QUALITY MICROFINANCE

SUCCESSFUL CLIENTS AND INSTITUTIONS

ANTON SIMANOWITZ

Anton Simanowitz is researcher at the Institute of Development Studies, University of Sussex, UK. He was a founder and for five years Director of the Imp-Act Consortium (www.Imp-Act.org). Imp-Act supports and promotes the management of social performance in microfinance, providing practical lessons for practice and public policy. The Consortium's Practice Guide, Putting the 'Social' into performance management' has been downloaded more than 25,000 times since its launch in December 2008, and is currently being translated into Spanish, French, Russian and Arabic. A recently launched film presents the practical experience of leading MFIs of how financial and social performance can be balanced http://www.youtube.com/watch?v=WKesX9KJ-9M and the SPM network brings together more than 1000 practitioners and supporters of microfinance www.spmnetwork.net. Anton is also Chief Development Officer and Advisor to the Board of the Small Enterprise Foundation (SEF), the largest developmental microfinance organisation in South Africa. His work with SEF focuses on improving efficiency and effectiveness through strengthening performance management and systems to balance social and financial performance.

→| OVERVIEW

"The greatest of evil and the worst of crimes is poverty."

G. B. SHOW

I RECENTLY HEARD ABOUT A TEAM OF MARKET researchers in Uganda, who were talking to clients of an MFI about what they liked and disliked about the services. The clients responded angrily about their treatment at the hands of field agents: *"they are devils […] all they care about is getting their money back"*.

This story from one of the most competitive microfinance markets got me thinking. Microfinance is coming of age, with accelerating growth in numbers of people reached and the financial value of the industry[1]. Annual growth rates have been between 40 and 60 per cent in a number of markets, with India growing 94 per cent per annum since 2003[2]. Yet the potential market for microfinance remains vast with some 2.5 billion people lacking access to even basic financial services. Scale drives profitability and profitability drives scale, and the race is on to serve more and more people and maintain the impressive returns that attract investment. But what do these numbers mean? Are we valuing what matters, and if not then what are the consequences?

ENSURING QUALITY AND RESPONSIBLE LENDING

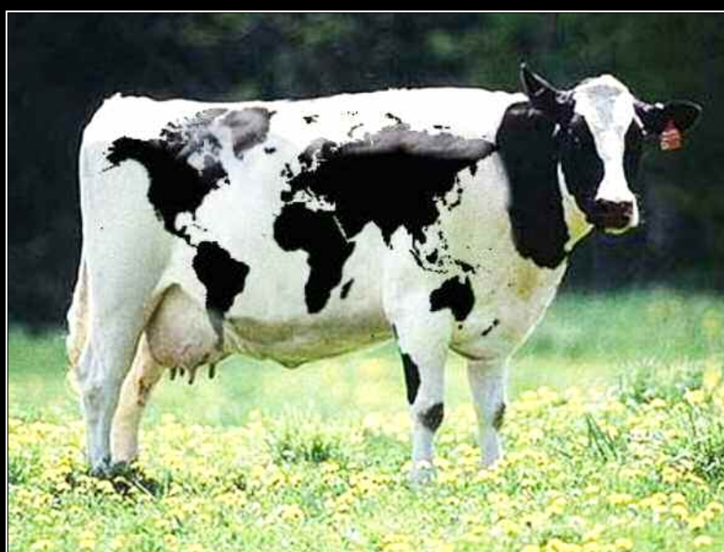
Increasing numbers of clients is not by itself an indicator of positive impact or the strength of an institution. The financial crisis and subsequent recession is exposing a loss of quality and inadequate systems in particular for ensuring responsible lending and collection practices in many MFIs.

Competition and a desire to generate high rates of return on equity so as to attract commercial investment and allow ever faster growth have led to multiple-lending and the pushing of credit. This combined with erosion of client livelihoods through increasing food prices, recession and retrenchment is leading to over-indebtedness and client delinquency. Severe delinquency problems are occurring or predicted in a number of countries[3], and a number of high profile, fast growing and seemly successful MFIs have run into serious problems – Zakoura (Morocco), Opportunity Bank (Montenegro), Kashf (Pakistan) and First Microfinance Bank (Afganistan). The most CSFI[4] Banana Skins report for 2009 survey concluded that credit risk is now the number one challenge for MFIs, demonstrating the impact on the very foundation of microcredit – the ability of clients to repay their loans. Like the famous pyramid schemes that feed off positive sentiment and collapse when confidence disappears, at least in some markets, it seems that in the rush for growth some of the fundamentals of responsible and quality business have been overlooked.

At the heart of these failures lies the breakdown of effective systems for managing the fundamentals of microfinance. High rates of growth put huge

pressures on management systems, challenging the ability to ensure consistency and quality in service delivery. The CGAP Banana Skins 2008 survey, for example, named management weaknesses as the number one challenge for the industry. In addition to this pressure on systems a short-term prioritisation of client numbers and return on equity diverts the attention of management, Board and investors away from a double-bottom line that puts client service and success at the foundations of successful microfinance.

The need to ensure that systems and management processes can secure an effective balance between social and financial performance is illustrated by the financial incentives that many MFIs provide to their staff. These often make up a third of a field agent's salary or more. Most incentive schemes in the industry focus squarely on growth, commonly rewarding three things: number of new clients; increase in portfolio outstanding; and arrears or portfolio at risk. That is to say that staff are incentivised to bring in as many clients as possible, give out as much money as possible, and make sure that the money comes back. This leads to a potential loss of quality in terms of not bringing in target clients (who may be more time-consuming to reach), poor attention to assessing capacity to repay, and harsh debt collection methods. The recognition of these problems, reflected in a number of high profile media reports on the negative impacts of over-indebtedness, is leading to movement in the industry to be much clearer need to take action to avoid possible negative impacts of microfinance – particularly over-indebtedness and harsh debt collection practices. Client protection is thus increasingly being seen as one of the key issues for the microfinance industry in the future[5].



RESPONDING TO CLIENT NEEDS

One of the defining features of poverty is the inability of poor people to cope with the inevitable problems that life throws up – illness, natural disaster, death, creditors not repaying etc. How MFIs respond to this vulnerability in the services they offer and in delinquency management makes a huge different to their social outcomes, and is a critical consideration for MFIs that seek to be responsible lenders.

This issue is illustrated by one of my formative experiences in microfinance visiting a group of women in Kenya. After three successive failures of the rains they were on the verge of starvation (so much so that they had to apologise for falling asleep in an afternoon meeting, explaining that they had not eaten that day). Despite their desperate situation they still managed to make a full repayment on their loans... they had clubbed together and sold a chicken to raise money.

There has been huge progress in understanding the needs of different client markets and developing a range of products that respond to client needs. Increasing emphasis on savings and the development of micro-insurance build client resilience to problems and provide the means to respond to problems. However, many credit-led MFIs offer little flexibility, locking clients into a rigid system of regular loan

repayments. Credit programmes that apply zero tolerance with little flexibility risk harming their clients. Most MFIs see delinquency management as being critical to success, and send out a strong message to staff that late payment should not be tolerated. This is supported by incentive schemes that often drastically cut financial incentives should the portfolio at risk rise above quite a low level. In the worst cases we see MFIs that achieve a 100 percent repayment rate through practices such as holding clients 'hostage' until all money has been collected – clients with repayment problems leave the meeting to 'find' the money and return after an hour or so. Where does the money come from? Perhaps from savings or from a friend, but more likely a money lender or selling assets. But organisational incentives do not ask this question, and just focus on whether the money is repaid rather than how it is repaid.

The issue is one of balance. I am not arguing that organisations should not emphasise repayment, rather that MFIs should understand this tension, and work to maximize their ability to be able to respond to problems that poor clients inevitably face, and structure products that are responsive to different cash flows and that promote savings as well as credit. To balance their social and financial performance MFIs need to combine appropriate services with an ability to be flexible and responsive to the problems that clients face whilst maintaining high repayment rates and a low portfolio at risk.

BEYOND ACCESS – ADDING VALUE TO MICROFINANCE SERVICES

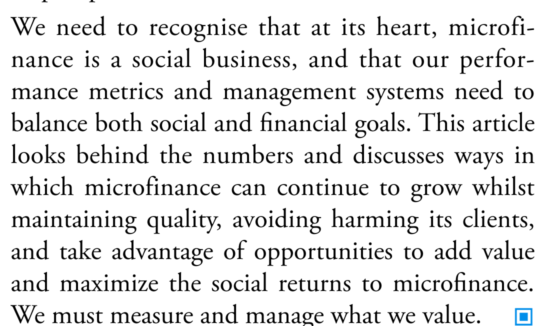
Beyond doing no harm, microfinance seeks to have positive social impact – to add value. As a social business an MFI can focus not just at how to increase efficiency and financial returns, but how to increase effectiveness and social returns. Value can be added in a number of ways: by developing financial that are tailored to client needs; through delivery mechanisms that are cost-saving for clients (eg. doorstep services) or that build capacity or empowering (eg. working through groups or through the staff-client relationship); non-financial services can be integrated with financial services (eg. business advice, education or legal support); the infra-structure of microfinance can be used to deliver other services to microfinance clients through partnerships with other organisations that specialise in such services.

It sounds like stating the obvious, but not all microfinance is the same. Listening to the debates raging about the 'impact of microfinance' it would seem that this point needs to be heard. We have different methodologies, products, different target clients, different management systems, and these lead to different outcomes. So when we look at microfinance, surely we should be looking beyond numbers of people accessing financial services?

For example, in the push for efficiency the value-added through human relationships is often over looked. The relationship between client and staff is important not just in terms of making a good assessment as to the clients' needs and eligibility for services, but can be at the heart of the ability of microfinance to do far more than provide access to financial services and build the capacity and self-esteem of its clients. But the main drivers of growth in the microfinance industry today are efficiency rather than quality or social value-added. Management drives up targets for field staff, pares down the methodology to reduce 'wasteful' contact time between field staff and clients for example to eliminating home visits or moving from weekly to monthly group meetings, centralises services into branch offices, and introduces technology that potentially can all but eliminate the need for any human contact between the MFI and clients.

This focus on efficiency, cutting costs and reducing the human interface combined with incentives that push growth in numbers risks undermining the very foundations of effective microfinance.

The vision of microfinance is 'doing well by doing good'. As the microfinance industry attracts greater investment and achieves increasing commercial success, there is much debate as to whether microfinance is achieving this 'win-win' balance, or whether commercial focus is compromising the social mission. Whilst the economic crisis brings challenges for the clients of microfinance and MFIs, it also creates an opportunity for reflection. This is a time to take stock and ensure that microfinance sets an example for responsible lending that provides access to financial services for the billions of people excluded, and adds value to this access to help improve the lives of its clients.



We need to recognise that at its heart, microfinance is a social business, and that our performance metrics and management systems need to balance both social and financial goals. This article looks behind the numbers and discusses ways in which microfinance can continue to grow whilst maintaining quality, avoiding harming its clients, and take advantage of opportunities to add value and maximize the social returns to microfinance. We must measure and manage what we value. ▣

---

[1] The Microcredit Summit Campaign reported a growth from 19 million microfinance borrowers in 2000 to 155 million in 2007, with a growth from 1567 to 3552 MFIs reporting.

[2] Data on the Microfinance Information Exchange, www.themix.org

[3] Presentation by Xavier Reille, CGAP, at the European Microfinance Platform conference, November 2009.

[4] Centre for the Study of Financial Innovation.

[5] See the SMART campaign for client protection www.smartcampaign.org.