WORKING PAPER **255**

Microfinance Impact and the MDGs: The Challenge of Scaling-up

Martin Greeley
March 2006

IDS Institute of Development Studies

About IDS

The Institute of Development Studies is one of the world's leading organisations for research, teaching and communications on international development. Founded in 1966, the Institute enjoys an international reputation based on the quality of its work and the rigour with which it applies academic skills to real world challenges. Its purpose is to understand and explain the world, and to try to change it – to influence as well as to inform.

IDS hosts five dynamic research programmes, five popular postgraduate courses, and a family of world-class web-based knowledge services. These three spheres are integrated in a unique combination – as a development knowledge hub, IDS is connected into and is a convenor of networks throughout the world.

The Institute is home to approximately 80 researchers, 50 knowledge services staff, 50 support staff and about 150 students at any one time. But the IDS community extends far beyond, encompassing an extensive network of partners, former staff and students across the development community world-wide.

For further information on IDS publications and for a free catalogue, contact:
IDS Communications Unit
Institute of Development Studies
at the University of Sussex
Brighton BN1 9RE, UK

Tel: +44 (0) 1273 678269
Fax: +44 (0) 1273 621202
E-mail: bookshop@ids.ac.uk
Web: www.ids.ac.uk/ids/bookshop

IDS is a charitable company, limited by guarantee and registered in England (No. 877338).

IDS WORKING PAPER 255

Microfinance Impact and The MDGs: The Challenge of Scaling-up

Martin Greeley

March 2006

Institute of Development Studies at the University of Sussex Brighton BN1 9RE UK

Paper for the Microfinance India conference, New Delhi
12–14 April 2005

Microfinance Impact and the MDGs: The Challenge of Scaling-up
Martin Greeley
IDS Working Paper 255

First published by the Institute of Development Studies in February 2006
© Institute of Development Studies 2006
ISBN 1 85864 605 7

A catalogue record for this publication is available from the British Library.
All rights reserved. Reproduction, copy, transmission, or translation of any part of this publication may be made only under the following conditions:

- with the prior permission of the publisher; or
- with a licence from the Copyright Licensing Agency Ltd., 90 Tottenham Court Road, London W1P 9HE, UK, or from another national licensing agency; or
- under the terms set out below.

This publication is copyright, but may be reproduced by any method without fee for teaching or non-profit purposes, but not for resale. Formal permission is required for all such uses, but normally will be granted immediately. For copying in any other circumstances, or for re-use in other publications, or for translation or adaptation, prior written permission must be obtained from the publisher and a fee may be payable.

Available from:
Communications Unit
Institute of Development Studies
at the University of Sussex
Brighton BN1 9RE, UK
Tel: +44 (0) 1273 678269
Fax: +44 (0) 1273 621202
E-mail: bookshop@ids.ac.uk
Web: www.ids.ac.uk/ids/bookshop

Printed by Imagedata Group, Brighton UK
IDS is a charitable company limited by guarantee and registered in England (No. 877338).

Microfinance Impact and The MDGs: The Challenge of Scaling-up

Martin Greeley

Summary

This paper concerns the potential for microfinance to make a difference in achievement of the Millennium Development Goals. It recognises that microfinance can contribute to several MDGs but that to do so in ways that make a real difference would involve a significant scaling-up of microfinance service provision. Herein lies the challenge. The expansion of developing country microfinance services is increasingly driven by commercial investors who do not usually assess Microfinance Institution (MFI) performance according to MDG criteria. At best, they will use some fairly loose 'social' criteria often borrowed from the corporate social responsibility literature; or they may refer, usually without precision, to a double bottom line of financial and social performance. These have little or nothing to do with achievement of the MDGs. As the empirical material presented makes clear, MFIs that do not deliberately and rigorously target poor households are unlikely to make any difference to MDG attainment. MFIs with a social mission focused on poverty reduction (MDG1) face a genuine difficulty. To expand coverage of poor households, they generally need to seek financial support, usually in the form of loans or equity. Their difficulty is that they face a serious risk of 'mission drift', concentrating on achieving an outstanding financial performance, which is necessary anyway and especially if they wish to access commercial funds, and neglecting their social mission. In other words, commercial funding may mean less attention to poor households in microfinance service delivery. The challenge for the industry is to manage scaling-up without losing sight of its social purposes. The paper argues for client-level assessment by MFIs that can both ensure that poor households are targeted and that microfinance impact on their poverty status can be monitored. Developing a social performance monitoring system based on client assessment is the principal way in which MFI impact on the MDGs can be established and maintained.

Keywords: microfinance, poverty, Millennium Development Goals, scaling-up, social performance, targeting, monitoring.

Martin Greeley is a Fellow at the Institute of Development Studies, Sussex. He is an Economist and works on poverty and public policy. He has published extensively on microfinance and this paper was first presented in New Delhi in April 2005 at a conference organised by CARE, India.

Contents

Summary, keywords, author note 3

1 Introduction 7

2 Impact assessment and the MDGs 7

3 Managing the transactions costs of microfinance 12

4 Conclusions 15

Tables

Table 2.1 The domains of microfinance impact 8

Table 2.2 PROMUC Impact Survey in two programmes – differences between the differences in the first and second rounds 10

Table 2.3 Summary of some poverty outreach approaches uses by *Imp-Act* partners 11

Table 3.1 Prizma poverty scorecard 14

1 Introduction

The context for this paper is twofold. First, the belief, a very reasonable one, that microfinance has the potential to help achieve the MDGs. Secondly, the knowledge that to realise this potential in a meaningful way requires a substantial scaling up of microfinance service provision.

This is the global context. South Asia provides most of the evidence and most of the client numbers that inform debate on MDG impact. South Asia has had a high growth rate in client numbers and has high growth potential. Elsewhere also there has been sustained growth, through a variety of institutional models. Context has a strong effect on both MDG impact potential and growth potential but, in different contexts, Microfinance Institutions (MFIs) have demonstrated that they can deliver sustainable services that contribute to the achievement of the MDGs.

This evidence has been reviewed elsewhere and is only discussed briefly here. In this paper the focus is more on the challenges of improving the evidence base. The point here is that, relative to the scale of MFI service provision, we know relatively little in a reliable form about the social and economic impacts of MFIs. The second part of the paper then relates this to the challenges of scaling up in ways that encourage achievement of the MDGs. It argues that both for the achievement of the MDGs and for sustainable scaling up, collecting, managing and using knowledge about clients are core organisational strategies for MFIs.

The paper draws in part on the work of 30 MFIs who have been partners in the Ford Foundation-funded *Imp-Act* action research programme. CYSD, SHARE and PRADAN from India were all very active participants. Although that global programme did not specifically address the MDGs, the focus of the programme findings, on the need, and means, to strengthen MFI social performance management, is underlined through the arguments here. In summary there are two arguments. First, we do not know enough at present to assess the contribution of MFI programmes to the MDGs. Secondly, MFI success in providing sustained financial services derives from their style of financial intermediation, specifically from the management of transactions costs. To be sustainable, scaling up has to preserve the character and value of these forms of intermediation. The arguments point to the requirements for knowledge about clients; knowledge is needed both about their socio-economic condition on joining and on how that changes as a consequence of their membership in an MFI. These needs can be met through systematic Social Performance Management.

2 Impact assessment and the MDGs

This paper provides a simple framework for examining impact. There are three main dimensions in which poverty is addressed through financial service provision. In examining the poverty status of clients at entry and subsequent poverty reduction impact on clients and their families, we distinguish between income poverty and all other dimensions affecting clients. The latter are put together under the heading of social impacts. These would include health, education and female empowerment benefits, crucial to the MDGs, as well as other direct welfare impacts on clients. Very often, these social impacts derive from the expenditure of additional household income so, at the stage of defining poor households, it is income poverty that matters.

There is also a third type of impact. Recognising that, as the scale of microfinance programmes grows, there are wider economic and social impacts, we also need to be concerned with these wider impacts and their effects on poverty for both clients and non-clients. These can be both economic, largely through market effects, and social, for example through the influence of microfinance groups on values, relationships and practices within communities. In practice, it is difficult for MFIs, or anybody else, to provide a rigorous assessment of these wider impacts but in some circumstances they can be very significant.[1]

1 For example, it seems reasonable to conjecture that the eight million plus borrowers from MFIs in Bangladesh have indeed had some collective social and economic impact on markets or values or other dimensions affecting wellbeing.

The broader term, 'social performance', can be used here, and increasingly is being used rather than 'poverty', to refer to these different aspects of MFI performance.[2] This framework (Table 2.1) provides four domains to social performance – Reducing Income Poverty, other Social Impacts on Clients and Wider Impacts.

Table 2.1 The domains of microfinance impact

Clients and their households		Wider impacts	
Income	Social	Social	Economic
1A	1B	2A	2B

Table 2.1 lists the four impact domains and labels them 1 (A and B) for individual impacts and 2 (A and B) for wider impacts. Our knowledge of these impacts is limited with most known about 1A and 1B. Comparing these domains with the MDGs, listed below, it is apparent that the potential impact linkages are many. Household-level income (1A) is the domain about which we have most evidence and is what most people believe to be the main impact domain. Gains in household income contribute most obviously to the first goal and indeed that goal is measured in terms of dollar a day poverty. Additional income also contributes to the health and education MDGs.

The Millennium Development Goals
Eradicate extreme poverty and hunger
Achieve universal primary education
Promote gender equality and empower women
Reduce child mortality
Improve maternal health
Combat HIV/AIDS, malaria and other diseases
Ensure environmental sustainability
Develop a global partnership for development

CGAP (2003) have summarised evidence in relation to income, education, health and female empowerment; effectively, the terrain of the first six Millennium Development goals. They identify specific MFI cases where evidence is available to show progress towards the MDGs. They note that, whilst there are occasional cases of negative impact, by and large the evidence is very supportive of significant MFI impact against the MDGs. A more detailed study is provided by Morduch and Haley (2002) who compile evidence in relation to the MDGs in a substantial literature review. Their conclusion is that the MDGs contribute to six of the eight MDGs. The two MDGs that are not treated are environmental sustainability and global partnerships. The latter does not have a target and the former, though it includes targets on slum improvement and access to safe drinking water, has not been a focus of MFI studies on these issues.

In addition to income growth, social gains (1B) to clients also arise in two other distinct ways. Firstly, where the, largely female, clients benefit through better exercise of, and more control over, expenditure choices there is a welfare gain. There are numerous studies on female empowerment related to MFI service provision and one important element of these is evidence of improvement in expenditure with more household resources going to health and education. Secondly, many programmes provide additional training and support services, often in parallel rather than in a closely unified model, that focus on health, education, production or empowerment for example. The evidence in support of the welfare gains from these MDG linkages is also strong. Health, education and empowerment linkages have all been established in a variety of contexts and with different types of institutional partner.

The distinction between these direct income effects on MDG status of clients and programme-driven effects on the MDGs is important. The former rest entirely on the consumption expenditure decisions of clients and presumes that they have an effective choice available to opt for improved health and education status. The latter depends on a combination of nurturing and education of clients and programme activities to ensure social service provision and access. If these latter are important in allowing

2 Social performance is used more loosely in other contexts to refer to any aspect of social impact not just that on poverty.

programme activities to ensure social service provision and access. If these latter are important in allowing MFIs to deliver on the MDGs then arguments for 'lean and focused' financial services imperil the future success of MFIs contribution to the MDGs.

The evidence in support of either 2A, wider social impacts, or 2B, wider economic impacts, is much thinner than either of the two types of direct client impact. As we move from left to right in the table both the volume of evidence and likelihood of any data establishing causality diminish. However, there is a growing literature on the role of groups and wider social impacts with a generally, but not wholly, positive analysis. Both in economic and social aspects, the role of the group has been a focal point of many studies. A main underlying reason for this is the importance of the group as a vehicle for managing transactions costs as discussed further below. However, groups formed through MFI programmes have also had a socio-political function in promoting the rights of their members, lobbying for improved access to services and actively organising for the provision of such services.

MFIs can also point to their poverty reduction efforts through the creation of an enabling environment for private sector growth (B2). By addressing financial market failure, MFIs can allow entrepreneurs to access investment loans and by providing insurance and savings services they can mitigate the risks associated with such borrowing … or indeed any risk to livelihoods. They can argue that increasing the size of the industry should be the priority because all neglected households including poor households benefit from the financial markets and growth created. Now, whilst we know that, on average, growth increases income per head of the poor in proportion to increases in mean income per head, there is substantial variation around this average (Dollar and Kraay 2001). The empirical evidence is clear on this and the elasticity of the poverty headcount with respect to mean income varies widely (Thorbecke 2004). Not all growth is pro-poor growth and important development objectives, such as the first MDG on income poverty, may not be best served by neglect of targeted service provision. Understanding how to achieve poverty reduction through growth is properly the subject of country-specific micro-research. Likewise, there is no global prescription for achieving poverty reduction through microfinance service provision.

The 'better financial markets to poverty reduction' argument points to the employment generated through loans to the non-poor and argues that this employment gives indirect benefits to the poor and is a substantial source of poverty reduction. Mosley and Rock (2004) provide an argument based on African data suggesting that, by some poverty definitions, this is likely to be the most important poverty outreach achievement of MFIs. However, there is no clear evidence that the employment generated through loans to the better off by MFIs results in employment for the poor. At least one authority (World Bank, 1999) argues that most of the employment generated is family employment.

Whilst it is clearly true that the main route to income poverty reduction through microfinance provision is through employment there is little reason to think that large volumes of self-employment by poor people using their own loans will generate less employment for the poor than loans given to larger farmers and entrepreneurs who then employ poor people. Indeed evidence on agricultural credit in India shows that credit has a negative effect on employment. This occurs as a result of loan use to substitute capital for labour. Capital labour ratios are likely to be smaller (more jobs per unit capital) with small loans than with large.

Thus, there is little empirical support for the proposition that a purely market-driven expansion of financial services will allow fulfilment of an MDG mandate through indirect mechanisms associated with growth. MFIs with a social performance mandate that do not focus on direct poverty outreach are reduced to relying on the unproven argument that the expansion of financial markets would be inclusive or would generate pro-poor growth. It is a very difficult perspective to reconcile with the use of scarce public funds earmarked for poverty reduction.

Drawing on this discussion and the framework above, the direct improvement – quality and quantity – of consumption expenditure is the main way in which the clients of MFIs achieve improvements measurable through MDG statistics. This can happen using savings and insurance products leading to consumption smoothing and reduced vulnerability. The main route though is from the income generated by productive use of loans. Whether loans are for household-based businesses or small enterprises, whether returns on loans are regarded as income or as profits, they are a financing instrument and produce financial returns that are of instrumental rather than intrinsic worth. Social value, as measured by the MDGs, is created when the extra money is used to buy improved consumption – better nutrition, more days in school, better health care – rather than when it is saved or re-invested. The crucial point to note here is that unless the clients are identified as poor at the time of programme entry then there is no reason for expecting any effect on the first MDG, income poverty measured by a dollar a day measure. MFIs who have clients that are not income poor will only contribute to the achievement of the MDGs when: (1) households are below target on the social and

education MDGs; and (2) they generate additional income that is then used for health and education expenditures contributing to the MDG targets. Without both knowledge of client condition on entry and monitoring of their socio-economic status over time, it is not possible to link MFI performance to MDG attainment.

The evidence on the income dimension is, understandably, stronger than in relation to the other MDGs. However, this evidence on income gains from MFI services has been subject to critique on both computational[3] and interpretative grounds. In many studies, problems of attribution and of fungibility limit how well we can compare with the counterfactual though that may not stop the data being useful for other purposes. The problems of providing sufficient and accurate data are in part because very high standards of evidence are expected, especially from donors, and for MFIs such standards are difficult.

Table 2.2 PROMUC Impact Survey in two programmes – differences between the differences in the first and second rounds

Variables		Araiwa		Alternativa	
	Unit/ scale	Mean value of differ-ences	Significance	Mean value of differ-ences	Significance
Personal decisions	0–24	0.95	NO	0.95	NO
Decisions regarding partner and chil-dren	0–3	0.95	(68–80)%	-0.7	(68–80)%
Business decisions	0–12	0.72	95%	-0.04	NO
Investment	Annual (in Soles)	-47.6	NO	-142.8	NO
Sales	Monthly (in Soles)	6600.3	(68–80)%	10896.0	(68–80)%
Expenses	Monthly (in Soles)	5972.3	(68–80)%	10868.0	(68–80)%
Profit	Monthly (in Soles)	-137.6	NO	-1375.6	(68–80)%
Assets	Monthly (in Soles)	2550.6	95%	2480.5	(68–80)%
Business management quality	0-8	-2.8	95%	-2.7	95%
Employees	Average	-0.08	NO	0.20	95%
Client Income	Monthly (in Soles)	160.5	95%	149.9	95%
Total Family Income	Monthly (in Soles)	246.7	95%	290.8	95%
Family income per-capita	Monthly (in Soles)	56.4	95%	72.7	95%
Household assets	0-28	-0.2	NO	-0.5	(68–80)%

Source: PROMUC, Final *Imp-Act* Report, 'Monitoring and Impact Assessment Project for the "La Chanchita" Community Bank Program', March, 2004.

One important approach is the 'difference of differences' method that compares the size of changes over time for a control group and a group of clients. Well-designed, as in the Peruvian study providing the data for Table 2.2 above, they are a relatively reliable source of data. The table is based on the change over time between the initial value and the new value of a range of variables (range specified) in two programmes. For each variable, the table shows the difference of the change for the client

3 For example, the selection of an appropriate control or comparison group, sampling procedures and the quality of data collection have all been problematic.

Table 2.3 Summary of some poverty outreach approaches used by *Imp-Act* partners

BosVita, Bosnia-Herzegovina	Refugees and local population (43% below national poverty line)Refugees and local population (43% below national poverty line)Refugees and local population (43% below national poverty line)
BRAC, Bangladesh	Targeting through land holding and occupation; women
CAME, Mexico	Geographic; the economically disadvantaged. CAME does not emphasis poverty so much as exclusion and marginalisation. Their *Imp-Act* survey suggests that clients are not among the poorest inhabitants of CAME's area of operation.
CARD, the Philippines	Housing, food security, education and assets. Means test form to screen clients on entry
CERUDEB, Uganda	Non-targeted
CMF partner SAC-COS, Nepal	Geographic
CYSD, India	Geographic
FINCA, global	No exclusion but targets women (95% plus of their village bank groups)
FINRURAL, Bolivia	Their partners include those e.g. Pro Mujer (Bolivia) who are effective in targeting poor women in the urban informal sector and Crecer who target poor rural and urban women…other partners have limited depth of outreach
FOCCAS, Uganda	Poor families in rural Uganda
FPC, China	Geographic,
K-Rep, Kenya	Various groups excluded from formal financial service access.
LAPO, Nigeria	Various income-related criteria via Participation Form
ODEF, Honduras	Clients with small and micro-businesses – scored in regulatory assessment of private finance institutions
PARTNER, Bosnia-Herzegovina	Low income and war-affected population (43% below national poverty line)
PRADAN, India	Geographic
PRIZMA, Bosnia-Herzegovina	Poor and low-income women and their families
PROMUC partners, Peru	Poor women, mainly urban, and targeting poor areas
Pro Mujer, Peru	The majority of their clients are female vendors who work in the informal sector.
SEF, South Africa	Participatory Wealth Ranking for their targeted programme; women
SHARE, India	Targeting through land holding and occupation; women
SAT, Ghana	Economically disadvantaged women (primarily, 80%)
UMU, Uganda	Self-selection

group compared to the change for the comparison sample and details the significance level of the difference. The changes reported here largely relate to the financial performance of the enterprise supported through the loan and are therefore largely related to the first MDG, but the method is equally valid with any quantifiable variable.

For this type of study, entry-level data and some limited monitoring data are required yet very few MFIs either collect or use such data. If they did, they could know the condition of the household, in relation to specific MDGs, at entry, and their subsequent progress. However, there are very few cases, unlike the PROMUC table above, where comparable changes over time in relation to income are clearly analysed.

The little impact data that is collected is not often directly comparable with MDG targets since those MFIs that do collect social performance data have other specific uses. The key overall point to note about this evidence is how thin it is relative to the size of the MFI industry. Table 2.3 illustrates the wide variety of definitions employed by MFIs to identify their clients. It is apparent from the table that many MFIs, whatever nominal commitment to poverty reduction they embrace, do not use great precision in their targeting. In effect, this means that many MFIs are not in a position to know impact against the MDGs since they do not have credible evidence on the poverty status of their clients at the time of

joining. For those MFIs that do have good targeting mechanisms and are confident that they are reaching poor households, including perhaps the majority of Indian service providers, assessing achievement against the MDGs then depends on monitoring client's socio-economic status over time. Without such monitoring, the social performance of MFIs, measured by the MDGs or otherwise, is an area of darkness.

The *Imp-Act* programme is one of several recent initiatives that are helping to establish methods for MFIs to develop systems that provide the type of information required. One of the key lessons from the *Imp-Act* action research is that developing better knowledge about the socio-economic condition of clients can be a cost-effective investment for the MFIs. This occurs because they can reduce drop out rates and can improve the relevance and quality of service provision through knowing better what clients want. However, through the focus on client entry condition and subsequent changes this agenda goes much beyond market research and is concerned with the social performance of MFIs.

3 Managing the transactions costs of microfinance

The challenge is to scale up the provision of services in ways that also seek to maintain and strengthen the MDG impact. Scale matters and the growth of the industry is seen as important for poverty reduction and therefore for the achievement of the MDGs. There is a growing momentum within the industry as commercial funders invest in the sector. Reflecting this concern for growth through commercial partnership those suffering 'financial exclusion' are frequently referred to as the clients in the MFI market. This term may not be very accurate[4] particularly since many MFI delivery mechanisms, especially member-based institutions, develop out of ROSCAs or other forms of endogenous institutional finance. Very poor households may not have had access to such institutions but many other households, not just poor ones, do. It is not clear therefore how well the concepts of poverty and of financial exclusion overlap.

This section argues that successful scaling-up requires a clear understanding of how MFIs have addressed the high transaction costs problem that drove away the commercial banks earlier. Specifically, it focuses on how these costs are managed through knowledge of clients.

The key development feature of microfinance is in the innovations – in products, terms, transactions costs and risk – that enabled MFIs to provide financial services where banks had failed. From the earliest development of these models, in Bangladesh and in Bolivia, these innovations were specifically identified as means to serve poverty reduction. Initially, they were entirely driven by this more specific agenda on poverty rather than as a solution to the expensive experience of more generalised failure of rural financial services; especially the poor performance of the development banks, farmer cooperatives and directed lending. Their success has led to expansion and to increasing financing needs. It has opened up linkages with the formal financial sector that had retreated rapidly from rural areas with the advent of liberalisation in financial markets. Growth -or scaling up, as it is sometimes called- is linked to investment resources and the financial markets are an obvious source for the MFIs to target. All MFIs face a pressure to achieve a financial performance that allows them to make this linkage so that they are not dependent on continuing donor support.

MFI success has been achieved because, using a variety of institutional models, they have developed methods to minimise transactions costs. These costs relate to client selection, service provision and the repayment problem. In various ways, from market research to social embeddedness, MFIs have developed a means to reduce the riskiness of their portfolio and the costs of running it. For example, the transfer of loan use monitoring to group members, or the discipline of regular weekly or fortnightly meetings, result in greater surety and greater knowledge that client loans perform.

The key problems in past financial failure relate to information costs and how poor information resulted in problems of adverse selection and moral hazard. MFIs address this through cost effective means of knowing about their clients. The risk they face, in scaling-up, is that their approach to transactions costs

4 Vijay Mahajan and Bharti Gupta Ramola, 'Microfinance in India – Banyan Tree and Bonsai', a review paper for the World Bank, August, 2003. See especially the discussion on page 22 showing the multiple and sizeable financial activities of the poor even in the absence of commercial banks.

will be compromised. Rhyne (2002)[5] documents the crisis in Bolivia arising from the failure to recognise this with the growth of consumption loans. In effect, it did not work to use the commercial bank approach of relatively low customer knowledge and, for large providers, the performance of their consumption loans collapsed.

Conning (1999) has provided a detailed discussion of the ways in which MFIs manage transactions costs through the use of groups, through repayment discipline and through the management of the information asymmetries that undermined past attempts at rural finance. He recognises that these costs will be higher when the market segment is the poor. This is because average loan size is typically lower. MFIs have to trade this off through staff efficiencies and lower default rates. Many MFIs have done this, especially those adopting the Grameen model or variants of it. Here, staff to client ratios can grow quite rapidly and a high share of the costs of repayment enforcement is borne by members. This is essentially true also in the operation of SHGs and in both cases client knowledge or use of agents (other villagers) with that knowledge is central. The challenge for the MFIs as they seek to grow is the maintenance of that knowledge and thereby the maintenance of the portfolio quality as client numbers and loan sizes increase.

Increasingly, access to financial market funds is being achieved. In India, the SHG-commercial banks linkage programme is an important example, though not without its critiques. Successful MFIs such as SHARE have developed an institutional structure that allows provision of multiple financial services, better financial ratios and thereby access to commercial funds. In India, these funds are in part available as a response to government encouragement but microfinance is in fact part of a much more general pattern of attempts to develop commercial links with underexploited rural markets. Amongst leading business thinkers there is a global push to exploit hitherto neglected market segments; the notion of the 'poor' or of 'rural' areas in developing countries as market opportunities for international capital is widespread. Within microfinance, there is a more specific appeal to market funds that are directed towards investment in double bottom line activities. In other words, MFIs are attractive to managers of social funds because they typically have a social as well as a financial goal.

It is important to recognise that the standards[6] used in these northern founded practices bear little relationship to the MDGs. The Corporate Social Responsibility literature is little different. Specific bond issues on behalf of the social funds sector are framed very generally with respect to poverty reduction. This is true also of bonds issued for microfinance. Scaling-up will obviously have access to commercial finance as a primary driver so the absence of standards relating to poverty (or the MDGs) raises legitimate concerns over mission drift for MFIs.

The core issue around poverty outreach is how a social performance agenda defined in poverty terms should be realised. The unsurprising answer is that MFIs should target their financial services portfolio to households defined as poor. That is, the selection of households with specific characteristics that correspond to a MFI's social mission. We should underline however, that targeting[7] can be used in both an 'exclusionary' and 'inclusionary' way. MFIs can target to exclude those that do not meet a criterion or they can target to ensure that they include households with some specific characteristics. This is a distinction between hard and soft targeting; between programmes that have a hard target of only poor people and those with a softer target of some poor people. The distinction is important because, other things being equal, lending to poorer people generally costs more. The achievement of financial self-sustainability becomes slower with exclusionary targeting because average loans are smaller. These extra costs can be absorbed through improving repayment performance; through staff serving higher numbers of clients, acquiring skills in use of targeting instruments and being given incentives to apply them; and, through gradual increase of services provided, including increases in average loan sizes over time. With inclusionary or soft targeting, the extra costs of the portfolio of the poor can also be cross-subsidised if necessary with the (potentially) higher profits from loans to the not so poor. This is not

---

5 Elisabeth Rhyne, 'Surviving the Crisis: Microfinance in Bolivia, 1999–2002', Kreditanstalt für Wiederaufbau, Symposium on Financial Sector Development in Southeast Europe, November, 2002.

6 An authoritative review of double bottom line accounting is the *Double Bottom Line Project Report: Assessing Social Impact in Double Bottom Line Ventures – Methods Catalog* by C. Clark, W. Rosensweig, D. Long and S. Olsen for the Rockefeller Foundation, 2004.

7 Poverty targeting is sometimes distinguished from poverty screening, the latter term being used for review of client applications rather than MFIs themselves selecting clients with specific characteristics. Both involve an assessment of poverty status. We can also distinguish these two activities from 'assessment' when assessment is used to mean review of poverty status of *existing* clients. Screening can be seen as 'passive' targeting and assessment as *ex post* evaluation of targeting success. In all three cases the objective includes making a determination of poverty status though the tools used may vary as may the use of the information. Other than exceptional circumstances where very detailed poverty information is available about the client population, direct targeting is likely to be more cost effective than assessment and more inclusive than screening.

possible with hard targeting. In both cases, cost absorption and cost reduction practices depend on organisational efficiency and learning in the use of targeting instruments, product development and portfolio management. Developing these practices is the core of the social performance management agenda.

Income poverty is objectively measurable and comparable. These are important characteristics of a social performance standard. Analysis of other social impacts and wider impacts can then be used to address all the other dimensions of poverty as part of a more context-specific assessment of organisational performance. In other words when we refer to poverty performance as a standard we are adopting a definition that will allow comparable measurement of performance. However, income itself is expensive to measure accurately. Instead, proxy characteristics that are both easy to collect and highly correlated with poverty are used. In some cases, much of South Asia, these proxies are easily specified in terms of assets and occupation; in other circumstances it may take some effort to develop them initially. Bosnia Herzegovina, with poor survey data and a recent history of long disruption from civil war, is a country where no easy target instruments were available.

Table 3.1 Prizma poverty scorecard

Poor and Very Poor 0-2 Vulnerable Non-Poor 3–4 Non-Poor 5+						
Indicator				0	1	2
Poverty Risk		Education	What is the education level of female household head/spouse/partner?	*≤ Primary*	*> Primary*	–
		Residence	Where is residence?	*Rural/Peri ≤ 10,000*	*Urban > 10,000*	
		Household	What is household size?	*5*	*< 5*	
	Change	Household Assets	Does household possess a stereo CD player?	*No*	*Yes*	
		Transport Assets	Does household possess a transport vehicle?	*No*	*Yes*	
		Meat Consumption	On average, how often does household consume meat each week?	*Rarely 0–2 times/ week*	*Sometimes 3–5 times/ week*	*Often 6+ times/ week*
		Sweets Consumption	On average, how often does household consume sweets with main meal each week?	*Rarely 0–2 times/ week*	*Sometimes 3–5 times/ week*	*Often 6+ times/ week*
		Poverty Status Score (0–9)				

Prizma work in Bosnia Herzegovina and wanted to improve their knowledge of outreach and ensure they were reaching their target group. The poverty scorecard they developed, (see Table 3.1) was decided only after a fairly exhaustive correlation checking process with new survey data on income poverty. The information covered allows both accurate identification of Prizma's market segment as well as monitoring of client progress. By using the scorecard, this MFI will be able to satisfy their clients, their staff, their board and their funders on the poverty status of their borrowers. Similar initiatives, with a variety of approaches, were adopted by a number of *Imp-Act* partners including PRADAN in India as well as MFIs in the Philippines, South Africa, Ghana and Nigeria.

4 Conclusions

In defining outreach strategy, the context-specific analysis of poverty underlining that strategy, is of paramount importance. The analytic focus on the household and its wellbeing characteristics are of course common to international statistics and national assessment of poverty. But, in some contexts, the approach to poverty reduction by service delivery agencies such as MFIs is strongly informed by structural assessment of poverty causation. In Latin America, such analysis often results in a programme focus on the informal sector, urban slums and neglected, usually more remote, rural areas. In Eastern Europe, the recovery from civil conflict and the 'new' poverty affecting displaced formal sector workers during economic and political transition drives targeting strategy. In these contexts, MFIs may perceive their role as part of broader political processes of engagement with structural conditions underlying poverty causation. For example, in Bolivia, microfinance has been a focal point of political agitation in the recent economic crisis. In these contexts, it is clear that direct poverty outreach is only a very partial assessment of the potential contribution of MFIs to poverty reduction. This is an important caveat to the argument that direct poverty outreach is the 'right' approach to fulfilling an MFI's poverty reduction mandate. However, 'poverty reduction success' from MFI engagement with economic and social inequalities[8] and exclusion that are structural in nature is necessarily difficult to determine. Without evidence on direct poverty outreach and monitoring client performance such MFIs will have difficulty in establishing their performance on poverty reduction.

The microfinance industry has embraced the concept of client assessment as a means to strengthen organisational performance. This has been widely understood as a shift away from a supply or product-led approach to a demand or market-led approach. Market research has been embraced as a means to identify client demands and improve the range and relevance of financial products. For MFIs concerned with poverty outreach, this market research will be of little use if it does not segment the specific product needs of poor people. The poor represent a market opportunity for MFI services to demonstrate competitive advantage and commercial value, but to achieve this requires appropriate forms of client assessment and monitoring.

The additional costs of monitoring impact may not be very high. These costs may even be outweighed by improvements in product design and service delivery. However, it is well known that targets influence activities and many MFIs have certainly been persuaded to focus their activities on the financial sustainability goal despite their avowed commitment to poverty outreach. The challenge for the industry is to manage scaling-up without losing sight of its social purposes. It is apparent from the discussion here that good knowledge about MDG impact and successful scaling-up both require knowledge at client-level. For these two fundamental reasons, developing a social performance monitoring system is the principal way in which MFI impact on the MDGs can be established and maintained.

8 Inequality is a quite distinct aspect of wellbeing from poverty. Poverty is most sensibly defined in absolute terms of deprivation, or what Amartya Sen calls absence of capabilities. Economic or social inequality might be associated with this but even where absolute poverty is absent, these inequalities are a source of ill being. It is no fun being relatively poor even if you can afford to eat.

References

CGAP (2003) *Is Microfinance an Effective Strategy to Reach the Millennium Development Goals*, Focus Note 24, January, Washington, D.C.

Conning, J. (1999) 'Outreach, Sustainability and Leverage in Monitored and Peer-monitored Lending', *Journal of Development Economics* 60.1: 51–77, October

Dollar, D. and Kraay, A. (2000) 'Growth is Good for the Poor', mimeo, Washington, D.C.: World Bank

Mathie, A. (2001) *Including the Excluded: Lessons Learned from the Poverty Targeting Strategies Used by Micro-Finance Providers*, Occasional Paper, Antigonish, NS: The Coady International Institute, St. Francis Xavier University, June

Morduch, J. and Haley, B. (2002), *Analysis of the Effects of Microfinance on Poverty Reduction*, Wagner Working Paper 1014, June, New York: New York University

Mosley, P. and Rock, J. (2004) 'Microfinance, Labour Markets and Poverty in Africa: A Study of Six Institutions', in A. Mushtaque, R. Chowdhury and P. Mosley (eds), *Journal of International Development, Special Issue, The Social Impact of Microfinance* 16.3: 467–500

Thorbecke, E. (2004) *Conceptual and Measurement Issues in Poverty Analysis*, Discussion Paper 2004/04, February, Helsinki: WIDER

World Bank (1999) *Sustainable Banking with the Poor – Microfinance Handbook; An Institutional and Financial Perspective*, J. Ledgerwood for Washington, D.C.: The International Bank for Reconstruction/The World Bank