

How to Focus on Breakthrough Organizations When Selecting MFIs

Input paper for the UNCDF/SUM and UNDP Africa
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Young and Promising Microfinance Institutions

by

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This paper has been prepared as an input paper to the “Global Microfinance Meeting on Young and Promising MFIs” that was held from May 30 to June 1, 2001, at the United Nations in New York. The paper reflects the situation as of June 2001. The meeting was sponsored by the United Nations Capital Development Fund (UNCDF), Special Unit for Microfinance (SUM), and the United Nations Development Programme (UNDP) Africa. The meeting brought together 60 representatives of UNDP MicroStart Programmes, UNDP Country Offices from around the world, technical service providers, experts in the microfinance field, and UNCDF’s Special Unit for Microfinance. UNDP’s MicroStart Programmes provide technical assistance to start-up and young, promising institutions by contracting the services of experienced microfinance service providers, many of whom are from the South. The purpose of the meeting was to improve the understanding of donors, technical service providers, and practitioners working with young institutions on issues crucial to the support of institutional development and growth of young microfinance institutions.

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Introduction

The purpose of this paper is to:

- Reflect upon Save the Children Federation's experience with selecting Microfinance Institutions (MFIs) under the MicroStart Morocco project to become breakthrough organizations;¹ and
- Draw out lessons learned that are useful and applicable to UNDP MicroStart and the wider microfinance community.

The midterm evaluation of MicroStart defines a breakthrough organization as:² *An organization that becomes a major service provider in its geographic area, attaining substantial independence from donors through financial viability and influencing other providers.*

Selecting young MFIs that might achieve this is often more of an art than a science. At times it may come down to a gut feeling that the potential is there or not there. The assessor is searching for traces, indications, and glimmers of potential rather than the clear-cut ratios generated by traditional microfinance assessment tools such as the CGAP Assessment Tool.³

This paper seeks to provide insights into the characteristics of MFIs that:

- Turned out to be breakthroughs or performed better than expected;
- Turned out not to be breakthroughs or performed worse than expected; or
- Were rejected at the assessment stage.

The selection process of Save the Children was based on a system developed by the organization—the Breakthrough Potential Matrix (BPM)—that assessors of small MFIs can use to complement traditional microfinance assessment tools. It is therefore deliberately short on hard numbers, which can be obtained by using other tools such as the CGAP Assessment Tool, and long on intangible insights.

The BPM should not be tackled as a mechanical checklist and score-sheet by someone inexperienced in microfinance assessment. It can be used by an experienced microfinance practitioner to assist them to probe and analyze a young MFI for its breakthrough potential. The BPM is based on Save the Children Federation's experience at assessing young MFIs in Morocco and other countries. However it has not been field-tested and is considered very much a work in progress.

¹ UNDP selected Save the Children Federation in November 1997 to be the Technical Service Provider in Morocco under a three-year contract. This involved reviewing 12 potential organizations and selecting five for ongoing technical assistance.

² Elisabeth Rhyne and Jill Donahue, *MicroStart: Finding and Feeding Breakthroughs*, UNDCF/SUM, December 1999.

³ *Format for Appraisal of Microfinance Institutions*, CGAP, Technical Tool Series No. 4, July 1999.

This paper is organized into the following sections:

- Initial Assessment of Breakthrough MFIs Using the BPM
- Midterm Indications whether an MFI Will Break Through
- Lessons for Donors
- Conclusion
- Breakthrough Potential Matrix

Initial Assessment of Breakthrough MFIs Using the BPM

The Breakthrough Potential Matrix was developed as part of this paper to assist future assessors of young MFIs. It tries to probe the intangible elements of an MFI that will lead it to success or failure. There appear to be almost no tools that address this issue for small MFIs.

Relatively few fully sustainable MFIs in the world serve the poor, in particular women. The challenge is to sort out at an early stage the “small and promising” from the “small and weak,” and to identify small MFIs that have the vision, commitment, and capacity to develop into sustainable and large-scale MFIs that serve the poor. Experience shows that the key areas for assessment are:

- Vision, Purpose, and Legal Structure
- Board
- Funding/Resources
- Management
- Systems
- Staff
- Delivery Structure
- Loan Tracking and Performance
- Organizational Culture
- Clients

The BPM is an analytical guide for grasping the potential of a young MFI and is for use only by an experienced microfinance practitioner. It should not be tackled as a stand-alone checklist or scoring tool by an inexperienced user. The BPM is designed to assist an experienced and attentive observer to focus on characteristics that traditional microfinance assessment tools gloss over. It deliberately does not use grades or numbers because it is difficult to weight the different characteristics. On site, MicroStart typically pairs a trained user with a local counterpart to develop experience in identifying and working with breakthrough MFIs.

The user should record conclusions at the end of each section and use these conclusions to assist in an overall conclusion. A variety of techniques are available to the user. These include:

- Discussions with key donors and microfinance networks in the country;

- Discussions with the Board and staff at all levels (watching out for consistencies and inconsistencies of answers);
- Discussions with clients; and
- Observation.

Most important is not just taking statements at face value, but probing: “what do you mean by xx?” or “tell me more about xx.” It is particularly important to spend extensive time with loan officers and clients to check the reality of what management thinks is happening.

Vision, Purpose, and Legal Structure

Vision is everything: a social-development-oriented organization that is adding microfinance as a new “project,” possibly because funding is available, and does not view sustainability and scale as prerequisites, is unlikely to become a large-scale MFI. A sole-purpose MFI that has a clear vision and commitment to the poor that is felt throughout the institution is more likely to achieve this. It is also important to assess whether the MFI has an understanding of what it might take to implement its vision. It is interesting to note that for MFIs in Morocco (Zakoura), and in other countries such as Bangladesh (Grameen, ASA), having a visionary founder is a positive indicator of future success. An international microfinance network can also play this seed role. Not all budding MFIs will have an optimal legal structure, but being at least aware of future options and working toward one do seem to be additional characteristics of success.

This section of the Breakthrough Potential Matrix aims to assess whether the Vision, Purpose, and Legal Structure of an MFI are likely to position it to be a Breakthrough Organization. Techniques include:

- Review of organizational documents (charter, legal registration, strategic plan, annual report, Board minutes); and
- Discussions with Board, management, staff.

Board

The role of the Board is often underestimated during assessments and by donors—sometimes, perhaps, because many bilateral and multilateral donors do not actually have Boards themselves. An excellent Board can make a significant difference in institutional performance. A dysfunctional Board can be a real hindrance. Common issues for Boards of small MFIs include Boards comprising a number of talented individuals who rarely attend meetings and do not work effectively together. Often Board members are oriented to social development, have little understanding of microfinance, and have never actually visited a client. It is generally a good sign to see Board members with strong financial and banking skills. In some parts of the world the concept of governance and how it differs from management is poorly understood.

This section of the Breakthrough Potential Matrix aims to assess whether the Board of an MFI is likely to assist it in becoming a Breakthrough Organization. Techniques include:

- Review of Board profiles and literature, including minutes and attendance;
- Discussions with Executive Director as to how Board members are selected;
- Discussion with staff as to their involvement with the Board; and
- Discussions with Board members.

Funding/Resources

There is an enormous difference in commitment and performance between a small organization that is seeking funds to build on its core activity and one that, seeing funds are available, decides to add microfinance as a project. MFIs that have a visionary founder who has put his or her own money into an MFI or who is already thinking about tapping into commercial sources of funding seem to be more likely to become Breakthrough Organizations. Organizations that have used their own funds to bring in external technical assistance also fall into this category. Organizations that are quick to accept new resources for something in which they have little experience and are willing to change everything with little thought merely to accommodate the donor should be avoided.

This section of the Breakthrough Potential Matrix aims to assess whether the current and future resource base of an MFI is likely to assist it in becoming a Breakthrough Organization. Techniques include:

- Discussions with Board and management; and
- Discussions with staff.

Management

Some say that finding the right person to be the Executive Director of an MFI is more than half the work and that if the wrong person is in place, the technical assistance workload quadruples. A good assessment of the style and competence of the Executive Director is a vital glimpse into the future. The ideal Executive Director is someone open to new ideas and hungry to learn; someone who manages in a participatory and decentralized style, who visits clients regularly, has learned from previous institutional mistakes (such as fraud), and sees the importance of accounting and audit functions. Dictatorial, “ivory-castle” types who never visit their clients and who are closed to suggestions are extremely unlikely to steer their MFI to success.

This section of the Breakthrough Potential Matrix aims to assess whether the management of an MFI is likely to assist it in becoming a Breakthrough Organization. Techniques include:

- Extensive observation;
- Meetings with the Executive Director and staff; and
- Spending time with MFI staff at all levels (observation).

Systems

Systems in a small MFI are unlikely to be perfect, but attitudes toward systems are indicative of future commitment. At minimum, small MFIs should have a basic manual that is enforced, a budget and growth plan that are tracked monthly, and cash-flow forecasts. One warning sign in group-lending programs is a situation where groups rarely meet and solidarity is weak. Lack of commitment to address this indicates an MFI that is unlikely to succeed.

This section of the Breakthrough Potential Matrix aims to assess whether the basic systems of an MFI and attitudes toward them are likely to assist it in becoming a Breakthrough Organization. It should be supplemented with a more traditional microfinance assessment tool. Techniques include:

- Review of all manuals, budget, client growth plan, cash-flow forecast;
- Basic testing of key procedures to see if they are followed (do not be afraid to ask, after someone has told you the theoretical procedure, “Please may I see a completed version of that form?”);
- Attendance at solidarity group meetings; and
- Observation.

Staff

Staff are the heart of an MFI and the clients’ primary contact. Their attitude often defines an MFI’s public image. MFIs that build staff loyalty through training and fair personnel policies have a good chance of success. Those that use people seconded from other organizations or pay their loan officers as casual laborers risk them identifying more with the clients than the institution. Signs of this are staff openly complaining about management and procedures. This typically leads to fraud and poor performance.

This section of the Breakthrough Potential Matrix aims to assess whether an MFI’s staffing practices are likely to assist it in becoming a Breakthrough Organization. Techniques include:

- Review of procedures/personnel manuals;
- Discussions with loan officers and other staff;
- Discussions with management;
- Observation.

Delivery Structure

The key to rapid and sustained growth seems to be a solid, decentralized, and replicable branch system with the emphasis on vertical growth (focusing on fewer areas to make each branch sustainable) rather than horizontal growth (spreading thinly throughout the country). This enables quick but controlled delivery of products in an efficient manner. Heavily centralized MFIs where all lending decisions are made in the head office are unlikely to achieve scale. MFIs that focus on more densely populated areas clearly have an advantage over those that focus only on remote rural areas, but geography is only one of many factors.

This section of the Breakthrough Potential Matrix aims to assess whether the delivery structure of an MFI is likely to assist it in becoming a Breakthrough Organization. Techniques include:

- Visits to branch offices;
- Discussions with management and staff at all levels, in particular loan officers;
- Discussions with clients;
- Review of future plans; and
- Observation.

Loan Tracking and Performance

While the Breakthrough Potential Matrix is deliberately light on hard numbers, there are some key areas where data must be known and available. MFIs must know each day, in terms of loans: how much is out there, how much is due back, and how much came back at the end of each day. This requires a basic loan tracking system (manual or computerized) and daily reports of key data. MFIs that do not have these are doomed to failure, as are those that do not have a clear handle on arrears or that attempt to cover them up. MFIs that prepare financial statements quarterly are more likely to succeed than those that see these purely as a legal requirement to be satisfied each year. Of course, without a sustainable interest rate, there is no chance of success.

This section of the Breakthrough Potential Matrix aims to assess whether the loan tracking and performance systems of an MFI are likely to assist it in becoming a Breakthrough Organization. It should be supplemented with a more traditional microfinance assessment tool. Techniques include:

- Review of portfolio management system, accounting records, Balance Sheet and Income & Expense Statement;
- Testing of arrears and portfolio at risk numbers (compare loan officer records with head office records, check for rescheduling of loans, visit clients);
- Review of interest rate calculation;
- Discussions with staff at all levels; and
- Observation.

Organizational Culture

Organizational culture provides a rare glimmer of the future potential of an MFI. It is very hard to change and therefore an assessment must try and understand it. For an MFI, organizational culture includes attitude toward and openness about delinquency and arrears, transparency of information and decision-making, willingness to learn from mistakes, client focus, and nepotism. Lack of basic transparency in an organization is extremely hard to change, as is a culture of nepotism. At the end of the day, an assessment needs to rely on a gut feeling of whether this is an organizational culture that will lead to a technical assistance relationship based on mutual trust and respect.

This section of the Breakthrough Potential Matrix aims to assess whether the organizational culture of an MFI is likely to assist it in becoming a Breakthrough Organization. Techniques include:

- Discussions with management, staff (particular focus on loan officers) and clients;
- Observation.

Clients

Without clients, there is no MFI. Meeting and spending time with clients is a vital part of an assessment. The assessor is trying to understand how clients perceive the MFI, how they are targeted, and whether they are satisfied with the services. It is also a good way of checking on how procedures such as group meetings and disbursements actually function. Indicators of client satisfaction include a high retention rate and the ability of clients to clearly articulate details on their loans.

This section of the Breakthrough Potential Matrix aims to assess whether an MFI's attitude toward clients is likely to assist it in becoming a Breakthrough Organization. Techniques include:

- Discussions with loan officers and clients;
- Review of dropout/renewal rates; and
- Observation.

Summarizing the Matrix Results

Once comments have been made in all sections, these need to be weighed up against each other and an overall assessment made. It is important to note that this is merely an indication as to the likelihood of an MFI becoming a Breakthrough Organization, no more.

Midterm Indications whether an MFI will Succeed

Organizations that succeed in breaking through have one additional key characteristic: they apply technical assistance willingly and are interested in an open, honest, and transparent relationship. This can take time to develop. In Morocco it was fascinating to watch how some organizations would take technical assistance from workshops or visits and apply it by themselves. These organizations have achieved scale and are on their way to being serious Breakthrough Organizations. Other MFIs viewed technical assistance as hoops to jump through that enabled them to continue to receive MicroStart funding. Those MFIs have not and will not make it. At times it was frustrating to visit an MFI and discover it had no accounting system, no monthly budgets, or any capability of tracking actual versus budgeted expenditures, when several workshops had been held on these topics. It was even more revealing to hear, "Well we thought all those workshops just applied to other MFIs, not us."

Another MFI consistently refused over several years to provide accurate client and delinquency numbers, or even the number of loan officers in some locations. The MFI head office even told us that there were three loan officers in a location, although at the sub-office we were told there were two (and met them both). When we returned to the head office they still insisted there were three. The same MFI claimed for months that there were two loan officers in another location, which we visited several times with advance notice. Each time we were unable to meet one of them or his alleged 200 clients. The loan officer in question was always sick, on vacation, still on vacation, or a relative had died. Without transparency and a basic trusting relationship, no technical assistance relationship will be productive.

Based on the author's experience with MicroStart Morocco, the key midterm indications that an MFI will or will not be a Breakthrough Organization, beyond improving the standard portfolio statistics, are that:

- It has been possible to develop a technical assistance relationship based on mutual trust and respect;
- The MFI is fully transparent internally and externally;
- The MFI has taken technical assistance and applied it by themselves; and
- In redoing the Breakthrough Potential Matrix, there is clear evidence of significant and further movement along the continuum to and beyond "Likely to be a Breakthrough MFI."

If none of the above has taken place, it is advisable to terminate the technical assistance relationship because the chances of improvement are remote. Based on our experience, where there were significant issues, we saw little movement from "Unlikely to be a Breakthrough MFI" along the matrix continuum from the project midpoint to the end. With a Breakthrough MFI one would expect to see significant movement in almost all categories to and beyond "Likely to be a Breakthrough MFI."

Lessons for Donors

Looking back on three years of MicroStart Morocco, two key lessons are glaringly obvious:

- The bulk of technical assistance time was spent on MFIs that are never going to become Breakthrough Organizations. Donors tend to take the attitude of, "If you just give them more technical assistance, monitor them more, give them more attention, etc., they will perform." Well—they won't. The time allotted to those groups would be better spent on one or two potential Breakthrough Organizations that could reach ten times as many times clients as MFIs with no potential. It is the number of clients that can be reached with financial services that is the issue, not the number of MFIs that can be provided technical assistance; and
- Institutional culture and transparency are vital and very hard to change. There is a limit to the extent that these can be changed by technical assistance. If it is clear

than an MFI has a closed culture and is not transparent, the technical assistance relationship should simply be terminated to avoid pain on all sides.

Conclusion

Assessing Breakthrough Organizations cannot be boiled down to mere numbers, and the conclusions from using the Breakthrough Potential Matrix are merely indicative of an MFI's potential. But, when used alongside traditional microfinance assessment tools, the matrix may challenge the assessor to confront issues such as institutional culture, which are easy to ignore.

Breakthrough Potential Matrix

Unlikely to be a Breakthrough MFI	←→	Likely to be a Breakthrough MFI
I. Vision, Purpose, and Legal Structure		
Social purpose organization seeking to improve the life of poor people		Clear vision of becoming a sustainable MFI to provide financial services to the poor and a strongly felt desire at all levels of the institution to make this happen
Multi-sectoral development		Sole purpose microfinance
Adding microfinance as a new “project”		Microfinance is core activity
Founded in haste because a donor/international PVO project was ending or no visionary founder		Visionary Founder (individual or international network)
Small project vision—reaching hundreds		Scale vision—reaching thousands
Unclear target group influenced by funding available		Clear commitment to serving target client market of the poor, including women
Current legal structure is not optimal for microfinance, there is little understanding of this nor any strategy to address		Optimal legal structure for microfinance or awareness about legal issues and strategy to address them
Comments on I.		
II. Board		
Board has no understanding of microfinance		Board understands microfinance or “hungry” to learn
Board has no businesspeople or few women		Board comprises professional businesspeople including women
“Trophy Board” of important people who rarely attend meetings and do not govern		Board members regularly attend meetings and take governance responsibilities seriously
Most Board members have never visited a client		All Board members have visited clients
Comments on II.		

Breakthrough Potential Matrix

Unlikely to be a Breakthrough MFI	←→	Likely to be a Breakthrough MFI
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III. Funding/Resources		
Interested in microfinance because there are donor funds available		Seeking donor funds to build on core activity
Board will not commit their own nor the organization's resources to microfinance		Founder or Board started programme with own funds and/or have funded operations
Board/management finds idea of commercial sources of capital abhorrent		Board/management have long-term plans to gain access to commercial sources of capital or find idea intriguing
Comments on III.		
IV. Management		
Weak Executive Director—"blinkered"		Strong Executive Director—"hungry" for new ideas
Typical answer to a suggestion: "We're different..... our clients are different.....this country is different.....that would never work here"		Typical answer to a suggestion: "Interesting.....we want to learn from the experiences of other successful MFIs around the world"
In a meeting with the Executive Director and several staff, only the Executive Director speaks		In a meeting with the Executive Director and several staff, all staff speak with a consistent perspective
Management see accounting, Internal Audit and training as an unnecessary expense		Accounting department in place, either already has an Internal Audit and training function or plans for one
Management never visit clients		Management regularly visit clients
Management culture is centralized and/or "divide and conquer"		Decentralized management culture with clear accounting abilities
Comments on IV.		

Breakthrough Potential Matrix

Unlikely to be a Breakthrough MFI	←→	Likely to be a Breakthrough MFI
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V. Systems		
No policies and procedures manual, or manual is ignored by staff		Clear policies and procedures manual that is used and enforced
No annual budget, client growth plan, or cash flow forecast		Annual budget against which expenses are tracked on a monthly basis, client growth plan and basic cash flow forecast on a quarterly basis
Group lending clients rarely meet and solidarity is weak		Group lending clients meet as per the MFI's policies and solidarity is strong
Comments on V.		
VI. Staff		
Organization uses government or staff seconded from another organization to deliver services		Organization builds own staff as they <u>are</u> the institution
Organization pays loan officers as casual laborers with no benefits, unlike treatment of other staff		Loan officers are an integral part of the staff and receive the same benefit package as other staff
Staff receive no training		Extensive staff training
Staff openly complain about management and have little loyalty to the institution		Staff talk about management showing support for their work and are proud of their institution
Comments on VI.		

Breakthrough Potential Matrix

Unlikely to be a Breakthrough MFI	←→	Likely to be a Breakthrough MFI
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VII. Delivery Structure		
Several inefficient branch offices (horizontal growth) with low penetration into target population		Few efficient branches (vertical growth) with high penetration into the target population before new offices are opened
Confused or inconsistently implemented branch office systems		Clear, documented, and consistent branch office systems
Highly centralized delivery structure out of one office		Branch structure or evolving toward one
Slow, laborious procedures for client access to services, no collateral substitutes		Quick delivery mechanisms for client access to services, often using collateral substitutes
Focus on remote rural areas with low population density		Focus on urban or rural areas with reasonable population density
Comments on VII.		
VIII. Loan Tracking and Performance		
No loan tracking system in place; no idea each day of number of active clients, O/S portfolio, and repaid/overdue		Basic loan tracking system in place; daily summary of number of active clients, O/S portfolio, and repaid/overdue
High arrears/claims of zero arrears turn out to be false or result from loan rescheduling		Low arrears that are clearly identified with an action plan to resolve
Balance sheet and Income & Expense Statement are prepared annually by the external auditor as a legal requirement or not prepared at all		Balance sheet and Income & Expense Statement are prepared quarterly and reviewed by management and the Board
Low/subsidized interest rate “to better serve the poor”		High-enough interest rate to achieve sustainability
Comments on VIII.		

Breakthrough Potential Matrix

Unlikely to be a Breakthrough MFI	\longleftrightarrow	Likely to be a Breakthrough MFI
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IX. Organizational Culture		
Tolerance of delinquency—"the poor can't repay"		Zero tolerance for delinquency: "100% repayment culture"
Cover-up of arrears at any level of the organization		Openness about arrears and how to resolve them
Closed culture and/or lack of transparency, evasive answers to simple questions or different answers to the same simple question by staff at various levels		Open and transparent culture, straight and consistent answers to simple questions from staff at different levels of the organization
Repeat mistakes—"it's our way"		Learn from mistakes
Nepotism is rife: relatives of Board and senior staff are working for the institution		Clear and enforced hiring and conflict of interest policies
"Save the staff," internally focused culture with little idea of external competition		Client-responsive, externally focused culture that is aware of the competition
Gut feeling that this would be a difficult organization to work with and that mutual trust and respect would be hard to develop		Gut feeling that this would be a great organization to work with and that mutual trust and respect would naturally develop
Comments on IX.		

Breakthrough Potential Matrix

Unlikely to be a Breakthrough MFI	←→	Likely to be a Breakthrough MFI
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X. Clients		
Clients include relatives and friends of the Board and staff and do not appear poor		Clients are from the MFI's client target market
Most clients are those who walked in off the street		Most clients are referred by existing clients or attracted by the institution's promotional efforts
Clients do not know the name of the institution that gave them the loan, complain about poor service and that they are always kept waiting for repeat loans		Clients know the name of the institution that gave them the loan and appear satisfied with overall client service
Clients have no idea of the loan amount they took, each repayment amount, nor the next loan amount for which they are eligible—often they look at the loan officer who dominates the conversation and answers all the questions for the client		Clients can clearly articulate the amount of the loan they took, each installment, and the amount of the next loan they hope to receive
Low renewal/high dropout rate		High renewal/low dropout rate
Comments on X.		
Overall Comments on Likelihood of becoming a Breakthrough MFI:		