



BWTP
Asia's inclusive finance community

Image courtesy of the Asian Development Bank

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By Ron Bevacqua, Co-Founder and Managing Director, Applied Cross-Cutting Empowerment Strategies and Solutions (ACCESS) Advisory, Inc.

Microfinance impact survey: a call to rebalance industry priorities?

Summary

If microfinance practitioners expect financial services to have an impact on incomes — and a survey of BWTP members suggests this is the case — then there is sufficient evidence that what the industry is doing now is not working (enough). Yet the industry's priority is heavily weighted toward more of the same — increasing access. BWTP survey respondents say that client usage of financial services is far more important than access in contributing to positive changes in clients' lives, but there has not been the same systematic and concerted effort to find ways to address usage issues as there has been to increasing access.

This paper presents a case for making understanding and positively impacting client usage as much of an industry priority as access has been for two decades.



This article is based on research and contributions from members of the Banking with the Poor Network, the largest regional network in Asia comprising a diverse range of microfinance stakeholders committed to improving the quality of life of the poor through promoting and facilitating their access to and use of sustainable financial services. The views expressed in this article are those of the author.

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Introduction

In January 2015, the American Economic Journal: Applied Economics published a series of articles on the impact of microcredit. The six randomized evaluations, conducted in six countries on four continents in both urban and rural areas between 2003 and 2012, found only modestly positive, but not transformative, effects from access to credit.

Each study found at least some evidence that expanded access to credit increases business activity and, in some cases, assets. However, none of the six studies found a statistically significant increase in total household income. There was also very little evidence from the studies that consumption, which is a widely used proxy for living standards, increased as a result of gaining access to finance either. In fact, there was not even consistent evidence linking access to credit to an increase in one of the most basic measures of living standards, food consumption.

There was some evidence that increases in business income was offset by reductions in wage income. This result suggests that although microcredit may not be transformative in the sense of lifting people or communities out of poverty, it does afford people more freedom in their choices (e.g., of occupation) and the possibility of being more self-reliant (Box 1).

Box 1: Conclusions based on six random evaluations¹

First, there is little evidence of transformative effects.

Second, the lack of transformative effects is not for lack of trying in the sense of investment in business growth. There is pretty strong evidence that businesses expand, though the extent of expansion may be limited, and there are hints (eye-balling the pattern of positive coefficients across studies) that profits increase. The evidence on why expansion does not produce strong evidence of increases in household living standards is mixed: some studies and evidence suggesting that households trade off business income for wage income, while others suggest that larger businesses are no more profitable, even in level terms, than smaller ones (at least on average).

Third, the lack of transformative effects should not obscure other more modest, but potentially important, effects. The studies find some, if not entirely robust, evidence of effects on occupational choice, business scale, consumption choice, female decision power, and improved risk management. As we stated previously, if microcredit's promise were increasing freedom of choice it would be closer to delivering on it.

Fourth, just as there is little support for microcredit's strongest claims, there is also little support for microcredit's harshest critics. The studies find little evidence of harmful effects, even with individual lending (Bosnia, Mongolia), and even at a high real interest rate (Mexico).

Fifth, the limited analysis of heterogeneous treatment effects in these studies does suggest the possibility of transformative effects—good for some, bad for others—on segments of microlenders' target populations.

In March 2015, the Wall St. Journal picked up on this story, quoting Dr. Abhijit Banerjee, an economics professor at the Massachusetts Institute of Technology who co-wrote one of the studies, as saying "They [the microlending industry] will definitely have to tweak the model"².

¹ Banerjee, Abhijit, Dean Karlan, and Jonathan Zinman "Six Randomized Evaluations of Microcredit: Introduction and Further Steps" *American Economic Journal: Applied Economics* 2015, 7(1): 1–21, p.14. <http://pubs.aeaweb.org/doi/pdfplus/10.1257/app.20140287>.

² Bellman, Eric, "Calls Grow for a New Microloans Model", *Wall St. Journal*, March 17, 2015. <http://www.wsj.com/articles/calls-grow-for-a-new-microloans-model-1426627810>.

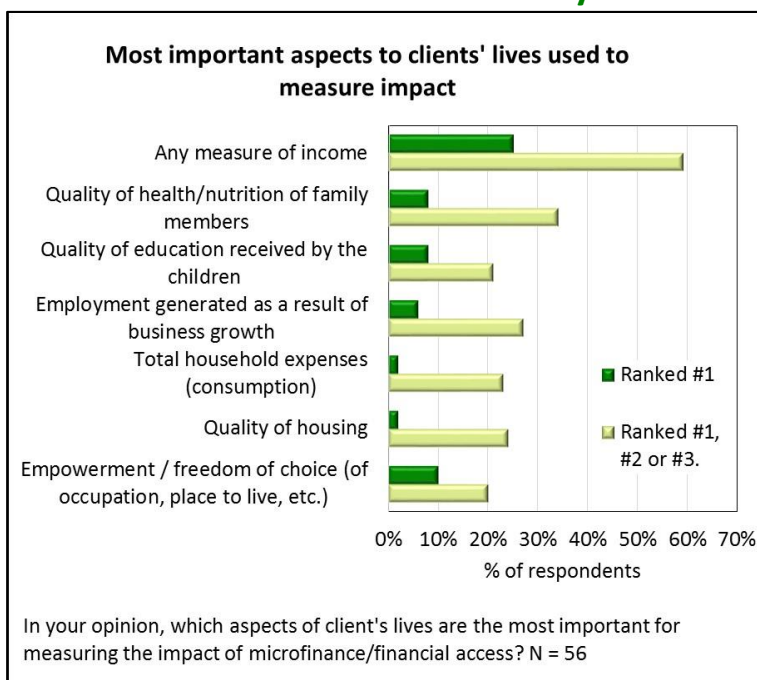
The question of the impact of microfinance has been raised often, particularly since the awarding of the Nobel Peace Prize to Muhammad Yunus and Grameen Bank in 2006 was quickly followed with negative press after the Compartamos and SKS IPOs, the entrance of purely profit-oriented actors as either investors or service providers, and the credit crises in several countries that began in 2008. One of the key industry initiatives aimed at addressing these concerns has been the promotion of a managerial approach to financial service delivery that utilizes social as well financial performance metrics in making strategic and operational decisions. Yet although a substantial body of literature and expertise has been developed in a relatively short period of time, even the guiding document for managing social performance, the Universal Standards for Social Performance Management (USSPM) defines client outcomes only in general terms as “a change in the well-being of the client, community or environment.”

That said, the USSPM are *process* guidelines. They do not refer to client outcomes because that is not their goal. To address this, the Social Performance Task Force (SPTF), which facilitated the development of USSPM, plans to include tracking outcomes as a goal and has formed an Outcomes Working Group³. The goal of the working group is to convene stakeholders to develop meaningful and consistent indicators for client outcomes.

The Banking with the Poor Network (BWTP) recently commissioned a survey of its members to understand how they, as microfinance practitioners and providers of a range of financial services to the poor and disadvantaged, understand the impact that microfinance has as well as what works and what could be tweaked in the model, as Dr. Banerjee suggests is necessary. It is important to note, therefore, that this paper reflects the practitioner’s perception of impact, rather than the effects reported by clients themselves.

The survey was conducted in December 2015 and January 2016. Sixty responses were received from every country represented by the BWTP membership except Mongolia and Myanmar. Forty-one of the 60 respondents represented financial service providers, most of whom were board members, CEOs or senior managers. Sixty-two per cent of respondents had more than 10 years’ professional experience in microfinance. The responses to the survey thus represent the collective insights of the BWTP members drawn from decades of first-hand experience.

Results of BWTP member survey



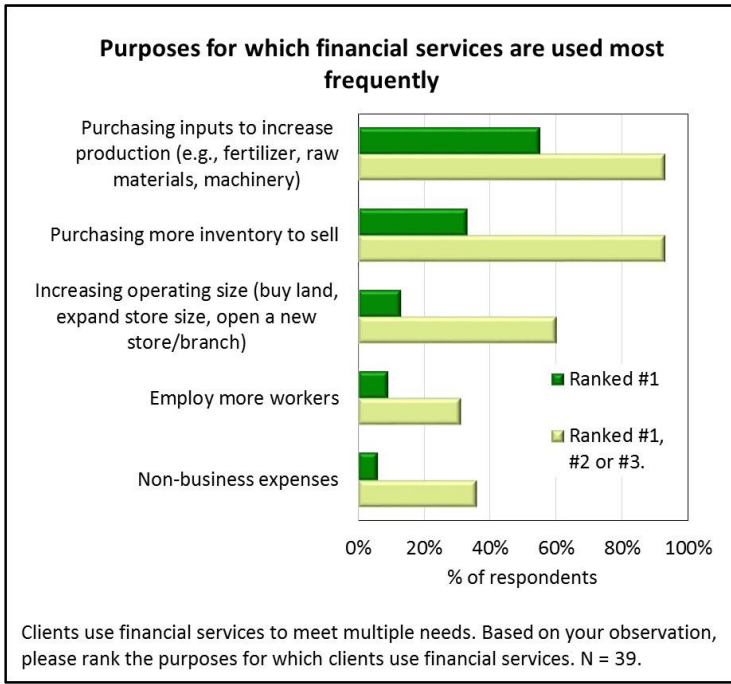
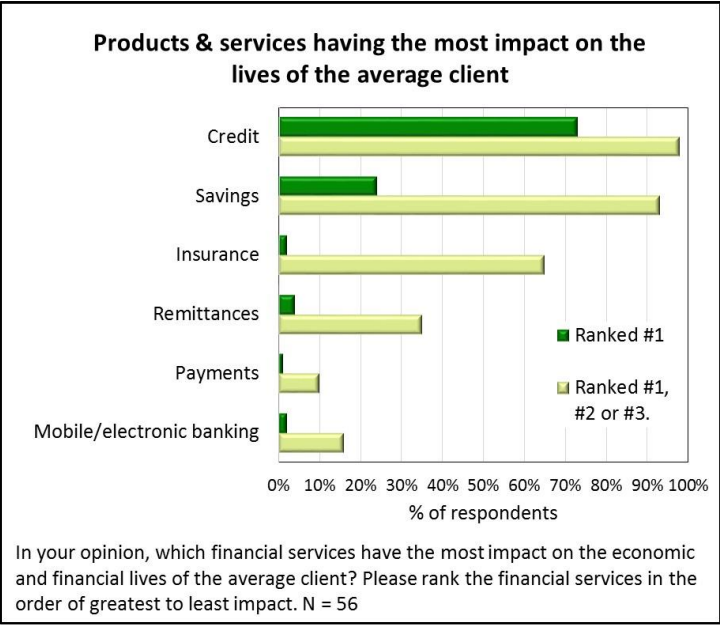
BWTP members overwhelmingly agree that some measurement of income (gross income, net income, or steadiness of income) is the primary metric for gauging the impact of financial services on clients’ lives.

Twenty-five per cent of respondents ranked income as the most important aspect of clients’ lives for measuring impact, and nearly 60% ranked income among the top three.

Quality of health/nutrition of family members and quality of education received by the children of clients were the most important social indicators cited for measuring impact, slightly ahead of quality of housing. Empowerment/freedom of choice (of occupation, place to live, etc.) was least often cited as a metric for measuring impact.

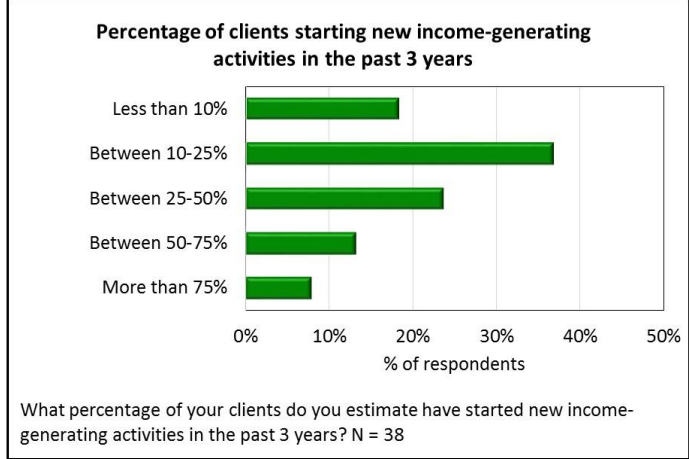
³ <http://sptf.info/working-groups/outcomes>.

Credit was identified by the vast majority of respondents as the financial service that has the most impact on the economic and financial lives of clients. Seventy-three per cent of respondents ranked credit as the financial service with the greatest impact on the lives of clients, and 98% ranked credit among the top 3. Savings is considered the second most important service, with 24% ranking it first and 93% ranking it in among the top 3. Remittances and insurance ranked third and fourth. The respondents believe that payments and mobile/electronic banking are the services with the least potential impact on the economic and financial lives of clients: 68% placed payments among the financial services having the least impact on the economic and financial lives of the average client; 72% placed mobile/electronic banking in this category.

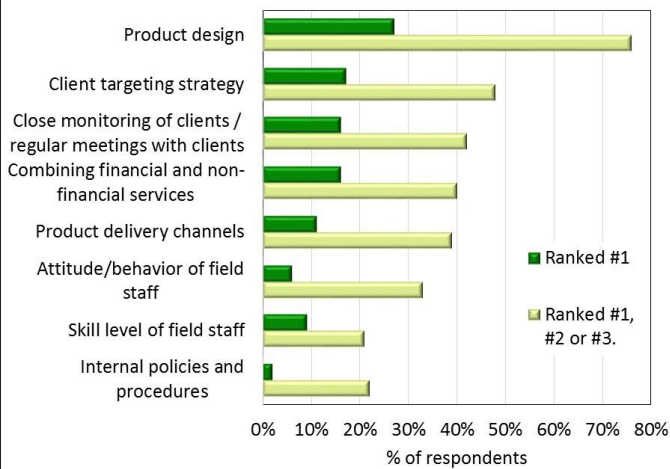


With regard to credit, respondents report that, to a very large extent, most clients borrow to maintain the operations of their farm, livelihood or enterprise: “Purchasing inputs to increase production (e.g., fertilizer, raw materials, machinery)” and “Purchasing more inventory to sell” were the two uses cited most often. In contrast, “Increasing operating size (buy land, expand store size, open a new store/branch)” was ranked a distant third as the primary use of credit by clients.

The majority of respondents (55%) also estimated that less than 25% of their clients started new income-generating activities in the past 3 years.



Factors of financial services providers having the greatest effect on client outcomes



What factors of financial service providers have the greatest effect on outcomes for clients? Please rank the factors in order of greatest to least effect. N = 55.

The respondents said that product design is the aspect of financial service provision that has the greatest effect on outcomes for clients, with 27% ranking it first and 76% ranking it among the top 3 factors. Client targeting strategy was considered the second most important factor on the side of the service provider in contributing to positive outcomes for clients, followed closely by close monitoring of clients and combining financial and non-financial services.

On the client's side, skill level and attitude/ behavior were overwhelmingly ranked as the most important factors affecting outcomes. The nature of client's source of income and how the client uses financial services were ranked third and fourth. Macro-economic and political/regulatory conditions were not considered to have much impact on outcomes for clients.

These results reveal that BWTP members generally hold what could be described as the conventional view regarding the link between microfinance and poverty reduction: clients use financial services (mainly credit and savings) to invest in economic activities that yield returns sufficient to increase household income and consumption, leading to poverty reduction. And while appropriately designed credit and savings products, properly targeted and delivered effectively, can have an impact on client outcomes, the client's skill level and attitude/behavior are also key success factors.

The second part of the survey sought to understand the nuances underlying these views by asking respondents the extent to which they agreed or disagreed with a series of statements. Nearly 75% of respondents agreed or strongly agreed with the statement "Gaining access to financial services has a direct impact on income" while only a bare majority (56%) agreed or strongly agreed that "financial access provides tools that empower clients to better manage their economic and financial lives but does not necessarily impact their income."

The survey respondents do not believe that clients are trapped by the nature of their income-generating activity: 58% disagreed/disagreed strongly with the statement "Most poor clients are engaged in low-margin livelihood activities that are not scalable; financial services cannot address these limitations" while only 25% of respondents agreed/strongly agreed. 78% agreed/strongly agreed that financial services "enable clients to transact with the

Factors on the client side having the greatest effect on client outcomes



Please rank the factors on the client side that you think have the greatest effect on outcomes for clients. N = 54.

market economy, which provides the potential to increase their income” and nearly 90% agreed or strongly agreed with the statement “How a client uses financial services matters more than simply having access.”

It is important to note the distinction between the survey responses, which refer to “financial services”, and the random evaluations, which focus exclusively on the impact of credit. For the survey respondents, savings services are almost as important as credit in contributing to positive outcomes for clients. Yet the distinction may be not as great as it first appears. Savings themselves do not increase income because savings is really a form of delayed (or future) expenditure. To the extent that clients use savings rather than credit to invest in their income-generating activities, the differential impact on income would be the difference between the amount saved on interest expenses on the loan minus the amount lost from reduced interest income on the deposit - a relatively small net increase.

Thus, whether clients use credit or saved funds to invest in their income-generating activity should not have a major impact on the ultimate outcome. In fact, even “free” money does not necessarily lead to an increase in income. One recent study⁴ evaluated the impact of grants, rather than credit and savings, on business profits (and, thus, incomes). 198 small-business owners in Ghana were provided either a cash (valued at about 120 USD) or an in-kind grant of equipment (of the business owner’s choice) of similar value. They were compared to 398 small businesses in the same area who received neither a grant or cash.

The grant recipients were chosen and the baseline set in in October and November 2008. They were surveyed quarterly, four times until February 2010, 14 months after the grants were disbursed. The results showed that, on average, for women-owned microenterprises with below-median baseline profits, neither type of grant (cash or in-kind) led to increased profits. Only for the larger women-owned businesses with above-median profits did the in-kind grants led to increased profits. However, cash grants to those same women did not lead to an increase in profits, suggesting that women with relatively profitable businesses chose not to use the cash grants for business development.

A common response to such results is that the research period was too short for the effects of the intervention (grants or loans) to manifest themselves. However, the research team conducted a long-term follow-up survey in March 2012, approximately three years after the grants were disbursed. The researchers were able to follow up with 86 per cent of the original grant recipients, of whom 72 per cent had maintained their business and were able to earn a profit. However, the overall research conclusions did not change: the in-kind grants had a large and lasting impact on enterprises that already had high profits, but no impact on low-profit enterprises. Three years later, the cash grant still had no impact at all. The results for men also suggest a lower impact of cash, but differences between cash and in-kind grants were smaller.

If even “free” money does not necessarily lead to an increase in income, it follows that access to credit and savings products matters less than what clients use those products *for*. This was evident in the Ghana study: women in the high initial profits group came from less poor households, were more educated, and were more likely to keep separate accounts for their business. In choosing a business sector, they were more likely to say that earnings potential was the main factor, whereas the low profit business owners choose their sector primarily because of the low investment requirement. Clearly, business acumen—and, related to that, how micro-entrepreneurs use financial products to grow their business—was the deciding factor, not simply access. Since the in-kind grant was designed to be completely used for the business while the cash may not have been, the researchers concluded that the difference in the effects of cash and in-kind grants was due a “lack of self-control”.

Regarding clients’ usage of credit, the BWTP survey respondents are generally in agreement: most clients use their loans to purchase inputs for production or inventory to sell. Start-up activity or business expansion is much less prevalent. If this observation is correct, it should become clear why it is so difficult to find evidence of an

⁴ Fafchamps, Marcel, David McKenzie, Simon Quinn, and Christopher Woodruff, “Microenterprise Growth and the Fly-paper Effect: Evidence from a Randomized Experiment in Ghana”, *Journal of Development Economics*, 2014, 106: 211–26.

appreciable change in client incomes resulting from access to credit. The vast majority of clients are simply maintaining their farm, livelihood or microenterprise. In doing so, their business activity and income are likely to increase only in line with general economic growth in their area. This is probably why the randomized evaluations find so little difference in income growth rates between those who do and do not use financial services: most of those with financial access do not manage their farm, livelihood or enterprise much differently than those without access.

This raises the question of why most clients opt to simply maintain their existing income-generating activity rather than borrow or save to grow it or start a new one. Are there causal factors on the side of the providers, in terms of product design, targeting, and delivery? Is it due to gaps in clients' skill level and attitude/behavior? And, if the latter is important, are the respondents who ranked non-financial services and close client monitoring as important factors affecting client outcomes correct?

A look back: the institutionalist approach to understanding the impact of microcredit and its effect on industry priorities

Back when financial services for the poor mainly referred to credit, the thinkers behind the modern microfinance movement very clearly warned against linking access to credit with increased income. John D. von Pischke, in his seminal work for the World Bank, argued that:

Fungibility and the simple fact that returns result only from uses of funds, not from sources, generally makes it impossible to identify unequivocally the returns to borrowers from credit or from a credit project⁵.

In Maria Otero and Elizabeth Rhyne's equally influential book, Elizabeth Rhyne's chapter on evaluating finance programs was even more explicit:

For the most part, evaluations of credit programs are still based on the old view's ideas about causality. They are centered on the presumption of a direct causal link between receipt of credit by individual borrowers and a particular desired economic response, for example, changed borrower income resulting directly from receipt of a particular loan. ... Financial services do not create economic opportunities directly. Rather, they help people and enterprises position themselves to take advantage of opportunities. In general, goals for finance programs should be specified in terms of improving the ability of financial systems to perform these three functions or extending them to new areas or client groups. Evaluation should focus on indicators that reveal whether assisted institutions perform these basic financial functions well⁶.

Even Jonathan Morduch's paper in the Journal of Economic Literature "The Microfinance Promise", which introduced microfinance to the broader academic public, argued for caution:

The best evidence to date suggests that making a real dent in poverty rates will require increasing overall levels of economic growth and employment generation. Microfinance may be able to help some households take advantage of those processes, but nothing so far suggests that it will ever drive them⁷.

⁵ Von Pischke, J.D., "Finance at the Frontier: Debt Capacity and the Role of Credit in the Private Economy", *World Bank*, 1991, p.56.

⁶ Otero, Maria, and Elizabeth Rhyne, eds., "The New World of Microenterprise Finance: Building Healthy Financial Institutions for the Poor", London, UK, *IT Publications*, 1994, p.106-107.

⁷ Morduch, Jonathan, "The Microfinance Promise", *Journal of Economic Literature*, Vol. XXXVII, December 1999, pp. 1569–1614, p.1610.

Concerns about directly linking access to or even usage of credit and other financial services to increased income were realistic, but it left the original thinkers behind the modern microfinance movement in a bind because the programs (and the donor funding for them) were ultimately justified as contributing to poverty reduction.

To address expectations that financial access programs would have an impact on poverty, these thinkers borrowed heavily from micro-economics, particularly consumer choice theory, which argues that rational consumers will not purchase a good or service unless they expect a net economic gain as a result (or are at least no worse off than before).

Applied to financial service providers, the assumption was made that if rational consumers pay the full economic cost of the services, then by definition the client's economic benefit exceeds the cost of the service. If the credit provider made a profit, this meant that in aggregate (over all its clients), the total social benefits from the service exceeded total social costs of delivery. This became known as the "institutionalist" approach to defining and measuring impact, because the focus was the financial and operational strength of the financial institution rather than how those services contributed to changes in the lives of clients.

Under this approach, the metrics for gauging the success of a financial service program were outreach and profitability (financial sustainability). Elizabeth Rhyne's recommendation for a framework for evaluating finance programs made this clear (Box 2).

Box 2: A Framework for Evaluating Finance Programs⁸

- A. The client-service relationship
 - 1) Outreach
 - a) Number of clients; market penetration indicators
 - b) Characteristics of clients: gender, location, income status, sector of enterprise
 - 2) Quality of service, alternatives
 - a) Market test: willingness to pay
 - b) Client transactions costs: convenience and timeliness
 - c) Service terms: price, loan sizes, maturity, collateral, access to deposits, eligibility requirements
 - 3) Enlarging clients' decision-making options; how the service fits into the client's financial management process-liquidity, consumption smoothing, investment
- B. Institutional viability
 - 1) Financial self-sufficiency of service
 - 2) Financial condition of institution
 - a) Profitability or ability to break even
 - b) Portfolio quality
 - c) Liquidity
 - d) Capital adequacy
 - 3) Institutional strength and context

⁸ Otero, Maria, and Elizabeth Rhyne, Op. Cit., p. 109.

To the extent that this approach to gauging the impact of microcredit programs investigated changes in the lives of the clients at all, the focus was on client choice (what they use financial services for) rather than outcomes (e.g. income):

While still examining the effect of finance on clients, evaluations should stay close to the direct uses of finance. The basic question to be pursued is: How has the availability of this financial service changed the clients' decisions? In other words: What can clients do now that was not possible without the service? The aim is to explain how the service changed the strategies and options available to the client, and how those financial decisions affected other economic decisions⁹.

The focus on client decision-making rather than outcomes implies that these thinkers believed that the main positive impact of credit specifically (and financial access generally) is client empowerment—the opportunity to have greater choice in making business and household financial decisions. This is in sharp contrast to the views of the BWTP survey respondents, 90% of whom ranked “Empowerment / freedom of choice (of occupation, place to live, etc.)” among the lowest of nine aspects of client's lives that are the most important for measuring the impact of microfinance/financial access. Only 10% agreed or strongly agreed with the statement “Financial access provides tools that empower clients to better manage their economic and financial lives but does not necessarily impact their income”.

The tepid belief among the BWTP survey respondents that the main impact of financial access is empowerment may be due to the fact that changes in empowerment are very difficult to measure accurately, and do not yield satisfying results. Elizabeth Rhyne does indeed warn that:

Rather than providing definitive "impact" results on predetermined indicators, such a line of questioning produces results that are indicative of the nature of the effect. Although they may seem less precise, such results are more likely to be accurate reflections of what the provision of financial services actually accomplishes.¹⁰

Two decades ago, with this debate over which aspect, if any, of the clients' lives should be measured left unresolved, the institutionalist approach became the *de facto* standard for gauging impact. Indeed, the shift in the industry that began in the early 1990s toward modern management techniques, emphasizing operational efficiency and financial self-sustainability, was ultimately justified in terms of social impact because of the need to achieve scale given both the worldwide prevalence of poverty and the estimated demand for microfinance services. Massive scale required massive financial resources that were far beyond the ability of public sector donors to provide. The commercial approach would attract private capital to make up the shortfall. If a financial service provider could reach an increasing number of clients willing to pay full cost for the service (including more commercial costs of capital), it was assumed that clients were satisfied and therefore the service had social benefits.

As Frank DeGiovanni, Director of Financial Assets for the Ford Foundation and former chairman of the SPTF recently described¹¹ the thinking during those years, “In short, the unspoken assumption was that if you built a strong MFI, and your heart was in the right place, then positive social outcomes would happen automatically.” Answering critics of this approach, Rhyne would write in 1998 that “Sustainability is but a means to achieve [outreach]. ... Sustainability is in no way an end in itself; it is only valued for what it brings to the clients of microfinance”¹².

⁹ Ibid., p 113.

¹⁰ Ibid., p.113.

¹¹ Social Performance Task Force, “Interview with Frank DeGiovanni: Reflections on 10 years of the Social Performance Task Force”, February 2016, <http://us12.campaign-archive1.com/?u=8c812b797a2f9ded471a394cd&id=a8e21f1a69&e=64481af96d>.

¹² Rhyne, Elisabeth, “The Yin and Yan of Microfinance: Reaching the Poor and Sustainability”, 1998, *MicroBanking Bulletin*, vol. 2, no. 1, pp. 6-8.

The survey results reveal that these views are also held among BWTP members. 60% of respondents agreed/strongly agreed with the statement “The most important indicator of impact of a financial service provider is that clients continue to use its services” against only 25% who disagreed. 62% agreed/strongly agreed with the statement “If a client has gone through many loan cycles and successfully repays larger and larger loans, it means s/he is less poor than when s/he first became a client” while only 16% disagreed.

The institutionalist belief that clients’ willingness to pay for the full cost of delivery plus a margin for the provider denotes positive impact dramatically shaped funding priorities for the industry. Emphasis was placed on increasing outreach by expanding access.

There is considerable evidence that this approach has yielded positive results. The World Bank’s latest Global Findex database (2014), based on interviews with 150,000 adults in more than 140 economies, found that 62% of adults worldwide now have an account at a formal financial institution (such as a bank) or a mobile money account, up from 51% in 2011, when the Global Findex was launched. The number of adults without an account fell by 20%, to 2 billion.

The idea that clients’ willingness to pay the full cost of delivery plus a margin for the provider denotes positive impact has dramatically shaped the priorities of the industry toward emphasizing increasing outreach by expanding access.

Yet the data also show that account ownership does not necessarily lead to use. In India, for example, although account ownership has nearly doubled since 2011, Findex research shows that 43% of accounts have gone unused for a year. The same is true for one-fifth of all accounts in the emerging world.

An April 2015 CGAP analysis¹³ of M-Shwari, a mobile savings and credit provider in Kenya, provides some clues as to why this is the case. In only two years, M-Shwari’s achievements have been impressive: 9.2 million deposit accounts, 20.6 million loans, PAR₉₀=2.2%. This is what we have been waiting for: massive scale using mobile technology.

But the same data also reveal the following:

- The number of active savings accounts is 4.7 million — half of all accounts opened. Although M-Shwari had only been operating for around for two years, already half their clients were no longer using their savings accounts.
- There has been a total of \$1.5bn deposited since launch, a huge amount. But M-Shwari’s total deposit balance was just \$45.3mn. Just 3% of the funds that have been deposited have stayed on deposit.

One way to interpret this information is that most clients made a deposit because it is a requirement for accessing M-Shwari’s credit service. After they paid off their loan, most borrowers reduced their deposit, possibly because the terms of the credit service are not attractive: the average loan balance is less than \$10, loans carry a term of 30 days but can be rolled over, and the interest rate is 7.5%/month flat (90% APR).

It turns out that only 14% of clients said they borrowed for business purposes, although even for them the loan seems to have been used to meet gaps in short-term business cash flow rather than for longer-term investment. Some borrowers used the loan to meet lumpy expenditures (school or medical fees) but mainly they used it to cover shortfalls in income versus expenses — what the authors of *Portfolios of the Poor*¹⁴ call “consumption smoothing”. As they explain in the book, the problem for most microfinance clients, and perhaps the main reason why they do not have access to the mainstream banking system, is that their income is not just low, it is also unpredictable. In such circumstances, household liquidity management becomes a regular—if not daily—activity.

¹³ <http://www.cgap.org/sites/default/files/Forum-How-M-Shwari-Works-Apr-2015.pdf>.

¹⁴ Daryl Collins, Jonathan Morduch, and Stuart Rutherford, “Portfolios of the Poor: How the World’s Poor Live on \$2 a Day”, Princeton University Press, 2009.

Microfinance helps address the problem of income unpredictability. A stable, reliable source of credit, combined with savings, allows clients to meet their spending needs even as income ebbs and flows.

There is no doubt that being able to smooth consumption – a notion similar to Elizabeth Rhyne’s concept of financial services empowering clients by giving them more choice – has an important positive impact on the lives of clients. There is no way to get ahead tomorrow if you have to scrounge to find money to eat today. But contributing to better household liquidity management is not, as the authors of the randomized evaluations point out, the same as contributing to increased income.

The institutionalist approach to impact today

Even before the American Economic Journal: Applied Economics published the randomized evaluation results, the industry had already begun to respond to the lack of concrete evidence linking credit and other financial services to increases in income. This has generally been to promote a reformed version of the institutionalist approach, emphasizing the quality of the service but still not directly measuring changes in clients lives. For example, in 2013 KfW published a book promoting a “new” version of microfinance, described as Microfinance 3.0:

“Microfinance 3.0” is a system where professionally managed, well governed, and financially sustainable financial institutions offer as part of a sound financial ecosystem a broad array of financial services beyond the classical micro-credit that are tailored to client’s needs, including the use of technology as a means to serve clients. They treat their clients in a fair and transparent way, are relentless on mobilizing local funding sources, ensure adequate staff training, and reduce transaction costs while maintaining a close relationship with their clients. Regulators are rigorous promoters, and funders help to foster good standards and innovation.¹⁵

Even David Roodman, long a prominent commentator and sometime critic of microfinance, takes an institutional approach to evaluating the impact of financial access:

[This paper] concludes that microcredit stimulates small-scale business activity, but that the best available evidence fails to show it reducing poverty. Its ability to empower people, especially women, is also ambiguous. Still, there is no question that all people need financial services. The main achievement of the microfinance movement has been the founding of businesses and businesslike non-profits that are delivering these services to millions of people on a sustainable basis.¹⁶

Both views essentially imply that a strong institution that sustainably (and, now, responsibly) serves its clients is achieving its social mission. Gains in income or poverty reduction more generally may or may not occur.

The revised institutionalist goal of serving clients responsibly as well as sustainably evolved out of the broader social performance management movement into the Client Protection Principles. Prominently promoted by the Center for Financial Inclusion’s Smart Campaign, client protection is also institutionalist in its approach to measuring impact, emphasizing service quality rather than direct measurement of changes in the lives of clients.

Yet there is evidence that financial service providers have been slow to adopt policies and procedures to ensure client protection. Based on a year-long consultative process carried out by the Financial Inclusion 2020 project, in mid-2015 the Center for Financial Inclusion itself noted¹⁷ several barriers: that client protection was seen as a

¹⁵ Matthias Adler and Sophie Waldschmidt, “Microfinance 3.0’ – Perspectives for Sustainable Financial Service Delivery”, in *Microfinance 3.0: Reconciling Sustainability with Social Outreach and Responsible Delivery*, Chapter 6, pp. 123-138.

¹⁶ Roodman, David, “Armageddon or Adolescence? Making Sense of Microfinance’s Recent Travails”, CGD Policy Paper 035, *Center for Global Development*, January 2014, p. 1.

¹⁷ Cheston, Susy, “Top Six Reasons Providers Don’t Invest in Client Protection”, June 16, 2015, <http://cfi-blog.org/2015/06/16/top-six-reasons-providers-dont-invest-in-client-protection>.

competitive disadvantage; providers focused on short-term profitability rather than long-term sustainability; internal cultural changes were difficult and providers lacked the capacity to implement them; and regulators were not provide incentives for providers to adopt the new practices and did not “understand how regulations affect the business”.

If even this fairly minimalist approach, which seeks to ensure social impact by simply inserting policies and procedures into the loan administration process that “do no harm”, has faced barriers to adoption, what can be said about the institutionalist approach in general, which sees outreach and financial sustainability as proxies for impact?

This question is especially relevant as the industry has evolved from microfinance to financial inclusion, whose chief metric of success is the number of accounts opened. The institutionalist view is strongly held across the spectrum of actors in the financial inclusion movement. An opinion piece in a report published by responsAbility, a leading microfinance investor/lender, explained this perspective succinctly:

[T]he very fact that the services are available represents an important step forward from the end-clients’ perspective. Furthermore, the fact that these services are paid at a price that covers the cost of the offering sends out a clear signal about the usefulness of the service, even if the outcome is not measured¹⁸.

The BWTP survey results show that the respondents are divided on this question. Although 73% of respondents agreed or strongly agreed with the statement “Gaining access to financial services has a direct impact on income”, 60% of respondents agreed/strongly agreed with the statement “The most important indicator of impact of a financial service provider is that clients continue to use its services”. A similar proportion also agreed/strongly agreed with the statement “If a client has gone through many loan cycles and successfully repays larger and larger loans, it means s/he is less poor than when s/he first became a client” while only 16% disagreed.

Looking ahead: a call for a rebalancing of industry priorities

The industry as a whole has been divided over the issue of impact since the modern movement began in the early 1990s, so it is not surprising that differing views are held among BWTP members. There were, however, several issues in which the respondent’s opinions were nearly unanimous:

- 73% said credit is the most important product for achieving impact, followed by savings
- 79% said that client skill and attitude/behavior are the three most important factors on the client side affecting impact
- 89% agree or strongly agree with the statement “How a client uses financial services matters more than simply having access”
- 89% agree or strongly agree with the statement “Measuring client impact should be part of every financial institution’s operations”
- 93% say that most often credit is used to maintain the client’s existing farm, livelihood or enterprise (e.g., purchase inputs for production or inventory to sell)

The near unanimity on these issues suggests that the industry’s practitioners know that successful alleviation of poverty through financial services is not just anecdotal but systematic, even if the randomized evaluations have

¹⁸ González, Henry, “How we measure”, *PERSPECTIVES 2015/16*, responsAbility, 2015, pp.9-12.

not demonstrated this statistically. They agree that impact of this nature should be measured. And they agree that how the client uses those services is probably the single most critical factor affecting outcomes.

And yet as the industry has broadened from microfinance into financial inclusion, the emphasis has continued to be heavily weighted toward reaching new clients.

For example, CGAP's 2015 Cross-Border Funder Survey reports that international funding of financial inclusion remained steady in 2015 at \$31 billion. These funders comprise 23 donors (bilateral agencies, multilateral organizations, and foundations) and investors (public or private entities such as development finance institutions, institutional investors, and microfinance investment vehicles). Almost three quarters (71%) of 2015 funding commitments were to retail financing and supporting the growth of financial services providers. Only 2% was committed to enhancing the financial capability of poor clients.¹⁹

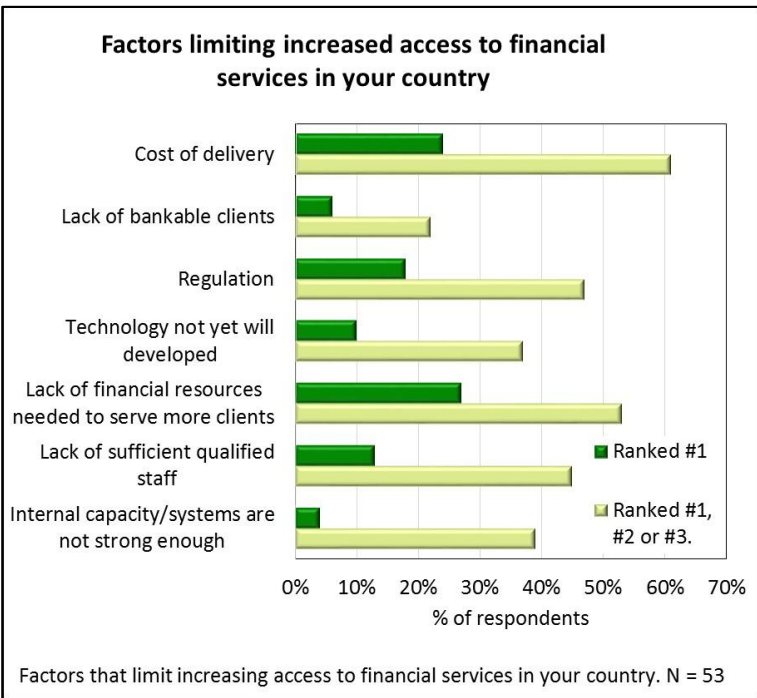
New technologies and new financial services (remittances, payments, mobile top-ups) do indeed offer an opportunity to reach clients who may not be creditworthy or able to save in a cost-effective way, but only 10% of the survey's respondents said technological challenges were the main barrier to reaching new clients.

Furthermore, while cost of delivery, which technology is meant to reduce, is an important barrier to expanding access to reaching new clients, it was not cited by survey respondents as the single largest barrier. Although 64% of respondents placed cost of delivery among the top three barriers, lack of financial resources was ranked first by more respondents than cost of delivery.

Over the past two decades, the prioritization of outreach with financial sustainability led the industry to emphasize cost-efficient growth. Management strategies were built around targets for client numbers, portfolio size, portfolio at risk and financial self-sustainability. Loan officer incentives were driven by outreach and portfolio quality.

The result, completely unexpected in the early 1990s, was the emergence of a robust model for delivering basic financial services to low-income, low-skilled clients operating at the margins of the economy, one that has been reformed, revised and contextualized all over the world with great success. None of the original thinkers behind the modern microfinance movement could have predicted the large number of financially self-sustaining service providers operating today, or that private sector

As the industry broadened from microfinance into financial inclusion, the emphasis has been heavily weighted toward reaching new clients rather than a systematic commitment to understanding what aspects of client usage of financial services have the most impact and how to distill and disseminate that knowledge to the millions of clients who are mostly treading water economically.



19 CGAP, "2015: International Financial Inclusion Funding Data", <http://www.cgap.org/data/2015-international-financial-inclusion-funding-data>.

investors and service providers would enter the market because they see sufficient business opportunities rather than because of public sector financial support.

In this sense, the microfinance model may not need to be tweaked, as Dr. Banerjee recommends. The model works just as it was envisioned, delivering a service that clients value enough to pay full cost for and use repeatedly. As for the lack of evidence linking credit and other financial services to increased income, there is a growing body of opinion that this is asking too much, just as the likes of von Pischke, Rhyne, Morduch and others warned.

This alternative view of impact is expressed in the most recent response to the results of the random evaluations, in January 2016, by the Grameen Foundation²⁰. Published in association with Accion and the Microfinance CEO Working Group, which represents leading organizations such as BRAC, Vision Fund, Pro Mujer, Women's World Banking, Finca, Opportunity International and Freedom from Hunger as well as Accion, the paper represents the views of some of the leading service providers in the industry.

The Grameen Foundation paper does not argue that the results of the randomized evaluations are incorrect in finding no causal link between microcredit usage and increased income:

In most contexts, access to credit leads to business expansion, although this often does not translate to increases in business profits or changes in income and/or spending in the business owners' households. ... [C]redit serves to provide households with increased freedom of choice and flexibility, helping to manage uncertainty and reduce the effects of negative shocks²¹

Instead the paper argues that there are flaws in the randomized control trial methodology in general, and that in these specific evaluations the emphasis was on measuring the impact of credit only rather than on the broader suite of financial services.

These critiques are accurate. There are flaws in the RCT approach, although there are also flaws in the "quasi-experimental" and "non-experimental" approaches, which the author acknowledges in the paper. It is also true that the random evaluations looked at credit in isolation, although the paper's discussions about savings, insurance, payments and mobile money make no attempt to link those services to changes in client income.

Based on this line of reasoning, the author draws a distinction between microfinance and financial inclusion:

Microfinance is the global industry that provides credit, savings accounts, insurance products, and various combinations of these products to poor households. Financial inclusion is the effort to ensure that poor households have access to the financial tools they need to build assets, manage risk, smooth cash flows, and take advantage of income-generating opportunities. While credit, savings, and insurance all remain central to this effort, financial inclusion brings increasing emphasis on the overall financial ecosystem, including payments systems and the engagement of a range of providers²².

This distinction is important for the paper's view on impact. The author says the existing body of research "makes a convincing case that while microfinance clients on average do not predictably exit poverty, access to financial services can make poverty less binding in a variety of ways"²³. Quoting Chris Dunford²⁴ of Freedom from Hunger, the author agrees that "a revised theory of change for microfinance" that reflects the shift toward the broader concept of the impact of financial inclusion would be:

²⁰ Odell, Kathleen E. "Measuring the Impact of Microfinance: Looking to the Future", *Grameen Foundation*, January 2016.

²¹ *Ibid.*, p.5.

²² *Ibid.*, p.5.

²³ *Ibid.*, p.5.

²⁴ Dunford, Chris, "What If We Turn the Microfinance Theory of Change on Its Head?", <http://microfinanceandworldhunger.org/2012/10/what-if-we-turn-the-microfinance-theory-of-change-on-its-head>, October 9, 2012.

People from poor households tap microfinance services to smooth consumption and build assets to protect against risks ahead of time and cope with shocks and economic stress events after they occur - leading to poverty alleviation.

As mentioned above, similar arguments about consumption smoothing and risk management – financial services as a shock absorber rather than a tool for increasing income – were made in Portfolios of the Poor, a pioneering study of financial diaries whose results provided the first deep understanding of the financial lives of low-income households.

Defining impact this way, however, also redefines the role of financial services in the lives of clients: they are now tools that make it easier to get by, not necessarily tools for getting ahead. In doing so, it brings the Grameen Foundation paper back to Elizabeth’s Rhyne’s view that the main impact of financial inclusion is that it contributes to empowerment. “There is also good evidence that access to a savings mechanism increases choices and financial freedom, working to buffer shocks and help households maintain consistent spending levels over time”²⁵.

This view is strongly expressed in the overview of the random evaluation studies as well:

*[T]he lack of transformative effects should not obscure other more modest, but potentially important, effects. The studies find some, if not entirely robust, evidence of effects on occupational choice, business scale, consumption choice, female decision power, and improved risk management. As we stated previously, if microcredit’s promise were increasing freedom of choice it would be closer to delivering on it.*²⁶

The idea that financial access reduces vulnerability by making it less likely for a household to fall back into poverty due to a shock is positive and worthwhile. The idea that financial services increases freedom of choice (“empowerment”) is also powerful.

But as BWTP survey results make clear, the industry has never been completely satisfied with this way of gauging impact. The survey respondents expect to have a material impact on the economic lives of clients – income or otherwise.

The author of the Grameen Foundation paper does not completely abandon the possibility that financial services can contribute to material change in the lives of clients:

*It is possible that increased profits and incomes simply take more time to appear. It is also very possible that MFIs with social aims can improve outcomes by focusing on business training and other strategies through which borrowers can translate increased business inputs into better overall outcomes*²⁷

Regarding the issue of business training, the author cites a 20-year panel study conducted in Bangladesh for the World Bank²⁸ that

[Market] trading is perhaps now saturated with microcredit loans and households have already started to experience diminishing returns. In such circumstances, households must be assisted through skill training and the development of improved marketing networks to expand activities in

²⁵ Odell, Kathleen E., Op. Cit., p.7.

²⁶ Ibid., p.14.

²⁷ Ibid., p.43.

²⁸ Khandker, Shahidur R., and Hussain A. Samad. “Dynamic Effects of Credit in Bangladesh.” Policy Research Working Paper 6821. Washington, DC, World Bank, 2014.

more rewarding sectors and beyond the local economy; otherwise, microfinance expansion cannot be sustained²⁹).

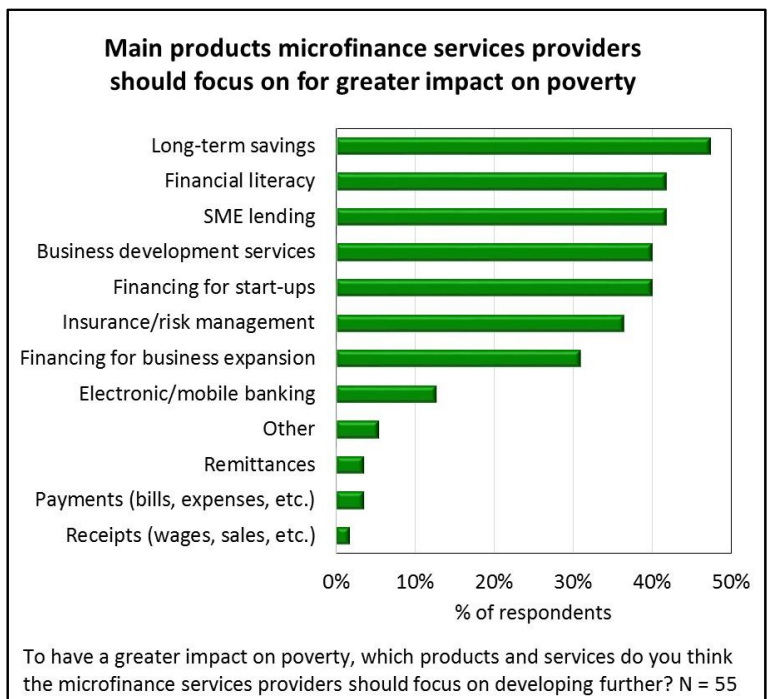
The author concludes that a natural next step is to study the impacts of particular models or implementations of credit, and then to study what aspects of credit programs are most correlated with positive outcomes³⁰. This view is echoed in the paper’s preface by Alex Counts, Founder of Grameen Foundation:

So the question is not so much “Does it work?” but rather, in which circumstances do certain financial products work best for low-income people, why does performance lag in some places, and what can this teach us about improving policy and practice?³¹

Further research is indeed needed. It should be noted that the results of the randomized evaluations find limited evidence of an increase in income resulting from microfinance *on average*. Some studies showed that at the “upper tail”, 5-10% of microcredit users did indeed demonstrate a statistically significant increase in income. As Alex Counts notes in his preface, “Even if only 5 to 10 percent of microfinance clients experience immodest benefits, that represents 10 to 20 million households”. This is an enormous data set to learn from.

But research is only the first step. In fact, research on usage already exists, and there have been and still are many efforts to affect usage through financial education and business development services. Unfortunately, however, these efforts are often viewed as add-ons to financial inclusion programs. Over the past 20 years, the industry has put an enormous amount of effort and resources into strengthening service provision and increasing outreach, and it still does. But there has never been the same systematic, global, concerted effort to understand what usage factors affect outcomes and to distill and disseminate that information to the clients in the same way they have been reached with financial services.

When asked what microfinance services providers should focus on developing further to achieve a greater impact on poverty, the BWTP survey respondents suggested three financial products (long-term savings, SME finance, and financing for start-ups) but gave exactly equal priority to financial literacy and business development services. Payments, remittances and receipts (e.g., wages or cash transfers), on the other hand, were cited among the top three priority products/services by just 2-3% of the respondents. Only six respondents cited mobile banking among the top three, of which two were not practitioners and three were practitioners from Bangladesh. It appears that electronic/mobile banking as a lubricant for financial inclusion is not uppermost in the minds of BWTP practitioners.



The survey results suggest that BWTP practitioners recognize that the current suite of products and services are mainly sufficient for most clients to maintain their existing farm, livelihood or enterprise. Greater impact will require deeper relationships with clients and more risk on the part of the service provider (SME

²⁹ Odell, Kathleen E., Op. Cit., p.29.

³⁰ Ibid., p.44.

³¹ Ibid., p.3.

lending, start-up financing) as well as more attention paid to changing the mindset, attitude and behavior of the clients (saving for the long-term, improving financial education and business management) rather than standardized products that are easy to deliver to a large number of people who do not have regular contact with their financial institution.

Changing client mindsets and behavior, and thus how they use financial services, recognizes an insight that is often lost in the debate about the linkage between financial services and poverty reduction: that the material aspects of poverty, such as low income and a lack of skills, are not the causes of poverty but their symptoms. While structural aspects of a country's political economy can contribute to or exacerbate poverty, the fact that some clients in the "upper tail" succeed demonstrates that structural barriers are not insurmountable. The true barrier is the psychological nature of poverty.

The psychological nature of poverty affects clients' usage of credit and other financial services. These decisions are influenced by clients' knowledge and ability to decide in the short, medium or long term for what activity they will use financial services. Poverty is stressful, and it leads clients to choose sub-optimal outcomes:

Stress makes people risk-averse, and it makes them more short-sighted, in the sense that they are more likely to make decisions that benefit them sooner than in the long term. That may put a limit on how much they are willing to invest in the future, in terms of business, health care, education, and so on³².

It follows, therefore, that truly contributing to poverty reduction requires much more than the institutionalist approach that goes no further than increasing access and ensuring quality service. Ensuring that clients make sound use of their money and financial services entails gradually changing their mindset, their behavior and their skills. In fact, addressing usage issues should ideally go beyond the clients themselves and include the family or entire household, which have a strong influence on decision-making.

Combining the right products (start-up finance SME finance, long-term savings) with appropriate support services (financial education and business development services) could begin to change behaviors and thus outcomes. But such products and services are idiosyncratic, requiring contextualization for local economic conditions and clients' needs. More importantly, successful delivery requires a close relationship between the service provider and its clients since the account officer or trainer needs a deeper understanding of the clients' business or learning needs than is required for standardized products.

And this is where Dr. Banerjee's comment about the need to "tweak the model" is relevant: the kinds of financial and non-financial products and services that BWTP members say are necessary to contribute further to impact are the exact opposite of the simplified, standardized products the industry continues to rely upon to expand outreach.

In the traditional model, loan officers handle at least 300 clients while seeking new ones. It is a stressful and difficult job, and as a result these staff—who are the primary contact point between the service provider and the client—often try to move up into a position in the branch or leave. Due to this high turnover, financial institutions often limit loan officer training to basic policies and procedures, and rarely invest in improving their skills in monitoring and guiding clients' financial service usage decisions. In many cases, loan officers are not in their position long enough to build the kind of relationship with the client that is needed to help guide them.

The financial inclusion movement today, with its emphasis on expanding outreach, often seeks to replace even this minimal interaction between institution and client with a generic financial product delivered by an agent or a mobile phone in the name of reducing the cost of delivery. Yet the survey results show that BWTP members are

³² Haushofer, Johannes. "The Cycle of Poverty Is Psychological, Not Just Financial" *Science*: Vol. 344, Issue 6186, 23 May 2014, pp. 862-867.

almost unanimous in the belief that electronic/mobile banking will not contribute to positive outcomes for clients and should not be a priority for the future. Their proposed solution is much more “high touch” than “high tech”.

High touch services such as start-up and SME financing, financial education and business development services are more costly to develop and deliver than basic, standardized products, and slower to reach scale. But if they will contribute to a material improvement in client well-being, thereby increasing the client’s bankability and need for financial services, perhaps the microfinance model can be tweaked to find a way to deliver these services profitably.

For too long, the industry has been divided between those who focus on building institutions and financial systems, with the assumption that sustainable institutions and systems are socially beneficial, and those who want to see a concrete reduction in poverty. This dichotomy has always been false: we need sustainable institutions and systems so that they can contribute to poverty reduction over the long term. Today, we know how to build those institutions and systems, but we actually know very little about MSMEs and how to spur their growth. And yet the industry’s financial resources and promotional efforts are still heavily weighted toward the former.

The survey results indicate that BWTP representatives see a need for a rebalancing of industry priorities: they believe that the industry should strive to have an impact on income and suggest an alternative approach to the mainstream goal of increasing the number of new accounts, one that puts greater emphasis on customized products and services that create new opportunities for clients, active use of these products and services, as well as positively impact their attitude, behavior and skills.

Changing client behavior to affect the way they use financial services is hard. But can it be much harder than changing client mindsets so that they become creditworthy borrowers and regular savers? The industry committed itself to change client behavior once before. It’s time to make the same commitment to understanding and affecting usage as to expanding access.

Now that the financing of access is within reach of an increasingly sophisticated private sector, is it time for the financial inclusion priorities of strategic stakeholders (bilateral agencies, multilateral organizations, and foundations) to shift away from retail financing and supporting the growth of financial services providers, to focus more on services such as start-up and SME financing, financial education and business development services?

Two decades ago, an experiment began to prove that basic credit and savings products could be delivered to the poor at a cost clients would be willing to pay. This global, concerted effort was such a success that the private sector became a partner and has helped expand financial services around the world to millions who previously had no access. The business case is clear.

The hoped-for improvement in clients’ lives, on the other hand, has been more difficult to detect. But there are millions of success stories and a considerable body of knowledge on financial education and business development services. If a combination of services can be found to have even a modest increase in income across the majority of clients, it would not just fulfill the industry’s true expectations. Greater wealth generation would likely stimulate demand for more financial services. The only question is whether the industry will give this approach the same systematic and sustained support that gave the current model time to incubate.

About the author



Ron Bevacqua is co-founder and Managing Director of ACCESS Advisory, a non-profit technical service provider that promotes organizational development, transfers knowledge and technologies, and facilitates access to resources for financial institutions and rural economic actors to improve performance, sustain operations and support growth. Founded in 2009, ACCESS is headquartered in Manila and has a presence in Cambodia, Vietnam, Myanmar and Nepal.

ACCESS Advisory is currently implementing a three-year IFAD-funded programme to increase savings and investment in rural economies by migrants and migrant households in the Philippines and Nepal.

An American citizen, Ron has lived and worked in banking and financial services in Asia since 1993. He was the chief economist for Merrill Lynch Japan until 2002. Since 2004 he has also been a contributing editor to the Economist Intelligence Unit, writing on East Asian business and economics as well as its annual *Microscope on Microfinance*. He is currently writing a book about the development of microfinance in Cambodia for the National Bank of Cambodia.

Ron holds two Master's Degrees in international economics and international relations and speaks Japanese and Spanish and is learning Khmer.

He can be reached at rbevacqua@accessadvisory.org.

