

**Emerging Issues for
National Microfinance Associations**

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It is estimated that national associations of microfinance institutions are active in at least sixty countries and are increasingly recognized as a distinct kind of organization. These associations are groups of independent microfinance institutions, predominantly direct retail providers of financial services, that collectively pursue selected activities under the broader umbrella of the association. Though they share certain core characteristics these national associations are quite diverse varying widely by size and level of formality. The activities they pursue range from advocacy to training or standard setting. The history of each is unique, but most are first formed or expand in response to changes they see or anticipate in their country's microfinance landscape. The vast majority have only built more substantial activities over the last five years making this a relatively new organizational form in the microfinance industry.

As national associations expand their mandate new questions are being brought to the fore. What functions are national associations suited for? Does rapid microfinance expansion suggest that a larger role may be appropriate, or will this crowd out other players? Who should the members be? Should association activities be financially viable? And, to what extent should associations mainstream their activities and membership with the broader financial sector?

This paper explores these questions and highlights key issues associations face as they venture into these expanded roles. These observations come primarily from the authors' work with the Pakistan Microfinance Network during the formative stages of its development. While the Pakistan experience is the springboard for many ideas, examples from a range of other national associations broaden the discussion. The paper does not advocate a single model recognizing that there are complexities which make such conclusions premature. Nonetheless, it is argued that national associations are beginning to expand their activities to a point that requires more rigorous examination. This paper aims to advance this discussion.

A Different Breed

The microfinance landscape contains many network organizations that bring together individual members organizations (also called "affiliates") under a common umbrella. Members remain largely independent and separate organizations but coordinate some activities, often through a central apex body. Membership provides access to technical assistance, information, training and tools, and, in some cases, funding. The universe of networks includes organizations spanning multiple continents such as Accion International, Women's World Banking, the Microfinance Network, and ShoreCap Exchange. There are also regional networks such as the Microfinance Center for Eastern Europe and AFMIN for Africa. National associations belong among this broad family of networks though they have important distinguishing characteristics explored in more detail below.

The members of national microfinance associations, like those of most networks, are primarily retail providers of microfinance services. While some associations begin with a primarily NGO member base, there is greater desire today to include a variety of financial service organizations such as commercial banks, leasing companies and other non-bank financial institutions. A broader membership is seen by many as a way to build influence and mainstream microfinance into the broader financial services industry.

National associations are similar in important ways to regional and international networks, but national associations also have certain distinguishing features that place them in a sub-category of their own. An obvious distinction is their focus on a single country; but less obvious is how this makes national associations fundamentally different. Unlike international or regional networks, members of national associations interact with the same government departments and must

operate under the same financial sector conditions. They also operate in relatively close proximity and sometimes in direct competition with one another. This closeness enables members to meet and communicate more easily. At the same time, members may be direct competitors for clients, staff, funding, or recognition which can restrict the information members are willing to share.

Some networks are brought together by shared philosophies that emphasize financial systems development, like Accion, or poverty outreach, like Grameen. Some networks are drawn together by operational similarities such as Credit Unions which often share the same legal structure, product offerings, and chart of accounts. SEEP defines these networks of like-minded organizations as Operating Alliances where members have closely aligned operations and these similarities, rather than a shared country, bind the network together. These similarities make Operating Alliances particularly well suited to transfer knowledge that can improve management, operations and internal systems. National associations, on the other hand, typically have a more diverse collection of members that often hold different philosophies and operational systems which can make knowledge transfer more cumbersome. National associations tend to focus on their common country context, engaging in activities where members have a common interest such as advocacy, standard setting and promoting industry infrastructure.¹

In addition to a single country identity, national associations tend to have a similar member-controlled governance structure. The term “association” implies a high level of member control exerted through democratic processes. An association’s secretariat or apex organization exists to administer association activities, but the final decisions on governance matters are in the hands of the members. A member-controlled governance structure is quite different from other networks that take more of their direction from a central body. Some international networks are led by an influential parent organization that may be a minority or majority owner of its member MFIs. These networks may encourage member MFIs to join the network’s Board and become involved in other decisions, but this level of participation is not nearly the same as an association in which members hold the final authority on the most important decisions (e.g. selection of the CEO).

These two key distinguishing features of national associations, focus on a single country and member-controlled governance structure, provide the basis for advancing the view that most microfinance associations will evolve to look more and more like the national associations of other established industries. This is why the term “national association” is increasingly replacing the term “national network”. This evolution suggests that microfinance associations may also need to consider their role vis-à-vis other national associations, particularly national Bankers’ Associations present in many countries. Partnerships and collaboration with these parallel associations may deserve more urgent consideration in countries where microfinance is expected to integrate with the broader financial sector more quickly.

Four Expanded Roles

The activities of most national associations begin modestly often by creating a central meeting point and facilitating experience sharing. At an annual meeting or over lunch, members of an association can discuss the latest development in their own institutions or gossip about the Governor of the Central Bank. GHAMFIN in Ghana operates a center that provides country information, international best practice materials, and an inventory of MFIs. Some associations establish working groups to examine selected issues more closely, often as a first exploratory stage for a potentially larger effort. Sa-Dhan in India initially established working groups on policy, financial standards, and capacity building (which later matured in to more defined

¹ There are important exceptions to this generalization. Some national associations have members with closely aligned operations, particularly national associations for credit bureaus such as APIFM in Madagascar. Operational similarities encourage more focus on knowledge transfer and they probably tend to focus their advocacy on their own type of organization. They may be less active sharing technical information with or promoting a more diverse set of MFIs that fall outside their membership base.

programmatic areas). These initially modest lateral learning functions focus internally on allowing members to learn from each other, in the process enabling members to learn more about microfinance.

Most countries with a microfinance sector that is gaining momentum and is expecting to grow to serve hundreds of thousands of clients would probably benefit from a well-run national association providing these modest functions. The cost should be minimal and may not even require full-time staff. At this modest level national associations may do little more than organize an annual gathering.

Five years ago a large majority of national associations were probably characterized by something close to the modest profile described above, but many national associations are expanding their activities. Associations are moving beyond basic lateral learning and information functions to become:²

- **Advocates** taking a more prominent role in dialogue with the financial sector, government bodies, and organizations outside their country.
- **Standard-Setters** proactively promoting financial transparency and codes of conduct.
- **Service Providers** offering fee-based services to members and non-members such as training, credit ratings, credit bureau information, and technical assistance.
- **Funding Agencies** channeling funds to retail MFIs.

In many countries these four functions are non-existent or very weak and national associations are tempted to fill the void. Should they take on these roles and what are the key challenges if they do? This core purpose of this paper is to examine these four expanded roles more closely and to advance discussion on these issues.

Advocates:

As membership organizations representing primarily private retail MFIs, national associations have an important voice. Their members have direct contact with microfinance clients and know the realities of service delivery. The most obvious and usually the most important audience for advocacy are government agencies such as the Central Bank and Ministry of Finance, or their equivalents. Many of the advocacy issues in microfinance are well known: regulations, interest rates, etc. Some national associations see their advocacy reaching an audience beyond government. Apex funding organizations play an important role in a number of countries and the private financial sector may be entering microfinance directly as a provider or indirectly as an investor. Attracting these audiences to dialogue or even encouraging them to become members of an association can be one way to mainstream microfinance. Building relationships with bilateral, multilateral, and private donors can broaden a network's influence and may give the association more leverage. National associations can also build relationships with international organizations and represent their country's microfinance industry to an international audience. In a few countries there are consumer groups concerned about interest rates or predatory lending that a national association might wish to engage with.

Associations engage in a range of different formal and less formal activities to further their advocacy goals. Some organize high visibility events such as seminars and conferences to highlight issues. Associations also commission policy research, publish papers, and serve on boards and committees. These formal advocacy activities are important, but it is equally important to consider the less visible informal modes of influence that do not appear in activity reports or budgets. Views are often formed in the corridors of meetings or through one-on-one

² Grzegorz Galusek Executive Director of the Microfinance Center noted that the *regional* network he works for engages in a fifth area - Research. While some national associations are considering Research we did not find many who have substantial Research activities; at least not yet.

conversations and associations can become more influential by building credibility through industry expertise and organizational integrity. Perhaps the most critical component of influence is the level of credibility and access to centers of influence that individual member organizations and individual personalities bring to an association.

It is inherently difficult to assess an association's advocacy effectiveness since it is difficult to measure outcomes or attribute them to advocacy efforts. For example, in 2000 the State Bank of Pakistan established a special unit to explore regulatory options for microfinance. Was this driven by the national association's lobbying efforts, donor agency influence, or by the government acting on its own? Such questions are difficult to answer. Another challenge is that advocacy takes time, requiring consistent effort over several years to build relationships and credibility. For this reason it is important to be persistent and to avoid on-again off-again efforts. It is important to be well placed to seize opportunities brought on by the replacement of a key minister or a shift on a wider policy issue. Persistence also prevents lapses in an association's visibility that might allow other stakeholders to easily overlook or discount the views of practitioners.

In many respects advocacy is natural for national microfinance associations since members share a common trade and face the same environment. These shared circumstances create natural alliances on some issues of common concern, and no other organization can represent these views in quite the same way. The challenge is to build and maintain member cohesion. Associations may seek to enhance their clout by attracting a diverse range of MFIs as members and it is usually in the interests of associations to include broad representation of the leading providers in the industry. At the same time, members that differ in their geographical focus, methodology and legal form may have different interests. For example, new legal windows to create microfinance banks may not be welcomed by commercial banks but could be widely supported by NGOs hoping to transform their operations.

A diverse and representative membership base should be an advantage in advocacy, but overcoming the differences among members requires concerted effort. Perhaps the best situation is to allow for differences among members, but to use these differences to generate creative tensions that promote internal dialogue and elevate the association to a higher common purpose.

Standard Setters:

Associations are often well placed to begin to set various kinds of financial and ethical standards in the microfinance industry. This role is, however, often confused by terminology. Some associations list "self-regulation" as one of their roles, though this can be mistakenly confused with the types of regulation that government provides. It would be highly unusual for a member-controlled association to be able to enforce regulations on members with the same authority as the government. If a member became dangerously under-capitalized, for example, could an association require an infusion of new capital and how would that requirement be enforced? Instead, associations are more often involved in voluntary efforts to promote compliance with a set of rules or standards. Public pressure, peer pressure, and a desire to do the right thing are the main compliance incentives. This voluntary standard setting and monitoring can be an important contribution but it should not be confused with, and it cannot replace, government regulation, particularly the prudential supervision of deposit-taking institutions.

A large share of national associations report standard setting as one of their key functions, particularly standards for financial transparency. Of the 28 national associations listed in SEEP's directory in 2003, half list performance monitoring among their activities. These efforts certainly vary, but nonetheless this appears to be an increasingly common role for national associations. The MIX Market and MicroBanking Bulletin partner with national associations to project internationally accepted financial transparency norms. National microfinance associations also recognize that it is in their self-interest to build financial transparency to enhance credibility with the public, donors, government, and potential investors. Associations are also particularly

concerned that unreliable financial information could steer funding towards weak MFIs and that a single well-publicized failure could damage the reputation of all MFIs.

The rigor of voluntary financial transparency efforts varies. The most basic may only involve selecting common industry indicators and ratios. Typically these include outreach statistics on the number of clients and ratios for efficiency, portfolio quality, and financial sustainability. A higher level of transparency is achieved by publicly disseminating aggregated performance data of member MFIs, or can even be taken further by publishing data on each organization individually. If such figures are widely available, accurate and meaningful, they can build credibility for microfinance and also enhance an association's effectiveness as an advocate.

The challenge in building financial transparency is that it can be a painful exercise for association members. MFIs are diverse and vary by age, size, geographic focus and methodological approach, and the selection of some indicators may show some members in an unfavorable light. Unless members agree to simply accept international standards as they are, it can be difficult to establish a mix of indicators that the members view as fair. A balance must be struck between pushing for greater transparency and ensuring that these efforts do not get ahead of members' buy-in to the association. There are three primary challenges in this endeavor. (1) Establishing *motivation* among members to compile accurate information that may be different from what they normally report. (2) Building the *technical capacity* of members and the association to collect and present meaningful and consistent information. (3) Overcoming the *lack of uniformity* that comes from diverse of methodologies, accounting practices and cost allocation rules which make it difficult to present financial data in a comparable way. Meeting these challenges is made easier in a constructive atmosphere, with a strong sense of member ownership and when meeting financial transparency requirements is rewarded with access to other association privileges.

Increasingly associations are setting standards in other areas such as various codes of conduct. AMFIU is establishing a Consumer Protection Code in Uganda and the SEEP Network is facilitating similar efforts among other networks. Consumer protection and other codes are explicit agreed upon rules that aim to prevent organizational behaviors that can damage the industry and its clients, for example inappropriate mobilization of savings or widespread borrower over indebtedness. While associations usually have no legal power to enforce the codes, the rules raise awareness and there can be significant public pressure to comply. Additionally, if there is a well-publicized breach of the code, the association may be better protected having advocated sound practices from the beginning. Codes can also pre-empt heavy-handed government responses that may not distinguish between the offending MFIs and those that are better behaved.

The forms of standard setting discussed here can be effective ways to strengthen a microfinance industry. Even so, it is important to ask what organizations ought to eventually maintain such standards. National associations can be useful places to begin norm setting efforts, but it is also worth asking whether specialized independent standard-setting bodies might eventually take on these roles.

Service Providers:

There are usually a number of gaps in service provision that if filled could potentially help the microfinance sector. There may not be training or technical assistance services to build the capacity of MFIs, there is often limited information on borrowers that may improve with a credit bureau, and MFIs may have difficulty raising funds from the market that can be partly addressed through credit rating services. National associations are often tempted to fill such gaps by developing services that can generate fee revenue and be offered beyond an association's own members to the entire microfinance market, especially where a viable private market for these services exists or there is the potential for one to develop. This potential distinguishes these services from the basic information sharing functions described earlier that have an internal focus on members-only and for which a viable private market may not exist.

By far the most common association service is training. A large majority of the twenty-eight national microfinance associations cataloged in SEEP's Global Directory of Networks in 2003 list capacity building services³, particularly training, among their activities. Though still uncommon, some national associations develop credit bureaus that collect and organize information on the credit-worthiness of borrowers. Access to this information can improve the quality of loan portfolios and drive down the costs of lending. A few national associations develop credit rating services to help MFIs access financing from investors who are unfamiliar with microfinance and would be reluctant to lend to or invest in the sector without an independent rating.

Associations often underestimate the considerable effort required to offer high quality services in these areas. In Pakistan, the association embarked on a national training program based on the expertise available with members without being aware of how to plan and put in place an effective training program including a regular assessment of needs as well as good curriculum design, course delivery and evaluation.

Box 1
National Associations and Credit Bureaus

National associations are natural advocates for building credit bureaus since members usually share an interest in knowing more about their borrowers' credit histories. But common interest is only a starting point; there are other considerations to factor in as national associations and other stakeholders consider whether and how to build credit bureaus for microfinance.

Market Conditions. Credit bureaus are particularly valuable where competition is, or will soon be, heating up. Where competition is limited, a credit bureau may be more of a luxury than a necessity. Lending methodology is another factor; group lending puts less pressure on lender access to information relying more on group screening. Credit bureaus may be more valuable where individual lending is more widespread.

Market Coverage. Experience indicates that credit bureaus that are unable to include information from a substantially large portion of lenders are limited in their value. Exclusion of large segments of overlapping microfinance markets leaves out critical information that would help prevent client over indebtedness and build more reliable credit histories. Ensuring wide participation is not always easy, particularly if there are state-owned lenders who have little incentive to improve the quality of their loan portfolios.

Specialized or Mainstreamed? There is some debate about whether to establish specialized microfinance credit bureaus or to link microfinance to broader credit bureaus serving other segments of the financial market as well. Being more specialized may enable more customized service. On the other hand, links to larger credit bureaus may bring microfinance further into the financial mainstream, enabling MFIs to reach up to new markets and for other lenders to reach down to the microfinance market. National associations may not be well positioned on their own to build a mainstreamed credit bureau.

In addition to requiring talented individuals with appropriate expertise, developing good service provision programs is relatively costly. The training program of the Pakistan association initially took up four-fifths of the budget even though the association was equally concerned with its advocacy and financial transparency efforts. High quality services demand time from expensive staff, requiring that services generate revenue to cover costs. There is general agreement that services should be profitable within a reasonable time frame in order to stimulate rather than block competition. Through a combination of cost control, quality services and appropriate fees can generate profits, but the initial financial outlay is often much greater than what is required for an association's other functions.

Given the large human, technical, and financial investments required, associations need to weigh their own direct provision of these services against attracting other organizations to provide such services. There may be training centers, consulting firms, credit rating agencies or others to take

³ The term Capacity Building is often used to describe a wide range of activities including lateral learning and information dissemination. For the purposes of this paper capacity building services refer more narrowly to training and technical assistance that can be offered on a fee-for-service basis to a wide range of institutions beyond association members for which a viable market, or potential market, exists.

on these tasks. All too often, however, outside firms do not perceive microfinance to be a large or a profitable business segment, leaving associations with the difficult choice of providing the services on their own or waiting for the service to appear. In Pakistan, the association tried to attract private credit rating agencies which at first showed little interest beyond the three largest MFIs and apparently did not want to target microfinance due to the limited capacity of most MFIs to absorb commercial funds. The association decided to continue the dialogue with credit rating agencies instead of taking on this role itself. At the same time, it felt compelled to respond to the upswing in government interest by starting a training program to deliver messages on best practice to help get microfinance off on the right foot. Nonetheless, some members still hold the view that the association should eventually cede its training service role to others and focus on the provision of public goods, particularly advocacy and building financial transparency. There is concern that providing services will crowd out other potential providers, particularly if the association uses its access to donor funds to offer services in a manner and at a price that dissuades others from entering. An association's involvement in service provision can also reinforce a perception that microfinance is an insular industry that would not welcome new competitors.

To avoid these traps, associations can prime the pump by providing high quality services at fee levels that could attract competition. In time associations can also sell or spin off their service programs. Another approach is to develop partnerships with private companies. COPEME an association in Peru has an agreement with INFOCORP, a private company, to provide credit bureau services. In exchange INFOCORP receives fees for service (at a discount negotiated by COPEME) and gains access to the data of COPEME's members. This arrangement takes advantage of COPEME's microfinance information and the professional credit bureau capabilities of INFOCORP.

Microfinance may in time reach a scale and establish a reputation which passes a "tipping point" that will convince more service providers to enter the microfinance sector. When that time comes, associations can either compete as one of several service providers or choose to exit service provision altogether. It is important to be realistic about the speed with which new markets for these services can develop. Even after five years, the association training program in Pakistan has not attracted substantial competition even though fees are high enough to cover all direct costs and even though the association did what it could to entice others to enter the market.⁴

Funding Agencies:

Although rare, a few national associations are considering ways to channel funds to retail MFIs. In this capacity, associations raise funds from donors, government, or private investors to invest in MFIs in the form of debt, equity, grants, or guarantees. Organizations that engage *primarily* in financial intermediation to MFIs, whether or not they provide other ancillary services, are best seen as Apexes⁵ with a different set of issues that are not directly relevant to this discussion. Nonetheless, channeling funds on a smaller scale, as one of several activities, is a role some national associations could possibly take on.

National associations might want to channel funds if their members are not able, for size or other reasons, to directly access funds on their own. An association might have a stronger financial profile and reputation that it can leverage to raise funds on behalf of its members. When individual MFI funding needs are small there may be some cost savings by pooling multiple member funding requests through the association.

⁴ The training program of the Pakistan Microfinance Network recovers the direct costs from course fees, although it relies on grants for course development and is therefore not fully sustainable in a pure sense.

⁵ See CGAP Occasional Paper 6: "Apex Institutions in Microfinance."

Taking the decision to become a funding agency on top of other association functions is a complex question that can fundamentally affect an association's identity. Becoming a funding agency raises a large number of questions. First, similar to the service provider role discussed earlier, there is the question of whether the association expects to become a permanent provider of funding for its members. If members are strong organizations but face cost or information barriers to access funding there may be a useful role for an association to play. But if members are worthy of investment, it may be better for the association to link members directly with funders, though the value added of an association playing an intermediary role in the funding process deserves careful consideration.

The second consideration is the financial risk borne by funding agencies. Grants invite little financial risk, but providing loans, guarantees, or equity investments are by definition risk-based arrangements. Loans may not be repaid, guarantees can be called, and equity investments may not generate the expected rate of return. These are financial risks that providers of financial services must be prepared to absorb, requiring adequate financial reserves and risk management capabilities.

The third question goes to the heart of association governance; how can member-controlled associations make objective funding decisions? Funding agencies need to develop mechanisms to select, structure, and monitor their allocation of funds. How will associations develop mechanisms to determine which members are eligible for funding? If a funding recipient fails to meet contractual obligations how will the association respond? There are mechanisms to help manage such difficulties, for example establishing independent investment committees or putting up "Chinese Walls" to protect the independence of funding decisions. Such structures still deserve careful consideration since there can be unintended consequences for the governance of an association.

Balancing Membership

Member-controlled associations are collections of individual MFIs that work under one umbrella to achieve a common purpose. The size, composition, and internal dynamics of the membership will drive which roles associations take on and how well they perform. The member composition of national associations varies widely. In Bolivia there are two associations; one for regulated microfinance banks and another for NGOs. One explanation is that Bolivia has a large enough market, and sufficiently demarcated differences in legal form, for two interest groups to exist. Even so, the Bolivian situation may be less than ideal since there is significant market overlap between the regulated and NGO microfinance markets. In fact, these two separate associations recognized this and entered a joint venture to launch a credit bureau, INFOCRED, serving the entire microfinance market. In Pakistan, where microfinance is younger, the association includes regulated and unregulated MFIs encompassing NGOs, commercial banks, microfinance banks and leasing companies. In time, separate associations may form, but the Pakistani industry is still small and young enough for only one national association to have established itself.

Most national associations focus membership primarily on MFIs, the direct providers of microfinance services. MFIs are in many ways the most critical players in any microfinance industry and share a common trade around which forming a national association makes a certain amount of sense. That said, some associations include non-MFIs such as research centers, interested individuals, consulting firms, training centers, government representatives, or even smaller sub-national networks. A more diverse membership base expands reach and incorporates different perspectives. Non-MFIs, however, may have different interests that must be accommodated and associations are understandably reluctant to offer training or other services that would compete with what members already offer. This can limit an association's range of activities.

Beyond member composition there are also important questions about scale: how many members should an association admit? The typical size is between ten and twenty, though industry growth

will naturally push these numbers up over time. Some associations are already much larger; AMFIU in Uganda and GHAMFIN in Ghana have close to 100 members each, though many are not MFIs. A network that includes a larger share of the microfinance players has a stronger claim to speak for the industry and this is one way to become more influential. A larger size also provides a stronger financial base from member dues. These benefits, though, need to be weighed alongside other potential consequences of larger membership; slower decision-making, perceived or real lowering of membership criteria, and potential dilution of member commitment.

There are strategies to help achieve a better balance between size and influence. Provincial associations can be formed to meet the needs of smaller MFIs. Training, conferences and other association events can be opened to non-members. Separate committees for Donors or Government Agencies can involve these stakeholders. A few seats on an association’s Board or on Committees can be set aside for non-members. These strategies that reach “up, down and around” to involve other stakeholders can broaden influence without disrupting the composition of membership. Other tactics include opening up membership gradually, allowing for incremental growth to a size members feel comfortably suits the association’s identity and mission. Some associations establish different classes of membership, for example introductory observer status or associate level membership may imply more limited privileges and responsibilities.

The capacity of an association to act collectively is based on a careful balance of the responsibilities and privileges of membership. Members make intellectual contributions, give their own time to ensure that a policy seminar or training event succeeds and should also be required to make financial contributions to the association’s activities. These responsibilities must be balanced with the privileges. SEEP observes that well-functioning networks are based on democratic principles where all members feel they have a voice. This voice may be heard in meetings or, in larger networks, expressed through the selection of a Board of Directors. Influence can also be expressed, though, in informal ways. In internal meetings and discussions some members are more influential due to their stature and the personality of their organization’s representative. Some members may contribute more of their staff time to association activities. A strong association will accommodate these less formal forms of influence in a way that may not be equal to all members, but is at least seen as fair.

Concluding Thoughts on Financial Viability

The rapid growth of national associations and the new roles they are taking on requires resources. Determining the appropriate mix of funding and roles can be made easier with the use of the summary table below.⁶

Main Sources of Funds

Service Fees from Clients
 Member Contributions: Dues + In-Kind
 Public & Private Grants
 Endowment & Investments

Primary Roles

Service Provision
 Lateral Learning/Information
 Industry Advocacy
 Self-Regulation

One area where there is consensus is that the provision of services ought to be fully funded by fees. Training, credit rating, credit bureaus, and technical assistance are private goods that ought to generate sufficient value to the user to justify the fee levels. Moreover, as emphasized earlier, ongoing subsidization of these services potentially crowds out new providers. Associations will make a greater contribution by aiming for profitability from the outset even if some up-front subsidy is required. For this reason, some associations segregate the revenues and expenses from service provision by establishing cost centers or providing services through subsidiary companies.

⁶ Building equity through retained earnings is another source of funds. Some donors allow associations to use grants to cover their operations and to accumulate member dues and other funds as equity. Also excluded from this discussion is the funding agency role since this opens up more complex questions that are better understood in the context of a discussion about wholesale apex funding mechanisms.

Opinions on member contributions and grants as funding sources are somewhat more controversial. It is safe to begin with the proposition that most associations ought to aspire to cover their basic core functions (lateral learning and information sharing) entirely from member contributions. This signals commitment and demonstrates the value members place on the association's functions. Where opinions vary is how soon this standard ought to be met. Younger microfinance industries with fewer, smaller and less profitable MFIs may be less able to meet this standard early on. In countries with more mature MFIs it is much harder to make this case.

It is generally believed that associations will be stronger if they aim to bring member contributions to a level that can fund a core set of association activities. Thus, even if external support were removed the association could still serve a basic function. It is also important to recognize that member contributions can be much more than dues. In-kind member contributions can be an association's most important resource, equivalent in some cases to several multiples of member dues. Associations are often housed in a member's office and can receive free or discounted access to phones, fax machines, office space, and computers, but the most important association resource can be the donation of time from the staff of member organizations, particularly the intellectual contributions from senior management.

Having stressed the importance of member contributions, there can also be solid justification for grants and other subsidies which are carefully designed to add to rather than displace member contributions. In addition to core activities, associations often take on additional roles for which extra resources may be justified. Even services that eventually become self-sustaining, such as training or credit bureaus, need start-up investment, for which grant funding may be sought. Some of the functions provided by associations are public goods that benefit the entire sector such as information centers and the publication of financial indicators. These public goods may be partly financed by member contributions but they can often be made even more effective using grants from external sources. One could argue that the standard setting function could justify some support from government since these are sometimes public functions the government does not have the capacity to take on. As long as an association can periodically make a rigorous case that it is adding value through the provision of public goods, there may be grounds to maintain some level of grant support.

Pushing too hard for complete independence from external grants can have unintended potentially damaging consequences. Some associations that are unsure of their long-term funding are building large service provision businesses in order to supplement their revenue. Large, multi-service national associations may not be in the long-term best interests of microfinance since services are often best provided by a variety of organizations in a competitive environment. In addition, associations that move too heavily into service provision may neglect their other public goods provision in advocacy and standard setting. Funding pressures can also push associations to rapidly expand membership in order to broaden their revenue base. GHAMFIN in Ghana grew from eight members in 1996 to eighty-seven by 2001 in part driven by financial pressures and this growth raised new questions about how the association would meet the needs of a larger organization with a different membership base.⁷

Having made a case for carefully placed grants, there are several cautionary considerations as well. Funding agencies need to be careful they do not artificially create associations that are ill-equipped to adapt to the changing needs of the sector. A larger and more active association may be useful for a time, but this role may change as new service providers enter. This may seem a distant concern for associations building their organizations, but there can be a tendency to look for ways to perpetuate projects and programs beyond a useful life.

There is a fourth source of funds that is worth mentioning since it is receiving more consideration - the accumulation of reserves. Pools of investment reserves are attractive because they provide

⁷ GTZ 2002.

greater financial security and they diversify revenue sources. Investment pools can be accumulated in lump sums from benefactors or there may be some circumstances where retained earnings are sufficient. A pool of investments can generate returns that diversify the association's sources of revenue, help associations to plan with a longer term perspective and may enable them to pursue innovative activities that cannot be supported by other sources of funds. Investment returns may also bridge timing gaps in the receipt of funds from other sources. Some associations believe that these investment pools can become semi-permanent endowments that help provide the basis for long-term operations. While some caution is warranted in establishing larger and more permanent endowments, there are perhaps grounds to consider the value of building modest pools of unrestricted investment funds. These reserves could generate alternative sources of revenue, and since they remain unrestricted, the association could draw upon such reserves to seize unforeseen opportunities. This kind of flexibility can be valuable in a fast changing microfinance environment.

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