

# Microfinance

A GUIDE FOR GRANTMAKERS

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**grantmakers**  
WITHOUT BORDERS

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## PREFACE

In late 2008, Grantmakers Without Borders began a period of research and focus on microfinance as it is carried out in the Global South. Microfinance had rapidly become a leading and in some cases the only poverty alleviation strategy among grantmakers, resulting in a shift of donor attention and financial assistance away from other important interventions and critical services.

Somewhat surprising to Grantmakers Without Borders was the fact that so much money was being directed towards microfinance despite the fact that, until very recently, no studies or evaluations adequately measured the actual impact of access to microcredit on reducing poverty.<sup>1</sup> Indeed, we had to ask ourselves: Should the anecdotes and stories of successful borrowers, aggressively used to promote microfinance, be the underpinnings of a billion-dollar development strategy?

As we furthered our research an issue of great concern to Grantmakers Without Borders emerged: the marked silence of voices most affected by microfinance initiatives and programming. To date, the success of microfinance has been largely based on the ability of borrowers to repay their loans and the presumed demand for credit evidenced by the phenomenal growth in the number of non-profit and commercial institutions embracing microfinance. But what are borrowers saying about their experience? What role, if any, do they play in creating, implementing, and evaluating microfinance programs in their communities?

As a membership organization of private foundations, grantmaking public charities, individual donors and philanthropic advisors, Grantmakers Without Borders felt a responsibility to better understand the strengths and weaknesses of microfinance as a tool for social change and poverty alleviation, to learn whether microfinance institutions<sup>2</sup> were realizing their advertised effects, and to support grantmakers as they evaluated the role microfinance played in their grantmaking.

## **ACKNOWLEDGMENTS**

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Grantmakers Without Borders also wishes to acknowledge the crucial role of the Goldin Institute in conceptualizing and reviewing this guide and for generously sharing its research and findings based on its work in Bangladesh. Many thanks to Kasia Paprocki, Jason Cons and Travis Rejman for raising important questions about understanding social impact from the perspective of microcredit recipients. It has been a pleasure to work together in a spirit of collaboration and collegiality throughout the development and production of this guide.

To learn more about the Goldin Institute's community-driven research and engagement work in Bangladesh and beyond, please visit their website at [www.goldininstitute.org](http://www.goldininstitute.org).



The Goldin Institute builds grassroots partnerships for global change that are rooted in the power of communities coming together to build their own solutions and determine their own futures. We achieve our mission by promoting innovative community-driven partnerships between a wide range of stakeholders and sectors of civil society, ensuring that often excluded voices have a seat at the table.

## INTRODUCTION

The central provision of microfinance is the delivery of small loans. In recent years, though, the industry itself has become macro. Estimates of the current amount of donor investment in microfinance range from \$12 to \$40 billion dollars globally.

The phenomenal expansion of microfinance since its humble beginnings was brought about, in no small part, by the marketing and fundraising efforts of microfinance institutions (MFIs). These strong promoters of microfinance convincingly made the case that the poor are credit worthy, and the commercial banking industry, which had previously excluded the poor from access to financial services, took notice and began entering the field. Previously marginalized communities increasingly became the new target markets of for-profit banks looking to expand their base of clients.

Along with this expansion came new tensions. Even within the field, as the institutions, methods, and motivations underpinning microfinance rapidly and radically transform, there is serious debate about the actual impacts of microfinance, who can benefit most from it, and what strategies and methods for implementation constitute best practice.

An example of these tensions is reflected in the case of Banco Compartamos. Banco Compartamos started as a nonprofit organization, lending money to Mexico's poor. In 2000, it became a finance company, and in 2006 it acquired a commercial banking license. The following year, Banco Compartamos issued an initial public offering, selling a staggering \$468 million in shares.

Certain advocates of microfinance were outraged by the action, claiming that Compartamos was putting profits ahead of clients and making money off the backs of the poor—a direct affront to the values and ideals of microcredit. In its defense, Compartamos and other MFIs argued that the stock sale demonstrated to private investors that microfinance could be profitable and thus would attract more private capital to the industry, facilitating potentially limitless expansion in reaching the “unbanked.”<sup>4</sup>

Another division within the field of microfinance has centered on who among the poor should receive support. Should the aim of microfinance programs be to reach the poorest of the poor, in the most remote regions of the world, as some in the sector believe? Or should microfinance programs focus on entrepreneurs in communities that lack access to credit but where there is a high degree of economic activity that an entrepreneur can take advantage of?

On the following pages, Grantmakers Without Borders explores these questions as well as the history and evolution of microfinance, prevailing arguments from advocates and critics about the industry, and philosophical differences on models of delivery and measurements for success. We share recent research findings on the impacts of microfinance on poverty alleviation and offer cautionary tales regarding the full-scale adaptation of microfinance. Finally, we offer recommendations for grantmakers to consider as they determine the role of microfinance within their own grantmaking.

# THE ORIGINS AND EVOLUTION OF MICROFINANCE

## HUMBLE BEGINNINGS

The story of the birth of microfinance is a fascinating and inspiring one. In the early 1970s, a team of international aid workers involved with ACCION, an organization dedicated to addressing poverty, wanted to better understand how the organization could most effectively support poor families and communities in Latin America. The team could see that a great deal of economic activity was taking place, and yet people were just scraping by. Rob Scarlett, a member of the ACCION team, recalls:

*The question that was raised was this: What would it take to increase the success of economic activity? The response: access to capital. Banking was not available to the people we spoke with, and they were forced to accept the terms of loan sharks, which were outrageous. These terms also led to social dysfunction—they were exploitative and could lead to violence.<sup>5</sup>*

Acting on these ideas, ACCION decided to issue small loans to a group of individuals in Recife, Brazil in 1973. Within four years, the organization had provided 885 loans, helping to create or stabilize 1,386 new jobs. Coining the term “microenterprise,” ACCION had found a way to generate new wealth for the working poor of Latin America.<sup>6</sup>

At the same time, across the globe, Bangladesh had recently won its war of independence. In the post-war period, Muhammad Yunus returned from the U.S. to Bangladesh, where he encountered great civil strife, with thousands of people devastated by famine and poverty. As head of the Rural Economics Program at the University of Chittagong, Yunus launched an action research project to examine the possibility of designing a credit delivery system to provide banking services targeted at the rural poor. The Grameen Bank Project (Grameen means “rural” or “village” in Bengali) came into operation, with several valuable objectives:

- :: Eliminate exploitation by moneylenders by extending banking facilities to poor men and women.

- :: Create opportunities for self-employment for the vast multitude of unemployed people in rural Bangladesh.
- :: Bring the disadvantaged, mostly women from the poorest households, within the fold of an organizing structure which they can understand and manage by themselves.
- :: Reverse the age-old vicious circle of “low income, low saving and low investment”, into a virtuous circle of “low income, injection of credit, investment, more income, more savings, more investment, more income.”<sup>7</sup>

And thus began the largest-ever experiment in development lending, known as microcredit.<sup>8</sup>

## THE MICROCREDIT MODEL

The primary objective of microcredit is to democratize access to capital by providing small loans to individuals or groups who lack traditional collateral. The assumptions that undergird microfinance as part of a theory of change are intriguing:

- :: First, the social construct of microfinance is one of individualism—a single borrower striking out on their own, engaging in economic activity that will help break the cycle of poverty. This contrasts with a social construct of collective or community action.
- :: Second, microfinance depends on the capacity of the very poor to harness the power of the marketplace to improve their lives. This contrasts with the idea that the very poor are victims of market forces over which they have no chance of taking control.

At the time of microfinance’s beginnings, the extension of financial services to the poor was truly radical. For the first time, conventional financial tools were made available to populations that were previously denied such access and were often blatantly discriminated against. Proponents of the sector point to other aspects of microcredit that contribute to the innovation of the model:

- :: Microcredit provides access to capital in locations around the world that are institutionally weak.
- :: Microcredit takes advantage of the free market, allowing entry and participation by the many, not just the few.
- :: Microcredit holds the potential to enable institutional sustainability and growth through the collection of interest charged on loans.

In its most basic and earliest form, microcredit is a single-development intervention, with loans being the sole service provided by a non-governmental organization (NGO) or bank.<sup>9</sup> Loan repayment schedules are usually short. Ideally, the loan is repaid as quickly as possible. As borrowers successfully repay their loans, they can avail themselves of new loans in increasing amounts.

In lieu of collateral, which the very poor lack, community members who are interested in receiving loans join other community members to form a credit group. Loans are made to individuals within a group, but all members assume responsibility for ensuring that every loan within the group is repaid, thus creating “joint liability” for repayment.<sup>10</sup> This method takes advantage of peer support, or peer pressure, depending on the lender and the group’s circumstances. Individuals must also typically contribute to a savings account, which the MFI often holds as a means of collateral.

Groups are usually required to meet certain participation requirements mandated by the MFI with whom they are working. For example, Grameen Bank works with groups of five members, all of whom participate in a training program on the bank’s policies and operations. Following the training, each member is tested in an oral examination by a bank official. Upon approval, two individuals within the group then receive loans. The terms of the loans are determined by the Grameen Bank, including interest rates, repayment schedule, and length of loan. If two members of the group are making their scheduled payments, additional members of the group become eligible for loans.<sup>11</sup>

### FROM MICROCREDIT TO MICROFINANCE

Over the last decade, a growing recognition of the importance of and need for additional financial services beyond loans (that is, microcredit alone) has expanded

the initial concept of microcredit to microfinance. The Consultative Group to Assist the Poor (CGAP) defines microfinance as an inclusive financial system whereby “...poor people everywhere enjoy permanent access to a wide range of quality financial services, delivered by different types of institutions through a variety of convenient mechanisms.”<sup>12</sup> Broadly speaking, the services offered through microfinance programs include loans, savings, money transfer services (remittances), and microinsurance.

Today, the reach of microfinance programs to the poor is truly amazing: As of December 2007, more than 3,500 MFIs had reported to the Microcredit Summit that they were reaching nearly 155 million clients, nearly 107 million of whom were among the poorest when they took their first loan. Of these poorest clients, 83 percent, or almost 89 million people, were women.<sup>13</sup>

Private and public funding has fueled this phenomenal growth. In 2007, according to a CGAP survey, nearly US\$12 billion was committed by donors in support of microfinance.<sup>14</sup> Increasingly, microfinance has also become an opportunity for “doing well by doing good,” with financial analysts demonstrating that investment in microfinance can offer profitable returns.

Microfinance also lends itself to a more immediate sense of impact on the part of donors. For example, Kiva, a microlending website, allows donors to view profiles and select individual borrowers they’d like to support. Contributions are made to Kiva, who in advance of the donor’s gift fronts the funds to the microfinance organization with whom the borrower is working. In turn, Kiva updates donors on the borrower’s progress and repayment history. This apparently intimate association with individual borrowers has inspired generous giving by donors.

### TWO APPROACHES TO MICROFINANCE: FINANCIAL SYSTEMS AND POVERTY-LENDING

by Jason Cons and Kasia Paprocki

To fully make sense of the field of microfinance as it is practiced today, it is important to understand the diversity in lending practiced by MFIs. Readers of this guide who are new to microfinance may be surprised to learn that MFIs vary greatly in size and approach—from tiny NGOs lending in a single rural village, to major microfinance investment funds managed by huge banks and lending in some of the world’s largest cities. Also

surprising to many is how largely unregulated the microfinance industry is, leading to a certain opacity that makes it very difficult to evaluate MFIs.

Within the microfinance field writ large, there is little agreement over what constitutes best practice, although many agencies and coalitions of MFIs have attempted to establish frameworks for agreeing on some minimum standards.

Like many philanthropic endeavors, it is also often difficult to discern how (and how well) the ideals and goals of each organization are manifest on the ground.

While distinctions can be made between various approaches to microfinance, the aim here is not to assess every model or institution individually but to give a broader perspective on microfinance practice at large. The research and analysis in this guide respond to microfinance as a whole and make no claims to addressing or evaluating one approach over another.

One of the central debates within the microfinance community is over the meaning of “sustainability”. In the context of microfinance, does sustainability refer to the institutions that provide loans or the people they serve? Is there a difference between the two and, if so, what is it?

Different ways of answering these questions yield widely divergent outcomes. As such, navigating the multiple meanings of sustainability is central to understanding the competing philosophies behind microfinance, the different kinds of lending programs produced, and the differing impacts on the individuals and communities these programs serve.

Within the microfinance community, there are two dominant schools of thought around defining sustainability. These are known as the “financial systems approach”<sup>15</sup> and the “poverty-lending approach.”<sup>16</sup>

### The Financial Systems Approach

In a nutshell, the financial systems approach focuses on sustainability of the microfinance institutions themselves. There are a number of perspectives among those who advocate a financial systems approach to microfinance, but broadly, proponents argue that MFIs are most effective when they stick to their core compe-

tency of providing financial services. In this view, the financial health of institutions is seen as a reasonable measure of (or more important measure than) the impact of loans on recipient livelihoods.

Proponents of this vision of sustainability argue that providing the best possible financial services to clients ensures their economic success, thereby providing a stable and sustainable base for the institution to continue providing services. As recipients thrive, repay, and take out new loans, and as new customers are attracted to the MFI, the organization will become financially sustainable and no longer need subsidies or donor support.

While the financial sustainability of the lending organization is the ultimate goal of financial systems MFIs, it is not the case that all MFIs practicing this approach are entirely financially self-sustaining.<sup>17</sup> In fact, only a minority of MFIs operate today without donor subsidies, though they represent a very large market share. This is reflected by the belief among financial systems advocates that a primary goal of microfinance should be to operate at a very large scale, and to do so it is necessary to be commercially profitable in order to attract investments from the private sector.

Financial systems practitioners regularly cite their “double bottom line” of social and financial returns. Though opponents often argue that profitability and poverty reduction are mutually exclusive, the double bottom line philosophy undergirds the social entrepreneurship movement, which claims adherents among financial systems and poverty-lending approaches alike.<sup>18</sup>

A number of the early advocates and practitioners of microfinance such as ACCION pioneered the financial systems approach. These organizations saw their role as providing ways for economically productive individuals whose primary limitation was access to credit to develop entrepreneurial ventures in the informal sector. The key assumption behind this approach is that financially self-sustaining MFIs will be able to reach more clients and help more people than could be serviced through donor-supported programs.

While the financial services approach has many proponents, it of course also has many detractors. One common criticism of the financial systems approach is that

*In the context of microfinance, does sustainability refer to the institutions that provide loans or the people they serve?*

it subordinates the needs of borrowers to those of institutions. As a result, microfinance providers end up looking more like debt collectors than service providers. If the main aspiration of microfinance is to have a major impact on poverty reduction, an overwhelming focus on debt servicing can appear mercenary or opportunistic.<sup>19</sup> In the words of economist and microfinance expert Iffath Sharif:

*One cannot help but question the integrity of organizations trying to achieve parallel objectives of poverty reduction as well as their own institutional financial sustainability at the expense of poor borrowers.<sup>20</sup>*

An equally salient concern raised by detractors of the financial systems approach: the apparent belief that lack of credit is the primary structural condition of poverty. Through this lens, food, health care, and education can be most efficiently secured by the poor by taking out loans that enable them to generate income. What these assumptions miss is the reality that conditions of poverty, such as hunger, lack of business know-how or restricted market opportunities often prevent recipients from effectively using their loans for entrepreneurial ventures.

Indeed, this reality contradicts the largely accepted notion that microfinance loans are used for entrepreneurial or business expansion purposes. Recipients who live on the margins of extreme poverty struggle to repay such loans and often find themselves enmeshed in cycles of debt and credit dependency rather than breaking out of cycles of poverty.

Where the financial services approach is adopted, other problematic realities may occur on the ground. For example, in Bangladesh the growth of microfinance programs is rapidly outstripping the number of NGOs that provide other critical rural services. Indeed, many organizations that previously focused on issues such as medical services are switching over to microfinance, in no small part because it is easier to secure funding for microfinance than other kinds of development programs.<sup>21</sup>

Advocates of the financial systems approach are more

likely to support the provision of services to the “economically active poor,” suggesting that the poorest of the poor, who are not economically active, may not be able to use loans effectively. This reasoning highlights a major debate within the microfinance industry: whether the poorest should be targeted or even eligible for microfinance loans and whether lending to the poorest can be profitable enough to ensure the financial sustainability of NGOs or commercial lending institutions.

When all is said and done, lack of access to credit is only one structural aspect of poverty. Failure to understand how all aspects of poverty work together can lead to disastrous outcomes for loan recipients. In such conditions, it may be the case that the sustainability of lending institutions is secured at the expense of the livelihoods of its clients.

### The Poverty-Lending Approach

If the financial systems perspective on sustainability focuses on institutions, the poverty-lending approach centers on clients and sustainable transformations in their livelihoods.

A primary argument made by advocates of the poverty-lending approach is that providing only financial services, including credit, is not enough to eliminate poverty. As economist and Nobel Laureate Amartya Sen observed, “Poverty must be seen as the deprivation of basic capabilities rather than merely as low incomes.”<sup>22</sup>

The poverty-lending approach emphasizes that, while providing credit to the poor can be an important tool in alleviating the problems that arise from inadequate income and employment opportunities, credit is incapable, in and of itself, of fully eradicating the basic deprivations that perpetuate the cycle of poverty. As Christopher Dunford, President of Freedom From Hunger, puts it:

*The problems of the poor go well beyond money or things. They suffer a broader syndrome of disadvantage...Just as they have been bypassed by formal banking and other financial institutions, the poor have little or no access*

*When all is said and done, lack of access to credit is only one structural aspect of poverty. Failure to understand how all aspects of poverty work together can lead to disastrous outcomes for loan recipients.*

*to education, health, and other services to build their 'human capacity.'*<sup>23</sup>

Advocates of the poverty-lending approach rightly argue that chronic poverty is insufficiently addressed through increased financial assets alone. Thus, this approach incorporates and emphasizes the importance of “economies of scope” as opposed to “economies of scale” insofar as it strives to maximize the necessary benefits to people instead of maximizing the number of people who can receive the minimum benefits.

One microfinance model practiced through the poverty-lending approach is known as “credit-plus,” which refers to the provision of additional services alongside microcredit programming. These services span a wide range of development interventions, from financial literacy and entrepreneurship development to health care and women’s empowerment programs.

Some credit-plus MFIs operate parallel programs that do not necessarily overlap with microfinance delivery, or even serve the same constituents or communities. These programs are often funded in part (or in whole) through interest earnings from the microcredit programs. Other credit-plus MFIs regard their microcredit programs as delivery platforms for additional services. One example of an MFI that uses this method is Freedom From Hunger, which provides education to women at their microfinance group meetings in areas of health, nutrition, business, and money management.

A focus on the sustainability of individuals, as opposed to institutions, recognizes the core goal of microfinance as poverty alleviation. However, within programs that adopt a poverty-lending approach, there are significant risks and concerns.

One major concern of the poverty-lending approach, where additional services are integrated directly into microfinance programming, is that it can have the unintended consequence of engendering dependency and greater vulnerability to abuse. In some instances, individuals who are interested in an MFI’s complementary services but who have no need for a loan may end up borrowing simply to have access to programs which meet their other needs. In other instances, poverty-lending MFIs may use the threat of losing essential services to encourage repayment, and borrowers requiring critical services may lose access to them if they miss a loan payment. As such, the control of other critical services by the same institution responsible for lending money can pose problems for clients. Indeed, the concentration of a number of such services under

one roof may increase recipient exposure and risk rather than improving access and support.

Poverty-lending institutions, particularly smaller ones, are often criticized for straying beyond their core competencies and overextending themselves by providing a number of different services or programs poorly, rather than a few things well. Also, many argue that poverty-lending institutions will never be able to secure the necessary capital to reach the millions who could benefit from microlending services because they cannot grow without donor support.

One other critical issue with poverty-lending approaches is that, despite a more social outlook, these organizations begin from the standpoint that microfinance is the primary service and all other support services are secondary. This means that on-the-ground success is tracked primarily through financial metrics, and social objectives are subordinated to financial ones.<sup>24</sup>

. . .

There are both strengths and weaknesses to the competing approaches to microfinance of financial systems and poverty-lending. At best, they both help to create access to financial services for their clients. At worst, they can both contribute to, rather than relieve, conditions of poverty.

It can often be difficult for grantmakers to differentiate between approaches, and in practice, the distinction between these models can often become muddled. Many organizations that previously applied a strict, financial systems approach to microfinance have begun to adopt pro-consumer pledges and consumer protection strategies to address criticisms that they are not pro-poor and to ensure that loans are having the desired social impact.<sup>25</sup> At the same time, some organizations known for their “credit-plus” approaches have gravitated towards a more pure banking approach. It is therefore critical to understand the specific lending practices and philosophies employed by different MFIs at the present moment when making decisions about what kind of model, philosophy, and approach to support.

In addition, neither perspective offers a full or adequate vision of “sustainability.” Further, both approaches to microfinance are based on the idea that access to credit is the cornerstone for poverty alleviation everywhere. By uncritically adopting either model to address poverty in any community, grantmakers and practitioners ignore the possibility that credit—or more credit—might not be what is needed in a given community and context.<sup>26</sup>

## WHAT WE BELIEVE—AND WHAT WE KNOW—ABOUT MICROFINANCE

### MICROFINANCE AS MIRACLE WORKER

From the beginning, microfinance has had tremendous appeal, capturing the imagination of donors in ways that other development interventions have not. The appeal of microfinance rests not only in the innovations of the model. Borrowing from a revered adage in our lexicon, microfinance offers a “hand up, not a handout.” For critics who say traditional development assistance can induce or increase dependency, microfinance appears to offer an antidote. For business-minded donors seeking a rapid “return on investment,” microfinance offers far greater appeal than the often slow and difficult path of, say, advancing human rights.

Proponents of microfinance argue that it is one of the most effective and flexible strategies in alleviating poverty. The Grameen Foundation, with a budget of \$25 million in fiscal year 2009 states:

*Microfinance has a positive impact far beyond the individual client. ... As families cross the poverty line and micro-businesses expand, their communities benefit. Jobs are created, knowledge is shared, civic participation increases, and women are recognized as valuable members of their families and communities.*<sup>27</sup>

ACCION, which reports that it has served over 7 million people in the last ten years, with 28.5 million microloans totaling \$23 billion dollars, reports the organization has “created an anti-poverty strategy that is permanent and self-sustaining.”<sup>28</sup>

These institutions, along with hundreds of others committed to microfinance, have among them an inspiring collection of stories about individuals who have lifted themselves out of poverty with the help of microloans. As the scope of microcredit has evolved to microfinance, proponents believe that, more than ever, access to financial services holds vast potential to improve poor people’s lives by providing the necessary capital for business activities which in turn can increase household incomes. The products now offered by MFIs, it is argued, can help diversify income sources and help

families better cope with shocks or crisis, thus avoiding the sale of critical assets. According to CGAP:

*By reducing vulnerability and increasing earnings and savings, financial services allow poor households to make the transformation from every day survival to planning for the future. Households are able to send more children to school for longer periods and to make greater investments in their children's education.*

*Increased earnings can lead to better nutrition and better living conditions, which translates into a lower incidence of illness.*<sup>29</sup>

### COUNTERVAILING EXPERIENCES

While few would deny that equitable access to financial services can help improve the circumstances of poor people, what remains unclear for many is whether microfinance has and can reduce poverty in a meaningful way. Also unclear is whether microcredit, the leading tool of the microfinance industry, might not in fact leave some people worse off.

While many people are familiar with the stories of individuals who have seen their life improve through access to credit, fewer people are aware that there exists, too, countervailing stories of individuals whose unsuccessful brush with microfinance has placed them in greater poverty and more precarious circumstances. Take the case of one of the women in Koppal, India, whose experience with microfinance programs is documented in the book, *The Meaning of Money: How Women See Microfinance*, by Smita Premchander:

*Lakshnavva joined a self-help group and took five loans. She paid interest on the loans, but the principal amount was outstanding. These loans were used for consumption smoothing, not to purchase productive assets, and helped Lakshnavva through particularly difficult periods when the availability of agricultural work was low and she had no source of income. She received an additional loan and acquired a buffalo with the funds, but she was unable to repay this loan. Notwithstanding her inability to pay*

## A Case Study from Bangladesh: Listening to Borrowers

by Jason Cons and Kasia Paprocki

In the contemporary debate on microcredit, the voices of those whose lives it affects on a daily basis are conspicuously absent. The Goldin Institute works to build grassroots partnerships for global change that are rooted in the power of communities coming together to build their own solutions and determine their own futures. This case study outlines the results of a project between a community in Northern Bangladesh and the Goldin Institute (based in Chicago, Illinois) with the goal of bringing recipients' experiences and opinions into the global debate on microcredit. To realize this goal the Goldin Institute adopted a strategy known as "oral testimony" that relies on extended, semi-structured, and unstructured interviews whereby recipients tell their own stories in their own words and convey their own understandings of how microcredit has transformed the history of their lives and their village. The community at the center of this case study is referred to as Arampur, to protect the identities of project participants.

The goal and logic of microcredit is to improve the lives of recipients by providing them with small loans to purchase productive assets for entrepreneurial activity. In Arampur, respondents described a different scenario, in which microcredit produces dependency on additional loans, trapping them in deepening cycles of debt. For example, with eight microfinance providers in a village of approximately 1500 households, it is common for households to have upwards of four loans at any given time.<sup>30</sup> In this overcrowded debt-market,<sup>31</sup> old debts are repaid by taking out new loans from different sources (and not infrequently from the same sources), often with the encouragement of field officers. As such, recipients frequently find themselves in positions of greater dependency and reduced self-sufficiency.

The notion that microcredit is a mechanism for breaking cycles of poverty and achieving financial independence is one that is questioned by recipients in Arampur. Rather than freeing them from the burdens of poverty and enabling them to move away from reliance on local moneylenders for emergency cash, many view microcredit itself as producing insidious cycles of dependency. As one respondent observed, "At the beginning, the NGOs said that their loans would bring happiness to our lives, as we would get money to start businesses. They lured us by telling us we would have chickens, a latrine, and many other things. We believed them. They said that we would have to repay the installments every week but we would never feel burdened by the loan. But later we felt the burden. Then we understood that we could never get rid of the loans even after selling our skin."

Such crises of dependency are deepened by the need to use loans for consumption purposes. In Arampur, microcredit has replaced other NGO-provided rural services such as food security and health care programs and eroded long-standing social safety mechanisms within the village.<sup>32</sup> The one notable

exception is a microcredit provider that offers limited primary education to the children of borrowers, although many reported that when they fell behind on making their loan payments, their children were no longer allowed to attend school. No other NGO in the village offered services besides microcredit. Many borrowers reported that during the hungry season, they had no choice but to use loans for the purchase of food. In fact, almost every respondent reported, when asked at what time of year he or she takes microcredit loans, that they do so at the beginning of this season. "I don't want to take microcredit loans any more," one respondent observed, "but at times of serious food problems we have no other way." Many in the village told the Goldin Institute they avoided microcredit for a time, but ultimately were forced to take loans during a household crisis (the most common being hunger or medical emergencies). This initiated a cycle of debt from which many have been unable to escape.

Proponents of microcredit frequently argue that high repayment rates indicate the success of microcredit on the ground. However, the experience in Arampur raises questions regarding the use of repayment rates as a proxy for poverty alleviation. The vulnerable positions of people living in poverty often makes it easier to coerce, pressure, and extort them into repaying, often at the expense of their livelihoods. Further, when repayment rates are the primary metric by which MFIs are judged, it becomes a way to track job-performance of field officers. As residents of Arampur reported in countless stories, this leads to an inherently exploitative relationship on the ground. Residents reported that it was not uncommon for field officers—who are in charge of sourcing and collecting weekly payments or "installments"—to resort to violence in collecting on loans. Reports of physical and sexual abuse were common and unauthorized repossession of assets, including the very roofs off of recipients' homes, was not infrequent.<sup>33</sup>

Villagers have little recourse in such events. Few, if any, mechanisms exist for borrowers to report such acts of abuse or to issue complaints to MFIs.<sup>34</sup> They are forced to choose between protecting themselves, their homes, and their families and purchasing basic needs. As one recipient put it, "They use many kinds of force to get their money back...torturing people or dragging people...it is a serious injustice. Say I tell the field officer 'I can't give you the installment today, my child is sick.' And then I bring the doctor to my house and he is sitting and giving my child medicine. Then the field officer comes and says 'Why can you buy medicine for your child, but you can't give me the installment?' What kind of a way is this to treat anyone?" Microcredit loan payments thus become a high priority among other household expenditures, including food and medicine. Rather than empowering individuals and communities, repayment creates an environment of fear and intimidation where recipients must regularly sacrifice basic needs to meet an inflexible repayment schedule.

See expanded version at <http://www.foodfirst.org/files/pdf/bgr%20microcredit%20winter%202008.pdf>

*Incidences of over-indebtedness do occur and clients may end up less well-off, reminding all of us that microfinance, in particular credit, must be used judiciously.*

– Consultative Group to Assist the Poor

*back what she had already borrowed, Lakshmauva was offered additional loans, but managed to avoid them. Over a four-year period, Lakshmauva's oldest son left school to care for and graze the buffalo; later her second son took over grazing the animal while the oldest son worked as an agricultural laborer. While Lakshmauva's "assets position" had improved, her children left school. In 2007, she sold the buffalo. Her children returned to school briefly, but dropped out again and now work as agricultural day laborers.<sup>35</sup>*

Needless to say, absent from pro-microfinance literature are stories like these, reports of cases of perpetual indebtedness, egregious interest rates, increased burdens on women borrowers, and more.

Equally problematic, many industry advocates tend to minimize the negative impacts experienced by borrowers. In *A Billion Bootstraps: Microcredit, Barefoot Banking, and the Business Solution for Ending Poverty*, authors Phil Smith and Eric Thurman write,

*. . . the penalties for default, while serious, do not involve physical punishment or cruel methods. The greatest consequence of failure to repay a loan is loss of both respect in the community and chance for a future loan.<sup>36</sup>*

This loss of stature should not be taken lightly. In the complex setting of families, communities and social hierarchy, it can in fact lead to devastating results. Errant members of a microcredit group may be

ostracized or even expelled from their community, and essential assets—most notoriously, the tin roofing that protects a borrower's house—may be seized.

## MEASURING IMPACT

The extreme contradictions in assessing the experience of microfinance borrowers, ranging from the laudatory to the scathing, lead to questions at the heart of the microfinance debate:

- :: What do we know for sure about the impacts of microfinance?
- :: In the pursuit of building sustainable institutions and decreasing donor dependency, are we willing to accept disproportionately high interest rates and perpetual debt as collateral damage, along with transforming NGOs into collection agencies?
- :: Ultimately, what is liberating or empowering about the economically vulnerable and the poor incurring more debt?

Despite hundreds of studies, evaluations and investigations into the efficacy of microfinance, what makes answering these questions so elusive is the difficulty with using correlation to prove causation, or being able to isolate access to credit as the sole contributing factor to improvements in an individual or family's economic and social welfare.

One attempt from within the microfinance sector to measure impact is the Grameen Foundation's Progress out of Poverty Index (PPI), a tool that is currently being applied in 21 countries to collect objective, easy-to-observe, non-financial data that serves as indicators of a family's status. Indicators include family size, the number of children in school, access to health care and clean water, and other relevant factors. This information helps to create client profiles and serves as baseline data from which MFIs can track a family's movement out of poverty over time. The PPI is also meant to support MFIs in better serving clients.

For donors, the PPI is intended to demonstrate that the MFIs they support are achieving a double bottom line: MFIs are effectively managing both the funder's investment as

*Ultimately, what is liberating or empowering about the economically vulnerable and the poor incurring more debt?*

well as delivering on their missions of moving people out of poverty.

Whatever value the PPI may have in other ways, though, it does not in fact measure the role microfinance plays in alleviating poverty. Mary Jo Kochendorfer, Grameen Foundation's PPI Deployment Officer, explains:

*We work with our partners to use the PPI so they can better understand who they are reaching and if they are moving out of poverty. If they are monitoring changes among products and services, and people are moving out of poverty more quickly with one product versus the other, the PPI can help identify and shape those products that are making a difference... It is more difficult to determine if microfinance is solely responsible for poverty alleviation—you must isolate all the variables affecting people in addition to microfinance. It is possible to correlate the relevance of microfinance, but [poverty alleviation] can't be attributed to it. You need a control group for that determination."<sup>37</sup>*

### DISCERNING THE IMPACT OF MICROFINANCE THROUGH RANDOMIZED CONTROLLED TRIALS

Recently, several researchers have taken up the challenge of measuring the impact, or lack thereof, of microfinance programs. Economic professors Dean Karlan (Yale) and Jonathan Zinman (Dartmouth) have used randomized controlled trials, working with microfinance clients affiliated with a bank in the Philippines.<sup>38</sup> From a pool of qualified applicants, some individuals were randomly denied loans while otherwise identical applicants were approved. Researchers followed borrowers' progress for up to a two-year period to see what difference the loan made in livelihoods, measuring indicators such as income, spending, health, and education.

Karlan and Zinman found that neither household income nor spending increased among borrowers. The findings also directly contradicted two important tenets of microfinance: that loans are used for productive purposes (launching or expanding entrepreneurial initiatives), and that they are an important tool for empowering women. Instead, the study found that many of the microfinance clients used their funds for household consumption, for paying off other loans, or for significant life events such as weddings or funerals. The study also found no evidence of empowerment of women or impact on gender roles. In fact, in the cases where some economic gains were realized, it was only among men with existing businesses.

In response to the findings, Karlan says:

*Microcredit is not a transformational panacea that is going to lift people out of poverty. There might be little pockets here and there of people who are made better off, but the average effect is weak and diffuse, at best.<sup>39</sup>*

Economics professors at MIT, also using randomized controlled trials, experienced similar findings. Abhijit Banerjee, Rachel Glennerster, and Esther Duflo<sup>40</sup>, researchers of a study in Hyderabad, India, found that spending remained the same in households receiving loans. Further, the researchers did not see changes in

the effect on children's health or increased decision-making on the part of women in borrower households (as compared with the control group).

Critics of these studies argue that they fail to portray the full effects of microfinance because the length of time spent tracking impacts, a one- to two-year period, is too short. Others counter that this critique has little validity given the way microcredit is delivered—fast and furious, with an expectation of rapid positive results. Indeed, the terms of many microcredit loans are as short as three to six months. If the presumed positive effects of

microfinance are only evident long term, and one or two years is not enough time for a poor entrepreneur to see incremental improvements in their livelihood, why the race for borrowers to pay back loans so quickly?<sup>41</sup>

*Microcredit is not a transformational panacea that is going to lift people out of poverty. There might be little pockets here and there of people who are made better off, but the average effect is weak and diffuse, at best.*

—Dean Karlan, Yale University

As the debate rages among microfinance advocates and skeptics, the above-mentioned studies are noteworthy because the researchers involved overcame the long-held position that controlled studies were impossible. These findings and other evidence suggest that, rather than playing a critical role in helping families overcome poverty, microfinance may play a palliative effect in the lives of the poor. Regardless of disagreement on these findings, the latest research should serve as a launching point for donors, lenders, policy advocates and MFI practitioners to keep searching for solutions and listening closely to borrowers about how to make microfinance more effective.

*...the latest research should serve as a launching point for donors, lenders, policy advocates and MFI practitioners to keep searching for solutions and listening closely to borrowers about how to make microfinance more effective.*

who took a loan to pay for her daughter's dowry was forced to give up her home when she had no way to repay the loan after the money was used for dowry.

Other research findings caution that female participation in microfinance programs should not be treated as an indicator of female empowerment. This huge leap in logic is frequently made in assessing the impact of credit availability on women. Researcher Linda Mayoux describes this notion as the "virtuous spiral": upon access to credit, it is assumed that women will experience economic empowerment. This, in turn, will lead to an increase in status within her family, and improvement in her well-being and that of her children. As the virtuous spiral continues, it is assumed women

experience ever-expanding social and political empowerment.

Skeptics of the belief that microfinance empowers women point to the fact that the majority of microfinance programs are not geared towards women for reasons of solidarity or empowerment but because women have higher repayment rates than men and are thus less of a risk to lenders. Working with women also helps cut costs by demanding that women contribute their time and resources for program administration, demands that are rarely made of men.

Of further concern, the increased demand on women's time as they embark on economic enterprises has been directly correlated to increases in the demands put on children. Girls in particular are made to assume responsibility for domestic work and to care for small children while their mothers are busy working to fulfill conditions of their loan.

In a paper commissioned by the Microcredit Summit Campaign on microfinance and the empowerment of women, MFI practitioners Susy Cheston and Lisa Kuhn of Opportunity International caution:

*... power is deeply rooted in our social systems and values. It permeates all aspects of our lives from our family to our communities, from our personal dreams and aspirations to our economic opportunities. It is unlikely that any one intervention such as the provision of credit or*

## GENDER AND EMPOWERMENT

A central claim of many MFIs is that microfinance empowers women and promotes gender equality. Like other claims about the benefits of microfinance, this one too needs to be carefully unpacked.

It is true that women are often the primary targets of MFI programs, but unfortunately they can also be used as conduits to, rather than end users of, credit. As one borrower explained:

*Women take microcredit as their husbands order them to do so. When their husbands fail to pay the installment, then NGO workers abuse the women a lot. Women have to bear the pressure coming from both sides.<sup>42</sup>*

One of the early goals of microcredit programs in Bangladesh was to free women and families from the burden of dowry.<sup>43</sup> Yet respondents in Arampur (see the Goldin Institute case study, page 11) report that microfinance is strengthening the dowry system in their village by precipitously inflating dowry prices. Numerous respondents used their loans to pay for their daughter's dowries, often requiring multiple loans to cover the costs. One woman who earns 100tk (approximately \$1.50) per day took a loan for 25,000tk (over \$360) to pay for her daughter's marriage. Another woman

*the provision of training will completely alter power and gender relations.*<sup>44</sup>

Promoters of the financial sustainability approach to microfinance would argue that community-based efforts, such as women's self-help groups in India, are too small to ever become financially sustainable. However, self-help groups and those NGOs who work closely with them insist that women must have more access to assets, management training and control over their own money and financial institutions in order for microfinance to be empowering. In a paper written for Microfinance India, researcher Shashi Rajagopalan writes:

*In whose interest is it to continue to project the savings of rural women as 'micro'? In whose interest is it to continue to ensure that the*

*savings do not get paid an interest? That the primary agency in which savings are being made is kept small and informal in nature? It will be unforgivable if we were to aim at women accessing the services of external agents, if this were at the cost of building strong, inter-generational institutions of their own—and if our efforts contributed to further flight of capital from their areas.*<sup>45</sup>

The debate on the empowering and disempowering effects on women borrowers presents another divide within the microfinance industry. Given the centrality of the idea of microfinance as a tool for the empowerment of women, this is a debate that most urgently needs resolving.<sup>46</sup>

### Women's Empowerment Through Sustainable Microfinance: Rethinking 'Best Practice'

by Linda Mayoux

The conflation of paradigms, coupled with continuing resistance to anything more than lip-service to gender mainstreaming in most programmes and donor agencies, means that even with recent moves within CGAP and the Microcredit Summit Campaign to pay more attention to poverty targeting [microfinance] continues to marginalise gender issues. Accompanying the rapid increase in women's access to micro-finance has been a progressive narrowing of the definitions of empowerment and decrease in funding for explicit strategies to achieve it.

There is a need to promote a much more diversified micro-finance sector than that implied by current 'Best Practice'. The evidence seriously calls into question the universal desirability of separate MFIs along the standard Grameen, ACCION or village-banking model as described in the replication literature. Women need a diversity of provision, both in view of their own individual needs for different types of savings, loans, insurance, pensions, etc., and in view of differences in needs between women.

Given donor commitment to gender mainstreaming, gender equality should be an integral criterion for funding decisions alongside any other requirements for sustainability or proven development contribution.

Women are not a minority but a marginalised majority amongst micro-finance clients and potential clients. Gender equality measures [outlined in this paper] can be implemented in any model of micro-finance from gender mainstreaming in private and public sector banks and other financial service providers, to smaller micro-finance programmes providing specialist targeted savings and credit, through to women's movements and labour organizations organizing self-help groups.

The empowerment strategies suggested can also be implemented in many different organisational models. Promoting empowerment requires a significant change in attitude, changes in working practices and challenging vested interests. Flexibility to women's needs and deciding the best ways of combining empowerment and sustainability objectives can only be done on the basis of extensive consultation with women, research on women's needs, strategies and constraints and a process of negotiation between women and development agencies. There is therefore a need to develop effective structures for participatory management, which combine requirements of efficient service delivery and contribution to empowerment.

What is worrying in the current situation is that enthusiastic assumptions of automatic beneficial impacts of micro-finance are being used as a pretext for withdrawing support for other empowerment and poverty alleviation measures, including support for subsidies for programmes targeting the poorest, and for empowerment strategies within micro-finance programmes themselves. Then in response to mounting evidence of potentially limited contribution to poverty alleviation and empowerment, donors are responding by saying that issues of empowerment and welfare need to be treated separately from micro-finance, despite the diversion of funds from these 'separate' strategies. There is therefore a need to develop effective strategies for networking between micro-finance programmes and other organisations working for change in order to challenge donor pressure and address the macro-level constraints on the empowerment contribution of micro-finance programmes themselves.

See the complete paper at [http://www.microfinancegateway.org/gm/document-1.9.26587/32112\\_file\\_53.pdf](http://www.microfinancegateway.org/gm/document-1.9.26587/32112_file_53.pdf)

## TRACKING MICROFINANCE PERFORMANCE

by Jason Cons and Kasia Paprocki

Microfinance has enjoyed the reputation for tremendous success as a tool for poverty alleviation. Yet how is this success measured? What does it mean for microfinance to be a “successful” intervention? These seemingly common sense questions are at the heart of a complicated debate within the microfinance industry. How success is defined is central to determining which microfinance projects have the most “positive” impact and what type of program grantmakers choose to support.

### FINANCIAL METRICS AS MEASURES OF MICROFINANCE SUCCESS: WHAT’S WRONG WITH THIS PICTURE?

The primary strategy most MFIs use to track impact is financial metrics. There are a number of these that MFIs collect and often publish, including total loan disbursement and portfolio growth over time. These measures are usually coupled with demographic data, including total number of borrowers, disbursement by gender, rural versus urban disbursement, and sectoral distribution (e.g., agriculture versus processing or trade). Yet perhaps the most simple, well known, and commonly used measurement of MFI success is repayment rates.

MFIs have famously high repayment rates. Muhammad Yunus strongly argues that such high repayment rates are excellent indicators of the success of microfinance. This is, he argues, in part because poor recipients know that by complying with the financial discipline demanded by loan participation, they become eligible for additional loans.<sup>47</sup> As such, high repayment rates are taken as indicators that recipients are putting their loans to productive use and becoming active participants in local economies. The assumed corollary is that recipients have risen out of poverty at a similar rate at which they have repaid their loans.

This argument is largely accepted within the microfinance community, and loan repayment rates are now standard metrics for success used by practitioners and donors alike. Most MFIs publish and highlight their often high repayment rates. In Bangladesh, home of

Yunus and the Grameen Bank (which boasts a repayment rate of 98%), more than 70% of MFIs report repayment rates higher than 95%.<sup>48</sup> These rates are carefully guarded and monitored, not just because they measure profits and income for local branch offices but because they are accepted indicators of positive impact and are the key to MFIs securing additional donor support. MFIs have also been very effective in documenting the number of clients reached and the number of loans distributed.

A real weakness here is the assumption that repayment rates can and do measure poverty alleviation. Missing from this assumption of success is how, and at what costs, borrowers are repaying their loans. Research on recipient experiences with microfinance throws some doubt on this long-held assumption within the microfinance community. Repayment rates as a measure for whether or not a donor’s investment has been successful is transferred down microfinance chains of command. As donors scrutinize MFI repayment rates, central offices measure branch office performance in similar ways. In turn, these imperatives to demonstrate high repayment rates are passed on to MFI field officers in charge of overseeing microcredit loans at a local level. As a result, field officers operate under enormous pressure to maintain high-repayment rates in order to keep their jobs.

In such contexts, there is little incentive for field officers to ensure that loans are being put to productive use or to support recipients in their entrepreneurial ventures. As one recipient in rural Bangladesh put it:

*The field officers do not help us at all. They come to our homes, collect our money, and leave. Their duty is only to disburse the loan and then take it back. We don’t have any other relationship with them and we never get any assistance from them.*<sup>49</sup>

This comment should not be viewed as an aberration but as a symptom of deeper structural factors governing the relationship between borrower and loan officer. Indeed, as researcher Jude Fernando has written:

*Communication between the FOs [field officers] at the local level and their central office is largely limited to the financial aspects of the program. From the perspective of FOs, there is neither enough time and resources nor a mandate for them to engage in matters other than achieving the financial targets set by their superiors. Consequently, one finds FOs unwittingly resorting to various methods that are distasteful to the members ...<sup>50</sup>*

In this way, the metrics used to evaluate microfinance programs have a direct impact on the efficacy of the programming and the livelihoods of the people these programs aim to improve. Through this lens, it becomes apparent that many of the conditions that facilitate the abuse of microfinance borrowers by field workers are direct consequences of the structural vulnerability of people living in poverty everywhere.

What is more, pressures to maintain repayment rates can lead to exploitive relationships between field officers and borrowers, with slim possibility of recourse to hold MFI staff accountable. In the case of Arampur (described on page 11), loan recipients regularly complained that field workers placed the imperative of collection above all other considerations. Recipients reported regular abuse—verbal, physical, and sexual—as well as frequent unauthorized repossession of assets to collect installments.<sup>51</sup> Under the threat of such abuse, recipients regularly go without food and other basic needs, sell other productive assets, borrow from other MFIs or local moneylenders, and generally make short-term decisions at the expense of long-term goals to meet weekly payment schedules.

While these egregious acts may not be a general condition of microfinance throughout the world, two salient and linked points emerge about the equation of repayment rates to poverty alleviation.

First, those living in poverty are structurally trapped in extremely vulnerable positions. They frequently have little recourse to official authorities and, what is more, are in dire need of maintaining their access to steady and/or emergency cash infusions. They can frequently be bullied, pressured, and coerced into meeting repayment schedules. As such, repayment rates may not indicate steps towards breaking cycles of poverty.

Second, the fact that loans are repaid sheds little light on loan use or on the general social conditions in the regions where they are being deployed. Successful

repayment of a loan could mean that the loan was put to productive use. It could also mean that another loan was taken to cover the initial loan. Ultimately, repayment rates, though popular measures of MFI success, are exceedingly poor proxy measures of poverty alleviation.

### CLIENT PROTECTION AND SOCIAL IMPACT

If repayment and organizational financial metrics more generally shed little light on the actual social impacts of microcredit programming, how can grantmakers know what programs are effective or whether their dollars are directly contributing to entrepreneurial growth and poverty alleviation?

Many measures of program impact are highly subjective and open to broad interpretation. This is particularly true as microfinance expands and spreads into new environments and regions. What might be considered as concrete criteria for success and sustainable development in a lowlands agricultural region, for example, might not be applicable in a mountainous region with strikingly different economic and environmental realities. Further, collecting data on how loans are used and how they transform social realities in villages can be a costly and time-consuming enterprise.

Nevertheless, how to measure social impact beyond financial metrics is a question that the microfinance industry is struggling to address, as it must do. There is growing recognition that developing a system for tracking a broader set of impacts is critical for the future of the field. This realization is linked to a shift towards a more pro-consumer model of lending<sup>52</sup> that responds to recent criticism of microfinance as being anti-poor or exploitative.

Examples of innovations in the field include the Small Enterprise Education and Promotion Network (SEEP), which has recently been engaged in developing a set of reporting standards that captures a broader range of measurements than purely financial data.<sup>53</sup> Further, Imp-Act Consortium is an organization that works with MFIs to help develop a set of social goals in line with their particular values and then develop objectives and strategies to help them meet and measure these goals.<sup>54</sup> In addition to this valuable work, many feel that practitioners and donors would do well to attend to other measurements of economic, financial and social health already laid out in programs such as the UN Human Development Index.<sup>55</sup>

## Microfinance | A GUIDE FOR GRANTMAKERS

It is outside the scope of this guide to comprehensively analyze each evaluation strategy or impact measurement tool being used by MFIs. However, one critical distinction to note is the difference between client protection and social performance.

Client protection, which has recently become the cornerstone of the pro-consumer movement within the field, recognizes the obligation of MFIs to do no harm to their constituents. This standard is increasingly becoming the primary criterion of microfinance best practice, and it is perhaps the only best practice standard which the field universally recognizes. It refers specifically to protecting borrowers from abuse by unscrupulous loan officers, recognizing the misconduct that has been uncovered by recent research.

Client protection, however, does not constitute improvement in the lives of borrowers. Social performance measurement can refer to a wide range of factors, including financial improvement, food security, women's empowerment, and the education of children. There is no universal agreement on what metrics should be used to measure social performance, reflecting the broad diversity of goals held by various MFIs for their programs and the variety of needs of borrowers based on their specific context.

In emphasizing the functionality and sustainability of institutions, little attention has been paid to the direct experience of borrowers. It is imperative that metrics for success become more inclusive, focusing on recipients, how microfinance is delivered, and understanding payment collection practices.

Catherine Duggan at Harvard's Business School argues that this is an important role for funders to play—to demand that measuring the success of MFI programs,

*...ought to include some measure of the degree to which institutions adhere to 'best practices' in their collection activities... This is of particular importance since relationships with Western donors and organizations may provide something of a 'seal of approval' to borrowers in developing countries.<sup>56</sup>*

Even with this evolution in the field, there is a challenge and risk that the specific needs of communities and individuals will become subsumed within broad-based assessment strategies that fail to capture and engage microfinance recipients in determining their own criteria for success. The microfinance industry is at a juncture where the notion of impact can be rethought, and this process needs to be located within, and carried out by and through, community participation.

While social impact measures can strengthen microfinance's social mission, there remains a risk that such measures could obscure more than they clarify. If, for example, social impact data are collected and reported by field officers, it will necessarily offer both a biased and a partial view of the real impact of microfinance in poverty alleviation.<sup>57</sup> Further, a set of measures developed in boardrooms and regional offices may not apply or make sense in the actual contexts in which microfinance operates. Only through engaging communities can the microfinance field develop social impact assessment tools that map to local realities, recipient aspirations, and constantly changing cultural, social, political, and economic contexts.

Such a project is no doubt a demanding and costly proposition for MFIs. However, such an effort is both possible and timely, utilizing just a small fraction of the billions of dollars invested in microfinance to date. Donors and philanthropic communities are critical to supporting creative efforts to undertake this essential task.<sup>58</sup> In any case, the question of how a MFI measures success must be a central question for grantmakers in evaluating an ever-expanding set of microfinance programs.

### Does Microfinance Help the Poor?

by Richard Rosenberg, Consultative Group to Assist the Poor

Ever since microcredit first began to capture public attention 25 years ago, the usual story line has been that it is a tool of extraordinary power to lift poor people—especially women—out of poverty, by funding their microenterprises and raising their incomes. This picture has been buttressed by hundreds of inspiring stories of microentrepreneurs who used tiny loans to start or expand their businesses, and experienced remarkable gains not only in income and consumption but also in health, education, and social empowerment. But how well do these individual anecdotes represent the general experience of the hundreds of millions who have gotten microloans and other microfinance services? Is microcredit—or microfinance more generally—being oversold?

If the only value proposition in microfinance were the claim that it raises poor people's income and consumption by funding their microenterprises, then perhaps it would be best for donors, governments, and social investors to declare a moratorium on microfinance support until there is better evidence to think that the claim is true. But before reaching that conclusion, we need to step back and take a broader look at how poor people actually use financial services like credit and savings, and why they value them. A remarkable new book, *Portfolios of the Poor: How the World's Poor Live on \$2 a Day* (Collins, Morduch, Rutherford, and Ruthven 2009), presents the results of year-long financial diaries collected about twice a month from hundreds of rural and urban households in India, Bangladesh, and South Africa. These diaries reveal that financial instruments are critical survival tools for poor households—indeed, that these tools are even more important for the poor than for richer people.

Whether or not financial services lift people out of poverty, they are vital tools in helping them to cope with poverty. The poor use credit and savings not only to smooth consumption, but also to deal with emergencies like health problems and to accumulate the larger sums they need to seize opportunities (occasionally including business opportunities) and pay for big-ticket expenses like education, weddings, or funerals. *Portfolios* shows us that poor households value microfinance because it is very helpful in dealing with their vulnerability, even though the nature of that help may differ substantially from the widespread story line about microloans funding investment in microenterprises that lift their owners out of poverty. But is *Portfolios* just another set of anecdotes, or does it paint a picture that is generally true for vast numbers of microfinance clients around the world?

If it eventually turns out that microfinance is not moving people out of poverty as its proponents have claimed, are its other benefits worth bothering with? When we hear that the evidence about microfinance raising poor people's incomes is unclear, and that many (sometimes most) clients use microloans and savings to smooth consumption rather than to grow enterprises, we tend to be disappointed, and to view consumption smoothing as a mere palliative. "If that's all it is, why bother?" we ask.

Based on what we know now, it seems unlikely that a year of microlending helps poor people as much as a year of girls' primary education (for instance). The true advantage of microfinance is not that each "dose" is more powerful, but rather that each dose costs much less in subsidies. Social programs like primary education and health care usually require large continuing subsidies, using up scarce tax dollars year after year. Microfinance is different: when it is done right, relatively small up-front subsidies lead to permanent institutions that can continue providing services year after year with no further subsidy needed, and can expand those services to reach many millions of low-income clients.

For instance, BancoSol in Bolivia represents a few million dollars of donor subsidies in the mid-1990s that turned into a loan portfolio of over \$200 million and services for over 300,000 active savers and borrowers by the end of 2008, funded almost entirely from commercial sources. This is not an isolated exception. Among microfinance providers reporting to MIX Market, the ones that are profitable and need no further subsidies already account for 71 percent of all the clients, and MFIs that are close to profitability account for another 22 percent.

All and all, isn't this a pretty impressive value proposition, even if we eventually find out that microfinance doesn't raise incomes the way some of its proponents have claimed?

See full article at <http://www.cgap.org/gm/document-1.9.41443/FN59.pdf>

## NEW DIRECTIONS AND TRENDS

There are widely varying microfinance vehicles, formulated with vastly different outcomes in mind, and institutions entering the field cut a wide path. For-profit entities are reaching new clients by investing in existing MFIs. Some NGOs are shifting direction and becoming commercial entities to overcome regulatory barriers to collecting savings. Other NGOs are expanding their services to incorporate technology transfer. Product offerings have expanded beyond microcredit to include insurance and savings.

Because of this growth and the diversity of actors entering the field, within the microfinance industry there is a growing cry for programs dedicated to positive social impact to stand up and be counted, and leading institutions have developed codes of conduct for standards ranging from client protection to transparency in how interest rates are determined. On ACCION's Center for Financial Inclusion Web site, the dilemma and need for developing conduct standards are explained:

*Why should consumer protection be a challenge for financial institutions whose purpose is to benefit their customers? Competition, desire to achieve profitability and internal incentives may all play a role in pushing financial institutions into practices that do not coincide with pro-consumer ideals. This project [Center for Financial Inclusion] is about understanding those incentives and creating new incentives for good practice.<sup>59</sup>*

Other Center for Financial Inclusion program initiatives focus on social performance measurement and reporting, poverty assessment, and impact research (specifically, alternatives to randomized controlled trials).

Likewise, the Grameen Foundation, a long-time champion of the poverty-lending approach, has provided cash incentives to organizations that demonstrate they have used the PPI to evaluate social impacts. The MasterCard Foundation has also dedicated significant funding to Catholic Relief Services—which assists more than 80 million impoverished and disadvantaged people annually—to advance social performance management by training over 100 microfinance institutions on the practice and reporting their findings on the Microfinance Information Exchange.

Currently, however, social impact assessments and adherence to a client-protection code is conducted internally and self-reported by the MFI or NGO, and no independent or external reporting or monitoring mechanisms exist. Indeed, the Center for Financial Inclusion writes, “The incentive framework in favor of consumer protection is presently weak.”<sup>60</sup>

The organizations mentioned here are to be commended for their efforts to develop and advance standards and external evaluation methods and for issuing the sounding call for change. These efforts may well help bridge the gap between advocates and opponents of microfinance, and more importantly, reconcile the contradictions in experience discussed in this guide and elsewhere. As Premchander writes:

*In many cases, savings and insurance services, micro-grants, infrastructure improvement, employment and training programs, and other non-financial services may be more effective tools for poverty alleviation and employment generation. Microcredit is generally most appropriate where ongoing economic activity and sufficient household cash flow already exist, as it may otherwise create an excessive debt burden.*

—Joan Parker and Doug Pearce, Microcredit: One of Many Intervention Strategies, CGAP, 2002.

*The voices that we hear from the field are certainly not the beautiful musical sounds orchestrated by the microfinance sector, they are actually a jarring cacophony that shocks, and so has been subdued. The programmes and projects go on unchallenged, as if everything that is happening is on the right track; to question this is blasphemy, it is seen as turning away from all that is 'advanced' and 'given knowledge' or 'best practice' in the sector.<sup>61</sup>*

There is also growing recognition that in the practice and delivery of financial services, one size does not fit all, and microfinance needs to become more flexible—with the understanding that the degree to which it is an effective strategy is contingent on the requirements of the situation, based on systemic analysis. At its core, this systemic analysis must include community-based assessment of needed services and programs. The assumption that things are “working out for people downstream,”

as one donor recently put it, has allowed us to become comfortable, not questioning the details of how microfinance is delivered to, and experienced by, borrowers.

Another shift taking place in the microfinance field is the increased call for programs that provide more diverse financial services than microcredit, particularly for savings and insurance mechanisms that can be offered to both individuals and groups. In 2007, researcher Thomas Dichter and editor of *What's Wrong with Microfinance* wrote:

*If, as Muhammad Yunus argues, access to credit is a human right, how it is delivered must become a human rights concern.*

*It may be time to entertain the possibility that our emphasis on credit, indeed, in some instances credit-only, has been misguided [and that] ...microfinance ought to shift wholesale into the encouragement of savings.<sup>62</sup>*

This call is being heeded within the funding community. For example, the Gates Foundation, through its Financial Services for the Poor program, has generously invested in the Oxfam America/Freedom from Hunger collaboration, Savings for Change, whereby women pool savings, earn interest, and make loans to each other from their funds shared in common.

Key questions related to the promotion of savings, however, include 1) who are the savings for? and 2) for what can they be used? The answer lies in a broad spectrum of terms. At one end are fixed sums, or forced savings, that MFIs require borrowers produce every week or month.<sup>63</sup> These savings cannot be withdrawn and are not

seen as the borrower's own money. Instead, the savings are meant to serve as collateral against which loans are given. At the other end of the spectrum are savings that are flexible, can be withdrawn as needed or desired, and are respected as the property of the borrowers.

## CONCLUSION: A PATH FORWARD

In this document, Grantmakers Without Borders has explored the history and evolution of microfinance. We've looked at the prevailing arguments from advocates and critics about the sector as well as the philosophical differences on models of delivery and measurements for success. We've shared recent research findings on the impacts of microfinance on poverty alleviation and offered cautionary tales regarding the known and potential pitfalls of microfinance.

In addition, we've raised the concern that industry leaders—whether promoting a financial systems or poverty-lending approach—often still advocate for microfinance as the singular strategy in which funders should invest, when in fact, the efficacy of microfinance is greatly disputed.

While Grantmakers Without Borders appreciates the significant value of the initial premise of microfinance—that poor families not be denied access to financial services—we are deeply concerned about the current state of affairs. As this guide has demonstrated, rigorous, critical assessment of the impacts of microfinance is urgently needed. Furthermore, if, as Muhammad Yunus argues, access to credit is a human right, how it is delivered must become a human rights concern.

To this end, our hope is that this guide will contribute to further exploration, debate, and ultimately, institutional change, leading to the best practices of microfinance elevated and its shortcomings addressed.

How can grantmakers help advance this debate and contribute to reform and borrower-centered microfinance? How can grantmakers and practitioners work together to strengthen the role of microfinance as a poverty alleviation strategy? In response to these questions, we offer the following recommendations for grantmakers' consideration.

### **1.** *Microfinance's potential for alleviating poverty must be rethought with and from the perspective of recipients and communities.*

Individuals and communities need power in the planning and implementation of any microfinance program in which they are involved. Grantmakers should make certain that the microfinance programs they support engage communities comprehensively and authentically. Without directly engaging borrowers in the design, implementation, and delivery of microfinance programs, the results can be disastrous. Utilizing impact assessment with significant community input regarding how to improve MFI products is an important step in making microfinance products and services more borrower-driven. In turn, designing products that are better suited to client needs should also improve impacts. Engaging communities in the debates that seek to determine their futures yields important results and builds participant investment in development projects. With this approach, opportunity and intention are placed on borrowers not as providers of information but as constructors of knowledge and participants in analysis. As such, community engagement can contribute towards community sustainability, a process that roots economic growth and improvement of social welfare in particular places and contexts.

### **2.** *Since microfinance alone can never lift people out of poverty, grantmakers must pay special attention to the availability and access of a broad range of critical human needs, such as healthcare, food, and education.*

By recognizing that, like all other development initiatives, microfinance is not a silver bullet and complementary services are critical, grantmakers can work with MFIs, NGOs, and community-based groups to employ a wide range of strategies to address poverty in a systemic and sustainable way.

As part of the due diligence process in assessing microfinance proposals, grantmakers should determine:

- How many MFIs are currently serving the given location?
- What other services currently exist in the targeted community, and who is providing these services?

- What if any services beyond financial do MFIs offer in the community? Under what conditions are these made available, to borrowers and non-borrowers alike? What happens to the provision of these services if a borrower is unable to repay a loan?

While we are not suggesting that MFIs are responsible for providing services that stretch them beyond their core competency, the degree to which these organizations can respond to the type of questions above demonstrates a deeper understanding of the context in which they seek to work (or are working). In addition, there is not one singular strategy for alleviating poverty. By seeking answers to these questions, grantmakers can do more than educate themselves about the complex situations the poor face and the MFIs they support. They can play a critical role in helping ensure effective, comprehensive, sustainable development.

### **3. Grantmakers should increase investment in a variety of research and evaluation initiatives that help clarify the efficacy of microfinance.**

More investment is needed to understand where and when microfinance alleviates poverty. Innovative research methods, such as those mentioned in this report, are breaking new ground in this arena, exploring the impact of a range of financial services such as insurance, savings and microcredit. For example, Innovations for Poverty Action's randomized controlled trial method is currently being applied to evaluate Oxfam's Savings for Change program in Mali, and other researchers are engaged in several more randomized evaluations of credit. Dean Karlan further explains the values of these studies, stating:

*The answer lies not with any one study as proof for the world: no doubt there will be circumstances in which credit is improving people's welfare, and others where it is not. The key is to figure out when credit works, and when it will not, so that donors and investors know where to focus their energy and resources.<sup>64</sup>*

The importance of conducting this research from the position of an independent, third party cannot be overstated. This kind of independent assessment is vital, and grantmakers can play an essential role in supporting community dialogues to better address the needs of specific communities with whom MFIs work. This approach also alleviates some of the anxiety community members feel—that there are right or wrong answers to questions that are posed, and that if they are frank in sharing their experiences, they may be at risk of losing access to existing financial and program services.

### **4. Grantmakers should support the further investigation of the role of insurance and savings as tools to support borrowers.**

The inherently risky nature of microenterprise for the poor, in tandem with a lack of training and technical assistance and unpredictable environmental circumstances, can lead to a high level of failure. For example, death of livestock purchased or crops failing due to floods or drought can be the beginning of ongoing cycles of debt from which borrowers never recover.

Making loans with insurance to cover specific assets may provide a measure of protection for borrowers from unforeseen circumstances. Insurance may also encourage borrowers to consider loans for potentially more productive ventures and can offer protection to the lending institution. However, grantmakers should understand the costs of microinsurance and who is responsible for covering this additional expense. In some cases, MFIs provide insurance by passing the cost on to borrowers by increasing interest rates; in others, MFIs may rely on outside funds to subsidize these additional costs.

Individual and group savings are also critical in helping families manage crises, as well as anticipated "lump sum" expenses, such as school fees. The microfinance industry distinguishes between savings (cash that is likely held by individuals or a family member) and deposit services (cash held by a full range of institutions that are comparable to checking or savings accounts). For some microfinance institutions, offering deposit services is an additional means of developing communities and empowering the poor by supporting this need via self-managed economic groups. In addition, some MFIs engage in mobilizing deposit services to improve the sustainability of their institutions, with deposits serving as a relatively stable means to finance microcredit lending portfolios. Grantmakers should be aware if deposit services provided by the organizations they support are voluntary or involuntary (a mandatory requirement of receiving a loan). In this case, the stability of the MFI comes at the expense of the client's access to his or her own savings.<sup>65</sup>

### **5. Grantmakers must insist that the financial metrics of microfinance institutions not be the primary indicators of successful programs.**

The standard measures of success currently employed by MFIs reveal more about the financial health and functionality of the lending institutions than the experience of the borrowers. Focusing on repayment rates and sustainable institutions, as opposed to sustainability in the experience of borrowers, is mislead-

ing. In addition, as Dean Karlan argues, a key problem with using repayment rates as an outcome measure is that it discourages MFIs from taking on healthy risks. Karlan explains:

*Perfect repayment probably means that MFIs are not working as hard as they can to solve a credit market failure and helping people who really need credit get it. In other words, people who need credit the most are screened out and are never reached.<sup>66</sup>*

Karlan also raises concerns about the use of social monitoring mechanisms as a proxy for measuring impact, warning that they are subject to bias and misreporting can occur to appease donors or investors.

Grantmakers can play a role in advancing a more comprehensive understanding of sustainability by searching for programs that engage the poor in planning, discussing, and evaluating projects that seek to determine their futures. In this approach, community sustainability becomes a condition for successful microfinance projects, rather than a presumed outcome. By focusing attention on needs in particular communities instead of on programming strategies in general, grantmakers should be open to the possibility that community needs may not involve access to microfinance. By engaging communities, grantmakers and practitioners can develop strategies that better address needs in the areas in which they seek to support.

There is no doubt that part of microfinance's appeal to grantmakers and practitioners alike is its potential for building organizations that are financially sustainable, bringing an end to a non-governmental organization's reliance on donor funds that ebb and flow, depending on circumstances outside the organization's control. Microfinance advocates also propose that donors do not have to make a choice between institutional sustainability and positive social impact. However, when pressed on why some pro-consumer advances and/or additional services—such as microinsurance or business training—are not provided to borrowers, MFIs cite costs as a primary deterrent, including costs to the organization or that are sometimes passed on to the borrower through higher interest rates. Grantmakers interested in poverty alleviation must consider that the most “cost effective” model of microfinance may not yield the greatest impact.

### **6.** *Grantmakers should support the advancement of a pro-poor approach to microfinance by supporting efforts to create an external, MFI rating process.*

The Center for Financial Inclusion and others have written that there are few incentives in favor of consumer protection measures within MFIs and that MFIs are under pressure to achieve and maintain other goals that may stand in direct contradiction to meeting consumer needs and positive, social impact.

Indeed, rather than raising standards, competition has lowered lending discipline and borrower selection criteria as well as weakened relationships with clients.<sup>67</sup> With this in mind, Deutsche Bank convened microfinance leaders in 2008 to discuss the state of the industry, to identify potential risks in the face of unprecedented growth in the field, and to consider possible solutions to address those risks. The findings from this meeting were published as the Poncatico Declaration,<sup>68</sup> issuing a call for an industry-wide code of conduct. As follow-up to this meeting, CGAP played a lead role in synthesizing existing codes, creating the Client Protection Principles and seeking endorsement by microfinance institutions to integrate the principles into their operations. The six Client Protection Principles, defined as “the minimum standard that clients should expect to receive when doing business with a microfinance institution” include:<sup>69</sup>

- Avoidance of over-indebtedness
- Transparent and responsible pricing
- Appropriate collection practices
- Ethical staff behavior
- Mechanisms for redress of grievances
- Privacy of client data

To further these efforts, the Center for Financial Inclusion at ACCION International expanded outreach, creating The Smart Campaign, a “global effort to unite microfinance leaders around a common goal: to keep clients as the driving force of the industry.” Grantmakers Without Borders agrees with the value of these principles. However, The Smart Campaign is currently limited in scope to seeking endorsers—investors, microfinance institutions, and funders—and lacks authority or capacity to verify that the principles are being practiced on the ground by those who sign the agreement.

Moving these principles from general agreement to actual observed and monitored practice is an area that grantmakers can bring pressure to bear.

Grantmakers can do this by supporting efforts to develop an external certification or rating process measuring the degree to which these principles are fully employed and that they could then utilize when determining whether to support a MFI.

**7.** *Finally, grantmakers must recognize that microfinance is just one tool in the poverty eradication toolbox and must diversify their funding to support other critical strategies.*

Long before microfinance was invented, and continuing in vital force alongside it since, have been a range of strategies that poor communities have employed to improve their lives—in healthcare, education, food production, civil and political rights, and much more. We must not forget that the greatest challenges and struggles of the past century—dismantling of apartheid in South Africa, or the near eradication of polio, to name just two—had nothing to do with microfinance. Rather, these and countless other successes came about through other proven methods—capacity-building, community organizing, community-based development, applied research, policy advocacy, movement-building, and more. These strategies, essential and potent, urgently need the support of grantmakers.<sup>70</sup>

*Long before microfinance was invented, and continuing in vital force alongside it since, have been a range of strategies that poor communities have employed to improve their lives...These strategies, essential and potent, urgently need the support of grantmakers.*

## ENDNOTES

- <sup>1</sup> See Innovations for Poverty Action and Jameel Poverty Action studies, at <http://poverty-action.org/work/sectors/Microfinance%2B%2526%2BEnterprise> and <http://www.povertyactionlab.org/evaluation/measuring-impact-microfinance-hyderabad-india>
- <sup>2</sup> For the purposes of this guide, microfinance institutions or MFIs, refers to entities delivering straight microcredit; microcredit-plus organizations providing access to credit, additional financial services, and/or other services such as training, education or healthcare; and to both non-governmental and commercial organizations.
- <sup>3</sup> Affiliations listed for identification purposes only.
- <sup>4</sup> Malkin, Elisabeth, "Lenders to the Poor Adopt Guidelines," *The New York Times*, September 25, 2008. [http://www.nytimes.com/2008/09/26/business/worldbusiness/26micro.html?\\_r=1&sc=6&sq=nonprofit&st=cse&oref=slogin](http://www.nytimes.com/2008/09/26/business/worldbusiness/26micro.html?_r=1&sc=6&sq=nonprofit&st=cse&oref=slogin)
- <sup>5</sup> Author interview with Rob Scarlett, January 23, 2009.
- <sup>6</sup> See <http://www.ACCION.org/Page.aspx?pid=797>
- <sup>7</sup> See [http://www.grameen-info.org/index.php?option=com\\_content&task=view&id=19&Itemid=114](http://www.grameen-info.org/index.php?option=com_content&task=view&id=19&Itemid=114)
- <sup>8</sup> For earlier examples of financial services for the poor see, The Chicken and Egg Dilemma in Microfinance, by Thomas Dichter, *What's Wrong with Microfinance?*, pp. 179 – 192.
- <sup>9</sup> Today, microlending and microfinance are often integrated with other services.
- <sup>10</sup> Increasingly, MFIs do make loans to individuals, but group lending remains the norm.
- <sup>11</sup> While the process of becoming an official member of the Grameen Bank has been criticized as being intimidating and patronizing, particularly for poor women, Muhammad Yunus writes in *Banker to the Poor*, "The pressure provided by the group and the exam helps ensure that only those who are truly needy and serious about joining Grameen will actually become members... We want only courageous, ambitious pioneers in our microcredit program."
- <sup>12</sup> See <http://www.cgap.org/gm/document-1.9.2746/donorguidelines.pdf>
- <sup>13</sup> Daley-Harris, Sam, *State of the Microcredit Summit Campaign Report, 2009*, [http://www.microcreditsummit.org/uploads/socrs/SOCR2009\\_English.pdf](http://www.microcreditsummit.org/uploads/socrs/SOCR2009_English.pdf)
- <sup>14</sup> Fifty-four donors responded to the CGAP survey. As a result, the total amount invested in microfinance is believed to be much higher.
- <sup>15</sup> The financial systems approach is also referred to as the institutional approach or commercial model in microfinance literature.
- <sup>16</sup> The poverty-lending approach is also referred to as impact assessment approach, pro-poor, social impact model or welfarist approach in microfinance literature.
- <sup>17</sup> MFIs practicing this approach represent NGOs and commercial MFIs alike. Many NGOs which practice this approach to microfinance delivery continue to raise money from private donors. The use of donor funds is considered to be one of the opportunities for innovation in the field and expansion to new markets (both geographically and socioeconomically).
- <sup>18</sup> In recent years, it has also become common to claim a "Triple Bottom Line," also known as "people, planet, profit," or "the three pillars," which incorporates a concern for environmental impact. This approach has been embraced by institutions as large as the United Nations.
- <sup>19</sup> This criticism was vigorously raised in response to Mexican microcredit provider Compartamos' massive IPO that made tremendous profits for the bank but did little for its customers. See Epstein, K and G. Smith. "Compartamos: From Nonprofit to Profit." Dec. 13, 2007. Business Week. [http://www.businessweek.com/magazine/content/07\\_52/b4064045919628.htm](http://www.businessweek.com/magazine/content/07_52/b4064045919628.htm)
- <sup>20</sup> Iffath Sharif, "Poverty and Finance in Bangladesh: A New Policy Agenda," in *Who Needs Credit? Poverty and Finance in Bangladesh*, ed. Geoffrey D. Wood and Iffath Sharif (London: Zed Books, 1997): 72-73.
- <sup>21</sup> Unpublished survey of NGOs working in Lalmonirhat District, Bangladesh conducted by Jason Cons and Sayeed Hassan. Additional information on the growth and expansion of microcredit can be found in KQ Ahmed. *Socio-Economic and Indebtedness-Related Impact of Micro-Credit in Bangladesh*. (Dhaka: University Press Limited, 2007) and documented in Credit Development Forum. 2007. Microfinance Statistics, Volume 19, December 2006. Dhaka: CDF.
- <sup>22</sup> Sen, Amartya, *Development as Freedom*, Knopf, New York, 1999, p. 71.
- <sup>23</sup> Dunford, Christopher, "Building Better Lives: Sustainable Integration of Microfinance with Education in Child Survival, Reproductive Health, and HIV/AIDS Prevention for the Poorest Entrepreneurs," in *Pathways Out of Poverty: Innovations in Microfinance for the Poorest Families*, ed. Sam Daley-Harris (Bloomfield: Kumarian Press, 2002), 78.
- <sup>24</sup> This is largely because the accepted strategies of measuring success for MFIs and the donors who support them are primarily financial and often are reducible to repayment rates. For more on this topic, see the essay on "Metrics" included in this volume.
- <sup>25</sup> See, for example, Devaney, P. 2006. "Bringing Pro-Consumer Ideals to the Client: A Consumer Protection Guide for Financial Institutions Serving the Poor." ACCION Publications. Monograph Series #14. <http://www.microfinancegateway.org/content/article/detail/33481> and Datar, S. et al. 2008. "In Microfinance, Clients Must Come First." Stanford Social Innovation Review. [http://www.ssireview.org/articles/entry/in\\_microfinance\\_clients\\_must\\_come\\_first/](http://www.ssireview.org/articles/entry/in_microfinance_clients_must_come_first/)
- <sup>26</sup> The Grameen Bank's move towards a pure commercial banking model is perhaps the most overt example of this. See Asif Dowla and Dipal Barua, *The Poor Always Pay Back: The Grameen II Story*, Kumarian Press, Bloomfield, 2006.
- <sup>27</sup> See [http://www.grameenfoundation.org/what\\_we\\_do/microfinance\\_in\\_action/](http://www.grameenfoundation.org/what_we_do/microfinance_in_action/)
- <sup>28</sup> See <https://www.accion.org/SSLPage.aspx?pid=1465>
- <sup>29</sup> "How do Financial Services Help the Poor?", CGAP, <http://www.cgap.org/p/site/c/template.rc/1.26.1305/>
- <sup>30</sup> The MFIs working in Arampur and represented in this research reflect a wide range of approaches to microfinance – NGOs, commercial banks, international and domestic programs.
- <sup>31</sup> Concerns about over-saturation of microcredit markets are not limited to Bangladesh. The Wall Street Journal, in reference to high returns for commercial investors on microcredit investments, has cited "worries that too much money is chasing too few loans," Rob Copeland, "For Global Investors, 'Microfinance' Funds Pay Off – So Far," 13 August 2009. The Wall Street Journal, Page A12, [http://online.wsj.com/article\\_email/SB125002519860023799-1MyQjAxMDI5NTIwM-DAYMjA1Wj.html](http://online.wsj.com/article_email/SB125002519860023799-1MyQjAxMDI5NTIwM-DAYMjA1Wj.html).
- <sup>32</sup> This concern was repeatedly reflected in personal communications with staff at NGOs in Bangladesh, including Nijera Kori, ActionAid Bangladesh, and CARE Bangladesh. According to Jude Fernando, "Even those NGOs that were at one time ideologically opposed to credit have made significant compromises. Indeed, today it is difficult to find an NGO that does not have credit as a main component of its overall program," J Fernando, 'Nongovernmental Organization, Micro-Credit, and the Empowerment of Women,' *Annals of the American Academy of Political and Social Science*, 554, 1997, pp. 150-177. See also the article by Linda Mayoux excerpted later in this guide.
- <sup>33</sup> This practice has also been observed by other researchers, both in Bangladesh and elsewhere. See L Karim, "Demystifying Micro-Credit: The Grameen Bank, NGOs, and Neoliberalism in Bangladesh,"

- Cultural Dynamics, 20(1), 2008, pp. 5-29; C Duggan, "Doing Bad by Doing Good?: Institutional Design and the Abuse of Microfinance Borrowers in Uganda," Harvard University Africa Research Seminar, November 13, 2008.
- <sup>34</sup> As other researchers have reported, the court system in rural Bangladesh almost uniformly supports MFIs over borrowers when legal disputes arise. Because of this, recipients rarely bring disputes to local courts. Furthermore, particularly in rural areas, field officers are often a borrower's only contact with an MFI, as these officers frequently travel some distance to collect loans at people's homes. Goldin Institute did record several instances of community members taking issues into their own hands by holding loan officers hostage inside of houses that were in the process of being stripped of assets to repay loans. The Smart Campaign, a very recently launched coalition of MFIs committed to client protection and creating a code of best practice for loan collection, has embraced as one of its core principles the necessity for Mechanisms for Redress of Grievances. The existence of such mechanisms would represent serious progress in the microfinance industry, though the verification that such tools exist is at this point difficult and uncommon. See also C Duggan, "Doing Bad by Doing Good?: Institutional Design and the Abuse of Microfinance Borrowers in Uganda," Harvard University Africa Research Seminar, November 13, 2008; J Cons and K. Paprocki, "Self-Help Fantasies: Microcredit and 'Cultural' Change in Rural Bangladesh," *Third World Quarterly*, 30(4), 2010, forthcoming.
- <sup>35</sup> Premchander, Smita. *Multiple Meanings of Money: How Women See Microfinance*. Sage Publications, New Delhi, 2009.
- <sup>36</sup> Smith, Phil and Thurman, Eric. *A Billion Bootstraps: Microcredit, Bare-foot Banking and the Business Solution for Ending Poverty*, McGraw-Hill, New York, 2007.
- <sup>37</sup> Author interview with Mary Jo Kochendorfer, December 9, 2009.
- <sup>38</sup> See [http://www.povertyactionlab.org/papers/122\\_Karlan\\_expandingaccess.pdf](http://www.povertyactionlab.org/papers/122_Karlan_expandingaccess.pdf)
- <sup>39</sup> Correspondence with author, February 10, 2010.
- <sup>40</sup> See [http://www.povertyactionlab.org/papers/101\\_Duflou\\_Microfinance\\_Miracle.pdf](http://www.povertyactionlab.org/papers/101_Duflou_Microfinance_Miracle.pdf)
- <sup>41</sup> The microfinance model is that borrowers who successfully repay small, short-term loans can graduate to larger loans over time. However, it remains unclear if borrowers who don't experience short term improvements in their economic situation are more likely to drop out of the program or default.
- <sup>42</sup> Goldin Institute interview, Arampur, Bangladesh.
- <sup>43</sup> The money and goods a woman brings to her husband in marriage.
- <sup>44</sup> <http://www.microcreditsummit.org/papers/empowerment.pdf>
- <sup>45</sup> Rajagopalan, Shashi, "User Owned and Controlled Organizations in the Field of Financial Services," for *Microfinance India*, February 24-26, 2008.
- <sup>46</sup> Parts of this section are drawn from previously published and unpublished writings by Kasia Paprocki and Jason Cons of the Goldin Institute, particularly Cons, Jason and Paprocki, Kasia, "The Limits of Microcredit - A Bangladesh Case," *Food First Backgrounder*, Winter 2008, Volume 14, Number 4.
- <sup>47</sup> See Yunus, M. 2003. *Banker to the Poor: Micro-Lending and the Battle Against World Poverty*. New York: Public Affairs, and Yunus, M. 2007. *Creating a World Without Poverty: Social Business and the Future of Capitalism*. New York: Public Affairs. See also Dowla, Asif and Barua, Dipal. 2006. *The Poor Always Pay Back: The Grameen II Story*. Bloomfield: Kumarian Press.
- <sup>48</sup> Credit Development Forum. 2007. *Microfinance Statistics*, Volume 19, December 2006. Dhaka: CDF.
- <sup>49</sup> Goldin Institute interview, Arampur, Bangladesh.
- <sup>50</sup> J. Fernando, 'Nongovernmental Organization, Micro-Credit, and the Empowerment of Women,' *Annals of the American Academy of Political and Social Science*, 554, 1997, pp. 150-177.
- <sup>51</sup> Other researchers have made similar observations, most notably, Jude Fernando, who observes that the relationship between borrowers and field officers is overwhelmingly shaped by the imperative to repay loans, "so much so that repayment takes precedence over the investment itself." Fernando, J. 1997. "Nongovernmental Organizations, Micro-Credit, and Empowerment of Women," *Annals of the American Academy of Political and Social Science*. 554. 150-177. Pg 171.
- <sup>52</sup> See, for example, Devaney, P. 2006. "Bringing Pro-Consumer Ideals to the Client: A Consumer Protection Guide for Financial Institutions Serving the Poor." ACCION Publications. Monograph Series #14. <http://www.microfinancegateway.org/content/article/detail/33481> and Datar, S. et al. 2008. "In Microfinance, Clients Must Come First." *Stanford Social Innovation Review*. [http://www.ssireview.org/articles/entry/in\\_microfinance\\_clients\\_must\\_come\\_first/](http://www.ssireview.org/articles/entry/in_microfinance_clients_must_come_first/)
- <sup>53</sup> For more information as well as a wealth of articles and background pieces, visit: <http://www.seepnetwork.org/content/library/?parent=sp>
- <sup>54</sup> See <http://www.imp-act.org/>
- <sup>55</sup> See <http://hdr.undp.org/en/statistics/>
- <sup>56</sup> See Duggan, Catherine, "Doing Bad by Doing Good?: Institutional Design and the Abuse of Microfinance Borrowers in Uganda," Harvard University Africa Research Seminar, November 13, 2008.
- <sup>57</sup> Which it usually is, particularly in the case of programs that use the Grameen PPI Index, which instructs MFIs to have Field Officers collect research data at the same time as they collect loan repayments.
- <sup>58</sup> For more information on the process used by the Goldin Institute in Bangladesh, visit [www.goldininstitute.org](http://www.goldininstitute.org)
- <sup>59</sup> <http://www.centerforfinancialinclusion.org/Page.aspx?pid=1322>
- <sup>60</sup> Ibid.
- <sup>61</sup> Premchander, Smita. *Multiple Meanings of Money: How Women See Microfinance*. Sage Publications, New Delhi, 2009.
- <sup>62</sup> Dichter, Thomas and Harper, Malcom. *What's Wrong with Microfinance?* Intermediate Technology Publications Ltd., Warwickshire, UK, 2007, p. 17.
- <sup>63</sup> Well known MFIs such as Grameen Bank and BRAC collect compulsory savings deposits from borrowers at the same time they collect loan payments.
- <sup>64</sup> Correspondence with author, February, 2010.
- <sup>65</sup> *Developing Deposit Services for the Poor*, CGAP, Washington, DC, February 2005.
- <sup>66</sup> Correspondence with author, February, 2010.
- <sup>67</sup> Srinivasan, N. "Multiple Borrowing or Multiple Lending: Who is to Blame for Debt Fatigue?," CGAP Microfinance Blog, August 28, 2009.
- <sup>68</sup> See [http://www.smartcampaign.org/storage/documents/Pocantico\\_Declaration.pdf](http://www.smartcampaign.org/storage/documents/Pocantico_Declaration.pdf)
- <sup>69</sup> See [www.smartcampaign.org/about-the-campaign/frequent-asked-questions](http://www.smartcampaign.org/about-the-campaign/frequent-asked-questions).
- <sup>70</sup> Several of these conclusions draw on Cons, Jason and Paprocki, Kasia, "The Limits of Microcredit - A Bangladesh Case," *Food First Backgrounder*, Winter 2008, Volume 14, Number 4; Cons, Jason, *Pursuing User-Driven Approaches to Microcredit: A View from the Village*, Chicago Global Donors Network Annual Conference, Chicago, 24 September 2008, Goldin Institute "Why Credit?" available at [www.goldininstitute.org/\\_includes/File/GI\\_Why\\_Credit.pdf](http://www.goldininstitute.org/_includes/File/GI_Why_Credit.pdf)



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