# Alleviating Global Poverty through Microfinance: Factors and Measures of Financial, Economic, and Social Performance

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## Abstract


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**Marc J. Epstein (Rice University) and Christopher A. Crane (CEO, Opportunity International)**

Microfinance has been used as a tool for alleviating global poverty for about 40 years. Billions of dollars have been loaned and the stories of success are impressive. But, though there have been many important contributions of microfinance institutions, the precise nature of the contributions are less clear. Further, determining how microfinance can be used as an important vehicle to make an even larger and more critical contribution to alleviating global poverty is in need of more careful research and articulation.

Two primary sets of questions were at the foundation of this research project.

1) What are the primary determinants of success for microfinance institutions? This question addresses why microfinance has been more successful in some cases than others. Is it the political or business environment? Is it the microfinance institutional leadership? Is it the strategy, structure, or systems to manage the organization? Is it the characteristics of the borrowers? Better articulation of the key drivers of success might lead to greater success of microfinance and a greater ability to obtain additional capital for growth.

2) What are the appropriate measures of success? Answering this question raises many issues. Is the primary goal of microfinance institutions to provide access to capital to the poor? Or, is it to provide additional income for the poor? Or, is it necessary that borrowers not only are able to increase their income but also improve living conditions that include better housing, nutrition, education for their children, and so forth?

The existing evidence on the contribution of microfinance is mixed. Is it a) that microfinance has a minor impact at best? Or is it that b) the research methods have been inadequate, c) it is often measuring the wrong variables, or d) it is not measuring the variables well? For much of its history, microfinance has primarily been conducted as an act of faith. If microfinance is to become a larger force in alleviating global poverty and to provide more scalability, better evidence of the payoffs of microfinance investments and of the impact on both the economic and social welfare of the borrowers is required.

This study is an attempt to carefully specify the antecedents and consequences of investments in microfinance, to examine the nature and amount of existing contribution, and consider how to enhance the contribution of microfinance to the alleviation of global poverty. We have completed a thorough review of the literature, examination of prior impact studies and data, interviews with senior officers at Opportunity International, and analysis of data and field interviews of microfinance activities in Ghana.

Based on our research, we have developed a microfinance contribution model that articulates the antecedents and consequences of investments in microfinance to identify both the key success factors and the key performance indicators of microfinance success. The model also includes a specification of the performance drivers and a set of measures for the inputs and processes that lead to success. We also develop a set of measures for both outputs and outcomes.

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Microfinance has been used as a tool for alleviating global poverty for about 40 years. Billions of dollars have been loaned and the stories of success are impressive. Organizations like Grameen Bank, Accion International, and Opportunity International have made impressive contributions. But, though there have been many important contributions of microfinance institutions, the precise nature of the contributions are less clear. Further, determining how microfinance can be used as an important vehicle to make an even larger and more critical contribution to alleviating global poverty is in need of more careful research and articulation.

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1) What are the primary determinants of success for microfinance institutions? This question addresses why microfinance has been more successful in some cases than others. Is it the political or business environment? Is it the microfinance institutional leadership? Is it the strategy, structure, or systems to manage the organization? Is it the characteristics of the borrowers? Better articulation of the key drivers of success might lead to greater success of microfinance and a greater ability to obtain additional capital for growth.

2) What are the appropriate measures of success? Answering this question raises many issues. Is the primary goal of microfinance institutions to provide access to capital to the poor? Or, is it to provide additional income for the poor? Or, is it necessary that borrowers not only are able to increase their income but also improve living conditions that include better housing, nutrition, education for their children, and so forth?

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The Evidence on the Contribution of Microfinance

The evidence on the contribution of microfinance is mixed. There have been many studies over the years by many diligent researchers in academics, non profit organizations, and microfinance institutions. (See, for example, Snodgrass and Sebstad, 2002; Morduch, 2000; Coleman, 2005; Hoque, 2004; Sebstad and Chen, 1996; Simanowitz and Walter, 2002; Cheston and Reed, 1999; Brau and Waller, 2005; ArmendarizdeAghion and Morduch, 2005) But, numerous obstacles exist to an evaluation of microfinance success. The studies have used different approaches to evaluation with a variety of measures and research methodologies leaving comparisons between the studies difficult. Further, differences between economic and political environment, program quality, leadership, and various contextual variables make comparisons challenging.

But, even within studies, the results are often inconclusive. Is it a) that microfinance has a minor impact at best? Or is it that b) the research methods have been inadequate, c) it is often measuring the wrong variables, or d) it is not measuring the variables well? For much of its history, microfinance has primarily been conducted as an act of faith and is logically and intuitively appealing. It provides access to capital and other financial services and can smooth and soften the financial impacts of crises (such as illness) and stabilize borrowers' income. It enables people to expand their businesses, increase their profits, and improve their lives.

For many observers, enabling the poor to gain access to capital and to reduce the impact of crises is enough. The provision of financial services to the poor is certainly an important contribution of microfinance. But, for many who want to expand microfinance and demonstrate the payoffs to capital providers in either the for-profit capital markets sector or the non-profit philanthropy sector, more conclusive evidence of impact is desirable or necessary. If microfinance is to become a larger force in alleviating global poverty and to provide more scalability, better evidence of the payoffs of microfinance investments and of the impact on both the economic and social welfare of the borrowers is required.

Background of Microfinance and Opportunity International

The field of microfinance is less than 40 years old yet it appears to have been remarkably effective in helping the poor work their way out of poverty. It typically provides loans to individuals (mostly women) to start or expand their businesses. The loans can be group or individual loans and are usually less than $1,000 and often less than $100.[1] They can be either individual or group loans and provide access to working capital and other financial services to the poor that did not previously exist. Repayment rates for microfinance are typically between 95%-100% dependent, in part, on many of the input and process factors discussed here.

Opportunity International is one of the world's largest microfinance organizations with over 700,000 clients in 27 countries on four continents. It operates through 42 operating entities, virtually all of which Opportunity founded. As opposed to some large MFIs (microfinance institutions) that have large numbers of clients located primarily in one country, Opportunity's client base may be the most widely dispersed among countries and continents.

The organization was founded 34 years ago by the former head of Bristol Myers' international operations and takes a business like approach to running its operations. The CEO and COO of Opportunity International, Inc are Harvard MBAs with extensive for profit experience and numerous other executives hold MBAs and have had meaningful corporate experience. Opportunity International is a 501(c) 3 but operates in numerous legal forms including: NGOs, finance companies, S&Ls, and chartered banks. In 2004 Opportunity International received $40 million in grant funding, raised an additional $29 million in debt funding, loaned $240 million to poor entrepreneurs and made $10 million in equity investments in MFIs. Opportunity's mission is to provide opportunities for people in chronic poverty to transform their lives. It builds on the foundation of microfinance and adds business training, mentoring, financial planning, and leadership development.

Opportunity International is an ideal setting to examine the drivers and measures of success (and failure) in microfinance. It operates throughout the world and has had significant successes and some failures in microfinance operations. By analyzing operations in various countries, sectors, size of loans, individual borrower characteristics, country economic, cultural, and political characteristics and numerous other factors, a framework can be developed that identifies the key drivers of success in microfinance and develops methods to measure social, economic, and financial success. This facilitates an examination of the tradeoffs that are often necessary between economic, social, and financial benefits and between various stakeholders including the microfinance organization, its funders, the individual borrowers, and the community. We can better understand who is benefiting from microfinance institutions and how to maximize the benefits to various constituents. Opportunity International's involvement in the conversion to for-profit savings and loans also provides a unique setting to evaluate alternative organizational structures for microfinance success to provide the greatest benefit to alleviating global poverty.

## Ghana

### Ghana: Background

Located in western Africa on the Gulf of Guinea, Ghana has a population of about 20 million. Its population has an average life expectancy of 56 years, is 99% Black African, and has a minimum wage rate of less than US$ 1 per day. Opportunity's savings and loan in Ghana, Sinapi Aba Trust (SAT), was established in 1994, currently has 55,000 clients, and is profitable and sustainable. It is growing rapidly and has plans to continue to expand to national scale. It has recently been converting from an NGO to a for-profit savings and loan. Though there have been some growing pains and some challenges in the conversion process, the current operations are successful.

### Ghana: Results of Field Research

The visit to Ghana in June, 2005 was completed to better understand the drivers and measures of success, and the challenges to improving, evaluating, and expanding microfinance. If microfinance is as beneficial for the alleviation of poverty as the anecdotal evidence suggests, a better identification of the key factors necessary for scalability, sustainability, and increasing economic and social impacts is desirable.

Interviews were conducted with 30 borrowers, along with loan officers and supervisors, senior officers, the CEO, and board chairman. All provided valuable data. The loan officers and senior officers provided valuable additional insight into the key drivers of microfinance success and potential measures of social and economic impact and success. The results of these interviews informed the development of the models and measures presented here.

The borrowers were primarily in trading and service businesses. They were selling food (cooked and uncooked), sewing or making clothes, running a beauty shop, selling staples, and so forth. They were doing this in a stall in the marketplace, in front of their home, and on the street.

Most of the borrowers were organized into group loans (or trust banks) of 35-40 borrowers though some individual loans exist. The group loans require liability of all the group members for the loans and are typically organized around affiliations through a) the marketplace, b) the home community or c) the church. The group social pressure and the mandatory attendance at weekly meetings are important elements in the high repayment rates. The weekly meetings also include compulsory business training that is needed by these new entrepreneurs.

The provision of financial services to the poor was widely appreciated. Though there are high transaction costs for the MFI related to weekly payment collections and small loans to a large number of borrowers, it does provide the poor with both increased access and lower cost capital. In addition, other financial services are often offered including insurance and safe and convenient deposit services.

The interviews with the borrowers were insightful. The interview questions were primarily focused on two sets of issues: 1) what did the borrower do with the money borrowed from Opportunity and 2) what did the borrower do with any additional profits that were facilitated by this borrowing? The results were reasonably consistent.

Borrowers reported that the loans typically allowed them to improve their businesses by either expanding product offerings or purchasing for cash in larger quantities or directly from producers to reduce cost. Though much of the loan proceeds were invested in the businesses, we do know that the loans were also used for personal needs.

The loans and the resultant business improvement did increase personal income and permit increased personal spending on children’s education, family illnesses, and improved housing, and nutrition. It also provided a cushion for the financial shocks that effect individual lives.

In addition, it often provided an opportunity for empowerment and decision rights never before encountered. This includes choices of public versus private schooling for children and other allocations of additional financial resources. The increase in confidence and self-esteem was also noticeable.

The field visits were convincing: microfinance has made a significant, positive impact on the economic and social conditions of the borrowers. Now, we examine the survey data to obtain further confirmation and details of the nature and level of the effect of microfinance on the individuals and their households.

Ghana: Analysis of Existing Survey Data

The Sinapi Aba Trust (SAT) is a microfinance institution trust providing lending services to poverty communities in Ghana. Numerous surveys and other assessments have been conducted to assess SAT's impact on its clients. As suggested in the many impact studies completed for microfinance generally, the result of prior research is mixed. Though there are some positive results in each of the studies, and taken together the results appear to be positive, the precise nature and amount of the impacts are unclear.

The results on the economic improvements are more clearly demonstrated than the social impacts but that may be due to deficiencies in the research methods and measures. There is also some evidence on the positive impact of microfinance in Ghana (and generally) on the empowerment of women, increase in respect and decision rights within the family, and increased self-esteem (Cheston and Kuhn, 2002; Fraioli, 2003)

In addition to a series of three studies conducted in 1997, 1998, and 1999 for SAT titled "transformation research" (See Afrane, 2002), there were surveys developed and carried out in 2002 and 2004 (Hishigsuren 2002; Hishigsuren et al 2004). These were a part of a continuing development of a Client Impact Monitoring System (CIMS) database and the development of baseline numbers and appropriate measures.

For the first study, five tools (two quantitative, three qualitative) were used in 2002 to gather data from existing, former, and potential clients in Ghana. This included an impact survey of 559 respondents (300 mature clients, 259 non-clients), an exit survey on 178 women who were no longer with SAT, individual in-depth interviews with 56 clients in their fourth loan cycle, and empowerment interviews with 49 clients. All respondents were women.

Surveys in 2004 were administered to SAT clients who had received at least one loan. The survey was taken by a total of 537 clients: 94 new (first loan cycle), 219 intermediate (second to third loan cycle), and 224 mature (fourth loan cycle or greater). A third study of SAT was conducted by Anthony Gyasi-Fosu as part of his post graduate work in 2002 (Gyasi-Fosu 2002) . Fifty SAT clients who had been participating in the program for at least two years were interviewed.

As a group, these studies present mixed results. Positive impact can be seen in the clients' businesses and the economic conditions of their households. Clients' businesses are becoming more successful, and therefore, they are able to provide more money to their households. However, this positive impact is not as clearly seen in terms of improvement in education, nutrition, or housing. Further, no assessment has been completed to measure the multiplier effects in the community and society.

There are some noticeable increases in clients' average monthly revenue, job creation, and clients reports of the benefits of training on their relationships with customers and suppliers. There is also some evidence of clients increasing their savings, contributing more money to their households, and spending more money on education and food. Though this evidence is not completely consistent, it generally demonstrates a positive economic impact of microfinance.

As for social impacts, it is less clear. An improvement in quality of life related to an increase in social activities, leadership, community involvement, time pressures and so forth is unclear at best and in some cases negative. Even on dimensions of housing quality, home ownership, and children's education results are unclear. In surveys of mature, intermediate, and new clients, on many social dimensions including decision rights, positive impacts were difficult to discern.

Ghana: Impact of Microfinance in Ghana

After a thorough review of previous surveys that focus on impact assessments, it appears that SAT has had a positive impact on the economic conditions of its clients. But, from the surveys, the social impact is less clear. The interviews are more convincing. Clients strongly articulate positive economic impacts on the individual, the household, and the community through job creation and economic activity. In the interviews, the clients also strongly support the significant improvement in the quality of their lives on social dimensions. Education for children, levels of nutrition, health care, and quality of housing are all improved. Thus, based on the field interviews it appears that not only is there an improvement in their economic welfare and business success but the additional income is used to help alleviate poverty and provide long term benefits to the family.

So, why aren't the results of the surveys more conclusive? In Ghana, and in impact studies in general, the research methods are still in development. The industry has not standardized appropriate measures of success and examined what specifically is necessary to achieve success in microfinance. So, in some cases the wrong variables are being measured, the variables are not being measured well, the research methods do not lead to clear conclusions, or too little data has been collected for adequate analysis. Thus, though the field research conclusions were clear, the survey data does not provide adequate support.

Microfinance Contribution Model

Analysis of the microfinance literature demonstrates the need for further specification of both the drivers of microfinance success and the measures of success. As mentioned earlier, most microfinance impact research includes economic measures for the individual, household, and business such as income, assets, and revenues (Sebstad & Chen 1996). Positive impact has been often shown in the areas of client business success and the economic conditions of the household. Business profits and household income increased for most borrowers after receiving a loan (Copestake, et al 2001; Dunn & Arbuckle 2001). But, again, the results are mixed with many studies remaining unconvinced about even the economic benefits. (For example, Hoque, 2004. Also see Coleman, 2005)

Impact assessments have also studied the social impact that loans might have on individual borrowers but this research is less comprehensive and less consistent. Most of these studies have not provided conclusive evidence that microfinance has had a positive social impact on client's lives. (For example Kabeer & Noponen 2005; Dunn & Arbuckle 2001)

Too often, studies have focused on enterprise growth, client retention, and default rates as the primary measures. Too little research has focused instead on the how the money (either the borrowings or the profits) is used and how it has improved economic and social welfare, empowerment and self esteem, and the lives of families.

Context is an important determinant of microfinance success. Measures such as growth rates, inflation rates, and policy changes in the country have been used in previous studies to measure how context influences the success of the clients' businesses, rather than how it affects the decisions of leaders in the microfinance organization (Sebstad & Chen 1996). This could certainly affect the comparability of the impact research. The impacts of microfinance can be extensive and varied and are often not documented in the research. Thus it is desirable for research to document impacts such as: the empowerment of the poor (especially women) to choose when and how to access health and education services, the reduction in vulnerability on many dimensions, and the creation of access to capital where no access existed including the building of financial systems that serve the poor which is an important aspect of growth for a developing economy. By better articulating the variety of potential impacts, MFIs can be designed to achieve these objectives and appropriate measures can be developed to evaluate success. A better understanding of the keys to success in microfinance and the appropriate measures of that success is necessary.

What are the key success factors that lead to success in microfinance? Is it the country, the political stability, level of corruption, senior management skills, loan officer skills, organization structure of the MFI, type of business created by clients, characteristics of borrower including age, gender or experience, size of loan, sector, size of community, trust bank composition, or other internal or external factors? Why has microfinance worked well in some countries and failed in others? What are the critical internal (MFI) and external (societal) variables necessary for microfinance success?

And, what are the appropriate measures of success? How much benefit is created? Are the benefits primarily financial (profit for the MFI), economic (for individual client and household), or social (for individual client and household)? Is there also a multiplier effect to the larger community and future generations (including job creation, increased spending throughout the community, and enhanced economic vitality and standard of living?

In general, we do not have adequate answers to these questions. We need to have a better understanding of the drivers of success and design MFIs to better achieve objectives. It is critical that appropriate measures be developed for the social and economic impacts and the MFIs financial performance. Any discussion about the performance of microfinance in alleviating global poverty should measure both financial success of the organization along with the success in improving the lives of the borrowers, and hopefully, through a multiplier effect, the lives of many others in the community.

## Identifying Objectives, Drivers, and Measures

Exhibit 1 describes the critical success factors that contribute to microfinance impact and success. It includes the primary inputs that guide the decisions of the MFI and the processes that the organization undertakes to provide services to its clients. These inputs and processes lead to success of the clients' businesses (intermediate output), and ultimately, the outcomes of MFI success and impacts on the clients, their households, community, and society.

Insert Exhibit 1 Here

The inputs in the microfinance contribution model help to establish the current context of the country and the microfinance institution. This includes the political, social, and cultural environment of the country and its stability, competition, and economic structure. These, along with the financial and human resource constraints of the MFI, help determine how the leadership will develop its strategy, structure, and systems in order to impact the lives of its clients and ensure the success of the MFI. The inputs and processes lead to improvements in the clients' businesses (intermediate output), which in turn, should lead to the long lasting impacts (outcomes): improvements in the social and economic conditions of the individual borrower, their households, community, and society. Additionally, in order for microfinance to have continuous success, the MFI must be sustainable and continue to have financial resources available to impact more lives. In Exhibit 2, the objectives of the inputs, processes, output, and outcomes of microfinance are further described.

Insert Exhibit 2 Here

Once the objectives of microfinance have been determined, the drivers of success and their corresponding measures must be developed. The drivers specify the critical elements that influence microfinance impact and organizational success. Drivers identify relationships that flow from the inputs to processes and then to the outputs and outcomes.

Causal relationships between the drivers within one stage and between stages are important determinants of the final outcome. Exhibit 3 provides a visual description of the causal links that drive microfinance success.

Insert Exhibit 3 Here

Inputs-Objectives, Drivers, and Measures

There are three types of inputs that are important to an MFI and help guide the decisions of the leadership in the organization. First, there is the political, social, and cultural environment of the country. This includes drivers such as government corruption, business corruption, political stability, and gender bias. Another input is competition and economic structure including an assessment of the country's economic stability, regulatory environment, physical infrastructure, and the presence and success of competitors. These are variables that the MFI has little ability to change or control. These two inputs determine the current context of the country. Among the appropriate measures for these two inputs include a political risk assessment, the number of female headed households, the prevailing interest rate, and the number of MFI's and banks currently lending to the poor. If a country is considered to be politically or economically unstable, it may affect the decision of whether to even enter. If entering such an environment, an MFI would need to develop a strategy, structure, and system that could operate and succeed within these constraints. This is part of an MFIs assessment of the country's environment.

Country analysis is a method of assessing the business environment of a country and can be used to provide organizations with valuable information before entering a particular country. It provides a classification system to identify the key factors, outside of the business, that can determine success. Country analysis consists of an evaluation of a country's strategy, context, and performance and the relationships among the three. The strategy is determined by a country's goals and policies, the context refers to the nation's resources, the "players" and "rules of the game" and the performance judges how well the country is doing economically, politically, and socially (Dyck 1997).

The information collected in country analysis can also be used to inform and be informed by the political, social, and cultural environment and competition and existing economic structure. Country analysis can be used by MFIs to help understand and evaluate these inputs. Both country analysis and the inputs of the microfinance contribution model capture the nature of the current business and social environment of the country and provide useful information for helping to determine the strategy an organization should use when entering a country. However, country analysis does not provide specific approaches to measure its information; it only provides guidelines as to what should be measured and how to organize the information collected. The microfinance contribution model provides a selection of useful measures to evaluate the current economic, political, cultural, and social condition in a country.

Lastly, there is the financial and human resources constraint of the microfinance organization, which describes two critical elements for the MFI to consider. First, the MFI needs the financial resources to provide loans and pay and train staff. Second, the country needs educated individuals willing to work at reasonable salaries to be loan officers and managers for the MFI. If an MFI must spend a significant amount of money and time to develop a capable staff, it may limit the financial viability of microfinance in a country. These two resources help determine the success of microfinance in a specified country.

Processes-Objectives, Drivers, and Measures

Leadership within the MFI must understand the context of the country to formulate a strategy, structure, and system that will be effective. Senior executives in the MFI must be knowledgeable, support the organization, and effectively communicate the mission, vision, and strategy to the other members of the organization. An excellent senior leadership team and board of directors are key elements of MFI success. The ability to effectively lead the organization could be measured through client and employee ratings and years of microfinance experience. If leaders are not experienced or knowledgeable enough about microfinance to motivate their subordinates or institute the proper strategy, structure, or systems, then microfinance is unlikely to be successful.

MF strategy is formulated by the leadership in the organization. The organization's choice of clients and products will greatly influence the direction the organization takes and the outcomes that will be achieved. Client characteristics such as business type and location, income level, and gender contribute to the level of impact that will be experienced. Additionally, the size (average and range) of client loans is an important choice, driver, and measure and shows the level of risk the MFI is willing to take. It reflects choices as to the target population and whether that is being achieved. It is a part of establishing a clear vision and mission and having the specific strategy aligned. The size of loans will impact the structures and systems necessary for effective strategy implementation.

The MFI structure will be impacted by the inputs and the strategy that is chosen. Whether an MFI chooses to acquire an existing institution or develop a group loan or trust bank system rather than or in addition to individual loans will influence the way that services are delivered and the impact that the services have on borrowers. The MFI systems designed to implement the strategy must encourage employees to be successful and the clients to participate and repay their loans. It must also encourage the learning and training that leads to success. The senior loan officers must be able to implement the systems that are in place to ensure that the final outcomes are achieved. MFI systems such as employee incentives and employee training are important for effective implementation of the strategy. Excellent credit monitoring and IT systems are also critical. In addition, client training and the social pressure that is part of group lending are drivers of success.

Intermediate Output-Objectives, Drivers, and Measures

The intermediate output of client business success is an important determinant of microfinance success because it is a primary contributor to the final outcomes. A well designed and executed MFI strategy, structure, and system should lead to improved client business performance. Indicators of a successful business include product line expansion, better management and accounting practices, and an increase in business income. If the loan does not lead to positive financial changes in the business, then positive changes in the lives of the borrowers and their respective households, communities, and societies cannot be expected. After receiving a loan, the business should experience increased revenue, increased income, and create more jobs. However, a successful business should not be the ultimate goal of microfinance; and therefore, business success cannot be considered the final outcome of microfinance impact.

Outcomes-Objectives, Drivers, and Measures

For microfinance to achieve its goals, the quality of life for individual borrowers must be improved. It is also desirable if these improvements also flow to their households, communities, and societies. Long lasting impacts should be noticeable in their economic and social lives, which could be assessed through indicators such as poverty, health, education, empowerment, housing, and self esteem. Additionally, the MFI must remain financially stable and sustainable. To earn money, the MFI needs clients to repay their loans and continue using the program. Additionally, if microfinance is a success, the MFI should be able to create growth through additional borrowings and donations and expand services.

Exhibits 4, 5, 6, and 7 provide a selection of measures that could be used to analyze microfinance success. This list is not comprehensive, but provides an example of the types of measures that should be considered by organizations when measuring impact. It also includes many more measures than would ever be appropriate for collection or analysis. They are provided as examples of the breadth of measures that could be used, and to aid organizations in choosing a very small number that are consistent with their mission, strategy, implementation process, and outcome objectives. No two impact assessments would or should be conducted the same. All impact studies must be guided by the goals and objectives of the management of the MFI and situated within the country context. The measures chosen should be aligned with these organizational objectives and the performance drivers. And, like the drivers they will need to be tested and revised. A clear understanding and measurement of the causal relationships that drive microfinance success are critical components of this model's effectiveness.

Insert Exhibits 4, 5, 6, and 7 Here

Proving and Improving the Benefits of Microfinance

For many observers, microfinance has been viewed as a success when borrowers reported high levels of customer satisfaction. But, customer satisfaction alone is not sufficient.

Donors and other funding sources are looking for evidence of both a positive social and economic impact to the individuals, households, community, and society.

Those impacts can certainly include a) providing the poor with increased access to working capital and other financial services and b) reducing risks and vulnerability and helping to protect the poor from life's financial shocks and helping to stabilize their income. And, the shocks can be significant and can quickly eliminate (at least in the short term) many of the benefits created by personal financial improvements. But, microfinance can do more. It can enable its borrowers to cross the poverty line – and stay across it. It may be able to facilitate significant improvements in social condition in additional to economic improvements.

Some observers have examined some of the variables that drive success and some measures of success. But, there have not been many comprehensive analyses of what specifically is needed to create successful microfinance enterprises and how success would be identified.

We have presented a model to look more broadly than just how many dollars were loaned and whether the borrowers were satisfied with the service. It includes a detailed identification of the inputs and processes necessary to achieve success. This includes the strategy, structure, systems, and leadership choices that microfinance organizations make that effect success. We also propose to more comprehensively measure the broad set of benefits that can be created through microfinance. This includes measures of the financial impacts on the microfinance institution and the social and economic impacts on individual borrowers and their households, community, and broader society. By better understanding both the drivers and measures of success, substantial improvements can be made that provides increased benefits for the microfinance institutions and the borrowers.

Microfinance has the promise of continuing to make major contributions to the alleviation of global poverty. And, the contributions can be much greater through a better understanding of the specific drivers of success and how the institutions can improve their operations to increase economic and social impacts. Through careful analyses of successes and failures, strategies, structures, systems, and leadership can be designed to improve microfinance success. More careful research design and implementation is necessary on both a) the inputs and processes that lead to success and b) on the appropriate measures to use to evaluate the economic and social impacts of microfinance. It can then better prove the payoffs of microfinance investments to various capital providers, move to more scalability, increase the use of the capital markets to enable growth, and more clearly articulate the important role of microfinance to society and to the alleviation of global poverty.

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**Exhibit 1: Microfinance Contribution Model: Antecedents and Consequences of Microfinance Investments**

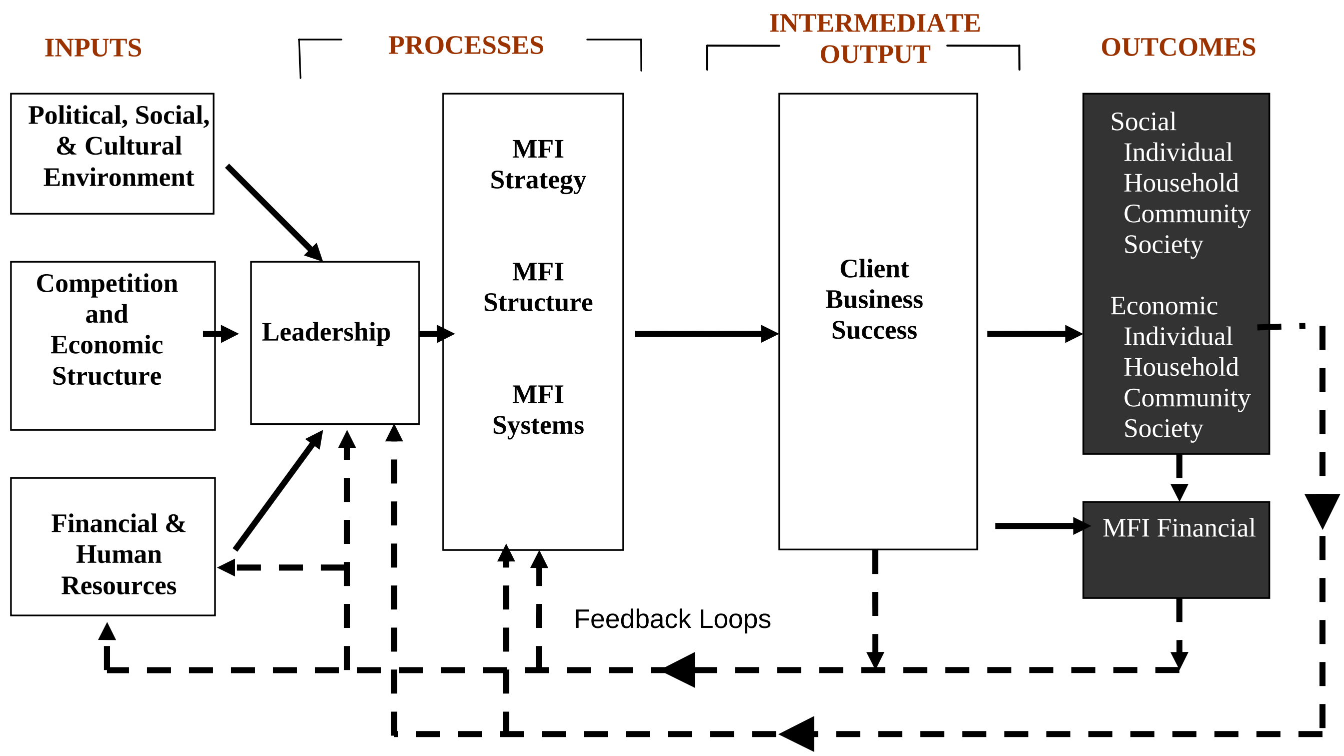

**Exhibit 2: Microfinance Contribution Model: Microfinance Performance Objectives**

| | |
|---|---|
| **Outcomes** | Social: Improved for individual, household, community, and society<br>Economic: Improved for individual, household, community, and society<br>MFI Financial: Profitability and sustainability |
| **Output** | Client Business Success: Improved financial performance and management skills and practices |
| **Processes** | MFI Systems: Appropriate processes for effective implementation<br>MFI Structure: Appropriate organizational structure aligned with strategy to achieve organizational goals<br>MFI Strategy: Adapted to environment and focused on microfinance and organizational goals<br>Leadership: Effective implementation of mission and commitment to employee and client satisfaction and microfinance goals |
| **Inputs** | Financial & Human Resources: Adequate capital and employees<br>Competition & Economic Structure: Encourages microfinance entities<br>Political, Social, & Cultural Environment: Supports microfinance development |

**Exhibit 3: Microfinance Contribution Model: Microfinance Performance Drivers**

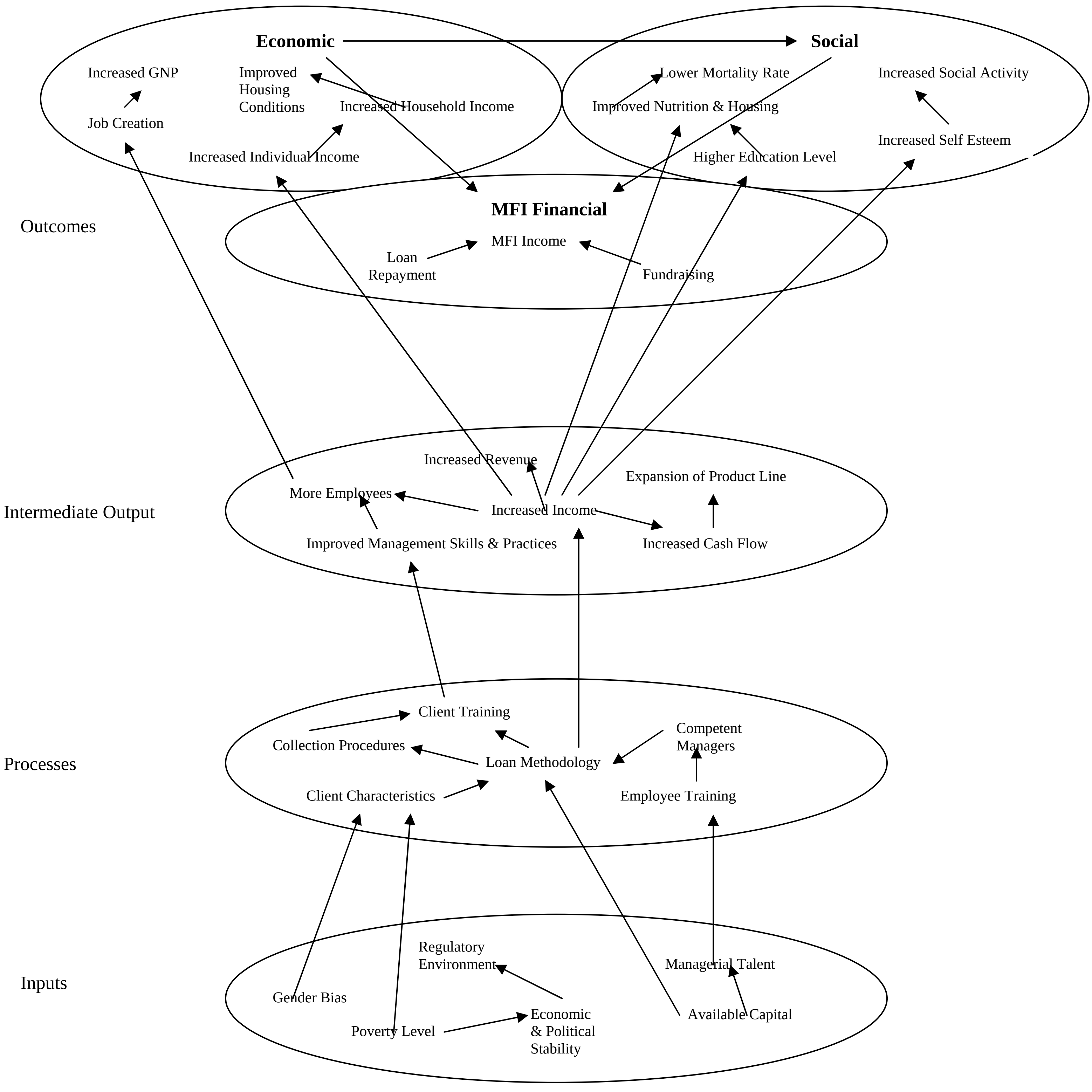

**Exhibit 4: Microfinance Contribution Model: Metrics for Microfinance Success-Inputs**

| Inputs | Performance Measures |
|---|---|
| Political, Social, & Cultural Environment | • political corruption<br>• business corruption<br>• government stability<br>• political risk assessment<br>• # of female headed households<br>• gender bias<br>• poverty level<br>• police officer to citizen ratio<br>• rate of reported violence against women<br>• education level of women<br>• % of population imprisoned<br>• community level of trust for group loans<br>• # of political alliances |
| Competition & Economic Structure | • inflation rate<br>• regulatory environment<br>• physical infrastructure<br>• interest rate<br>• GNP<br>• unemployment rate<br>• default rate on loans from other institutions<br>• national debt<br>• poverty rate<br>• # of MFIs and banks lending to the poor<br>• government support for MFI<br>• # of loans already given to business owners<br>• competitors' return on investment<br>• # or $ amount of credit subsidies to competitors<br>• $ of foreign direct investment inflows |
| Financial & Human Resources | • dollars donated<br>• dollars borrowed<br>• dollars available for employee training<br>• cost per employee<br>• median or average years of schooling<br>• median or average salary<br>• # of hours of training needed for loan officers<br>• cost of training per employee |

**Exhibit 5: Microfinance Contribution Model: Metrics for Microfinance Success-Processes**

| Processes | Performance Measures |
|---|---|
| Leadership | • average years of MF experience-senior exec.<br>• average years of MFI experience-loan officers<br>• client ratings of loan officers<br>• turnover rate of loan officers<br>• CEO evaluation<br>• board evaluation<br>• clearly articulated vision |
| MFI Strategy | • amount of loan portfolio<br>• loan size (average & range)<br>• credit ratings of clients<br>• demographics of market served<br>• # of clients<br>• % of women clients<br>• % of budget allocated to fundraising<br>• % of budget dedicated to market research<br>• % of budget allocated to marketing<br>• # of individual loans<br>• # of group loans<br>• # of other products offered to clients (saving accounts, insurance) |
| MFI Structure | • # of acquisitions of other MFIs<br>• # of loan officers<br>• % of decisions made by loan officers<br>• # of directors located locally<br>• centralized/decentralized<br>• for profit/non profit<br>• # group vs individual loans<br>• $ group vs individual loans<br>• # of branch offices<br>• # of owners and governance structure |
| MFI Systems | • dollars invested in training (client & employee)<br>• % of employees compensated based on performance<br>• # of clients per loan officer<br>• % of clients who attend training<br>• hours of training (client and employee)<br>• % of clients who re-apply and are granted loans<br>• % of income clients are required to save<br>• length of repayment period<br>• frequency of payments (weekly, bi-weekly, monthly) |

| | |
|---|---|
| | • quality of IT system<br>• quality credit monitoring system<br>• success of collection procedures<br>• frequency of required client meetings |

**Exhibit 6: Microfinance Contribution Model: Metrics for Microfinance Success- Intermediate Output**

| Intermediate Output | Performance Measures |
|---|---|
| Client Business Success | • default rate<br>• # of paid employees<br>• % change in profits<br>• % change in revenue<br>• dollars spent on inventory<br>• # of products offered<br>• % of goods purchased with cash<br>• new management skills<br>• improved business practices<br>• quality of MFI service to clients |

**Exhibit 7: Microfinance Contribution Model: Metrics for Microfinance Success-Outcomes**

| Outcomes | Performance Measures |
|---|---|
| Social Individual | • % of decisions made with client's input<br>• # of times attend church per month<br>• average hours per week dedicated to community organizations<br>• % of clients registered to vote/who voted<br>• # of leadership roles in community organizations and/or church<br>• reduced impact of financial shocks<br>• % who report higher levels of self esteem |
| Social Household | • % of school aged children who are in school<br>• # of household utilities<br>• quality of housing<br>• % of children who finish school<br>• % who go to trade school or college<br>• % of clients who stay married<br>• average hours per week families spend together<br>• # of meals per day<br>• divorce rate<br>• weekly consumption of meat, fish, milk, and eggs<br>• # of children who have current immunizations |
| Social Community | • crime rate<br>• average years of schooling |
| Social Society | • % change in poverty level<br>• life expectancy |
| Economic Individual | • access to more financial services<br>• % increase in personal income<br>• reduced impact of financial shocks<br>• % of income contributed to personal savings<br>• % of savings placed in formal financial institution<br>• dollars borrowed from other sources<br>• dollars invested into personal insurance policies |
| Economic Household | • % of individual income contributed to household<br>• $ and % spent on food and education<br>• home ownership<br>• # of household utilities (running water, toilets, electricity) |
| | |

| | |
|---|---|
| Economic Community | • wage rate<br>• number of jobs created |
| Economic Society | • % change in GNP<br>• income distribution<br>• value of currency |
| MFI Financial | • % of loans repaid<br>• % of loans in default<br>• dollars donated and invested<br>• dollars received from capital markets<br>• return on investment<br>• # of active clients<br>• # of repeat clients<br>• # of clients now borrowing from commercial banks |

[1] For further details about microfinance, see for example Drake and Rhyne, 2002; Daley-Harris, 2002; Jurik, 2005; Brau and Woler, 2005;