MACRO-LEVEL PROBLEMS IMPACTING FINANCIAL INCLUSION IN ARGENTINA; AN EXPLORATION OF THE ROLE OF MULTILATERAL DEVELOPMENT INSTITUTIONS AND INTERNATIONAL ORGANIZATIONS PLAY IN HELPING ADVANCE FINANCIAL INCLUSION

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ABSTRACT

Across the world, microfinance has emerged as a critical tool to help reduce poverty by bolstering economic participation and financial inclusion rates. In particular, microcredit loans offered through microfinance institutions have helped dramatically increase the availability of financial services targeting low-income populations, resulting in higher rates of financial literacy and improved access to capital. Despite microcredit’s overall success in transforming the landscape of financial services for the poor around the world, Argentina’s microcredit industry has failed to achieve scale, leaving millions of low-income Argentines without access to financial services. Academics have investigated the various potential reasons why microcredit has been unsuccessful in Argentina, but there is very little documented on the subject from the perspective of one key group of practitioners: investors and donors from the multilateral development banks or impact investing funds. This thesis compares and contrasts data compiled from academic literature with data collected during primary source interviews with experts from development banks and investment funds, with the objective of having a fuller understanding of why microcredits have failed to reach scale in Argentina. The research reveals that while there are some overlaps between the reasons academics and practitioners cite as the barriers preventing industry growth, there are significant breaches between the two groups. For example, while
practitioners overwhelmingly believe that a poor business climate is the primary barrier facing
the microcredit industry, academics believe that cultural reasons play just as an important role in
impeding industry growth. This thesis concludes that the breaches are significant enough to
make a plea for improved communication and collaboration between the academic and
practitioner bodies to ensure that every best effort is made to have cohesive messaging and
policy recommendations for lawmakers.
This thesis is dedicated to the many kind and patient individuals who supported me during the entire Masters program and thesis-writing process. In particular, Dr. Martin Grandes, who served as my advisor for this thesis, and provided wonderful guidance and valuable feedback whenever I needed it. A special thank you to all of the individuals who agreed to be interviewed as part of this thesis; your willingness to take time to share your knowledge and expertise is greatly appreciated. Without your contributions, this thesis research would have not been possible. And lastly, to my parents, family, and friends, especially Michael Denly; thank you for your words of encouragement when I needed them most.

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Introduction

Microfinance in its present form emerged in the late 20th century and has since greatly changed the way development practitioners, politicians, and the private sector view citizens at the bottom of the pyramid. Instead of perceiving a country’s poor as in need of handouts to survive, microfinance has introduced the idea that by giving a hand up in the form of a small microcredit loan, citizens can begin to engage in productive activity, and with continued support from financial services, pull themselves out of poverty. Although microfinance cannot alleviate poverty on its own, it has garnered respect around the world as a critical piece of the puzzle in addressing the needs of the world’s poor.

Argentina is a nation rich in history of economic volatility. Argentina entered the 20th century as one of the wealthiest countries in the world, and exited as an economic pariah, cut off from the international lending markets due to their repeated history of defaults and accusations of reporting inaccurate economic statistics. Despite the turbulent past and spikes in poverty rates that would have signaled an opening for microfinance institutions to begin operations to meet a market need, Argentina remains a country relatively unpenetrated by microfinance. Microfinance institutions have tried to enter the market and address the needs of Argentina’s low and lower middle class, but have faced tremendous difficulty in scaling up operations. While there is no comprehensive database to track the exact number of microcredit clients in Argentina, experts estimate that between 21,000 and 38,000 Argentines currently are served by microfinance institutions. Out of a total population of approximately 40 million, this figure is curiously low.

Despite their best efforts, microfinance institutions have continually failed to scale up their lending operations, and some have even shut down as a consequence. Academics
researching themes of social and economic advancement picked up on this phenomenon, and began to research the challenges and barriers microfinance institutions face, in an effort to better understand the root causes of why microcredit hasn’t worked in Argentina as well as it has in countries with similar demographics of poverty. The literature on the topic brings awareness to the many unique economic, social, and historical factors that have prevented microcredit from reaching its potential in Argentina, yet they do not bring in the perspective from one critical group: multilateral development bank staff and investors. In many countries, the involvement and support of the multilateral development banks and impact investors has been critical in helping overcome the initial barriers to developing a vibrant microfinance industry, such as high start-up costs, consumer education, and working with regulators to ensure proper oversight. The absence of literature and perspective from multilateral development banks and impact investors inspired this thesis. The objective of this thesis is to help fill this knowledge gap and more fully understand the barriers the Argentine microfinance industry has faced, as well as what the future may hold for the industry.

This thesis is divided into seven chapters. First, an overall history of microfinance, key definitions, and a discussion on the benefits of microfinance and financial inclusion are presented. Chapter two explores the role multilateral development institutions and impact investors have in promoting financial inclusion through strategic investment, and how financial inclusion fits into the landscape of broader development objectives. Chapter three looks closely at the history of microfinance in Latin America and Argentina, with an examination of how the Argentine market has evolved in comparison to its peers. Chapter four provides a thorough review of the existing academic literature on what some of the potential root causes behind Argentina’s underdeveloped microfinance market may be. Chapter five introduces the research
methodology, approach, and preliminary hypotheses of this thesis, and chapter six presents the results of the research. Chapter seven is dedicated to analyzing the information gathered through the interviews conducted, and, most importantly, interpreting what the results may indicate about the current and future state of microfinance in Argentina. The goal of this thesis is to provide a more comprehensive view of what challenges the Argentine microfinance industry has historically faced in achieving scale, as well as what the future outlook for the industry may be given the recent changes in government regime.

Chapter 1. Origins of Microfinance

Although the world’s poor have depended on informal financial mechanisms since much earlier, the origins of the formal provisions of financial services to the poor can be traced back to 1978, when a group of young Bangladeshi men formed the Association for Social Advancement (ASA). ASA’s goal was simple; to fight the divide between the ‘have’ and ‘have-nots’ in Bangladesh by giving the rural poor access to financial tools so they could improve their lives (Armendáriz and Morduch, 2010). Not long after ASA was formed, a rural economics professor, Muhammad Yunus, made his own observations of rural Bangladeshi villagers unable to escape the trap of indebtedness to usurious local moneylenders. The villagers lacked access to fairly-priced working capital, thus Yunus’ experimented with providing low-interest small loans (“microcredits”) to the villagers in an attempt to break the cycle of debt between villagers and merchants who supplied them raw materials. As a result of Yunus’ microcredit loans, the villagers were able to avoid costly debts to the merchants and generate higher incomes from their product sales with such success that Yunus decided to create Grameen Bank to formalize the microcredit lending process. Grameen Bank quickly became known as the “The Village Bank”.

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The Village Banking methodology uses group lending, in lieu of individual lending, which requires collateral, to take advantage of the close relationships borrowers had with other borrowers in their group to create joint liability. Repayments are made weekly and occur in public, taking advantage of local information, peer support, and if needed, peer pressure, resulting in Grameen borrowers having high repayment rates (Grameen Bank, 2014). In addition to providing funds to finance microcredits for the villagers, earliest donor interventions involved setting up credit unions to focus on savings mobilization in rural areas in an attempt to “teach poor farmers how to save” (Ledgerwood, 1999). Government agencies also engaged in lending activity to the poor, in particular small farmers, to promote domestic agriculture production and food security. However, these targeting lending and savings programs became the subject of criticism for their high rate of loan defaults and operational losses, leading to a new school of thought that promoted the integration of institutions that serve the poor into the traditional financial markets (Ledgerwood, 1999).

Due to the diversity of markets and types of financial services that are provided, it is essential to define the terms “microfinance” and “microcredit”, as they will be frequently used in this work. According to Armendariz and Labie, (2011) “Microfinance is the provision of small-scale financial services to people who lack access to traditional banking services. The term microfinance usually implies very small loans to low-income clients for self-employment, often with the simultaneous collection of small amounts of savings”. This is similar to Ledgerwood’s (1999) definition of microfinance as the “provision of financial services to low-income clients, including the self employed”. Ledgerwood elaborates that “financial services generally include savings and credit; however, some microfinance organizations also provide insurance and payment service…social intermediation services such as group formation, development of self
confidence, and training in financial literacy and management capabilities”. Morduch and Armendariz (2005) share a similarly basic definition of microfinance as “a collection of banking practices built around providing small loans (typically without collateral) and accepting tiny savings deposits”. Bekerman and Cataife (2004) expand to this basic definition, including that microfinance products should be targeted at disadvantaged individuals whom are otherwise excluded from the formal banking sector, and additionally note that microfinance schemes should be designed to provide innovative products in the most efficient manner possible.

Armendariz and Labie (2011) provide the most inclusive definition of microfinance through their list of nine features that traditional microfinance institutions typically, but are not required to, have: “Small transactions and minimum balances (whether loans, savings, or insurance), Loans for entrepreneurial activity, Collateral-free loans, Group lending, Focus on poor clients, Focus on female clients, Simple application processes, Provision of services in underserved communities, and Market-level interest rates.” Within all of these definitions, it is important to emphasize that the term microcredit refers specifically to the small loans provided to low-income clients, whereas microfinance is the suite of broader financial services (microcredit, microsavings, microinsurance, micropensions, and money transfer programs). Additionally, the definitions are subjected to how one defines ‘small’ and ‘poor’, as these both alter what does and does not constitute microfinance (Armendariz and Labie, 2011).

ASA and Grameen are the anchor institutions of the global microfinance movement that is continuously growing. Since ASA’s and Grameen Bank’s establishment, both organizations, and microfinance itself, have undergone transformations, receiving accolades and applause from business and political leaders worldwide. Since the 1980’s, microfinance has attracted the attention of donors and investors, allowing the market to shift from subsidy-based integrated
credit and training programs to a focus on MFI’s that are committed to expanding outreach and achieving financial sustainability (Ledgerwood, 1999). In 2005, ASA was ranked the number one microfinance institution in the world based on the criteria of scale, efficiency, risk, and returns (Forbes, 2005). Grameen’s Village Banking methodology has since been copied countless times across the global, with new versions and adaptations continuing to emerge to meet the demands and needs of local markets (Murdoch, 1999). Although ASA and Grameen were the first institutions to institutionalize microfinance, actors today continue to innovate with both the methodology and products they offer to clients. While regional penetration rates vary, the global presence of microfinance institutions today is significant. As of December 31, 2012, 3,718 microfinance institutions reported reaching 203,672,249 clients, 115,747,387 of whom were among the poorest when they took their first loan. Of these poorest clients, 83.3%, or 96,386,285, are women (Microcredit Summit Campaign, 2012).

Many applaud microfinance as changing the lives of the poor and revitalizing communities through untapping entrepreneurial spirits worldwide and providing working capital to millions. In 1997, the United Nations General Assembly requested the Secretary General to report on the subject of microcredit in recognition of the “importance of empowering all people by increasing access to all factors of production, including credit” (United Nations, 1997). In further recognition of the important role of microfinance, the United Nations declared 2005 International Year of Microcredit, which called for the “promotion and building of even more inclusive financial sectors” (United Nations, 2005).

Microfinance presents an exciting opportunity to extend access to financial markets, reduce poverty, and foster social change, although scholars and researchers are not in agreement about its ability to do so. Before microfinance’s efficacy within a country can be debated, the
overall political and economic context of the country in which institutions operate needs to be evaluated, as this has a significant impact on how well microfinance is provided. Typically, an assessment of the country’s context can be achieved through asking the following questions:

Who are the suppliers of financial services and what products/services do they supply? How do existing financial sector policies affect the provision of financial services, including interest rate policies, government mandates for sectoral credit allocation, and legal enforcement policies?

What forms of financial sector regulation exist, and are MFIs subject to these regulations? What economic and social policies affect the provision of financial services and the ability of micro-entrepreneurs to operate? (Ledgerwood, 1999)

Once the country context is established, evaluation can be performed. In general, impact evaluations of microfinance programs can be divided into four general categories: (1) microfinance services delivered to end clients; (2) loans to programs (state-owned banks, second-tier lenders/public or private banks, or NGOs); (3) technical assistance to microfinance institutions to improve their operations and efficiency; (4) public policies (Armendariz and Labie, 2011). Although, as Ledgerwood (1999) asserts, a necessary caveat of microfinance is to not confuse it as a panacea for poverty alleviation. A poorly designed microfinance activity can in fact disrupt informal markets that have reliably provided financial services to the poor, albeit at a high cost. Armendariz and Morduch (2005) explicitly state in their work that one of the biggest myths of microfinance is that it has a clear record of social impact and has been shown to be a major tool for poverty reduction. And although it promotes the development of microfinance as a whole, the UN Report on the Role of Microcredit notes that “although a large number of studies undertaken so far…show that participants usually have higher and more stable incomes than they did before they joined the programmes…there are serious disagreements among experts on the validity of methodologies
used in some of the published studies. In some cases, even the more rigorous studies have produced inconclusive results. Some studies show that there are limits to the use of credit as an instrument for poverty eradication, including difficulties in identifying the poor and targeting credit to reach the poorest of the poor. Added to this fact that many people, especially the poorest of the poor, are usually not in a position to undertake an economic activity, partly because they lack business skills and even the motivation for business” (UN, 1997). In contrast, Jacques Attali, President of PlaNet Finance, expresses no doubt that microfinance is an integral part of international development as he declared, “Along with the 3 other pillars of development – democracy, education and infrastructures – microfinance is increasingly considered a key instrument in implementing effective and sustainable strategies in the fight against poverty”. While it is not without imperfections and its effectiveness has received mixed consensus amongst academics and practitioners, microfinance presents itself as a solution to the challenge of combining the rich information that informal lenders have access to (such as neighbors, moneylenders, relatives, etc) with banking resources. Microfinance has been the best attempt to bridge the gap between informal and formal access to finance (Armendariz and Morduch, 2005).

However, while microfinance is an important tool for increasing marginalized populations’ access to formal financial services, it is only one piece of the puzzle needed to achieve full financial inclusion. Today, financial inclusion is widely considered not only as a gateway to social inclusion, a better quality of life, and a tool for strengthening the economic capacities of the poor, but also as a citizen’s right (Banco Central do Brazil, 2010). As a result, financial inclusion has entered the political arena and attracted new and diverse actors as policymakers have embraced financial inclusion as an important development objective. To date, more than 90 developing countries have joined the Alliance for Financial Inclusion (AFI), a
network focused on ensuring member countries have access to the most innovative modes of expanding financial inclusion, while maintaining sound and stable financial systems (AFI, 2016).

As demonstrated through the diverse definitions of ‘microfinance’ presented earlier, access to microcredits, savings accounts, and insurance products typically offered through microfinance institutions are considered by many to be the key aspects of financial inclusion, but they are not the only aspects. Financial inclusion encompasses a broader range of services and conditions that determine how well a financial system meets the needs of the entire population. The Center for Financial Inclusion defines financial inclusion as “Full financial inclusion is a state in which everyone who can use them has access to a range of quality financial services at affordable prices, with convenience, dignity, and consumer protections, delivered by a range of providers in a stable, competitive market to financially capable clients” (CFI, 2016). This definition is similar, but not identical, to that of the Global Partnership for Financial Inclusion (GPFI) uses as their working definition of financial inclusion, which refers to “a state in which all working age adults, including those currently excluded by the financial system, have effective access to the following financial services provided by formal institutions: credit, savings (defined broadly to include current accounts), payments, and insurance” (GPFI, 2016). To provide an example from a national level, the Central Bank of Nigeria defines financial inclusion as “…a state where financial services are delivered by a range of providers, mostly the private sector, to reach everyone who could use them. Specifically, it means a financial system that serves as many people possible in a country” (Kama and Adigun, 2013). The Central Bank of Nigeria definition is interesting because of its emphasis on who drives the provision of financial services (the private sector) rather than what services are provided. These various definitions emphasize
the range of services and actors needed to create a truly inclusive financial system, of which microcredit plays an important, but not the only, role.

An inclusive financial system has several merits, including: efficient allocation of resources, thus potentially reducing the cost of capital; increased access to appropriate financial services which can improve day-to-day financial management of individuals; and a reduction in the growth of informal credit sources, such as moneylenders, which are costly and inefficient compared to the formal banking sector (Sarma and Pais, 2008). Furthermore, the benefits of widespread financial inclusion reach beyond the consumer. “[Financial inclusion] provides the possibilities for the creation of a large depository of savings, investable funds, investment, and therefore global wealth generation. In other words, access to financial services, that are well suited for low-income earners promote enormous capital accumulation, credit creation and investment boom…Harnessing and accumulating these [low-income earners deposits] resources provides a huge source of cheap long-term investable capital (Kama and Adigun, 2013).

Furthermore, a working paper by the International Monetary Fund studied the impact of financial inclusion on GDP growth and efficient allocation of resources. The study found that eliminating blockages related to access to credit (i.e. high transaction costs), depth of credit (i.e. high collateral requirements), and intermediation of credit (i.e. information asymmetry resulting in high interest rates for borrowers), had significant direct impacts on GDP and increased aggregate output (IMF, 2015). With regards to benefits for financial regulators, financial inclusion increases the flow of transactions completed in the formal banking sector, enhances transparency, and makes monitoring and compliance easier (Mohan, 2006). Thus, financial inclusion has become an explicit strategy for accelerating national economic growth while simultaneously advancing social and household economic indicators.
The level of financial inclusion a nation achieves is linked to income level at both a supranational and national level; the World Bank’s Global Financial Inclusion Database (Global Findex), cites that while 89% of adults living in high-income economies have a bank account, that figure drops to only 41% in developing economies (GPFI, 2016). At a national level, the richest 20% of adults in developing countries are more than twice as likely to have a formal account as the poorest 20%. Women in developing economies are at an even further disadvantage, with an average gender gap of 6 to 9 percent across income groups in developing economies (Findex, 2015). In addition to overall income, financial inclusion tends to have a strong positive correlation with overall human development index levels of a country, levels of formal sector employment, income inequality, urbanization levels, and adult literacy rates. Along with economic and social indicators, physical infrastructure variables, such as the presence of paved roads and number of telephone and internet subscriptions per 1000 people, also showed positive correlations to financial inclusion levels (Sarma and Pais, 2008).

While the poor don't have the same access to financial products as wealthier individuals, their need for financial services may be even greater. The lack of access to financial services, also referred to as financial exclusion, signifies “lack of access by certain segments of the society to appropriate low-cost, fair and safe financial products and services from mainstream providers” (Mohan, 2006). Financially excluded individuals in developing nations often have no alternative but to rely on informal mechanisms, such as moneylenders, who frequently charge extortionate interest rates, the selling off of valuable assets, or borrowing from friends and family members, when faced with financial hardship. In addition to providing alternatives sources of emergency funding, such as an affordable consumer loan, access to formal financial services allows individuals and families to save money safely outside the house, reducing the temptation to
spend savings on impulse purchases, or worse, become the victims of theft. Financial inclusion opens doors to various mechanisms that can help low-income individuals better cope with financial shocks.

The impacts of financial inclusion have been documented to go well beyond that of a family’s or individual’s finances. Research shows that access to savings products – and, in particular, to “commitment” savings, in which individuals restrict their right to withdraw funds until they have reached a self-specified goal – can have important benefits beyond simply increasing one’s amount of savings: It can also help empower women, increase productive investment and consumption, raise productivity and incomes, and increase expenditures on preventive health (World Bank Group, 2015).

However, achieving financial inclusion and banking the poor is not without varied and vast challenges. Barriers, such as cost, travel distances, and lack of documentation required to open accounts, all affect poor peoples ability to gain access to financial services. Financial inclusion programs and policies should address not only the availability of financial services tailored to meet the poor’s needs, but also the direct and indirect barriers to access. The entrance of new distribution channels, such as mobile phone operators, retailers and post offices, in addition to new business models that have emerged due to technological advances, have addressed some of these barriers, yet much work remains to be done. Furthermore, public and private-sector initiatives to rapidly expand the access to financial services, coupled with critical reforms in banking policy at national levels, can accelerate gains towards full financial inclusion.

For example, the World Bank’s Universal Financial Access 2020 (UFA2020) initiative is focusing on 25 countries where 73% of the world’s unbanked live, with the commitment of enabling 1 billion people to gain access to a transaction account through targeted interventions.
The Bank believes that through enabling people to convert from a cash-based to transaction account-based financial system, they will have increased access to financial services, gain empowerment to use other formal finance services, save their money with higher security, and more easily receive government benefits (World Bank Group, 2016). Additionally, the Consultative Group to Assist the Poor (CGAP) highlights that “Bringing people into the formal financial sector would not only improve their lives, but it would also contribute to the soundness of financial systems themselves. The global financial crisis shed light on the fragility of financial systems and the important links among financial inclusion, stability, integrity, and financial consumer protection” (CGAP, 2016). An inclusive financial system reduces dependence on informal, and often exploitive, purveyors of financial services (such as moneylenders), and promotes secure savings and efficient allocation of resources, while reducing the overall cost of capital. The role of governments and regulatory bodies, as well as specific policy recommendations, will be elaborated upon in chapter 3.

Chapter 2. The Role of Multilateral Development Institutions and Impact Investors in Promoting Financial Inclusion

When ASA and Grameen began operations in the 1980’s, the focus of microfinance was strictly on poverty reduction and social change, and the key players were non-governmental organizations (NGOs) whose mission was focused on poverty alleviation and economic development at a household level. However, when it became recognized that poor households could benefit from a broader offering of financial services, such as consumption loans and savings facilities, formal microfinance institutions emerged, and microfinance became commercialized, with profits lucrative enough to attract the attention of mainstream investors (Ledgerwood, 1999, Morduch and Armendariz, 2005). While microfinance’s origins are rooted
in the core values of poverty reduction and social advancement, increased documentation of the
economic benefits of financial inclusion have attracted a wide range of actors to the industry,
from purely altruistic donors to profit-motivated investors. This chapter begins with an
exploration of the role of private sector investors, and later focuses on the regional development
banks, and how they have helped shape the landscape of microfinance beyond the early days of
NGO-driven interventions.

In the early 2000’s, private sector investors, who were lured by the seemingly endless
earning potential that MFIs had to generate income via ‘banking the unbanked’, were a welcome
boom to the industry. Outside investment alleviated some of the funding and capitalization
constraints that had been preventing MFIs from scaling-up their operations, and also infused the
industry with cash that could be spent to innovate products and develop new, more efficient ways
of reaching the hardest to reach customers. However, after several high-profile Initial Public
Offerings (IPOs) by MFIs in Mexico, India, and Kenya, some industry veterans raised doubts
about whether commercially minded investors’ motives were in conflict with protecting the
interests of low-income clients. Following the IPO of Indian microfinance institution SKS,
Muhammad Yunus, founder of the village banking/microcredit lending methodology, expressed
his concern about the industry straying from its roots in social empowerment and development.
Yunus frowns on MFIs who put themselves in the position to answer to outside investors in the
form of stock ownership, arguing “This is pushing microfinance in the loansharking direction.
It’s not mission drift. It’s endangering the whole mission. By offering an IPO, you are sending a
message to the people buying the IPO there is an exciting chance of making money out of poor
people. This is an idea that is repulsive to me. Microfinance is in the direction of helping the
poor retain their money rather than redirecting it in the direction of rich people” (Roodman, 2010).

However, before IPO’s and the ethical questions that accompanied them came into the spotlight, microfinance institutions’ main source of outside financing were donors and private funders. Since the early 1990’s, private and public funders steadily increased their commitments to financial inclusion, before eventually reaching a plateau at $31 billion in 2014 (CGAP, 2015). In 2014, approximately 72% of all funding came from public sources, such as bilateral and multilateral and development banks, with the remainder coming from private sources driven by a mix of forces. Funders focused their financing on initiatives that addressed the primary barriers impacting financial inclusion; insufficient range of appropriate products and services, limited institutional capacity among financial service providers (such as MFIs and banks engaged in down-scaling activities), followed by inadequate financial infrastructure for financial inclusion. The majority of funds, 80%, were allocated directly to financial service providers in the form of financing or capacity building activities. Most typically, the financing provided directly to MFIs and banks reached clients in the form of new microcredit loans or investment in new financial services. Capacity building includes activities such as strengthening management and governance, increasing operational efficiency, or infrastructure improvements such as software upgrades, building new branches, or adopting new distribution methodology. Approximately 4% of global funding was dedicated to improving market infrastructure and policy environment. Such funds target governments and their ability to promote financial inclusion from a regulatory and supervisory perspective. In terms of instrument, debt accounted for the vast majority of funding, reaching nearly $12 billion USD in 2014. The next most popular financing instruments, equity and grants, were each approximately $2.5 billion USD, with guarantee and structured
finance transactions trailing behind with $1 billion USD and $.5 billion USD each, respectively (CGAP, 2015). In 2014, the top five most funded countries were India, Egypt, Turkey, Indonesia, and Pakistan. The region that received the most funding was Eastern Europe and Central Asia (31%), while Sub-Saharan Africa had the largest number of projects that received funding (553 projects). This panorama enables us to see high-level where and how funding related to financial inclusion has evolved over the years as motives and priorities of donors have shifted.

Instead of ‘going public’ with an IPO to raise funds, development banks and social investment firms offer MFIs alternative sources of funding that allow them to access capital while maintaining their socially-conscious values. Multilateral development banks (such as the World Bank Group), regional development banks (such as the Inter-American Development Bank, Asian Development Bank, the Corporacion Andina de Fomento, etc.), and social investment firms (such as Blue Orchard Finance and Oikocredit) are fundamental actors that all support microfinance in various capacities, including debt, equity, technical assistance funding, and cooperation agreements. Of the above institutions, social investment funds are the only private actors, and therefore are driven by a different mix of motivations. For example, a foundation that supports financial inclusion may do so because of its impact on poverty alleviation, while a private investor may do so because it’s an opportunity to diversify their portfolio while doing good. However, unlike social investment funds, which are privately managed and financed by independent investors, international and regional development banks rely on member nations funding to operate. Thus, it is critical to understand the motives and arguments for why nations would want to donate federal funding to engage in development assistance abroad.
The multilateral development banks were established following the great wars of the 20th century with the purpose of helping rebuild war torn nations. The first multilateral development bank, the World Bank’s International Bank for Reconstruction and Development (IBRD), was established in 1944 after the conclusion of World War II. While the IBRD focused its efforts on rebuilding Europe and Japan, the Inter-American Development Bank (IBD), Asian Development Bank (ABD), and African Development Bank (AfDB), established in 1959, 1964, and 1966, respectively, focused on development within their region. The newest regional development bank, the European Bank for Reconstruction and Development (EBRD), was formed after the fall of the Soviet Union in 1991 (Linn, 2013). Although the regional focus of each bank is distinct, the banks are all characterized by their membership of developed donor countries and borrowing developing countries, and the high level of cooperation towards achieving common development goals they maintain. In addition to the multilateral development banks, there are smaller, more nimble development institutions that have emerged, such as multilateral finance institutions and sub-regional development banks. These institutions operate with a narrower focus, either in geography or development objectives, and typically have a smaller number of member countries. Examples include The Nordic Development Fund (focused on financing climate change initiatives), the Corporacion Andina de Fomento (the Latin American regional development bank), and the International Fund for Agricultural Development (invests specifically in rural agricultural development). In the context of financial inclusion and microfinance, sub-regional multilateral finance institutions and multilateral development banks have been early and active supporters of both.

Membership to any of the aforementioned development banks and institutions is voluntary, and motives vary greatly. A multitude of variables, including history, geography, and
politics, all influence a nation's decision to become a member of a development institution. These motives can be generally divided into the categories of moral and humanitarian principles, political and national security considerations, and economic and trade considerations (Degnbol-Martinusse, et al, 2005). While bilateral international aid continues to be rooted most strongly in national security and political considerations, nations who become donor members at the multilateral development banks do so for humanitarian and economic angles. Mounting evidence has shown that availability of financial services for poor households is a critical contextual factor with strong impact on the physical and economic welfare of the world’s neediest people.

“Evidence from the millions of microfinance clients around the world demonstrates that access to financial services enables poor people to increase their household incomes, build assets, and reduce their vulnerability to the crises that are so much a part of their daily lives. Access to financial services also translates into better nutrition and improved health outcomes, such as higher immunization rates. It allows poor people to plan for their future and send more of their children to school for longer. It has made women clients more confident and assertive and thus better able to confront gender inequities” (Littlefield, Mordoch, and Hashemi, 2003).

In addition to the short-term economic and social welfare outcomes, microfinance is viewed among the development community as unique in its ability to deliver long-term and scalable assistance to a community, even after the project’s funding has ended and donor intervention has concluded, as many MFIs have the potential to successfully operate free of external support. Additionally, because of the effect access to financial services has on the overall wellbeing, and not just their finances of a household, many development institutions support microfinance and financial inclusion initiatives as a means to achieve the other objectives, such as improved health, education, and women’s empowerment. The economic and
social welfare of the world’s developing nations have implications beyond geographic borders, and the multilateral development banks support of financial inclusion and microfinance is well aligned with the complimentary objectives of targeted poverty eradication and improvement of livelihoods. These interests have been weaved into the fabric of the multilateral development institutions and are reflected in the rhetoric used. For example, in 1990, the World Bank’s World Development Report focused on the theme of poverty problems and outlined specific areas of intervention most apt for solving them. The report underscored the importance of development aid, and the role it should take in emphasizing (a) growth with equity and the creation of better opportunities for the post; (b) improved access to education, health services, and other social services; (c) direct assistance to those living under the worst conditions (World Bank, 1990). In 2013, the World Bank underscored the importance poverty alleviation has in its work when it established the Twin Goals of “End extreme poverty by decreasing the share of people living on less than $1.25 a day to no more than 3 percent” and “Promote shared prosperity by fostering the income growth of the bottom 40 percent for every country” by 2030. The Twin Goals are positioned as the cornerstones of the World Bank Group, and as such, emphasize the critical importance poverty alleviation and promoting shared prosperity have within their portfolio of work. Similarly, the Inter-American Development Bank’s (IDB) mission statement begins with: “We work to improve lives in Latin America and the Caribbean. Through financial and technical support for countries working to reduce poverty and inequality, we help improve health and education, and advance infrastructure.” The IDB’s mission statement reflects the interconnectedness of poverty and inequality within a society on its health, education, and infrastructure outcomes. The multilateral development banks are committed to poverty alleviation and improving the lives of the world’s most vulnerable populations.
Since these earliest iterations of interventions in poverty alleviation, multilateral development banks have continued to expand upon their work in these areas, while forging partnerships with organizations that share similar values. Although unaffiliated in mandate, operations, and governance structure, the multilateral development banks and sub-regional development banks work hand in hand with the United Nations, since put simply “their objectives are our objectives” (World Bank, 2016). The same year the World Bank published the aforementioned “World Development Report”, the United Nations Development Program (UNDP), published its first Human Development Report, which formulated its principal development goals, one of which read “The opportunity to have access to the resources needed for a decent standard of living” (UNDP, 1990). Similar to the UFA2020 and twin goals of the World Bank, the United Nations also has set ambitious time-bound global initiatives; the Millennium Development Goals (MDGs), eight global development goals active between 2000 and 2015, and the subsequent Sustainable Development Goals (SGDs), 17 global development goals active between 2015 and 2030. The main MDG objective (eradicate extreme poverty by 2015) was supported by 7 complementary goals that served as a blueprint for nations to take action on meeting the needs of the world’s poorest: Achieve universal primary care, Promote gender equality and empower women, Reduce child mortality, Improve maternal health, Combat HIV/AIDS, malaria and other diseases, Ensure environmental sustainability, and a Global partnership for development (UN, 2016). Although none of the goals explicitly reference financial inclusion or microfinance, achieving the MDGs relied heavily upon mobilizing and organizing communities of underserved populations, building local capacity, and promoting awareness, leadership, and literacy, all strengths that MFIs have demonstrated and developed over the years, and therefore MFIs were successful partners in many MDG projects (INAFI,
The SDGs, officially known as “Transforming our World: The 2030 Agenda for Sustainable Development”, reflect a global shift towards a heightened awareness of the impacts of human activity on the sustainability of our planet. Therefore, the SDGs call for development activities to respect the intertwined nature of the environment, economics, and society, to ensure all development work promotes long-term global sustainability, and not short-term objectives.

The SDGs are: No Poverty, Zero Hunger, Good Health and Well-Being, Quality Education, Gender Equality, Clean Water and Sanitation, Affordable and Clean Energy, Decent Work and Economic Growth, Industry, Innovation and Infrastructure, Reduce Inequalities, Sustainable Cities and Communities, Responsible Consumption and Production, Climate Action, Life Below Water, Life on Land, Peace, Justice and Strong Institutions, and Partnerships for the Goals (UN, 2016). Similar to the MDGs, the SDGs have many natural synergies to microfinance and financial inclusion. A report from CGAP highlights research that access to financial services has a direct impact on the UN’s ability to achieve the goals of No Poverty, Zero Hunger, Good Health and Well-Being, and Quality Education. Financial inclusion, particularly in the digitization of payments, also has direct and positive effects on low-income and rural community’s access to basic infrastructure set forth in the SDGs Clean Water and Sanitation and Affordable and Clean Energy. Lastly, including the poor in the formal financial sector promotes broader economic and social goals, such as SDGs Decent Work and Economic Growth, Industry, Innovation and Infrastructure, Reduce Inequalities, and Justice, Peace, and Strong Institutions (Hess et al, 2016). Given the strong links between financial inclusion and development, governments and the UN are urged to continue prioritizing financial inclusion and microfinance high on their agendas.
Although their areas of focus and interventions strategies have evolved over the years, multilateral development banks and international development organizations have been steadfast influencers in the landscape of financial inclusion and microfinance. As the World Bank Twin Pillar Goals and United Nations Sustainable Development Goals demonstrate, whether the focus is on two or 17 goals, collaboration and coordination of efforts from actors at various levels are critical components of success. The multilateral development banks offer the regional and technical expertise that international development organizations success depends on, and are therefore important partners in both design and implementation.

Chapter 3. Microfinance and Financial Inclusion in Latin America and Argentina

The interventions of private investors and donors, international development organizations, and multilateral development banks and their partners have had profoundly positive impacts on the expansion of microfinance institutions and financial inclusion as a whole. One region that has had a particularly unique evolution, and subsequent relationship with donors and investors is Latin America. The origins of microfinance in Latin America can be traced to Bolivia in the 1970’s. When a collapsing populist regimen led to wide spread unemployment, Banco Sol (at the time an NGO) began addressing the problem of urban poverty, and the unemployment that accompanied it, through microcredit loans. From the start, actors viewed microcredit loans as a business opportunity, not a social development intervention as ASA and Grameen had in Bangladesh. This early focus on microenterprise and targeting the ‘economically active poor’ led to Latin American microfinance institutions having different characteristics than their Asian counterparts, and many of these differences continue to remain true (Weiss and Montgomery, 2004). On average, MFIs in Latin America show higher returns
and larger savings deposits than Asian MFIs, although the market penetration rates of microfinance vary greatly country to country. In 2016, four of the top-10 countries with the most enabling environments for financial inclusion as ranked by the Economist’s Global Microscope were Latin American nations; Colombia, Peru, Chile, and Mexico. If you expand the selection to look at the top-20 ranking nations, six additional nations from Latin America and the Caribbean are included; Uruguay, Bolivia, El Salvador, Nicaragua, Paraguay, and the Dominican Republic (The Economist, 2016). Despite the region’s consistently high performance across the 12 indicators measured by the Global Microscope, the favorable operating and regulatory environment has not necessarily translated into a steady supply and demand for microfinance products and services nor financial inclusion. With regard to financial inclusion, 51% of adults have accounts at formal financial institutions, which places Latin America at a similar inclusion level as Europe and Central and South Asia, but below Eastern Asia and developed economies. One important contributing factor has been a push in recent years to bring the poor into the formal financial system via initiatives to disburse government payments into bank accounts. This effort alone has brought an additional 40 million into the formal banking sector (Microfinance Gateway, 2016). With respect to the availability of financing, according to the Inter-American Development Bank (IDB) microcredit is only available to about 1 in 6 potential clients in Latin America and the Caribbean. However, in countries with the longest histories of microfinance experience, such as Bolivia or El Salvador, penetration rates can be as high as 1 in 3 potential clients (IDB, 2014). In terms of portfolio size, Latin America has reached larger scale than any other region in the world, but has reached fewer clients than in Asia and Africa. This is due to the individual loans being issued for higher amounts in Latin America than in other regions (Curat, Lombardi, and Lupano, 2005).
Due to the strong financial performance of MFIs in Latin America, there has been a trend toward the commercialization of microfinance in the region. In 1992, Banco Sol transformed from an NGO to a commercial bank, and was the first MFI to access international capital markets. Despite being more commercialized than other regions, Latin America contains MFIs on both ends of the spectrum with respect to profitability (most and least profitable); however, as a group, Latin American MFIs are less profitable as a whole when compared other regions (with the exception of Sub-Saharan Africa). The information revealed by MiX Market, the international database for MFI statistics shows that this is because of the higher cost structures of Latin American MFIs, primarily due to higher financing and operating expenses (Curat, Lombardi, and Lupano, 2005). Many NGO’s depend on subsidized financing to operate, thus have not yet achieved financial sustainability, while commercial MFIs have stricter lending criteria that limit their outreach to the poor. However, it is important to note that commercialization does not need to be contradictory to providing financial services to the poorest people, although it is quite clear that microcredit can only be provided to those people who have an established minimum capacity to repay a loan (Maldonado and Otero, 2005). In general, the trend towards commercialization marks a tendency for MFIs to use individual lending techniques as opposed to group lending methodology, and provide more complementary financial services to clients, such as savings and insurance (Weiss and Montgomery, 2004).

The fragmentation between NGO-based lending and commercially driven banking for the poor, coupled with the lack of rigorous studies available that compare the effectiveness of different structures, make it difficult for conclusions to be drawn about the optimal design for microfinance programs. Such studies can pave a way forward for microfinance by sharpening the microfinance community’s understanding of the role of microfinance in reaching the poor, its
impact in different environments, and its cost-effectiveness as a poverty intervention (Weiss and Montgomery, 2004). Accion International’s report on the state of microfinance in Latin America emphasized the important role NGOs have in moving the microfinance industry forward, stating “…the most important role for NGOs is to continue innovating in the field to support the development of systems and procedures to extend credit to the population sectors as yet not adequately served …The very fact of not being regulated and not having to administer savings collected from the public actually gives NGOs the operational flexibility to take on these challenges” (Maldonado and Ortero, 2005). Although operating as NGOs affords MFIs unparalleled flexibility and opportunity to innovate without the burden of complying with local financial regulatory authorities, there are tradeoffs. For example, NGOs can not accept deposits from clients, thus forfeiting the opportunity to educate clients on how to save their money in a safe place to achieve long-term financial goals, while simultaneously having access to clients’ deposits as capital to issue new loans to new clients. Without access to clients’ deposits, NGOs are forced to rely on a steady stream of donations to fund their operating expenses and finance the issuance of microcredit loans to clients. If donor funding is reduced or withdrawn, NGOs have very few options at their disposal that would allow them to continue financing their operations, unless they raise the interest charged on microcredit loans to rates high enough to cover costs. In contrast, MFIs that are authorized deposit-accepting institutions can use clients’ savings to issue loans to new clients, effectively creating a self-sustained flow of capital, which can be supplemented by donor funds or outside investment, as needed. However, commercial MFIs are subject to supervision by local financial regulation authorities, which often can stifle MFIs freedom to grow and innovate due to their stringent capital requirements and operational guidelines. There are clear advantages and disadvantages to both the commercial and NGO
models that MFI\textsuperscript{s} can operate within, and in many markets both models co-exist peacefully, each leveraging their competitive advantages.

In addition to the challenges of identifying the best design for microfinance institutions, there also exists a knowledge gap regarding the success of microfinance in the region. For a long time, microfinance was accepted as having a positive impact on the lives of the poor; however, this was based on anecdotes and client testimonies, with limited quantitative evidence. A working group paper published by Inter-American Development Bank undertook the task of analyzing the effectiveness of microfinance across Latin America and the Caribbean. Although the paper acknowledges the difficulty of cross-comparing results from evaluations conducted using different methodology within differing macroeconomic and political contexts, based on the results of 20 independent impact assessment studies, the following conclusions were drawn about microfinance in the region: (1) Microfinance has an overall positive affect on variables such as income, education, employment and business performance, (2) The impact of non-microcredit products depends of quality and type of non-financial services offered, (3) Good financial and social performance of financial institutions may be the first step to ensure a positive impact on clients, and (4) The majority of microfinance institutions do not have evaluation incorporated into their design, thus complicating data collection and impact studies (Gutierrez and Soares, 2011). The results, while very general and inconclusive in many areas, do highlight the need for more evaluations to be completed within the region that use quantitative methodology while also account for differing macroeconomic and political landscapes.

Microfinance in Argentina has had a very different history than that of other Latin American nations. Several important factors have contributed to Argentina’s unique microfinance market. Firstly, until the 1990’s, Argentina’s labor market was characterized by
being based in the formal sector and unemployment rates were low, fluctuating between 4-6% until 1991. The development of the microenterprise sector was very weak, as it was an expression of voluntary initiation rather than a forced action out of necessity for survival (Bekerman and Iglesias, 2014). However, as a result a series of economic sufferings during the 1990’s and the sovereign bond default crisis in 2001, the urban poverty rate greatly increased, reaching a high of 57.5% in October 2002 according to the Instituto Nacional de Estadísticas y Censos (INDEC). Similarly, the unemployment and sub-employment rates rose drastically, reaching rates of 17.9% and 19.9% respectively (INDEC). The table below shows the dramatic decline of Argentina’s economy after the 2001 crisis, as reflected in unemployment and poverty rates, as well as GINI index and Human Development Index (HDI) ratings (Grandes, 2014).

Table 1. A History of Argentina’s Unemployment Rate, Poverty Rate, GINI Index, and HDI

<table>
<thead>
<tr>
<th>Year</th>
<th>Unemployment Rate</th>
<th>Poverty Rate</th>
<th>GINI Index</th>
<th>HDI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>5%</td>
<td>6%</td>
<td>.4</td>
<td></td>
</tr>
<tr>
<td>1985</td>
<td>6%</td>
<td>16%</td>
<td>.42</td>
<td>.79</td>
</tr>
<tr>
<td>1995</td>
<td>19%</td>
<td>24%</td>
<td>.48</td>
<td>.82</td>
</tr>
<tr>
<td>2003</td>
<td>17.3%</td>
<td>50%</td>
<td>.534</td>
<td>.86</td>
</tr>
<tr>
<td>2004</td>
<td>13.6%</td>
<td>42.3%</td>
<td>.502</td>
<td>.86</td>
</tr>
<tr>
<td>2005</td>
<td>11.6%</td>
<td>36.4%</td>
<td>.493</td>
<td>.85</td>
</tr>
<tr>
<td>2006</td>
<td>10.2%</td>
<td>29.2%</td>
<td>.483</td>
<td>.86</td>
</tr>
<tr>
<td>2007</td>
<td>8.5%</td>
<td>22%</td>
<td>.474</td>
<td>.86</td>
</tr>
<tr>
<td>2008</td>
<td>8%</td>
<td>32%</td>
<td>.463</td>
<td>*</td>
</tr>
</tbody>
</table>

Source: Grandes, 2014

In response to the unavailability of employment in the formal labor market, informal microenterprises emerged, and in 1997 the informal employment rate was 39.9% (Bekerman, 2004). According to the National Household Survey of 1998, 1.9 million people identified as self-employed. However, the prolonged recession and economic hardships between 1998 and

1 Starred items are statistics that are not available
2003 dramatically increased the number of self-employed individuals, up to an approximately 3 million people in 2004, primarily in the informal sectors (DAI, 2005). Income inequality, the high number of new people living below the poverty line, and the emergence of the working class “new poor” are the notable characteristics of the potential clients for microfinance in Argentina (Bekerman and Iglesias, 2014). Although these conditions created the opportunity for microfinance to add value and meet a need for financial services for the poor in Argentina, the microfinance phenomena in Argentina is relatively recent when compared to Asia or the earliest Latin American markets.

The first microcredit provider in Argentina was Fundación JUNTOS, launched by the public bank Banco de la Provincia de Buenos Aires in 1987. However, Fundación JUNTOS only lasted three years before stopping activities (Curat, Lombardi and Lupano, 2005). In the 1990’s, several new microfinance projects were launched to meet the needs of the newly unemployed; Fundación Pro Vivienda Social, Fundación Emprender, Secretaría de Enlace de Comunidades Autogestionados (SEDECA), Instituto para el Desarrollo de la Micro y Pequeña Empresa (IDEMI), Cáritas Quilmes, Banco Mundial de la Mujer. Most notable during the 1990’s was the formation of the Fondo de Capital Social (FONCAP SA) in 1997. FONCAP, housed in the Ministry of Social Development, was created with the purpose of stimulating credit assistance to more than a million ‘microbusinesses’ in the country via distribution of funds to local institutions involved in microfinance, making it a “second floor” organization. FONCAP has recently been renamed to Impulso Argentino, and currently provides assistance to 45 microfinance institutions that reach a total of 45,000 clients (Impulso Argentina, 2014). While Impulso Argentino provides funds to civil societies, NGOs, and cooperatives that perform microfinance activities, to date there are no formally regulated finance institutions devoted
exclusively to microfinance in Argentina. The microfinance market is dominated by NGOs and
government agencies that channel funds through institutions, such as mutual loan organizations,
credit cooperatives, and other NGOs to reach clients (Delfiner, Paihle, and Peron, 2006).
Some commercial banks, such as Banco Provincia and Banco Galicia, have launched products
for low-income entrepreneurs as preliminary efforts to downscale into microfinance operations.
For example, Banco Provincia created a new entity, “Provincia Microempresas”, with a mission
to provide financing to independent workers and small business owners within the province of
Buenos Aires. However, the products are very limited in scope and scale since they are only
available to independent workers whose business has been in operation for at least one year
(Banco Provincia, 2016). These limitations prevent them from reaching the many Argentines
who do not own their own businesses or are trying to start a business and could benefit greatly
from access to working capital and financial services. Argentina’s commercial banking sector
has yet to fully explore the full depth of ways it can reach more customer segments, thus
achieving broader financial inclusion objectives. The limitations and constraints preventing such
growth will be expanded upon in the following sections.

The informality and lack of regulation governing the operations of microfinance
institutions brings both opportunities and challenges. According to the Economist Intelligence
Unit report “Global Microscope 2016: The enabling environment for financial inclusion”,
Argentina ranks 44th out of the 55 countries examined in the report. Out of a potential 100 points.
Argentina scored only 39 points, a far cry from South American neighbors Colombia and Peru
whom topped the charts tied in first place with 89 points each (EIU, 2016). The report ranks
countries based on how conducive a country’s policies are with promoting financial inclusion
and development. One of the drivers behind Argentina’s low score is that fact that the
Government of Argentina has not established policies that support microfinance institutions as formal purveyors of financial services for low-income clients. The Ministerio de Desarrollo Social (Ministry of Social Development) created the law 26.117/06, "Promoción del microcrédito para el desarrollo de la economía social" (Promotion of microcredits for the development of the social economy) in 2006, but the law served as a channel to disseminate funds to NGOs that met certain characteristics the government set forth, rather than establish regulations and norms to support organic growth within the industry. The establishment of such regulations would typically include policies that allot for beneficial tax treatment of MFIs, a credit bureau to track client activity, and allow eligible institutions to accept deposits, actions that would formalize the sector and promote expansion. However, according to an in-depth market analysis completed in 2005 by the international development organization PlaNet Finance, after comparing the experience of other microfinance markets in Latin America to that of Argentina, the model of NGO and donor driven microfinance best suits the needs and size of the Argentine market. The paper recommends that due to the small scale and limited range of products available, regulatory intervention in Argentina at this early stage would be harmful. Once the institutions grow large enough in scale and receive the proper training to become deposit-accepting institutions, they can then approach the central bank with a proposal for tailored regulation to better facilitate their operations. Until NGOs operating as MFIs reach financial self-sustainability and expand product offerings, regulation is not recommended (Curat, Lombardi and Lupano, 2005).

The caveat to the PlaNet Finance analysis is that it does not acknowledge the positive impact policy interventions can have to promote market growth through facilitating ease of new entrants thus stimulating healthy competition and product innovations. The low penetration rate
of microfinance in Argentina, despite nearly three decades of operations, indicates that there are market failures and exceptional circumstances that have impeded growth, and policy intervention may be necessary to overcome these obstacles and achieve broader financial inclusion. In the most traditional definition, regulators are tasked with establishing and enforcing policies and laws that ensure stability and soundness of financial institutions and markets, protect consumers from predatory practices, and prevent fraud and money laundering. However, many regulators are now taking active measures to promote financial inclusion in recognition of the close ties between financial exclusion, economic development, and political and economic instability (CGAP, 2016). As a result, financial inclusion has found its way onto the political agenda of financial regulators. Although the strategies vary between countries depending on the current state of financial inclusion and microfinance market, in general there persist to be a mix of policies that both enable and threaten market growth. Enabling strategies, such as a renewed focus on second-tier financing innovations, legal and regulatory reform to reflect new institutional and supervisory needs, and simplified documentation requirements can be observed in many markets. However, in many of the same markets, interest-rate ceilings and competing governmental institutions threaten or stifle market growth (DAI, 2006). A lack of cohesion in the policymaking arena causes mixed-messaging and lackluster outcomes, and regulators need to weigh their options carefully to achieve the optimal policy mix to achieve maximum financial inclusion.

Various development institutions and academics have published research on the role of policy and the impact it has on microfinance markets in an effort to help regulators navigate the complex array of intervention options. For example, CGAP conducted a global study of regulatory and supervisory policies that address financial inclusion, and developed “A Guide to
Regulation and Supervision of Microfinance” (hereforth referred to as “Guide”) to highlight best practices and provide regulators with a roadmap for policymaking (CGAP, 2012). The Guide does not provide country-specific recommendations, but rather, draws upon global experiences to outline principals and recommendations that can be applied in various local contexts. A sampling of key recommendations from the guide are (a) regulators should conduct a thorough evaluation of what is holding back the microfinance market before determining whether or not to create a ‘special window’ (a distinct regulatory category) for MFIs, (b) create tightly framed definitions of “microfinance”, “microcredit” and other key terms based on market-specific characteristics, (c) create a clear legal path for NGO MFI transformations to allow deposits, (d) ensure non-depository MFIs are not subjected to prudential regulation (regulation which seeks to reinforce their financial soundness) and supervision, (e) establish minimum capital requirements for depository MFIs should be in principle high enough to ensure start-up costs and infrastructure are covered, but not so high that it overburdens the institutions and supervisors, (f) for countries that do not have yet depository MFIs, the most successful countries to implement regulations for deposit-accepting MFIs are those who already had a strong microfinance industry in place, and (g) interest rate caps can restrict access by making it impossible to serve small or remote clients, so it may be politically difficult to set a cap high enough to cover the unavoidable costs of microlending while simultaneously attract enough capital to MFIs (CGAP, 2012). The Guide covers all regulatory and supervisory dimensions that should be carefully considered by policymakers, and in effect, serves as a roadmap for developing policy that balances financial soundness and stability, consumer protection, and market development objectives.

Although the Guide published by CGAP is the most comprehensive in scope, other international development organizations, such as the International Monetary Fund (IMF) and
International Institute for Sustainable Development (iisd) have also published recommendations for policymakers to consider when designing microfinance policy. The IMF working paper “Microfinance Institutions and Public Policy” highlights the concept of proportionality (designing regulation that is proportional to the needs and size of the market), and advises that any one piece of regulation can serve to achieve both consumer protection and financial soundness objectives. The explicit policy recommendations they make regarding when regulatory intervention should occur are (a) All deposit taking MFIs must be subject to regulation in order to protect consumers, (b) If MFIs demonstrate local market monopoly and adopt usury lending practices to the poor, there are grounds to set regulatory limits on pricing, (c) In markets where MFIs occupy a significant portion of the banking sector and their collapse could impact overall financial market soundness and confidence, stricter regulation would be rational, (d) Under certain circumstances, regulation and supervision of MFIs may increase the public’s confidence and trust in MFIs, and therefore the market may be promoted as a result of regulation, and (e) When public funds have been used to establish a MFI, authorities have a responsibility similar to that of any major shareholder to monitor the quality management and business decisions (IMF, 2002). In addition to the guidance provided regarding whether or not to regulate MFIs, the IMF provides strategies for the prudential regulation of MFIs in markets where intervention is determined to be necessary. The IMF emphasizes that supervisors should be most concerned with the types of activities a MFI engages in (i.e. lending out funds, deposit taking, etc.), rather than the legal structure of the institution (NGO, commercial bank, cooperative, etc.) when considering if and how regulation should be designed. They propose a graduated regulatory structure that expands and contracts the amount of regulations and limits a MFI must conform to based on the activity and size of the MFI. Emphasis is placed on
flexibility and understanding that MFIs are not homogenous, and tailoring regulation not only based on a market’s level of development, but also based on a MFIs maturity and market share (IMF, 2002).

The iisd report, “The Regulation and Supervision of Microfinance: Main issues and progress”, explores the three main aspects of the debate surround how to best regulate and supervise MFIs, without stifling industry growth and innovation. The paper presents arguments for why appropriate regulation of MFIs is critical to expanding financial inclusion to the poor and underserved in developing countries (protect the financial system and depositors, address consequences of rapid growth, protect consumers against abusive interest rates, address new technology and distribution methods, apply lessons from recent financial crisis, and prevent fraud and financial crimes), while simultaneously recognizing how nuanced and challenging designing such regulations can be. Iisd encourages regulators to carefully weigh the costs and potentially unintended consequences of regulation, as well as the mechanisms that need to be in place to ensure adequate oversight and supervision. They suggest that in markets with a large number of MFIs that vary in size and legal structure, a one-size-fits-all approach is unsuitable due to the non-uniform impact of reporting and capital requirements on small institutions versus large. They recommend that softer legislation may be appropriate for small MFIs, while more rigorous policies can be reserved for MFIs whose misconduct or failure would have more severe impacts on the financial soundness of the market. However, regardless of institution size, consumer protection measures must be instilled, with the main focal points being the prevention of abusive lending and loan collection techniques and opaque and excessive loan pricing. Iisd concludes by emphasizing the importance of supervision, because “the most critically conceived
regulations will be useless or worse, if they can’t be enforced with effective supervision” (Pouchous, 2012).

Although the three reports place slightly different emphasis on what factors to focus on most when designing MFI regulation, one of the common threads among the CGAP, IMF, and iisd recommendations is the importance placed on understanding the current microfinance market prior to developing regulation. Without a thorough assessment of the strengths, weaknesses, and infrastructure of the existing market, regulators are unable to appropriately evaluate what areas could benefit from regulatory intervention and promote market development. Unfortunately, Argentina faces significant obstacles in evaluating the current microfinance market because there is no comprehensive database of information available. Information is gathered sporadically by individual researchers or self-reported by institutions to the Microfinance Information eXchange (MIX), an online data hub where MFIs and supporting organizations share institutional data to broaden transparency and promote responsible investment (mixmarket.org). There is an Argentina microfinance institution network, Red Argentina de Instituciones de Microcredito (RADIM), however not all microfinance providers are associates, thus their data fails to capture the entire market. According to the MIX database, most recently published data (reporting dates range between 2000 and 2015), there are 12 microfinance institutions serving 21,360 clients with a total loan portfolio of approximately $22.66m USD. However, because MIX only captures self-reported data, there have been several other studies and academic works published in Argentina which provide different figures. In a paper published by Curat, Lombardi, and Lupano in 2005, they cite a total of approximately 100 MFIs that serve approximately 25,000 clients, with the average credit ranging from $250 to $1,000USD. This figure is similar to what Bekerman provides in 2005, estimating that the
approximately 130 MFIs in Argentina reach 30,155 microentrepreneurs, and have an active portfolio of a $55.8m USD. These figures are in contrast to a 2013 investigation performed by Fundación ANDARES and RADIM, which reported a total of 41 MFIs serving 72,025 clients with a total portfolio of $428.3M pesos Argentinos (RADIM, 2013). At a September 2016 presentation, RADIM reported their current number of members as 22, serving 38,000 clients and with an active portfolio of $312M pesos (Olmos, 2016). However, it is critical to note the figures provided by MFIs to these various outlets do not reflect the downscaling efforts by commercial banks, such as Banco Galicia and Banco Provincia. Because these commercial banks do not identify themselves as MFIs, they are reluctant to share information regarding their portfolio of lower-income or microcredit loan clients. As a result, it is difficult to have an accurate measure of how many Argentines lack access to financial services.

While none of these figures are comprehensive in capturing the whole microfinance market, they do allow us to draw the same conclusion; with a total population of approximately 40,000,000 people, a poverty rate of approximately 30%, and the informal labor market accounting around 50%, the penetration of microcredit in Argentina is incredibly low. Using these figures in conjunction with data on the average microcredit amount per borrower, the potential demand for microcredits in Argentina can be estimated at 1,310,005 clients requiring microcredit (Grandes, 2014). Based on the MiX Market database figure of 21,360 microcredit clients as of 2015, we can extrapolate that microcredits are only reaching approximately 1.6% of their potential clients, a figure which indicates that while the industry has faced great challenges in reaching scale, there is abundance of open landscape and opportunity for the market to grow. This prognosis is similar to another industry standard measurement of market penetration, number of microcredit clients out of total working population, which estimates that microcredits
are currently utilized by .29% of the total working population. By this measure, Argentina falls in last place with the lowest penetration in the Latin American and Caribbean region, and Bolivia, El Salvador, and Chile rank in the top three, with penetration rates of 24.95, 18.54, and 15.46% respectively (Trujillo and Navajas, 2014). My thesis centers on understanding the economic, social, and political reasons why Argentina has failed to develop a scalable and efficient microfinance industry. In Chapter 4, extensive academic literature that has been published on the subject of microcredit supply and demand in Argentina is presented, with a particular focus on documenting the specific challenges the market has faced throughout its evolution. Chapter 5 introduces the research objectives of this thesis and methodologies used, as well as information about how the recent change of government regime in Argentina and the resolution of the external debt crisis make this the opportune time to perform this research. Chapter 6 presents the findings and results of the investigation, and offers some insight as to what the outlook on the future of microcredits and financial inclusion in Argentina may be.

Chapter 4. Why Did Argentina Fail to Develop a Scalable and Efficient Microfinance System? A Review of Academic Literature on the Topic

When I began researching the subject of microfinance and the microcredit market in Argentina, a somewhat surprising trend in the types of information that I found published in works written by consulting firms and industry practitioners versus academics authors emerged early on. While nearly every published document on the subject makes reference to the low penetration rate of microcredit and the potential demand that exists, in general, it was only the academic literature that went one step further to cite the possible reasons why the market had failed to achieve scale. Studies and papers published by consulting firms or the research
departments of development institutions were most often diagnostic in nature, frequently providing statistics and a mapping of the industry, but failed to provide insight as to the why the market was facing low penetration rates or what changes could be made to improve the situation. In contrast, academic literature did not shy away from exploring the present-day weaknesses of the market, the historical economic, social, and political influences at play, and in some cases, even providing recommendations for remedial actions to improve the industry outlook. It was this breach between consulting firm/microfinance practitioner produced research versus academic research that served as inspiration for this thesis, as it left me wondering, “What do practitioners and experts working within the industry think are the reasons why microcredits have failed to reach scale in Argentina?” Because the publishing years and focus of each academic work varies, the scope of this chapter is to concisely synthesize the reasons cited in the various works, and to serve as groundwork to compare and contrast with the reasons cited from industry practitioners later in this thesis.

Roberto Crouzel’s 2009 research “Why hasn’t microfinance developed with more success in Argentina?” identifies seven challenges to development of microfinance: (1) Lack of funding for microfinance institutions, (2) Lack of consumer education leading to a negative perception of the industry, (3) High taxes imposed on the sector, impeding MFIs ability to offer competitive interest rates, (4) Legal obstacles resulting from a lack of regulation for the sector, (5) Lack of opportunity for professionalization, training, and education of industry actors, (6) Inability to access to capital markets due to high transaction costs, and (7) Clients do not have the habit of making deposits into formal savings accounts at MFIs, resulting in one less source of financing for them (Crouzel, 2009). Crouzel concludes that while the work of developing Argentina’s microfinance market may find it difficult to obtain immediate progress, the education of public
administration officials and collaboration of international organizations is key to sustainable change and long-term development. He also states that in the short-term, simple modifications to existing laws and regulations that were created without taking into account financial inclusion objectives and the unique characteristics of MFIs may be an effective mechanism to improve the sector.

In the working paper “And Where is the Demand? A New Methodology for Quantifying and Characterizing the Demand Potential for Microcredits in Argentina”, Dr. Martin Grandes analyzes the economic, social, historical, and cultural barriers that the microcredit market and MFIs face in generating enough demand for a viable business model. Dr. Grandes and his co-authors synthesize the obstacles to microfinance achieving scale as the following: (1) High transaction and information acquisition costs from potential clients, (2) Lack of collateral to back the microcredit loans, (3) Problems of asymmetric information, such as moral risk and adverse selection, (4) Illiquidity, Macroeconomic and institutional instability, and (5) Social/Psychological factors (trust, credibility of MFIs, etc.) (Grandes et al, 2014). Grandes emphasizes that while these factors discourage the demand for microfinance, one cannot ignore the regulatory, legal, and tax structures that also impede the supply of microcredit. Additionally, Grandes work explores in further depth social, psychological, demographic, and historical factors that have hindered microfinance growth. Examples of these include the lack of consumer confidence in the Argentine banking sector, low financial literacy levels among the unbanked, and large segments of the low-income population being located in rural, harder to access locations, thus adding an additional barrier and cost to the already expensive operating costs.

An extensive study led by PlaNet Finance is the only non-academic research that explored the root causes of the underdevelopment of microfinance in Argentina. Published in
2005, the study is one of the earliest included in this literature review, although its findings are consistent with many of the later reports. According to the report, the principal reasons that help to explain the small size and heterogeneity of the Argentine microcredit market are: (1) Recurrent financial and economic crises have caused not only an increase in poverty and social exclusion, but simultaneously were obstacles to the development of traditional and microfinance markets, (2) The financial crises generated an aversion to the taking on of debt from formal financial institutions, (3) Common belief that poverty is a recent phenomena generated by the last economic crisis, when in reality it is an issue that has been emerging since the 1970’s, (4) Argentina is viewed as by outsiders and considers itself to be a middle-income country, and therefore does not view itself as needing microfinance in the same capacity other Latin American nations do, (5) After the 2001 debt default, public policies were oriented towards assistance programs rather than productivity generating programs, (6) Strong presence of direct subsidies and cash-transfer programs from the government, generating a sense of ‘rights’ for the low-income individuals to receive from the government without working or repaying the money received (Curat el al, 2005). The PlaNet Finance study also outlines a series of social and cultural elements which distinguish the Argentine case from other nations, which can be summarized as follows: (1) Argentines view poverty as temporary and accidental, (2) Microenterprise is viewed as unstable and undesirable, as even the poor are accustomed the expectation that employment shall be formal and with benefits, (3) Lack of confidence and motivation amongst the ‘new poor’ who emerged in the late 1990’s, (4) The presence of informal moneylenders in the interior of Argentina and suburban Buenos Aires, (5) The comparatively large proportion of self-employed laborers in the service industry who are able to get advances on payment from their clients, thus eliminating the necessity for microcredit loans for working
capital, (6) The absence of networks which unite microentrepreneurs to facilitate the access of MFIs to clients (Curat et al, 2005). The combinations of these social and cultural elements with the aforementioned economic and historical factors have resulted in the underdeveloped supply and demand for microfinance services in Argentina.

While the research performed by Delfiner, Pailhe, and Peron was more descriptive than diagnostic, they characterize the market as constrained by “lack of stable funding and an absence of a legal structure in which to frame microfinance activity, tax treatment for MFIs, and the difficulty for those requiring loans to meet the statutory requirements governing their commercial activity” (Delfiner, et al, 2006). The research also cites the weak market as both a result of low supply and latent demand, driven by a lack of information from both sides; Consumers lack awareness of the microcredit offerings available to them, while financial institutions have insufficient information about the risk-profiles and needs of low-income clients, and thus are risk-averse to lending to them. Additionally, the work presented the theory that Argentina’s underdevelopment may be circumstance due to it’s relative wealth compared to neighboring counties, such as Bolivia, Peru, and Ecuador, where international NGOs or investors who want to address the topic of microfinance choose to channel their funds. Also cited are the very high operating costs that all MFIs face (Delfiner, et al, 2006).

University of Buenos Aires professor and microfinance expert Dr. Marta Bekerman and Florencia Iglesias, member of the Board of Directors of Fundacion AVANZAR, published a case study report detailing the experiences the AVANZAR microcredit program has faced in achieving scale in Argentina. The report highlighted that the very low penetration rate of 3.5%, and that figure drops to 1.8% if public programs are excluded, in Argentina can be a contributing factor to why the microfinance industry has not grown. They reference what is called the
“demonstration effect”; In Argentina, there are no widely successful institutions that have proven strategies, operating models, and business practices from which other MFIs can learn, and thereby encourage entry into the industry (Bekerman and Iglesias, 2008). Additionally, Bekerman and Iglesias present fundamental strengths and weaknesses of microfinance in Argentina. The strengths cited are strong local insertion, high compromise of human resources (resulting in high customer satisfaction with the institution), and low delinquency rates (in NGOs). The noted weaknesses are lack of resources and funding, operational weakness due to limited management skills, lack of professionalism of human resources, high operating costs, high instability of public programs and budgets, use of procedures inadequate for the objective population, high delinquency rates, especially in public microcredit programs (Bekerman and Iglesias, 2008). Bekerman and Iglesias conclude that it is very difficult for MFIs to reach financial self-sustainability while at the same time scaling-up operations to have a further outreach. This contrasts public microfinance programs that reach a greater number of borrowers, but lack proper mechanisms to reduce poverty.

Dr. Bekerman’s previous research with Dr. Guido Catalfe, researcher at the Center for Studies of the Economic Structure at the University of Buenos Aires, in 2004 examined the conflicting goals of outreach, sustainability, scale, and social impact of microfinance programs. The publication highlighted specific challenges to the development of microfinance in urban and rural areas of Argentina. In rural areas, the population dispersion makes it very costly for credit agents to reach clients, thus creating operational challenges for suppliers of microcredits. With regard to demand, the prevalence of government subsidized loans and ‘clientelism’ have created a culture of viewing loans as a form of government assistance, and therefore microcredits from commercial institutions have low public acceptance. These two factors are the primary reasons
why microfinance remains underdeveloped in rural areas. In the urban context, Bekerman and Catalfe say the market has many of the conditions necessary for wide distribution of microfinance; restricted access to formal credit markets, high number of microentrepreneurs, and a sizeable population living in poverty. However, government programs and subsidized interventions make commercial microcredits from microfinance institutions unattractive options in comparison. Finally, the proliferation of barter as a popular financial tool in the informal sector further constricts the demand for formal microcredit offerings.

Although the academic reports and studies on the state of microfinance in Argentina vary in scope and focus, each of the reports dedicate a significant section to examining the reasons why the market for microcredit remains underdeveloped. The reasons documented share insight to the complex legal and regulatory environment that microfinance institutions operate within, as well as the impact historic economic events and government interventions have had in shaping demand. This chapter lays the foundation for the upcoming chapters, as frequent reference to the academic literature cited here will be made to compare and contrast information gathered from multilateral development institutions, international donors, and impact investing funds.

Chapter 5. Surveying the Landscape of Actors

A. Research Objectives

The research objectives of this thesis are two-fold and complimentary in nature, and seek to provide new information to help answer the primary question driving my interest in this topic, “Why did Argentina fail to develop a scalable and efficient microfinance system?” More specifically, “Do the reasons cited by academics as to why market for microcredit in Argentina failed differ from the reasons for failure cited by field practitioners (i.e. multilateral development
bank staff and international donors)?” The first objective is to document the role multilateral
development banks, impact investing funds, and international donors have played in the
development of the microfinance industry in Argentina. The second objective is to gain insight
into whether the recent change of government regime, and therefore more positive economic
outlook, has changed the appetite of the donors and multilaterals to engage in new business
related to microfinance in Argentina. The primary source for information to achieve these
objectives will be interviews with the staff of development institutions that have operations in
Argentina. The interviews will also collect information to answer a secondary research question,
“What changes or interventions need to occur for Argentina to achieve fuller financial inclusion
and for microfinance institutions to achieve higher penetration rates amongst the financially
excluded?” The answer to this secondary research question may reveal a breach between the
approaches and remedies to the market constraints proposed by academics and the challenges
cited by practitioners. The implications of my thesis are that the international development
community will have a source for understanding multilaterals and international donors appetite
for investing in expanding financial inclusion in Argentina in the future. It will also give insight
to the specific challenges to success different types of investments and technical assistance/grant
projects have faced in the past, and in essence, document the specific contributing factors that
cause the market failure to persist. In addition to results of the interviews and surveys, my work
will serve as a base for the international development community to gauge the levels of
engagement from the multilateral development banks and international donors in regards to
addressing financial inclusion issues in Argentina, as well as insight on where these issues rank
in relation to others.
B. Approach

The methods used to gather relevant data and information to fulfill the research objectives of this thesis were extensive desk research combined with primary source interviews conducted in-person and by telephone. The desk research centered on the global history of microfinance, the history of microfinance in Latin America, followed by a focus on both the history and present-day situation of microfinance in Argentina. The sources used for these sections were a mix of journal articles, consulting reports, academic publications, presentations, books, statistics from international donors and research organizations, and governmental reports. This research established the theoretical framework for this thesis and was vital to creating the questions for the interview guides used to gather data from multilateral development banks and investors regarding their work in Argentina and why they believe microcredit has failed to reach scale. Primary source interviews were required to gain access to this information for several reasons. First, information regarding project operations and investments are not easily accessible to the public via the Internet, and the information that is available is not detailed beyond general information, such as loan or grant amount, date of disbursement, and a short description of the objective. Second, the information the interviews sought to gather was very specific in scope; details of operations performed in Argentina related to financial inclusion, opinion on the challenges microcredit has faced, and the outlook for the microcredit market given the recent change in government administration. Primary source interviews with employees that have a deep institutional knowledge and an expertise in the area of financial inclusion in Argentina were the only means to access the information needed to achieve the research objectives of this thesis.
C. Methodology

The decision to approach data gathering for this thesis through literary review and primary source interviews was quite straightforward given the nature of the investigation, however, the selection of the population to invite to participate in the interviews was more complex than anticipated. The first step in the process was to identify the relevant contacts within the multilateral investment banks that have operations in Argentina; the Inter-American Development Bank (IDB), the IDB’s Multilateral Investment Fund (MIF), IDBs’ Inter-American Investment Corporation (IIC), The Corporacion Andina de Fomento/Development Bank of Latin America (CAF), World Bank, and the International Finance Corporation (IFC). After identifying the institutions, it was necessary to locate the appropriate contacts within the institutions to request interviews with. This was a fairly straightforward task and all of the individuals contacted were willing to participate in an interview by telephone (if located in a field office) or in-person (if based in Washington, D.C.), as well as suggest other relevant contacts within the industry that may be able to provide additional insight to the subject matter. There are two exceptions to this: the Inter-American Development Bank and the Inter-American Investment Corporation. Through my initial two interviews with financial inclusion experts at the IDB’s Multilateral Investment Fund, I was informed that due to restrictions on the types of investments and operations allowed in Argentina, the MIF was the only IDB entity that has performed projects related to microfinance or increasing financial inclusion. Similarly, at the World Bank, after efforts to identify a point of contact working on the subject matter within Argentina, I was surprised to learn that the contact I identified was indeed the one person working on the topic. While it sometimes was a lengthy process to identify the correct contacts and schedule the
interviews within each of the multilateral development banks, the diligence and effort ensures that no institution’s work is excluded from the dataset.

Outside the realm of multilateral development banks, the other key actors interviewed were select investors and donors who compliment the financing and technical cooperation grants given by multilateral development banks. Identifying and contacting these actors proved much more challenging than anticipated. To begin, desk research was performed on various national development aid agencies to identify which agencies have operations in Argentina. After contacting the French, Australian, United States, Spanish, Canadian, and British development agencies, it was determined that only the Spanish agency has done projects and given loans to Argentina for development activities. The primary reason for the lack of presence of the development aid agencies in Argentina is that compared to neighboring counties in the region, Argentina is relatively prosperous and well-off. Therefore, aid agencies focus their resources on the countries they feel they can have the greatest development impact.

In addition to the multilateral development banks and international aid agencies, representatives from two major international impact investors who provide loans and have made investments in microfinance institutions in Argentina participated in interviews. They received the same interview questions as the staff at the development banks and development aid agencies, which aimed to understand their institutional profile, history of operations in Argentina, impressions of financial inclusion and barriers the industry has faced, as well as outlook towards the future of financial inclusion given the recent change in government regime.

Throughout the process of identifying potential interviewees, I remained keenly aware of the importance of selecting as wide of a range of participants as possible, so as to make every best effort to avoid skewed results. One strategy to achieve as diverse and neutral of a sample as
possible was to interview multiple staff from the same organization to avoid having only one perspective captured in the data. In particular, I tried in all instances to interview one staff member based in Argentina and one staff member based at the global or regional headquarters. While the information regarding business operations and project/investment details remained unchanged, interviewing staff at both the local offices and headquarters allowed for differences in opinion and perspective based on proximity and intimate knowledge of the local context versus overall organizational or regional strategy to shine through. To further support the effort to get the least skewed results possible, I cast a wide net in identifying organizations to interview in order to ensure no relevant institutions were missed. Although the scope of the institutions eligible for interviews was specific (multilaterals, international impact investors with a focus on financial inclusion, and international government-led aid agencies), I consulted with Dr. Martin Grandes, one of Argentina’s top investigators on microfinance and the advisor of this thesis, to ensure no institutions within that scope were overlooked. Also, after conducting each interview, I asked the interviewee if there were any other staff within their organization whom would also be knowledgeable enough on the topic to participate in the research, and also if they had any recommendations for organizations or contacts that could help increase the sample size. Lastly, one area I exercised extreme caution in so as to avoid skewed responses was in respect to politics. Due to the intertwined nature of the topics of financial inclusion and politics, an interviewee’s strong stance for or against the new Argentine government administration may skew their responses regarding the outlook of Argentina’s financial inclusion and microcredit penetration levels. To prevent this, the questions regarding politics were very succinct and limited in scope so as to keep the interviewee focused on the topic and avoid entering a broader conversation on the political climate. Overall, as a result of these strategies, I strongly believe
that the data collected from interviewees accurately represents a neutral and representative sample of the objective population.

Many of the historical constraints Argentina has faced in attracting international investors, thus resulting in a small number of multilateral banks and impact investors doing business in the country, were closely connected to a multiyear external debt crisis that excluded Argentina from participating in international capital markets. On July 30, 2014, Argentina defaulted on its sovereign debt for the fourth time since 1980, for a total of eight sovereign defaults since 1820. Argentina’s previous default was in 2001, when the country reneged on $81 billion USD in debt, was the root cause of the country’s 2014 default. Argentine President Cristina Fernández de Kirchner and chief negotiators refused to pay back the “vulture” hedge funds who were insisting that Argentina pay back bonds issued on the 2001 defaulted debt at full principal plus interest. The conflict situation resulted in Argentina needing to pay $1.3 billion USD to the “vulture” funds in order to proceed paying back other bondholders at reduced rates, or tip back into default. Argentina remained in default until April 2016 when newly elected President Mauricio Macri and his team came to an agreement with the holdouts to begin repayment, and Argentina was once again able to participate in international capital markets. With one of the most exuberant bond offerings in history for a country of its history and credit rating, Argentina re-entered the international $16.5 billion USD multi-tenure bond sale in 2016. Approximately $10 billion USD of the proceeds from the bond sale will go towards repaying the hedge funds and other investors from previous issuances. In addition to opening Argentina back up to international capital market, President Macri has taken bold steps to recalibrate the nation’s exchange rate, drop export tariffs, cut government subsidies, and revamp the country’s statistics agency. While the long-term impacts of these changes are yet to be seen, there has been a lot of
talk from investors about changes their confidence and what this means for Argentina’s economy overall.

The multilateral development banks and international investment funds ability to provide funding to Argentina have been impeded by Argentina’s barring from international debt markets. The development banks and investment funds have stringent investment criteria and risk profiles to adhere to, and therefore, the size and types of investments they were able to make in Argentina’s markets were severely limited. As a result of President Macri’s new economic policies and Argentina’s reentrance to international debt markets, many of the restrictions once in place have been revised or removed entirely. Therefore, it was critical to capture the perspective of the interviewees with regard to how the new government administration has affected their strategy for Argentina, and in particular investment in Argentina’s microfinance institutions or financial inclusion more broadly. The full interview guide can be found in Annex 1.

D. Preliminary Hypotheses

Primary research objective: Why did Argentina fail to develop a scalable and efficient microfinance system? Do the reasons cited by academics as to why market for microcredit in Argentina failed differ from the reasons for failure cited by field practitioners (i.e. multilateral development bank staff and international impact investors)?

Secondary research objective: What changes or interventions need to occur for Argentina to achieve fuller financial inclusion and for microfinance institutions to achieve higher penetration rates amongst the financially excluded?
Preliminary hypotheses: Based on my existing knowledge and experience as a microfinance practitioner, and in conjunction with the literature review of the information available from academics regarding the specific to the challenges of microfinance in Argentina, I have formulated a primary hypothesis and several secondary hypotheses. My primary hypothesis is that field practitioners will cite that microcredits have failed to reach scale in Argentina because of the prevalence of government interventions that make microcredit an unattractive option to the target population. These interventions can be direct in form, such as conditional cash transfers and heavily subsidized loans, or indirect, such as unfavorable regulation framework or tax/legal obstacles so as to disable the expansion and innovation of microfinance products. I also hypothesize that microfinance institutions in Argentina have struggled in obtaining the technical training and capacity building necessary to design products and the distribution channels necessary to meet the needs of the Argentine client base. Lastly, I hypothesize that the unique history of Argentina’s banking sector has contributed to an overall distrust of financial institutions, thus damaging the credibility of MFIs in the eyes of the target population. A side effect of this distrust and aversion to the financial sector has enabled the government to be the preferred source of loans and financing to the poor. With respect to the secondary research objective, I hypothesize that with that practitioners will state that with strategic investment from multilaterals and support from donors Argentina will be able to address several key issues that have impeded growth in the past. In particular, I believe that the recent change of national governmental leadership offers a unique opportunity to introduce new models of financial inclusion led by the public sector, thus taking steps to reform the negative perception of financial institutions that has impeded microfinance historically. The opportunities to re-legitimize microfinance institutions, engage in financial education initiatives, and promote labor market
formality are all areas that multilaterals and donors interventions can make great strides in improving the landscape of financial inclusion in Argentina.

Chapter 6. Presentation of Findings

The presentation of findings chapter will be broken into subsections to reflect the progression and flow that the interviews generally followed based on the interview questionnaire guides. To begin, brief profiles of the interviewees and the institutions they represent will be presented to provide context to the range of participants and their backgrounds. Their ranking of and overall impressions of financial inclusion and microfinance in Argentina will be shared, followed by any strengths they feel the industry has compared to its peers and neighboring nations. Presented next will be an overview of the types of projects and investments the institutions have made related to financial inclusion or microfinance, as well as whether these projects achieved their intended outcomes, and if not, the obstacles encountered. Finally, the data most pertinent to the research objectives will be presented. First, a summary of the reasons cited by academics for why the microcredit market has failed to reach its potential compared to the reasons cited in the interviews with field practitioners. Second, what is the interviewees’ outlook for the industry given the recent change of political regime? And lastly, what actions or interventions need to be made to increase the penetration of microcredit in Argentina? The responses will be analyzed in Chapter 7 in the context of addressing the primary and secondary research objectives.

A. Interviewee and Institution Profiles
To set the stage and provide context for the responses gathered during the primary source interviews, it is important to understand the backgrounds of the individuals interviewed and the institutions they represent. The interviewees are employees of eight different institutions, all of which are international development organizations. Three are multilateral development banks, and two are specialized funds within multilateral development banks that specialize in private sector development. The remaining institutions are impact investment funds that have a global footprint, and specialize in supporting financial inclusion and microfinance institutions through funding and technical assistance. The average number of years of operation in Argentina among the institutions is 29 years. All of the institutions began their operations first outside of Argentina and then entered the country, with the first entrant beginning operations in Argentina in 1959, and the most recent entrant arriving in 2000. With regard to scope of work, five of the institutions target investments and projects that positively impact low-income populations, while one institution solely focuses on investing in MFIs. The remaining institutions align their strategic priorities with the national government, and revisit these strategies on an annual basis. The individuals interviewed all hold senior positions within the institutions, including President, Senior Vice President, Country Manager, Regional Lead, and various Senior Specialists. On average, they have been in their current role for eight years, and they possess an average of 15 years of experience in international development. All interviewees have worked outside of Argentina at some point in their careers, and therefore they can provide insight to the situation in Argentina while comparing and contrasting to previous experiences in other contexts.
B. Impressions of Financial Inclusion in Argentina

Table 2: Impressions of Financial Inclusion and Microfinance in Argentina

<table>
<thead>
<tr>
<th>Ranking</th>
<th>Number of Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Very good</td>
<td>0</td>
</tr>
<tr>
<td>b) Good</td>
<td>0</td>
</tr>
<tr>
<td>c) Fair</td>
<td>1</td>
</tr>
<tr>
<td>d) Weak</td>
<td>9</td>
</tr>
<tr>
<td>e) Severely lacking</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: Authors own

The interviewees were asked to rank their impressions of financial inclusion in Argentina on a gradient scale (Very Good, Good, Fair, Weak, or Severely Lacking) and elaborate on why they selected the ranking. All interviewees assigned a ranking of “Weak”, with the exception of two; one selected “Fair”, another selected “Severely Lacking”. The respondents who selected the rank of “Weak” cited many reasons, including lack of regulation, high labor costs, lack of funding, overall macroeconomic weakness, overall distrust of the banking sector, and the limited geographic outreach of the initiatives that do exist to enhance financial inclusion. The respondent who characterized financial inclusion as “Fair” did so acknowledging the challenging and volatile macroeconomic environment that Argentina has impacted financial inclusion efforts during the last decade, but feels hopeful for a better outlook moving forward. The respondent who selected “Severely Lacking” cited the lack of institutional capacity to successfully implement financial inclusion initiatives, which is further compounded by an overall lack of individual capacity of citizens to want to engage with the formal financial services sector. When
asked in regard to the comparative advantages or strengths the Argentine microcredit industry has, the majority of respondents said “None”, and elaborated by remarking that they feel the industry for microcredit does not yet truly exist enough to compare to other nations. There were three alternative responses, however. First, Argentine’s have good repayment habits; no MFI has gone out of business due to high delinquency rates. Second, the underdeveloped nature of the industry means there is ample opportunity to expand and pursue new clients, compared to other nations that may have already saturated microcredit markets. Third, Argentina has highly skilled human capital, resulting in a talented pool of labor to employ at MFIs.

C. Types of Investments Made

Table 3: Investments and Projects Related to Financial Inclusion in Argentina

<table>
<thead>
<tr>
<th>Type of Project</th>
<th>Number of Mentions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technical Assistance</td>
<td>4</td>
</tr>
<tr>
<td>Loan</td>
<td>3</td>
</tr>
<tr>
<td>Line of Credit</td>
<td>3</td>
</tr>
<tr>
<td>Collateral Guarantee</td>
<td>1</td>
</tr>
<tr>
<td>None</td>
<td>2</td>
</tr>
</tbody>
</table>

Source: Authors own

Although all of the institutions interviews were solicited from multilateral development banks and investment funds, not all institutions structure their investments in a similar manner. Some are technical assistance grants (designed to increase the capacity and skills of the recipient institution), coupled with loans or equity investment. Others are traditional loans that are repaid on a mutually agreed upon repayment schedule. Alternatively, performance-based loans require the recipient to repay the loan only once certain performance metrics have been reached, so as to
prevent the MFI from incurring financial struggles for the sake of repaying the loan. Similarly, there are loans which are only disbursed based on results, as well as investments that begin as loans but can convert to equity based on performance. Because of the variety of investment types and risk profiles associated with each type, it is important to understand what investment tools were used in Argentina, as well as how each of these tools performed.

Of the institutions interviewed, the most frequently utilized investment tool used for projects related to financial inclusion was technical assistance grants. Three institutions used technical assistance in conjunction with loans or lines of credit, while one institution solely used technical assistance. Of the four institutions that used technical assistance, all four reported mixed results with regard to whether or not the project achieved the desired outcomes. One reported that although the projects achieved their objectives, the volume of new clients reached was consistently lower than anticipated. Similarly, another institution reported that while most recipients of technical assistance grants were a success, one project was terminated prematurely due to lack of capacity at the recipient institution was so low that it impeded the project from being implemented. The last two institutions lamented that although the projects were success because they achieved their targets, they viewed them as a failure because there was no support from internal or external stakeholders that would enable the project to continue scaling-up.

The second most frequently utilized investment tools were a tie between lines of credit and loans, each with three institutions using them. The lines of credit were unanimously rated as highly successful given that they filled a critical need for financing for MFIs. The institutions who issued loans to MFIs also said the loans were repaid successfully, except that several MFIs that received loans have since closed or were absorbed by other institutions, thus indicating that despite the loans, there wasn’t a significant long-term impact in enhancing financial inclusion in
Argentina. The last investment tool used by the institutions was a collateral guarantee fund created to support MFIs in lending to Small and Medium Enterprises (SMEs). However, the collateral guarantee fund was not successful because it was not competitive or able to scale-up due to market conditions.

It is important to note that two institutions of the institutions interviewed have not made any investments or given technical assistance grants to projects related to financial inclusion in Argentina. The reasons cited for not investing were that investments in MFIs in Argentina did not fit the risk profile for eligible investments, as well as the country strategy for Argentina has given priority to other areas of work and investment.

D. Reasons for Low Penetration of Microcredit

Table 4: Reasons for Low Penetration of Microcredit in Argentina

Academics have researched the subject of financial inclusion and the reasoning behind why microfinance institutions have a low penetration rate; Using the following categories as a guide, what do you think the reasons are?

<table>
<thead>
<tr>
<th>Category</th>
<th>Number of Mentions in Academic Literature</th>
<th>% of the time mentioned in literature</th>
<th>Number of Mentions in Interviews with Practitioners</th>
<th>% of the time mentioned in interviews</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macroeconomic instability</td>
<td>2</td>
<td>33%</td>
<td>5</td>
<td>45%</td>
</tr>
<tr>
<td>Business Climate</td>
<td>4</td>
<td>67%</td>
<td>8</td>
<td>73%</td>
</tr>
<tr>
<td>Government Interventions</td>
<td>1</td>
<td>17%</td>
<td>4</td>
<td>36%</td>
</tr>
<tr>
<td>Lack of Technical Knowledge and Institutional Capacity</td>
<td>3</td>
<td>50%</td>
<td>5</td>
<td>45%</td>
</tr>
<tr>
<td>Cultural Reasons</td>
<td>4</td>
<td>67%</td>
<td>5</td>
<td>45%</td>
</tr>
<tr>
<td>Other</td>
<td>2</td>
<td>33%</td>
<td>3</td>
<td>27%</td>
</tr>
</tbody>
</table>

Source: Authors own
Earlier in chapter four of this thesis, an overview of academic work on the subject of microfinance in Argentina was covered, with a specific focus on the author’s perspective on why microcredits have failed to reach scale in Argentina. In an effort to understand what, if any, disparities exist between the academic perspective and the institutions that invest in promoting access to microcredit, survey questions were designed to capture this information. Due to the wide range of reasons cited in the academic literature, organizing them into categories that capture the essence of the various reasons was essential. First, a comprehensive list of all the reasons mentioned in the academic articles was created, and reasons were divided into subgroups based on the market, social, or economic characteristic it portrayed. After dividing the reasons into subgroups, the groupings were reviewed for accuracy and given titles to be included in the survey as response choices to a semi-close ended interview question (“Academics have researched the subject of financial inclusion and the reasoning behind why microfinance institutions have a low penetration rate; Using the following categories as a guide, what do you think the reasons are?”) The subgroups, or “categories” as they are referred to in the survey, are: (a) Macroeconomic instability; (b) Business climate (high taxes, unfavorable regulations, high nominal interest rates, instability of public programs and budgets, etc.); (c) Government interventions (such as conditional cash transfers, subsidies, social programs, etc.); (d) Lack of technical knowledge and institutional capacity; (e) Cultural reasons (lack of financial education, dependency on government, lack of trust with financial institutions); and (f) Other. The responses received in the interviews are compiled in the table above. Analysis of the responses will be presented in Chapter 7.
E. Outlook on Microcredit in Argentina

Table 5: Changes in Organizational Strategy or Areas of Focus

**Given the recent change of government and current administration, is your organization making any revisions to strategy or areas of focus?**

<table>
<thead>
<tr>
<th>Response</th>
<th>Number of Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>5</td>
</tr>
<tr>
<td>No</td>
<td>6</td>
</tr>
</tbody>
</table>

Source: Authors own

Table 6: Changes in Appetite to Invest in Financial Inclusion

**How have the changes of government affected your organizations appetite for investing in financial inclusion project, even if no strategy revision has taken place?**

<table>
<thead>
<tr>
<th>Response</th>
<th>Number of Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, there has been an increase in appetite</td>
<td>2</td>
</tr>
<tr>
<td>No, no change in appetite</td>
<td>5</td>
</tr>
<tr>
<td>Undecided, too early to determine</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: Authors own

The institutions interviewed were asked two questions in regard to how their outlook for microcredit and microfinance institutions have or have not changed given the recent change in government administration. The questions (“Given the recent change of government and current administration, is your organization making any revisions to strategy or areas of focus?”; “How have the changes of government affected your organizations appetite for investing in financial inclusion project, even if no strategy revision has taken place?”) aimed to capture not only overall impressions of the future of the industry, but also if tangible actions are being made to overcome some of the barriers previously mentioned.
With regard to whether or not institutional or investment strategies were being revised in light of the change of government administration, there was a near even split among respondents. The institutions that responded “yes” did so for two primary reasons: (1) Yes, because they feel it is appropriate to re-evaluate investment strategy given the re-opening of international capital markets, (2) Yes, because every year strategy is reevaluated regardless of whether or not there are significant changes to market outlook or government regime. The institutions that responded “no” cited that they are not in the position to revise because their strategy is regional, not country specific, or because they are in a ‘wait and see’ position and are not ready to make changes yet.

When asked whether there is increased appetite to invest in MFIs or projects related to financial inclusion, the responses were quite mixed. Two institutions responded with a confident “yes”, remarking that there are indicators that the government is moving in the right direction to improve the investment climate overall, and therefore investment in MFIs or commercial banks downscaling to serve lower-income clients will be more attractive. The majority of respondents said “no”, stating that there would be no new investments until macroeconomic conditions stabilize, especially given the recent currency devaluation. Another reason mentioned for not having an increased appetite in the short-term was related to strategy; MFIs and financial inclusion are still not part of the institution’s investment strategy for Argentina. Lastly, there were four institutions that responded with not yes or no, but instead a “we have increased interest, and are optimistic, but are still in a wait and see position”.

F. Actions Needed to Increase Financial Inclusion in Argentina

The interviews concluded with the open-ended question “What actions do you think the government needs to take to increase financial inclusion in Argentina?” Despite being open-
ended and non-leading, the responses from the institutions were very similar across the board. Tied for first place with the same number of mentions were increased economic stability and increased financing options for microfinance institutions. Historically, inflation, sovereign debt defaults, high unemployment, and tight credit markets have made it very difficult for consumers and lenders alike. Stabilizing the economy to build consumer confidence, attract foreign investment, and strengthen the Argentine Peso is an essential step to beginning to build a robust microcredit supply and demand. On a similar note, microfinance institutions have long suffered from a lack of financing options. Under Argentine law, MFIs are unable to accept deposits from customers, restricting them to be purely lending institutions. As a result, their growth and expansion is subject to the amount of capital available to them. However, due to the aforementioned economic conditions of Argentina, many MFIs struggle to obtain financing due to the domestic credit crunch, and are often seen as too risky from foreign investors.

Given the challenges MFIs face in obtaining financing, the second most frequently cited intervention needed is for the government to create a legal framework for MFIs. As of now, there is no legal definition or regulation applicable to MFIs. Due to this loophole, MFIs only exist as downscaling operations run by commercial banks, non-government organizations, or as “sociedad anónima”, the Argentine form of a public company. As such, MFIs do not have a legal structure that allow them to operate in regulatory conditions that suit their unique needs and acknowledge the social benefit that increased financial inclusion brings. Instead, they are by default forced to operate in an ambiguous state that does not address the needs of the industry, and results in severely limiting their ability to grow.

Similarly, the need for tax reform for MFIs was mentioned as the third most urgent intervention. Because there is no regulation or legal structure created for MFIs, they are
currently taxed twice: once under the financial services tax, and again on all revenues. This double taxation makes it very difficult for MFIs to offer microcredits at rates attractive to consumers. Respondents stated that if the government created a tax policy that encouraged MFIs to reach more customers and increase financial inclusion, Argentina would reap great benefits.

However, even if there were better products at lower interest rates available, there is a great need to increase the transparency in the banking sector and increase the public’s trust. The volatile history and debt defaults of the past have deeply affected the public’s trust in the banking sector, and many people, especially the poor, lack confidence in the stability and ethics of the sector. Therefore, several interviewees stated that before any new regulations or activity to promote financial inclusion can occur, the government and sector need to focus on rebuilding trust and enhancing transparency. Lastly, both strengthening a culture of entrepreneurship and encouraging less dependence on the government each received one mention in the interviews. One felt that Argentines view microcredits as a tool for entrepreneurs, and not for the broader population who is financially excluded. The other stressed that the poor still view the government as responsible for providing opportunities to escape poverty, and therefore do not seek solutions from the private sector.

Chapter 7. Analysis of Survey Results

The primary source interviews with multilateral development bank and international impact investment firm staff were critical inputs needed to fully answer the primary and secondary research objectives of this thesis. While academic investigation provides valuable, unbiased input and perspective on the issues and challenges MFIs have faced in scaling-up their operations in Argentina, financial inclusion and development experts who have experience
working directly with microfinance institutions and partners trying to overcome the market challenges offer an important perspective. Without their contributions, a comprehensive understanding of the problem and potential solutions could not be achieved. This chapter will draw upon the academic literature and primary source interviews to answer the research objectives.

A. Addressing the Primary Research Objective

*Primary Research Objective: Why did Argentina fail to develop a scalable and efficient microfinance system? Do the reasons cited by academics as to why market for microcredit in Argentina failed differ from the reasons for failure cited by field practitioners (i.e. multilateral development bank staff and international impact investors)?*

The responses obtained during the interviews with field practitioners did not support the hypothesis I developed earlier in the research phase. My original hypothesis, that practitioners would cite government interventions as the primary inhibitor to the microcredit industry, was disproven. I hypothesized that field practitioners and academics would have diverging perspectives of what the biggest challenge prohibiting growth of the microcredit industry would be. I hypothesized practitioners would cite government interventions as the main barrier to growth, while academics cite business climate and cultural reasons, tied for first place, as the top challenges facing the industry. Instead of disagreeing with what academics cited as the main challenge, field practitioners agreed that the Business Climate in Argentina is the inhibitor to industry growth. 67% of academics cited factors fall into the category of Business Climate as a reason, and 91% of all interviewees also cited poor Business Climate as a reason for why the microcredit industry has failed.
However, within the category of Business Climate, there were notable variances between what academics and practitioners mentioned most frequently. Of the practitioners who cited Business Climate as a main challenge, 90% specifically mentioned lack of funding and financing options available to MFIs in local currency as a challenge impeding the offer of microcredit, in comparison to only 33% of academics. Practitioners lamented that MFIs cannot accept deposits from clients nor do they have access to capital markets that can provide financing at competitive rates, severely limiting how much they can grow their portfolio, open new branches, invest in new technology to increase efficiency, or allocate funds for client education campaigns. The lack of availability of financing was often the first thing they mentioned, while the academic literature wrote in about the subject in broader terms, using language such as “lack of stable financing” (Delfiner et al, 2006), or focus on different issues entirely, such as inability to raise capital through public IPOs (Crouzel, 2009). In total, financing constraints were only mentioned by 33% of academics. This disparity highlights that academics may need to bring more attention to the importance of financing options for MFIs to help increase the supply of microcredit in the market. The role of academics are particularly important since politicians sometimes rely on academic research to guide their decision-making, especially when gathering resources to debate state-funded initiatives revise regulation or provide low-cost financing options to MFIs. Therefore, academics bringing more attention to the lack of financing options available to MFIs may be an important step in helping move the industry forward.

Also within the category of Business Climate, the issue of taxation emerged with slightly different treatment from academics and practitioners. 50% of academic literature mentioned high taxes and a lack of tax framework specific to MFIs, while only 36% of practitioners cited tax rates as a constraint. This goes hand-in-hand with the issue of a lack of legal definition and
regulatory framework for microfinance institutions. Academics mentioned this issue 50% of the time, while it was only mentioned by 20% of practitioners. These differences may be indicative of a more general misalignment of perceived versus actual barriers to market growth. A next step to further refine and hone in on whether or not these differences are significant would be to interview MFIs. With the perspective of MFIs on these issues, a cohesive view of the issues affecting the overall business climate for MFIs in Argentina can be formed, and recommendations for optimal intervention and reform can be made.

Cultural Reasons was tied for first place with Business Climate within the academic community with the most number of mentions. Among the interviewees, Cultural Reasons also ranked high as a barrier, with 45%, but it was also tied with Macroeconomic Instability and Lack of Technical Knowledge and Institutional Capacity, both also mentioned by 45% of respondents. This reveals that while Cultural Reasons are felt to be an important contributing factor to the market challenges, they are not more impactful than economic or institutional capacity. One reason this may be is because investors and multilateral development bank staff are not working directly with end-user clients, and therefore do not have as much exposure to the cultural issues. Their increased awareness of the macroeconomic conditions of Argentina and exposure to MFIs from an investment risk perspective may be causing their responses to downplay the affect culture has on how receptive Argentine consumers are to engaging with MFIs. However, the interviewees that cited Cultural Reasons as a barrier emphasized the role that lack of awareness that MFIs exist and knowledge of what MFIs can provide as the main constraints. This is in contrast to academics, whose Cultural Reasons centered more on the public’s perception of the banking sector and a lack of trust. Although the specific interpretations of Cultural Reasons vary between the academic literature and the information gathered during the interviews, the
appropriate interventions to overcome these obstacles in the market would be very similar, and likely could address both sets of issues at the same time.

Closely related to the primary hypothesis, a secondary hypothesis investigated was whether or not a Lack of Institutional Capacity and Technical Knowledge play an important role in preventing the microfinance industry from reaching its full potential. I hypothesized that microfinance institutions in Argentina have struggled in obtaining the technical training and capacity building necessary to design products and the distribution channels necessary to meet the needs of the Argentine client base. To my surprise, only one respondent mentioned a lack of capacity with respect to understanding client wants and needs, thus preventing the design of adequate products and services to meet the target client segments needs. Instead, the responses that fell within the category of Lack of Institutional Capacity and Technical Knowledge focused on poor institutional management and high labor costs. Because of the subject matter expertise possessed by the interviewees, I expected their responses would be more focused on the technical aspects, such as distribution channels and the types of microcredit products offered to clients, and less so on operational issues, such as frequent staff turnover and high labor costs due to Argentine law. This provides insight to constraints that were not cited in the academic literature. The academic literature that mentioned Institutional Capacity and Technical Knowledge constraints discussed high operating costs, limited management skills, and a lack of training available to MFI's in Argentina as primary barriers to growth. Studying the cases of specific MFI's that have struggled to increase their scale is out of the scope of this thesis, but would be a valuable next step to take to further understand what can be done to help Argentine MFI's have stronger technical capacity and management.
The final hypothesis associated with the Primary Research Objective was that the unique history of Argentina’s banking sector has contributed to an overall distrust of financial institutions, thus damaging the credibility of MFIs in the eyes of the target population. A side effect of this distrust and aversion to the financial sector has enabled the government to be the preferred source of loans and financing to the poor. This hypothesis was also disproven in light of responses to the interviews. The respondents who gave reasons that fell into the category of Government Interventions gave responses that centered more on the government’s lack of support for the microfinance sector as a whole, rather than interventions that compete for the attention and business of low-income clients, such as subsidiary programs. Political interference in the microfinance sector, such as the imposition of interest rate caps on MFIs that accept government funding, was also cited. Only one interviewee cited a lack of trust of the banking sector as a possible hindrance to growth of the industry, but the aversion was not specific to MFIs, just banks in general.

Although every academic and practitioner has a unique perspective on the industry, there were notable trends in what areas the two groups diverged in their responses. One of the reasons for these differences is likely the amount and type of information investors and practitioners have access to compared to academics. When investors and project managers evaluate the feasibility of an investment or project, the due diligence process enables them to learn about a MFI or local implementing partner in great detail. After thorough analysis, a decision to proceed with or reject the investment/project is made. The information and conversations between practitioners and the MFIs oftentimes contains information that would not be shared in any other context, meaning that academics or other researchers would not be privy to the same information as practitioners. This disparity in the level of detail and type of information likely is a direct or
indirect driver behind some of the differences observed in this research. Furthermore, because of the recent change in government administration, the difference between when the academic literature was written (between 2005 and 2014) and when the interviews with practitioners took place (2016) may be influencing some of the differences. The election of current President Mauricio Macri has heavily influenced the outlook of many Argentines with regard to the macroeconomic and political future of the country, and therefore it is essential to recognize that there may be some differences in opinions expressed due to the influence of the President and political climate at the time of writing or interviewing.

The interviews revealed important differences in the perception of what challenges academics believe are inhibiting the microcredit market versus what challenges multilateral bank and impact investment fund practitioners believe the industry faces. Although these differences in perspective do not have a direct impact on how the Argentine government intervenes via public policy or financing schemes, both groups are consulted and revered as industry experts by politicians, and therefore have an important indirect impact. Increasing dialogue between academics and investors and multilateral development bank staff will help generate a more cohesive understanding of the nuanced challenges the market for microcredits in Argentina faces, and ultimately contribute to greater financial inclusion.

B. Addressing the Secondary Research Objective

*Secondary Research Objective: What changes or interventions need to occur for Argentina to achieve fuller financial inclusion and for microfinance institutions to achieve higher penetration rates amongst the financially excluded?*
The challenges that microcredits and microfinance institutions face in Argentina have been well documented by academics, so I did not want to limit the scope of this thesis to only compare and contrast the challenges. Instead, I wanted the opportunity to gather information and industry practitioners expert opinions on what changes and interventions need to occur for Argentina to overcome the identified challenges. This analysis is slightly different than the analysis performed on the Primary Research Objective because it will not be compared against the suggested actions made in academic literature. Instead, since investors and multilateral development banks are in the position to finance certain types of interventions, such as institutional capacity building and financial education campaigns, this analysis interprets the data gathered through the lens of what potential impact investors may be able to make to overcome the barriers the industry faces.

To begin, the hypothesis I developed before conducting the interviews was that practitioners’ responses would be more related to cultural factors and an improvement in the overall stance of the government towards financial inclusion. I hypothesized that responses would suggest that with strategic investment from multilaterals and support from donors Argentina would be able to address several key issues that have impeded growth in the past. In particular, I hypothesized that the recent change of national governmental leadership offers a unique opportunity to introduce new models of financial inclusion led by the public sector, thus taking steps to reform the negative perception of financial institutions that has impeded microfinance historically. The opportunities to re-legitimize microfinance institutions, engage in financial education initiatives, and promote labor market formality were all areas that multilaterals and donors interventions could make great strides in improving the landscape of financial inclusion in Argentina. However, this hypothesize was disproven. Similar to the
responses regarding the challenges facing the industry, investors and development bank staff’s recommended interventions were much more focused on business climate and macroeconomic factors.

The most frequently mentioned recommendation is that the Argentine government needs to develop microfinance-specific regulation. As of now, microfinance institutions are not recognized by the government as financial institutions, and therefore need to register as a non-governmental organization (NGO), a “sociedad anónima”, or be a full-fledged commercial bank in order to operate. However, MFIs have unique business needs and attend to clients whom may be interacting with a formal financial institution for the first time, and therefore merit regulation that addresses the issues and challenges that accompany this. For example, MFIs face higher operating costs than a traditional bank because each loan amount is smaller than a loan issued by a traditional bank, yet their clients are frequently located in more remote, harder to reach areas. Also, clients often lack collateral or formal employment, and therefore their risk profile and ability to repay a loan can be difficult to assess. Clients often do not have high levels of financial literacy, and may require more in-person credit counseling to ensure they understand the loan. Also, because of the lower financial literacy rates, regulators should be paying close attention to consumer protection measures in place to ensure clients are not targeted with predatory lending practices or collection methods. These are a sampling of characteristics that differentiate MFIs from any other type of NGO, “sociedad anónima”, or a commercial bank. Without recognizing MFIs as a unique type of financial institution that requires separate regulation from other types of entities, MFIs will be forced to continue to operate in a legal form that doesn’t meet their needs. The majority of MFIs are presently registered as NGOs or “sociedad anónimas”, and therefore cannot accept deposits from consumers. This limits the range of financial services
these MFIs can offer their clients, as well as limits the sources of funding available to the MFI. Thus, creating a legal definition for MFIs to register and operate within, followed by developing policies and a regulator framework for MFIs, is viewed as essential in the eyes of practitioners.

Tied for second place for the most number of mentions was to revise the tax policy for MFIs and to increase funding available to MFIs. These two recommendations almost go hand-in-hand because if the tax policy is revised so MFIs pay a lower tax rate than they currently do, then MFIs will inherently retain more earnings and have more funds available to grow their business or serve new clients. At present, MFIs pay income tax as well as a financial transactions tax to the government of Argentina. This was referred to by many interviewees as ‘double taxation’, and was an issue that came up repeatedly with regard to why no one wants to open a MFI in Argentina. MFIs already face very low margins due to their high operating costs, and therefore coupling the low margins with a high tax rate makes for an extremely difficult business model. With a lower tax rate, MFIs can retain more income and potentially expand their operations. Also, lower tax rates may attract new entrants to the market, however, without increased access to financing, the institutions will soon face the same constraints to growth as veteran MFIs face. Interviewees mused that the recent opening of Argentina’s economy to the international capital markets may have some trickle down effect and positively impact the access MFIs have to funds at affordable interest rates, but the best way to ensure these funds reach MFIs is through targeted efforts led by the government. Despite the aforementioned overall optimistic perspective of the impact investors and development bank staff, all but two institutions said they were not interested or able to make any commitments in the near-term to invest in MFIs or financial inclusion projects in Argentina. This puts the government in the position to lead the way in creating funding sources for MFIs, at least for the short-to-medium timeframe.
Lastly, interviewees emphasized the importance for the Argentine political and economic environment to stabilize. Overcoming its historic reputation for instability can be achieved through increased transparency, improved coordination and messaging between government agencies, and normalized economic performance. Interviewees shared that what Argentina’s microcredit sector could benefit most from right now is a prolonged period of ‘normalcy’ and no dramatic economic shifts. While no one can predict the future, interviewees openly expressed their optimism that Argentina is headed in the right direction.

Conclusion

The unique characteristics and challenges of the Argentine economy have impacted the lives and household finances of all Argentines, yet there is no group more vulnerable and less resilient to macroeconomic shifts than the poor. Across the world, microfinance has helped provide financial services such as microcredit loans, savings accounts, microinsurance, and micropensions, and in doing so, increasing the financial stability and quality of life of millions. Argentina’s microfinance sector has struggled to evolve beyond a limited offering of microcredit products, barely scratching the surface in terms of impact and outreach to vulnerable populations. The aim of this research was to gain more insight from industry professionals regarding their experience investing in and completing projects related to microfinance in Argentina, while also answering specific research objectives regarding barriers to market development and getting insight to what the future investment climate may look like. The interviewees’ openness and willingness to give thorough, thoughtful answers provided unparalleled insight into an industry that has very little written from a similar perspective.
Although both of the hypotheses related to the primary and secondary research objectives were disproven, there were several other key insights that emerged. First, the findings from the interviews revealed several key breaches between the academic literature available on the topic and the perspectives of investment officers and staff at development institutions. Business Climate was by far the most critical barrier to growth according to the interviewees’, with 91% of them bringing it up as the biggest challenge the microfinance industry has faced. The issues of ‘double taxation’, lack of financing mechanisms and lines of credit available to MFIs, and the absence of a legal framework for microfinance were all topics that came up frequently and with a sense of great urgency among the respondents. In contrast, only 67% of academics cited Business Climate as a challenge, giving it equal weight as Cultural Reasons, which also was mentioned 67% of the time. This reveals an important difference in not only the perception of how much business climate impacts the microfinance industry according to these two groups, but also how business climate compares to other factors, such as cultural reasons, government interventions, macroeconomic instability, and lack of technical knowledge and institutional capacity. Furthermore, according to the interviewees, Cultural Reasons are a much less important contributing factor; only 45% of respondents made reference to cultural reasons playing a role in impeding the microfinance sector, and the specific reasons mentioned varied significantly from those mentioned by academics. Academics cited reasons more related to social and psychological factors, such as lack of trust in the banking sector, poor consumer education, and an aversion to repaying debts, while interviewees felt Argentine’s were simply not aware of the offerings of MFIs and the resources available to them. This sampling of differences between the perspectives and observations from these two segments very important to the development of the microfinance industry is important to take note of. Improved communication and
coordination between the various thought leaders and experts can make an impact in a coherent and unified voice to lobby for changes that will help the microfinance industry advance.

The research also reveals the need for increased coordination between the public sector and private sector. As evidenced through the interviews, the barriers impeding growth of the microcredit market cannot be overcome by investment from impact investors and projects completed from multilateral development banks alone. Although investments have historically been successful in being repaid, and projects for the most part have achieved their objectives, the interviewees quite consistently lamented that despite their success ‘on paper’, projects and investments had little future of scaling up due to market conditions. This history of market failures, in conjunction with the responses to the secondary research objective (“What changes or interventions need to be made to increase the penetration of microcredit and financial inclusion?”), duly emphasize the need for a response in the form of public policy to support the expansion and fruition of the microfinance industry. Action items short-listed as urgently needing to be addressed by policymakers include a revision of tax rates for MFIs, creation of a legal definition and framework for MFIs to operate within, and greater support for the industry overall. Although policy reform is a slow process, prioritizing the tax reform and legal definition should have an immediate positive impact on the industry’s ability to operate more efficiently.

Although the scope of this thesis’ research was limited to the subject of microcredit, with additional time and resources, there exist a range of other research areas that could greatly benefit financial inclusion in Argentina. For example, research on commercial banks efforts to downscale and design new products to serve low-income clients is one area of research that can help further understand the landscape of actors working towards greater financial inclusion. Research on how many banks are engaging in downscaling efforts, the motivations behind their
expansion into low-income client bases and what obstacles they are encountering would
compliment this thesis’ research. More importantly, it would enable lawmakers and relevant
actors to focus their attention on making improvements to the regulations that create the most
positive impact for the various entities (MFIs, commercial banks, etc.) that serve low-income
clients. Another area of research that would expand upon this thesis’ work would be
investigation into other products and services designed to meet the needs of low-income or
financially excluded populations, such as microinsurance, micropensions, remittances, savings
accounts, and financial literacy trainings. Microcredits are just one product within a suite of
products and services within the realm of microfinance. Without a comprehensive understanding
of how these complementary products and services interact and support one another in the
Argentine market, it is impossible for them to reach their highest potential. Additional research
on the offer, uptake, and barriers these products face is an essential next step.

Microfinance is not a panacea for poverty or alleviating the multitude of issues that a
nation’s poor face, but access to microcredit and other financial services tailored to the needs of
low-income individuals are essential to supporting their economic and social growth. While the
Argentine microfinance industry has faced notable challenges due to a range of issues, this paper
has also revealed an overall sense of optimism and hope. Argentina is a country with a strong
spirit of resilience, and with a few key changes and support from policymakers, the potential for
a vibrant microfinance industry is certainly high. Multilateral development bank staff and
investors are hopeful and ready for a rebirth of microfinance in Argentina, and have hinted they
are ready to invest and aim to have a higher impact than ever before. In true Argentine spirit, the
microfinance industry and its supporters are not prepared to let the industry’s past dictate its
future, and I strongly believe that once key reforms are made, a very bright future lays ahead.
Appendix A. Interview Guide

Intended for senior staff at multilateral development banks and impact investors with operations in Argentina

Personal Information
Name:
Institution:
Position/Title:
Years in Current Position:
Previous positions held at Current Institution:
Years working in international development:
Have you worked outside of Argentina?
If so, what countries and in what capacities?

Institutional Profile
How long has your institution been in operation?
How long has it been in operation in Argentina?
How would you summarize your country strategy for Argentina?
How often is the strategy revisited?
Does this strategy focus on certain geographic areas of Argentina?
Certain populations?
Does your institution work with both public and private entities on development projects?

Financial Inclusion Interventions
What are your impressions of financial inclusion and microfinance in Argentina? Please select one of the following rankings and elaborate on why.
a) Very good
b) Good
c) Fair
d) Weak
e) Severely lacking

What strengths do you think the Argentine microfinance industry has?

Academics have researched the subject of financial inclusion and the reasoning behind why microfinance institutions have a low penetration rate; Using the following categories as a guide, what do you think the reasons are?
a) Macroeconomic instability
b) Business climate (high taxes, unfavorable regulations, high nominal interest rates, instability of public programs and budgets, etc.)
c) Government interventions (such as conditional cash transfers, subsidies, social programs, etc.)
d) Lack of technical knowledge and institutional capacity
e) Cultural reasons (lack of financial education, dependency on government, lack of trust with financial institutions)
Has your institution ever made investment or done projects related to financial inclusion in Argentina? If so, please tell me about them.

Did the projects achieve their intended outcomes? If no, what obstacles did you encounter?

- Low uptake/latent demand
- Lack of institutional support from the project sponsor
- Unfavorable macroeconomic conditions
- Lack of systemic support/infrastructure
- Regulatory barriers
- Other

How does financial inclusion rank in comparison to other areas of work your organization does projects in? Is it a high or low priority? Why?

Outlook
Given the recent change of government and current administration, is your organization making any revisions to strategy or areas of focus?

1. Yes (why)
2. No

How does political instability/short-termism impact your organizations strategy and outlook regarding financial inclusion or related programming?

Do you think there will be any changes in regard to financial inclusion and microfinance?

What actions do you think need to be made to increase financial inclusion in Argentina?

Any additional comments?

Bibliography


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