

The Social Impact of Microfinance and How to Measure It

“By living up to the credit contract, poor people discover their own capacity to direct their future”

Microfinance provides Financial Services to the active poor. Thereby it contributes to a positive social impact on three different levels: personal/household level, community level and regional level.

responsAbility's Discussion Papers

responsAbility publishes Discussion Papers on a regular basis. They are aimed at providing state-of-the-art information on actual topics relevant to microfinance and to our clients. Their aim is to support the ongoing discussion with our partners, clients and stakeholders with the ultimate objective of developing a common understanding of key issues in the field of microfinance and social investments.

Introductory remarks

Microfinance holds a big promise to generate income and employment and alleviate poverty in developing countries. This, in turn, can have positive social effects at different levels of society, from the personal, to the community, to the regional level.

The whole discussion about the social impact of Microfinance has just started. International bodies (namely CGAP, UNCTAD and others), development agencies, academic institutions etc. are all engaged in deepening the understanding about the social impact of Microfinance and a series of social impact studies at local and regional level are under way.

With this brief paper we would like to offer a simple framework to better understand how and where Microfinance can offer a social benefit. By no means we want to suggest that all Microfinance

institutions and projects contribute at all levels and with the same strength. On the contrary, we believe that it is important to constantly monitor also potential negative impacts, such as over-indebtedness of clients or risks of corruption and illegal use of credits.

At the same time we would like to stress that Microfinance is not the solution to all the problems in developing countries, but should be focused on economically active poor, who can afford to borrow and repay money as part of their normal budget and who are not living in an emergency situation.

The social impact of Microfinance takes place on different levels

Social impact can be categorised according to three levels: the personal, the community and the regional level (see Fig. 1).

First and foremost, the access to Microfinance usually leads to a higher and better diversified income situation, both at the personal, and at a community/regional level. From this stems a whole series of positive social impacts.

Different types of social impact at different levels have been observed in past social impact studies:

1) Personal/Household level

At this level the following effects can take place:

- Empowerment of women, who are often preferred clients of MFIs. This can lead to a higher social status, better education and more independence of women, all factors that have been shown to contribute positively to a more sustainable development of whole regions.
- Better education and further development of MFI clients, as MFIs often support them in acquiring basic skills and financial knowledge
- Ability to cope with economic shocks (e.g. loss of an important family member, natural catastrophes etc.), by means of savings, credit, microinsurance products.

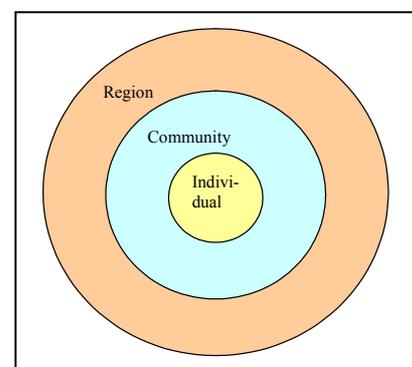


Fig. 1 Categories of Social Impact

- Higher income in general leads to better access to education, healthcare, sanitary infrastructure, food supply etc.

2) Local community level

- Creation of jobs
- Higher quality of jobs (i.e. labour conditions, productivity, skills base, empowerment)
- Higher and more stable income of the community as a whole, making it more resilient to external shocks
- In the context of savings/credit groups, members start educating and helping each other. This can support the cohesiveness of a community. At the same time, access to financial services can trigger entrepreneurship and a healthy competition among community members
- Entrepreneurship usually leads to increased trade with neighbouring communities and regions, in turn improving the economic base and resilience of the community.

3) Regional level

- Creation of jobs at the regional level
- Strengthening of the microenterprise sector which in many developing countries represents the back-bone of the economy, providing up to three quarters of jobs
- The provision of financial services to rural areas supports income and employment generation in those areas, This in turn mitigates the pressure on the environment and natural resources, and can help to reduce migration flows to urban areas
- Strengthening of the financial sector as a whole, widening its scope and outreach.

If you can't measure it.....

All actors in the Microfinance market agree with the importance of better assessing and reporting social impact. It is relatively difficult to define *meaningful* indicators, though, because of the many

Indicator	Type of impact covered
Structured descriptions of MFI mission/vision and main stakeholders	General approach of the MFI towards social impact and stakeholder relations
Structured descriptions of MFI clients and their economic activity	Check that clients are economically active. Estimate economic impact on personal/community/regional level. Estimate job supporting/creation potential. Trade versus production oriented activities.
Type of products and services offered to different client groups ¹ (loans, savings, training, other...)	Check that services offered are adapted to the needs/possibilities of different client groups and income levels
Number of branches or credit officers operating in rural/urban locations	Contribution of Microfinance to income and job creation in rural areas
Number of active borrowers	Outreach of Microfinance
Number of outstanding loans	Outreach of Microfinance
Average amount of loan, by client group	Check that loan amounts are adapted to the needs/possibilities of different client groups and income levels
Average annualized interest rates for loans, if possible by client group	Financial viability of borrowing money, from the point of view of the client
Number of clients with saving accounts	Possibility to save money as an additional source of financial income, supporting job and income creation and resilience to external shocks
Share of women, as part of total clients	Empowerment of women

indirect effects, and to define *viable* indicators, because of the large work and cost associated with collecting the necessary data.

Nevertheless, the ongoing international discussion around the social impact of Microfinance has produced a series of useful proposals for viable indicators that are summarised in the table below. responsAbility plans to test several of these indicators and to actively contribute to the international efforts to improve the reporting of the social impact of Microfinance.

Ultimately, it will be important to integrate financial and social performance indicators in an overall assessment of an MFI. *Without financial sustainability there is no contribution to social sustainability in the long run*, because the MFI will not be able to survive. The social disruption caused by the termination of services provided by the MFI can be considerable, therefore we would like to stress the importance of financial sustainability based on good financial reporting.

¹ We are exploring the possibility of roughly categorising clients by their income level. As proposed by ACCION, national minimum income levels (as defined by governments) could be used for that purpose. We are aware, though, of the challenge of collecting this type of data and will explore this possibility carefully with our Partners.