the target group in the control village.
- B) The number of Grameen Bank members that live below the poverty line has been reduced. It is only 20 percent compared with the 56 percent for comparable that are not members of Grameen Bank.

4. D) Grameen Bank nowadays

Before, almost nobody thought that banks as Grameen Banks can operate because of their lack of profitability. However, nowadays, it is completely proved that the non-performing loans are almost zero; “99 percent of the loans are repaid. After 20 years, Grameen is a commercially profitable bank. But more important, it saves its borrowers’ lives (...)” (Jolis, 1997). Then, it is proved that the system works well and accomplishes with the objectives.

In the official Grameen Bank website, they define the bank as a “reversed conventional banking practice by removing the need for collateral and created a banking system based on mutual trust, accountability, participation and creativity”. They continue lending money to the poorest of the poor in the rural areas of Bangladesh without any collateral. Muhammad Yunus

⁶ As it is defined in Grameen web site

establishes as a fundamental feature that terms and conditions of the credit are appropriate and reasonable. Surprisingly, it provides microcredits to 8.81 million of borrowers, 94 percent are women, and it has 2.568 branches and provides services in 81.392 villages. Grameen Bank has been able to cover more than 97 percent of the total villages in Bangladesh⁷. In fact, many researchers and external agencies (World Bank, the International Food Research Policy Institute (IFPRI) and the Bangladesh Institute of Development Studies (BIDS)) have documented the Grameen Bank's positive impact.

5. KEY FEATURES OF MICROCREDITS

In Flores 2007, Calderón 2001 and in the Grameen Bank website, we can find the general features of microcredits. The most important are the following:

- The credit promotion is a human right in order to encourage human development.
- The main mission is to help the poor families to get financial resources and overcome poverty. They are very focused on women.
- Not based on collateral or guarantees or legal process, just based on “trust” on borrowers.
- Targeted to boost the self-employment and incomes generation from investments in productive activities. Also, housing.
- It is the opposite of conventional banking and does not believe that poor people are “not creditworthy”. It creates its own methodology.
- Based on the principle that “people should not go to the bank; bank should go to the people”. For that reason, it tends to allocate in rural areas.
- A typical technique used is through what is called “solidarity group”⁸: anyone who wants loans needs to join and participate in a “group of borrowers”. The other way is the individual methodology.
- They are granted in very small amount of money and in the short-term (less than one year or until one year). (Calderón 2001)
- “Loans can be received in a continuous sequence. New loan becomes available to a borrower if its previous loan is repaid”. (Grameen bank web site)
- The amortization of notional and interests are in installments (notional plus interest weekly/monthly) and in small quantities easier to pay back. Then, there are very short replacement periods and reimbursements in insignificant amounts. (Calderón 2001)
- Each borrower can receive more than one loan or credit simultaneously.
- There are compulsory and voluntary savings programs.
- Normally, these loans are granted through NGOs or institutions owned by the borrowers. Sometimes it can be done through for-profit organizations not owned by borrowers. The general rule for grameen credit is to keep the interest rate close to the market rate but focusing on and having as a priority the sustainability more than investors' returns. When the interest rate is fixed, it is considering the market interest rate as a reference rather than the moneylenders' rate. For that reason, helping poor people and sustainability are the core goals.

⁷ Grameen.com .These data is updated as of December, 2015.

⁸ Solidarity group is a group between five and eight people linked since they are friends or neighbours. They create the group in order to access to credit. This definition is from Flores 2007.

- Another priority is the generation of social capital. It promotes the creation of groups and centers owned by the borrowers and led by them. It tries to encourage them to establish rules, an agenda and activities. The main objectives are the formation of human capital, the environment protection, education improvement, scholarships and student loans for better and higher education, boosting the modern technologies.

For instance, in the case of Grameen credit, it is aware of the need to reduce poverty in the world and all of its activities are focused on that. According to Grameen Bank vision the best way to decrease poverty is not through charity, but changing the institutions and policies and create new ones. Another affirmation that is worthy to highlight from Grameen Bank objectives is that poor people have skills to develop themselves, the problem are not the poor people themselves or their lack of skills, it is the institutions and organizations that surround them. For that reason, Grameen Bank wants to promote the generation of group of people who collaborate each other with the same purposes: obtain financing in order to develop activities. This is the main target of microcredits.

6. MAIN CHARACTERISTICS AND PRINCIPLES OF MICROFINANCE INSTITUTIONS

According to Grameen Bank and Calderón, 2001, the most important features are:

- 1) Good knowledge of the target market: these kinds of institutions have to deepen in the needs, preferences and limitations of their clients. This kind of client has enough capacity to develop a project but does not have sources to have access to the traditional banking system. For instance, the Grameen Bank is based on the social background of the person rather than established pre-requirements. That means: “Start with the problem rather than the solution”. According to Calderón, 2001 it is based on “no need of guarantee”. Instead of that, there are solidarity guarantees (each institution determines the guarantee is going to require). The main ways of solidarity guarantees are as follow: other people guarantee with their own goods or belongings instead of the own debtor; social pressure of other group members (Grameen calls it “peer pressure”) or savings requirements. Other techniques are, for instance, progressive loans programs (commitment of future loans with bigger amounts if the client is able to accomplish with the principal and interests repayments at maturity).
- 2) Other features:
 - Simple contracts and simple transactions. Clients easily can understand the content.
 - Branches⁹ are located close to the clients, in the villages where clients work or life. It is a clear that clients do not have resources to move to another place looking for banks.
 - Simple and quick policies and procedures to apply for and grant a loan. In one or few weeks individual can have the money. It is very important the monitoring of each case.

⁹ This is not always easy and nowadays, some microfinance institutions are developing other solutions such as banking correspondent or mobile banking.

- 3) Credit system is only for low or non-income individuals (Calderón, 2001): the main objective is the poor people. Each institution has each own method. For instance, the Grameen Bank has a system in which officers go to villages and let people know them. They offer their services to people and not the other way around. In Latin America, we will study how the method is very similar (direct visits to clients).
- 4) Personalized treatment to people with no credit access.
- 5) Risk evaluation: it is according to the personal relationship between borrower and lender. In some case, the selection of a client is because this client has been recommended by other client. (Lacalle 2001 from Christen and Wright, 1993).
- 6) Importance of savings: microinstitutions not only offer loans but also savings accounts. Traditionally it was thought that poor people could not save money and because of that they did not need savings accounts products. But currently, it is well known that if microinstitutions provide poor people with savings products, they could save in a safer way. They did not save money because they did not have access to those products. People save in order to face new investments opportunities and emergencies. This is very important for the financial self-sufficiency. The savings services have to be voluntary and free programs and with direct and quick access to saved money in case of need (liquidity), they are for everyone, not only those who demand loan services and be safe. (Calderón, 2001).
- 7) Mainly focused on women. Most clients in microfinance are women. There are several reasons (Calderón, 2001). The main are that women are generally in a worse position than men, and then women are, in most cases, the kind of clients that are eligible. Moreover, women have better repayments rates than men.

7. PROBLEMS OF ADMINISTRATIVE COSTS AND SOLUTIONS

One of the most relevant characteristic of microcredit is that the amount of each credit is really small and adapted to each person. For that reason, microcredit institutions have to deal with the fact that they need to reduce as much as possible the transaction costs so that the loan costs are proportional to the small amount of credit granted.

The main problem is that microfinance institutions need to be able to cover these transaction costs. These costs are mainly formed by the following, according to Calderón, 2001:

- Operation and funds costs (including opportunity costs)
- Non-performing loans provisions costs
- Inflation costs
- Margin to ensure future development of the institution

All these costs would involve, in many cases, to the establishment of higher interest rates than the market in order to cover these costs since the kind of credits granted are characterised by the large amount of tiny loans. Consequently, they have to do a lot of transactions and follow each client carefully. For that reason, costs tend to increase more than in other normal banking activity. However, due to the kind of clients in which they are focused on (poor people), they cannot impose a high interest rate, since the purpose of microcredit would not make sense and people could not repay the debt and interests. So, the conclusion is that there

are usually high administrative and transaction costs but the interest rates they collect have to be fair.

Moreover, a lot of microfinance institutions offer not only financial services, but also advisory and training services since, in many cases, clients need, apart from money, advice and basic financial courses in order to improve their knowledge and let them be independent and deal correctly with the money lent out. These kind of non-financial services are financed via profits collected from financial services (in many cases do not exist) or via international cooperation resources. Consequently, this kind of services is another handicap that microfinance institutions have to cope with.

In this way, microfinance institutions can have problems to achieve what is called “financial self-sufficiency”. According to Calderón, 2001, “financial self-sufficiency” is referred to financial operations carried out by the own institutions.

There are two parts to deal with: the reduction of transaction costs and the establishment of adequate interests’ rates. The most relevant solutions to costs problems are:

- Simple application procedures. They try to reduce application only using one page.
- Decentralization of decision-making to local branches. In this way, when some decisions need to be taken regarding any new credit operation, it is more effective that the near local branch decides because it is the one who has direct access to the client and can easily to collect data.
- Some institutions try to spread the use of what is called “solidarity groups”. In this way, some institutions tend to delegate some activities and decision-making to the own clients. Then, own clients are who manage the situation, learn with the help of the institutions and become more independent. On the other hand, institutions avoid having high administrative costs through delegation.
- The use of adequate IT systems in order to manage big amounts of data and transactions. The thing is that not always is easy to have access to these kinds of IT products because of the costs.
- The establishment of methodologies that let institutions assess new clients faster and in a more automated way such as bigger financial institutions do when dealing with new clients.

On the other hand, to achieve “financial self-sufficiency”, institutions need to cope with the adequate interest rate determination. This issue is not easy because microfinance institutions need resources to be able to operate and provide people in needs with services, but the collective of target people are low or very-low-income individuals.

According to Calderón, 2001; these interest rates must be similar or relatively higher than those imposed by formal financial intermediaries, but, at the same time, lower than those imposed by informal intermediaries –such as usurers- (Rhyne y Otero, 1998).

From the very beginning of microcredit programs, there has always been a debate regarding the amount of interest rates to charge. Taking into account the purposes of microcredits the debate tries to see if it is better to apply subsidized rates or markets rates. According to Calderón, 2001, historically it has been seen that it is more fruitful to charge markets rates than subsidized as the non-performing ratio is lower in the first case than in the second one.

Most researches confirm that interest rates cannot be subsidized since (Castelló 1995) it affects directly to the long-term viability of microfinance institutions¹⁰ and it is irresponsible with the poor entrepreneur that is going to be helped. Then, once decided that subsidized rates are not the more appropriate, the debate has been between the charge of markets interests or (in order to achieve financial self-sufficiency) the interests that let the institution cover all transactional costs despite being higher than markets rates.

According to the “United Nations Development Program 1997” the way in which microfinance institutions have to act is the following: in a first stage of help it is used subsidized rates in order to make easier and cheaper financing. But in a second stage, it is pretty advisable to charge interests that allow the microfinance institution to cover all costs and receive a little positive margin. The main reasons are to ensure the long-term viability of microfinance institutions, as it has been said before; and also because clients accept these interests since they are not usurer (they are correctly justified) and then significantly lower than usurer interests. Later, we are going to deepen on the interest rates handicap using specific examples of institutions in Latin America.

8. MICROFINANCE IN LATIN AMERICA. A GENERAL APPROACH AND EVOLUTION. KEY FIGURES

In this part of the paper, I am going to provide the reader with a general outlook about microfinance in Latin American. According to Gonzalez, 2015 microfinance has been developed in Latin America in a quick way becoming an important tool for fighting against poverty and financial exclusion in the last twenty years. This positive evolution for microfinance has been conditioned by the lack of efficiency of the official development aid (ODA) provided by Governments in developed countries and also because of the failure of macroeconomic policies developed in these Latin American countries.

It is interesting to point out that in Latin American countries there are estimations that affirm that there are around sixty millions of microenterprises (with less than five employees) in 2015 (Gonzalez, 2015). However, less than 10% of these microenterprises have access to basic financial services such as credit and savings accounts. In fact, this author says that, if workers and poor individuals are taken into account, this gap is even worse. On the other hand, it is true that in the last years, especially in the last ten years, microfinance tendencies and models have improved significantly in Asia and Latin America. For instance, the specialists from BBVAMF confirms that they have observed and contributed to the professionalization of this sector in those countries. Then, microfinance in Latin America is an incipient sector where there are more and more professionals and entities that compete for providing vulnerable people with financial resources.

As mentioned before, Calderón 2001, it is said that the first microfinance institution in Latin America was *Acción Internacional* who developed a similar Grameen bank methodology. This NGO started in Venezuela in 1961 but has spread through other Latin American countries, Africa, Asia and the United States. In the seventies, *Acción Internacional* started to work granting micro-loans in Brasil. In fact, after the first year, they reported that almost the 100%

¹⁰ We will deepen in the Bancamia and Apodem Banck Comments section

(99,5%)¹¹ of people repaid their credits. Nowadays, *Acción Internacional* collaborates and offers technical support to a big framework of microfinance institutions. Its main strategy is to help small entities to reach a major scale, sustainability and efficiency. They support them so that they can effectively offer services and new products. To do that, they employ efforts in regions with scarcity of resources, not only in Latin America, but also in India, China, Myanmar and Sub-Saharan Africa.

As reported in Gonzalez, 2015 one of the main ways of microfinance institutions creation is through the process called “upgrading”. In this process, the microfinance services emerge from NGOs (they are called microfinance NGOs as *Acción Internacional*) who usually tried to offer these kinds of services and they were the only kind of institutions in the sector. However, many of these NGOs have improved their services and have started to operate as specialised and regulated microfinance institutions.

The main structural reasons that have been an obstacle for financial inclusion in Latin America have been studied in the II Report of Financial Inclusion 2016, Felaban¹². In this report, Felaban carried out a research in order to know what these main obstacles are by countries. As a general conclusion, the research affirmed that the more relevant handicaps are as follow:

- Economic informality
- Lack of financial education and economic culture
- Level of poverty
- Legal or financial supervision barriers
- Lack of public policy incentives
- Costs of financial services
- Financial entities not supervised
- Lack of trust on banks
- Interest rates control
- Geographical accessibility

They are sorted by level of importance, from the most relevant to the lower one, although this depends on each country.

Firstly, the most important obstacles are the economic informality and the lack of financial education. The economic informality refers to the lack of formal labour market, credit registers, lack of information and microenterprises accounting, the gap between urban and rural areas and so on... In fact, according to Felaban, the World Labor Organisation said that 48% of the employment in the region is informal. The lack of financial education is the second one. Although it is linked to economic informality is a complex topic. The report also comments that legal and financial barriers are referred to the lack of or excessive regulation (depending on the country). For instance, in some Latin American countries there are compulsory allocation of credit resources to specific sectors (legal rule). Another example is the existence of regulation or supervision that does not recognise the need of financial inclusion and/or treats new clients with the same severity than other clients. In other Latin American countries, there are maximum interest rates and, as mentioned before, interests’ rates are crucial to keep long term viability. Moreover, Felaban points out that another problem is usually the restriction to credit access because these countries want to protect the

¹¹ www.accion.org

¹² The original name is II Informe de Inclusión Financiera 2016, Felaban. Felaban is an institution called Federación Latinoamericana de Bancos in Spanish.

financial stability. However, Governments are conscious that financial inclusion must increase because it is directly related to the GDP increase and other important macroeconomic variables.

On the other hand, there are some handicaps that can affect depending on the characteristics of the country (they are more idiosyncratic variables). For instance, geographical accessibility problems exist in rural areas, small villages, mountainous areas and this provokes financial inclusion handicaps that these countries have to overcome.

In any case, it is very remarkable that the sector is improving little by little. The last data available shows us that, in Latin America countries and Caribbean, microcredit portfolio is greater than US\$44 thousand of million¹³ with more than 18,5 million of clients. This was something unthinkable ten years ago. Another interesting point is that 50% of microcredits clients are covered by banks, the other 50% are covered by non-banking and specialized institutions and cooperatives: 15% covered by regulated institutions and the rest 35% are covered by non regulated institutions (limited companies, financing companies...).

The report from the FOMIN¹⁴ and BID affirms that the average interest rate in the entire region is 27%, being the same as previous years. We will deepen in interest rates issues in the following pages. However, the report also says that this rate changes significantly depending on the country. In countries where the market is more mature, the microcredit market is more consolidated and there is more competence (such as Bolivia, Peru, Ecuador or Colombia), the interest rate is even lower than 25%. While, in less competitive countries and with less microcredit experience, the interest rate could be 60% (such as Argentina).

9. CASE STUDY: BBVA MICROFINANCE FOUNDATION (BBVAMF) IN LATIN AMERICA

The BBVAMF is a Spanish foundation that was created by the BBVA bank ten years ago, in 2007. It is a non-profit organisation fully dedicated to microfinance services in Latin America. So, it is one of the most relevant and active institution focused and completely specialized in offering different financial products to individuals with low incomes in order to provide them with credits basically and also with other products. According to the own foundation¹⁵, its main mission is “to boost the economic, sustainable, social and inclusive development of especially vulnerable individuals in the society that have or want to generate productive activities”. In this way, the BBVAMF is really focused on what is called “responsible productive finance”.

¹³ Figures from Inclusión Financiera y Desarrollo del Sistema Financiero en América Latina y el Caribe. BID y FOMIN. Octubre 2016

¹⁴ Inclusión Financiera y Desarrollo del Sistema Financiero en América Latina y el Caribe. BID y FOMIN. Octubre 2016

¹⁵ <http://www.fundacionmicrofinanzasbbva.org>

9. A) Main History and Features

It is created in 2007 by BBVA bank. The foundation is completely independent from the bank itself. It is independent from the point of view of government and management and it also has its own legal personality. Initially the BBVA bank decided to provide the foundation with two hundred¹⁶ million of Euros. It invested its donation in creating and boosting a group of microfinance institutions in Latin America. The foundation also declares that all the profits obtained through the activity is reinvested in the own activity of the institution and do not generate any financial return for the BBVA as a bank.

Until now, the foundation has declared that it has provided services to more than five million of people in Latin America and currently have around 1,8 million of clients in the entire region. Furthermore, between 2007 and 2016, the foundation has granted more than \$8.200 million in credits becoming one of the most relevant institutions regarding the social impact in Latin America. Moreover, it is well known because it is the first institution in the region who applies an individual methodology. We will explain further, through a specialist from the foundation, how they have developed the individual methodology¹⁷. This methodology implies a deep and individual knowledge of each microentrepreneur.

According to the own BBVAMF¹⁸ the foundation works with microfinance institutions in five countries in Latin America and plays a key role acting as a holding. The main function of the foundation is to act as a consultancy service for microfinance institutions. In this sense, the foundation advises them in several financial areas and provides technical and economic support and new ideas. The foundation has resources and the experience to do it since it was born from one of the main banks in Spain. That basically means that the foundation sometimes helps with financial resources, although each institution is independent and has each own infrastructure and local resources. Consequently, the support is sometimes based on technological issues and how to develop new products and services. In any case, from the BBVAMF they want to promote its role as a group of entities because this let them have more bargaining power.

As we can observe from the table 1, the BBVAMF is focused on vulnerable (77%) (low-income) people, people without or low education and women (more than half of the credits are for women). Moreover, they have a third of its credit portfolio in rural projects and a significant part in young people.

Table 1. Total BBVAMF credit clients at the end of 2016

Vulnerable	Low education (primary educ)	Women	Rural environment	Lower than 30 years
77%	45%	60%	32%	19%

Source: own elaboration from Informe de Desempeño Social BBVAMF 2016

As reported by the specialists from BBVAMF, the foundation is not only worried about improving “general practises” or introducing “better practises”, it also collaborates daily with institutions in the management level. Consequently, the main objective of the foundation is to

¹⁶ Informe de Desempeño Social BBVAMF 2016

¹⁷ In microfinance there are usually, two ways to offer products: directly client by client (individual methodology) or through solidarity groups.

¹⁸ Interview to BBVAMF specialists, Carmen Zaragoza and Paloma Pérez Castañares

use the background and the deep knowledge of the BBVA as a bank in order to help these institutions to develop themselves. In this sense, there is a good mixture between traditional banking capacity, who knows how to develop efficient processes and products, and local knowledge that these entities have (because they know their clients and the way in which processes are done in each country). This mixture has been successful and has let them professionalize the way in which these entities act respecting local processes.

There are two ways to introduce new products: directly by each institution with technical assistance from the foundation or innovative ideas that are generated from the foundation and are introduced little by little in each institution, firstly with some trials. According to the specialists BBVAMF point of view, one example of innovative ideas generated from the foundation directly is the banking correspondent system introduced in Colombia and Dominican Republic. On the other hand, one example of products developed from each institution with technical assistance and support is microinsurance and microsavings.

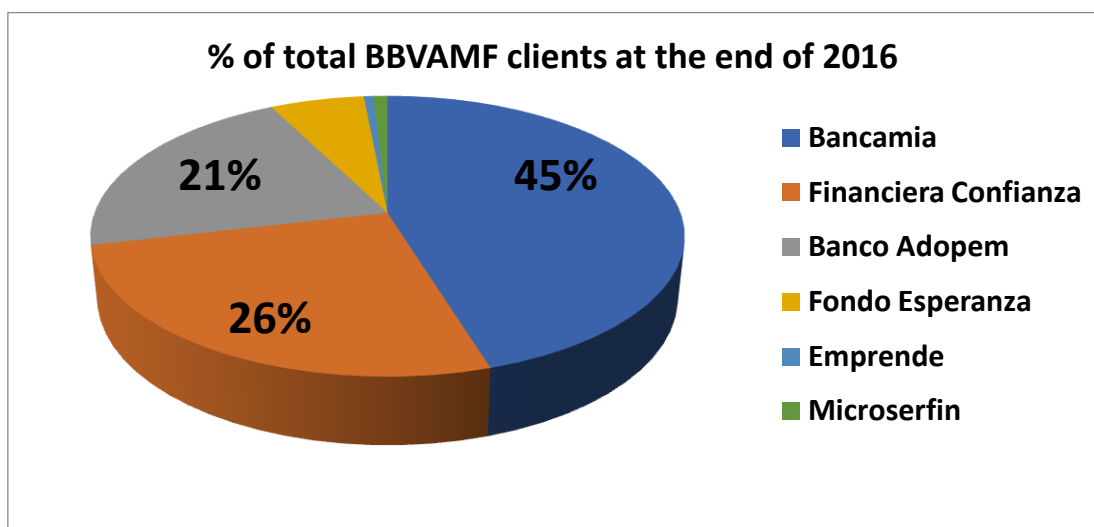
9. B) Main BBVAMF Microfinance Institutions: A General Overview

The BBVAMF works directly through six microfinance institutions that were created in Latin America locally. The BBVAMF decided to invest directly in these microfinance institutions becoming the main investors (shareholders). Consequently, the BBVAMF has invested in the equity as the major investor in each of the following institutions we are going to talk about. But it is important to highlight that these microfinance institutions were created before the BBVAMF, they are independent each other, operate and work in different countries and have developed their own products and services locally. However, as the BBVAMF is the main shareholder of all of them, they receive support from the foundation in terms of financial support, technological support, advisory and, in general, help to develop innovative ideas and projects. In this sense, we will see that in some cases, these institutions develop from the beginning their own initiatives and receive support from Spain; and in other cases, the innovative idea comes from the BBVAMF directly. Then, the foundation creates the product or service and tries to implement it in one of the institutions in Latin America doing one or several pilot programs¹⁹. When the foundation makes sure that it works correctly, it implements it in other institutions of the group. We will see it deeply in the next section.

The Latin American countries where the foundation is currently carrying out projects are Colombia, Peru, Dominican Republic, Chile and Panama. In graph 1, it is shown the six microfinance institutions and the percentage over the total amount of BBVAMF clients. The most relevant are Bancamia, Financiera Confianza and Adopem Bank. We will focus on Bancamia and Adopem Bank.

¹⁹ Carmen Zaragoza, BBVAMF

Graph 1. % total BBVAMF clients at the end of 2016



Source: own elaboration from Informe de Desempeño Social BBVAMF 2016

Table 2. Credit Portfolio and average credit by institution (2016)

2016	Bancamia (Colombia)	Financiera Confianza (Peru)	Adopem Bank (Dom Republican)	Fondo Esperanza (Chile)	Emprende (Chile)	Microserfin (Panama)
Credit portfolio	\$380 mill	\$468 mill	\$128,6 mill	\$64,6 mill	\$15,2 mill	\$25,5 mill
Average credit	\$1.270	\$1.973	\$705	\$729	\$1.331	\$1.473

Source: own elaboration with "Informe de Desempeño Social 2016" of each institution

From Table 2, it can be observed that the average credit, by individual, has been around 1.246 dollars (by credit) and the average credit portfolio in 2016 has been 180,32 million of dollars. The greatest credit portfolios are observed in Bancamia and Financiera Confianza. This has been a great advance in microcredit sector since these portfolios were significantly smaller ten years ago or these portfolios did not exist because most institutions were created in these last ten-twelve years. Then, these institutions are contributing positively in order to provide microentrepreneurs and individuals with microcredits and credits than before they did not were available. In the case of Bancamia (one of the biggest) registered \$524 million in credits) in 2012 (its greatest amount), \$523, \$449, \$350 and \$380 (million) in 2013, 2014, 2015 and 2016 respectively. Consequently, Bancamia had its peak in 2012 although, its credit portfolio is reduced the following years and registering an increase in 2016.

The general features of all institutions can be summed up as follow:

- Specialized in entrepreneurs with low incomes.
- Tailor-made products and services focused on its specific clients and region.
- Work for "responsible productive finance"
- Try to reach to clients with difficult access because of the region, the lack of transportation or the lack of resources.
- They are independent each other. In all cases the BBVAMF is the major shareholder.
- They receive technical assistance, economic assistance, advisory and monitoring from the BBVAMF.

- Want to generalise the use of financial institutions and provide individuals with credits and other products in order to make possible to develop productive activities that let people become independent and improve their standard of life.
- Take care of the clients in the long term and measure the impact of their services in families.
- They are not interested in offering just credits to obtain profits and increase the level of debts unnecessarily²⁰. For instance, they do not provide credits for just buying consumer products.
- They have developed strategic alliances with other national and international institutions (World Bank, Interamerican Development Bank).
- They usually work with “specialized officials”. The term in Spanish is “oficiales”. They are people who are trained and specialized in microfinance and work for the microfinance institution locally. Their main commitment is to move to other cities and rural areas where the clients are to provide them with services, products and financial help and monitor them. They are necessary because entrepreneurs are usually in areas of difficult access²¹.

As reported by the BBVAMF²² specialist point of view, the more relevant resources that these institutions have are the following:

- Local resources from the own entity.
- Technological resources and economic support from the BBVAMF
- US Aid: it is official support from the USA Government. It is based on technical advisory, improvement models and so on..
- Sometimes they receive funding to develop specific programs or projects from local Governments (subsidies). This is the case of the credits for women developed by Adopem bank in Dominican Republican.
- They usually have collaborators with who sign agreements to develop programs and have specific technical and economic assistance. The two more relevant collaborators are the Interamerican Development Bank (IDB) and the World Bank.

Specifically, we are going to show a general outlook of BBVAMF ´s institutions:

- **Bancamia S.A. (Colombia):** it is one of the most relevant microfinance institutions in Colombia. It was created in 2008 from the assets integration of two institutions (Corporación Mundial de la Mujer Colombia and Corporación Mundial de la Mujer-Medellín) plus the BBVAMF. In 2010, International Finance Corporation (IFC) started to be shareholders as well. Its purpose is to provide low-income entrepreneurs with services using its own methodology and products and services focused on covering the needs this specific segment of the population has. It provides services in urban and in rural areas. They are specialized in services for entrepreneurs that have difficult economic situations and, because of that, they are excluded from other financial resources.²³

²⁰ Carmen Zaragoza, BBVAMF

²¹ Carmen Zaragoza, BBVAMF

²² Carmen Zaragoza, BBVAMF

²³ According to the “Informe de Desempeño Social de Bancamia” for 2016.

- **Financiera Confianza S.A.A. (Perú):** it is a Peruvian financial institution that was created through the merger of other small institutions in the country in 2013: Caja Nuestra Gente and the older Financiera Confianza. It is a financial institution that offers financial products to improve the life standard of people. Its products are focused in the distinct stages of the productive activity. Besides, they also provide financial training and education²⁴. It is the only microfinance institution that provides services in all the country and it is the one whose services reach more rural areas. This is very important due to the fact that the most needed individuals are in rural areas. It has a relevant project based on providing entrepreneurs with financial education through what is called “Group Credit” *Palabra de Mujer* and its program *Ahorro para todos*.
- **Banco Adopem (Dominican Republican):** it is a microfinance institution that wants to invest in clients so that they could start to use the formal financial and economic system²⁵. Its real name is Banco de Ahorro y Crédito Adopem, S.A. It is mainly focused and socially compromised with micro, small and medium entrepreneurs and the poorest people. It started in 2004 as a financial institution (as a bank). However, it has been providing people with credits as an NGO three decades ago. So, in this case, this entity has a vast experience in the sector. From 2012 onwards, it is part of the BBVAMF. They are really focused on entrepreneurs from production and sale of food products, clothing and shoes manufacture, handmade products, carpentry and other services. It has 74 branches around the country and has also a really advanced system of correspondents or banking agents.
They have developed specifically a project called “Finanzas Rurales y Medio Ambiente” in 2016. This project is focused on the development of business projects for entrepreneurs with a low environmental impact. Some examples of this project are: “*Promoviendo Créditos Verdes como Estrategia de Inclusión Financiera en Zonas Rurales de República Dominicana*” created to provide entrepreneurs with credit from rural areas or primary sector makes possible that they can improve productive processes becoming more eco-friendly.
In 2010, Adopem Bank was chosen by the Interamerican Development Bank (IDB) as the best microfinance bank in Latin America and the Caribbean region. In the next section, we are talking about its products and services.
- **Fondo Esperanza (Chile):** it is the biggest Community of solidarity entrepreneurship in Chile that has been working for fourteen years. It is focused on financial services and also support for people in prison²⁶. This last program only focused on people in prison is called “*Segmentos Excluidos*” and started in 2013 when a group of 17 prisoners from the Osorno prison in Chile decided to trust on Fondo Esperanza and use their manual skills to become entrepreneurs. This was a really successful initiative that shows how people that are in prison, and have a difficult situation to reintegrate into the society, can do it. In fact, this initiative allowed them to change their future and have incomes to maintain their families. The success of this program has made possible to apply the initiative in other penitentiary centres. In 2015, this project started to be applied for homeless people. One of the last initiative of Fondo Esperanza has been the agreement to engage in the program called “Programa de Servicios Financieros en

²⁴ Informe Desempeño Social Financiera Confianza 2016”

²⁵ “Informe Desempeño Social 2016 República Dominicana”

²⁶ “Informe Desempeño Social Fondo Esperanza 2016 Chile”

Centros de Desarrollo de Negocios”²⁷. Its creation comes from the agreement signed by Chile and the United States Government with regard to the Promotion of the Entrepreneurship and Development of Small and Medium Enterprises. The main objective of these centres is to make possible the improvement of productivity and sustainability of businesses. Fondo Esperanza has created a school²⁸ to provide individuals, families and communities with financial knowledge.

- **Emprende Microfinanzas (Chile):** it was the first microfinance institution in Chile fully dedicated to low-income entrepreneurs. Two main focuses are the financial education and microinsurances for small promoters. It has been more than thirty years in this sector. Initially, it was a savings and credit cooperative and from 2009 onwards has been member of the BBVAMF group. Due to its years of experience it is pioneer in Chile regarding microcredits. It is defined as a “social responsibility and non-profit institution”²⁹. In November 2016, as Fondo Esperanza, signed an agreement to participate in “Programa de Servicios Financieros en Centros de Desarrollo de Negocios”. Microinsurance is another kind of product in which the foundation is focused on since, in origin, microfinance institutions were focused on credits but almost no one had basic insurances. Nowadays, this is also changing little by little³⁰. One interesting data, Emprende was able to provide more than 11.000 entrepreneurs with credits.
- **Microsefin (Panama):** it is a Panamanian entity that provides its services around Panama especially in rural areas. Microsefin³¹ has an especial commitment in rural areas and serves agricultural entrepreneurs. It follows up from the beginning and also through their development. As rural areas usually are far from cities, Microsefin works with “specialized officials” who move to rural areas to manage entrepreneurs’ needs. On the other hand, Microsefin is part of “Mesa Estratégica de Emprendimiento de Panamá”. This is coordinated by the Panama Government and brings together the main private, public and academic institutions of this sector. Its target is to promote the best practises and conditions so as to boost the entrepreneurship in Panama.

9. C) Methodologies for Credits in BBVAMF Institutions

Generally, there are two methodologies³² to grant credits. The individual methodology that works with credits granted individually and the group methodology, where credits are granted based on the group and where group guarantees are used. The individual methodology is more expensive for the entity but, at the same time, more adapted to each client, than the group one. For that reason, the average amount of individual credits is higher (1.000-1200 dollars) than group (300-500 dollars). On the other hand, group methodology is very useful because, as we have a group of people in an analogous situation and who want to use financial services, it is easier to provide financial education through the group. Here, institutions in addition to credits, they offer some basic knowledge that transmit it to the clients. This financial education tends to make the services more expensive. Additionally, in a group methodology, it is more

²⁷ It is part of the Services of technical Cooperation network (Sercotec): Economy and Tourism Ministry of Chile.

²⁸ It is called “Escuela de Emprendimiento”

²⁹ “Informe Desempeño Social Emprende Chile 2016”

³⁰ Paloma Pérez BBVAMF

³¹ “Informe de Desempeño Social Microsefin Panama 2016”

³² Paloma Pérez BBVAMF

difficult to measure the risks involved than in an individual one. For these reasons, interest rates applied in group methodologies need to be well chosen and carefully analysed. Some microfinance institutions work mostly with group methodologies such as Fondo Esperanza in Chile, others only individual or both such as Adopem bank in Colombia.

→ Individual methodology: process to grant a credit

Institutions follow a specific process to approve credits. It is very simple and is representative of what is usually done in microfinance institutions in general.

- 1) There are two options: the client goes to the physical office (branch) and applies for the credit or officials visit villages and offer their services and meet the population directly.
- 2) Workers of the institution visit directly the enterprise to know the local, the atmosphere and how the entrepreneur is managing his/her business and to collect documentation. In microfinance, the entity needs to evaluate the business directly because they do not have financial statements, documents or previous background. Sometimes, they need to interview neighbours so as to know better the client and its responsible behaviour. Officials check the real situation and if the entrepreneur can provide a guarantee, but the general rule is that guarantee is not compulsory. However, the entity evaluates this possibility and if the person can provide guarantee, they ask for it, if not, they do not demand them, but need to study carefully the situation and adapt the credit to that entrepreneur. For that reason, the amount of credit is very small and they repeat the operation in the short term to lend more money and not to have excessive risk exposure in one operation.
- 3) In some days, the institution studies the situation and contacts the client to let him/her know if the credit has been approved.

→ Group methodology to grant a credit

They have to choose a group of people, usually with features in common (neighbours, same profession, and same kind of projects or same background). Then, they provide credit (very small quantities) individually but based on solidarity guarantee. In this sense, they are based on personal trust. When someone does not pay, the rest of the group have to pay. The main advantages are the creation of strong sense of loyalty and responsibility and "group entity". We have already said that, sometimes it is cheaper for the institution but, when the institution provides other services such as financial training, it could be expensive. Moreover, we can think that in a group methodology, there is more diversification and then, cheaper interests can be applied. However, in a group, the entity usually provides financial education and training (very expensive in term of human resources and time) and have to make a bigger effort to measure risks (group risk and individual risks inside the group). Consequently, interests could be similar to or higher than individual methodology.

9. D) Bancamia and Adopem Bank. A better approach of microfinance institution activities

In this section, we are going to deepen in two of the six microfinance institutions that the BBVAMF manages. We are going to explain their services and products and, in the following section, we are going to explain a new project that these two institutions are developing currently with the technical assistance of the BBVAMF.

Bancamia (Colombia)

As it has already been pointed out, Bancamia is one of the most relevant microfinance institution in Colombia created in 2008.

The main products and services that they are developed are: microcredits, savings accounts, certificates of deposits, insurances or International money transfers, distribution channels and services such as debit cards, financial training and mobile banking³³.

It is a microfinance institution that is based on the trust on the clients' abilities to generate productive activities. In fact, its main clients are those who are entrepreneurs in trade, services, production and agricultural sector.

Moreover, Bancamia has currently almost 200 branches through the country. In fact, Colombia is divided into 32 departments and Bancamia has branches in almost all of them (91%)³⁴. It is also relevant to highlight that it has a good system of banking correspondent, both with own network and externalised (in total 2.400 correspondents that make possible that individuals can access to financial services). In the next section, we are going to deepen in the concept of banking correspondent. In 2016, it is shown that the total credit portfolio was 380 million of dollars to microentrepreneurs (the biggest among all institutions considered) and the average credit by individual around \$ 1.270 (table 2).

This kind of actions are considered very relevant since Colombia are now in a peace process and there are still a lot of people who were displaced by the conflicts are need financial support. With this purpose, Bancamia has signed an agreement with the Colombian Agency for the Reintegration³⁵ the last September. This agency is dependent on the Defence Ministry and is in charge of the development of the steps needed to achieve the reintegration of demobilized individuals.

The methodology that they used is what is called "Responsible Productive Finance" with a clear mission of contributing to the social and economic development of disadvantaged communities. They provide entrepreneurs with services and products that make possible the incomes generation in the future through businesses development.

Products and services

- **Credits:** Bancamia has developed many lines of credits thinking of several needs that its clients can have and distinguishing in which business stage the entrepreneur is and the sector.

³³ "Informe de Desempeño Social Bancamia Colombia 2016"

³⁴ According to the last data from "Informe Desempeño Social de Bancamia 2016".

³⁵ Original name: Agencia Colombiana para la Reintegración

In this way, Bancamia³⁶ has:

- Credits for microentrepreneurs that has been the best clients and has a consolidated relationship with the bank (Clientemia 1A).
- Credits for microentrepreneurs who want to improve or update their enterprise (Línea Mejoras Locativas).
- Line of multi-purpose credit for microentrepreneurs (Linea Credimía).
- Line of additional credit to satisfy immediate needs of working capital (Linea Paralelo).
- Credit focused on new microentrepreneurs who desire to consolidate their business (Consolidation Line).
- Line of credit focused on working capital needs of agricultural productive activities (Agromía Capital Trabajo).
- Credit for acquiring or rehabilitating fixed assets to develop rural activities (Agromía Inversión).
- Line of microcredit targeted to rural microenterprises allocated in rural areas (Credirural 8 and Credirural 25).

Table 3.a. Main Bancamia credits. Types.

Features	Clientemia 1A	Línea Mejoras Locativas	Linea Credimía	Linea Paralelo
Purpose	Money available all time. If quotas are paid, bank liberates resources that can be used again when needed.	Investments	Working capital and investments: - inventories -suppliers' payments -machinery acquisition	Additional credit for immediate working capital needs
Client	Excellent clients, as an incentive	Old, urban and rural (but not agricultural)	New, old, urban and rural but not agricultural	Old clients
Term	6-36 months	6-48 months	6-48 months	6-18 months
Periodicity	Monthly	Monthly	monthly	monthly
Requirements	At least: 2 credits cancelled + 24 months of relationship	At least 1 current credit, being the owner of the local + budget about works to do	Ownership of the business at least 10 months Punctual repayments and not being in delinquent lists 18-74 years old	At least 1 credit cancelled and 1 current credit; or 1 current credit with 50% already repaid
Interest rate	39%	45-49%	45-49%	45-49%

Own elaboration based on www.bancamia.com.co/productos/detalle

³⁶ www.bancamia.com.co

Table 3.b. Main Bancamia credits. Types.

Features	Consolidation Line	Agromía Capital Trabajo	Agromía Inversión	Credirural
Purpose	Working capital + investments	Working capital in agricultural, livestock, aquaculture, fishing, environmental, agroindustry activities	Fixed assets investments: acquisition and renewal. In agricultural, aquaculture, fishing, environmental or agroindustry activities	Working capital
Client	New microentrepreneurs who want to consolidate their business.	Rural entrepreneurs	Rural entrepreneurs	Rural entrepreneurs in determined rural areas
Term	-Working capital: 12 to 36 months -Investments: 12-48 months	3-24 months	3-60 months	3-23 months
Periodicity	Monthly	Multiple: no more than annual	Multiple: no more than annual	Multiple
Requirements	-Be the owner and at least 2 years of experience - 18-74 years old - Min seniority in the business place: 12 months - Min seniority in residence place: 6 months -Punctual repayments and not being in delinquent lists	-Seniority of at least 24 months in the productive unit -Agricultural activities until 24 months	-Seniority of at least 24 months in the productive unit	-Develop rural activities in the regions defined -Seniority of at least 24 months in the productive unit
Interest rate	29%	45-49%	45-49%	45-49%
Others	The bigger amount, the less interest rates	Credit provided according to payment capacity, instalments depend on when cash flows are generated (economic cycle). They finance one or several production cycles	Credit provided according to payment capacity, instalments when cash flows are generated (economic cycle). Finance several production cycles. (max 12 months).	Credit provided according to payment capacity, instalments depend on when cash flows are generated (economic cycle). They finance one or several production cycles

Own elaboration based on www.bancamia.com.co/productos/detalle

- **Savings Accounts**

Bancamia has developed three kinds of savings accounts.

-The first one is *Ahorramía*. It is a saving account that allows the client to carry out transactions and have their money available at any time. Bancamia gives three options to make transactions. The first one is through the branches, the second through own banking correspondent³⁷ or externalised correspondent and lastly, through ATM.

-The second one is *Soñemos Juntos* that is a scheduled savings account in which the client chooses the savings' amount and time. The terms are 6, 12, 18 and 24 months and money is fully available after this term. The institution pays an interest rate for the amount saved but distinguishing if the client accomplishes or not with the prefixed term. If the client respects the term the interest paid is 5%, if not (client wants to withdraw money before) the interest is 3%.

-The third one *Ahorro Progresivo*. It is a saving account targeted to people who receive international transfers from relatives abroad. Bancamia manages these international transfers for its clients and encourages them to save part of the money received. Bancamia pays an interest rates for the savings. Depending on the amounts the interest has a range of 0,25-4,5%. The bigger the amount saved, the higher the interest received.

Adopem Bank (Republican Dominican)

Adopem bank³⁸ was funding by a group of professional women more than 25 years ago. Originally, it was an NGO whose main purpose was to provide the poorest women with economic resources so that they could carry out productive activities by themselves. From 2005 onwards Adopem started to operate as a financial institution accomplishing with compulsory regulation for financial institutions.

The main objective of Adopem bank is to serve the society focusing on non-resource people and small-scale entrepreneurs. To do that Adopem bank has developed many projects in different areas, mainly in vulnerable people and poorly communicated areas. As mentioned before, Adopem bank is part of the BBVAMF group from 2012 receiving technique and economic assistance.

According to the own institution, the mission is to directly promote activities in order to develop the standard of life of Dominican families. The institution wants that everyone can have access to basic financial products such as formal credits.

An interesting feature is that Adopem bank is valued by Fitch as a solvent institution with an AA- rating with stable perspective in the long term.

Products and services

They provide loans and credits, savings accounts and insurances.

- **Credits and loans**

Firstly, the main products they have developed are loans classified by the use or the purpose.

³⁷ We will explain this concept in the following section

³⁸ <http://www.bancoadopem.com.do>

Table 4.a. Main Adopem Bank credits. Types.

Features	Microenterprise	Solidarity group	Micro-micro	Small loans
Purpose	Microenterprises development	Turn clients into groups (productive units) to improve their life standard	Microenterprises development	Help entrepreneurs that are already clients
Client	Entrepreneurs	Clients who want to develop productive activities through domestic microenterprises.	Clients already in 2-5 group of people when their businesses have certain economic and operational development	Previous clients of the Adopem Bank. Production, services and commercial activities
Term	Until 24 months	Until 14 months	Until 18 months	Until 60 months
Requirements	-Minimum 6 months operating as a microenterprise (commercial activity) -A guarantor (could be an employee or an employer)	-Living in the same neighbourhood -Each member needs to have independent business -Good personal and credit references -2-5 people -Group guarantee -Group members selected by themselves	-Solidarity guarantee -Good personal and credit references -Min 6 months operating as a microenterprise	-A guarantor -> 1 year of activity Good personal and credit references
Interest rate	48,96% annually	48,96% annually	48,96% annually	36% annually
Others	The biggest loans include a life insurance. When debtor dies the loan is condoned.	Each client has its own business with individual loans but with group guarantee.		
Amounts	1) from RD\$800 to RD\$19,999.99 or 2)RD\$20,000.00 to RD\$49,999.99	Between RD\$800.00 and RD\$10,000.00 + life insurance	Between RD\$10,000.00 and RD\$30,000.00, + life insurance	RD\$50,000.00 - RD\$500,000.00

Source: own elaboration with data from www.bancoadopem.com.do

Table 4.b. Main Adopem Bank credits. Types.

Features	PYME	Housing loans	Women credits	Consumption loans
Purpose	Credits for more developed entrepreneurs	Acquisition, repairs or housing construction	Since 2007. Credits for women who suffered abuses to help them in productive activities	Satisfy needs such as diseases, education, and other issues of employees and other people from institutions with who Adopem has previous agreements
Client	For physical and legal persons. Commercial, construction and services sectors.	For clients who have micro, small or medium enterprises	Women	
Term	Until 5 years, flexible according to investment plan	Until 60 months		
Periodicity		Equal and successive instalments		
Requirements	-Having an small or medium enterprise more than 1 year -Certain level of business formality -=>10 employees -Min level of sales and assets -solidarity guarantor (if legal person, the greatest partner) -Provide with financial statements and banking accounts	-Have a microenterprises -Min 1 year with business -Guarantor -Officials visits	Women with abuses problems Guarantor	-Guarantor -Certificate of being employee > 1 year in the business
Interest rate	Physical person: 24-34% annually. Legal person: 20-28% annually	32% annually	Preferential conditions	36% annually
Others	>RD\$300.000	RD\$20,000.00 y RD\$500,000.00 + life insurance	In coordination with the State, donation received by them	

Source: own elaboration with data from www.bancoadopem.com.do

Table 4.c. Main Adopem Bank credits. Types.

Features	Agrocredit Adopem	Finanzas Rurales y Ambiente (FRA)
Purpose	Finance agricultural activities	Credits focused on rural activities + environmental care
Client	Rural microentrepreneurs	Several types: Agricultural producers, women dedicated to agricultural activities...
Term	Flexible	
Periodicity	Monthly	
Requirements	Having an agricultural activity Guarantor Having alternative income resources	-Guarantor -have an agricultural business aware of environmental issues -Good credit and personal references
Interest rate	34-42% annually	

Source: own elaboration with data from www.bancoadopem.com.do

- **Savings programs**

Adopem bank, as Bancamía, has developed different savings programs. One of them is the usual saving account in which people can save money little by little and be withdrawn whenever the money is needed. But there is also a program, *Ahorro Programado*, in which the person save money through a regular term deposit. In this way, the program let the client save a prefixed amount in a prefixed period in order to cover a specific purpose.

Adopem bank has also a specific saving account for children and Young people called “*MIA Cuenta de Ahorro Infantil*”. This account includes a financial education program focused on providing children with financial knowledge and awareness of the importance of savings for the future. This could seem very obvious in developed countries, however, in these kinds of countries there is no a clear culture of saving and planning for the future. There are still a lot of people without savings accounts and living with fears of having events or unexpected expenses that they cannot assume, such as repairs, education expenditures, diseases, general housing expenses, burials or others. For that reason, not only it is necessary to provide people with credits (the main product) but also with this basic service that let people become more independent and more conscious of the future planning.

- **Other services**

There are other services that Adopem bank has developed such as mobile banking. This service allows clients to make transfers, manage savings accounts and carry out payments through the mobile phone. This kind of service is really important because people who live in villages and rural areas not always have quick access to branches. Then, the solution is mobile banking or banking correspondent (as we are going to see later).

9. E) Bancamia and Adopem Bank Comments

After analysing the main characteristics of these two entities, it is worthy to analyse some points:

- First of all, it is very striking the high level of interest rates that these entities collect from clients. In average, 30-35% annually. We can think that if these credits are addressed to low-income people the interest rates should be lower than the market and not higher. However, there are several reasons³⁹ that justify the use of high interest rates, compared to traditional banking by microfinance institutions.
 - Institutions have high transactional costs. It is very expensive in term of time and resources to reach at clients. They are usually in rural areas with bad communication, and then there are travel costs.
 - Credits are in small or very small quantities and they have a lot of clients. Then, they have huge administrative costs (a lot of credits approvals procedures, follow ups etc...)
 - In general, the level of digitalization is low and they have a lack of technologic support. Consequently, there are more costs (more things done by hand).
 - They are assuming high risks. That means that the client risks are very high because institutions usually do not have credit background of the client and it is difficult to value them. This is something that does not happen in the traditional banking activity because they do not have transactional cost or correspondents' costs that exist in microfinance. Besides, clients are low-income people and do not have or have few resources, then the risk is high.
 - As institutions do not have clients' backgrounds, they need to develop a more personal relationship with the client. Consequently, these institutions spend resources on knowing the client personally, visit them directly and follow their activities.

All these reasons provoke that microfinance activities are more expensive in resources and efforts than traditional banking. Therefore, it is very difficult to compare both activities and these reasons also justify why traditional banking does not want to enter in this sector, it is a complex segment because it is necessary to generate incentives for repayments and also keep enough space for development and that is not easy.

In this sense, there is a clear difference⁴⁰ between traditional banking and microfinance. Traditional banking usually does not want to enter in this sector because of the costs and risks explained before. So, if microfinance institutions enter they need to cover these huge costs and risks. While traditional banking has huge returns with one big operation in the long term, microfinance institutions have a lot of small operations, many times (in the short term because credits are usually granted for months) and with small returns and huge risks. Then, they need to compensate this and be sustainable and efficient. With this situation, it is very difficult to establish the same interest rates that the traditional banking because they could not be sustainable in the long term.

³⁹ Carmen Correa, BBVAMF

⁴⁰ Paloma Pérez Castañares, BBVAMF

Moreover, as mentioned before, microfinance institutions need to be self-sufficient and be able to operate in the long term. To do that, they have to cover their costs, and then they usually have to establish higher interest rates than those charged by traditional banking. However, in any case, that means that they can charge usurer rates⁴¹ that means that institutions will charge fair interests rates that allow them to continue their activities and cover costs. Besides, as it can be observed, when the client has more experience or has been a good debtor of the institution, interests charged are lower.

When low interest rates are observed is because Governments are giving subsidies that allow to charge lower interest rates. But, in other cases, it is not possible. Subsidized interests are another option applied in some specific programs, for instance, in some credits only for women (the case of Adopem bank in its women credits program). Subsidies are good to boost and help entities to survive at the beginning of their activities or to promote certain programs (more vulnerable individuals). However, the main objective of microfinance is to make possible that poor people have access to financial products and can use them in a regular and formal way but, they do not want that clients are dependent on subsidies, they want that clients can participate in the financial activities with independence, with market conditions (as the rest of the people) and in a responsible way. Consequently, subsidies are good at the very beginning, but it is not the core objective of microfinance institutions.

Another key point regarding subsidies is that these subsidies are given or granted once and for only one project but not in the long term. Then, official aid is necessary and good to boost some activities but only microfinance institutions have the capacity to grant credits and repeat this operation in the long term when the client or the entrepreneur needs more resources in the next years.

On the other hand, it is proved that when an entity provides a microenterprise with financial support at the very beginning, it is highly probable that this client is not profitable, but, this support has boosted its initial possibilities. Then, in the long term, this microenterprise has more resources to develop and become bigger. In this situation, the client usually is loyal to the entity and continues asking financial support, but now, it is more profitable. Consequently, it is a win-win model.

In any case, from the BBVAMF specialists point of view, it is said that, nowadays, there are more and more competence in the sector, then that is forcing interests' rates to decrease. In the future, they are going to continue decreasing.

According to the interviewees from BBVAMF, there are two main ways to reduce interests. The first one is reducing costs⁴² (transactional costs, travel costs etc...) through innovative ideas such as more sophisticated and cheaper channels such as mobile banking or banking correspondents as we will see later. Secondly, through subsidies but only in certain cases.

- Secondly, these entities, despite being microfinance institutions, are making serious efforts to develop more specific products with different characteristics. It is important to highlight that, in those countries; Colombia and Dominican Republic, the provision of financial services are quite new. In fact, ten years ago, most villages and

⁴¹ From the BBVAMF they remember the case of "Compartamos" in Mexico. This is an institution that charged huge interests rates, 100%-120%, they wanted to benefit from that. This is not the justification of interests rates in microfinance and it is an exceptional case.

⁴² Some solutions were commented previously in "Problems of administrative costs of microcredits institutions" section

rural areas did not have any kind of financial product or banking branches. Then, people were not used to the use of credits, savings accounts or similar. For that reason, and for the obvious difficulties that we have already studied about financial products provision in these areas, it is worthy to point out that, nowadays, these institutions are making possible that the poorest people can have access to financial products for productive activities that other kind of banks are not interested in providing with.

- These institutions classify its products taking into account idiosyncratic characteristics of that population and the sectors in which they are operating.

They dedicate special attention to the rural and agricultural sector. This is admirable because, microfinance institutions are making efforts to adapt their programs to the kind of sector that is predominant in these economies. Agricultural and rural activities (in general the primary sector) are the most relevant one or at least, need more attention because the weighting of this sector tends to be important. Furthermore, this sector has particular features that involve more vulnerability. For instance, rural workers incomes depend, in many cases, on the weather conditions, the land quality, plagues, animals' conditions or other external factors that are unpredictable. In addition to that, they do not receive regular wages since these wages depend on the productive cycle. Then, these activities involve more risks for entrepreneurs and for microfinance institutions that try to help them but are necessary. In this sense, we observe that both institutions have specific credits for rural projects and entrepreneurs. In the case of Bancamia, they adapt the repayments to the productive cycle and adapt credits to the payment capacity considering when cash flows are generated. Besides, they do not ask for guarantees. Consequently, they highly contribute to the development of this sector in the country, although interest rates are high (for reasons previously commented).

They also pay special attention to women⁴³ designing products only for them. For instance, the program designed by Adopem bank called "women credits" granting credits with better conditions than in the rest of the cases. This is very crucial because women have been a collective historically more vulnerable (they did not have assets or properties) and with less rights and more dependence on men. According to the specialist⁴⁴ of BBVAMF, providing credits adapted to women involves more empowerment for them. Women have been taking care of their entire families and houses problems for centuries. Then, when they receive funding to productive activities the impact on the well-being of the entire family and house incomes (Hashemi et al. 1996) tend to be higher than with men. That means that the impact on the real economy is higher because women employ incomes generated in activities that improve the family's life, education and general standard of life due to their traditional dedication to their families and the future. Moreover, that let them be more independent and free in the near future.

- The institutions are working to be enough profitable to survive in the long term, but adapting the interest rates charged to each situation. When they can, they charge less interest rates (for example in products designed for initial entrepreneurs with more risks, they need to cover these risks with higher interest rates, but adapting the

⁴³ According to the BBVAMF specialist, it exists a wages breach between women and men, women dedicate more time to non-paid works, women do not usually have properties, the legal issues do not favor them and there are gender violence problems.

⁴⁴ Carmen Zaragoza, BBVAMF

products to the client situation. However, when working with experienced entrepreneurs they tend to reduce interests).

- They have, as a core objective, the client care⁴⁵, not to be very profitable. This sector is focused on vulnerable people. For that reason, institutions need to take care of the client, know the client personally and maintain a system of periodical visits (as we cited in the tables).
- Guarantees: as a general rule, guarantees are not a requirement since they are working with collective with few resources (no assets, no properties or incomes). That facilitates the credit process and the possibilities to obtain a credit. They are basically based on personal trust and sometimes in solidarity guarantees and group guarantees. For instance, Adopem bank has a specific product that works with group guarantee (solidarity group). As reported by the BBVAMF⁴⁶ interviewee, group guarantees or solidarity guarantees are based on the trust on human relationships since when one of the group do not pay its credit, the rest of the group have to response. That has been proved to be a good incentive for repayments mainly because the group create a “group entity” and support entity. Then, people in the group create a powerful sense of responsibility that has been proved to be efficient and sustainable through time. Consequently, microfinance institutions can be profitable with a group credit system (using solidarity guarantees).

In other cases, there are more formal guarantees. For instance, in Table 3 Adopem bank, we can observe that, for products addressed to more vulnerable people (solidarity group, microenterprises), they do not ask for guarantees or these guarantees are more flexible or based on a group. However, Adopem bank has also products for entrepreneurs who have more experience or a more consolidated business and, in these cases, they ask for more formal guarantees.

- Lastly, it can be observed an appropriate level of development at institutional level. Adopem bank and Bancamia have achieved product and sector diversification (this help to reduce risks) and to distinguish between more simple products and others more complex, such as housing loans (Adopem bank). Moreover, they are making efforts to diversify not only in term of credits, but also in other products such as insurances and savings accounts (relatively new products in these economies but very important to provide better life standards and general security for families). In developed societies, we are not completely conscious of the importance of savings because we have always had access to them. However, in Latin America, there are many people without access to formal savings that provide them income stability in the long term. For that reason, the role of these institutions in savings accounts provision is crucial⁴⁷. Finally, they provide direct financial education for individuals and children that will have a positive impact in the families’ future.

We observe that Adopem Bank has more developed products than Bancamia. It is in the next step of institutional evolution (usually ask for guarantees; provide housing loans, consumption loans...). Although these more advanced loans are granted to individuals that are already clients and based on personal trust and long term relationship with the client.

⁴⁵ Paloma Pérez, BBVAMF

⁴⁶ Paloma Pérez, BBVAMF

⁴⁷ Paloma Pérez, BBVAMF

What more apart from credits and savings accounts?

It is true that the main product developed is credit (and savings accounts). However, they are not the only products. Adopem bank and Bancamia have also developed a crucial product that provides security and stability in a family: microinsurances. This kind of product is not generalised and, until five-eight years ago, most people did not have basic insurance. From the BBVAMF⁴⁸ specialist, it is known that, in Fondo Esperanza and Empeude Microfinanzas, both in Chile, the foundation has developed the major project in order to start to offer microinsurances deeply in the region. They have started to offer the simplest insurances (life and accidents) in the simplest way with a small amount of premium (they need to be affordable for people). They had to train workers (so that they know how to offer the product), analyse the potential market, design the insurance (characteristics), contract with local insurance companies and promote it. The target clients were those that had already relationship with the entity through credits. Currently, it is a little bit more used product, but it is less advanced than credits.

9. F) New project: Distribution channels in microfinance institutions. Banking correspondents in BBVAMF institutions

After talking about two institutions in Colombia and Dominican Republican, we are going to explain a specific project developed by the BBVAMF that is being put into action in both, Bancamia and Adopem bank with the technical assistance of the foundation. This project refers to banking correspondents. The main way to collect the data is through qualitative research, carrying out direct interviews in the BBVAMF. Consequently, this section is made with primary sources. The specialist that has provided with the data is Carmen Zaragoza Correa who is currently working in the Commercial Development area (Channels distribution) in the BBVAMF.

Before talking about banking correspondents, I would like to highlight that it is a kind of distribution channel that can be used. Generally, distribution channels are the diverse ways in which institutions bring products and services close to clients. In this sector, distribution channels are a key point because we are not talking about traditional banking and, in microfinance, there are two main handicaps:

- Very dispersed target clients and far from branches
- The poorest people are in rural areas where there are no branches (or limited)

For these two reasons distribution channels have a crucial role that is worthy to highlight. In this sense, without distribution channels would be pretty complicated to reach to some clients that have basic financial needs.

The main distribution channels that exist are branches, credit counsellors⁴⁹ (loan officers/ microfinance officers), mobile banking and banking correspondents. Ten years ago, the way to provide financial services to people was mainly through branches. However, opening a new office/branch is usually very expensive. When establishing branches,

⁴⁸ Paloma Pérez, BBVAMF

⁴⁹ Asesores de crédito

the bank will have to incur in physical infrastructure, technology, security requirements, among other expenses so, there are big efforts to cover these costs and reach sustainability. Also, in Latin American countries, because of the characteristics of the region, many areas are difficult to access and/or there are few clients (or low potential market) and could be not recommendable, in terms of sustainability and efficiency, to invest in heavy infrastructure.

For those reasons, in the last decade, the BBVAMF has developed new and stronger distribution channels with the main purpose of bringing financial access to more people in a more efficient way.

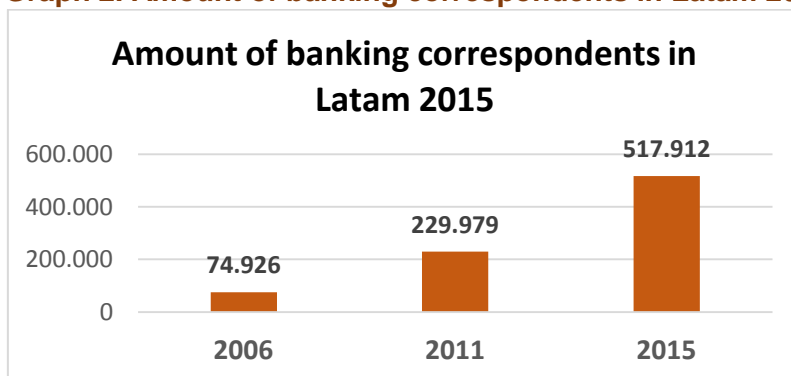
Banking correspondents

As it has been said, banking correspondents is one of the alternative distribution channels that allows the microfinance institutions to reach customers that otherwise may be impossible. The channel (currently developed and used in the entities located in Colombia and Dominican Republic) is an intermediate that helps to makes possible the transactions between the microfinance institution and the client. In this sense, the channels used are small businesses, like small markets or shops, (usually clients of the microfinance institutions) allocated in distant neighbourhoods that are contracted to play the role of correspondent (banking correspondents or banking agents).

Their main functions are: withdrawals and deposit of money, payments and collections management, but also to promote the products and services of the institution to potential clients. Correspondents are needed mainly because there are clients located far from the institutions' branches but also, because it is an appropriate system to reduce branches overcrowding by giving more channels to the client.

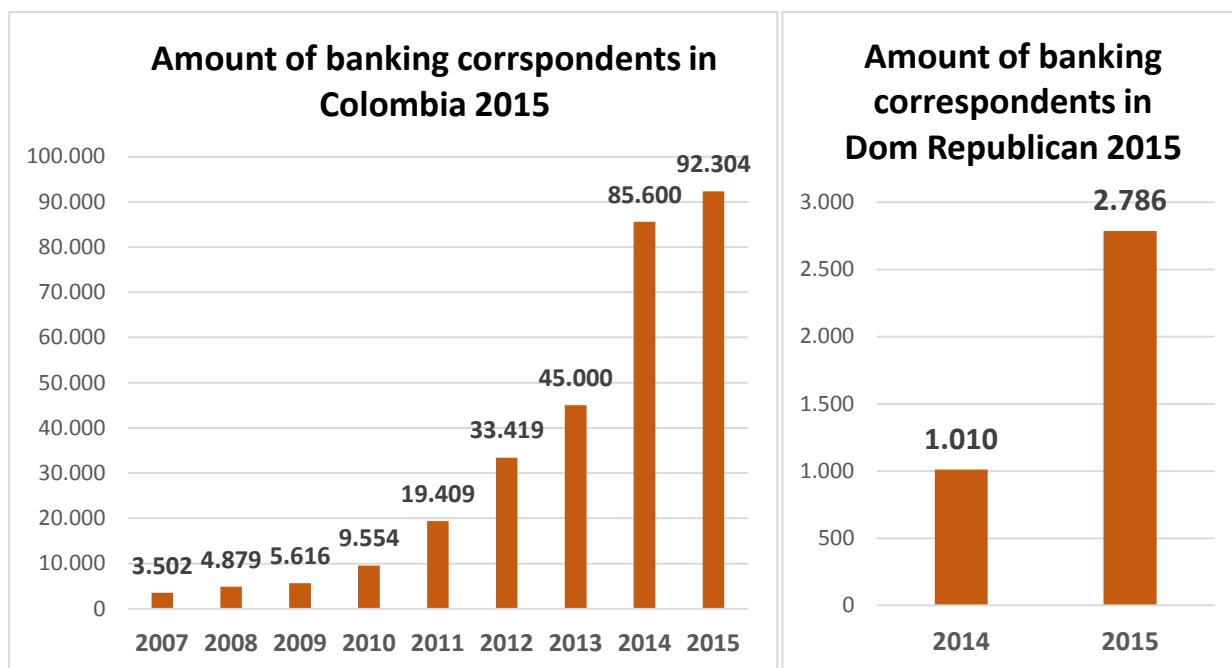
As we can observe from graph 2, the evolution in the Latin America region has been very positive, with an exponential increase. In fact, in the II Report of Financial Inclusion 2016 from Felaban it is shown that, year by year, this system to spread financial services has been a remarkable success. In 2006 the amount of banking correspondents was 74.926 and in 2015 the amount was 517.912, more than five times. In the case of Colombia, graph 3, the amount has been increasing significantly. In 2015, the official amount was 92.304. In the case of Dominican Republic, we have only data available for 2014 and 2015, graph 4, observing a huge jump in only one year. In the case of Bancamia, in 2016, it registered 4.459 correspondents. It is clear that this innovative model to spread microcredits has been a success.

Graph 2. Amount of banking correspondents in Latam 2015



Source: own elaboration based on II Report of Financial Inclusion 2016, Felaban

Graph 3, 4. Amount of banking correspondents in Colombia and Dom Republican



Source: own elaboration based on II Report of Financial Inclusion 2016, Felaban

The main advantages for the own correspondents are that, thanks to this new function, the shop or market that plays the role of correspondent is going to receive a commission from the institution (more profits). Moreover, more clients are going to visit the correspondent to do their transactions and then, the correspondent has more potential clients and can have what is called “cross sales” or “crossselling” that is going to benefit directly (this activity generates additional incomes).

The main advantages for the client (the microentrepreneurs) is that they do not have to go to branches, that in many cases are far from their businesses or houses, they can manage their savings accounts and pay their loans through the correspondent that is closer (maybe in their neighbourhood or the closest villages). However, branches can be too far, sometimes a person can last three or four hours to reach at the closer branch. So, in this way, the client saves in term of time and costs (transportation costs and the cost of having to close their business).

The main advantages for the microfinance institution itself are that they do not have to send a loan officer to receive the payment. With correspondents, the institution makes sure that it is going to cover clients’ needs through correspondents and save costs by reaching new markets without the need of heavy infrastructures. In addition to that, the entity receives new contacts or future clients thanks to correspondents’ promotion.

Consequently, it can be observed that it is a win-win method that achieves to cover easily poor people needs and save costs to the entity and the client.

It is worthy to point out that, although this system allows to achieve the social objective of microfinance institutions, it requires an initial effort by the microfinance institution. The main effort for the institution (Bancamia and Adopem bank) is that they have to look for their correspondents, have to go through villages and choose the best shops. Then, they have to do

a risk analysis, and if selected, train these shops so that they can know what to do and how. As a consequence, at the very beginning, having own correspondents need time and some costs (training costs, contract costs and transportation costs). And it has also some risks, such as correspondent risks. However, once this initial step is done, this system let the institution save money and effort in the future.

Currently there are two kinds of agents/correspondent networks:

- Own correspondents: the microfinance institution chooses who the correspondents are and where they are going to be allocated. So, microfinance institution looks for its own correspondents and prepares and signs contracts. This is the option we have been talking about.
- A second option is to use what is called "externalised model"⁵⁰: the own entity does not have to look for correspondents, instead of that, the entity joins an external network usually called "external correspondents network". This external network is in charge of looking for correspondents and trains them appropriately. One example is *Movilred (in Colombia)* The main advantage is that the microfinance institution does not have to make the effort to look for own correspondents and train them and they can use this network of correspondents to offer their products. However, the institution has to accept the correspondents that the network offers. Besides, with this method, they spread their possibilities but with less intensity; they cannot reach as clients as with own correspondents and this kind of network does not reach at very far or less accessible clients (more limited). Finally, the microfinance institution cannot boost its own brand since they act through a network in which there are a lot of microfinance institutions and correspondents do not promote a specific institution (brand is shared with other institutions), while in the own correspondent model, the correspondents promote the specific institution and its products.
In any case, the advantages of the externalised model are that is cheaper for the institution (less costs and efforts) and implies less risks regarding correspondents (these risks are managed by the network itself).

The FMBBVA (currently using both models) is focusing in the "own correspondent model" mainly because they want to boost its own correspondents and create trust on the brand.

The process to choose correspondents is as follow:

- Search for correspondents and selection. There are some travel costs and several direct visits to them.
- Risks analysis of correspondents, although, in several cases, it is a system based on trust each other. The correspondents are, in many cases, the best clients of the microfinance institution.

It is also curious how the correspondent works. The microfinance institution, in this case, Bancamia and Adopem bank, trains the correspondents previously. In this way, they know how to act and proceed. The institution establishes when and how the correspondent must report and transfer the money managed or collected. An example given by the own foundation (the interviewee) is: "you can collect payments until \$2000, then you have to deposit the amount in the institution's specific banking account and transfer the amount collected". Every month the correspondent will receive a commission per transaction.

⁵⁰ Modelo tercerizado o de corresponsalía externalizado

Currently, in Colombia there is a special project to improve their banking correspondent model, and with the direct support of the commercial and technology team in Spain, they are working in a new technology that will turn these agents from being transactional points to commercial points. Nowadays, it is limited to savings accounts (transactions-withdrawals and transfers) and credits (payments and collections) and the intention is to train them so that they can sell insurances, saving accounts or other products. In fact, in February, the interviewee visited Bancamia to analyse the current model and develop a plan for the new project.

In the near future, the intention of the BBVAMF is to test these technological improvements to the model and implement it in another institution of the BBVAMF Group.

9. G) Improvements needed in microfinance sector

Although, nowadays in Latin America, there are many successful cases of microfinance institutions that work for improving social and economic standard of life, there are still a lot of things to do. From the point of view of the interviewee⁵¹ there are many obstacles to overcome.

- There is a need to change from mono-product vision to a multi-product model. That basically means that, in many microfinance institutions, the main products offered is credit, but there are many basic products that need expansion such as savings accounts and insurance that are not generally used. That means that, in a lot of areas, villages and regions there are many people that do not save money through savings accounts (as a safe way to save money) and do not have any basic insurance services such as life or accident insurance.
- It is necessary to improve the long-term monitoring system. It is recommendable to improve the follow up of clients and their families and check, through time, what the real impact on families' life is. The foundation is very focused and does this kind of impact evaluation, but in other cases (other microfinance institutions), it is not done at all or it is very deficient.
According to the interviewee, in her personal opinion, in this sector, it is common for institutions to grant credits to individuals with no or low incomes and, in many cases, without credit history. If there is not a correct monitoring or control, institutions can provoke what is called "overindebtedness" of families or individuals. That is the reason why credits needs to have a clear objective and taking care of the clients (know the client, follow its activities, advisory services) are crucial.
- A relevant issue is that there are more institutions involved, and people that didn't have financial access before, now, in countries like Peru, different institutions are approaching these people. Not only there are microfinance institutions focused on granting credits for productive activities that allow people to improve their life and generate their own incomes, but also are there other institutions such as other banks, non-regulated institutions, and even supermarkets chains that are giving credits for consumption purposes (for example, to buy consumption products -tv, furniture-etc). These institutions do not have a social target and are focused on profitability, then they do not monitor the client correctly and, what is more relevant, they do not worry about the clients' standard of life. However, in a society where there are still a lot of

⁵¹ Carmen Zaragoza, BBVAMF

basic needs uncovered and many people living below the poverty line, these kinds of credits only generate people overindebtedness and then, in many cases, families cannot give back the money, they are excluded of the system and cannot obtain credits for productive activities anymore.

10. CONCLUSIONS

Throughout the entire document, it has been studied how microfinance was born in Bangladesh and how Muhamad Yunus elaborated a method in order to make possible that non-income and non-resource people could have access to financing and could develop their own businesses. That has allowed microentrepreneurs to receive small amount of money to invest in their ideas and projects. Microcredits are managed so that people can receive small amounts that they can repay without problems, boosting their confidence. In the beginning, nobody knew if this model that mixes financing with social development was going to work, why? Because this sector is focused on the most needed people (in many cases, no income, no many assets and without a clear future). However, through the study of the evolution, the different models of microfinance and through the deep analysis of a specific case of success of microfinance institutions (the case of the Spanish BBVAMF that has been working for ten years for microfinance institutions in Latin American with a clear success), it is proved that this sector has a lot of things to do to improve societies from an economic and a social point of view.

Then, they are creating a system based on “responsible productive finance” and sustainable and social development. Moreover, they have clear ideas about what microfinance is and what it is not, trying to avoid “bad practises” that other institutions such as banks or consumption companies are developing and that generate overindebtedness without any economic and social improvement in the long term. Microfinance does not grant credit only to consume or to get profits, microfinance grants credit to develop productive activities that allows people to generate its own incomes. We have study that the average microcredit is around 1.200 USD by individual (small quantities), with many small operations (this let the entity avoid too risk exposure in one operation), without guarantees (generally speaking) and based on personal trust. Moreover, we have analysed the advantages and disadvantages of the two methodologies: individual (very personal treatment and sometimes more expensive for the entity) and the group methodology (with solidarity guarantees and financial training. It is more difficult to set up interest rates because there are several people in the group). In any case, it has been said that around 77% of microentrepreneurs achieve to give up poverty thanks to microcredits. In addition, the II Report of Felaban shows that microcredits contribute positively to GDP and Gini coefficient.

It is very important to highlight that microfinance institutions need to be sustainable in the long term in terms of covering their costs. For that reasons, it is crucial how they manage their costs and create alternative ways to be more cost-effective (through new partners, new agreements and new models) avoiding, at the same time, charging excessive interest rates to their clients (this is not their objective). However, it has been studied that the interest rates charges are usually higher than the market (around 27%) since they are riskier clients (and institutions have to cover costs to be sustainable) and they receive not only credit but also financial education and other services. Therefore, achieving this balance is one of the key

points. Microfinance institutions do not want to be profitable (in terms of obtaining profits from their clients), but need to be sustainable in the long term (financial self-sufficiency). Currently, the Latin American markets are more mature and interest rates are decreasing little by little. Another key point highlighted is risks evaluation because institutions work with people without background, credit experience and assets or financial statements, then they have more risks than in traditional banking. This connect directly with interests' rate selection.

On the other hand, we have studied why it is especially positive to grant credits for women, the greatest vulnerability of rural credits due to the lack of regular wages and their dependence on external factors (weather...), the subsidies and how they are good in the short term but only microfinance institutions can provide people with funding not only in the present but also in the future. Besides, it has been analysed the main causes of the lack of financial inclusion in Latin America: economy informality, lack of financial education and geographical access problems among others.

In 2015, credits have been granted to more than 220 million of clients (businesses and individuals) in Latin America and Caribbean region. The microcredits portfolio has been increasing progressively due to the increase of the offer and the increase of data availability. The last data⁵² available shows that microcredit portfolio is greater than US\$44 thousand of million with more than 18,5 million of clients. The rural portfolio is around US\$153 thousand of million (microcredits and other types of credits) in 2015. It has made possible that many people start to live above the poverty line and receive financial education year by year. Moreover, there are around 189⁵³ million of depositors (deposits are new products in Latin America that did not exist few years ago), 60% with short term deposits and 40% with long term deposits. They have made possible that low-income people can save money and can have access to their money.

The real examples that have been used are the six microfinance institutions of BBVAMF, specifically Bancamia and Adopem bank. It has been done a complete research on their interest rates applied, specific products, how they adapt perfectly their products to its type of client (special focus on rural credits, women credits...), the relevance of client care and guarantees. For instance, Bancamia (Colombia) has registered \$380 million in credits for low-income people and small and medium entrepreneurs in 2016.

It is proved that microfinance institutions, specifically in Latin America (that is our focus) but also in other countries, have developed models that let people carry out businesses that otherwise would be impossible. The effort that these institutions are doing to reach and find new clients is really appreciated (considering difficulties such as isolated areas, rural areas, tiny villages, bad geographical conditions and roads, lack of financial education...). They are creating innovative ways to give services and looking for new partners such as banking correspondents. It is a new model of distribution channel that has allowed institutions to offer their products without new branches (more expensive) and through the collaboration of existing commercial establishments. It has been shown that correspondents usually are the best clients of the institution. This has allowed to create a win-win model. Institutions can reach to more clients (small villages, rural areas...) and avoid travel costs and administrative

⁵² Figures from Inclusión Financiera y Desarrollo del Sistema Financiero en América Latina y el Caribe. BID y FOMIN. Octubre 2016

⁵³ II Report of Financial Inclusion 2016, Felaban

costs. Clients do not need to move to or make efforts to look for branches (sometimes very far from their locations) and correspondents receive more clients and spread their businesses. In fact, in the last nine years, banking correspondents' system has been multiplied by more than five times in Latin America being a remarkable success.

Finally, it has been pointed out the main improvements needed. In this sense, microfinance is not only credits for low-income people to improve life standard in the long term. Microfinance institutions have to promote other basic financial products not very well-known in many regions or villages in Latin America, such as savings accounts or insurances (from mono-product view to multi-product view). Nowadays, there are still a lot of people who do not save money in a safe way and do not have insurances to cover their businesses risks. In this way, they are in a riskier situation and exposed to events that they cannot control. Another key point is to develop new and more effective systems to check the long-term impact of microcredits in families' life. Finally, the poor people overindebtedness deserves special attention: microcredits should be for productive activities not for consumption or other purposes due to the target collective.

As a general conclusion, it can be said that, there are a lot of improvements to do because there are still many people in Latin America without financial education and services. However, this situation has improved in these last ten years showing huge positive changes: credit and amount of clients' increase, more rural areas covered, specific programs for women, flexibility in terms and amounts and more professionalism and direct contact with clients (client personal attention).

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