Impact Assessment of Microfinance

Interim findings from a national study of MFIs in India

July 2003

EDA Rural Systems Pvt Ltd

for Small Industries Development Bank of India
This is the summary version of

“The Maturing of Indian Microfinance: A longitudinal study”,
Impact Monitoring and Assessment Report 1

The full version of the pre-test report and this report with
annexes and statistical tests are available at

EDA Rural Systems Pvt Ltd
107 Qutab Plaza, DLF Qutab Enclave-1, Gurgaon 122 002, India
Tel: (0124) 235 0835, 235 6692, 505 0739, Fax: 235 2489
edarural@vsnl.com

and

Small Industries Development Bank of India, SIDBI Foundation for Microcredit
10/10, Madan Mohan Malviya Marg, Lucknow 226 001
Tel: (0522) 2209517-21, Fax: 2209513-14

These can also be downloaded from the websites
www.edarural.com
www.mitrabharathi.com
www.enterprise-impact.org.uk

Study team: Frances Sinha, Nand Kishor Agrawal, Meenal Patole, Rajendra Prasad,
Nishant Tirath, R Vardhani, Rakhi Sahay, Saurabh Srivastava, Sakshi Varma, Sanyukta

In association with: David Hulme, Jennefer Sebstad

Advisory Committee: S Rajakutty, Renana Jhabvala, M S Sriram, Amit Ray
Introduction and Acknowledgements

The SIDBI Foundation for MicroCredit (SFMC), a department of Small Industries Development Bank of India (SIDBI), has commissioned EDA Rural Systems, Gurgaon, (EDA) to design and carry out Impact Assessment of its microcredit programme in India. This is part of the Micro Finance Support Project (MFSP), started in April 2000, and supported by the Department for International Development (DFID), UK and the International Fund for Agricultural Development (IFAD), Rome.

The research coincides with the implementation of the MFSP, and combines longitudinal design (panel data) and impact monitoring. The comparison of panel data (baseline and follow-up) will provide evidence for impact at the end of the project (impact being defined as ‘change that can be plausibly associated with involvement in a microfinance programme’). Interim findings are already emerging from outreach analysis, cross-sectional analysis of the baseline data, and client feedback. This research summary presents some of the findings from the first baseline sample of ten microfinance institutions (MFIs) – (Report 2 shown in the ‘Time Line’ below). Another ten MFIs will be added to the baseline sample in the next research phase, already under way.

<table>
<thead>
<tr>
<th>Time Line for Impact Assessment</th>
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<tbody>
<tr>
<td><strong>Pre-test [5 MFIs]</strong></td>
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<tr>
<td><strong>Baseline [10 MFIs]</strong></td>
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<tr>
<td><strong>Baseline [+10 MFIs]</strong></td>
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<tr>
<td><strong>Follow-up</strong></td>
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<tr>
<td><strong>Follow-up</strong></td>
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<tr>
<td>July ’01– March ’02</td>
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<tr>
<td>April ’02– March ’03</td>
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<tr>
<td>April ’03– Jan ’04</td>
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<tr>
<td>2004–2005</td>
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<tr>
<td>2005–2006</td>
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<tr>
<td>Report-1</td>
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<tr>
<td>Report-2</td>
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<td>Report-3</td>
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<td>Report-4</td>
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<tr>
<td>Report-5</td>
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</tbody>
</table>

The study will assess on a national scale the outreach and development impact of MFI programmes in relation to different product designs and delivery systems in various parts of India. A series of reports is intended for use by policy makers, MFI practitioners and researchers.

Impact assessment is being undertaken by a team from EDA in association with the Institute for Development Policy and Management at the University of Manchester, UK. Field work is carried out directly by the EDA team assisted by local field researchers, and involving MFI staff. Reports are reviewed by participating MFIs and by an Advisory Committee of representatives from SFMC, DFID, the National Institute of Rural Development, Jawaharlal Nehru University, Indian Institute of Management (Ahmedabad) and the Self Employed Women’s Association.

We thank the many people who have contributed in different ways to this research, and accept responsibility for any gaps and limitations. An understanding of impact takes time and reflection, and involves various approaches to data collection, analysis and reporting. We trust this short summary – and the larger report – contributes to such an understanding and look forward to feedback and suggestions on any aspect.

Frances Sinha and the Impact Assessment Team
EDA Rural Systems Private Limited
July 2003
The microfinance context

In India there is a diversity of approaches to microfinance, involving banks, government agencies, NGOs. The focus of the MFSP – and of this study – is the specialized MFIs who provide financial services whilst building their own financial sustainability.

Most MFIs use groups as intermediaries for financial transactions, but there are different ways of working with groups. These may be broadly classified as the Self Help Group model (SHG), the Grameen replicators and Cooperatives (the latter often catering to a specific economic sector – such as fishing, handlooms, dairying). In each of these models, the group usually assumes joint liability for loans taken by its members, but there are significant differences in the services offered and in the extent of client responsibility in financial transactions (discussed further in the report). A small number of MFIs have an individual banking approach.

Currently, SFMC directly provides funds for on-lending and capacity building support to 44 MFIs with over 1.3 million members. SFMC also partners an Apex MFI which supports another 47 smaller MFIs with over 0.3 million members. The majority of MFIs follow the SHG model of microfinance.

<table>
<thead>
<tr>
<th>SFMC partners in microfinance (March 2003)</th>
<th>No of MFIs</th>
<th>No of members</th>
<th>% members by model</th>
<th>% members who are MFI borrowers</th>
</tr>
</thead>
<tbody>
<tr>
<td>SHG</td>
<td>23</td>
<td>833,000</td>
<td>64.5</td>
<td>28</td>
</tr>
<tr>
<td>Grameen</td>
<td>10</td>
<td>383,000</td>
<td>29.7</td>
<td>75</td>
</tr>
<tr>
<td>Individual banking</td>
<td>6</td>
<td>61,000</td>
<td>4.7</td>
<td>90</td>
</tr>
<tr>
<td>Cooperative</td>
<td>5</td>
<td>14,000</td>
<td>1.1</td>
<td>22</td>
</tr>
<tr>
<td></td>
<td><strong>44</strong></td>
<td><strong>1,291,000</strong></td>
<td><strong>100.0</strong></td>
<td><strong>45</strong></td>
</tr>
</tbody>
</table>

Impact assessment is essentially about whether a programme is meeting its objectives. Therefore, the starting point was the overall goal of MFSP, stated as: “Substantial poverty elimination and reduced vulnerability in India amongst users of microfinance services, especially women”. The MFSP goal was developed into key research questions, taking MFI objectives into consideration:

- Who is being served by microfinance? Are the poorest getting left out?
- Does microfinance lead to a reduction in poverty: Is it sufficient to move poor families out of a situation of poverty deprivation and vulnerability? Or does it enable the better-off to provide employment opportunities to the very poor?
- Which products and services are most effective in reaching the poor, responding to the needs of the poor – and at the same time providing a cost-effective and sustainable microfinance service?
Does women’s role as clients for microfinance translate into empowerment for them? Or is this merely a pragmatic means of ensuring repayments and group discipline?

What effect does microfinance have on other systems or sources of finance – both formal (local banks) and informal (moneylenders, traders)?

These questions were framed as hypotheses linking input variables (MFI services) and moderating variables (client characteristics, programme characteristics, other context factors) to impacts at the levels of household, individual client and local community.

Methodological approach

The scale of the study (a number of institutions across a large country), the number of hypotheses and impact pathways, and the long-term timing of the study entailed adaptations - and some innovations - in established methodologies, as listed below. Indicators and tools (quantitative and qualitative) were pre-tested at 5 MFIs (see Report 1 for details).

Drawing on established approaches:

- Longitudinal analysis of panel data – the same baseline sample is revisited after 2-3 years
- Cluster based sampling: 2-6 ‘clusters’ randomly sampled at each MFI, the number depending on the variation within an MFI
- All MFI members within a cluster interviewed (150-200/MFI: the minimum number of households required is 96 for a statistical confidence level of 95% for each MFI model at regional level)
- A mix of quantitative (survey, questionnaire based) and qualitative (focus group discussions, case studies, semi-structured interviews)
- Non-member households as a comparison group in the ratio of 1:3 clients (selection on the basis of wealth ranking is intended to address the difficult issue of client self-selection)
- Including dropouts (all in the cluster who have left a programme in the previous 2 years)
- Regional development ranking to compare different operational contexts of MFIs.

Adaptations and innovations

- Poverty ‘measurement’: combining local indicators and contextual information based on ‘participatory wealth ranking’ with an ‘objective’ standardised scale. Results in 5 wealth rank categories: very poor, poor, borderline, self-sufficient, surplus. These categories can be applied across the entire sample. In terms of income/expenditure based definitions, “very poor” and “poor” correspond to ‘below local poverty line’; “borderline” correspond to below ‘$/day’ (at purchasing power parity)
- “Empowerment” indicators: explored through the perceptions of clients in terms of issues which are important to them (rather than assuming predetermined indicators)
- Financial landscaping and household portfolio analysis details the context in which MFIs are operating (alternative local finance providers, household credit needs and access over a 2 year period)
- Combining longitudinal with cross-sectional analysis: analysing the base line sample by levels of involvement in an MFI programme (in terms of time of membership and access to loans, including both MFI and group loans to incorporate different MFI approaches); 3 levels defined as ‘low’ (recent members less than 2 years with the programme), ‘medium’ and ‘high’
MFI profile information collected in detail – including savings and loan products, indicators of portfolio performance, growth, age of the programme, approach to targeting and gender – as part of the analysis comparing inputs to outreach and impact.

MFI sample: 10 MFIs are covered in this interim baseline report. They have been selected from different regions of the country and represent the different MFI models as follows: 6 SHG, 3 Grameen, 1 Cooperative. The findings at this stage of the research are based on a sample of 39 clusters, 1,871 clients in 1,728 households, 568 non-client households, 129 dropouts; around 800 participants in FGDs, and 74 case studies. Fieldwork was carried out from April to October 2002.

Who are MFI clients?

The current SFMC partner MFIs are concentrated in the southern states which account for 90% of total members. Membership is mainly rural (78%) and predominantly (95%) women.

The study sample shows that the MFIs are operating in underdeveloped areas – poorer districts and urban slums – where the majority of people have very limited access to formal sector finance. Within these areas, MFI clients usually come from all economic and social sections of the community: 30% of members are scheduled caste or scheduled tribe; 39% of recent members (those who joined the MFI within the previous two years) are poor, 33% are borderline (vulnerable non-poor), 28% are non-poor. MFIs do not specifically target the poorest who are 8% of recent members.

Women heads of households (widows, women deserted by their husbands, having to bring up their children practically single-handed and regarded as a particularly vulnerable group in their local communities) are 14% of members.

What do clients use microcredit for?

Some 49% of the sample (841 clients) had borrowed from the MFI in the two years prior to the survey. The average amount borrowed by each household over this period was Rs9,100 ($165). Of this, 72% was used for investment, 28% to meet household needs. Clients of SHG MFIs have greater flexibility of loan use, and are more likely (across all categories of involvement) to use microcredit for household needs. SHG clients also have access to group funds (based on their savings) for internal loans and these are used primarily for household needs.
How significant is microcredit to client households?

Microcredit (MFI or group loan) is one source of loans. The majority (70%) of client households also borrow from informal sources – moneylenders, pawnbrokers, ‘finance companies’, family and friends. These sources continue to be important on account of their easy and speedy accessibility, and flexibility in amount and terms.

Data for total reported household borrowings over the previous two years, shows that the share of microcredit was 34% - on par with moneylenders, who charge interest rates of 36% and above, sometimes as much as 200% for short-term loans. Nevertheless the comparison with non-customers suggests some reduction in client dependency on high cost sources (and is also indicated by data comparing recent with high involvement clients).

Assuming (on the basis of FGD feedback and case studies) that, if there were no MFI programme, clients would have borrowed half the microcredit amount from higher cost informal sources, there would be an estimated saving of Rs1,110 ($24)/borrower on interest payments as a result of the MFI programme. This is a significant amount for a poor household.

<table>
<thead>
<tr>
<th>Household borrowings (over 2 years)</th>
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<tbody>
<tr>
<td>N – sample borrowers</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Clients : 1,491</td>
</tr>
<tr>
<td>Non-customers : 394</td>
</tr>
</tbody>
</table>

Source: Survey data, 9 MFIs; Cooperative sample not included since average credit levels are much higher in the economic sector covered. Statistical tests for differences between client and non-client households are significant for informal sources.

<table>
<thead>
<tr>
<th>Microfinance products and services (10 sample MFIs)</th>
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</thead>
<tbody>
<tr>
<td>MFI loans</td>
</tr>
<tr>
<td>Enterprise or general loans</td>
</tr>
<tr>
<td>Housing</td>
</tr>
<tr>
<td>Emergency</td>
</tr>
<tr>
<td>Repayment</td>
</tr>
<tr>
<td>Annual interest</td>
</tr>
<tr>
<td>Effective Interest Rate</td>
</tr>
<tr>
<td>Savings</td>
</tr>
<tr>
<td>Regular deposits</td>
</tr>
<tr>
<td>Annual interest</td>
</tr>
<tr>
<td>Internal group loans</td>
</tr>
<tr>
<td>Terms</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Variable – often 3% interest/month, repayment within 3-12 months</td>
</tr>
</tbody>
</table>

* The Effective interest rate (EIR) converts all financial costs to the borrower (such as interest, fees) into a declining balance interest calculation. (The figure in the table does not include the cost of compulsory savings, which would add another 5% to the EIR)

* From member savings, mainly in SHG model
Microcredit for enterprise

Just over half (53%) of the sample - 919 clients - had used microcredit for over 1,000 productive activities or assets; (47% of clients had not used microcredit for investment). The sectoral distribution is evenly balanced in the rural sample between agriculture, animals and non-farm activities. In the urban sample, services and trade are the main activities. (Manufacturing accounts for less than 10% of supported enterprises). Nearly one fourth (245) of supported activities were new non-farm enterprises (e.g. a milch animal, a small shop) although 20% of these had closed by the time of the survey.

Supported enterprises are mainly small scale, family based, with 950 employed (mainly self employed or family labour) in 615 non-farm enterprises (excluding agriculture and coastal fisheries). Half of those working are men – although most of the enterprise loans have been taken in the name of women clients. But 8% are children, half working full time, one fourth as hired labour.

An increase in income was reported for 70% of supported enterprises as a result of microcredit – through for example the use of working capital to diversify or improve the quality of goods, or to take advantage of seasonal bulk purchase. However, there were problems: of illness in the household (especially for the very poor) – directly affecting productivity and draining working capital; loss or damage to an asset (a broken push cart, a sick animal) or seasonal marketing constraints.

Case studies illustrate both successful enterprises supported by microfinance – resulting in improved economic status – and examples of closure or difficulty.

Microfinance and poverty reduction

Data so far indicates that microfinance has contributed to poverty reduction by supporting asset formation (mainly productive assets and savings) especially for poor and very poor clients. Client households have a slightly higher number of income sources and a lower dependency burden in comparison with non-client households.

Trends in debt liability are mixed: data for the Grameen sample shows lower dependency on moneylenders for high involvement clients, but in the SHG sample, the data indicates significant moneylender contributions to an increasing overall debt amount. The latter may suggest increasing creditworthiness but there are cases of the debt servicing requirements exceeding estimated income.
There is no apparent difference between clients and non-clients in whether they send their children to school (primary, secondary or college level). Some 16% of clients with school-age children had borrowed from various (mainly informal) sources to meet schooling costs. Microfinance (only group loans in the SHG model MFIs) contributes just 17% of total borrowings for education.

Microfinance and management of risk

Apart from a promotive role (through boosting economic status and opportunities) microfinance may also play a protective role – enabling vulnerable groups (the poor and borderline categories, women headed households) to protect against risk (or loss) ahead of time, or to cope with risks when they occur.

Ex ante, microfinance has helped women to earn independently and to build assets, which may be sold (for example animals) at times of financial stress. Ex post, microfinance has contributed (40%) to client borrowings in risk situations, and the microfinance group can be an important source of peer support and example for women facing such situations.

Client savings are not necessarily an immediate resource since in most MFIs these are non-withdrawable, unless the client drops out. Insurance products are only at a preliminary stage: 15% of the client sample had coverage (loan linked asset or life) through an MFI.

Microfinance and women’s empowerment

Although the sample MFIs are working with women, their gender approach is at best supportive, sometimes neutral; none are transformative with a focus on gender relations.

Nevertheless, the findings indicate positive impacts at individual and household levels. In terms of savings and access to loans, contribution to household income and role in household decision-making, there is a positive direction of change, especially for women who are directly earning (~77% southern sample, ~55% northern sample).

Women gain a sense of self-respect and confidence from the opportunity to meet other women in a group, sharing experiences and ideas, and having the support of common action (more likely in mature groups, in SHG model).
However, at the household level, conventional gender patterns (ownership of assets by men, enterprise management by men) continue. Thus, women are not necessarily involved in the enterprises for which microcredit is provided in their name. They are involved in enterprise management (solely, or jointly with men) in 71% of supported enterprises in the southern sample, but just 39% in the northern sample. (The north Indian culture especially delimits opportunities for women).

Is this an issue for them? Maybe not, since women say that what is important for them is not whether they manage the enterprise or not, or own an asset, but that the activity generates income for the family.

Less positive feedback was that group leaders get more opportunities than other members, women sometimes find it difficult to find the time for meetings and there is some continuing discrimination against scheduled caste women in mixed groups. Groups would like to take action against alcoholism – but group based initiatives within the community were few, and not necessarily successful.

**Observations**

The findings of this study so far support substantial achievements of SFMC partner MFIs who are moving towards greater outreach to the unreached (to the poor, to women – including women headed households and to marginal social groups). Microfinance provides a safe savings mechanism and options for microcredit (both from the MFI and from internally circulated group savings) which compare favourably with formal bank loans in terms of accessibility, and with alternative informal moneylenders in terms of cost.

The MFIs covered in the sample represent different models of microfinance with variations in focus, approach and products. While there are variations too within ‘models’, SHG based MFIs have a more people-centred approach with opportunities for women’s leadership and member involvement in group-based decision making and activities. Grameen type MFIs usually focus only on credit delivery and repayment. Each represents an effective mechanism but there are issues and lessons emerging from both approaches.

- **Regional imbalance:** the North and East of the country, where poverty is most concentrated, are under-served; this should be addressed through support to local MFIs as well as to regional extensions by southern MFIs

- **Targeting the poor:** nearly all MFIs say they target the poor, but they could do so more systematically; the research so far shows that the poorest are not being significantly covered

- **Poverty reduction through social protection:** in addition to the promotive role of helping poor people increase their incomes, microfinance can help them manage vulnerability

- **Women’s empowerment:** most MFIs target women clients for pragmatic reasons. MFIs should be encouraged to make gender concerns more of a focus in their strategy and approach, especially in the North where cultural constraints are very strong
• **Widening of social capital**: there tends to be a focus on group leaders for training inputs and skill development. There is scope for spreading leadership responsibilities and widening skill effects through encouraging rotation of group leaders and peer training.

• **Savings**: are an important component of microfinance. This service could be made more flexible in terms of deposit frequency and allowing some withdrawability, with clearer communication about interest benefits.

• **Loan products**: need to be designed with greater flexibility in purpose, amount and repayment terms. This applies particularly to Grameen MFIs which have weekly repayments and a very high EIR (based on a flat rate of interest). Loan products for different types of enterprise need to be linked to specific enterprise requirements – and these need to be better understood by MFIs.

• **Insurance services**: are a prime need, especially for assets and for health (of the family, not just the client). MFIs can now link clients to insurance schemes operated by national agencies.

• **Business Development Services**: linked to, but not part of, microfinance would help enterprise growth, especially for example through identifying opportunities, financial planning, and helping traditional manufacturing units respond to changing market demands.

• **Other development issues**: the research has shown some child labour and negative environmental effects in enterprises supported by microfinance. These are not extensive but MFIs should have an avoidance policy.

Other issues of development policy and implementation, which affect poverty reduction and the utility of microfinance, need to be addressed at a different level altogether: these include more cost-effective medical care, promotive/preventive health, and remunerative employment opportunities for women.

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The next report will cover an additional 10 MFIs, extending the total sample to approximately 5,000 households (clients, non-clients and dropouts). The larger sample will enable more detailed analysis in relation to context (region and rural/urban area) and input variables (MFI portfolio performance – repayment rates and portfolio at risk, operational self-sufficiency, and product innovation).

The next phase will also include: more case study based analysis on enterprise economics, credit needs and returns on investment; data presenting range of credit needs and a sub-sample profiling household incomes, dietary patterns, health/education expenditures and understanding of accounts/banking procedures by clients from different wealth rank categories.
This study assesses the development impact of microfinance in the context of the wide variety of product designs and delivery systems in different regions of India. Conducted on a large scale and over an extended period of time, the research adapts existing tools to pioneer a comprehensive methodology for impact monitoring and assessment. The interim findings documented in this summary contribute to an understanding of how microfinance supports the financial needs of its clients, whilst highlighting issues of targeting, product design, women’s role as microfinance clients and the competition from moneylenders.

SIDBI

The SIDBI Foundation for MicroCredit (SFMC), a department of Small Industries Development Bank of India (SIDBI) has emerged as one of the primary support institutions for microfinance in India. Under the National Micro Finance Support Project (MFSP), initiated with DFID and IFAD support in April 2000, SFMC is taking an important step towards meeting the growing demand for financial and non-financial support to MFIs in the country.

SFMC is providing funds for on-lending to 45 microfinance institutions (MFIs) in different parts of India. The list includes the names of some of the best-known MFIs in the country. By 2007, SFMC expects to increase its number of MFI partners to 80.

EDA

EDA Rural Systems Private Limited, Gurgaon, is a development consultancy organization that specialises in microfinance and micro-enterprise development as well as monitoring/evaluation services. EDA has been selected by SFMC to design and carry out impact assessment of the MFSP over the seven-year period of the project.

During the 20 years of its existence, EDA has carried out over 200 assignments on policy research, capacity building, and monitoring/impact assessment of livelihood programmes. It is one of the premier institutions providing specialised services to the microfinance sector in India and the Asian region.