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An Assessment to Establish a Regulatory Framework for Microfinance Institutions in Jamaica

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Executive Summary

Over the last twenty-five years Jamaica has seen the emergence of a wide range of entities that provide financing to microenterprises. The majority of these operations confirm that providing credit to the microenterprise sector is very costly, with very low margins to cover costs. The lack of a regulatory framework in Jamaica for the microfinance institutions (MFI) has been identified as a constraint both by wholesalers of funds, and the micro lenders themselves. A major concern is the lack of open and widely distributed data about the Jamaican microfinance sector.

MFIs believe that a regulatory framework will provide legitimacy to their operations, establishing international benchmarks against which they can be assessed, and open additional avenues to obtain funding to on-lend. There is a common understanding of the need to order, coordinate and supervise the activities of microfinance in Jamaica through a comprehensive regulatory framework. It should involve as many of the players as possible. It should be designed to consolidate, coordinate, oversee and expand financial intermediation services provided by the microfinance industry, with the aim of providing these services in an optimal way, and facilitating investors to the industry in Jamaica.

It is important to find cost-effective ways of improving the standards of the many MFIs that have been operating in Jamaica, while at the same time avoiding restrictions that would impair their efficiency or effectiveness. There are no plans in the near future by the Bank of Jamaica to issue regulations for the microfinance sector. Therefore, the remaining option at this time for the MFIs is to set up a self regulatory system. The regulation and supervision of non regulated MFIs must include systems and procedures to protect investors, to promote sound business practices, and to address risk issues.

For Jamaica's unregulated, non-deposit taking microfinance institutions, some combination of self regulation that includes reporting requirements similar to those of DBJ is probably the best approach to begin with. To start a process of regulation, the first step is to create an MFI network, a partnership of several MFIs with a common interest to follow some common rules and to share information, activities, and experiences, among others. There are some preconditions to establishing a regulatory framework. The first and most important one is to determine whether the MFIs are really ready to share standardized data.

New developments to strengthen lending to micro-entrepreneurs include a law that will allow establishing a credit bureau in Jamaica, but microenterprise lenders are not specifically included in the group of information providers. They have the ability to overcome this by establishing a network, and standardizing and sharing data and information. A private sector risk rating agency to provide risk ratings for Jamaican MFIs would be the last step to the overhaul of the microfinance industry in Jamaica.

International best practice has MFIs offering baskets of products that combine credit, savings, micro-insurance and facilities to make transfers and sending money through savings. As the Jamaican MFI sector becomes more regularized, a highly innovative way in which to gain market share is for the MFIs to establish strategic alliances with regulated financial institutions to offer this broader range of services. Partnerships would be based on the comparative advantages of each.

The first step is for the MFIs to create a network, and establish and adhere to some common rules and to share information. This network should have a Secretariat to attend the needs of the members. The MFI network should work on the basis of a Memorandum of Understanding and a Code of Ethics.

Section I: Introduction

Over the last twenty-five years Jamaica has seen the emergence of a wide range of entities that provide financing to microenterprises. Some of these lenders were initiated through international donors and established as not for profit operations. Others established themselves as commercial operations, financed with resources from private investors. Nevertheless, the majority of these operations confirm that providing credit to the microenterprise sector is very costly, with very low margins to cover costs. This is further exacerbated when wholesalers of funds, particularly those associated with the public sector and international donors, may impose limits on interest rates that can be charged when the microfinance institutions (MFIs) on-lend these funds to sub-borrowers.

The lack of a regulatory framework in Jamaica for the microfinance institutions has been identified as a constraint both by wholesalers of funds, and the micro lenders themselves. One main barrier is that wholesalers do not have a standardized basis against which to measure the financial strength of the MFIs. Additionally, MFIs believe that a regulatory framework will provide legitimacy to their operations, establishing international benchmarks against which they can be assessed, and open additional avenues to obtain funding to on-lend. New developments to strengthen lending to micro-entrepreneurs include a law that will allow establishing a credit bureau in Jamaica, but microenterprise lenders are not specifically included in the group of information providers. Several MFI managers believe this is due to the fact that they are not governed by a regulatory framework, though they do believe that a credit bureau could reduce their risk exposure and help to improve their efficiency and transparency.

Another key issue identified by the MFIs is their need to offer a wider array of products and services to their customers, such that profits from these services can help to offset costs from their lending operations, which currently are not being covered.

The subject of this assessment was to determine what level of regulation and reporting should be established to enable Jamaican MFIs not only to be sustainable but also to expand their services, and how and where this regulatory authority should be housed. The recommendations should not place burdensome costs and expensive requirements such that MFIs are unable to comply with the new rules.

The consultant was asked to conduct a review of existing microfinance institutions in Jamaica, and recommend an operational/legal definition of a microfinance institution in Jamaica for purposes of a proposed regulatory framework. Within the scope of recommending an operational/legal definition of a microfinance institution, the consultant was to also recommend a definition of a microenterprise and the microenterprise sector in Jamaica.

The consultant was also requested to determine the level and scope of a regulatory framework that would be appropriate for microfinance institutions to provide an expanded range of services to their clients, but which is not overly burdensome for the MFIs to comply with. Based on these services, an appropriate regulatory body to provide oversight was also to be recommended.

Lastly, the consultant was asked to review the present range of services that microfinance lenders are providing, their constraints and opportunities regarding cost recovery and profitability, and suggest any additional services to improve the profitability of microfinance institutions.

Section II: General Review of the Microfinance Sector in Jamaica

Based on a review of existing microfinance institutions in Jamaica, recommend an operational/legal definition of a microfinance institution in Jamaica for purposes of a proposed regulatory framework. This may include size and scope of services, source of funding, size of institution's financial resource base, or others that the consultant may determine. Within the scope of recommending an operational/legal definition of a microfinance institution, also recommend a definition of a microenterprise and the microenterprise sector in Jamaica.

2.1 Background

In 2010 Jamaica's population was estimated at 2.8 million people, 61% of whom were between the ages of 15 and 64.[1] The Jamaican economy is heavily dependent on services, which now account for more than 60% of GDP. Jamaica obtains most of its foreign exchange from tourism, remittances, and exports of bauxite/alumina. The economy faces serious challenges: a substantial merchandise trade deficit, high unemployment and underemployment, and a debt-to-GDP ratio of more than 130% that is the result of government bailouts to ailing sectors of the economy, most notably to the financial sector in the late 1990s. At the beginning of 2010, the Government of Jamaica signed a $1.27 billion Standby Agreement with the International Monetary Fund (IMF) for balance of payment support and currently has a difficult fiscal position that hinders spending on infrastructure and social programs, particularly needed as job losses rise in a shrinking economy.

On the issue of the financial sector, the IMF indicated that Jamaica has strengthened its financial system oversight following the crisis in 1996–97. Nowadays, the commercial financial system is deep and well-developed; the regulatory framework follows in line with best international practices, and supervision appears to be implemented in a systematic and professional manner. Lending has increased substantially and there are

[1] CIA World Factbook – Country Profile Jamaica; https://www.cia.gov/library/publications/the-world-factbook/geos/jm.html

more lenders competing for clients. However, the IMF stated, because of data limitations, it was not possible to formulate a full system-wide quantitative analysis of risks facing the financial industry in Jamaica (IMF, 2006). This lack of information, particularly in the microfinance sector, is still a serious problem to conduct thorough financial research, and it created a serious challenge to develop this report. Consequently it was necessary to rely on other studies carried out some 4 to 6 years ago to establish some parameters about the microfinance sector.

Wenner and Chalmers (2006), a financial specialist and a consultant, respectively, in the Microenterprise Unit of the Inter-American Development Bank (IADB), stated that there are no legal constraints on commercial banks, credit unions, and Non Governmental Organizations (NGOs) that provide microfinance loans in Jamaica. Currently Jamaica's central bank, -Bank of Jamaica (BOJ) - serves as a regulator of all banks and building societies other than credit unions. The banking industry is composed of commercial banks, merchant or "near banks," building societies and credit unions. The Banking Act of 1992, the Financial Institutions Act of 1992, and the Building Societies Act of 1995 regulate the banking sector, exclusive of credit unions. As dictated by the Cooperative Societies Act, no one member may hold more than 20% of a credit union's shares. Credit Unions are regulated by the Department of Cooperatives and Friendly Society under the Cooperative Societies Act and the Jamaica Co-operative Credit Union League Limited (JCCUL); however, the Bank of Jamaica has begun provisional regulation of credit unions.

Regarding the microfinance industry, despite the improvements in commercial banking and the aid given to the former, the demand for credit in Jamaica's Micro, Small and Medium Enterprise sector (MSME) continues to go unfulfilled. According to a recent survey by the Inter-American Development Bank (IADB) 42% of small enterprises reported a need for credit, while only 7% of them were able to obtain it from MFIs.

Corresponding to a discussion paper prepared by Development Options Ltd. (2006), the Jamaican microfinance market is comprised of several programs, initiatives and institutions that have all been derived from three distinct types of policy and philosophical frameworks, namely: (a) government (b) multilateral and bilateral (donor) and (c) private sector. These programs or institutions are involved either at the wholesale or the retail end of the micro-financing spectrum.

Wholesale lending agencies in Jamaica are the public sector Development Bank of Jamaica and the Micro Investment Development Agency (MIDA), and the private ones: Development Options Limited (DO Ltd) and Pan Caribbean Financial Services Limited (PCFSL). The main microfinance institutions (MFI) that work as retail lending agencies include the Micro Enterprise Finance Limited (MEFL), Self Start Fund (SSF), Jamaica National Small Business Loan Limited (JNSBL), First Union Financial Company Limited (FUFC), COPE Foundation, and Access Financial Services (AFS).

A major concern is the lack of open and widely distributed data about the Jamaican microfinance sector. In that sense, there is no public information available about total number of clients, or products and services provided. To overcome this obstacle, the consultant prepared a questionnaire (Annex 6) to obtain data from the MFIs regarding their portfolio, productivity ratios and information sharing. From the initial answers to the questionnaire, we can state that the average loan balance per borrower in Jamaica stands at around US $2,000, which puts Jamaica in a category close to that of MFIs from Eastern Europe & Central Asia. (See table 2.1)

Table 2.1.

Some indicators from MFIs around the world

Year 2008			
Region	**Personnel**	**Number of Active Borrowers**	**Average Loan Balance per borrower ($US)**
Sub - Saharan Africa	**51**	**9,302**	**329**
South & East Asia	**79**	**7,364**	**237**
(Eastern Europe & Central Asia)	**14**	**980**	**3054**
(Latin America & the Caribbean)	**40**	**4,938**	**639**
Middle East & North Africa	**43**	**4,271**	**372**

Source: MIX

Investigating the development of the microfinance industry in several countries, including Jamaica, The Economist Intelligence Unit (2010), issues a yearly report which includes assessments of the microfinance environment in 55 countries across Asia, Africa, Eastern Europe and the Middle East. This study—and the index that sits behind it—ranks those selected countries based on evaluations of each nation's regulatory, investment and institutional environment for microfinance. Jamaica scores poorly in the overall index that measures the microfinance environment in those 55 countries, being in 52nd place, just two spaces from the bottom of the list.

The thirteen criteria for the scoring index, and the categories into which they are subdivided, are as follows:

Table 2.2.

The Economist Intelligence Unit
Scoring Criteria for Microfinance Climate

	Regulatory Framework (weight: 40%)		**Investment Climate (weight: 20%)**
1	Regulation of microcredit operations	**8**	Political stability
2	Formation and operations of regulated/supervised specialized MFIs	**9**	Capital market stability
3	Formation and operation of non-	**10**	Judicial system

	regulated MFIs		
4	Regulatory and examination capacity	**11**	Accounting standards
	Institutional Development (weight: 40%)	**12**	Governance standards
5	Range of MFI services	**13**	MFI transparency
6	Credit bureaus		
7	Level of competition		

Source: The Economist Intelligence Unit: "Global Microscope on the Microfinance Business Environment" 2010.

The reasons why Jamaica's scores so low are three: a) the country has no regulatory framework for the microfinance industry; b) its institutional development is fairly poor, the main obstacle being the lack of a Credit Bureau; and c) the lack of information about the industry.

Another aspect that seems important for explaining the low development of microfinance in Jamaica appears to be the relatively small size of the overall market of people that could be involved in micro enterprise activities. Indeed, using international economic and social ratios, it seems that there is a correlation between the amount of people that are living below the absolute poverty line (less than US $2 daily) and the developing of the microfinance industry.

According to Table 2.3, neither the Gross National Income per capita (GNI p/c), life expectancy, urban development, literacy or unemployment ratios give a solid explanation about why microfinance did not develop further in Jamaica; however, if we consider merely the absolute poverty index, the country has approximately 115,000 very poor people. If one considers only the adult (potential borrowing) population that is very poor, there are around just 60,000 people who would shape the critical mass that would comprise the lowest end of the microfinance market. In other countries, this figure is between 700,000 (Dominican Republic) to 7,000,000 (Colombia) an amount 10 to 100 times bigger than Jamaica's one.

Table 2.3
Jamaica main Indicators compared with other countries. (2008)

Country	Jamaica	Dom. Republi	Colombia	Bolivia	Peru	Romania
GDP ($US billion)	$14,6 (2008)	$45,5 (2008)	$243.7 (2008)	$16,6 (2008)	$129,1 (2008)	$200,7 (2008)
Population	2,687,200 (2008)	9,952,711 (2008)	45,012,096 (2008)	9,694,711 (2008)	28,836,700 (2008)	21,513,622 (2008)
Income Level	Upper middle income	Upper middle income	Upper middle income	Lower middle income	Upper middle income	Upper middle income
GNI p/c (Atlas method) $US	$4,800	$4,330	$4,620	$1,460	$3,990	$8,280
Life expentancy (years)	72	73	73	66	73	73
Literacy rate	86%	88%	93%	91%	90%	73%
Poverty Line ratio	19%	48.50%	45,1%	37%	51,6%	28.90%
% of people living with less than $US 2	5.80%	15.10%	27.90%	30.30%	18,5%	3.4%
Amount of population living with less than $US 2	115,846	1,502,859	12,558,374	2,937,497	14,879,737	731,442
Urban development	82%	81%	85%	54%	85%	88%
External debt (as % of GNI) 2008	130.70%	23.80%	20.20%	34.30%	23.90%	54.30%
Unemployment	10.60%	15.60%	11.70%	5.40%	7.0%	5.80%

Source: World Bank, 2008

This small number could also explain why Jamaican MFIs don't widely practice the most common microfinance technique that is community banking or group lending, which draws on the strength of relationships built with other members of their communities for those who would seek a loan. Loan seekers approach the microfinance institution not as individuals but rather as a group that has come together to form a community bank. This approach is still commonly used in Colombia, Dominican Republic, Bolivia, and Peru, which have a very large number of extremely poor people; but in Jamaica and Romania, the two countries in table 2.3 with the lower poverty index, they have a smaller critical mass for making "classic" microfinance prosper. [2]

2.2 Definition of Micro-entrepreneurs

According to The Consultative Group for Advancing the Poor (CGAP) the Micro, Small, and Medium Enterprise (MSME) operators are people who operate small businesses,

[2] The Group lending model requires groups to be formed, usually with an average 20 people, preferably who know each other and who try to make a living in a broad base of activities. Usually, the Group goes through 4 weeks of training where they learn about the lending model, the importance to each other of repaying, are taught very basic accounting and business skills to help them organize themselves and to grow their activities. Loans from $US 50 are given to each client who counter guarantee the other group members. Savings is encouraged so ideally each group member will have saved a portion of the loan before drawdown. The system requires a Relationship Officer to ensure that the Groups are real (ghosts are an industry issue) and that the group has a spread of activities, i.e. not all chicken farmers or carpenters so if one group member's activities are depressed all will likely be. When a group repays they automatically become entitled to a new loan for an increased amount. The loans tend to be between 4 to 6 months. The fast turnaround means people who have no assets can quickly build up trading stock and earn amounts that allow them to feed, clothe their families and educate their children. This is a high cost product to deliver but as the client will trade the funds many times over the life of the loan it is not so difficult to meet the interest and repayment requirements. Hopefully at the end of each cycle the client will own more stock than he started with, but if not, he will still get more money to trade with.

work on small farms, or work for themselves or others in a variety of businesses – fishing, carpentry, vegetable selling, small shops, transportation, and much more. This complex group of people constitutes the microfinance clients and it can be affirmed that they are truly entrepreneurs because they enjoy creating and running their own businesses.

The Planning Institute of Jamaica (PIOJ), Private Sector Organization of Jamaica (PSOJ) and the Ministry of Industry, Commerce and Technology (MICT) provide definitions for MSMEs (See table 2.4). PSOJ regards a micro business as one with an annual turnover of less than US$160,000, MICT indicates less than 3 employees, and MICT and PIOJ both conclude an asset value (excluding land and buildings) below US $10,000. MICT includes an average loan size of US $2,500. MICT defines a small business as one with an annual turnover less than US $100,000, whereas PIOJ defines turnover as less than US $1,000,000 (PIOJ). MICT defines small as less than 10 employees, PIOJ includes an asset value (excluding land and buildings) below US $100,000, and MICT an average loan size of US $10,000. Finally, Medium Size Businesses are regarded as annual turnover below US $1.6 million (PSOJ) and staff below 49 people (MICT).

Table 2.4

Definitions of Micro, Small and Medium Enterprises (MSME)

	MICT	PIOJ	PSOJ
Microenterprise			
# employees	<3		
Total Sales		<US $125,000	<US $160,000
Total Assets	<US $10,000	< US$ 10,000	
Average Loan Size	<US $ 2,500		

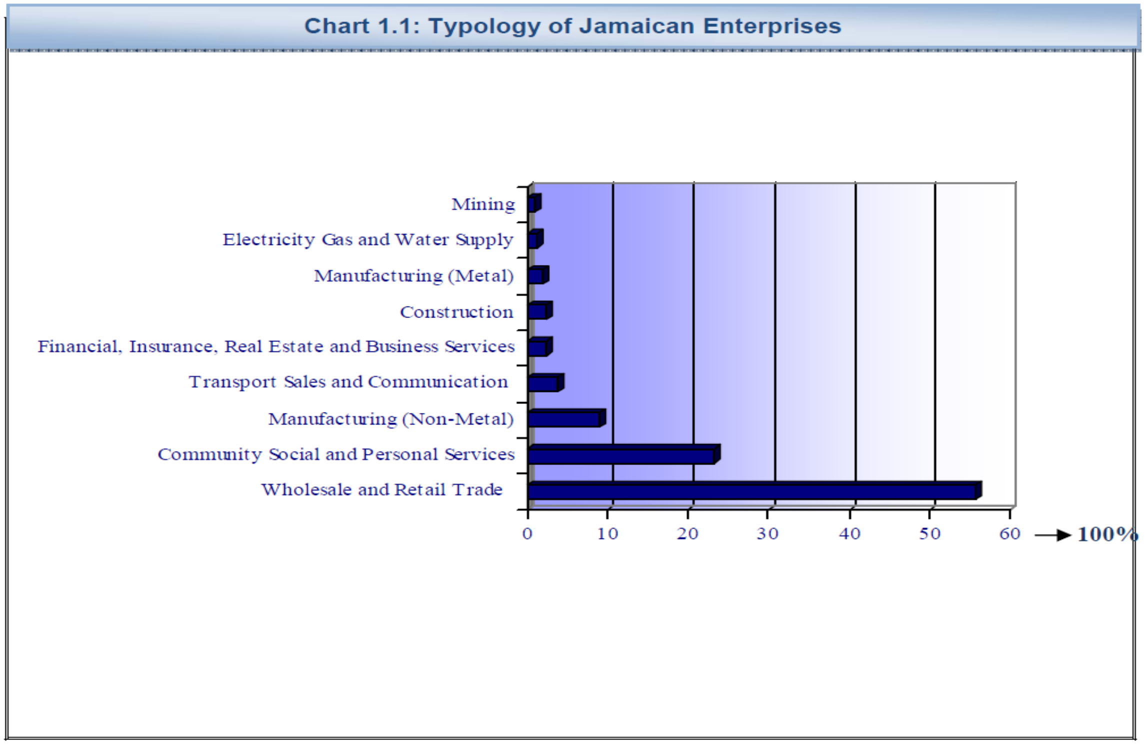
Source: PSDP, David Thennant, 2009

A recent study by the Private Sector Development Programme (PSDP, 2009) indicated that MSMEs are providing close to 80 per cent of the island's new employment opportunities. At the same time, according to the same study, PIOJ indicates that self employed people, who make up the vast majority of MSMEs, employ some 400,000 of the labor force, this being the number that should be considered as the potential market for developing the microfinance industry in this country.

Generally speaking, MSMEs, women, rural borrowers, and other less secure groups typically have limited capital, short entrepreneurial histories, or precarious social situations, conditions which are deemed to present greater risks. The situation is further exacerbated by the fact that lenders often lack the experience and knowledge necessary to understand the needs of small businesses, those based in the agriculture sector in particular. (International Year of Microcredit, 2006)

About the economic activities in the MSME sector, chart 2.1 indicates Wholesale and Retail Trade accounts for more than half of the sampled population, that is, 55.7%. The other main sectors were Community Social and Personal Services, 23.3%; Manufacturing (Non-Metal), 9% and Transport Sales and Communication, 3.9%.

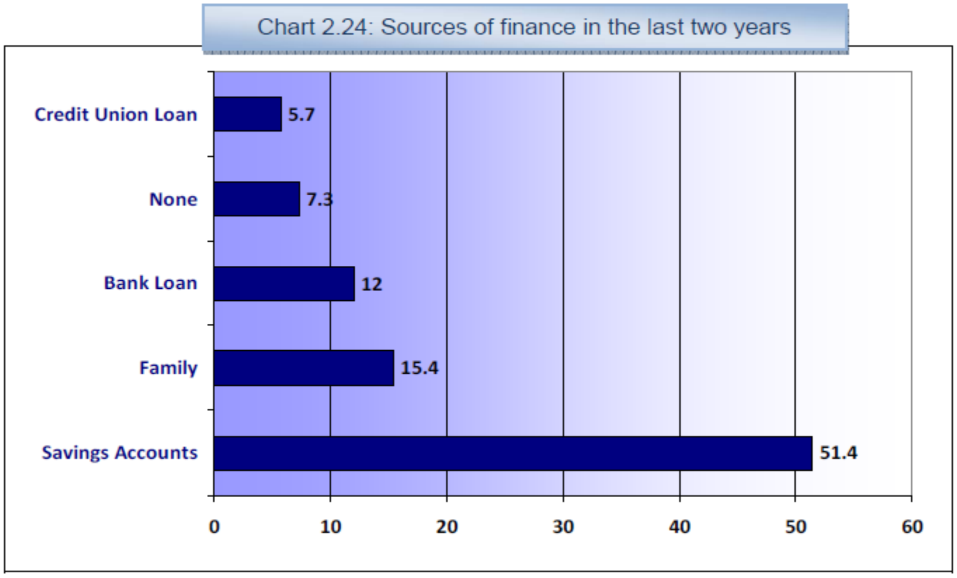
Chart 2.1



Source: Private Sector Development Program, “A landscape assessment of Jamaican micro small and medium-size enterprises (MSMEs)” Jamaica, 2008

Of those asked about the funds source for financing their business, 66.8 % answered that the funds were coming either from their own savings or from a relative. This ratio also supports the notion that these are potential customers for the Jamaican MFIs to serve if they overcome the challenges they have. (Chart 2.2)

Chart 2.2



Source: Private Sector Development Program, "A landscape assessment of Jamaican micro small and medium-size enterprises (MSMEs)" Jamaica, 2008

2.3 A Microfinance Institution Definition

Success in reaching poorer people with microfinance is determined by the mission of a microfinance institution and its ability to translate that mission into effective products and services. With the industry's renewed focus on social performance, there is not one definition of what a microfinance institution (MFI) is, and it depends on the means to translate that particular mission into action, having as its main goal to serve poor people with an appropriate and varied array of products.

Applying this concept to the Jamaican microfinance industry, it is safe to say that more than defining a concept to frame the MFIs, it is better to define a framework about what microfinance is, who the stakeholders are, what their values are and how they deliver their services to the poor. This framework can actually serve, in fact, as a code of ethics and each MFI should freely participate in it.

There are many Code of Ethics developed and applied in the industry, all of them having roughly the same topics. Following, we quote the main facets of the Code of Ethics of The Microfinance Council of Philippines. This Code could easily be applied in the Jamaican microfinance industry.

Microfinance Council of Philippines

Code of Ethics

A. For our members, clients or partners, we shall strive to:

1. Provide the poor with permanent and sustainable access to appropriate social and financial services;
2. Charge market rates of interest on loans and savings, avoiding interest rate subsidies or excessive interest rates;
3. Provide access to all forms of information requested by members and clients regarding past, current, and future transactions;
4. Adequately inform members and clients about policies, procedures and transaction costs in order to enable them to make informed choices and decisions;

B. For our co-microfinance institutions, we shall endeavor to:

1. Enhance mutual development recognizing that MFIs are partners, not competitors, in poverty reduction and as such, have a stake in each other's growth and development;
2. Maintain a high standard of professionalism based on honesty, equality, reciprocity and dedication to be able to serve the poor;
3. Foster constant dialogue and sharing of resources, expertise, information and experiences;
4. Refrain from recruiting existing members and clients to avoid credit pollution;
5. Ensure that relations with other MFIs are based on mutual respect and close collaboration, acknowledging the accomplishments of other MFIs as achievements of the entire microfinance sector.

C. For our staff, we undertake to:

1. Provide ample avenues for personal growth and development;
2. Provide just compensation and promote the rights and welfare of all personnel;
3. Ensure the accountability of the leaders and managers to their staff members;
4. Encourage a simple lifestyle consistent with pro-poor orientation and the principles of total human development.

D. In our relation with funding agencies and loan fund providers, we will:

1. Nurture an atmosphere of openness and mutual respect towards a common vision and goal;
2. Request funding agencies and loan fund providers to clarify and share their development framework, areas of priority, procedures and other relevant information;
3. Ensure that the relations and transactions are above board. Deception and misrepresentation will be avoided at all times, such as overstating client outreach and loan portfolios, double funding, diversion of grants and loans to unrelated activities;
4. Strive to diversify funding sources in order to avoid perpetual dependence on one or two institutions.

E. In our relation with the Government, we shall seek to:

1. Create an atmosphere of openness and mutual respect based on the perspective that the Government and MFIs share the common objective of reducing and minimizing the extreme poverty amongst our people;
2. Foster a continuing dialogue for policy reform conducive to the development of microfinance institutions;
3. Coordinate closely with different branches of government to further promote poor people access to sustainable financial services;
4. Support government initiatives to unify all sectors so as to make financial systems work for the poor.

This type of code of conduct usually touches on all the activities of the stakeholders involved in microfinance and it is intended to be a reference guide for MFIs in support of day-to-day decision making. It is meant to clarify the MFIs' mission, values and principles, linking them with standards of professional conduct. A code being applied by Jamaican MFIs would be an open disclosure of the way they operate and it will provide visible guidelines for their behavior. A well-written and thoughtful code also serves as an important communication vehicle that deals with such matters as its commitment to employees, its standards for conducting the business of microfinance, and its relationship with the poor that the MFIs serve.

Finally, we suggest a code of ethics developed by the Jamaican MFI community as a means of creating a positive public identity for themselves which can lead to a more supportive political and regulatory microfinance environment, and to an increased level of public confidence and trust among important constituencies and stakeholders in Jamaica.

Section III: Jamaica's Microfinance Regulatory Challenge

Review Jamaica's existing regulatory framework for commercial banks, non-bank financial institutions, cooperative banks and other relevant frameworks of institutions that provide the kinds of services that microfinance lenders may want to provide. Determine the level and scope of a regulatory framework that would be appropriate for microfinance institutions to provide similar services to their clients. Suggest an appropriate regulatory body to provide oversight. A key factor is to determine an appropriate level of regulation that provides options for microfinance lenders to provide additional services, but which is not overly burdensome for them to comply with whatever type of regulation is developed.

3.1 Background

There is no question about the importance of regulation and supervision for a healthy microfinance sector which supports the delivery of financial services to the poor in a sustainable manner; but the question is whether both, the financial authorities of Jamaica and the MFIs, are prepared to implement the desired level of regulation the market needs.

It is important to find cost-effective ways of improving the standards of the many MFIs that have been operating in Jamaica while at the same time avoiding restrictions that would impair their efficiency or effectiveness. The ruling can be both prudential and non-prudential regulation and supervision. While prudential regulation directly sanctions and assumes the responsibility for the soundness of the system, non-prudential regulation only offers guidelines and standards.

From an interview with officers of the Bank of Jamaica (BOJ), it is safe to say that there are no plans in the near future by the BOJ to issue regulations for the microfinance sector. The BOJ's major concern is its current level of regulatory responsibility for other institutions, and the cost that such supervision of the MFI sector would require. Therefore, the remaining option at this time for the MFIs is to set up a self regulatory system, a regulatory system applied by an APEX[3] organization such as the Development Bank of Jamaica (DBJ), or a combination of both.

The regulation and supervision of non regulated MFIs must include systems and procedures to protect investors, to promote sound business practices, and to address risk issues. Since around the world there is a wide array of institutional arrangements governing the operation of microfinance markets, there is considerable diversity in the regulatory framework applicable to non deposit taking MFIs. Many economies have several authorities responsible for the regulation and supervision of regulated MFIs; however, non deposit taking MFIs usually have no regulation at all, as is the case of Jamaica, and they have to look at a self-regulating framework for achieving goals such as transparency, fairness and efficiency in providing its services to the poor.

The challenge, therefore, is to determine and introduce an optimal degree of self regulation for the MFIs in Jamaica. Five objectives are identified for the Jamaican microfinance industry:

1. Creating a network of MFIs
2. Building a database with standardized information and creating a framework of supportive regulations and policy;
3. Supervision and monitoring of the performance standards and dissemination of the information;
4. Access to a Credit Bureau; and
5. Rating or qualification of the MFIs belonging to the network.

3.2 Creating a Network of MFIs

In Jamaica, for many years microfinance has worked without much benefit and potential for the economic and social development of the country. Around the world, the entry of many new players has caused microfinance to become a competitive market and will become more so in the future. Jamaica has been absent of this tendency where microfinance has become a formal industry with great potential in the financial markets.

To support this change in Jamaica, it will require that MFI managers and directors adapt their views to use networking as an important instrument to develop the industry, and to have well-trained staff with the ability to survive in a competitive market, without losing

[3] An APEX is a wholesale mechanism that channels funds, with or without supporting technical services - to retail microfinance institutions in a single country or integrated market. In Jamaica DBJ is an Apex institution.

the social development approach that marks the sector.

Networks can contribute to the continued development and success of the sector through setting standards for operating, disclosure of information, training and some kind of formalization of its member institutions.

As the Red Financiera Rural (2006) states: "National microfinance networks are a key strategic objective for developing the industry". In particular, microfinance networking efficiently supports the development of activities such as:

1) Representation of the sector;
2) Setting up a common set of self regulatory measures;
3) Dissemination and standardization of information;
4) Development and monitoring of benchmark indicators in the microfinance industry;
5) Advocacy regarding the regulatory framework and public policies;
6) Training;
7) Use of credit reference bureaus;
8) Second tier funds for microfinance institution financiers;
9) New product development;
10) Establishing and facilitating twinning partnerships with regulated financial institutions (FIs);
11) Organizing national capacity building activities via workshops and targeted training events;
12) Developing and maintaining websites that will serve as an information clearinghouse, or "knowledge hub" on the network activities and outcomes.

To start a process of regulation, the first step is to create an MFI network, which is a partnership of several MFIs with a common interest. In this case we are talking about institutions working in the microfinance sector grouped to form a national network, to follow some common rules and to share some information, activities, and experiences, among others.

Networks can promote transparency, standardization and professionalism of the sector and its institutions. Microfinance Information eXchange (MIX) is a network formed in 2002 to collect information on the sector. Currently, more than 1,800 MFIs and investors are reporting to it on a voluntary basis. What they present as a benchmark (or benchmarks) plays only a small percentage of all the information sent to MIX and to the organizations active in the sector. Networks can promote this kind of exchange of information and data, which, ultimately, helps to standardize and professionalize the sector.

The consultant prepared a draft model of a Memorandum of Understanding (MOU) that could be of assistance to the MFIs that want to participate in a Jamaican network. This MOU recognizes the mutual interest of the Jamaican financial institutions working in the microfinance industry to champion the cause of developing the Jamaican microfinance market according to the best practices around the world. The partnership of MFIs represent an inter-agency approach to addressing the issue, by means of establishing a network which is comprised of regulated and non regulated financial institutions committed to advocating and promoting the cause of microfinance in Jamaica. The MOU model is presented in Annex 7.

3.3 Building a Database with Standardized Information and Creating a Framework of Supportive Regulations and Policy

There are some preconditions to establishing a regulatory framework. The first and most important one is the MFIs' willingness to share standardized data.

About information sharing, it is important to note that even though Jamaican MFIs know very well the advantages of sharing information, there still does not appear to be the willingness to do so. This assessment is sustained by the preliminary results found in the answers (and lack of response) to the questionnaire that the consultant used to appraise the sector. (The questionnaire is contained in Annex 6.)

The research about information sharing in credit markets (Jappelli and Pagano, 1993) finds that information sharing is more likely to occur when the mobility of households is high, the pool of borrowers is heterogeneous, the credit market is large and the cost of information exchange is low. Benefits of information sharing include an improved pool of borrowers, reduced default rates, lower interest rates and lower cost of transactions. It is very common to find that fear of competition can make lenders hesitant to share their client information, which is exactly the case among MFIs in Jamaica.

On the other hand, data standardization is the process of making all data of the same type or class conform to an established convention or procedure to ensure consistency and comparability across different databases. This is especially important and necessary in a database environment that contains information from many sources. Without data standardization, no relationship can be established between the various data sources to produce reports that include information from multiple data sets within the database.

The following list shows some information that could be introduced in a database used by the MFIs. Some of this information does not have to be shared among the providers, but it could be useful to set up a benchmarking for the industry.

1) Name of reporting institution
2) Loan amount
3) Name of borrower with a proper ID
4) Rating of loan
5) Business activity
6) Type of collateral
7) Value of collateral
8) Name of holder(s) of collateral
9) Maturity of the loan
10) Address
11) Interest rate
12) Income Statement
13) Name of the borrower
14) Borrower Demographic Data
15) Date of loan
16) Grace period
17) Type of loan (by sector)
18) Purpose of loan

As its name implies, a database is constructed in standardized blocks of data. Each data element must have a defined value, a set of characteristics, and a relationship to other data elements. Database structure defines how the separate data elements relate to each other and how users access the elements so they can be combined to provide needed information about a particular subject. It is quite clear that data elements named above and their definitions/values have to be documented in a standard way so that providers understand what data is used by the application and how it should be processed and used across the MFI industry. For data standardization it is necessary that the MFIs have a common understanding about the kind of information they are sending. Therefore, one of the initial tasks of an MFI network is to prepare - if it is possible to agree with a credit bureau provider- the guidelines to standardize the information that MFIs will submit to the data base.

Considering all of this information and from the preliminary survey information, it is very significant that among the MFIs there is not agreement on which kind of information should be shared. This leads to the conclusion that an important precursor and first step is to determine whether the MFIs are now ready to share information, and secondly for them to agree on the common set of data to be shared.

The indicators and standards can be used in various ways. Management can use these ratios and standards in identifying weak areas in their microfinance operations and in determining the appropriate measures to improve operations. Domestic and international private investors can use these standards as guideposts in deciding whether they will invest in an MFI or not. Wholesale financial institutions, whether public or private, can use these standards in assessing the creditworthiness of MFIs. Donor agencies, on the other hand, can use the ratios for identifying the type of assistance to a specific MFI.

Once there is an agreement about information sharing and the kind of information to be shared, it is possible to set up a set of rules for regulating the market. Currently, Jamaican MFIs face the absence of a single regulatory framework, and no single entity is responsible to regulate, coordinate, manage and supervise the operation of non-deposit taking MFIs in the Jamaican microfinance market. This has resulted in a lack of transparency and mistrust within the microfinance industry.

This situation leads the MFIs to face serious problems trying to access funds, given that the BOJ will not in the near future license MFIs for taking deposits directly from the public, other than through a normal commercial bank license. Additionally, government programs designed to provide resources charge interest rates that do not necessary provide for recovering the costs of loan delivery and servicing. Besides, once the clients know that the funds were provided by a public sector bank, the loans tend to have higher delinquency rates. Another issue is that some MFI operators self-apply rules that damage the already low transparency of the market[4]. There is a lack of transparency in the market and this problem is exacerbated by the fact that many of the MFIs act as islands. There is duplication of effort, lack of coordination[5] and unfair competition.

As a result, there is a common understanding of the need to order, coordinate and supervise the activities of microfinance in Jamaica through a comprehensive regulatory

[4] Usually charging high fees without the knowledge of the clients.

[5] A good example is that DBJ is buying operational software for MFIs, and there are two MFIs that are developing their own software. This will lead to the necessity of developing software interfaces.

framework. It should involve as many of the players as possible. It should be designed to consolidate, coordinate, oversee and expand financial intermediation services provided by the microfinance industry, with the aim of providing these services in an optimal way, and facilitating investors to the industry in Jamaica.

There are a number of objectives that regulation for Jamaican MFIs should include. Among them are: a) raise awareness among the non-regulated MFIs that the success of their activities and their competitive positioning depends in good measure on how their efficiency, efficacy and ethics are judged; b) maintain and foster a healthy and balanced development of the microfinance sector, attaining stability and solvency by applying some norms of financial prudence; and c) promote mechanisms for analysis, linkages and negotiations with the monitoring organizations and government agencies in order to obtain additional funds for services.

There are 3 potential approaches for setting up a regulatory system in Jamaica: self regulation by the MFIs; an APEX regulation; or, a combination of the two. The objective of self-regulation is for the MFIs belonging to the network to self impose the rules among themselves to increase the credibility of this non-regulated financial sector. For the MFIs that participate and are interested in seeking a fair and transparent financial market, this self-regulation will minimize risk, and also generate a scenario that fosters an enhancement of the internal capacity of the institutions (efficiency, efficacy and effectiveness), facilitating access to resources, implementing strategic actions, and diversifying financial services.

An Apex regulation system could be established based on the requirements that the Development Bank of Jamaica (DBJ) has already established for any institution that wants to access funds from DBJ to on-lend. In this system, the enforcer is the APEX institution.

Finally, a third possibility is a combination where in a common agreement, the MFIs and DBJ jointly set up the rules for regulating the MFIs which are receiving funds from DBJ. The enforcer of the rules would be DBJ, with the advantage that any MFI that does not follow the rules will not receive funds from DBJ.

The preliminary results of the questionnaire sent to the MFIs indicates that some combination of self regulation and some requirements of DBJ is probably the best approach to begin with in regard to a regulatory system for non deposit taking financial institutions in Jamaica, and there is some common ground to start with this.

3.4 Supervision and Monitoring of the Performance Standards and Dissemination of the Information

As it is accepted that prudential regulation and supervision for commercial banks are not appropriate for most categories of MFIs, it is necessary to consider other means of supervision and monitoring standards for the Jamaican microfinance sector. While it is very unlikely that all MFIs would adhere to such standards, the standards offer the potential to improve the operations of the larger and more businesslike MFIs, and thereby increase the sustainability of the microfinance sector as a whole.

There is a core set of performance standards for microfinance operations, some of which apply to all types of financial institutions, and these standards are defined and consistent with international best practices about data standardization. These standards should likewise also be endorsed and adopted by a rating agency, concerned MFIs and regulatory authorities. The MIX database shows the information that is internationally shared among MFIs and it compiles information about portfolio quality, efficiency, stability, and outreach indicators. The specific list of indicators requested by MIX is:

Minimum set of Parameters for Assessing the Performance of Microfinance Institutions

1. **P**ortfolio Quality
    1.1. Portfolio at risk
    1.2. Past due ratio
    1.3. Provision for loan losses
2. **E**fficiency Indicators
    2.1. Administrative efficiency
    2.2. Operational self-sufficiency
    2.3. Financial self-sufficiency
3. **S**tability Indicators
    3.1. Liquidity
    3.2. Net institutional capital
4. **O**utreach Indicators for microfinance
    4.1. Growth of number of clients
    4.2. Growth of microfinance loan portfolio
    4.3. Growth of savings[6]

Once there are the indicators, it is necessary to provide the appropriate supervisory and regulatory framework for MFIs that will enable them to develop new and innovative product lines and services to cater to the demands of poor households and microenterprises.

Supervision and monitoring, in the Jamaican context, refer to the systematic oversight of the MFIs that are associated to a network to ensure their compliance with the self imposed established rules and regulations.

Given that the existing regulatory institutions lack the capability to effectively undertake the necessary supervision and monitoring for microfinance, it is necessary to establish an alternative structure.

In countries where there are significant second tier microfinance institutions that lend to retail MFIs, one possible approach for ensuring that MFIs operate on a sound basis is through the lending policies of those second tier institutions. This model could be applied in Jamaica through DBJ, which can in practice require MFIs that borrow from it to meet certain performance and reporting standards. If we consider that the goal of DBJ is to become the major second tier lender in Jamaica, there is a strong incentive for retail

[6] This measure may not apply to MFIs in Jamaica at this time, as Jamaica's MFIs do not directly take deposits.

MFIs to meet DBJ's standards, and it is likely that such standards will have broader influence throughout the entire microfinance sector.

Another approach to establishing performance and reporting standards for Jamaican MFIs is through self-regulation. Self-regulation may take a wide variety of forms, ranging from a voluntary code of conduct to which MFIs agree to adhere, to a rigorous licensing system administered by an APEX body selected by the MFIs themselves. In between, there is a range of possibilities with varying degrees of monitoring and compliance. The feasibility in Jamaica of any particular mode of self-regulation depends on a number of factors, including whether there is an apex body, other than DBJ, which can represent MFIs as a whole, the quantum of resources available for monitoring and supervision, and the availability of incentives and/or sanctions to enforce compliance.

Yet another approach may be to establish an independent credit rating agency, which would rate MFIs according to pre-established performance standards. Ideally, ratings would be made public and used by all funding agencies, including second tier institutions, donor agencies, and commercial lenders. This would provide a powerful incentive for MFI compliance. This issue will be addressed below.

For instance, it seems that the most rational and feasible approach for the Jamaica microfinance sector is to name DBJ as the supervision and monitoring body given that DBJ already requires some conditions as an APEX institution for on-lending funds to the credit retailers, and the financial intermediaries accept these.

In terms of MFI data dissemination, currently in the microfinance markets stakeholders have expressed interest in knowing the following in the microfinance sector:

- Investors/Donors to identify MFI investment opportunities and assess risk;
- Networks for promoting services to MFIs, investors and regulatory agencies;
- Rating Agencies for accessing data for comparative risk assessment;
- Regulatory Agencies for creating benchmarks and streamline monitoring processes;
- MFI clients to have more transparent MFIs and more information to increase their access to financial services;
- Government: as a mean of helping the poor and providing new employment opportunities.

All these stakeholders need data for decision making in the microfinance market. Generally speaking, it is necessary to establish a body to gather and disseminate this data. In Jamaica, the answer can be provided by a Credit Bureau (CB) acting as the repository and dissemination body of all information regarding microfinance clients and MFIs.

CB's are utilized to disseminate data not only for expanding the quality of the MFIs' performance but also to fortify regulation and supervision. In addition, the data gathered and disseminated by the CB can be used to establish some type of benchmarking by providing standardized reports using available statistics and information from its database. As an additional service to the MFIs, the CB could disseminate data according to what the stakeholders are interested to know. Data can be arranged by any subset of information, and these information subsets will be useful to analyze how the microfinance market is being affected by different policies and movements of the domestic and international economy.

Another possibility is that data dissemination could be delivered using the DBJ's Management Information System (MIS). The data that MFIs already send to DBJ may be disseminated through a web site. In any case, however, there have to be funds available for both setting up the dissemination system and operating it on a 24/7 basis.

3.5 Establishing a Credit Bureau

If there is one matter where all Jamaican MFIs agreed, it is the need to establish a Credit Bureau (CB). The reasons are well established, the primary one being the increasing competition between micro-lenders to capture customers. This means that the MFIs have to start keeping track of each borrower's exposure. The overlap between MFIs is an important and increasing problem in Jamaica. Since there is a general attempt by all of the MFIs to grow their portfolios, there is a negative impact in terms of client over-indebtedness, and no institutional means to measure a client's outstanding commitments.

There are several ways a CB may enhance credit access. First, the use of a CB may, for a constant level of risk, allow a financial institution to expand its loan portfolio. The marginal increase in the loan portfolio will particularly benefit those micro-entrepreneurs that have a sound repayment history but lack other obvious indicators of creditworthiness such as wealth, or lack guarantees. The use of CB data may then enable MFIs to predict credit risk more accurately and more efficiently.

Credit registry data facilitates the evaluation of prospective borrowers, reducing the need for more costly and intrusive background and reference checks. If an adequate supply of data is available for statistical analysis, then automated or semi-automated credit decision tools can be developed, reducing the cost and time required for processing loan applications. Under competitive market conditions this should increase the supply of credit and reduce its cost.

Finally, there are other ways in which a CB can affect access to credit. A list of negative information often referred to as a "blacklist", can encourage borrowers to repay obligations in order to stay off the list. The existence and use of such a database then enhances "willingness to pay". However, negative-only databases have several shortcomings compared to those with complete (both positive and negative) information. Negative information alone has less predictive power than positive and negative information combined. Decision tools, such as credit scoring, are difficult to develop without positive data. Databases with negative only information then tend to focus only on reducing "unwillingness to pay" and not on enhancing predictions on repayment probabilities.

More generally, a database of positive and negative information would assist MFI borrowers to develop a "reputation collateral" or proof of a good payment history. The value that the debtor attaches to his or her good credit history or "reputation collateral" is likely to be greater than the value associated with being off the "blacklist", especially since most negative information databases enable borrowers to settle claims to remove themselves from the list. The greater the value "reputation collateral" is to borrowers, the harder borrowers will work to maintain good standing. Thus, if it is known that the database is used extensively for credit decisions, then willingness to pay risks will be reduced further. Again, this is particularly important for borrowers who lack physical collateral, such as low-income individuals or small firms.

The process of a CB's "MFIs only" implementation in Jamaica will require many joint efforts from the MFIs. We suggest dividing the process in phases to implement it.

Phase I of the process will be dedicated to set up the network of MFIs which participate in the contract with the CB and to prepare the process to hire one credit bureau. Phase II will include gathering standardized information and establishing the MIS for running the system. [7]

3.6 Rating or Qualification of the MFIs Belonging to the Network

Rating of MFIs provides the investors and creditors a transparent, credible, independent and objective assessment of the institutions' capacity to meet their short term and long-term obligations, future outlook, and enables investors to make informed decisions about investment. The rating of the MFIs by credible rating agencies would provide a much higher level of confidence to investors and donors comfortable in their dealings with particular MFIs. Considering its critical importance for the overall health of the microfinance system and to safeguard the interest of prospective stakeholders, a rating system needs to be seriously considered for all Jamaican MFIs.

Ratings are expected to provide a clear and concise summary of the institutions' risk profile that can be understood by investors who have limited knowledge about the MFIs' business operations. This rating system should help microcredit retailers to attract funding on better terms. A specialized rating system examines portfolio structure, and quality and operational risk and efficiency; benchmarks against other MFIs; assesses areas of MFI performance and risk, such as, microfinance operations, portfolio quality, management and organization; assesses governance and strategic positioning; and measures financial performance, governance and decision making.

This consultant suggests promoting a private sector risk rating agency to provide risk ratings for Jamaican MFIs as the last step of the overhaul of the microfinance industry in Jamaica. It is quite clear that a rating agency cannot work in the microfinance sector if there is not a minimum base of regulation and data. These agencies, such as Microrate, are specialized in microfinance and are already working in Central America.

The Inter-American Development Bank's Multilateral Investment Fund (MIF) and Corporación Andina de Fomento (CAF) are supporting a project to assist small-scale microfinance institutions in Latin America and the Caribbean to obtain credit risk ratings and performance assessments. A report on an earlier project financed by the MIF, which helped more than 146 microfinance institutions in 17 countries get credit risk ratings or performance assessments, found that newly rated MFIs saw increases in the volume of funding available to them, as well as better financial terms for borrowing. The MIF, an autonomous fund administered by the IADB, approved a $986,161 grant for the project,

[7] A detailed explanation of the process of hiring and putting to work a CB was presented in the Working Group session and it is offered in Annex 3, the Power Point presentation "Section II", of this report.

while CAF will contribute $200,000. Participating microfinance institutions will provide around $400,000.

Even though the Jamaican microfinance market needs many preliminary steps to arrive at this phase, this consultant considers it necessary to outline this last requirement in order to establish a sound microfinance industry in Jamaica.

Section IV: Review of the Present Range of Services and Additional Services Jamaican MFIs Wish to Offer

Review the present range of services that microfinance lenders are providing, their constraints and opportunities regarding cost recovery and profitability, and additional services they wish to offer. The consultant shall suggest other services that may improve the profitability of microfinance institutions.

4.1 Background

The following presents conclusions using data gathered from the questionnaire developed for this assignment[8]:

a) The range of services provided now by MFIs to the Jamaican micro-entrepreneurs is very narrow, comprising only credit products.
b) There are a few services, such as micro-insurance, basket of products, mobile banking, consumer loans, etc., that currently could be provided, however, the lack of funds and information are obstacles; in the case of mobile banking, a regulatory framework must be established;
c) Jamaican MFIs have realized that the minimum loan amounts that a start up micro-entrepreneur requests is higher than loans to a fellow micro-entrepreneur in a Latin American country; so few comparisons can be made with Latin American peers due to overall differences in the markets;
d) MFIs realize that if there is not a CB working in Jamaica, it is very risky to increase their portfolios with new products offered to the same clients;
e) They understand that every product line they offer should be sustainable and that cross-subsidy between products is not a best practice;
f) Their current tight financial performance does not allow the MFIs to take risk, and costly procedures limit their ability to introduce new products in the market.

This part of the report will discuss the development of new products around the world, with a view to those that could be offered in Jamaica currently, and with more sophisticated products offered later. The more sophisticated products will require that the basic conditions for developing the microfinance market have been achieved, namely, the establishment of a Credit Bureau, and benchmarking ratios that will allow investors to invest in MFIs so that these funds can be on-lent to micro-entrepreneurs.

[8] As of the date of this report, 4 out of 10 responses were received.

As a precedent, it is very important to underline that microfinance around the world has evolved from offering a single type of credit (the single-product), to offering a broad spectrum of financial services. Additionally, the target market has expanded from sole financing of the micro-entrepreneur's business needs, to financing their home consumer needs. MFIs now recognize that the needs of low-income people are as wide as those of the middle class, but at a lower level of loan amounts. An ideal range of financial services to serve the market of micro-entrepreneurs has a minimum basis which includes savings, credit, insurance and cash transfers. Most households, both middle and low income ones, need combinations or "baskets" of these four different services and Jamaica's MFIs could offer flexible packages so as to suit the different needs of each client.

For example, a basket of financial services can be offered through segmenting the market according to the customer's life cycle. This can include in the case of households with young children, their business credit, loans or savings accounts to finance education; and home improvement credit and savings schemes for micro-insurance combined with the offer of health insurance. At the other extreme, it is clear that a household where both men and women no longer have children to care for and do not want to invest more in their business will be interested in savings instruments which pay good interest, or pay off certain basic amounts that will reduce the cost of health insurance. Considering that MFIs in Jamaica are not allowed to take deposits, these baskets of products should be developed with a partnership between the MFI and a commercial bank.

Currently, MFIs in other countries also offer specialized loan products on the basis that each of their clients have different abilities and time to repay the loan. In this regard, MFIs are leaving aside the criteria of having a standard credit approach for each type of microenterprise and to compel the lender to suit that model. Also, MFIs are offering other types of credit to suit the particular needs of micro-entrepreneurs, such as leasing schemes, loans for purchase of vehicles and equipment whose depreciation follow the business cycle, a combination of savings and credit, savings with micro-health insurance products, savings that offer special facilities for the payment of water and electricity, money transfers, etc.

Specifically, the MFIs now tend to offer baskets of products that combine credit, savings, micro-insurance and facilities to make transfers and sending money through savings. MFIs are increasingly moving away from the strategy of having an isolated supply set of loan products and instead have come to offer product baskets. MFIs in Jamaica, if they want to develop the microfinance market, must adopt this strategy as soon as possible. This will obviously require new technologies (software and hardware) and a well trained and motivated sales force.

A highly innovative and useful scheme to gain market share once Jamaican MFIs overcome the problems they have, is to establish strategic alliances with regulated financial institutions (FIs) that do not have the microfinance expertise or are not interested in investing in the microfinance market segment. Partnerships would be based on the comparative advantages of each. Unregulated MFIs maintain a local presence advantage that reduces their cost of customer evaluation. On the other hand, FIs can use their position as a regulated entity to offer savings accounts, transfers, product baskets, micro-insurance, etc.

A very interesting example of strategic alliances is India's ICICI Bank, which is the second largest commercial bank in that country. It managed to double its portfolio in the rural sector in a nine-month period (measured in April, 2006). The model is as follows:

a. The unregulated entity acts as agent collector rather than a financial intermediary. Micro-loans are contracted directly between the FI and the customer, so that the risk of the unregulated MFI is separated from the credit risk. MFIs are then paid on the basis that they permanently originate loans and maintain a pre-agreed rate of arrears. The credits, meanwhile, are in the portfolio of ICICI.
b. Another scheme occurred in which ICICI bought some of the portfolio (securitization) from non-regulated MFIs, but the scheme kept the responsibility for recovery in the MFI-based on incentive mechanisms.

This model could be developed in Jamaica; however it is necessary to know if current regulation allows this scheme. Regulators should not have concerns because the risks and responsibility stay in the regulated entity, and it offers the option to generate economies of scale and reduce operating costs, which in turn would facilitate the growing of microfinance portfolios in the country.

4.2 Innovations in Financial Products for Micro-entrepreneurs Around the World

Major global trends regarding innovation of micro-finance products are in the following areas:

a) Decisions to give loans tend to be automated and decentralized. This is already a reality in terms of consumer credit, which is a type of loan that virtually all MFIs around the world have included in their portfolios. If micro-entrepreneurs do not get this type of credit from the MFI they obtain it anyway from other financial intermediaries, in many cases at excessive rates, affecting or corrupting their ability to repay. The automation and decentralization have been greatly facilitated by the technology of "credit scoring" and the existence of Credit Information Bureaus. This trend toward automation challenges the traditional focus on the important role of trust and almost personal relationship that the loan officer has with the customer. In this regard, several MFIs around the world are already experiencing (see Table 1) modifications to the conventional lending technology using Palms, cellular telephones and credit scoring combined with data mining. All these technologies and automated processes help increase loan officer productivity by facilitating the processing speed and consequently the loan disbursements. The objective pursued is to respond to the growing and increasingly aggressive competition by escalating productivity and reducing unit costs in an industry characterized for being labor-intensive.

b) Simplified processing and intensive support from the back office. It is clear that MFIs that do not have good information processing systems and have not automated their processes cannot compete in the current market. These systems, used extensively by the back office staff to support the sales force will allow, for example, automatic repayments and minimizing time for credit assessments. Even a key step in microfinance technology, which typically is a visit to the customer, in many cases may be ignored at least in the case of known clients. Some MFIs are making strategic alliances with commercial banks with a global presence to interconnect their systems and offer a wider range of services to its customers. In that sense, for example, a MFI could pass a client automatically to a bank with whom it has a strategic alliance if that customer wants a credit amount that exceeds the limits the MFI has.

c) Outsourcing. This is a mechanism already being widely used in commercial banking, but not well developed in the microfinance industry. Outsourcing significantly decreases costs with the FI hiring specialized companies to manage the accounting and administrative tasks because these areas are very labor intensive and innovation is difficult and expensive. Similar processes can be adopted by MFIs, whereby the communication channel is the internet, enabling constant communication to manage these areas.

d) Technologies for automatic transactions. It is a myth that the client of microfinance is reluctant to use ATMs or cell phones to make credit transactions. The myth has been largely broken with the examples of Prodem (Bolivia) and its ATMs in rural areas to serve illiterate clients, or the Rural Banker's Association of Philippines which has had success throughout using cell phone technology to do all sorts of transactions. The hardware that facilitates this type of transaction includes cell phones, ATMs, payments and transactions via Internet, smart cards (whether credit or debit cards), etc. This type of technology greatly facilitates financial transactions of micro-entrepreneurs, enabling them to make purchases and sales with the obvious gains in speed and security. The advantages are clear and Jamaican MFIs could greatly reduce the amount of steps and transactions that require the customer to go to the office, and even redesigning the current size of offices, making them smaller and more efficient. This trend goes even further, and in countries like Peru and Bolivia, MFIs have opened small offices in convenient locations for their clients, such as supermarkets and pharmacies.

Table 4.1 below shows a summary of how the technological applications have revolutionized the design of micro-finance products.

Table 4.1
Information technologies that have helped create new financial products

Innovation Type and Current Status
Payment System: Payments via mobile phones: Cell phones are transformed into electronic wallets, using SMS technology (messages and transactions via cell phones)[9]
• Philippines: Smart Communications and Globe have introduced cell phones that can accumulate and transfer cash to make payments. The system is being introduced by "Rural Banker's Association of Philippines".Kenya: M-Pesa has made an alliance with Vodafone, Faulu-Kenya (a local MFI) and CBA (a local bank): M-Pesa system allows money transfers,

[9] Transactional mobile banking in Jamaica is presently being developed. The Bank of Jamaica and other regulators, along with cell phone companies and banks, are presently assessing the legal and regulatory framework that may need to be introduced, in addition to putting into place the necessary technological requirements to support this.

cash withdrawals and deposits, payments within small shops and disbursement and loan repayment interchangeably in the MFI or the Bank.

- Equity Bank offers e-banking services and uses the cell phone to meet the demand of its customers especially in remote rural areas.
- South Africa: A program called Wizzit allows customers of certain MFIs to use their cell phones to send money and pay bills, in addition to buying airtime.
- Latin America: Motorola recently unveiled M-Wallet, which is software that is downloaded from the internet via cell phone that allows bill pay, buy products in any store - provided that the grocer has a cell with the same program, and also transfer money, nationally and internationally. Regarding transfers, Motorola is targeting the huge market that includes money transfers of migrants.
- Bolivia: MFIs are using text messages to consult the Credit Bureau.

Electronic payment systems

- Guatemala: Land and VISA are driving the use of debit cards or savings accounts for the disbursement of credits for FINCA clients in any of the commercial banks associated with the VISA system.
- Peru: Mibanco associated with VISA introduced to Mibanco customers the classic consumer credit card and new products such as Miahorro (a savings account with a debit card), VISA business (a line of credit or pre-approved credit that Mibanco clients operate with a VISA card that can be used at ATMs of all banks affiliated to the VISA system.
  Point of Sale devices. (POS). Devices are connected via dedicated phone lines or Internet, and are installed in small stores. The clients, using the POS, can make small deposits and withdrawals.
- Uganda: Uganda Microfinance Limited is driving the use of POS to extend its services in rural areas.
- Senegal: Ferla (an MFI)is using the same system as in Uganda.
- Colombia: 45 cooperatives, with different computer systems, were pooled to use a single POS system.

Information Systems: Management Information Systems (MIS) to track the customer

- USA: Open Source Microfinance Project (Mifos) commissioned by the Grameen Bank seeks to develop control and monitoring systems for its customers through open access systems using the internet.
- India: FINE, a private company belonging to ICICI Bank is developing a MIS for MFIs to provide "outsourcing" of certain accounting and financial areas and disbursements and payments by credits.
  Andean Region: Action is a joint effort among Latin American banks Bancosol (Bolivia), Banco Solidario (Ecuador) and Mibanco (Peru) to create a unified credit methodology that would be sustained by a single MIS with technology developed by Total Ban.

Credit Processing 1: PDAs (Palms) are used for credit evaluation at the time the loan officer visits the costumer

- Latin America: Ecuador (Banco Solidario), Bancamia (Colombia), Venezuela (Bangente), Bolivia (BancoFIE) loan officers are using either handheld computers or PDAs to assess customers in their own business.

Credit Processing 2: Credit Scoring to automate credit processing and to profile potential clients

- All around the world: While some MFIs already use their databases to score their clients, the generic methodology of "credit scoring" still cannot replace the micro-lending technology (particularly the personal relationship between the client and the loan officer); however, many MFIs are conducting studies to apply credit scoring both for old and new customers to reduce cost and time of credit appraisal.

Source: Brand, Monica. "The MBP Guide to New Product Development. Draft Manual for Field Testing. "Bethesda, Md.: Development Alternatives, Inc., 2006. Updated by Mario Requena, Pride Jamaica, 2010.

The paper "Microfinance through the Next Decade: Visioning the Who, What, Where, When and How" by Rhyne and Otero, 2006, presents a series of views of experienced operators on the prospects for the industry in terms of new global financial new products and services. The views are as follow:

- In the future, we will see financial products offered to almost everyone. (Eduardo Bazoberry, Prodem, Bolivia)
- Regulated MFIs diversify their portfolios and offer not only a product to a customer, but a mixture of them using specialized packages tailored to customer needs, such as flexible mortgages, leasing, insurance , credit counseling, etc. (Ganhuyag Chuluun, XacBank, Mongolia)
- Insurance and savings are now the products needed by clients; however the regulation is not developed for MFIs to offer these products. (Motaz The Tabaa, ABA, Egypt)
- Loans for working capital and longer terms to buy machinery for raising their productivity, savings, housing improvement loans, loans to buy housing, micro-insurance, international money transfers. (Clara de Akerman, WWB Cali, Colombia)
- The classic credit for business and savings account remain as core of the MFI business, but increasingly larger amounts for both. At the same time, consumer loans and to finance the purchase or improvement of houses, are the fastest growing areas. Then we have other financial services such as savings accounts and checking accounts using new information technologies. Additionally, there is strong demand for micro-insurance, consumer loans, and loans to buy or upgrade their homes."(Nimal Fernando, Asian Development Bank).
- There will be a strong demand for individual loans, especially in Asia, where loans given through community banks are still the mainstream. (Gera Voorrips, ING Bank, Netherlands)

4.3 Methodologies for Developing New Micro-finance Products and Services in Jamaica

As is well known, the commercial success of a new product depends crucially on how well that product design meets client needs. In the current Jamaican market for microfinance it is not possible to focus on client satisfaction only from the standpoint of the MFIs. The challenge for MFIs in Jamaica is then to adapt their systems, processes and staff to think and act according to client needs.

Placing new products on the island market should be phased. During stage one there should be products that offer lower costs and simple procedures, such as micro-insurance in partnership with insurance companies. At the same time, Jamaican MFIs should focus in strengthening their MIS so they can lower the costs using technologies like mobile banking. This phase should focus on making changes in rates, amounts and terms for credit products currently offered. The aim is rather to focus on improving efficiency and lowering costs. This includes changes in micro-lending technology, equipment, software, etc. The method then involves an incremental process change that requires strong participation of administrative and operational areas and high motivation of the staff using incentives, training, etc.

It also requires modifications to infrastructure and equipment (offices, software and hardware) so that average cost of delivering credit usually goes down. Also it is possible to offer the same products whose management is not complicated for the institution but under new conditions that favor the well-known clients. In general, we will find a lower impact on institutional culture, administrative and operational result because of this gradual approach to modernize the MFIs processes and systems for delivering it services. Also, this method is particularly recommended when institutions are weak or are in the process of profound change, which is the case of Jamaican MFIs.

The second phase of delivering new products and services comes once there is some considerable development on many of the pre-conditions explained within this report, because there must be in place not only substantial administrative, financial and transparency innovations within the MFIs, but also within the Jamaican microfinance market taken as a whole.

Section V: Conclusions and Recommendations

5.1 Conclusions

- The lack of a regulatory framework in Jamaica for microfinance institutions has been identified as a constraint both by wholesalers of funds, and the micro lenders themselves. One main barrier is that wholesalers do not have a standardized basis against which to measure the financial strength of the MFIs;
- This lack of information is a serious problem that inhibits financial research about the sector, and it was a serious challenge to develop this report.
- The Economist Intelligence Unit (2010), issues a yearly report which includes assessments of the microfinance environment in 55 countries across Asia, Africa, Eastern Europe and the Middle East. Jamaica scores poorly in the overall index, being in 52nd place.
- There are 3 main reasons why Jamaica scores so low: a) the country has no regulatory framework for the microfinance industry; b) its institutional development is fairly poor, the main obstacle being the lack of a Credit Bureau; and c) the lack of information about the industry.
- With only 2% of the population below the international poverty line[10], and only a percentage of these adults, there is a relatively small critical mass for creating the lowest segment of the microfinance market. This is a small market of potential micro-finance borrowers. In other countries, this figure is much bigger, between 700,000 (Dominican Republic) to 7,000,000 (Colombia).
- To define the microfinance sector, it is better to delineate a framework about what microfinance is in Jamaica, who the stakeholders are, what are their values and how they deliver their services to the poor. This framework, in fact, is a code of ethics and each of the MFIs should participate in this framework freely.
- Based on an interview with officers of the Bank of Jamaica, there are no plans in the near future for BOJ to issue regulations for the microfinance sector. The BOJ does not have sufficient staff given its other priorities. Therefore, there are 3

[10] UNICEF Jamaica Country Information: http://www.unicef.org/infobycountry/jamaica_statistics.html

options at this time for the MFIs: establish a system of self regulation; apply a regulatory system used by an APEX organization such as the Development Bank of Jamaica (DBJ); or, apply a combination of both.

- The challenge is to determine and introduce an optimal degree of self regulation for the MFIs in Jamaica. For developing an appropriate and comprehensive microfinance system, five objectives are identified for the Jamaican microfinance industry:

    1. Creating a network of MFIs
    2. Building a database with standardized information and creating a framework of supportive regulations and policy;
    3. Supervision and monitoring of the performance standards and dissemination of the information;
    4. Participating in access to a Credit Bureau; and
    5. Rating or qualification of the MFIs belonging to the network.

- Based on the information collected from the MFIs, it is very significant that among them there is not full agreement on what kind of information should be shared. This leads us to state that a major first step is for the MFIs to agree to share information, and secondly to agree on the common set of data to be shared.

- About the new products and services that Jamaican MFIs could offer, the following conclusions are relevant:

    1. The range of services provided now by MFIs to the Jamaican micro-entrepreneurs is very narrow, comprising only credit products.
    2. There are some few services, such as micro-insurance, basket of products, consumer loans, etc., that currently could be provided; however, the lack of funds and information hinder this.
    3. Jamaican MFIs have realized that the minimum loan amounts that a start up micro-entrepreneur requests is higher than those provided to a fellow micro-entrepreneur in a Latin American country. So a number of the comparisons between the Jamaican MFI sector and their Latin American peers do not apply.
    4. MFIs realize that if there is not a credit bureau working in Jamaica that they will have access to, it is very risky to increase their portfolios by simply offering new products to the same clients.
    5. MFIs understand that every product line they offer should be sustainable and that cross-subsidy between products is not a best practice.
    6. The current tight financial performance of the MFIs does not allow them to take risk, and costly procedures limit their ability to introduce new products in the market.

- Offering new microfinance products require a phased approach. During phase one, modifications to infrastructure and equipment (offices, software and hardware) should be undertaken so that the average cost of delivering credit goes down. They are presently constrained by high costs, lack of funds, and limited transparency.

- The second phase of delivering new products and services comes once there is some development on many of the pre-conditions explained within this report, because there must be in place substantial administrative, financial and transparency innovations within the MFIs, and within the Jamaican microfinance market taken as a whole.

- DBJ is taking responsibilities and tasks that could overwhelm the current staff in terms of efficiency and delivery of service. It is clear that the current staff is professionally able; however, they will not be capable of facing all the new challenges if DBJ does not receive some additional support in terms of staff.

5.2 Recommendations

- To begin a regulatory process, the first step is to create a MFI network. This is a partnership of MFIs with a common interest. In this case we are talking about institutions working in the microfinance sector grouped to form a national network, to follow some common rules and to share some information, activities, and experiences, among others. This network should have a Secretariat to attend the needs of the members;

- To assemble the Jamaican MFI network, we suggest two main founding documents: a Memorandum of Understanding and a Code of Ethics.

- The recommended regulatory framework for the Jamaican microfinance market is a combination where the MFIs and DBJ jointly set up the rules for regulating the MFIs, using as a basis the rules that DBJ applies to institutions that access its funds. The enforcer of the rules would be DBJ.

- At this time, the most rational and feasible approach for Jamaica's microfinance sector may be to name DBJ as the supervisor and monitoring body, given that some conditions are already required by this APEX institution for lending funds to the credit retailers, and which are already accepted by these borrowers.

- For data dissemination there are two possibilities. The first one is to disseminate through a website the data that MFIs are already sending to DBJ, using the DBJ's Management Information System (MIS). The second option is to use the credit bureau. In either case, funds must be available for both setting up the dissemination system and operating it on a 24/7 basis.

- DBJ's microfinance division needs to be reinforced, bearing in mind, however, the current constraints of the available budget resources. If resources are not available, DBJ should review its level of activity with the MFI sector and consider focusing its efforts in a few key areas and revisiting the way it presently interfaces with the MFIs. This may include instituting higher level approaches to monitoring how MFIs are managing funds that DBJ provides.

- The need to establish a Credit Bureau is a matter on which all the Jamaican MFIs agree. To achieve this goal, it is necessary to have a fully functional MFI network to be able to negotiate the services from the provider as a group. Otherwise, there is not a critical mass to justify the investment needed to provide registry services.

- For developing new products and services for Jamaican MFIs, we recommend a phased approach. During stage one there should be products that offer lower costs and simple procedures such as micro-insurance in partnership with insurance companies. At the same time, Jamaican MFIs should focus on strengthening their MIS so they can lower the costs using technologies like mobile banking. This includes changes in micro-lending technology, equipment, software, etc.

- About the software being bought by DBJ, we suggest four important aspects:

    a) It is necessary to be clear with the provider about the usage and licensing of DBJ's software among the MFIs, and the need for intensive and extensive training for both, DBJ and the MFIs.
    b) DBJ should use the software as a management tool. This means establishing indicators (such as a balance score card) for making decisions and overseeing the MFIs. The software provider should be aware of this need and should be willing to fulfill these requirements. The training that DBJ should receive on the software has to be from the managerial point of view. For the MFIs that may submit information to this system, they should receive training about how to use the software so they can submit information correctly. In this sense, training is a fundamental part of the contract with the provider and it should be stated clearly.
    c) It is necessary that the software provider develop interface software to communicate the MIS of the MFIs with the new software of DBJ.
    d) Communication between DBJ and the MFIs (forward and backward) is not defined in terms of hardware, use of the internet, dedicated phone lines, etc. A review should ensure that MFIs could easily utilize the new software.

Key Recommendations

Priority	TOPIC	
1	**Network of Jamaican MFIs**	
	Action	Establish an Association of non-regulated MFIs through a Secretariat /Technical Group
	By Whom	1. DBJ should initiate the effort, making contact first with the two MFI associations that already exist. 2. Pride Jamaica can support this as the neutral outside party on a non-member basis.
	Milestones for Monitoring Progress	1. Memorandum of Understanding (MOU) and a Code of Ethics (COE) should be agreed and signed among at least the MFIs that are currently on-lending DBJ funds. 2. Officially nominate a Secretariat for the MFI network. January, 2011.
	Impact	1. Represents and advocates for the sector. 2. Establishes a common set of self regulatory measures. 3. Disseminates and standardizes information. 4. Develops and monitors industry benchmarks. 5. Can utilize credit reference bureaus when these are established. 6. Can expand access to second tier funds for on-lending. 7. New product development for clients. 8. Establish and facilitate twinning partnerships with regulated financial institutions to expand services. 9. Organize MFI and borrower capacity building activities via workshops and targeted training events. 10. Establish transparency by developing and maintaining websites that will serve as an information clearinghouse, or "knowledge hub" on the network activities and outcomes
2	**Establish a Database with Standardized Information and Create a Framework of Supportive Regulations and Policy**	
	Action	Obtain agreement within the MFI network about: 1. Information sharing and data standardization, 2. Self- regulatory body norms and organization 3.Agreements for hiring a Credit Bureau (CB)
	By Whom	1. The Secretariat should establish the database on behalf of its membership once there is agreement on information to be shared. 2. The Secretariat -utilizing a combination of self-regulation that incorporates DBJ requirements for entities that on-lend DBJ funds. 3. The Secretariat on behalf of the members.
	Milestones for Monitoring Progress	Agreements among the MFIs, working through the Secretariat, confirming: 1. Information sharing & data standardization 2. Self regulatory body and norms 3. Draft contract with a credit bureau by end of March, 2011
	Impact	1. Improved pool of borrowers, reduced default rates, lower interest rates and lower cost of transactions. 2. Facilitating additional investors to the microfinance industry in Jamaica. 3. Increase the supply of credit and reduce its cost.
3	**Pilot Tests on Supervision and Monitoring, Performance Standards and Dissemination of the Information**	
	Action	Obtain agreement for the Secretariat to test the performance standards against at least 1 MFI to identify any flaws of the system design that includes norms application, data standardization and dissemination, norms supervision, benchmarking, etc.
	By Whom	The Secretariat, in conjunction with DBJ and the credit bureau (if it is functioning within the timeframe)
	Milestones for Monitoring Progress	1. Pilot test completed: 2. Data standardization; 3. Data dissemination, 4. Norms application and supervision, 5. Credit Bureau working with MFIs (will depend on license being issued by GOJ) 6. End of June 2011
	Impact	1. Finalize norms, data, systems, MIS, etc., in order to submit to credit bureau for use by the sector. (Credit bureau will result in improved pool of borrowers, reduced default rates, and lower transaction costs.) 2. Enable improved assessment of MFIs by second-tier financiers, rewarding performing MFIs with additional funds to on-lend.

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