MICROFINANCE and Poverty

Questioning the Conventional Wisdom

HEGE GULLI

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This page intentionally left blank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

MICROFINANCE AND POVERTY

Questioning the Conventional Wisdom

HEGE GULLI

Microenterprise Unit
Sustainable Development Department
Inter-American Development Bank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ABOUT THE AUTHOR

Hege Gulli is currently a Ph.D. candidate at the Norwegian School of Economics and Business Administration, Bergen, Norway. She has served as a consultant to the Royal Norwegian Ministry of Foreign Affairs, NORAD, and the Microenterprise Unit of the Inter-American Development Bank, where she prepared this study. She can be reached at hgulli@hotmail.com.

ACKNOWLEDGEMENTS

The author would like to thank the numerous experts who contributed ideas and comments to this book. The author is especially grateful to Marguerite Berger, Chief of the IDB Microenterprise Unit, for her encouragement and inspiration, in general, and her extensive and valuable contributions to the content of the book. IDB staff members who were especially generous with their time include Tor F. Jansson, Lara Goldmark, Mark Wenner, Gabriela Torres, Fernando Lucano, Gloria Almeyda, Catalina Rizo and Stefan Queck. The book was edited by Nancy Morrison, whose input is greatly appreciated. Practitioners, consultants and researchers who contributed include Tatiana Guzmán, Mark Schreiner, Monique Cohen, Sergio Navajas, Dale W. Adams, Robyn Eversole, Molly Pollack, Steve McDowell, Robert Boyce, Xavier Nogales and Stuart Rutherford. Among the various persons and institutions in Bolivia who generously provided valuable information to the study, the author is especially grateful to the microfinance institutions PRODEM, FIE, FADES, Fassil and IDEPRO.

Both the author and the Inter-American Development Bank wish to acknowledge the generous support of the Government of Norway, which helped make this publication possible.

The views and opinions expressed in this book are those of the author and do not necessarily reflect the official view of the Inter-American Development Bank.

Microfinance and Poverty: Questioning the Conventional Wisdom

© Copyright 1998 by the Inter-American Development Bank

Inter-American Development Bank
1300 New York Avenue, N.W.
Washington, D.C. 20577

ISBN: 1-886938-45-8

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

PREFACE

Microenterprise is one of the major instruments that we have to face the challenge of reducing poverty in Latin America. Without meeting that challenge, we will not have true development.

This technical book is an important contribution to the fight against poverty. It gives careful guidance to countries in the region, donors, and microfinance institutions on ways to make microfinance a more effective tool in poverty reduction.

The book pares away certain misconceptions about microfinance, and marshals evidence and analysis to clarify how, when and which low-income microentrepreneurs may benefit through the extension of microfinance. The message that emerges is clear: microfinance is a powerful tool, but one with certain real limitations. Those strengths and weaknesses make it important to use the tool well.

The Inter-American Development Bank has a special responsibility to improving the use of microfinance. The Bank is proud to have played a pioneering role in providing support to Latin American microentrepreneurs, and to have assisted in building the microfinance industry in the region. The Bank has a commitment to carrying that work forward. We have learned much about microenterprise and microfinance in the past two decades. This thoughtful book consolidates some of those lessons, and offers a springboard for action.

Waldemar Wirsig
Manager, Sustainable Development Department
Inter-American Development Bank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

CONTENTS

Preface iii

Executive Summary vii

Part I. Microfinance and Poverty: Main Issues 1

Part II. Common Assumptions about Microentrepreneurs and Microfinance Institutions (MFIs) 7

Assumption 1: Most microentrepreneurs are poor 7

Assumption 2: The most serious obstacle facing microentrepreneurs is lack of access to credit 10

Assumption 3: The main objective of most microfinance institutions is poverty reduction 12

Part III. Common Assumptions about the Outreach of Microfinance Institutions 17

Assumption 4: The poorest microentrepreneurs are reached by NGOs that apply the solidarity group methodology 19

Assumption 5: MFIs face a trade-off between reaching the poor and achieving financial sustainability 25

Assumption 6: Rural and poor areas remain underserved by MFIs 29

Assumption 7: MFIs must specifically target the poorest people and areas 36

Assumption 8: MFIs working with poor people in rural areas merit subsides 43

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Part IV. Common Assumptions about the Impact of Microfinance . . . 47
Assumption 9: Microcredit programs improve the livelihoods of the poor . . . 47
Assumption 10: For people below the poverty line, microcredit has a lower impact on income . . . 51
Assumption 11: The best indicator of the impact of microfinance is a change in clients' income . . 54
Assumption 12: MFIs need to target the manufacturing sector to have an impact on the microenterprise sector . . . 58
Assumption 13: The high interest rates charged by MFIs inhibit growth of microenterprises . . . 62
Assumption 14: Savings is more effective than credit in reducing poverty . . . 66
Assumption 15: Microfinance needs to be integrated with other development services to have an impact on poverty and business growth . . . 72

Part V. Conclusions and Recommendations . . . 79

Annex 1: Contacts and Resources on Microfinance and Poverty . . . 87

Annex 2: Supporting Data . . . 91

Bibliography . . . 101

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This page intentionally left blank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

To what degree, *how* and *when* can poverty be reduced through microfinance programs? The answers depend, among other things, on whether and how successfully microfinance programs address the real constraints faced by the poor in a certain context. Posing the question this way is important because microfinance is receiving increasing attention and support from governments, donor agencies and the public. It is widely assumed that microfinance is an effective tool for poverty reduction. In many cases and in many ways, it can be.

Making good use of microfinance in the task of reducing poverty requires understanding both the strengths and limitations of microcredit, and recognizing that other tools and measures are needed to complement it. This book is an attempt to improve these understandings. As a first step, this study probes a set of assumptions that have arisen about microfinance and poverty reduction. Many of these assumptions have become the conventional wisdom, although they have not been proven. These assumptions are examined through a review and analysis of theoretical and applied literature on microfinance and poverty. The view of microcredit that emerges is more complicated, but the policies that grow out of this revised view may ultimately prove more effective.

Challenging Common Assumptions about Microfinance

Development agencies commonly consider assistance to microfinance institutions as poverty interventions. This notion rests on three assumptions:

- **microentrepreneurs are poor;**
- **microentrepreneurs are constrained by inadequate access to credit; and**
- **microfinance institutions aim for poverty reduction.**

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

These assumptions mask a more complex reality, as the evidence presented below suggests.

Are most microentrepreneurs poor?
Although many poor people make their living from microenterprise, a recent IDB study demonstrates that not all microentrepreneurs are poor. The percentage of poor microentrepreneurs varies by country, and is highest in the poorest countries. For the region as a whole, only one-fourth of microenterprise owners are poor, but this percentage ranges from less than 5 percent in Uruguay to over two-thirds in Honduras. Across the region, workers in microenterprises are much poorer than workers in other businesses.

Is lack of credit the main constraint facing microentrepreneurs?
Studies show that lack of credit is not always the main constraint for microenterprises' growth and development, and that poor people demand a wide range of financial, business development and social services for different business and household purposes.

Is poverty reduction the main objective of microfinance institutions (MFIs)? While some MFIs see poverty reduction as their primary mission, many do not. The microfinance industry today consists of a wide range of institutions serving different market niches, which can directly or indirectly contribute to poverty reduction.

Accordingly, microfinance should be seen as provision of small-scale financial services to businesses and households traditionally kept outside the financial system, rather than the more narrow view of microfinance as production credit for poor microenterprise owners.

How Well Do Microfinance Institutions Reach the Poor?

It is commonly believed that most clients of MFIs are poor, and that there is a relationship between type of institution and the poverty level of its clients. However, few MFIs reach the poorest of the poor,

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

and many MFIs have a high percentage of non-poor clients, studies indicate. In general, NGOs reach poorer people than formal financial institutions, but many banks reach the poor — and some of their clients are even poorer than NGO clients. Credit unions, banks and other formal financial institutions in Latin America reach a significantly *larger absolute number* of poor people than most NGOs, although their percentage of poor clients is generally lower than NGOs'. Furthermore, no clear relationship exists between lending methodology and the poverty level of MFI borrowers. Individual lending methodologies can reach clients as small as those using solidarity group and village banking models, but they tend to cover a wider range.

Is there a tradeoff between financial sustainability and outreach to the poor? It is commonly believed that the more MFIs aim for financial sustainability, the less their impact on poverty reduction will be: that is, that a trade-off exists between financial sustainability and outreach. However, the evidence provided by numerous studies does not support this conclusion. It is unclear whether there is a trade-off between an institution's emphasis on financial sustainability and its willingness or ability to reach the poorest. There is a positive correlation, however, between achieving financial sustainability and reaching *many* poor people: well-run financial institutions of all types are able to reach greater numbers of poor people.

The effectiveness of targeting. Some microcredit advocates argue that MFIs *should* reach the poorest of the poor with microcredit and therefore actively target their services to the poorest. However, *lack of use of credit* at a certain point in time does not necessarily mean there is a problem. Microenterprises that do not use microcredit at a particular point in time may not want to borrow, or their businesses may be unable to utilize the credit effectively. *Lack of availability of financial services,* however, is a deficiency that should be addressed. An enterprise can be creditworthy but still lack access to credit.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Furthermore, narrow targeting is not necessarily a condition for reaching the poorest. Some large-scale non-targeted schemes have proven to reach the poorest stratum of the population. Finally, more poor people can be reached by building a competitive, sustainable financial system that provides a wide range of small-scale financial transactions than through narrowly targeted programs. A combination of broad and narrow targeting in microfinance might be most effective for poverty reduction: that is, to secure both large-scale sustainable outreach and encourage innovation to promote improved access to financial services for the poorest of the poor.

The rationale for subsidies. It is often argued that MFIs working with very poor clients and/or in poor areas should be subsidized. Poverty-oriented MFIs do not automatically merit subsidies, however. Subsidies may be in order for pilot projects if their activities involve high start-up costs, or if the returns are likely to be captured not by the innovator but by successors. The rationale for subsidies depends on factors such as the actual operating costs in the area in question, the presence of competing MFIs, and the programs' poverty-reducing effects compared to other poverty interventions. In addition, subsidies have some disadvantages; they may create political problems and undermine sustainable MFIs.

How Well Do Microfinance Programs Improve the Livelihoods of the Poor?

So far, the evidence on the impact of microcredit on poverty is inconclusive. Most impact studies utilize weak methodologies that do not control for effects of factors other than credit or initial differences between borrowers and nonborrowers, and they do not distinguish between the poor and nonpoor. Some studies surveying MFIs worldwide indicate that microentrepreneurs below the poverty line experience lower percentage income increases after borrowing than those above the poverty line. But this has not been shown in Latin America. Studies also demonstrate that people below the poverty line tend to use loans for consumption purposes to a

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

greater extent than people above the poverty line; thus their income should be expected to increase less.

Most impact assessment studies focus on income-generation through microcredit. However, enhanced income is an *indirect impact* and not always the main purpose of borrowing. Few evaluations assess *direct impacts* of microfinance—such as improved money management, which is an important justification of microfinance. Assessments of direct impacts of microfinance should evaluate the client-service relationship and the financial strength of the MFI and distinguish between different loan and savings products.

Are the interest rates charged by some MFIs too high? A frequently heard concern about microfinance is that the interest rates charged for loans are too high and do not allow clients to earn enough income and grow. Studies indicate that financing costs constitute an insignificant portion of microenterprises' total costs, however. Furthermore, studies demonstrate that the level of non-financial transaction costs is as important for microentrepreneurs as the financial costs. In order to secure outreach in the future, MFIs need to charge adequate interest rates. Because their loans are small, their costs of operation are high. Adequate competition in the microfinance market will help to lower operational costs and bring interest rates down.

What are the relative merits of small-scale savings versus loans? Studies demonstrate that poor people have both the capacity and desire to save, and that impediments in policies and instruments inhibit mobilization of savings more than poor people's savings preferences. Important principles for small-scale savings schemes include convenience and security, availability of a broad array of savings products with different levels of liquidity and returns, low minimum required balance, and competitive interest rates. In addition to being a valuable service that low-income people need, savings can enhance poor people's creditworthiness and MFIs' sustainability. However, there is no evidence that savings is the

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

only financial service microentrepreneurs require. Savings, credit and insurance serve slightly different purposes for poor people, and it is the availability of all three services that can make a contribution to poverty reduction.

Should microfinance be integrated with other services? Some practitioners and donors argue that MFIs should not only remedy financial constraints, but should simultaneously address other, more qualitative causes of poverty. MFIs are generally less effective when they expand into new non-financial activities, however, and thus reach fewer poor people. Arguments for integration of complementary services are often based on certain perceived limitations of microfinance. Such "limitations" are, however, no more than a reflection of what financial services can and cannot accomplish. While it is true that microfinance is not the only service required by poor microentrepreneurs to improve their productivity and incomes, this does not mean that all needed services must be provided by MFIs. Microfinance's limitations are more relevant for discussion for overall programming of development assistance: that is, in the choice of a mix of instruments for poverty reduction and economic development through promotion of microenterprise.

Conclusions and Recommendations

Microfinance can play an important role in poverty reduction, but its benefits are not only poverty-related, and it is only a partial tool for poverty reduction.

Within the limitations of microfinance as a tool for poverty reduction, actions can be taken on different levels to expand the outreach and impact of microfinance programs.

- The ***quality of financial services*** can be improved to enhance their responsiveness to the needs and demand of poorer customers.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

- The ***depth of outreach*** can be expanded through provision of financial services that are tailored to the needs of the poorest and their economic activities; provision of a variety of financial products to suit different household and business needs; and promotion of pilot projects aimed at the poorest households and areas.
- The ***scale of outreach*** can be expanded through promotion of an enabling environment for small-scale financial transactions and microfinance methodologies; provision of a wide range of financial services; enhanced focus on savings mobilization; transformation of NGOs to commercial MFIs; and competition that ensures low cost and high quality services.
- The ***geographical outreach*** can be expanded through regulations and policies that facilitate expansion to remote areas; local infrastructure that enables provision of small-scale financial transactions; and promotion of pilot, rural MFIs.
- Finally, ***income impact*** can be improved through complementary income-generating interventions — enhancement of access to productive assets, improvement of the quality of assets, and promotion of an enabling environment for productive use of assets. Complementary nonfinancial services, such as business development and social services and community development, may also be helpful.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This page intentionally left blank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

PART I.
Microfinance and Poverty: Main Issues

This book aims to improve the understanding of microfinance and poverty and outline some implications for microfinance programs. The study is structured around a critical assessment of common assumptions about microfinance and its impact on poverty reduction. In the pages that follow, these assumptions are explored, qualified, and in some cases, rejected.

The analysis appears at a time when governments, donor agencies, and private investors are funding an increasing number of microfinance programs in low-income countries. In large measure, their interest in microfinance is based on the belief that microfinance institutions (MFIs) can contribute to poverty reduction.[1] There is less consensus, however, about *to what degree*, *how* and *when* poverty can be reduced through microfinance.[2]

Two main "camps" have arisen regarding microfinance and poverty reduction: the financial systems approach and the poverty lending approach.[3]

The ***financial systems approach*** views the overall goal of microfinance as the provision of sustainable financial services to low-income people, but not necessarily to the poorest among them. If loans are demanded and paid back in time, the market has demon-

[1] The concept "microfinance institutions" (MFIs) will be used as a common concept for all formal institutions providing financial services to low-income people, including credit unions, village banks, NGOs, commercial banks and development banks.

[2] The term "microfinance" is used when referring to small-scale financial services in general, such as credit and/or savings. The term "microcredit" is used when reference is made only to credit.

[3] See for instance Malhotra, 1992.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

strated that the services provided are valuable, so there is no need for further impact studies. The services should not be targeted exclusively to the poorest, but to underserved market niches in general. There is no rationale for subsidies, and NGOs are seen as having only a minor role in the microfinance market. Financial sustainability is stressed because sustainable MFIs imply outreach in the future. Lack of institutional capacity is perceived as a more binding constraint on the outreach of microfinance than availability of funds. Finally, among many of the proponents of the financial systems approach, credit is not seen as the most important tool for poverty reduction. As economists Adams and Von Pischke (1992:1468) argue, "In our opinion, debt is not an effective tool for helping most people enhance their economic condition — be they operators of small farms or microenterprises, or poor women. In most cases lack of formal loans is not the most pressing problem faced by these individuals."

The ***poverty lending approach*** claims that the overall goals of microfinance should be poverty reduction and empowerment. There is no need to discuss financial sustainability if the services provided do not have any impact on clients' poverty levels. Since the overall goal is poverty reduction, complementary services are often needed and integrated approaches are commonly applied. Some donor funding and subsidies may be needed because availability of funds is the most binding constraint in expanding the supply of financial services to the poor. While the financial systems approach considers provision of financial services to be the *main objective* of MFIs' operations, the poverty lending approach views provision of such services as *a means* to achieve the main objective of poverty reduction. Credit is perceived as an important and effective tool for poverty reduction. The director of Grameen Bank, Muhamad Yunus, states this view forcefully: "...credit is more than business. Just like food, credit is a human right" (Yunus in Microcredit Summit, 1997:10). "If we are looking for one single action which will enable the poor to overcome their poverty, I would go for credit" (Yunus, 1994:1).

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This book advocates a more moderated approach: a "contingency approach."[4] Rather than analyzing the question of *whether or not* microfinance is an important tool for poverty reduction, a contingency approach analyzes *how, to what degree,* and *under which conditions* microfinance can contribute to poverty reduction. Like Rutherford (1998), this study views financial services for poor people as "largely a matter of mechanisms that allow them to convert a series of savings into usefully large lump sums... Financial services for poor people are there to help them get hold of usefully large sums of cash when they *need* the cash or have an *opportunity* to invest it."

The Relationship between Microfinance and Poverty

The effectiveness of microfinance programs as tools for poverty reduction depends, among other things, on whether and how successfully they address the real constraints faced by the poor. These constraints and factors vary. The amounts and/or quality of assets of the poor may be inadequate. Opportunities to generate welfare from assets may be constrained. Qualitative factors such as vulnerability and powerlessness may prevail. Furthermore, poverty, by nature, is contextual: manifestations of poverty and processes leading to or intensifying poverty vary in time and by location.

How can financial services address the different causes of poverty? The main contribution of microfinance — savings, credit and insurance — is to help people overcome *financial* constraints and facilitate the management of their money. The use of these services may or may not change the underlying economic condition of a household or enterprise.

The use of financial services can be classified into two broad categories: consumption and household risk-management; and production and investment. Thus financial services can potentially

[4] See for instance Mahajan and Dichter, 1990.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

BOX 1: HOW CAN MICROFINANCE ASSIST THE POOR?

Promote investment in assets

Finance provides additional purchasing power, permitting individuals to exceed the limitations of their current economic situations. For instance, access to financial services provides a means to accelerate accumulation of assets.

Facilitate activities to earn a livelihood

Access to financial services enables poor people to manage their economic activities in a more efficient manner. For instance, they can reduce working capital outflows if financing allows them to purchase inputs at lower prices.

Protect against income shocks

Access to financial services may reduce households' vulnerability by providing means to cope with emergency needs and smooth consumption. Access to consumer loans may prevent a sale of productive assets in times of low cash flows, and thereby increase the economic security of the household.

Build social capital and improve quality-of-life

The poor may generate social capital as they participate in solidarity groups (build networks), and establish a credit history and trust. In addition, household members may experience a rise in self-esteem, dignity and a sense of empowerment through opportunities provided by access to financial services.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

play a dual role for the poor: cushioning the consumption of poor households in the face of income volatility, and strengthening their economic activities. (See Box 1, p. 4.) Although financial services provide a means to purchase assets, such services cannot directly enhance the availability, quality or productive use of assets. Other services may be needed to allow poor borrowers to use financial services effectively.

This book explores the possibilities and limitations of poverty reduction through microfinance. Various factors — contextual and agent-related — can influence the outreach and impact of microfinance programs, as outlined in Figure 1 below:

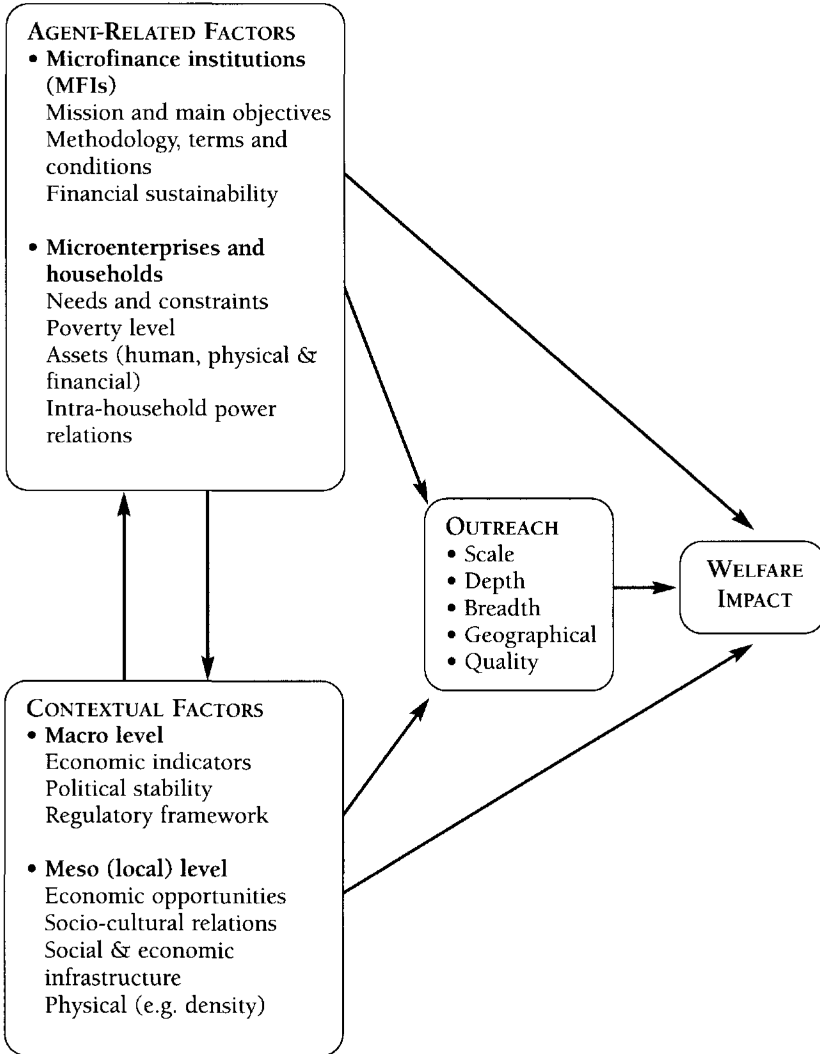
- *Agent-related factors* include the mission and methodology of MFIs, as well as the financial needs and constraints of microentrepreneurs and low-income households.
- *Contextual factors* are external circumstances such as regulatory frameworks and local infrastructure that may affect the outreach of microfinance institutions and the welfare of microenterprises and households.
- *Outreach* of microfinance has different dimensions: how many people are reached (scale of outreach); how poor are the clients (depth of outreach); in which economic sectors are they engaged (breadth of outreach); and where do they live (geographical outreach). Another dimension of outreach is the quality of the services provided, such as the terms and conditions and clients' transaction costs.
- *Impact* refers to the effects of microfinance on the livelihoods and welfare of their clients.

Together, these conditions constitute the basis for poverty reduction through microfinance.

The next three parts of this book present and analyze common assumptions about microfinance and its impact on poverty reduction.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Figure 1: Factors Influencing Outreach and Impact of Microfinance Programs



Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

PART II.

Common Assumptions about Microentrepreneurs and Microfinance Institutions

Development agencies commonly consider assistance to microfinance institutions as poverty interventions. This notion rests on three assumptions: microentrepreneurs are poor; microentrepreneurs are constrained by inadequate access to credit; and microfinance institutions aim for poverty reduction. While there is an element of truth in each of these assumptions, this section presents evidence demonstrating that this is not *always* the case.

Assumption 1 | *Most microentrepreneurs are poor.*

Contrary to the common view of microenterpreneurs as poor and in need of assistance, the microenterprise sector is not a homogeneous pool of poverty-stricken households, but a highly heterogeneous collection of enterprises ranging from units engaged in survival activities to highly sophisticated businesses. A recent IDB study of the poverty profile of people employed in the urban microenterprise sector in Bolivia, Chile, Costa Rica, Honduras, Paraguay, and Uruguay indicates that not all microentrepreneurs are poor (Orlando and Pollack, forthcoming).[5] This study is based on national household surveys, and poverty is defined as the average household income of the microenterprise owner or worker, using the ECLAC poverty line.[6] The poverty profile is compared

[5] Microenterprises are defined as businesses (farming and non-farming) with 10 employees or less and total assets equivalent to less than US$20,000, excluding those in professional sectors such as medical and legal practices.

[6] It should be noted, however, that informal economic activities often are underreported in household surveys.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

between sectors and between occupational status, encompassing owners, the self-employed, wage-employees and non-remunerated family members. The main findings from the study are the following:[7]

- There is a wide range of poverty incidence in the microenterprise sector across countries in the region (see Graph 1 below). The poverty rate for self-employed microenterprise owner/operators ranges from less than 5 percent in Uruguay to 68 percent in Honduras.

- The poverty incidence in the microenterprise sector is higher than the poverty incidence in the population as a whole, except for employers (with one or more employees). However, the unemployed and economically inactive people are generally poorer than the employed part of the population.

- Employees of microenterprises generally are poorer than people employed in the rest of the private sector and in the public sector. Region-wide, 25 percent of microenterprise workers are poor, as compared to only 12 percent of workers in the rest of the private sector.

- Microenterprise owners are generally less poor than wage-employees in microenterprises. The self-employed (microentrepreneurs with no employees) have poverty levels at or above those of employees in the sector.

- People employed in manufacturing microenterprises are generally poorer than those employed in commerce and services.

- Poverty incidence is roughly the same for women and men microentrepreneurs. Although women in the microenterprise sector earn less than men, they do not live in poorer households.

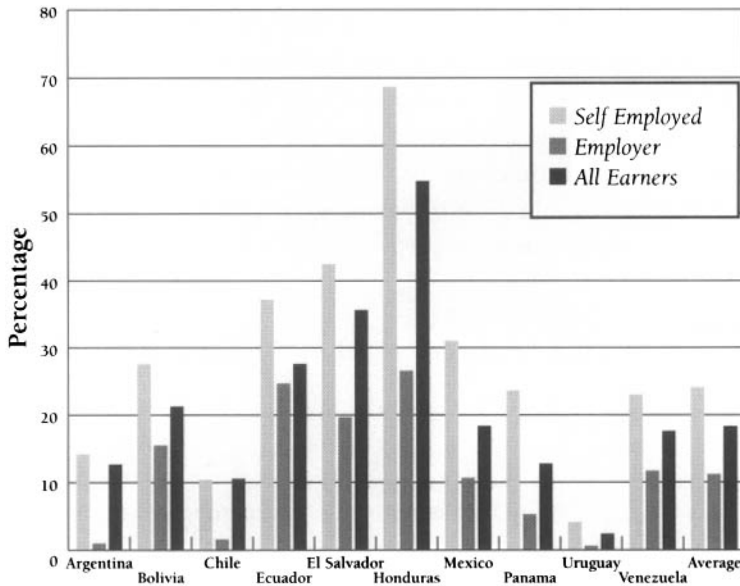
- The poverty profile of the microenterprise sector varies markedly by city within a country (based on data from Bolivia).

[7] See Tables I-II in Annex 2.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

- Microenterprises run by indigenous people tend to be poorer than those run by non-indigenous people (based on data from Bolivia).
- People working in microenterprises generally have less formal education than people employed in the private non-microenterprise sector.

Graph 1: Poverty Profile of People Employed in the Microenterprise Sector*



Source: Orlando and Pollack, forthcoming.

*Poverty is defined by average household income, using a poverty line defined by the IDB, equivalent to $US 60 per month.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

These findings suggest that urban microenterprise development programs may not necessarily reach poor people. Non-targeted microenterprise programs may indirectly reduce poverty by creating new employment for poor people and increasing spending by wealthier microenterprises, but special measures may be needed to directly reach poor microentrepreneurs.

Assumption 2 | *The most serious obstacle facing microentrepreneurs is lack of access to credit.*

A common assumption upon which most microfinance programs are based is that lack of access to credit is the most serious constraint faced by microentrepreneurs, and that vast numbers of the poor lack this access. Various studies have been conducted on this issue in relation to the microenterprise sector in Latin America and the Caribbean, and the evidence does not unambiguously support this assumption. Table 1 below summarizes findings from studies in the Dominican Republic, Honduras, and Ecuador. Only in

Table 1: Main Constraints Perceived by Microentrepreneurs

CONSTRAINT	DOMINICAN REPUBLIC % reporting constraint	HONDURAS % reporting constraint	ECUADOR Rating of constraints
Problems related to markets	40	21	4
Lack of basic public services	18	—	—
Lack of access to credit	13	19	1
Inadequate business skills	—	—	2
Technical skills/ technologies	—	—	3
High cost of raw materials	—	5	—
No major constraint	17	38	—

Sources: Ponz and Ortiz, 1995, ESA Consultores, 1996, Magill and Swansson, 1991.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Ecuador was lack of access to credit reported as the most binding constraint. In Honduras and the Dominican Republic, the credit constraint ranked second and third, respectively. In both the Dominican Republic and Honduras, the most binding constraint perceived by microentrepreneurs was problems related to markets.

Loans for business purposes, for both working and fixed capital, are commonly seen as the financial services microentrepreneurs need the most, and most microfinance institutions limit their activities to provision of such loans. Business loans are important for microenterprise development, but evidence indicates a mismatch of demand and supply of different types of financial services. Various studies stress the importance of not only targeting specific loan uses, but also focusing on overall household financial management. Other research demonstrates that the poorest microentrepreneurs tend to exhibit a greater demand for financial services that will protect household consumption from shocks, such as savings and consumer credit.[8] In a study of the clients of two MFIs in Bolivia—PRODEM and CRECER—Nanci Lee (1996) demonstrates that rural households in Cochabamba use financial services for various livelihood activities, and that credit generally moves freely within the household according to needs. Clients report the following applications of financial services, among others: restocking after emergencies, storing wealth, investing in capital, diversifying activities, meeting household expenses, and financing traditional events such as weddings and funerals.

Few studies have analyzed poor people's need for deposit services, but evidence indicates that the demand is high once such services are available.[9] In Indonesia, BRI (Bank Rakyat Indonesia) has reached more than 16 million savers—six times more than the total

[8] See for instance Almeyda, 1996, Lee, 1996, Albee and Reid, 1992, Gonzalez-Vega *et al.*, 1996, Hulme and Mosley, 1996, Montgomery, 1996, Johnson and Rogaly, 1997, Mahajan and Ramola, 1996.

[9] See for instance Wisniwski, 1997 and 1998, Robinson, 1994, and Rutherford, 1998.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

number of borrowers (CGAP, 1998). In India, SEWA (Self-Employed Women's Association) had more than 44,000 depositors as of December 1996—four times the total number of borrowers (Bhatt, 1998).

The evidence presented above demonstrates that lack of access to credit is often an important constraint, but not always the main constraint perceived by microentrepreneurs. Furthermore, a financial system for the poor must focus on various needs and provide a wide range of financial services, not only credit for production purposes.

Assumption 3 | *The main objective of most microfinance institutions is poverty reduction.*

The microfinance industry consists of a wide variety of institutions, ranging from NGOs pursuing exclusively social objectives to profit-maximizing institutions. NGOs normally use microfinance as a *means for poverty reduction,* whereas commercial institutions perceive provision of financial services as their *main objective*. In the microfinance community, there is a strong divergence of opinion as to whether financial sustainability or poverty reduction should be the main objective or "raison d'être" for MFIs. In addition, among those who see poverty reduction as the ultimate goal of microfinance, there is no agreement as to whether this goal is best fulfilled by exclusively targeting the poorest of the poor, or by providing financial services on a broader basis to low-income people. Rather than discussing competing approaches in microfinance, this study emphasizes the heterogeneity of MFIs, as presented in Table 2 below.[10] In addition to representing different opinions about how and why to extend microfinance, different approaches and institutions constitute a division of labor or fill different market niches in microfinance.

[10] This typology is developed by Fernando Lucano of IDB's Microenterprise Unit (Lucano and Taborga, 1998).

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table 2: A Typology of Microfinance Institutions

	COMMERCIAL FFIs*	SPECIALIZED FFIs	SPECIALIZED NGOs	MULTIPURPOSE NGOs
Strategy and goals	• Expansion into new markets • Institutional image	• Profitability • Social impact	• Social impact • Cost coverage • Graduation	• Social impact • Initial cost coverage
Clients	Various microenterprises in minority	Micro and small enterprises	Microenterprises	Microenterprises
Legal form	• Banks • Finance companies • Credit unions	• Banks • Finance companies • Credit unions	NGOs	NGOs
Methodology	• Individual lending • Instruments vary according to segment	• Individual and/or solidarity group lending • Leasing	Individual and/or solidarity group lending	Individual and/or solidarity group lending
Sustainability	The FFI as a whole is sustainable	Striving toward profitability and efficiency	Striving toward operational efficiency	Difficult to isolate microenterprise activities
Capital sources	• Capital • Certificates • Inter-bank loans • Clients' savings • Donor funds	• Capital • Certificates • Inter-bank loans • Clients' savings • Donor funds	• Bank loans • Subsidized loans from private organizations • Social funds • Donor funds	• Few bank loans • Subsidized loans from private organizations • Social funds
Examples from Latin America	Bco del Comercio (C.R.) Bco Empresarial (Guat.) FASSIL (Bolivia) Bco del Pacifico (Ecuador) Fin. Familiar (Paraguay)	FIE (Bolivia) MiBanco (Peru) Los Andes (Bolivia) BancoSol (Bolivia) Fin. CALPIA (El Salv) Multicredit (Panama)	PROPESA (Chile) Emprender (Arg.) Fundasol (Urug) PRODEM (Bolivia) ADEMI (Dom. Rep.) Funadeh (Honduras)	CARE FINCA Catholic Relief Services Various NGOs, village banks and grassroots organizations

Source: Lucano and Taborga, 1998.
* FFIs stands for Formal Financial Institutions.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Commercial formal financial institutions (FFIs) and multipurpose NGOs may serve very different purposes, and they may have few things in common except for providing small loans. However, both types of institutions may contribute directly or indirectly to poverty reduction. Commercial FFIs see microfinance mainly as a way of expanding into new markets, and microentrepreneurs do not comprise the majority of their clients. Specialized formal financial institutions work entirely with provision of financial services to microenterprises. Within each typology of FFIs there are two subcategories: one category consists of FFIs with mainly commercial goals, and the other of FFIs with a mix of commercial and social objectives. Another type of MFI are the specialized NGOs which limit their activities to microfinance; however, they are normally more socially oriented than formal financial institutions. NGOs are also more dependent upon donor funds since their legal status normally prevents them from capturing savings or borrowing in the commercial markets. Finally, multipurpose NGOs provide other services for microentrepreneurs in addition to microfinance, such as health and education services. For these NGOs, microfinance is used as a means for poverty reduction and may also be seen as a way to attract poor people to other development programs.

In this book, we will concentrate on *institutional* microfinance providers and their role in poverty reduction. *Informal* financial arrangements — savings and credit clubs, family and friends, suppliers credit, private moneylenders, and private depositors — play important roles in microfinance, however. Many innovative solutions to lower transaction costs and substitute collateral, such as the solidarity group lending methodology, stem from indigenous practices such as Rotating Savings and Credit Associations (RoSCAs).[11] Informal arrangements play complementary and substituting roles even in markets with highly competitive formal financial institutions. In Bolivia, for instance, membership in RoSCAs is widespread and common in different strata of the population (Adams *et al.*, 1989).

[11] In Bolivia, RoSCAs are called "Pasanakus."

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumptions 1-3 | CONCLUSIONS

Are most microentrepreneurs poor?

- *Not all urban microentrepreneurs are poor, and the percentage of poor microentrepreneurs varies by country.*

Is lack of credit the most serious obstacle facing microenterpreneurs?

- *Lack of credit is not always the main constraint for microenterprises' growth and development.*
- *Poor people demand a wide range of financial services for different business and household purposes, both as investment and coping strategies.*

Is poverty reduction the main objective of most microfinance institutions?

- *Many MFIs do not have poverty reduction among their main objectives.*
- *The microfinance industry today consists of a wide range of MFIs serving different market niches that can directly or indirectly contribute to poverty reduction.*

What is the role of microfinance in poverty reduction?

- *Microfinance can only address poor people's financial constraints: that is, enable them to manage money more efficiently and accelerate investments.*
- *Microfinance should be seen as provision of small-scale financial services to businesses and households traditionally kept outside the financial system, rather than the more narrow view of microfinance as services for poor microenterprise owners.*

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This page intentionally left blank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

PART III.

Common Assumptions about the Outreach of Microfinance Institutions

The microenterprise sector is characterized by a continuum from tiny survival enterprises to dynamic, sophisticated enterprises. How well do microfinance institutions reach these various firms? In this section, dimensions of outreach of microfinance programs are discussed through a presentation and analysis of the available empirical evidence. The focus will be on microcredit, since most studies analyze this part of microfinance.

There are five dimensions of outreach:

- Depth of outreach (how poor are clients);
- Scale of outreach (how many people are reached);
- Breadth of outreach (in which economic sectors are they engaged);
- Geographical outreach (where do they live); and
- Quality of outreach (quality of the services provided).

Figure 2 below explores the first three dimensions.

The vast majority of enterprises in the sector are very small; at this level, the household income of the majority of owners/workers falls below or close to the poverty line. Relatively larger and more prosperous firms are far less numerous. This distribution is illustrated with the triangle in Figure 2.

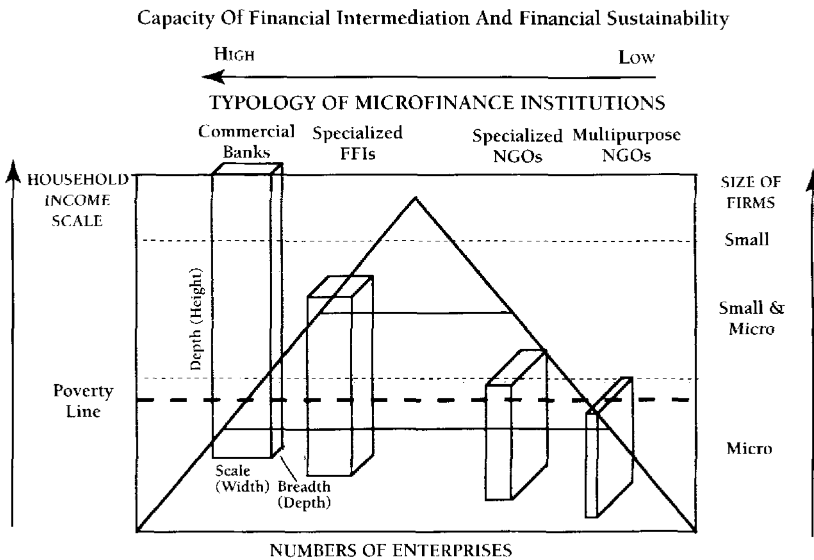
Around this triangle are arrayed the various types of microfinance institutions. They are arranged in order from high to low capacity for financial intermediation and financial sustainability. Clients of formal and more sustainable microfinance institutions tend to be

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

less poor than clients of NGOs. This *depth of outreach* is illustrated by the height of the cubes below the name of each institution.

On the other hand, commercial institutions may reach a larger number of poor people than NGOs because of their greater capacity for financial intermediation. This *scale of outreach* is represented by the width of the cubes. Some microfinance institutions tend to reach a narrow niche of the microenterprise sector. The dominant part of their microenterprise clients are often small traders. *Breadth of outreach* is illustrated by the depth of the cube.

Figure 2: Outreach of Microcredit



Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 4 | *The poorest microentrepreneurs are reached by NGOs that apply the solidarity group methodology.*

It is commonly believed that MFIs' clients in general are poor, and that there is a relationship between type of institution and the poverty level of its clients. Studies indicate, however, that few MFIs reach the poorest of the poor, and that many MFIs have a high percentage of non-poor clients.[12] One of the main reasons cited for poor peoples' inadequate access to institutional credit is their lack of physical collateral. Therefore, it is commonly believed that MFIs using solidarity group guarantees reach poorer people—especially NGOs, since they are the MFIs that are the most poverty-oriented. Does evidence support such a relationship between depth of outreach and loan methodology, and between outreach and type of institution?

A World Bank survey of MFIs in Latin America and the Caribbean (LAC) indicates that, on average, NGOs serve poorer clients than credit unions, and that credit unions serve poorer clients than banks (SBP, 1996b).[13] However, if the MFIs' clients fall in a broad range, it is possible for institutions with higher average loan size to reach more numbers of poor clients. In fact, credit unions and banks reach on average ten times as many clients as NGOs (see Table 3 below). MFIs that employ the village banking or self-help group methodology (groups of 11-50 people) have the lowest loan sizes. MFIs using the individual lending methodology tend to operate with higher loan sizes. Institutions which utilize the solidarity group method (groups of 2-10 persons) have average loan sizes between the two mentioned above (SBP, 1996b).

[12] See, for instance, Christen *et al.*, 1995 (worldwide), Hulme and Mosley, 1996 (worldwide), Navajas *et al.*, 1996 (Bolivia), Hashemi, 1997 (Bangladesh), Mahajan and Ramola, 1996 (India) and Johnson and Rogaly, 1997.

[13] Average loan size expressed as a percentage of GNP per capita is used as a proxy for depth of outreach.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table 3: Loan Portfolio by Institutional Type in Latin America and the Caribbean

	NGOS	CREDIT UNIONS	BANKS
Number of MFIs in sample	65	12	8
Average no. of outstanding MFI loans	5,600	52,404	62,315
Average loan size	$303	$1,343	$1,840
Median loan size	$693	$2,049	$1,348
Avg. loan size as % of GNP/capita	18	81	111
Median loan size as % of GNP/capita	42	124	82
Annual growth in loan portfolio 1994 (%)	49	25	39
MFIs with more than 50% women (%)	46	20	57
MFIs offering social services (%)	26	0	0
Percentage of rural clients	42	29	20

Source: SBP, 1996b.

This difference in average loan size and outreach between banks, credit unions and NGOs is also demonstrated by Gloria Almeyda (1996) in her study of women microentrepreneurs' access to financial services in Latin America and the Caribbean.[14] Even though the general observation seems to be that NGOs reach *poorer* clients than other MFIs, there are some exceptions. For instance, the private bank Banco del Pacifico, in Ecuador, has a lower average loan size than FED (Fundación Ecuatoriana de Desarrollo), a non-profit organization. In addition, NGOs tend to reach a *smaller* number of microentrepreneurs than other MFIs (Fundación Ecuatoriana de Desarrollo). Almeyda also found that lack of assets for collateral is not the main constraint on poor people's access to institutional credit. In fact, very few commercial banks in Latin-America require physical collateral for loans less than US$1,000.

Studies of village banks worldwide indicate that such MFIs reach poorer clients than other MFIs (SBP, 1996a; GEMINI, 1993; and Nelson *et al.*, 1996, among others). As for commercial banks, Baydas *et al.* (1997) recently conducted a worldwide study of such institutions. The depth of their outreach varies significantly, and average loan size is between 20 and 844 percent of GNP per capita.[15]

[14] See Table IV in Annex 2.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

In the studies referred to above, average loan size expressed as a percentage of GNP per capita is used as a proxy for clients' poverty level. This proxy might be inaccurate for two main reasons: GNP per capita does not necessarily reflect the citizens' real income; and loan size does not necessarily correlate with clients' poverty level. There are two other main limitations of using average loan size as a proxy for clients' income level:

- Many MFIs have a fixed, low entry-level loan size regardless of the debt capacity of the clients, and a maximum loan size that is too low for some clients.
- In contexts where an MFI is the sole financial institution operating, there might be a considerable percentage of non-poor clients: that is, clients who would have preferred larger loans.

Furthermore, average loan size does not provide information on the actual *poverty profile* of the clients: their distribution above and below the poverty line. Navajas *et al.* (1996) assess the poverty profile of clients of five Bolivian MFIs (FIE, Los Andes, BancoSol, PRODEM, and Sartawi), and conclude that some of the most well-known MFIs in Bolivia do not reach the poorest of the poor, and have a significant number of non-poor clients (see Table 4). BancoSol, PRODEM and Sartawi use solidarity groups, whereas FIE and Caja los Andes apply the individual lending methodology. PRODEM, Sartawi and FIE are specialized NGOs, and BancoSol and Caja Los Andes are specialized formal financial institutions.[16] Among the urban MFIs (FIE, BancoSol and Los Andes), BancoSol's clients have the highest poverty incidence (36 percent). However, the poverty incidence of the urban population in La Paz as a whole (56 percent) is significantly higher than the incidence among BancoSol's clients. The poor clients of the three urban MFIs are concentrated close to the poverty line, and none are among the poorest. The rural NGOs reach poorer strata of the population than the urban MFIs, both in terms of overall poverty incidence and percentage of indigent

[15] See Table V in Annex 2.
[16] FIE transformed from an NGO to a private financial fund in early 1998.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table 4: Distribution of Clients of Bolivian MFIs by Basic Needs Achievement*

Area/MFI	NON-POOR			POOR			
	Satisfied	Threshold	TOTAL	Moderate	Indigent	Poorest	TOTAL
La Paz–urban	26.6	17.0	43.6	39.0	16.7	0.7	56.4
FIE	34.1	45.7	79.8	18.1	2.1	0.0	20.2
Caja Los Andes	23.4	50.8	74.2	22.7	3.1	0.0	25.8
BancoSol	21.3	42.3	63.6	33.9	2.5	0.0	36.4
La Paz–rural	0.9	2.3	3.2	21.0	64.0	11.9	96.9
PRODEM	10.8	8.1	18.9	66.2	14.9	0.0	81.1
Sartawi	4.7	19.7	24.4	57.0	17.4	1.2	75.6

Source: Adopted from Navajas *et al.*, 1996; data from 1995.
* The Basic Needs Achievement Index consists of four components: housing, public services, education and health. In the "non-poor household" category, the "threshold" households are those that on average satisfy 90 to 110 percent of the basic needs, and "satisfied" households satisfy 110 percent or more. In the "poor household" category, "moderately poor" satisfy 69 to 90 percent, "indigent" (destitute) 30 to 60 percent, and "poorest" satisfy 0 to 30 percent of the basic needs.

clients. On the other hand, the incidence of poverty in rural areas is significantly higher than in urban areas in Bolivia.

Navajas *et al.* (1996) indicate positive relationships between both depth of outreach and type of institution and the solidarity group methodology. The relationship, however, is not strong. Contrasting this, two worldwide studies of MFIs found no relationship between lending methodology and depth of outreach (Christen *et al.*, 1995 and Hulme and Mosley, 1996). In addition to comparing the *poverty level* of MFIs' clients, however, it is important to compare the *absolute numbers* of *poor* people they reach (see Table 5 below). Although both PRODEM and Sartawi reach significantly poorer clients than BancoSol, BancoSol reaches more than twice as many poor microentrepreneurs in the La Paz area than PRODEM and Sartawi together, and twice as many destitute families as PRODEM.[17]

[17] However, this might not be the case at the national level (see table note, Table 5).

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table 5: Poverty Profile of the Clients of Five Bolivian MFIs*

MFI	NON-POOR CLIENTS		POOR CLIENTS			TOTAL
	Satisfied	Threshold	Moderate	Indigent	Poorest	
FIE	34% (1,877)	45.7% (2,484)	18.1% (994)	2.1% (110)	0%	100% (5,465)
Los Andes	23.4% (2,163)	50.8% (2,805)	22.7% (1,253)	3.1% (171)	0%	100% (6,392)
BancoSol	21.3% (6,393)	42.3% (12,696)	33.9% (10,175)	2.5% (750)	0%	100% (30,014)
PRODEM	10.8% (268)	8.1% (201)	66.2% (1,642)	14.9% (370)	0%	100% (2,481)
Sartawi	4.7% (232)	19.8% (976)	57% (2,810)	17.4% (858)	1.2% (59)	100% (4,935)

Source: Navajas *et al.*, 1996, data from 1995.

* Absolute numbers in parentheses. However, the absolute numbers refer only to the total amount of clients in the area of the study: La Paz, El Alto, and the Altiplano. In Bolivia as a whole, BancoSol has 73,000 clients; FIE, 37,000; PRODEM, 28,000; Los Andes, 23,000, and Sartawi, 6,500 (as of June 1997).

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 4 | *CONCLUSIONS*

How well do MFIs reach the very poor?

- *Studies indicate that few MFIs reach the poorest.*

- *In general, NGOs reach poorer people than formal financial institutions, but there are also many examples of banks reaching the poor, and in some cases their clients are even poorer than those of NGOs.*

- *Credit unions and other formal financial institutions reach a significantly larger number of poor people than most NGOs. However, the percentage of poor among bank clients is less than among NGO clients.*

- *Some of the best known MFIs in Bolivia do not reach the poorest of the poor and have a high percentage of non-poor clients. There is no clear relationship between lending methodology and the poverty level of MFI borrowers.*

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 5 | *MFIs face a trade-off between reaching the poor and achieving financial sustainability.*

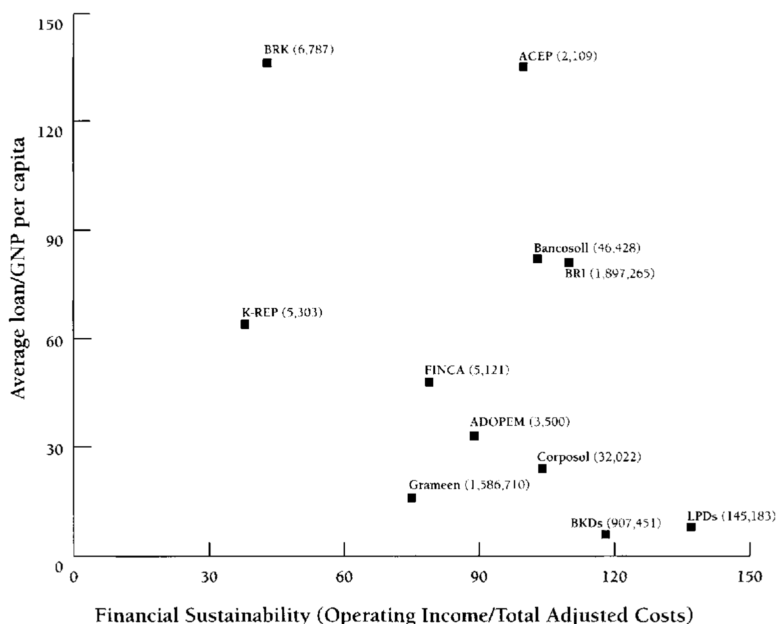
It is commonly argued that the more MFIs aim for financial sustainability, the less will be their impact on poverty reduction: that there is a trade-off between outreach and financial sustainability. This is not necessarily correct, and the concept of "trade-off" needs to be clarified. There might be a trade-off between the financial sustainability and the *depth* of outreach: that is, how poor are the people it is possible to reach with sustainable services. However, there is not necessarily a trade-off between *scale* of outreach and financial sustainability. What evidence, then, do studies on trade-offs in microfinance provide on these issues?

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

In a study of eleven MFIs worldwide it was found that financially sustainable institutions can reach very poor people, and that there is no trade-off between reaching the poor with credit and financial sustainability (Christen *et al.*, 1995). The main findings on the MFIs examined are shown in Table VI in Annex 2 and in Graph 2 below. Loan size is applied as a proxy for clients' income level, and the depth of outreach is compared between MFIs by expressing the average loan size as a percentage of GNP per capita. Two Indonesian MFIs—LPD (Lumbago Perkreditan Desas) and BKD (Badan Kredit Desa)—score high on financial sustainability and seem to reach down to the poorest strata of the Indonesian population, BKD with an average loan size as low as US$38. In addition, these institutions operate on a large scale; each serves about one million borrowers. The authors argue that scale, rather than an exclusive focus on the poorest, determines whether the very poor are reached. This is not always true, however, as shown in Graph 3: BRI in Indonesia with almost two million clients does not seem to reach the poorest.

Christen *et al.*'s conclusion that there is no trade-off between financial sustainability and depth of outreach should be interpreted with

Graph 2: Financial Sustainability and Depth of Outreach*



Source: Adapted from Christen *et al.*, 1995, data from 1993.
* Total number of borrowers in parenthesis.

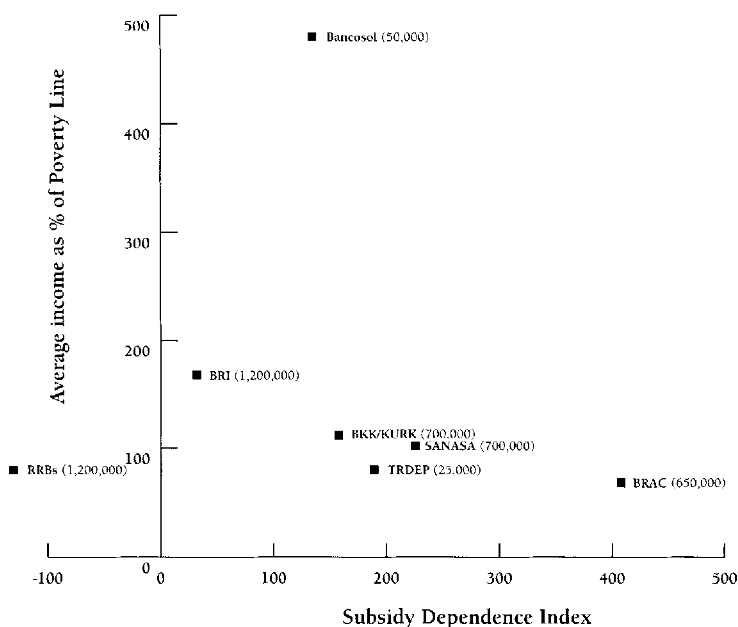
caution. The data as presented in Graph 2 show no trade off, but the data is not strong and the proxies for sustainability and for outreach are not perfect. The indicators of financial sustainability represent financial performance for 1993 only, and performance may vary from year to year. Furthermore, loan size is used as a proxy for poverty; the clients' poverty level is not directly measured.

Contrary to Christen *et al.*, Hulme and Mosley (1996) argue that microfinance programs do not reach the poorest of the poor, and that there is a trade-off between sustainability and depth of outreach (measured as clients' average income as percent of the country's poverty line). The majority of the institutions in their study appear to have borrowers below the poverty line, but few of these clients are very poor.[18] Graph 3 below indicates that MFIs that are highly dependent on subsidies, such as TRDEP and BRAC in

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Bangladesh, reach poorer clients than more sustainable MFIs like BRI and BKK/KURK in Indonesia. The trade-off between depth of outreach and sustainability is not very strong, however. On the other hand, Hulme and Mosley give other evidence of the existence of a trade-off between outreach and sustainability after a detailed analysis of each MFI. They show strong positive correlation between loan size and household income, and strong negative correlation between loan size and cost of lending.

Graph 3: The Relationship between MFI Subsidy Dependence and Depth of Outreach*



Source: Adapted from Hulme and Mosley, 1996, data from 1992.

* Total number of borrowers in parentheses. The Subsidy Dependence Index is a measure of the extent to which the lending interest rate would have to be raised in order to cover all operating costs if any subsidies were taken away (see Yaron, 1997).

[18] See Table VII in Annex 2.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Hulme and Mosley found that institutions that target the poor have a much higher *percentage* of clients below the poverty line than institutions that do not attempt to target the poor only. On the other hand, of the five MFIs studied that reach more than 500,000 microentrepreneurs, three are non-targeted (BRI Unit Desea, BKK, and SANASA). This shows that open-access institutions may reach a *larger number* of poor and hence contribute to poverty reduction—even though their clients might be less poor than clients of targeted programs.

We have seen studies showing a trade-off between depth of poverty outreach and financial sustainability, and one study claiming that there is no such trade-off. The two most thorough studies on the subject conducted in the last five years reach opposite conclusions. The data presented do not provide enough evidence, however, for rigorous conclusions on the question of whether it is possible to reach the poorest of the poor with sustainable financial services. More research needs to be conducted to analyze if there is a lower limit to the loan size: that is, whether there is a "floor" below which it is not possible to operate in a financially sustainable manner.

Assumption 5 | *CONCLUSIONS*

Do MIFs face a trade-off between reaching the poor and achieving financial sustainability?

- *Whether there is a real trade-off between financial sustainability and reaching the poorest remains inconclusive.*

- *There is a positive correlation, however, between financial sustainability and reaching* many *poor people.*

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 6 | *Rural and poor areas remain underserved by microfinance institutions.*

This assumption reflects a general concern in Latin America and the Caribbean that development efforts are biased toward metropolitan areas, leaving rural areas and remote towns underserved. More concretely, the concern is based upon the fact that there are certain impediments to financial transactions that are more severe in rural than in urban areas. Among such obstacles are imperfect information, inadequate contract enforcement, low population density, high prices and production risk, and a larger number of missing or incomplete complementary markets.[19]

One of the best countries to look at to confirm or deny the validity of these beliefs may be Bolivia. Bolivia is one of the poorest countries in Latin America. Nevertheless, it has a relatively mature microfinance industry compared to other countries in the region. Hence, the status of the microfinance industry in Bolivia today might be a good indicator of what other countries can achieve. Contrary to what one would expect based on the obstacles to rural finance previously mentioned, the expansion of MFIs in Bolivia has been stronger in rural than in urban areas in recent years (see Table 6). Furthermore, rural branches outnumbered urban branches as of December 1996.

Rural outreach does not necessarily mean outreach to poor areas, however, since poverty incidence varies between regions. Hence, one should also take into consideration the location *within* urban and rural areas. For rural locations, Marconi (1996) conducted a study of the geographical outreach of 16 NGOs in Bolivia (see Table 7). The 16 MFIs have 78 branches distributed in eight of

[19] The IDB is currently conducting research on promising practices in rural finance, and is also developing a new Rural Finance Strategy with the aim of promoting efficient and sustainable rural financial services. Mark Wenner in IDB's Microenterprise Unit is coordinating this work.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table 6: Urban and Rural Outreach of Bolivian MFIs

	% of total population	Poverty incidence (%)	% of total no. of poor	No. of MFIs	No. of branches	No. of clients	% of total clients
Urban	61	51	40	8	71	124,126	57
Rural	39	94	60	6	80	94,627	43
BOLIVIA	100	70	100	14	151	218,735	100

Sources: CIPAME and FINRURAL, 1997, INE's (Instituto Nacional de Estadísticas) web page.

Bolivia's nine states *(departamentos)*. Most MFIs are concentrated in the three main states—La Paz, Santa Cruz and Cochabamba—and none of the MFIs are located in the state of Pando. This does not necessarily reflect a bias toward more developed areas, however, since 68 percent of Bolivia's population live in the three principal states, and only one percent resides in Pando. Furthermore, Potosi—one of the poorest states of Bolivia—is among the fastest growing areas with regard to availability of microfinance services. Besides differences between states, there are also variations in coverage within states. Marconi (1996) finds a strong negative relationship between coverage of financial services and the level of poverty in each province, and none of the MFIs are serving any of Bolivia's 35 poorest provinces.

The urban MFIs are highly concentrated in the principal states, and do not have branches in the more remote states of Beni and Pando. Urban MFIs are expanding quickly in states such as Potosí and Tarija, however, which are among the poorest states in Bolivia (see Table 8).[20]

[20] The table and the data are taken from CIPAME's newsletter with data on its members BancoSol, FIE, IDEPRO, PROA, CIDRE and FUNBODEM. CIPAME is an umbrella organization for urban MFIs in Bolivia. It is important to note that Caja Los Andes, with more than 23,000 clients, was not a member of CIPAME in December 1996 and therefore is not included in the data.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table 7: Geographical Outreach of Rural MFIs' Total Portfolio in Bolivia

STATE	Population 1997 (urban and rural)	% of total population in Bolivia	GNP per capita (1993) (US$)	% of total value of total portfolio of rural MFIs (12/95)	No. of clients as % of rural EAP* (12/95)
La Paz	2,268,824	29	$678	27.8	10.3
Santa Cruz	1,651,951	21	$976	32.7	8.9
Cochabamba	1,408,071	18	$687	17.1	4.3
Potosi	746,618	10	$391	11.2	5.3
Chuquisaca	549,835	7	$586	3.0	1.9
Oruro	383,498	5	$744	5.3	12.7
Tarija	368,506	5	$817	2.3	5.4
Beni	336,633	4	$793	0.6	4.4
Pando	53,124	1	$913	0.1	0.1
TOTAL	7,767,060	100	$750	100	6.8

Sources: Marconi, 1996, INE, 1996 and INE's (Instituto Nacional de Estadîsticas) web site.
* EAP stands for Economically Active Population (work force)

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table 8: Geographical Outreach of Urban MFIs' Total Portfolio in Bolivia

STATE (city)	Population 1997 (urban and rural)	% of total population in Bolivia	% of total clients of urban MFIs as of 12/96	Growth in no. of clients 1995-96 (%)
La Paz (La Paz)	2,268,824	29	La Paz 23	La Paz -3
La Paz (El Alto)			El Alto 15	El Alto 11
Santa Cruz	1,651,951	21	37	172
Cochabamba	1,408,071	18	13	16
Potosi	746,618	10	2	29
Chuquisaca (Sucre)	549,835	7	1	6
Oruro	383,498	5	9	52
Tarija	368,506	5	1	108
Beni	336,633	4	–	–
Pando	53,124	1	–	–
TOTAL	7,767,060	100	100	

Sources: CIPAME, 1997 and INE's (Instituto Nacional de Estadísticas) web site.

The data on geographical outreach in Bolivia demonstrate that rural and urban MFIs in Bolivia tend to be biased toward the most developed states and provinces, measured by the relative coverage of their services. Bolivian MFIs are, however, increasingly expanding into more remote areas, and the coverage of financial services might therefore be more equal in the future. For instance, PRODEM now has more than 40 offices in secondary towns and rural areas.

The case of Bolivia also offers some conclusions on how to promote geographical expansion of MFIs. In a field study of various MFIs in Bolivia conducted by the Inter-American Development Bank, the following factors were reported as important determinants for the establishment of a new branch:

- Population concentration (expressed especially by urban MFIs that experience high competition).
- Easy access, such as well-developed infrastructure and modes of transportation.
- Areas with good opportunities for economic growth, such as areas with micro-irrigation systems (expressed mainly by specialized rural MFIs).
- Poverty level (expressed mainly by poverty-oriented rural NGOs).

Outreach at this time does not guarantee continued access, however. Rural MFIs appear to have greater difficulty reaching sustainability. Managers of formal Bolivian MFIs and NGOs in the process of graduation explained that it is not possible to operate in a sustainable manner in the most marginalized and remote areas of the country. In this regard, the experience in Mali is instructive (see Box 2). There, village banks have managed to operate in a sustainable manner in the country's poorest areas by using participatory methods and mobilizing local savings before starting with lending activities.

In Bolivia, there seems to be a stronger trade-off between geographical outreach and financial sustainability than between depth of outreach and financial sustainability. At least the experience of

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

BOX 2: DEVELOPING FINANCIAL SERVICES IN POOR REGIONS: THE CASE OF VILLAGE BANKS IN PAYS DOGON, MALI

Pays Dogon is located in a Sahelian zone that has suffered from severe droughts for the past twenty years or so. It is an extremely poor region, accessible only with the greatest difficulty via a dilapidated network of dirt roads, and has one of the country's lowest school enrollment rates. How on earth was it possible to develop a viable and sustainable financial system in such a location? The answer is, by calling on the strength of the Dogon villagers— their sense of social community and value systems that are grounded in mutual help and solidarity (particularly toward the weakest among them), integrity, honor, and respect for the elders. The village banks in Pays Dogon offer a savings service that is accessible to all members who deposit sums as small as CFAF 100 (20 US cents) a week. Interest rates on deposits vary from one village to another, averaging around 20 percent a year, far higher than the rate offered by formal banks (5 percent). All of these local savings are reinvested in loans within the village, at the decision of a management committee made up entirely of villagers elected by their peers...

At present, each bank has a varied portfolio comprised of loans from US$5 to women for cotton-spinning activities to loans of US$50 made to women and young people wishing to develop a sheep-raising business, as well as loans ranging from US$400-1,000 for blacksmiths to help them improve their production of farm implements and household utensils or weavers interested in diversifying their product range...The 54 village banks of Pays Dogon, which served close to 17,000 members in 1995, have connections with the formal banking sector for annual refinancing to expand their lending capacity...

[In addition to] the difficult environment in Mali and the challenges normally associated with a micro-finance operation, the village banks in Pays Dogon are faced with yet another challenge: that of delivering cost-effective financial services to a very poor clientele.... From the very beginning, before attempting to cover their operating costs, the village banks mobilized local savings and linked with the existing banking system. This strategy, however, is in contrast to micro-finance institutions in other parts of the world that started out by focusing on lending alone, which was facilitated by the availability of subsidized external capital.

(Excerpted from Chao-Béroff, 1996.)

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

the Inter-American Development Bank in Bolivia has shown that NGOs operating with grants are able to locate in poorer and more remote areas than non-subsidized institutions with higher capital costs. However, in areas where both donor-funded and more sustainable MFIs operate, such as in the city of Potosí, they tend to work with the same type of clients.

The possibility of geographical outreach is influenced not only by contextual factors like density of population and infrastructure, but also by the legal framework. Some of the rural NGOs in Bolivia manage to operate in marginalized and remote areas by having the branch open only once a week—market day, when a large number of economic transactions take place. In most countries in Latin-America, however, the Superintendency of Banks regulates the opening hours of formal financial institutions (Jansson, 1997). In Bolivia, formal financial institutions are required to be open five days a week, and a minimum of 7.5 hours a day (Jansson, 1997), making it difficult for regulated MFIs to operate in remote and dispersely populated areas.

A World Bank survey of MFIs in Latin America and the Caribbean indicates that, on average, NGOs have a higher percentage of rural clients than credit unions and private banks (see Table 3 and SBP, 1996b). The average share of rural borrowers in MFI portfolios is 39 percent in Latin America, which is significantly lower than both Africa and Asia (SBP, 1996a). On the other hand, Latin American MFIs face a considerably lower rural population density than other regions in the world, a factor that affects transaction costs in rural areas.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 6 | CONCLUSIONS

Do rural and poor areas remain underserved by MFIs?

- *MFIs' expansion into poor rural areas is limited by difficulty of access, poor quality of infrastructure and limited local markets.*

- *The regulatory framework, such as opening hours of bank branches, influences the ability to operate in a sustainable manner in remote areas.*

- *MFIs' operations in remote areas may be facilitated by links to local communities' existing social and economic organizations and mobilization of local savings.*

- *Evidence from Bolivia shows that MFIs are quickly expanding into rural areas. However, they have not yet reached the poorest areas.*

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 7 | *MFIs must specifically target the poorest people and areas.*

While Assumptions 5 and 6 relate to the actual outreach of MFIs and the factors that influence outreach, Assumption 7 concerns more normative issues of whether MFIs should have as their main objective reaching the poor, and if so, whether they should narrowly target the poorest. The issue arises from a concern that few MFIs reach the poorest strata of the population.

For instance, the Microcredit Summit Campaign limits the main target group of microcredit to the "poorest of the poor," defined as the bottom half of the population living below their country's poverty line. The purpose of the Microcredit Summit movement is to launch a global campaign to reach 100 million of the world's poorest families with credit and other services by the year 2005 (Microcredit Summit, 1997). Application of poverty yardsticks and targeting methods are perceived as necessary means for reaching this goal. It is not clear, however, to which extent it is feasible and desirable to work with only destitute clients — a client profile very few, if any, MFIs have today. For instance, for the MFI with the deepest poverty outreach in the study from Bolivia—Sartawi—only 20 percent of the clients fall within the Microcredit Summit's target group.

Assumption 7 and the Microcredit Summit's mission are based on certain assumptions:

- All MFIs strive for poverty reduction;
- Poverty is most effectively reduced by targeting financial services to the poorest of the poor;
- The fact that most of the poorest of the poor do not have credit from MFIs reflects a real underlying problem that can and should be solved; and
- Narrow targeting is an important condition for outreach to the poor.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

The discussion that follows addresses the last two assumptions through a discussion of *who* does not have access to microcredit and *why*: it explores the extent to which lack of access reflects a real problem that should be addressed. Finally, the discussion examines how poorer people and more poor clients can be reached.

Who are the poorest, and why do they not always have access to microcredit?

Microfinance has special characteristics that make it different from other poverty interventions. Provision of credit to poor people is complicated and expensive, requires creditworthiness, and involves risk for both borrowers and lenders. Consequently, MFIs apply various requirements for granting of loans. Common requirements for obtaining a loan from an MFI in Latin America include:

- Being the owner of the economic activity in question;
- Presenting an identification card;
- Having at least 6-12 months experience with the economic activity in question; and
- Restricting the use of the loan to productive activities.[21]

As demonstrated in Part II of this study, poverty is more severe among underemployed and unemployed people than among those employed in the urban sector. Furthermore, wage-employees that work in microenterprises are in general poorer than owners. Hence, the poorest of the poor do not necessarily own a microenterprise, and few MFIs provide loans for start-ups.[22] Furthermore, the poorest of the poor are often vulnerable and might not be willing to take the risk of borrowing to invest in income-generating activities. For example, Hashemi (1997) explains that most hard

[21] However, more and more MFIs operate with fewer restrictions on loan use. For instance, PRODEM in Bolivia has the policy of providing credit of free use ("libre disponibilidad").

[22] Microcredit for start-ups seems to be more common in Asia (for example, the Grameen Bank), than in Latin America. In Bolivia, only village banks seem to provide loans for enterprise establishment.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

core poor in Bangladesh consider themselves not creditworthy. They self-select themselves out of Grameen Bank membership because they feel they do not have enough assets to generate income for loan repayment. If poor people are not among MFIs' clients because they are not creditworthy at a certain point in time, or because they do not want to borrow, inability to reach them with credit should not be looked upon as an institutional failure. If some of the poorest are credit-constrained due to other reasons, however, it might be possible to deepen MFIs' outreach through complementary actions aimed at microfinance institutions and/or potential clients.

What influences depth of outreach, and how can poorer people be reached?

Creditworthy persons may lack access to credit because of inability to comply with one or more of the MFIs' *requirements*. In Bolivia, for instance, many of the poorest people in rural areas do not have identification cards — a constraint that might be addressed through complementary interventions. A program funded by the Inter-American Development Bank with the aim of providing more people with identification cards is currently in execution in Bolivia. Other interventions that might enhance poor people's access to credit are programs at the municipal level that provide licenses for locating and operating a business at a particular site.

In some cases, lack of access to credit can be explained simply by inadequate information. Almeyda (1996) discovered a significant degree of *misinformation* and *lack of knowledge* among women microentrepreneurs in Latin America regarding existing microfinance opportunities. In Bolivia, the NGO FADES uses flyers and local radio stations to inform poor neighborhoods about its microcredit program.

Several studies stress the importance of *organizational commitment* to working with the poor as a condition for actual outreach to this

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

group.[23] In a study about Indonesia, Chavez and Gonzalez-Vega (1996) conclude that success in outreach and sustainability is explained by organizational design and the willingness and ability of the individuals involved. The tendency of NGOs reaching the poorest may be directly related to such institutions' mission and strategy. Hulme and Mosley (1996) found some evidence of changes in staff incentives in favor of capturing fewer poor clients as MFIs grow and professionalize.

As discussed, the degree to which MFIs' *loan methodologies* influence outreach to the poor remains inconclusive. What seems to influence outreach to a greater extent than the methodology and the loan size, however, is the *content* and the *flexibility* of the program and its terms and conditions: the degree to which an MFI meets poor people's special needs by tailoring the characteristics of its loan products to them, and whether it does so in a cost-effective manner. As previously mentioned, poorer strata of the population might be reached if a broader range of financial services, such as savings and consumer credit, is provided to both wage-employees and the self-employed. Deposit services are particularly important for the poorest households that do not have an effective demand for credit because they self-finance consumption and investment (Wisniwski, 1998). In Sri Lanka, for instance, SANASA's poorest clients use savings services more than credit services (Hulme and Mosley, 1996).

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

What influences scale of outreach, and how can more poor people be reached?

As demonstrated in the discussion of Assumption 5, there seems to be a positive relationship between financial sustainability and *scale* of outreach. Consequently, in order to enhance the *scale* of outreach to the poor, efforts should be made to build a sustainable

[23] For instance Jain, 1996; Hulme and Mosley, 1996; Chavez and Gonzalez-Vega, 1996; Almeyda, 1996; Nelson *et al.*, 1996; Johnson and Rogaly, 1997; and Mutua *et al.*, 1996.

financial system for the poor. The following are necessary conditions for making microfinance a large-scale industry:[24]

- There are numerous and varied types of MFIs in the market;
- Most of the institutions are able to mobilize savings;
- The services are diversified and opportune;
- The majority of the institutions are capable of providing their services on a permanent basis: that is, they are profitable and sustainable;
- There is a fair and strong competition in the market that secures cost-efficiency and low prices; and
- The regulatory framework allows financial institutions to serve the microfinance market without unnecessary costs and restrictions.

Broad or narrow targeting: should MFIs target the poorest?

Despite the difficulties of reaching the poorest, some MFIs do attempt to specifically target this stratum of the population. MFIs use different methods to target their services, such as location, community identified needs, and peer group self-selection (CGAP, 1996). Among targeting indicators are ownership of land, loan size, literacy, income proxies, gender, number of employees, nutrition and housing. Hulme and Mosley (1996) argue that self-selection targeting strategies, such as loan size and services tailored to the needs of the poorest, are among the most effective strategies, given appropriate staff incentives within MFIs to provide small loans. In Box 3 below, a targeting method using indicators of housing quality is described.

If the ultimate goal is poverty reduction, it might be as effective to aim at reaching a large number of poor within a diversified client group as striving toward reaching the poorest of the poor exclusively. Moreover, a narrow definition of the target group for the

[24] See also Jansson, 1997 and Lucano, 1998.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

BOX 3: AN INNOVATIVE POVERTY-TARGETING METHOD IN ASIA

CASHPOR ("Credit and Savings for the Hard-core Poor"), Philippines, is a network of 23 Grameen Bank replications in nine countries in Asia. In the remarks below, made in a speech at the 1997 Microcredit Summit, CASHPOR Executive Trustee David Gibbon explains how his organization determines the poverty level of potential borrowers (Microcredit Summit 1997:50):

> In the case of Grameen Bank, [the asset wealth line] is 50 decimals of average agricultural land and household assets of not more than the value of one acre of agricultural land in the area concerned. So, Grameen Bank is exclusively for poor households below that line... We have moved away a bit from Grameen's targeting, which involves a household interview, because we feel a household interview is too expensive and produces information of questionable reliability, validity, especially if you focus on household income... So we have found an indicator that we think, in most cases, enables us to identify about 80 percent of the poor very quickly. And that is what we call the house index... There are three dimensions of the house, and we look at it from the roadside. We don't have to conduct any interviews. We just go up and down the lanes in the village and map the houses which appear to be qualified. We look at size, we look at physical condition or building materials, and we look at the material of the roof... Now, there is one major limitation of this house index, which I should mention. And that is in communities where there is an effective government housing program, such as many parts of India now... Then you can have very poor people living in so-called pucca houses (modern brick, cement and concrete houses). But they have nothing else. So it doesn't work where there is an effective government housing program for the poor. For those cases we have found it very useful to use the PRA method, the Participatory Rural Assessment method, for wealth ranking. We bring the whole village together to find out who are the very poor, who are the not-so-poor, who are the non-poor, through participatory methods.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

microfinance industry as a whole will inhibit the growth and development of the industry. On balance, it appears that to contribute to poverty reduction, a wide variety of approaches and MFIs are needed: sustainable institutions to secure scale of outreach and reduction in absolute poverty; and poverty-oriented pilot programs that might serve as a "seed of the market," providing innovative ways of expanding the frontier of the industry.

Assumption 7 | CONCLUSIONS

Should MFIs narrowly target the poorest people and areas?

- *Lack of access to credit at a certain point in time does not necessarily reflect an underlying problem that should be addressed. For example, the person may not be creditworthy or willing to borrow.*

- *Lack of availability of financial services is, however, a deficiency that should be addressed.*

- *Narrow targeting is not necessarily a condition for reaching the poorest. Some large-scale non-targeted schemes have proven to reach the poorest stratum of the population.*

- *More poor people can be reached through building of a competitive, sustainable financial system providing a wide range of small-scale financial transactions than through narrowly targeted programs.*

- *A combination of broad and narrow targeting in microfinance might be most effective for poverty reduction: that is, to secure both large-scale sustainable outreach and innovation to promote improved access to financial services for the poorest of the poor.*

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 8 | *MFIs working with poor people in rural areas merit subsidies.*

Proponents of subsidies argue that higher transaction costs connected with operating in rural areas, and the expected high social welfare impact of supporting poor people and promoting growth in the rural sector justify subsides for rural microfinance. In economic terms, however, poverty-oriented MFIs do not automatically merit subsidies. There are two main arguments for subsidizing MFIs, both related to the existence of positive externalities: positive impacts on other institutions' operations; and/or increased social welfare for clients and non-clients.

Positive impacts on other MFIs' operations

Because they target clients who have no formal credit history, pilot microfinance institutions might face high risks and high information and start-up costs, and the returns for entry into new markets would not be captured by the first institutions to enter, but rather by the followers. Once the market is explored, it is likely that operating costs and risk will decrease. For that reason, it might be beneficial for society to subsidize innovative projects. Innovations might be related to a new product or methodology, or to expansion to new, underserved geographical areas.

One route is being explored in Bolivia, where it is common to view the role of NGOs in microfinance as "the seed of the market." Bolivian NGOs can afford to test new niches such as poorer strata of the microenterprise sector and/or poorer areas because they receive some grants. Formal financial institutions may watch them and follow. This view of the role of NGOs has been called "the Bolivian model." The first MFI to successfully expand on a large scale to rural areas was PRODEM. However, PRODEM was able to use donor funds to establish rural branches—not to subsidize the interest rate charged on loans, but to cover fixed start-up costs. Some of the NGOs in Bolivia that are in the process of transform-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ing themselves into formal financial institutions have chosen to transfer the majority of their microfinance portfolios to the formal MFIs they have created, while maintaining the NGOs to attend to poorer parts of their clientele and support other social goals. In contrast, some NGOs plan to transfer their entire microfinance portfolios to the new formal MFIs and maintain only business development services within the original NGO.

Increased social welfare

MFIs' operations might generate social welfare effects beyond the economic value of the financial service in question, for instance by empowering women and improving the nutrition of children. This rationale for subsidies is contingent for its justification upon its poverty-reducing effects compared to other poverty interventions. This is difficult to demonstrate: there are many methodological difficulties associated with impact assessments and cost-benefit analysis. (See discussion of Assumptions 9-11, below.) Nevertheless, donors should gather adequate information in order to make good decisions about poverty interventions. Investment in a microfinance program will not necessarily reduce poverty more than a health project, for example. Among other things, the relative impact of a certain development project depends upon the nature of poverty and the presence of other projects in the area in question.

Disadvantages of subsidies

Subsidies create their own problems. They are prone to political manipulation and provide opportunities for corruption.

Subsidies could be justified only under the following circumstances:

- The positive effects of correcting the market failure by using a subsidy will not be outweighed by political problems connected to the subsidy or other distortions;
- The poorest cannot be reached in a sustainable manner; and/or
- Market failures block the expansion of microfinance.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

The rationale for subsidies also depends on operational costs in the area in question and the presence of competing MFIs. For instance, in a country like Bolivia where the microfinance industry is highly developed and competitive, MFIs plan to expand into rural areas to work with poor farmers, and do not necessarily need grants. Finally, there is a danger that subsidies will undermine the development of a sustainable microfinance industry: financial institutions considering entrance into underserved markets will be reluctant to do so if they have to compete with organizations that can cover their costs with donated funds. In order to avoid market distortion and undermining of more market-based approaches to microfinance, the *interest rate* of MFIs should never be subsidized, since this creates incentives for better-off clients to appropriate the subsidy and undermines the institution's sustainability and savings products.

Assumption 8 | CONCLUSIONS

Do MFIs working with poor people in rural areas merit subsidies?

- *Pilot projects may merit subsidies if their activities imply high start-up costs, or if the returns are not likely to be captured by the innovator, but by successors.*

- *Rationale for subsidies depends on the actual operational costs in the area in question, and the presence of competing MFIs.*

- *Poverty-oriented MFIs do not necessarily merit subsidies; it depends on their programs' poverty-reducing effects compared to other poverty interventions.*

- *Subsidies might create political problems and undermine sustainable MFIs.*

- *Subsidies should not be given through the interest rate.*

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This page intentionally left blank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

PART IV.

Common Assumptions about the Impact of Microfinance

What is the impact of microfinance on poverty? To answer this question, impact assessment studies of microfinance programs have been conducted on different levels.[25] The most commonly used impact indicators are household income, expenditure patterns, vulnerability, and women's empowerment. All the impact studies referred to in this book assessed the impact of microcredit. However, it is important to note that studies designed to measure the impact of microcredit programs are plagued by a series of methodological problems, ranging from the difficulty in obtaining reliable data on a non-borrowing control group to measurement problems with informal sector incomes to the challenge of controlling for other causal variables. These factors complicate any interpretation of impact studies.

Assumption 9 | *Microcredit programs improve the livelihoods of the poor.*

At the household level, most impact assessment studies have found that borrowers of microfinance institutions experience positive impacts on income, asset accumulation and consumption (Sebstad and Chen, 1996).

In a study from Ecuador, Berger and Buvinic (1989) found that clients of the NGO FED experienced an increase in hourly income, an increase that was more significant for women than for men. Furthermore, they found positive impacts on job stability, but little impact on job creation. An evaluation of Banco del Desarrollo in

[25] See Sebstad and Chen, 1996 for an overview of impact assessments of microfinance programs.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Chile demonstrated that the majority of the clients experienced improved relationships with suppliers of inputs for their businesses, increased household consumption, improved quality of their children's education, increased income, and improved employment generation (Time, 1995).

Studies from Bangladesh indicate that credit to women is more likely to have an impact on girls' schooling, food expenditure and child welfare than credit to men. Women tend to invest more in the household, and men tend to invest more in the business. Hulme and Mosley (1996) found evidence of women being less isolated after joining a microfinance program. In a study of five group-based microfinance programs from South Asia, Bennett and Goldberg (1993) conclude that all five programs had a strong impact on women's sense of empowerment. Hulme and Mosley (1996) found a trade-off between changes in income and vulnerability: poverty—as measured by income—can be reduced by borrowing, but such debt can make the poor more vulnerable because of the added risks associated with borrowing. Hulme and Mosley found little evidence of reduced vulnerability as a result of borrowing. The main reason for this is that most schemes treat "the poor" as an undifferentiated group and focus on production credit rather than more diverse credit and savings services that are better suited to improve the economic security of low-income households (Hulme and Mosley, 1996).

Some researchers find evidence that some of the impact of microfinance programs may be negative. Hulme and Mosley mention several examples. In Bolivia, 10-15 percent of BancoSol's clients' enterprises go bankrupt. In Bangladesh, drop-out rates for MFIs range between 10-25 percent. In India, many programs have had negative as well as positive impacts on women, such as costs related to heavier work load and control and misuse of their loans by men (Mayoux, 1997). In a study from Bangladesh, Goetz and Sen Gupta (1996) demonstrate that a significant number of female clients of rural MFIs do not control the use of their own loans once they have gained access to MFIs (see Table 9).

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table 9: Women's Control over Loans in Bangladesh (%)

MFI	None or very limited control	Partial control	Significant or full control
BRAC	56	13	31
Grameen Bank	10	28	62
TMSS	25	34	41
RD-12	45	27	28
ALL	39	24	37

Source: Goetz and Sen Gupta, 1996.

Although negative impacts of borrowing have been observed, it would be wrong to conclude that these impacts are due to the loans. As outlined in Figure 1, the welfare impact of borrowing can be influenced by both agent-related and contextual factors. For instance, negative impacts of borrowing can result from unequal power relationships between the borrower and spouse, bad investments by the borrower, unforeseen external shocks, misjudgment of creditworthiness by the lender, and lack of a credit repayment culture. Hence, evidence of negative impact does not necessarily serve as an argument against credit, but in favor of improved screening and loan use because of the risk involved in borrowing.

Furthermore, the studies referred to above measure the impact of borrowing on the clients' livelihoods without taking into account the poverty level of the clients. As discussed earlier, many MIFs have a large percentage of non-poor clients. Hence, the welfare impacts found do not necessarily reflect impacts on poor clients. This raises an interesting question: whether welfare impacts of microcredit programs differ between poor and non-poor clients. This question is analyzed in the next section.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 9 | CONCLUSIONS

Do microcredit programs improve the livelihoods of the poor?

- *So far, the evidence of the impact of credit on poverty is not conclusive.*

- *Impact studies have found, in general, positive impacts on welfare indicators such as clients' income level, asset accumulation and consumption.*

- *Some studies do, however, indicate negative client impacts, such as bankruptcy and increased vulnerability because of added risk. Evidence from Bangladesh suggests that women may be forced to work harder in order to pay off their loans because the use of the loans is often controlled by their husbands, not by the women themselves.*

- *Most client impact studies simply cannot measure the impact of credit on poverty because they do not distinguish between poor and nonpoor microentrepreneurs, but look at impacts for all borrowers.*

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 10 | *For people below the poverty line, microcredit has a lower impact on income.*

This statement is presented as a conclusion in several impact studies demonstrating that microcredit produces smaller improvements in income for people below the poverty line than for those above. A study of El Salvador found that development of successful enterpries and improvement of the income of very poor people were conflicting goals. Programs that selected those enterprises most likely to be successful for credit and training moved away from the poorest clientele (Tomlinson, 1995 in Johnson and Rogaly, 1997). From six case studies in Mexico, Pakistan, the United Kingdom, Gambia, and Ecuador, and from case studies conducted by other researchers, Johnson and Rogaly (1997) conclude that most microfinance programs are unlikely to improve the income of the poorest people but do have an impact on better-off, but still poor, people. The authors argue that the poorest need to build up a certain degree of assets before they can increase their income through investments, and that financial services other than credit for investment can play an important role in this, such as savings and consumer loans. A study from India supports the conclusion that there are strong limits to the ability of the poorest to absorb and take advantage of credit. Among such limits were lack of skills, technology and marketing opportunities (Mayoux, 1997).

Hulme and Mosley (1996) support this line of reasoning. All the MFIs in their study had a positive overall impact on their clients' income. However, for MFIs in Indonesia (BRI), Sri Lanka (SANASA), India (RRBs), Kenya (KREP) and Malawi (SACA and Mudzi Fund), the income impact was greater for clients above the poverty line than for

[26] The impacts were measured using a control group of program participants which had not yet received any loans, which gives a proxy for "before and after" borrowing comparisons. Income was compared by expressing increase in borrower household income as percentage of control group's average increase.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

clients below it.[26] Borrowers below the poverty line in India and Malawi were, in fact, even worse off after borrowing. In Bolivia (BancoSol) and Bangladesh (TRDEP), however, clients below the poverty line did experience a *higher* increase in income than clients above the poverty line. In the case of BancoSol, the borrowers below the poverty line experienced an income increase twice as high as clients above the poverty line. Still, the authors concluded that better-off borrowers are more likely to experience a rise in income. Hulme and Mosley, and others, explain this partly by the poorest being less able to take risks or use credit to increase their income — the more skills and assets a person possesses, the more able he or she is to make use of the credit.

Another explanation given by Hulme and Mosley of why "less-poor" borrowers experience a greater impact on income is that the poorest and the less-poor borrow for different purposes. A comparison of loan use among poor borrowers shows that those with household income less than 80 percent of the poverty line take out smaller loans mainly for consumption purposes (following the *protection strategy* to reduce vulnerability), whereas those with income above 80 percent of the poverty line take out bigger loans for investment in working capital and fixed capital (pursuing the *promotion strategy* to generate income).[27]

The new studies referred to in this section have one thing in common; they conclude that the poorest of the poor may experience less income impact from borrowing because of certain limits on the ability to generate income through investment. But what are these studies really comparing? Hulme and Mosley demonstrated that the majority of the poorest did *not* borrow for income-generating purposes, and the other studies indicate the same. Hence, two quite different products — consumption and production loans — are compared, and it is demonstrated that the latter is most likely to result in increased income, which is exactly as should be expected.[28]

---

[27] See for instance Chambers, 1995 for a discussion of poverty as income-poverty and poverty as income-vulnerability, and promotional versus protectional poverty-reducing strategies.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 10 | CONCLUSIONS

Does microcredit produce less income impact for people below the poverty line than for people above?

- *No clear conclusion emerges to whether there is a correlation between poverty level and income impact, based on an examination of empirical evidence on impact.*
- *Some studies indicate that people below the poverty line experience lower percentage income increases after borrowing than people above the poverty line.*
- *Studies demonstrate that people below the poverty line tend to use loans for consumption purposes to a greater extent than people above the poverty line, and their income should therefore be expected to increase less.*
- *The poorest might need a stronger asset base to take advantage of production credit, but this might not be the case for other financial services.*

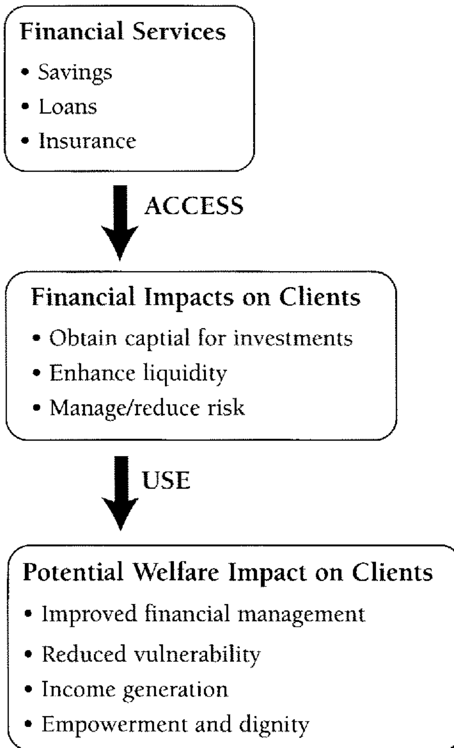
Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

[28] An analogous situation in the United States would be to compare the return of a private car loan with investment in information technology in a small enterprise. From which investment would we expect the highest impact on income?

Assumption 11 | *The best indicator of the impact of microfinance is a change in clients' income.*

As noted, most impact assessment studies measure the change in clients' income. Is this always the best indicator of the impact of microfinance programs? Income generation is not a direct result of use of financial services and not always the main reason for demand and supply of such services. Financial services provide a means to manage money, and more efficient financial management constitutes one of the main financial impacts of microfinance. Improved money management can enable income generation, reduce vulnerability and empower individuals and households, which are potential welfare impacts of microfinance programs (see Figure 3).

Figure 3: Potential Impacts on Clients of Microfinance



Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Surprisingly few impact assessment studies aim at measuring microfinance programs' financial impacts on clients, including clients' satisfaction with services. A better understanding of financial services for the poor can lead to better provision of such services. A broader evaluation of microfinance programs would concentrate on two main indicators: the client-service relationship and financial sustainability (see Box 4).

BOX 4: INDICATORS FOR EVALUATION OF MICROFINANCE PROGRAMS

1) The client-service relationship

- Indicators of outreach of the financial services provided (numbers of clients and socio-economic characteristics of clients).
- Indicators of the quality of the services provided (willingness to pay for the service; client transactions costs; terms and conditions).
- Indicators of enlargement of clients' decision-making options as a result of enhanced access to financial services: how the service supports the clients' financial management process — liquidity, consumption smoothing and investment.

2) Indicators of financial sustainability

- Financial self-sufficiency of service.
- Financial performance of the institution.
- Institutional strength and context (qualitative assessments).

Source: Adapted from Rhyne, 1994.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Impact assessment studies can be classified by purpose, and placed on a continuum between proving impact on clients' welfare and improving MFIs' operations and practice (Hulme, 1997). Evaluations aimed at *proving impacts* are more concerned about the ultimate outcome of the program (such as poverty reduction) than the inputs (such as number of clients per staff). The primary goal of assessments aimed at *improving practice* is to understand and improve MFIs' operations. Current research and new practices of impact appraisals intend to bridge the gap between client impact assessments and MFIs' performance evaluations by focusing more on the *quality* of the services provided.[29] For instance, ADEMI in the Dominican Republic uses a client monitoring system that is integrated into its management information system, and the impact data gathered are used for both credit analysis and impact measurement. BRAC in Bangladesh conducts frequent in-house evaluation studies, and the findings from these studies lead to changes such as redesign of loan and savings products, changes in frequency of group meetings, and modifications of targeting strategies.[30] From a study in Sucre, Bolivia, Robyn Eversole found that weekly payment requirements created liquidity problems for some microentrepreneurs, and that such problems often were solved by selling products at a loss (Eversole, 1998). Hence, information of clients' satisfaction with the services can lead to changes in the terms and conditions of the loans that may increase clients' welfare.

Many impact assessment studies move too quickly to the stage of proving poverty reduction using poverty impact indicators such as changes in income, reduced vulnerability and empowerment. While these are very important indicators, interesting and important information can be lost if the stage between availability of

[29] This is the case with CGAP's Working Group on Impact Assessment Methodologies, chaired by Monique Cohen, USAID.

[30] Information on ADEMI and BRAC was gathered during a virtual meeting in CGAP's Working Group on Impact Assessment Methodologies in April 1998.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

services and poverty impact is ignored, thus missing indicators of more direct impacts of microfinance:

- Who gets access?
- For what purpose do the clients borrow?
- Does the institution provide a wide range of services with flexible terms and conditions?
- How high are clients' transaction costs?
- How is the quality of the service perceived by the clients?
- How does the increased availability enlarge poor people's decision-making choices?

Impact assessments of microcredit programs should distinguish between different purposes of borrowing (such as consumption vs. production), and different loan products (such as long-term vs. short-term loans) because the impact of different loan products might be expected to be different. In addition, assessment studies should evaluate the role of the financial service provided by a particular MFI in relation to other financial sources used by the borrower in order to attribute the impact to the correct financial source.

Impact assessment studies tend to be biased toward the analysis of *individual clients'* impact and sustainability of *individual institutions* as opposed to impacts on the microenterprise sector, the local society, and building of a financial *system* to which the poor have access. In order to produce significant impacts in a particular country, small-size financial services need to be provided on a large scale (see Assumption 7). While impacts on non-clients and the local economy in general might be hard to measure, impact on poverty-reduction through job creation for the poor by non-poor microentrepreneurs may nevertheless be an important contribution of microfinance to local development and poverty reduction.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 11 | *CONCLUSIONS*

Is a change in clients' income the best indicator of the impact of microfinance?

- *Most client impact assessment studies focus on income generation through microcredit.*
- *Enhanced income is, however, only one of the potential welfare impacts from enhanced access to financial services, and not always the main purpose of borrowing.*
- *Few studies assess improvements in clients' financial management, which is the main justification of microfinance.*
- *Evaluations of microfinance programs should evaluate both the client-service relationship and the financial performance of the MFI.*

Assumption 12 | *MFIs need to target the manufacturing sector to have an impact on the microenterprise sector.*

Some observers detect a bias in microfinance against manufacturing. For instance, a frequently heard concern about urban MFIs in Bolivia is that their clients consist mainly of petty traders: this is thought to reflect a bias against manufacturing. The assumption follows that these MFIs do not have a significant impact on income and employment generation because the retail sector is severely saturated and can grow very little.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Many people tend to believe that manufacturing, by definition, is more "productive" than trading and service activities, and thus generates more employment opportunities. Thus, the reasoning follows, MFIs should target the manufacturing sector to a greater extent.

However, according to basic economic theory, all economic activities that yield a positive return are by definition productive: that is, the price someone is willing to pay for the goods/services is higher than the costs of producing them. The perception of a pro-manufacturing bias is based on several observations: there are "too many" petty traders in the market; few of them seem to grow; and they constitute the major group of most MFIs' clients. However, many factors complicate the picture:

- Petty trading is often one of several income sources of a poor household, and the merchandise sold is often manufactured/produced within the same household. In a study from La Paz, Bolivia, Gonzalez-Vega *et al.* (1996) demonstrate that between 49 and 82 percent of the MFIs' clients have multiple occupations, and between 35 and 74 percent of the traders sell items that they have made themselves.
- Demand is a function of price and quality. Consequently, it might be difficult, but not impossible, to expand operations in so-called saturated markets by lowering prices or raising quality.[31]
- The return on investment in trading activities may in fact be higher than for manufacturing, a study of microenterprises in Philippines suggests (Lapar *et al.*, 1995).
- The reason why some microenterprises do not seem to grow may be that many microentrepreneurs invest in the household rather than in the microenterprise. In addition, it is common to create a new microenterprise instead of expanding the existing business.

[31] As expressed by a female trader in Santa Cruz, Bolivia, "La manera de crecer es traer novedades al mercado, y por eso necesito crédito" ("The way to grow is to bring novelties to the market, and for that purpose I need credit").

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

To ascertain whether there is a bias against manufacturing in microfinance, the distribution of MFIs' clients between sectors must be compared with the sectorial distribution in the microenterprise sector as a whole. The dominance of commerce in the microenterprise sector is demonstrated in an IDB study of people employed in the urban sector in Latin America (Pollack, 1997 draft). In all the countries in the study, the majority of people employed in the microenterprise sector are engaged in commerce and services (see Table 10).

Forty percent of all people employed in the urban microenterprise sector in Bolivia work in the trade sector. It seems that traders are slightly over-represented among the clients of PRODEM and BancoSol, according to the data in Table 11 below. FIE and Los Andes, which have a relatively high percentage of manufacturing firms among their clients, differentiate their interest rates according to economic sector, charging 2 percent and 3 percent per month for manufacturing firms, respectively, but 3 percent and 3.5 percent per month for retail trade firms for loans in local currency. One possible reason for the general high percentage of traders among MFIs' clients is that small traders are more profitable for MFIs due to their quick rotation of capital, ready cash flow and ability to pay relatively high interest rates.

It is commonly believed that traders are among the poorest microentrepreneurs. But data from Bolivia and five other countries in Latin America do not confirm this belief (see Tables II and III in Annex 2). According to these data, the overall poverty incidence of people employed in manufacturing is higher than for commerce, and higher than the average for the microenterprise sector in Bolivia. In addition, the incidence of destitute people is higher for manufacturing than for commerce. Eversole (1998) indicates that many manufacturers in Sucre, Bolivia lack adequate access to credit because local MFIs represent expensive credit in insufficient quantities. Consequently, microfinance's contribution to poverty reduction may improve if loan products are better tailored for businesses engaged in manufacturing.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table 10: Distribution of Urban Work Force by Economic Sector (%)

	MICROENTERPRISE SECTOR						PRIVATE SECTOR					
	Bolivia	Chile	Costa Rica	Honduras	Paraguay	Uruguay	Bolivia	Chile	Costa Rica	Honduras	Paraguay	Uruguay
Primary	2.3	5.8	5.3	14.0	6.2	6.1	3.7	8.8	3.8	6.9	1.4	3.9
Manufacturing	20.3	16.2	18.4	23.2	17.1	19.7	27.2	18.4	30.8	37.6	25.4	25.2
Construction	11.0	10.4	8.5	8.5	12.6	9.6	12.4	9.5	7.4	8.6	4.2	7.3
Commerce	39.9	32.2	36.9	34.5	42.5	35.0	12.6	15.1	20.9	14.8	17.7	15.1
Services	26.4	34.4	29.9	19.7	21.7	29.6	44.1	46.9	35.1	31.9	51.3	48.5
Others	0.0	1.0	1.2	0.2	0.0	0.0	0.1	1.3	2.0	0.2	0.0	0.0
TOTAL	100	100	100	100	100	100	100	100	100	100	100	100

Source: Pollack, 1997 (draft).

Table 11: Distribution of Clients of Bolivian MFIs According to Loan Purpose (%)

	Los Andes	BancoSol	FIE	PRODEM	Sartawi
Production	39	20	49	41	53
Trade	49	63	33	50	28
Services	12	17	18	9	19
Monthly nominal interest rates (%)					
In Bolivianos (Bs)	3—4 (Bs)	4 (Bs)	2—3 (Bs)	4 (Bs)	3—3.5 (Bs)
In US $	2—2.5 ($)	2.5 ($)	2 ($)	2.5 ($)	2.5 ($)
Effective real interest rates (%)					
In Bolivianos (Bs)	1.9—2.9 (Bs)	4.0—4.9 (Bs)	1.5—2.0 (Bs)	4.0—4.2 (Bs)	2.1—3.2 (Bs)
In US $	1.8—2.3 ($)	2.5 ($)	1.6—1.9 ($)	2.1—2.2 ($)	2.3—2.4 ($)

Source: Gonzalez-Vega, *et al*. 1996. Data as of 1995. The inflation rate in 1995 averaged 0.9% per month.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 12 | CONCLUSIONS

Do MFIs need to target the manufacturing sector to a greater extent?

- *Observations of "market saturation" in retail trade do not necessarily reflect a real problem.*
- *There is no clear evidence of differences between the rate of return on investment made in trade vs. manufacturing microenterprises.*
- *Traders seem to be over-represented among MFI borrowers compared to manufacturers, as in the case of Bolivia, but this tendency is not very pronounced.*
- *In order to reach more manufacturers, MFIs might need to differentiate their products and their interest rates.*
- *People employed in microenterprise manufacturing tend to be poorer than petty traders, as shown in the case of Bolivia.*

Assumption 13 | *The high interest rates charged by MFIs inhibit growth of microenterprises.*

The statement above reflects a common concern, especially among poverty-oriented practitioners, that the interest rate of some MFIs is too high. Unraveling this seemingly simple assumption is very complicated, however, because it requires answering a series of

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

questions. In order to discuss whether an interest rate is "too high," the following should be considered:

- What is the minimum interest rate for MFIs to achieve financial sustainability?
- Is it possible to reduce MFIs' operational costs in order to lower the interest rate?
- Do MFIs with lower interest rates reach poorer microenterprises and/or have a greater impact on their well-being?
- Do the financing costs constitute a significant portion of the microenterprise's total costs?
- How high are *total* transaction costs for microcredit clients (both monetary and non-monetary)?

There is a consensus in the microfinance literature that MFIs must charge interest rates equal to or higher than those charged by other commercial lender in order to cover the high costs of making small loans (see for example, Christen *et al.*, 1995). Moreover, the rates charged by MFIs are typically lower than those charged by informal moneylenders—one of the main alternative sources of financing for microentrepreneurs. Although lower cost sources of funds may exist—such as funds from family and friends—these are not always available when microentrepreneurs need them, or in sufficient amounts. The most efficient MFIs in Latin America tend to charge interest rates approximately equivalent to those of credit cards and other forms of consumer credit in their local markets. The experience going back to the 1970s is clear: the practice of setting artificially low interest rate ceilings to try to reduce rates on microloans forces institutions to ration credit, and tends to create incentives for better-off borrowers to try to capture the benefits of any subsidy used to support the low rates. This has the effect of excluding microentrepreneurs (Adams, 1984). Interest rate ceilings may have another distorting effect: they may also force MFIs to pay lower rates on savings, hurting microentrepreneurs who save.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Another factor contributing to higher interest rates is the policy environment, especially in countries with high inflation and limited financial sector competition. The alternative to controls is to promote competition among MFIs. As is being shown in Bolivia today, when microentrepreneurs have a choice of lenders, they will choose those that offer the best service for the lowest rate of interest (Owens, 1998). Encouraging competition in microfinance markets will help push down operational costs *and* interest rates.

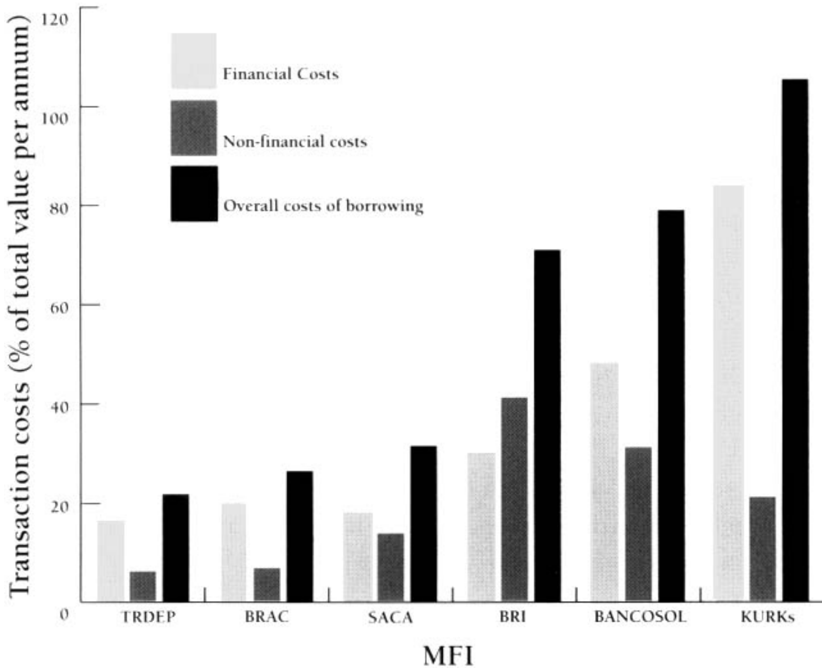
As for poverty performance, there is little evidence demonstrating that MFIs with lower interest rates reach poorer people or have a greater impact on their livelihoods. Castello *et al.* (1991) conducted a study of financing costs of microentrepreneurs in Colombia, Dominican Republic and Chile. The financing costs were found to constitute an insignificant portion of microenterprises' total costs, ranging from a low of 0.4 percent to a high of 3.4 percent. Financing costs were found to be relatively low even in programs that charge an effective real interest rate of almost 10 percent per month. The low portion of loan costs is explained, in part, by the fact that the overall indebtedness of the microenterprises is low.

In her study of the NGO PRODEM and the village bank Crecer in Bolivia, Lee (1996) finds that preferences for one MFI over another tend to be more related to location, and to the flexibility of the terms and conditions of the loans, than to interest rates. Several other studies show that the cost to the borrower in terms of time used for financial transactions is as important a part of total borrowing costs as the interest rate, especially for poor microentrepreneurs.[32] Hulme and Mosley (1996) calculated borrowers' total transaction costs of six MFIs (see Graph 4). Transaction costs vary significantly between MFIs, both in terms of total costs, and in terms of distribution between financial and non-financial costs. Proxies of the MFIs' poverty outreach indicate that the institutions with the lowest total transaction costs—BRAC, TRDEP and SACA—reach poorer people than the others.

[32] For example, Almeyda, 1996; Lee, 1996; Hulme and Mosley, 1996; and Koopman, 1996.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Graph 4: Borrowers' Transaction Costs (as percentage of total loan value per year)



Source: Hulme and Mosley, 1996.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

The literature provides no clear evidence that MFIs' relatively high interest rates reduce the potential for poverty reduction through microcredit. The issue may translate into a concern about long-term vs. short-term effects. MFIs' financial sustainability is important to ensure outreach and impact over the long term; a goal,which requires interest rates set to cover costs. To reduce interest rates and the overall cost burden for microcredit clients, MFIs will need to improve their operational efficiency. Competition for clients can play a significant role in getting MFIs to reduce their operational costs and interest rates.

Assumption 13 | CONCLUSIONS

Do the high interest rates charged by MFIs inhibit growth of microenterprises?

- *Financing costs constitute an insignificant portion of microenterprises' total costs, studies indicate.*
- *The level of non-financial transaction costs associated with borrowing is as important for microentrepreneurs as the financial costs, studies demonstrate.*
- *To secure outreach in the future, MFIs need to charge adequate interest rates so they can cover their costs.*
- *Adequate competition in the microfinance market will help to push operational costs and interest rates lower and promote institutional sustainability.*

Assumption 14 | *Savings is more effective than credit in reducing poverty.*

Lately, development researchers and practitioners have been discussing the relative importance of deposit services and loans.[33] Those who believe that savings is more important often stress that "credit is debt" and makes no return to the borrower (see for instance Adams and Von Pischke, 1992). This study argues that what is most likely to contribute to poverty reduction is not credit *or* savings per se, but building of a sustainable financial *system* that

[33] For instance, the virtual discussion group "development finance list" administered by Ohio State University and the virtual library on microcredit (see Annex 1 for internet addresses).

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

offers small-scale and opportune loans, deposit services and insurance facilities. Both savings and credit are important. Provision of a wide range of financial services will not only better fulfill clients' needs; it may also improve MFIs' sources of funding.

Although the microfinance industry tends to place a greater importance on provision of loans, savings accounts and deposit services seem to be as important as credit for low-income people. Savings deposit services are important tools for efficient liquidity management. As Wisniwski (1998:1) argues, "The advantage that deposit facilities show over informal savings is a good mix of accessibility to cash, security, rate of return and divisibility of savings." Additionally, the ability to mobilize savings can contribute crucially to the long-term sustainability of microfinance institutions. Savings deposits demonstrate the clients' capacity to save, and hence mirror their debt capacity. However, since NGOs are not allowed to mobilize savings, the task of providing deposit services to the sector is a difficult one. Furthermore, donors' provision of grants or low-cost loans to MFIs engaged in deposit mobilization may threaten the organizational incentives for savings mobilization.

Several studies over the last three decades have documented poor people's strong willingness and capability to save (Robinson, 1994 and Wisniwski, 1998). Robinson points to several myths about poor people's savings behavior. Such myths include the notion that low institutional deposits in rural areas demonstrate that rural households are too poor to save, that they prefer to consume rather than save, and that they prefer to save in non-monetary forms such as grain and animals. However, studies of local savings demand in Indonesia have demonstrated that while poor households save extensively in cash, grain, animals and gold, most of them would prefer to store savings in a safer and more liquid form. Institutional savings provide various benefits to poor households: liquidity for household expenses, emergencies and investments; savings for retirement; returns on deposits; and savings to build credit ratings and to serve as collateral.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Experience has shown that inadequate terms and conditions of services hinder institutional savings more than people's savings behavior. For instance, a national savings program in Indonesia permitted withdrawals only twice a month—which was far less than what customers wanted. Cases from other countries have provided similar insights. In a study of RoSCAs in Bolivia, Adams *et al.* (1989) demonstrate that substantial capacity for voluntarily savings exists even when inflation is nearly overwhelming. The predominant reason for joining a RoSCA was to save more. The popularity of RoSCAs is explained by their low transaction costs, flexibility and adaptation to the needs of their members. They provide an attractive form of "contract saving" and offer the opportunity to build a credit reputation that would permit borrowing in the future. In Bangladesh, the institution *Safe*Save for the poorest in the slums of Dhaka demonstrates that the poorest of the poor are capable of saving (see Box 5).

Based on case studies of six MFIs, Wisniwski (1998) draws the following conclusions about small-scale savings products and technologies:

- Savings products and technologies must be designed appropriately to respond to the characteristics of different market segments.
- A broad array of savings products with different levels of liquidity and returns should be offered.
- Individual voluntary savings facilities attract a larger number of depositors and volume of savings than compulsory savings do.
- Savings mobilization is much more competitive than the loan business, so financial institutions must be more active and offer competitive interest rates to attract deposits.
- The minimum opening balance should be low in order to reduce the barriers for poor people to open a savings account.

Evidence from various countries demonstrates that the demand for deposit services is high, that such services have benefits for both

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

BOX 5: ADAPTING INFORMAL FINANCIAL ARRANGEMENTS TO REACH THE POOREST: *SAFE*SAVE IN BANGLADESH

*Safe*Save is an institutional solution to two needs not fulfilled by informal financial arrangements used by the poor in the slums of Dhaka:

- Poor people need to store savings for the long run, for widowhood or old age or for their heirs.
- Poor people's ability to save fluctuates with time.

Both these shortcomings are particularly difficult for the very poor. It is the very poor who suffer most hardship in old age and most need financial protection for the end of their lives. And many poor people get excluded from these devices - and often indeed *exclude themselves* - out of anxiety that they won't be able to save the same amount every day (or week, or month) for a *whole* year (or other period). *Safe*Save allows for the fact that the poor can save and want to save, but can save only in small amounts. It allows for the fact that the poor need to turn those savings into usefully large lump sums at both short and long-term notices, and sometimes without notice. It recognizes that to help them do this it must allow them - on a daily basis - all three of the 'basic personal financial intermediation' functions:

- The chance to save and withdraw.
- The chance to take an advance against *future* savings.
- The opportunity to store up savings for long-term needs.

*Safe*Save has collectors (field staff) who visit each client each day at their home or workplace. This provides the same *opportunity* to save (or repay) that private deposit collectors and ROSCAs do. On each occasion, clients may save in any amount they like. From this accumulation of savings clients may *withdraw* a lump sum at any time they like. Usefully large lump sums is a relative term - *Safe*Save has one very poor client who has withdrawn as little as two taka (about five cents US). This sum is 'usefully large' enough for her to buy kerosene to prepare the evening meal on days when her husband has no work and there is no cash in their home.

(Taken from Rutherford, 1998 (draft). See also: http://services.toolnet.org/safesave)

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

MFIs and their clients, and that capturing small deposits is feasible. But are savings facilities more effective than lending programs in reducing poverty? Some analysts argue that savings diminish vulnerability whereas credit enhances it, and that self-financed investments are less risky. Savings and credit facilities can, however, serve the same purposes, and the choice of one over the other is part of a household's risk management and coping strategy. For instance, a small consumer loan to cope with a crisis at a time when saved resources are scarce does not necessarily make a household more vulnerable; it depends on the overall financial situation and debt burden of the household.

Some observers argue that savings and loans are substitutes because repayment of a loan is equivalent to savings: with savings, small amounts accumulate to create a larger lump-sum in the future; with credit, one receives a lump-sum now and pays for it in small amounts in the future. This is also an important *difference* between savings and credit, however; loans provide an opportunity of *accelerating investments* when the amount saved is inadequate. People save slowly, but can borrow quickly. For a poor tailor, the opportunity to buy a sewing machine today as opposed to after a year of saving might make a big difference. Consequently, it is the availability of all three types of financial services (credit, savings and insurance) that can make a difference in reducing poverty. Availability of financial services does not mean that all poor households need to be in debt or save at a certain point in time. However, all households and businesses will benefit from the *availability* of financial services so that they can save when they want, cope with a crisis at any point in time, and borrow to take advantage of good investment opportunities.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 14 | CONCLUSIONS

Is savings more effective than credit in reducing poverty?

- *Poor people have both the capacity and desire to save, studies demonstrate.*

- *Mobilization of savings is inhibited more by impediments in policies and instruments than by poor people's savings preferences.*

- *Important principles for small-scale savings schemes include convenience and security, a broad array of savings products with different levels of liquidity and returns, a low minimum opening balance, and competitive interest rates.*

- *In addition to being a valuable service that low-income people need, savings enhance poor people's creditworthiness and can contribute to MFIs' sustainability.*

- *Savings, credit and insurance serve slightly different purposes for poor people, and the availability of all three services can make a contribution to poverty reduction.*

- *Donors should promote a financial system that encourages savings, insurance and credit, and savings should be a more important component than it has been to date.*

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 15 | *Microfinance needs to be integrated with other development services to have an impact on poverty and business growth.*

This assumption relates to the conditions to improve the poverty impact of financial services: that is, determinants of the ability of such services to generate welfare improvements. A practitioner, Ela Bhatt, makes this case: "Development finance institutions that offer only traditional microfinance services are not as effective as institutions that also help borrowers overcome the psychological burdens of poverty" (Bhatt 1998:1). Bhatt's argument emphasizes the importance of simultaneously addressing other, more qualitative causes of poverty than financial constraints as a condition for poverty reduction. Related arguments stress local economic conditions, such as availability of productive assets and markets for the goods and services produced by the clients. Observers also note the conditions regarding the microentrepreneurs, such as the range and quality of their business skills, and the household's asset base and poverty level. All these conditions are connected to the nature of poverty and related, perceived limitations of financial services to reduce poverty. Severe poverty occurs mainly in areas with few opportunities for income generation. Access to financial services will not create new opportunities, but it will enable the exploration of existing ones or new opportunities generated by other institutions.

A more practical question is whether MFIs will be more effective by integrating non-financial services to enhance the social welfare effect of microfinance. The answer depends on the type of MFI, its basic objectives and the type of nonfinancial services in question. The term "non-financial services" is very broad and such services may not be complementary to the mission of a particular MFI. As shown in Table 12 below, there is a wide range of complementary services and investments that can be linked directly or indirectly to microfinance in order to enhance the effectiveness or impact of the

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

latter. These interventions range from business development services, such as management consulting or marketing assistance to infrastructure—and even social services such as health care. Depending on how broadly an MFI defines its mission, it may find reasons to offer many of these services, or none at all.

Table 12: Potential Complementary Services to Microfinance

SERVICE	PURPOSE
Business development services (see Goldmark, 1996) e.g. improve access to raw materials and skilled labor, provide business training courses and technology transfers	Strengthen the management and reduce nonfinancial constraints to improved performance of the microbusiness.
Training offered in conjunction with financial services	Improve the "economic literacy" of clients to improve their investment decisions and enhance the likelihood of repayment.
Productive and infrastructure projects e.g. road building, irrigation projects, policy reforms, promotion of small and medium sized enterprises	Promote an enabling environment for income-generating activities (improve conditions for investment in micro-enterprises, access to markets and demand for microenterprise products).
Social intermediation (see Bennett and Goldberg, 1993) e.g. organization building, mobilization and empowerment	Enhance marginalized groups' knowledge of, communication with, and access to financial and business development services.
Social services e.g. health, nutrition, education, family planning	Strengthen human capital or create conditions for the poor to utilize microfinance well, and thereby improve the impact of microfinance on income generation and poverty reduction.

Commercial MFIs whose main objective is to provide small-sized loans in a sustainable and large-scale manner are unlikely to be more effective by expanding into new areas of non-financial activities. For instance, although many microentrepreneurs need, and

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

demand, business development services (BDS), MFIs might not be the institutions best suited to provide these services. Studies demonstrate that most BDS programs cannot become fully sustainable activities, even though some programs do cover their variable costs. [34]

However, if an MFI uses microfinance mainly as a *means* for poverty reduction, provision of other development services *may* be desirable. For instance, many MFIs offer training in conjunction with financial services. A common purpose of this is to create synergy effects: for the MFIs, in terms of increased repayment and more economically literate or dynamic clients; and for the clients, in terms of increased returns from borrowing. However, few studies have demonstrated that such synergy effects actually occur, and many highly successful MFIs do not provide training. A study of MFIs in the Philippines shows that training constituted a significant component of the transaction costs of lending to the poor (Llanto *et al.*, 1996). The authors suggest that training of potential clients represents an investment cost most MFIs may not be able to bear, and that co-funding from governments or donors may be needed. Kilby and D'Zmura (1985) show in a study from Latin America that training and technical assistance programs placed an additional cost burden on both the MFIs and their clients. Simple loan delivery systems proved to be the most cost-effective. Furthermore, technical assistance did not strengthen the managerial and technical capacity of the borrowers as intended.

In general, institutional specialization has proven important to achieving cost-efficiency and effectiveness. However, for a poverty -oriented MFI that is the sole operator in a particular area, it might be desirable to provide social services such as literacy, family planning and nutrition. MFIs targeting marginalized groups and

[34] See, for instance, the IDB's Microenterprise Unit's research project on business development services, managed by Lara Goldmark: Goldmark, 1996, Goldmark, Berte and Campos, 1997, Goldmark and Londoño, 1997, and Hagen-Wood and Højmark Mikkelsen, 1998.

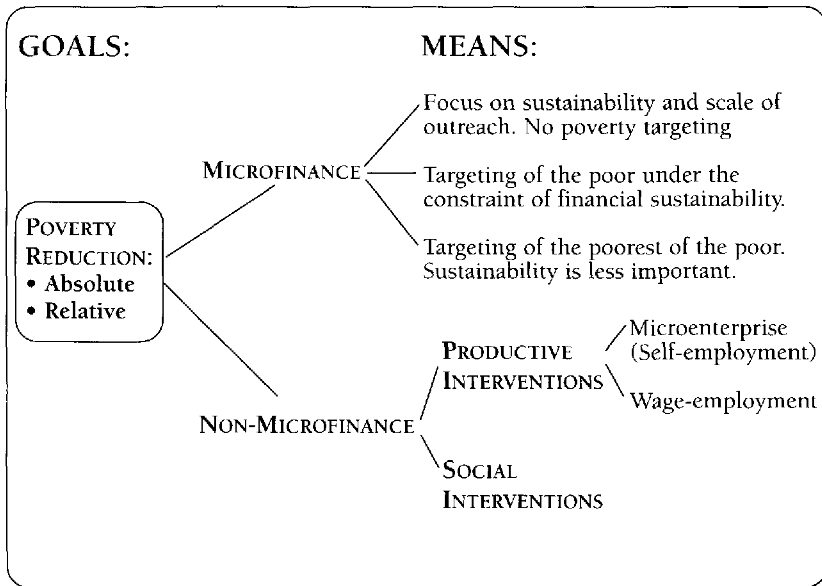
Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

geographical areas may find it necessary to provide social intermediation services in order to reach out to the defined target group (see Table 12). If an MFI finds that complementary services are needed, it is important to create distinct cost centers for the financial and non-financial programs (see Helms, 1998).

Arguments for integration of complementary services are often based on certain limitations of microfinance. Such "limitations" are, however, no more than a reflection of what financial services can accomplish and what they cannot accomplish. Microfinance's limitations as a poverty-reducing tool are more relevant for a discussion of the overall programming of development assistance: that is, in the choice of a mix of instruments for poverty reduction and economic development. The nonfinancial interventions are part of a range of choices for development assistance programs seeking to improve the livelihoods of low-income people; this is illustrated in Figure 4 below.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Figure 4: Strategic Choices in Poverty Interventions



In Table 13 below, *microenterprise interventions* and microenterprise related interventions are classified according to the level of the intervention (micro, meso or macro), as well as the main constraint addressed (social vs. economic/technical).

- *The micro level.* Interventions aim at strengthening institutions that promote the microenterprise sector (for example, through technical assistance to MFIs) and programs that aim to promote microenterprise development more directly (for example, through funds to institutions for on-lending and/or business development services).
- *The meso (local) level.* Programs aim at promoting an enabling local environment for microenterprise development—for instance, by establishing marketing associations and industrial districts—and providing social services such as education and health care. In addition, geographically targeted interventions,

Table 13: Microenterprise and Related Interventions—A Classification

LEVEL OF INTERVENTION	MAIN CONSTRAINTS ADDRESSED: Social	MAIN CONSTRAINTS ADDRESSED: Economic/Technical
MACRO (national)	• Social Safety Nets • Social Investment Funds • Labor laws	• Financial reforms • Regulatory reforms • Land titling
MESO (local)	• Community development (incl. health and education)	• Building of local financial system • Industrial districts • Community economic development
MICRO (Households, microenterprises and institutions)	• Promotion of grassroots organizations • Poverty lending • Participatory subsector approach	• Technical assistance to MFIs • Equity investment in MFIs • Provision of financial services • Business development services

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

such as strengthening financial institutions in under-developed areas, occur at the meso level.

- *The macro or national level.* National programs and policies that may affect microenterprise development institutions and/or microenterprises, such as financial and regulatory reforms, occur at this level.

The social-to-economic/technical continuum refers to the degree of social components in the project. For example, poverty lending may aim to empower microentrepreneurs as well as provide them with financial services. The optimal mix of instruments for microenterprise development and poverty reduction is contextual: it depends on situational variables such as the nature of poverty and barriers faced by the microentrepreneurs. The evidence shows that a range of options exists to improve the livelihoods and well-being of poor microentrepreneurs, and that the impact on the poor of microfinance alone is not unambiguously positive. On the other hand, there is clear evidence that the organizations that provide multiple services (financial and nonfinancial) to microenterprises are less sustainable. Therefore, although these microenterprises need, and demand, complementary services, MFIs might not be the institutions best suited to provide these services.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Assumption 15 | CONCLUSIONS

Does microfinance need to be integrated with other development services to have an impact on poverty and business growth?

- *Commercial MFIs are likely to be less effective when they expand into new non-financial activities, and thus reach fewer poor people.*

- *For a poverty-oriented MFI that is the sole operator in a particular area, it might be desirable to provide a broader range of services for the poor.*

- *Institutional specialization has proven to be important to achieve cost efficiency and effectiveness.*

- *Arguments for integration of complementary services are often based on certain limitations of microfinance. Such "limitations" are, however, no more than a reflection of what financial services can accomplish and what they cannot accomplish.*

- *While it is true that microfinance is not the only service required by poor microentrepreneurs to improve their productivity and income, this does not mean that all services must be provided by MFIs.*

- *The limitations of microfinance should be considered in the overall programming of development assistance: that is, in the choice of a mix of instruments for poverty reduction and economic development which may include microfinance.*

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

PART V.

Conclusions and Recommendations

> Many ingredients are needed for the poor to come out of poverty, and credit is only one of them. Credit is an important ingredient, but is not even the most important one. Financial services play the role of facilitating the work of growth-promoting forces, but only when the opportunities exist. (Gonzalez-Vega, 1994:9)

Microfinance as a Tool of Poverty Reduction: Possibilities and Limitations

The task of reducing poverty is complex and difficult—which makes it all the more important to use various tools of poverty reduction effectively. Microfinance, as such a tool, can be very effective in addressing poor people's financial constraints: that is, improving money management, reducing risk, and accelerating investment. While its effectiveness is clear, its limitations also must be recognized, as noted in this book.

The best route for poverty reduction through microfinance may be to combine narrowly targeted programs to assist the poor with broad steps to build a competitive, sustainable finance system that provides a wide range of small-scale financial transactions. This dual approach could help secure both large-scale sustainable outreach and encourage innovation to promote improved access to financial services for the poor.

As this book has argued, the starting point for efforts to improve the effectiveness of microfinance is to assess the actual constraints faced by the poor. The fact that a poor household is not borrowing at a certain point in time does not necessarily reflect a real problem that needs to be addressed. Three kinds of conditions must be met, by both MFIs and microentrepreneurs, in order for microfinance

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

programs to reach poor people: willingness, knowledge, and ability (see Table 14 below). Each cell in the table represents a different cause of lack of access to credit. The policy implications of these various combinations are clear: different interventions are required on different levels.

Table 14: Potential Reasons for Lack of Access to Credit and Policy Implications

	MICROENTERPRISE (access to microcredit)	MICROFINANCE INSTITUTION (outreach performance)
Willingness	The microentrepreneur does not need or want to borrow *Policy implication: No action required.*	Poverty outreach is not among the MFIs main objectives. It works mainly with other market niches. Therefore, the incentive structure is not meant to maximize the depth of outreach. *Policy implication: No action required.*
Knowledge	The microentrepreneur lacks adequate information and knowledge about existing MFIs and their programs. *Policy implication: Disseminate information about microfinance programs.*	The MFI has inadequate information and knowledge about how to reach poor microentrepreneurs, and/or apply terms and conditions that exclude parts of the microenterprise sector. *Policy implication: Disseminate information and technical cooperation.*
Ability	The microentrepreneur is not creditworthy: he/she does not have debt capacity today. *Policy implication: No action, or activities needed to improve the poor's debt capacity.*	It is not possible for the MFI to use existing technology to expand the frontiers of its operations. *Policy implication: Technical cooperation is needed, along with promotion of an enabling policy and regulatory environment for small-scale financial transactions.*

This contextual backdrop can help determine what specific interventions (if any) should be undertaken.

Interventions to Expand Outreach

As noted, it is a combination of broad measures and narrow targeting that is most effective for poverty reduction: that is, to secure both large-scale sustainable outreach and improved access to finan-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

cial services for the poorest of the poor (depth of outreach). These interventions are summarized in Table 15.

Depth of outreach can be expanded by:

- Providing high quality and low cost financial services that are tailored to the needs of the poorest and their economic activities.
- Providing a wide variety of financial products to suit different household and business needs.
- Creating an enabling environment for small-scale financial transactions.
- Carrying out pilot projects aimed at the poorest households and areas.

Scale of outreach can be expanded by:

- Encouraging an enabling environment for small-scale financial transactions.
- Providing a wide range of services.
- Enhancing the focus on savings mobilization.
- Transforming NGOs to commercial MFIs.
- Promoting competition that ensures low cost and high quality services.

Geographical outreach can be expanded by:

- Enacting regulations and policies that facilitate expansion to remote areas.
- Establishing local infrastructure that enables provision of small-scale financial transactions.
- Promoting pilot, rural MFIs.

Within this range of options, different actors are better suited to take different actions.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table 15: Interventions to Expand Outreach and Improve Impact of Microfinance

	OUTREACH			IMPACT
	Depth	Scale	Geographical	
Macro (national) level	• Lift or prevent restrictions on interest levels.	• Promote political stability. • Encourage low inflation. • Establish a regulatory framework that encourages provision of small-scale financial services without unnecessary costs and restrictions.	• Establish a regulatory framework that enables operation in remote areas, such as flexible branch opening hours. • Develop national credit bureaus.	• Encourage competition in the microfinance market. • Coordinate microenterprise and other development interventions.
Meso (local) level	• Disseminate information about local MFIs in poor neighborhoods. • Issue business licenses and land titles to the poor.	—	• Identify and address local impediments to financial transactions. • Develop infrastructure to enable provision of small-scale financial services.	• Promote business development services to improve access to: -input markets -product markets -information -technology -training
Institutional (MFI) level	• Provide services to both self- and wage-employed. • Tailor instruments and products to the poorest's needs: deposit services, consumer loans, insurance facilities, and production loans. • Extend flexible terms and conditions. • Apply targeting mechanisms. • Establish an organizational commitment and staff incentives to reach the poorest. • Diversify interest rates for different types of clients.	• Strengthen poverty-oriented MFIs to improve their capacity for financial intermediation. • Transform NGOs to commercial MFIs. • Extend technical assistance to expand the frontiers of commerical MFIs. • Encourage mobilization of savings.	• Promote pilot, rural MFIs. • Link self-help groups to commerical banks. • Mobilize local savings. • Provide products that fit the seasonality and diversity of rural livelihood activities.	• Take steps to lower the level of total transaction costs for clients. • Conduct client satisfactory studies to improve services provided.
Micro (enterprise and household) level	• Promote complementary intervention to build the assests base and debt capacity of the poorest.	—	—	• Provide business development services to improve business skills.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

The Role of Different Actors

The Private Sector

The private sector is the ultimate long-term source of financing for the microfinance industry. The demand for credit is simply too great to be met by NGOs and donors.

For-profit MFIs can serve large numbers of poor microentrepreneurs. As this book has shown, they can reach greater numbers of poor and marginalized microentrepreneurs than poverty-oriented NGOs, even if their percentage of such clients is lower.

For-profit MFIs may further strengthen their efforts to reach poor and marginalized microentrepreneurs as they experiment with initiatives to capture new markets and improve the efficiency and client-friendliness of the services they provide to microentrepreneurs (see Table 15, meso and institutional levels). Development agencies can support this process by promoting financial reforms and financing technical assistance to disseminate microfinance techniques and innovations.

NGOs

NGOs' forte is innovation, along with proximity to poor microentrepreneurs. NGOs are uniquely placed to try out new solutions to meet the demand of microenterprises and serve the hardest to reach clients at a reasonable cost.

NGOs need help to make their activities more efficient, to increase the scale of their operations, to work more effectively with the for-profit world, and to develop new ways of financing their activities on a sustainable basis.

Donors play a pivotal role in strengthening NGOs. In selecting NGOs as partners, donors are advised to identify MFIs with the ability to reach poor microentrepreneurs in a cost-efficient manner. The following characteristics can serve as eligibility criteria for poverty-oriented MFIs:

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

The MFI has:
- Poverty reduction as part of its mission and main objectives.
- A proven record of reaching poor people and areas.
- Appropriate staff incentives and commitment to economic *and* social goals.
- A variety of loan and deposit products.
- Few restrictions on loan use.
- Deposit services, where allowed.
- Easy access for the intended target group (for example, through mobile banking).
- Methodologies that imply low transaction costs for borrowers.
- Location in poor areas/neighborhoods.
- Significant volume of lending at low levels, even if the average loan size is above the poverty level.

Support for these poverty-oriented NGOs will promote the development of new approaches to deepen the outreach and impact of microfinance (see Table 15, institutional level).

Public Sector and Development Agencies

Government's main role is to establish the overall conditions necessary for investment and growth of microfinance (see Table 15, macro and meso levels). By maintaining economic stability and competitive markets, fostering political plurality, developing the appropriate legal and regulatory framework, and promoting sensible oversight, government can help create an environment that facilitates the proliferation and strengthening of financial institutions that serve the microenterprise sector. Government can also create incentives for new private sector investment to attend to non-financial needs of microenterprise, such as business development services, and improve the efficiency and transparancy of licensing and other regulations.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

For their part, bilateral and multilateral development agencies can support the process of change, focusing on key points of leverage—whether the regulatory framework, the financial system or the MFIs themselves. These agencies can provide financing, advice, technical know-how and a forum for policy dialogue and consensus-building to support changes at the macro, meso, and institutional levels (see Table 15).

For development institutions, the goal of microenterprise development continues to be the expansion of economic opportunities. The immediate objective is no longer put in terms of reaching a certain number of microentrepreneurs with loans, training or other forms of support. Instead, the focus is on creating the conditions necessary for the growth and development of the microenterprise sector. Utilizing a combination of instruments—policy dialogue, loans, grants for technical assistance, and equity of quasi-equity investments—the key is to go beyond project-by-project approaches, and even institution-by-institution approaches. By looking at each country as a whole and targeting assistance to activities where they have a comparative advantage, or combining their instruments in a strategic fashion so that they become mutually reinforcing, development agencies can have greater impacts on microenterprise development.

As this book makes clear, no one institution can address all the constraints to microenterprise development. But utilizing the comparative advantages of the various actors—public, private or non-profit—can improve the effectiveness of microfinance as a tool to reduce poverty.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This page intentionally left blank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ANNEX I

Contacts and Resources on Microfinance and Poverty

The Virtual Library on Microcredit (formerly "The Informal Credit Home Page")
The most complete web page on microfinance, including a bibliography, mailing lists, and information on microfinance training programs, microfinance institutions, and links.
www.soc.titech.ac.jp/icm

CGAP (The Consultative Group to Assist the Poorest: A Microfinance Program)
Washington, DC
www.worldbank.org/html/cgap/cgap.html
e-mail: cproject@worldbank.org
tel: (202) 473-9594
fax: (202) 522-3744

USAID's Microenterprise Innovation Program (MIP)
Many high-quality publications on line.
www.mip.org
Microenterprise Best Practices Project
c/o DAI, Bethesda, MD USA
tel: (301) 718-8288
Assessing the Impact of Microenterprise Services (AIMS)
c/o MSI, Washington, DC USA
tel: (202) 484-7170

World Bank Project "Sustainable banking for the poor"
www-esd.worldbank.org/html/esd/agr/sbp/page.htm
tel: (202) 458-0277
fax: (202) 522-1662

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

International Labour Organisation (ILO)
Social Finance Unit, Enterprise and Cooperative Development Department
Geneva, Switzerland
www.ilo.org/public/english/65entrep/finance/index.html
e-mail: entreprise@ilo.org
tel: 41-22-799-6070
fax: 41-22-799-7691

Inter-American Development Bank
Microenterprise Unit, Sustainable Development Department
1300 New York Avenue, Washington, DC 20577 USA
www.iadb.org/sds
e-mail: sds/mic@iadb.org
tel: (202) 623-3056
fax: (202) 623-2307

Ohio State University's Rural Finance Department
www-agecon.eg.ohio-state.edu/ruralfinance
Publications on-line. Information on how to subscribe to the discussion forum "development finance list."

Accion International Publication Department
An umbrella organization for a network of microfinance institutions in Latin American countries and eight U.S. cities.
Publication Department
130 Prospect Street, Cambridge, MA 02139 USA
www.accion.org
tel: (617) 492-4930
fax: (617) 876-9509

The Economics Institute, Boulder
Microfinance Training Program
Boulder, Colo., USA
www.colorado.edu/EconomicsInstitute/bfmft/mft98.htm
e-mail: mft@spot.colorado.edu
tel: (303) 938-2538
fax: (303) 942-3003

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

FINCA International Village Banking
Washington, DC
www.villagebanking.org
e-mail: finca@villagebanking.org
tel: (202) 682-1510
fax: (202) 682-1535

GEMINI Papers
Mainly publications on microenterprise development, which are available through Pact Publications:
www.pactpub.org
Or contact: Development Alternatives, Inc. (DAT).
7250 Woodmont Ave., Suite 200, Bethesda, MD 20814 USA
tel: (301) 718-8699
fax: (301) 718-7968

IFPRI (International Food Policy Research Institute)
Washington, DC
www.cgiar.org/ifpri
tel: (202) 862-5600
fax: (202) 467-4439

Microcredit Summit
Washington, DC
www.microcreditsummit.org
tel: (202) 546-1900
fax: (202) 546-3228

SEEP (The Small Enterprise Education and Promotion Network)
New York
Publications of SEEP are available through Pact Publications:
www.pactpub.org
tel: (212) 808-0084
fax: (212) 692-9748

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This page intentionally left blank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ANNEX 2
Supporting Data

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

TABLE 1: Poverty Incidence of Microenterprise Sector, All Earners and Total Population*

Per capita income level of country/Country	Year	1990s (percent poor in each category) Micro workers	Non-micro workers	Micro self-employed	Micro employer (1-5 employees)	All earners	Total population
High income							
Argentina	1996	19.0	9.9	14.0	0.8	12.7	20.0
Upper middle-income							
Chile	1994	16.0	9.9	10.2	1.4	10.6	17.8
Mexico	1994	24.4	4.5	30.8	10.5	18.4	25.9
Uruguay	1995	5.0	1.3	3.9	0.4	2.4	4.8
Venezuela	1995	25.3	10.2	22.8	11.5	17.6	25.3
Lower middle income							
Bolivia	1995	26.3	17.5	27.4	15.3	21.3	30.0
Costa Rica	1995	14.9	3.5	14.1	7.3	8.8	13.1
Ecuador	1995	29.2	14.6	37.0	24.5	27.6	33.8
El Salvador	1995	53.1	30.6	42.3	19.5	35.6	53.0
Panama	1995	24.3	6.0	23.4	5.1	12.8	25.0
Paraguay	1995	7.4	1.4	7.2	n.a.	5.8	26.6
Low-income							
Honduras	1996	59.1	35.6	68.5	26.4	54.8	61.4
AVERAGE							
Latin America	1990s	25.3	12.1	23.9	11.0	18.3	27.1

Source: Orlando and Pollack, forthcoming.
*Poverty measured at household level with IDB poverty line (equal to aproximately $60 per month at 1985 purchasing power parity prices).

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table II: Poverty Incidence of Women in Microenterprise Sector and All Women Earners*

Per capita income level of country/Country	Year	1990' s (percent poor in each category) Women micro workers	Women non-micro workers	Women micro self-employed	Women micro employer (1-5 employees)	All women earners
High-income						
Argentina	1996	18.4	6.0	14.0	—	10.4
Upper middle-income						
Chile	1994	10.8	5.7	6.9	—	6.9
Mexico	1994	15.0	1.9	32.4	6.3	15.1
Uruguay	1995	5.4	0.5	2.2	—	2.1
Venezuela	1995	21.1	6.1	21.5	4.2	12.8
Lower middle-income						
Bolivia	1995	18.6	10.5	26.5	10.6	17.1
Costa Rica	1995	10.3	2.1	11.0	5.1	5.7
Ecuador	1995	22.1	7.8	31.2	12.9	21.3
El Salvador	1995	39.0	22.3	43.3	10.8	29.4
Panama	1995	15.8	2.2	32.8	6.4	10.0
Paraguay	1995	7.0	1.1	9.1	—	5.1
Lower income						
Honduras	1996	40.3	26.9	63.7	29.4	45.2
AVERAGE						
Latin America	1990s	18.7	7.8	23.4	7.1	14.4

Source: Orlando and Pollack, Forthcoming.

*Poverty measured at household level with IDB poverty line (equal to aproximately $60 per month at 1985 purchasing power parity prices).

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table III: Poverty Incidence of Microenterprise and Non-Microenterprise Sectors According to Economic Activity

MANUFACTURING

	Microenterprise Sector (%)				Non-microenterprise Sector (%)			
	Total	Destitute	Poor	Non-poor	Total	Destitute	Poor	Non-poor
Bolivia	100	15.1	31.4	53.5	100	9.9	32.0	58.1
Chile	100	3.3	15.1	81.6	100	2.1	15	82.9
Costa Rica	100	4.4	15.3	80.3	100	0.4	9.9	89.7
Honduras	100	47.6	32.2	20.2	100	28.5	35.6	35.8
Paraguay	100	19.7	27.5	52.8	100	7.9	34.4	57.7
Uruguay	100	0.9	6.9	92.2	100	0.3	3.7	96.0

COMMERCE

	Microenterprise Sector (%)				Non-microenterprise Sector (%)			
	Total	Destitute	Poor	Non-poor	Total	Destitute	Poor	Non-poor
Bolivia	100	11.3	27.3	61.4	100	3.1	25.6	71.4
Chile	100	3.4	13.5	83.1	100	1.5	10.3	88.1
Costa Rica	100	2.6	12.3	85.1	100	0.3	8.4	91.3
Honduras	100	38.9	36.8	24.3	100	19.1	41.7	39.1
Paraguay	100	9.7	25.2	65.1	100	3.3	23.7	73.0
Uruguay	100	1.2	3.8	95.0	100	0.5	4.2	95.3

continued next page

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table III: Poverty Incidence of Microenterprise and Non-Microenterprise Sectors According to Economic Activity (continued)

SERVICES

	Microenterprise Sector (%)				Non-Microenterprise Sector (%)			
	Total	Destitute	Poor	Non-poor	Total	Destitute	Poor	Non-poor
Bolivia	100	10.3	25.7	64.0	100	9.5	20.2	70.3
Chile	100	3.9	14.5	81.6	100	2.1	10.3	87.7
Costa Rica	100	2.9	11.3	85.8	100	2.5	9.8	87.7
Honduras	100	37.4	31.0	31.6	100	27.7	26.7	45.6
Paraguay	100	11.8	30.1	58.1	100	11.8	31.2	57.0
Uruguay	100	0.8	5.1	94.2	100	0.8	5.2	94.0

Source: Pollack, 1997; with U.N. ECLAC poverty lines based on minimum consumption basket in each country.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table IV: Outreach of MFIs in Latin America

COUNTRY	TYPE OF MFI					
	BANKS		CREDIT UNIONS		NGOs	
CHILE	BANDES	BECH	—	PROPESA	FINAM	—
Number of loans	3,492	691	—	3,565	1,190	—
Avg. outstanding loan	$988	$8,065	—	$305	$245	—
Avg. loan/GDP per capita	34%	274%	—	10%	8%	—
COLOMBIA	CAJA SOCIAL	—	CUPOCREDITO	ACTUAR	—	—
Number of loans	3,756	—	25,274	24,685	—	—
Avg. outstanding loan	$1,346	—	$687	$174	—	—
Avg. loan/GDP per capita	91%	—	46%	12%	—	—
COSTA RICA	—	—	COOCIQUE	AVANCE	F. MUJER	FINCA
Number of loans	—	—	1,000	786	526	4,081
Avg. outstanding loan	—	—	$1,560	$1,111	$570	$289
Avg. loan/GDP per capita	—	—	86%	61%	31%	16%
DOMINICAN REPUBLIC	BHD	—	SAN JOSE	ADEMI	FDD	—
Number of loans	194	—	1,616	9,525	2,210	—
Avg. outstanding loan	$10,309	—	$1,856	$724	$588	—
Avg. loan/GDP per capita	1454%	—	262%	102%	83%	—
ECUADOR	PACIFICO	—	PROGRESO	FED	—	—
Number of loans	9,004	—	3,433	4,544	—	—
Avg. outstanding loan	$239	—	$874	$329	—	—
Avg. loan/GDP per capita	18%	—	65%	24%	—	—
JAMAICA	—	—	C. OF KINGSTON	—	JDF	EDT
Number of loans	—	—	4,909	—	669	262
Avg. outstanding loan	—	—	$218	—	$1,725	$935
Avg. loan/GDP per capita	—	—	14%	—	111%	60%

Source: Almeyda, 1996, data based on outstanding loans as of December 31, 1992 equivalent in US$.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table V: Outreach of Commercial Banks Worldwide

	Number of micro loans	Outstanding average loan/GDP per capita
AFRICA		
Egypt: National Bank for Development	20,852	0.83
Kenya: Family Finance Building Society	6,000	0.93
Uganda: Centenary Bank	3,900	7.80
South Africa: Standard Bank	226	0.20
ASIA		
Indonesia: Bank Rakyat Indonesia (BRI)	2,400,000	0.76
Indonesia: Bank Dagang Bali	13,133	3.73
Philippines: Panabo Rural Bank	1,602	1.06
LATIN AMERICA		
Bolivia: BancoSol	57,745	0.67
Bolivia: Caja de Los Andes	17,854	0.62
Chile: Banco de Desarrollo	17,500	0.28
El Salvador: Banco Agrícola Com.	9,305	2.27
Guyana: Scotia Enterprise	9,000	0.25
Peru: Banco Wiese	4,760	1.89
Paraguay: Financiera Familiar	4,658	0.61
Ecuador: Banco del Pacífico	4,000	0.78
Panama: Multicredit Bank	1,450	0.23
Guatemala: Banco Empresarial	840	1.98
Jamaica: Workers Bank	177	8.44

Source: Baydas *et al.*, 1997

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table VI: Outreach and Indicators of Eleven MFIs*

REGION	ASIA				AFRICA			LATIN AMERICA			
COUNTRY	Indonesia	Indonesia	Indonesia	Banglad.	Kenya	Niger	Senegal	Dominican Republic	Costa Rica	Colombia	Bolivia
MFI	BKDs	LPDs	BRI	Grameen	K-REP	BRK	ACEP	ADOPEM	FINCA	Corposol	BancoSol
Pop. (millions)	181	181	181	108	25	8.5	7.9	7.7	3.2	32.8	7.3
GNP/capita*	$610	$610	$610	$210	$340	$163	$753	$940	$1,898	$1,558	$650
Location	Rural	Rural	Rural	Rural	Urban	Rural	Rural	Urban	Rural	Urban	Urban
Branch offices(#)	5,345	651	3,267	1,031	6	14	19	6	1	0	21
Solidarity groups (%)	0	0	0	100	100	80	2	40	100	90	100
Borrowers(#)	907,451	145,183	1,897,265	1,586,710	5,303	6,787	2,109	3,500	5,121	32,022	46,428
Size of outstanding average loans**	$38	$130	$494	$101	$217	$221	$1,016	$308	$310	$366	$535
Average loan/ GNP capita	6%	8%	81%	48%	64%	136%	135%	33%	16%	24%	82%
Effective real interest rate	46	27	25	12	-9	18	14	67	23	52	46
Adj. return on assests	3.2%	7.4%	1.6%	-3.3%	-18.5%	-11.5%	0.1%	-0.8%	-6.3%	4.9%	1.0%
Finan. self-sufficiency***	118%	137%	110%	79%	38%	43%	100%	89%	75%	104%	103%

Source: Christen *et al.*, 1995

* Data from 1993
** On basis of 1993 dollar-adjusted accounts equivalent in US$
*** Operating income/total adjusted costs

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table VII: Characteristics and Outreach of Twelve MFIs

MFI:	BancoSol	BKK	BRI Unit Desas	Reg. Rur. Banks	Grameen Bank	BRAC	TRDEP	PTCCs SANASA	KREP	KIE-ISP	SACA	Mudzi Fund
Country	Bolivia	Indonesia	Indonesia	India	Bangladesh	Bangladesh	Bangladesh	Sri Lanka	Kenya	Kenya	Malawi	Malawi
No. of borrowers	50,000	700,000	1,800,000	1,200,000	1,400,000	650,000	25,000	700,000	1,177	1,717	400,062	223
Avg. client household income per month	$360	$125	$296	$87	$115	$107	—	$143	$217	$445	$197	$78
Avg. income as % of poverty line	480%	163%	195%	112%	—	68%	80%	192%	—	—	—	—
Proportion below poverty line	29%	38%	7%	—	Vast majority, but few hard core poor	Vast majority	Vast majority, (no hard core poor)	—	52%	—	48% (7% hard core poor)	Vast majority
# below poverty line	14,500	266,000	126,000	—	—	—	—	—	612	—	192,000	—
Average loan size	$322	$38	$600	$99	$80	$75	$75	$50	$347	$799	$70	$52
Real interest rate	45%	60%	6%	3%	15%	15%	15%	11%	9%	-1%	7%	8%
Subsidy Dependence Index *	135	32	-9	158	142	408	199	226	217	—	398	1884
Sol. Group (G) or Indiv. lending (I)	G	I	I	I	G	G	G	G	G	I	G	G

Source: Hulme and Mosley, 1996, data from 1992 equivalent in US$

*Subsidy Dependence Index is a measure of the extent to which the lending interest rate would have to raised in order to cover all operating costs if any subsidies were taken away. Data for 1988-1992.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table VIII: Performance and Outreach of Microfinance Institutions in Latin America

Location	Peer Group	No.	Avg. Loan	Adj. ROA	Financial Self Sufficiency	Profit Margin*	Real Interest Yield	Administrative Expense**	Staff Productivity***
World	Fully sustainable	26	$428	4%	113%	10%	34%	27%	108
Lat. Am.	Large broad-based	6	$636	4%	116%	12%	26%	26%	130
Lat. Am.	Med. broad-based	7	$414	6%	115%	15%	45%	32%	96
Lat. Am.	Med./low broad-based	8	$340	-8%	83%	-23%	31%	42%	160
Lat. Am.	Small/low broad-based	5	$120	-17%	73%	-42%	49%	69%	96

Source: The Microbanking Bulletin, No. 2 (July 1998), Boulder, CO: The Economics Institute.

* Profit margin = net operating income/total operating income
** Administrative expense = administrative expenses/outstanding loan portfolio
***Staff productivity = number of clients per staff member

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Adams, Dale W., Douglas Graham, and J.D. Von Pischke. 1984. *Undermining Rural Development with Cheap Credit.* Boulder, Colo.: Westview Press.

Adams, Dale W. and Marie L. Canavesi de Sahonero. 1989. Rotating Savings and Credit Associations in Bolivia. *Savings and Development* 13(3):219-236.

Adams, Dale W. and J. D. Von Pischke. 1992. Microenterprise Programs: Déja Vu. *World Development* 20(10):1463-70.

Albee, Alana and K. D. Reid. 1992. Women and Urban Credit in Sri Lanka. *Small Enterprise Development* 3(1):52-57.

Almeyda, Gloria. 1996. Money Matters: Reaching Women Microentrepreneurs with Financial Services. Washington, D.C.: UNIFEM and Inter-American Development Bank.

Baydas, Mayada M., Douglas H. Graham, and Liza Valenzuela. 1997. *Commercial Banks in Microfinance: New Actors in the Microfinance World.* Microenterprise Best Practices Working Paper. Washington D.C.: U.S.Agency for International Development (USAID).

Bennett, Lynn and Carlos Cuevas. 1996. Sustainable Banking with the Poor. *Journal of International Development* 8(2):145-152.

Bennett, Lynn and Michael Goldberg. 1993. Providing Enterprise Development and Financial Services to Women: A Decade of Experience in Asia. Human Resources and Social Development Division Paper, The World Bank. Washington, D.C.: The World Bank.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Berger, Marguerite and Mayra Buvinic. 1989: *Women's Ventures: Assistance to the Informal Sector in Latin America.* West Hartford, Conn: Kumarian Press, Inc.

Bhatt, Ela. 1998. A Bank of One's Own. In CGAP Newsletter No. 5 (January). Washington D.C.: CGAP Secretariat.

Castello, Carlos, Katherine Stearns, and Robert P. Christen. 1991. *Exposing Interest Rates: Their True Significance for Microentrepreneurs and Credit Programs.* Accion International Discussion Paper Series, Document No. 6. Accion International, Cambridge, Mass., USA.

CGAP. 1996. *Working Group on Poverty Yardsticks and Measurement Tools.* Draft Report and Dicussion Paper. Washington, D.C.: CGAP Secretariat.

___. 1998. *Savings Mobilization Strategies: Lessons from Four Experiences.* CGAP Focus Note No. 13. Washington, D.C.: CGAP Secretariat.

Chambers, Robert. 1995. Poverty and Livelihood: Whose Reality Counts? *Environment and Urbanization* 7(1)173-205.

Chao-Béroff, Renée. 1996. Village Banks in Pays Dogon: A Successful Home-Grown Approach. CGAP Newsletter No. 2, Washington, D.C.: CGAP Secretariat.

Chavez, Rodrigo A. and Claudio Gonzalez-Vega. 1996. The Design of Successful Rural Financial Intermediaries: Evidences from Indonesia. *World Development 1996* (24)1:65-78.

Christen, R. P., E. Rhyne, R. Vogel and C. McKean. 1995. Maximizing the Outreach of Microenterprise Finance: An Analysis of Successful Microfinance Programs. USAID Program and Operations Assessment Report No. 10. Washington, D.C.:USAID.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Christen, Robert Peck. 1997. *Banking Services for the Poor: Managing for Financial Success*. Washington D.C.: Accion International Publications Department.

CIPAME. 1997. Sistema de Información Interno de CIPAME. SISINF No. 1 (May). La Paz, Bolivia: Corporación de Instituciones Privadas de Apoyo a la Microempresa.

CIPAME and FINRURAL. 1997. Boletín Financiero Microfinanzas (Octubre). La Paz, Bolivia: CIPAME.

Copestake, James G. 1995. Poverty-oriented Financial Service Programmes: Room for Improvement? *Savings and Development* 14(4):417-436.

Cotter, Jim. 1996. "Distinguishing between Poverty Alleviation and Business Growth." *Small Enterprise Development* 7(2):49-53.

ESA (Economía Sociedad Ambiente) Consultores. 1996. Estudio de la Pequeña y Micro Empresa en Honduras. Tecucigalpa, Honduras: Fundación José María Covelo.

Eversole, Robyn. 1998. Little Business, Big Dreams: Households, Production and Growth in a Small Bolivian City. Unpublished Ph.D. dissertation, McGill University, Montreal, Canada (revers@po-box.mcgill.ca).

FONDESIF. 1996 (October). Instituciones Privadas de Microcredito: Indices de Autosustentabilidad, Gestiones 1992 a 1995. La Paz, Bolivia. Unpublished paper.

Garson, José. 1996. *Microfinance and Anti-Poverty Strategies: A Donor Perspective*. UNCDF Working Paper. New York: UNCDF.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

GEMINI. 1993. *Village Banking: A Cross-Country Study of a Community-Based Lending Methodology*. GEMINI Working Paper No. 25. Washington, D.C.: GEMINI.

Goetz, Anne Marie and Rina Sen Gupta. 1996. Who Takes the Credit? Gender, Power and Control over Loan Use in Rural Credit Programmes in Bangladesh. *World Development* 24(1):45-63.

Goldmark, Lara. 1996. *Business Development Services: A Framework for Analysis*. Washington, D.C.: Microenterprise Unit, Inter-American Development Bank.

Goldmark, Lara, Sira Berte, and Sergio Campos. 1997. *Preliminary Survey Results and Case Studies on BDS for Microenterprise*. Washington, D.C.: Microenterprise Unit, Inter-American Development Bank.

Goldmark, Lara and Rosario Londoño. 1997. *Profitable Technology Access Services for Microenterprise*. Washington, D.C.: Microenterprise Unit, Inter-American Development Bank.

Gonzalez-Vega, Claudio. 1994. *Do Financial Institutions Have a Role in Assisting the Poor?* Economics and Sociology Occasional Paper No. 2169. Rural Finance Program, Department of Agricultural Economics, The Ohio State University, Columbus, Ohio, USA.

_____. 1997. *Pobreza y Microfinanzas: Lecciones y Perspectivas*. Presentación en el Encuentro Nacional sobre "Microempresa versus Pobreza: ¿Un Desafío Imposible? Paper presented at conference, November 14, La Paz, Bolivia. Columbus, Ohio, USA: The Ohio State University.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Gonzalez-Vega, Claudio, R. Meyer, S. Navajas, *et al.* 1996. *Microfinance Market Niches and Client Profiles in Bolivia.* Economics and Sociology Occasional Paper No. 2346. Rural Finance Program, Department of Agricultural Economics, The Ohio State University, Columbus, Ohio, USA.

Hagen-Wood, Margaret and Lene Hojmark Mikkelsen. 1998. *Experiences in Taking Crafts to Market.* Washington, D.C.: Microenterprise Unit, Inter-American Development Bank.

Hashemi, Syed M. 1997. Building Up Capacity for Banking with the Poor: The Grameen Bank in Bangladesh. In *Microfinance for the Poor?* ed. H. Schneider. Development Centre Seminars. Paris: IFAD/OECD.

____ and Sidney R. Schuler. 1993. Defining and Studying Empowerment of Women: A Research Note from Bangladesh. Arlington, Virginia, USA: John Snow Inc, JSI Research and Training Institute.

Helms, Brigit. 1998. Cost Allocation for Multi-Service Microfinance Institutions. CGAP Occasional Paper No. 2. Washington, D.C.: CGAP Secretariat.

Hulme, David. 1997. Impact Assessment Methodologies for Microfinance — a Review. Paper submitted to the virtual meeting of the CGAP working group on impact assessment methodologies (chaired by USAID), Management Systems International, Washington, DC (available at CGAP's web page)

____ and Paul Mosley. 1996. *Finance Against Poverty,* Volumes I and II. London: Routledge.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

INE (Instituto Nacional de Estadísticas). 1996. *Cuentas Regionales 1988-1993*. La Paz, Bolivia: Instituto Nacional de Estadísticas.

INE Web Page. www.ine.gov.bo. La Paz, Bolivia: Instituto Nacional de Estadísticas.

IDB (Inter-American Development Bank). 1997. *Microenterprise Development Strategy*. Washington, D.C.: Microenterprise Unit, Inter-American Development Bank.

Jain, P. 1996. Managing Credit for the Rural Poor: Lessons from the Grameen Bank. *World Development* 21(1):79-89.

Jansson, Tor, with Mark Wenner. 1997. *Financial Regulation and its Significance for Microfinance in Latin America and the Caribbean*. Washington, D.C.: Microenterprise Unit, Inter-American Development Bank.

Johnson, Susan and Ben Rogaly. 1997. *Microfinance and Poverty Reduction*. Oxfam Development Guidelines, Oxford, UK.

Kilby, Peter and David D'Zmura. 1985. Searching for Benefits. AID Special Study No. 28. Washington, D.C.: U.S. Agency for International Development.

Koopman, Jeanne. 1996. *Client Impact Assessment of Women's Entrepreneurship Development Program in Bangladesh*. Report prepared as part of Women's Enterprise Development Project Evaluation for USIAD/Dhaka conducted by Chemonics International under the Microserve Project. Washington, D.C.: Chemonics International

Lapar, Lucila A., Douglas H. Graham and Richard A. Meyer. 1995. The Effect on Credit on Output: Are there Sectoral Differences? Economics and Sociology Occasional Paper No. 2230. Rural Finance Program, Department of Agricultural Economics, The Ohio State University, Columbus, Ohio, USA.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Lee, Nanci. 1996. Scratching Where It Itches: What Bolivian Microlending Programs Can Learn about Rural Household Strategies from Participants. Msc thesis, School of Rural Planning and Development, University of Guelph, Guelph, Ontario, Canada.

Lipton, Michael. 1988. The Poor and the Poorest: Some Interim Findings. World Bank Discussion Paper No. 25. Washington, D.C.: The World Bank.

Llanto, Gilberto M., Edgardo Garcia and Ruth Callanta. 1996. An Assessment of the Capacity and Financial Performance of Microfinance Institutions: The Philippine Case. Discussion Paper Series No. 96-12. Manila, Philippines: Philippine Institute for Development Studies.

Lucano, Fernando and Miguel Taborga. 1998. *Tipología de Instituciones de Financiamiento a la Microempresa.* Washington, D.C.: Microenterprise Unit, Inter-American Development Bank.

Magill, John H. and Donald A. Swanson. 1991. Ecuador Microenterprise Sector Assessment: Summary Report. GEMINI Technical Report No. 8. Washington, D.C.: GEMINI.

Mahajan, Vijay and Thomas W. Dichter. 1990. A Contingency Approach to Small Business and Microenterprise Development. *Small Enterprise Development* 1(1).

Mahajan, Vijay and Bharti Gupta Ramola. 1996. Financial Services for the Rural Poor and Women in India: Access and Sustainability. *Journal of International Development* 8(2): 211-224.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Malhotra, Mohini. 1992. *Poverty Lending and Microenterprise Development: A Clarification of the Issues*. GEMINI Working Paper No. 30. Bethesda, MD.: Development Alternatives, Inc.

Marconi, Reynaldo O. 1996. *ONG's y crédito rural en Bolivia.* La Paz, Bolivia: FINRURAL (Fundación de Instituciones Financieras para el Desarrollo Rural).

Mayoux, Linda. 1997. The Magic Ingredient? Microfinance and Women's Empowerment. Unpublished briefing paper for the Microcredit Summit, February 1997.
c/o RESULTS Educational Fund.
Web page: www.microcreditsummit.org.
e-mail: microcredit@igc.apc.org.

Microcredit Summit. 1997. The Microcredit Summit Report.
c/o RESULTS Educational Fund.
Web page: www.microcreditsummit.org.
e-mail: microcredit@igc.apc.org.

Ministerio de Desarrollo Humano. 1995. *Mapa de Pobreza: Una Guía para la Acción Social*, 2nd ed. La Paz, Bolivia: Ministerio de Desarrollo Humano.

Montgomery, Richard. 1996. Disciplining or Protecting the Poor? Avoiding the Social Costs of Peer Pressure in Micro-Credit Schemes, *Journal of International Development* 8(2): 289-305.

Mutua, Kimanthi, Pittayapol Nataradol and Maria Otero. 1996. The View From the Field: Perspectives From Managers of Microfinance Institutions. *Journal of International Development* 8(2):179-193.

Navajas, S., R. Meyer, C. Gonzalez-Vega *et al.* 1996. *Poverty and Microfinance in Bolivia.* Economics and Sociology Occasional Paper No. 2347. Rural Finance Program, Department of Agricultural Economics, The Ohio State University, Columbus, Ohio, USA.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Nelson, C., B. McNelly, K. Stack and L. Yanovitch. 1996. Village Banking — the State of the Practice. New York: SEEP Network and UNIFEM.

Nogales, Gottret and Asociados, Consultores Internacionales. 1997. Bolivia: Estrategia Recomendada al Banco Inter-Americano de Desarrollo para el Financiamiento de Microcrédito. La Paz, Bolivia: Consultores Internacionales. Unpublished paper.

Noponen, H. 1997. Participatory Monitoring and Evaluation — A Prototype Internal Learning System for Livelihood and Micro-Credit Programs. *Community Development Journal* 32(1):30-48.

Nueva Economía 1997. *El primer semestre bajo la lupa.* Informe Especial (August 19). La Paz, Bolivia.

Orlando, Maria Beatriz and Molly Pollack. Forthcoming. *Microenterprises and Poverty. A Study of Poverty in the Microenterprise Sector: Evidence from Latin America.* Washington D.C.: Inter-American Development Bank.

Osmani, S. R. 1989. Limits to the Alleviation of Poverty through Non-farm Credit. *The Bangladesh Development Studies* XVII(4):1-20.

Otero, M. and E. Rhyne, eds. 1994. *The New World of Microenterprise Finance—Building Healthy Financial Institutions for the Poor*. London: IT Publications.

Owens, John. 1998. Bolivia's Microfinance Industry: Leading the Way. *Microenterprise Development Review* 1(1):5. Washington, D.C.: Microenterprise Unit, Inter-American Development Bank.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Pollack, Molly. 1997, draft. *Pobreza y Microempresa en Latino América. Situación en 6 países de la region.* Washington, D.C.: Microenterprise Unit, Inter-American Development Bank. Unpublished paper.

Pons, Frank Moya and Marina Ortiz. 1995. Indicadores de las Microempresas en la República Dominicana 1994-1995. Santo Domingo, República Dominicana: FONDOMICRO.

Rhyne, Elisabeth. 1994. A New View of Finance Program Evaluation. In *The New World of Microenterprise Finance—Building Healthy Financial Institutions for the Poor*, eds. M. Otero and E. Rhyne. London, UK: IT Publications.

Robinson, Marguerite S. 1994. Savings Mobilization and Microenterprise Finance: The Indonesian Experience. In *The New World of Microenterprise Finance—Building Healthy Financial Institutions for the Poor*, eds. M. Otero and E. Rhyne. London, UK: IT Publications.

Rogaly, Ben. 1996. Microfinance Evangelism, Destitute Women and the Hard selling of a New Anti-poverty Formula. *Development in Practice* 6(2):100-113.

Rutherford, Stuart. 1998 (draft). The Poor and their Money: An Essay About Financial Services for Poor People. Dhaka, Bangladesh: SafeSave (stuart@bd.drik.net).

Schneider, Hartmut, ed. 1997. *Microfinance for the Poor*? Development Centre Seminars. Paris: IFAD/OECD.

Sebstad, Jennefer and Gregory Chen. 1996. Overview of Studies on the Impact of Microenterprise Credit. Paper Submitted to USAID by the AIMS Project, Management Systems International, Washington, D.C.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

SBP (Sustainable Banking with the Poor). 1996a: A Worldwide Inventory of Microfinance Institutions. Washington D.C.: The World Bank.

____. 1996b. An Inventory of Microfinance Institutions in Latin America and the Caribbean. Washington D.C.: The World Bank.

Time. 1995 (July). Impacto de crédito en micro empresarios." Santiago, Chile: Time.

Von Pischke, J. D. 1991, Finance at the Frontier Debt Capacity and the Role of Credit in the Private Economy. EDI Development Studies. Washington, D.C.: The World Bank.

Wisniwski, Sylvia. 1997. Savings in the Context of Microfinance. Draft prepared for CGAP Working Group Financial Instruments and Savings Mobilization. GTZ, Germany (www.gtz.edu).

____. 1998. Savings in the Context of Microfinance. Paper presented at the Inter-American Forum on Microenterprise, Mexico City, March 26-28, 1998. GTZ, Germany (www.gtz.edu).

Yaron, Jacob. 1997. How to Assess Performance of Development Finance Institutions. In *Microfinance for the Poor*? ed. Hartmut Schneider. Development Centre Seminars. Paris: IFAD/OECD.

Yunus, Muhammad. 1994. Does the Capital System Have to Be the Handmaiden of the Rich? Extracts from the keynote address delivered at 85th Rotary International Convention, June 1215, 1994, Taipei, Taiwan. Available on internet: http://titsoc.soc.titech.ac.jp/tit soc/higuchilab/icm/grameenkeynote.html

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This page intentionally left blank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Design by Studio Grafik, Herndon, VA

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Inter-American Development Bank
1300 New York Avenue NW
Washington, DC 20577 USA

ISBN: 1-886938-45-8

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub