Improving the Impact of Microfinance on Poverty

Action Research Programme

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Ensuring Impact: *Reaching the Poorest while Building Financially Self-sufficient Institutions, and Showing Improvement in the Lives of the Poorest Families*

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This paper is about microfinance and its contribution to the eradication of poverty for millions of the world's poorest people. The Millennium Development goals set a critical challenge of halving absolute poverty in the world by 2015. Microfinance can make an important contribution to these goals by reducing income poverty, vulnerability, and empowering women to choose when and how to access other development services such as health and education. Donors should invest in poverty-focused microfinance as a key part of their Millennium Development strategies. Practitioners should explore how to ensure that programs become more effective in working with the poorest.

- The paper demonstrates the fallacy that microfinance cannot be an appropriate strategy for the poorest. It is not the poverty level of potential clients that determines access and impact, but the design of the services provided. Not all people need microfinance, but most groups can benefit.
- There are trade-offs between social and financial objectives, but MFIs can and do reach and impact on the poorest and achieve financial self-sufficiency.

Achieving poverty impact in financially self-sufficiency MFIs

Two case-studies look at the achievement of combined financial and social objectives.

Poverty Outreach: SHARE and CRECER work with the poorest clients by international, national and local definitions:
- By *international standards* 72.5% of SHARE and 41% of CRECER clients are living in *absolute* poverty, as defined by living below US$1/ day (purchasing power parity).
- By *national standards* 60% of SHARE and 73% of CRECER clients live below their national poverty line.
- By *local standards* SHARE and CRECER reach the poorest people in the communities in which they operate. 58% of SHARE clients and 38.6% of CRECER clients are amongst the poorest third of people in their communities.
- SHARE and CRECER achieve great *depth of outreach*. 32.5% of SHARE and 19.8% of CRECER clients are amongst the *poorest 20%* in their own communities.

Impact: CRECER and SHARE achieve significant positive impacts on the lives of the majority of their clients.

- *Impact on economic poverty:* 76% of SHARE's mature clients experienced significant reductions in poverty, and one-third are no longer poor. 66% of CRECER clients experience income increases.
- *Fulfilment of basic needs:* Clients experience significant improvements, particularly health care, housing and clothing.
- *Reduction in risk and vulnerability:* Clients experienced income smoothing, increase and diversification, increases in savings and assets, and improved financial and business management skills.
- *Women's empowerment:* Both MFIs achieve social impacts. On an empowerment scale of 1 to 7, CRECER clients score 4.2, compared to 2.7 for non-clients/control group.
- The integration of education services into CRECER's work contributes to impact on basic needs and empowerment.
- The poorest clients benefit more than the average for all clients in SHARE.
- Few negative impacts were reported.

Financial Performance: SHARE and CRECER both have excellent financial performance. They have both achieved 100% financial self-sufficiency, and are rated *investment grade* by internationally recognised rating agencies.

Balancing Social and Financial objectives

Microfinance is a compromise between social and financial objectives. To date most emphasis has been on financial and institutional performance. This has compromised the opportunities for maximising poverty impact and client performance.

The microfinance industry has demonstrated what can be achieved; it has not demonstrated what cannot be achieved. It is now time to innovate and design services that maintain high standards of financial performance, but which set new standards in poverty impact. There is a need to -

- understand the costs (eg. smaller loan size, increased demands on staff, smaller portfolios, more remote areas) and benefits (eg. lower exit rates and arrears, higher penetration rates) of working with the very poor.
- innovate to make poverty-focused microfinance more cost-effective;
- improve the impact of microfinance;
- base institutional self-sufficiency on client self-sufficiency and success. Where their vulnerability can be overcome, very poor clients can achieve significant growth and changes.

Design and delivery of poverty-focused microfinance

Most MFIs do not reach large numbers of very poor people. Conventional microfinance acts through deliberate and unintentional mechanisms to exclude the poorest. Programs therefore need to be designed to include the poorest, and to facilitate mechanisms that will lead to poverty impacts. Through increasing their understanding of poverty, MFIs can take simple steps to improve their outreach and their effectiveness for the poorest.

Improving outreach

- Market forces operate to serve the less-poor first. Very poor people are excluded through self-exclusion, deliberate or unintentional MFI policy, exclusion by other clients, or by leaving the programme.
- MFIs should understand who they do reach or exclude and why.
- MFIs should target poorer areas in the countries they work through rigorous geographic targeting.
- MFIs wishing to have an <u>exclusive</u> poverty focus should target and motivate poorer people in the areas in which they work - active targeting leads to a greater focus and inclusion of the very poor.
- To reach the poorest MFIs need a 'culture of poverty' – organisational vision and commitment felt by staff at all levels and by clients.
- Systems to work with the very poor develop from this vision

Ensuring impact

- Market research should understand clients' underlying needs, and not just listen to the the loudest voices.
- Impact is dependent both on the right products and services, and the way in which they are delivered.
- Microfinance can create negative impacts and these need to be understood and steps taken to or reduce these.

Appropriate products:

- Design of products should be based on their potential to reduce poverty, risk and vulnerability, not their attractiveness to clients.
- Very poor clients need a range of financial services, including both credit and savings. The very poor are economically active and can often use credit.
- Access to credit should be linked to ability to repay – either through demonstrating savings capacity or business profits.
- Where loan repayment is made *from existing income sources* there is a need for flexibility in savings and loan repayments. Savings in particular should be easily accessible, both for deposits and withdrawals. Loans do not need to be tied to a particular activity.

- Where repayment is made *from business profits*, regular repayments and pressure from the MFI are important to encourage focus on the business activity and to develop business management skills.
- A range of other financial and non-financial products, such as emergency loans, insurance or educational inputs, can help clients cope with emergencies, smooth consumption, and generally reduce their risk and vulnerability.
- Client need for flexibility and a range of products needs to be balanced with an MFIs capacity to manage an increasingly complex and diverse portfolio.

Delivery:

- Very poor clients are vulnerable and often experience problems. MFIs should support clients in coping with these, rather than coercing them into making loan instalments.
- An organisational culture of poverty-focus and impact in an MFI is key to achieving positive impact.
- There should be no compulsion to take a loan.
- Client support and skills-sharing should be encouraged.
- Lessons should be learned from community-based organisations and other models of microfinance.
- Gender awareness should be integrated into program practice at the level of field staff-client relations, and within organisations' procedures and culture.

Measuring performance

The microfinance industry has established clear best practice for measuring and reporting financial performance, but has not established comparable standards for performance in poverty outreach and impact. Systems need to be developed for transparent reporting of such data.

- Industry standards and reporting guidelines need to be developed using performance measures that take into account both *efficiency* and *effectiveness*.

Poverty outreach

- MFIs should monitor and report on the poverty level of new clients, as well as who they are not reaching. This data should be relative to the local context, and be comparable to national poverty lines.
- Reporting on 'penetration rate' ie. the concentration of poor people reached in an area.
- Loan size (average or initial) is an inadequate proxy.

Impact

Basic impact information is needed for program design to ensure effective management towards improved impact on the poorest.

- Poverty outreach data.
- Disaggregation of client loan and/or savings performance by poverty level.
- Client monitoring can give basic, regular information about a small number of proxy indicators for impact, which could form the basis of industry-wide indicators.
- Poverty auditing can monitor institutional performance in terms of design and delivery of poverty-focused microfinance, and form a basis for assessing whether MFIs are likely, given their approach, to impact positively on poverty.

Creating space for innovation – the role of donors

Donors can encourage innovation, experimentation, and improved understanding on the possibilities for poverty-focused microfinance.

- Providing financial incentives towards the achievement of certain goals i.e. depth of poverty outreach and impact
- Creating space for MFIs to improve their effectiveness eg. by creating pilot schemes, or exploring different time-frames for achievement of different objectives.
- Establishment of clearer industry standards for good practice in poverty-focused microfinance
- Promoting greater transparency in reporting on poverty outreach and impact.
- Funding research, particularly that focused towards improving operational effectiveness, and understanding the trade-offs involved in a poverty-focus.