LATIN AMERICA: Microcredit will grow at brisk pace

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Abstract

The outlook for microcredit.

During the last decade the microcredit sector in Latin America and the Caribbean (LAC) has seen strong growth both in terms of loans and number of clients. This expansion has been the result of an increase in the number of microfinance institutions (MFIs) and other microcredit providers, supportive regulatory actions and improvements in information transparency.

Full Text

SUBJECT:The outlook for microcredit.

SIGNIFICANCE:During the last decade the microcredit sector in Latin America and the Caribbean (LAC) has seen strong growth both in terms of loans and number of clients. This expansion has been the result of an increase in the number of microfinance institutions (MFIs) and other microcredit providers, supportive regulatory actions and improvements in information transparency.

ANALYSIS: Impacts.

Greater financial inclusion is expected to contribute to further poverty reduction as well as overall economic and social development.

This process will also help to reduce the region's large informal economy and protect more people from unauthorised financial providers.

The still large number of unserved and under-served micro enterprises will continue to offer attractive growth opportunities.

The increased use of non-traditional delivery channels and modern technology will lead to greater outreach and lower costs.

The microcredit sector in LAC is one of the most sophisticated and developed in the world. In 2005, there were fewer than 400 institutions providing microcredit in LAC with 6.0 million customers and a combined loan portfolio of only 5.5 billion dollars, according to the Multilateral Investment Fund (MIF), a member of the Inter-American Development Bank (IDB) Group (see LATIN AMERICA: Microfinance to expand despite downturn - June 26, 2009).

However, by the end of 2013, there were more than 1,000 institutions providing microcredit with a combined loan portfolio of approximately 40 billion dollars. A wide range of microcredit providers served more than 22 million clients in the region last year, according to MIF.

The majority (67%) of these institutions are not regulated. However, regulated institutions dominate in terms of their share of the microcredit sector's total loans (79%) and customers (65%). The average loan size in 2013 was 1,800 dollars. Loans averaged 2,223 dollars for regulated institutions and 1,063 at non-regulated institutions.

The region's microcredit sector has evolved from being a niche market dominated by NGOs and specialised MFIs into a large and fast-growing industry in which a wide range of lenders (including commercial banks, non-bank financial institutions and cooperatives) offer an increasingly broad range of products and services. These include current and savings accounts, deposits, debit and credit cards, micro insurance, leasing, payment services, and national and international money transfer services.

Several MFIs and other microcredit providers -- especially larger ones -- have also expanded their loan offering from working capital financing to a broader range of consumer, vehicle, mortgage and education financing.

The sector's potential for continued strong growth in the future is vast since last year's 22 million microcredit clients represent about one-quarter of the total number of micro enterprises in LAC, according to MIF.

Regional differences.

The development and sophistication of microcredit and microfinance varies greatly across LAC:

In relative terms, the micro credit sector plays the largest role in the economies and financial systems of Bolivia, El Salvador, Nicaragua and Peru, according to MIF (see LATIN AMERICA: Majority still lack financial services - October 21, 2010).

Overall, Bolivia, Chile, Colombia, Ecuador, Peru and Mexico have the most developed microcredit markets in the region, whereas development is still limited in countries such as Argentina, Uruguay and Venezuela.

The regional differences are due to several factors, including economic development, poverty levels, the role of commercial and state banks, and operating environments and regulatory frameworks that promote or obstruct the development and growth of microcredit and microfinance.

Falling interest rates.

The global microcredit industry has come under fire in recent years for charging the poor high interest rates.

It is widely accepted that MFIs and other microcredit providers must charge higher interest rates than traditional commercial banks to be profitable since the cost of serving microenterprises and poor households is higher than serving larger companies and higher-income individuals.

However, several MFIs charging elevated interest rates have also reported high profitability -- which has led to accusations of excess interest rates and an extreme focus on profitability.

In a new report, MIF shows that microcredit interest rates in LAC have gradually declined although they are still much higher than those charged by traditional banks:

The regional average for annual microcredit interest rates dropped to around 27% last year from more than 30% in 2004.

This decline has been driven by countries such as Bolivia, Ecuador and Peru due to a combination of increased competition and growing customer bases in those markets.

The average loan interest rate charged last year in LAC's financial systems was approximately 17%.

However, there are significant differences within LAC, with Mexico having by far the highest average last year (67%), followed by Argentina (53%) and Guatemala (36%). Bolivia had the lowest average interest rate at approximately 18%, followed by Costa Rica, Ecuador and Panama with average rates of around 20%.

Microcredit interest rates are likely to continue falling gradually in the coming years due to improved operational efficiency at MFIs, increased competition and greater use of technology -- especially mobile banking -- in serving LAC's micro enterprises and poor households.

The acquisition of MFIs by larger commercial banks could also lead to lower interest rates due to economies of scale and the latter's lower funding costs.

Risks.

However, the microfinance industry in LAC and other regions faces various risks, some of which can be viewed as the result of the industry's spectacular growth and success over the last several years.

Microfinance practitioners and other industry stakeholders in Latin America see over-indebtedness, credit risk and competition as the top risks out of a total of 19 risk factors, according to the latest (2014) global microfinance risk survey from the Centre for the Study of Financial Innovation. The survey shows that the problems of over-indebtedness and credit risk were seen as more acute in Latin America than in any other geographical region.

The rapid growth and increasing competition in recent years have often led to MFIs and other microcredit providers targeting the same customers. A general lack of credit bureaus for microcredit clients has led to a growing number of these taking on excessive debt. Fierce competition at present in several countries has also led to laxer lending standards as microcredit providers seek to gain or defend their market share while maintaining profitability levels.

However, an excessive focus on growth, market share and profitability could be harmful both for lenders and borrowers -- and cause damage to the industry's financial health and reputation. Ratings agency MicroRate warned earlier this year that profitability was under pressure and asset quality deteriorating in the Latin American microfinance sector as a result of increasingly stiff competition.

CONCLUSION: LAC will in the coming years see millions of new clients enter the formal financial system with the help of microcredit and other basic financial services aimed at micro enterprises and poor households. Combining a sound commercial focus with a social mission will be one of the main challenges for the industry as it grows and incorporates new clients, lenders, products and delivery channels.

Details

Subject	Economic conditions; Industry; Social conditions & trends; Banking industry; Debt; Financial institutions; Poverty; Regulation; Microfinance
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