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# MICROFINANCE IMPACT EVALUATION:

# GOING DOWN MARKET

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## INTRODUCTION

In the burgeoning field of microfinance, practitioners and policy makers are focused on how best to deliver financial services to the poor on a sustainable basis. With the push toward financial sustainability and outreach, client level impact assessment has been marginalized in favor of the assessment of institutional performance. However, this has begun to change. Responding to demands by practitioners, donors and policy makers, a great deal of attention has been given to developing middle range approaches to impact assessment that are at once credible, cost effective and useful.

Evaluations of the performance of microfinance institutions (MFIs) with their emphasis on sustainability and outreach, place a premium on financial criteria. Conventional wisdom has that clients will automatically follow if the services are available, and high rates of repayment and repeat borrowing can be taken as proxies of client satisfaction and are indicative of a positively valued service. However, such measures fail to answer the persistent questions that are at the center of impact assessment, who these programs reach and whether and how they make a positive difference to clients' lives.

Meanwhile there are a growing number of rigorous impact assessments that offer valuable insights into the benefits associated with participation in particular programs:

- Employment generation occurs primarily among the larger micorenterprises.
- Household investment in housing and education are evident across income levels.
- Benefits are often greater for the better off than the poorer clients.

Linking client impact to levels of program participation reveals another set of trends:

- The cumulative value of loans may be an important determinant of positive change.
- While the first loans may be used for working capital in lower risk, existing or known economic activities, once a steady flow of income is established, subsequent loans may be used for housing, and more risky investments.

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[1] The views expressed here are those of the author and do reflect those of USAID.

- To mitigate risk the poor split the use of their loans among multiple uses, production and consumption.

However, even such generalizations are at best tentative. There are many mediating variables that affect these outcomes. Programs differ noticeably in whom they reach, the range and types of services they provide as well as the environments in which both the clients and the programs operate.

This paper will review the impact assessment discussions currently circulating in the microfinance sector and the emerging agenda. In view of the challenges facing the microfinance field in undertaking such evaluations, the paper will look at some of the more innovative approaches to lower cost impact assessments under consideration. Lastly, the paper will consider very briefly a work currently in progress, a commissioned paper for the WDR 2001 on the impact of microfinance on poverty alleviation. It reflects another of the evolving attempts to understand client perspectives on impacts and to develop lower cost impact assessment methods.

## CLIENT LEVEL IMPACT EVALUATION: THE EMERGING AGENDA

Existing microfinance impact assessments cluster around two poles:

> A limited number of large scale, methodologically rigorous, quantitative impact assessments which use sophisticated econometric analyses. Many have been donor driven with the goal of proving that resources have been well spent and the results conform to the donor's priorities. A disproportionate number have been undertaken in Bangladesh.
>
> A large number of small scale impact assessments that use less sound methods. The designs often lack control/comparison groups and a time perspective. They employ either quantitative and qualitative instruments or take a mixed method approach. Even though the funding for such studies usually comes from outside, the agenda for such impact assessments maybe an unarticulated mix of both donor and practitioner objectives.

Meanwhile, a middle range approach is starting to emerge. Donors and practitioners find that that large scale assessments are too expensive. While they have an important role to play, the main push within the sector is to lower the cost of impact assessment. Advocating for lower cost approaches puts the onus on evaluators to develop a reliable set of instruments that can measure impact more cost effectively and generate credible results.

To understand where the pressure for impact assessment is coming from we can identify the stakeholders and recognize what they are seeking from these impact assessments. Hulme's (1997) continuum of objectives for impact assessment, extending from <u>proving</u> impacts for the purposes of measuring the results of an investment to <u>improving</u> the practice of a MFI, suggests that donors and policy makers, practitioners, and researchers bring to the debate different priorities, standards, uses and approaches to impact assessment.

Donors and Policy Makers

Policy makers guide the climate for investment in microfinance, while donors have been a principle source of investment funds in the industry. Both want proof of the effectiveness of these financial services in relation to their developmental objectives. In addition to measures of program sustainability, outreach and deepening financial markets, they want know whether these services are reaching the poor, helping to alleviate poverty and putting the clients on the road to self-sufficiency. Positive results provide evidence of the value of investment in microfinance services and indicate whether they are helping the poor get out of poverty. Failure to demonstrate impact raises the prospect that funds for microfinance will be reprogrammed for other uses.

Practitioners

A mix of proving and improving goals drives practitioners' interest in impact assessment. As recipients of grant funds they often are required to show that their programs are contributing to the donors' strategic objectives. At the same time practitioners' interests in ensuring that their financial products are responsive to client needs dictate an improving purpose for impact assessments. Most practitioners' recognize a strong link between program performance and client level impact: a loan to a client with a stable and growing income base can make for a repeat borrower who will add to the long term health of a MFI. For clients, knowledge that the institution will be around for a while and that they have access to credit, by itself, may place them in a better position to make riskier investments than they might otherwise (Diagne,1997).

In its improving role, an impact assessment is a management tool. Practitioners have noted that impact assessments can

- identify which clients are receiving more benefits and which less, and illuminate the reasons why;
- provide information on the growth, decline and saturation of different sectors in which the clients are working, and
- inform institutional understanding of what products and services clients prefer, what barriers they are facing and what the clients value in the programs, (Cohen and Gaile, 1997).

Impact assessments document client change over time. Combined with client feedback on program services, an impact assessment can amplify the underlying meaning of performance criteria. With lower than hoped for repeat borrowing rates or higher than desired ratios of new to old clients, understanding client behavior and their changing needs interests many institutions. The findings can inform product development. A comparison of clients and non-clients can offer insights into who the programs and products are and are not reaching, and suggest strategies for how to attract new clients.

Researchers
The most rigorous impact assessments are conducted by researchers with support from donors looking for accountability in the use of their funds. In a field requiring complex methodologies and plagued by conceptual problems such as client self-selection bias, fungibility and attribution[2], researchers have made key methodological contributions. However, for many practitioners these types of studies often have limited applicability. With details about services accessed, length of program participation, levels of arrears and the volume or size of loans often ignored, the impact assessments can appear disconnected from MFI operations. Furthermore, from a practitioner's perspective, such studies are expensive, demand analytical methods which are difficult for them to replicate and rarely generate results in a timely manner.

A growing body of microfinance impact literature is beginning to reveal what microfinance can and cannot do. But we still have far to go, particularly when it comes to understanding the relationship of microfinance to poverty alleviation. The jury is still out on this issue. Hard data to support the case for the poverty alleviation benefits of microfinance are limited. Outside of Bangladesh there has been very little research on this issue. Rhyne (1998) recently noted that the field knows 'very little about the poverty levels of clients in various microfinance programs.' But perhaps this is not surprising since " few microfinance programs have received the rigorous statistical evaluations" necessary to prove this premise (Morduch, 1998)

## MOVING TOWARDS LOWER COST IMPACT ASSESSMENT IN MICROFINANCE.

While this field is still in search of robust lower cost approaches to impact assessment, there are a range of initiatives underway that are moving towards this end. At the center of debate is the trade-off between methodological rigor and reliability of the results. There is a growing consensus that three key parameters are important for overall effectiveness of lower cost impact assessments: *credibility, usefulness and cost effectiveness* (Sebstad, 1998). Through a series of virtual meetings conducted by the Consultative Group to Assist the Poorest (CGAP) Impact Assessment Methodologies Working Group, general agreement is emerging on many of these issues. The proposed parameters of such lower cost or middle range impact assessments include:

- a small set of key hypotheses grounded in a sold conceptual framework;
- well defined contextually meaningful variables;
- reliable measures that reflect the degree of precision needed;
- a comprehensive assessment of the program and local contextual factors;
- inclusion of clients in all stages of the impact assessment;
- a longitudinal design;

[2] For further discussion of these factors see Gaile and Foster, 1996.

- use of control groups;
- use of mixed quantitative and qualitative research methods;
- systematic analysis of data (Sebstad, 1998)

The highly participatory process that built consensus is as important as the conclusions reached by the Working Group. In 1996 the Working Group began with six donor members and two members of the CGAP Policy Advisory Group. The Group's initial agenda focused on methodological options for undertaking impact assessment. The decision was taken to debate the issues in a series of virtual meetings. A discussion paper was commissioned which reviewed the issues and drew on the voluntary submissions of case studies by Working Group members. Following distribution of the discussion paper to Working Group members, a two week virtual meeting, with a moderator, was held in April 1997. It involved 22 participants from 9 countries around the world. Out of this meeting came a general consensus that while there were many methodological options, what was needed were guidelines for credible and lower cost impact assessments.

A second virtual meeting, held in April 1998 followed the same sequence. The aim was to build consensus on guidelines for credible, useful, and lower cost impact assessments. By this stage the membership of the Working Group had grown from 6 to 11 and many of the donors also sponsored the participation of 20 researchers and practitioners whom they contracted either to undertake impact assessments and/or participate in the meeting. Seventeen countries were represented. The emerging view was the loosely defined guidelines indicated above.

The proposed next step was to test the viability of the guidelines in the field. We are at this point now. Several of the donors and practitioners are completing impact assessments undertaken in accordance with the proposed guidelines. The next virtual meeting will take place in October 1999. The product from this meeting will be a manual that will be developed based on the field tests and the conference debates. Meanwhile donor membership of the group has grown, the virtual meetings have become well known outside the Working Group and a number of practitioner organizations have asked to participate. In welcoming their input we have asked them to also submit papers using the guidelines as a framework. Stay tuned, as we anticipate an output for general circulation early in the year 2000.

Using this mechanism to build consensus on impact evaluation in microfinance has proven advantageous as an end in itself. However, other benefits deserve comment. The process has:

- engaged a global mix of people, policy makers, donors, researchers and practitioners who might not have otherwise attended such a meeting;
- attracted practitioners, staff, managers and evaluation specialists who might not have been able to devote the same amount of time if this has been the

theme of a conventional conference. This way they could contribute intermittently from their home base;

- created a forum which has permitted the participation of many of the younger players who might not have been otherwise selected to attend a meeting;
- allowed for participation of people actively engaged in field work who were able to provide very practical suggestions both on substance and methods;
- led to a strong debate on trade-offs in going down market, an issue that lies at the center of this topic;
- lowered the cost of the meeting for everyone by spreading the costs among all participants;
- imposed a limit on the length of email contributions to no more than two paragraphs. This not only constrained verbosity, but promoted a pointed debate and also strengthened the participation of non-English speakers.

## IMPACT STUDIES AS 'ADVANCED MARKET RESEARCH'

As the donors have steered one course, the practitioners are steering another. Parallel but not separate has been a push by numerous MFIs to undertake impact assessments. Their purpose reflects a mix of objectives – a reinforcement that they are achieving their mission, which in many cases is poverty focused, and the growing application of the findings to program management.

Data from across a range of MFIs indicate that the main market reached by many of these institutions are the poor that concentrate around the poverty line. MFIs seeking to broaden their client base, downwards to the extreme poor, upwards to include the vulnerable non-poor or simply grow with their clients, will have to look more closely at client behavior. Success will require delivering new products and services that respond to the differing needs of these various segments of the population. This calls for product innovation in not only the type of loan products but also the introduction of other services such as savings and insurance. The key will be flexibility to ensure that chunks of money can be accessed that are appropriate to the needs of each strata, delivered in a timely fashion, and with terms of repayment that correspond to the clients capacity to pay.

Understanding client behavior in greater detail is increasingly being recognized by many practitioners. Some MFIs – the Small Enterprise Foundation in South Africa, Freedom from Hunger in the US, GRET, a French NGO, as well as many of the large MFIs in Bangladesh- are developing the in-house capacity to better comprehend clients, how they manage money, and how financial services can be used to improve money management. They understand how the findings can inform an institution's strategic planning and improve its institutional performance. In other instances, the donors are responding to this need and providing the financial support for practitioners to experiment with different approaches. An important goal of USAID's AIMS (Assessing the Impact of Microenterprise Services) Project is the development of low cost impact assessment tools which are within the resource capacity of MFIs and generate credible and useful results. SEEP, a membership organizations of microenterprise and microfinance institutions, took charge of the development of a package of five tools, a mix of quantitative and qualitative instruments, which are intended to service a combination of program improvement and impact objectives (see Box 1) In the first stage the tools were pilot tested in Mali and Honduras. Based on this experience a manual, which will be reviewed in draft by numerous NGOs who have in the interim tested the tools, will be published in English, French and Spanish. The target publication date is the second quarter of 2000.

BOX 1: Aims Tools

1. Household survey;
2 Exit survey;
3 Loan/savings use tool;
4 Focus group discussions on client satisfaction;
5 Focus group discussions on empowerment

## IMPACT OF MICROFINANCE ON POVERTY ALLEVIATION

Microfinance remains a hot development topic. The impression left by many of the defenders of this faith is that here lies a magic bullet that can help raise the living standards of the poor and help them climb out of poverty. Clearly the real world is not so simple. There is general sense within the practitioner community that microfinance can make a positive difference to peoples lives, even when the margin of change appears small. However, as already noted, hard data to confirm the poverty alleviation benefits of microfinance are limited. Overselling the benefits of microfinance runs the risk of misunderstanding what realistically can be expected from microfinance and disillusionment when it fails to live up to overexpectations.

Yet, even where there is credible data the methodological complexities associated with client self selection and issues of fungibility have ensured an ongoing controversial discourse on this subject. This is perhaps exemplified by a recent study by Morduch (1998). Using a data set of clients and non-clients from three Bangladeshi institutions[3] which had been previously analysed by other researchers (Khandkar, 1998) he arrived at contradictory conclusions, arguing that microfinance had little effect on poverty alleviation but was important in reducing the vulnerability of the poor through consumption smoothing and movement of labor from casual work to self-employment.

### Framing the Issues

USAID's response to the request for a contribution to the World Development Report 2001 on the impact of microfinance on poverty reflects this young industry. Outside of Bangladesh, sound studies are still limited in number and to generalize from Bangladesh to the rest of world was deemed inappropriate. At the same time the microfinance literature on this topic has been largely focused on income poverty indicators and outcomes. There has been much less research on the dynamics of how clients used microfinance services to reduce vulnerability and improve their standards of living.

[3] Grameen Bank, Bangladesh Rural Advancement Committee (BRAC) and Bangladesh Rural Development Board's Rural Development Program

The central theme of the USAID-led contribution to the WDR 2001 is an examination of the experience with microfinance in reaching the poor and reducing vulnerability. This focus parallels the themes which are central to this WDR: listening to the voices of the poor and considering non-income dimensions of poverty such as the role of assets in helping the poor cope with risk and reducing their vulnerability to shocks. Tight time constraints also dictated the approach. While USAID designed and managed this activity, it was a highly collaborative team effort. A consortium of donors funded the activity[4]. multidisciplinary field teams in four countries worked interactively and virtually throughout the design, implementation, analysis and review process.

The Approach

The starting point for the study was selected non-income dimensions of poverty, specifically, those related to assets, vulnerability and risk. The elements were articulated in "Assessing the Impact of Microenterprise Interventions: A Framework for Analysis" (Sebstad et al,1995) and elaborated upon as a household resource management model based on Chen and Dunn's (1996) household economic portfolio model. Risk was defined as a chance of a loss. Reduced vulnerability was defined as the maintenance of a minimum economic threshold that enables individuals and households to cope with problems as they arise (Hulme and Mosley, 1996). The sources of risk were differentiated among structural factors, such as natural disasters or economic reform, crises, of which the recurrent ones are death and sickness within the family and loss of income by household members, and life-cycle factors, with marriage and education of family members ranking highest. The distinction was made between strategies people use to protect against risk ahead of time (ex ante) and the coping mechanisms used in the face of a shock (ex post)[5].

The central thesis is that the impact of financial services on reduced vulnerability may be described in terms of making 'chunks' of money available to clients that enable them to *protect against risks* by fulfilling needs and taking advantage of opportunities when they present themselves, and to *cope with an economic loss* resulting from unexpected crisis, shocks, and downward pressures (Rutherford, 1998). The major thrust of the study was to improve understanding of the relationship between assets and vulnerability. To this end, the core research focused on the role of assets in protecting against risk and coping with losses.

The study employed a broad definition of assets which include:

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[4] USAID, DFID and CGAP

[5] We use a broad definition of poverty which considers both income and non-income dimensions. Income poverty, relates specifically to household income and consumption levels. Vulnerability, while related to income poverty, more specifically is defined as the capacity of a household to deal with risk. This, in turn, is a function of a household's asset levels, its crisis coping mechanisms, and the number of income earning sources. Income poverty can be reduced at the household level by smoothing income and consumption, by increasing income, and by increasing consumption. Vulnerability can be reduced at the household level by strengthening crisis coping mechanisms, increasing income earning sources, building household assets and empowering women.

*financial assets*: cash, savings, loans and gifts, regular remittances or pensions, other financial instruments

*physical assets:* housing, buildings and land and improvements to these, other physical items which maintain or increase in value such as gold jewelry, or physical items that decrease in value including consumer durables such as household appliances, shoes, clothing, and vehicles.

*human assets:* skills and knowledge, ability to labor, good health, self esteem, bargaining power, autonomy, control over decisions

*social assets:* networks, membership of groups, relationships of trust, access to wider institutions of society, freedom from violence.

Underlying the research and framing the issues is the premise that microfinance has a key role to play in this nexus between assets and risk. The chunks of money provided by these financial services permit the accumulation of a broad array of physical, financial, human and social assets that allows households to withstand shocks. Over time the accumulation of assets both reflects and contributes to income stability and positive change within the household, enabling poor households who participate in microfinance programs to follow the slow, often jagged road out of poverty.

To address these issues, a core set of questions related to asset building, asset management, and control of assets were addressed in all of the field studies.

**Whom among the poor do micro finance programs reach?**

**What is the nature of the risks confronting these poor clients?**

**How do clients use assets to protect against risks and cope with loss?**

**What is the role of financial services in this process?**

In answering these four questions, this activity used qualitative research to explore two hypotheses:

*Hypothesis 1:* Financial services reduce the vulnerability of poor individuals and households by providing access to ‘chunks’ of money to protect against risk and cope with shocks.

*Hypothesis 2*: Social intermediation combined with financial services contributes to reduced vulnerability and increased empowerment for women clients (see Box 2).

BOX 2: Hypotheses

***Hypothesis 1***:

Financial services help to protect against risk by

providing chunks of money to build assets (selected financial, physical, and human assets, risk reducing technologies);
providing chunks of money to better manage cash flow and assets;
increasing the diversification of household assets;
offering a place to safely store savings;
increasing women clients' control over assets.

Financial services help poor clients cope with shocks:

providing savings or emergency loans to draw upon ;
building assets that can be pawned, mortgaged, or sold.

***Hypothesis 2***:

Social intermediation combines with financial services to

build women's human assets (skills and knowledge, self esteem, bargaining power, control over decisions)

increase women's social assets (social networks, membership of groups, relationships of trust, access to wider institutions of society).

This design is fairly simple but in a short time has generated a substantial body of information from four countries. Moreover, it falls within the cost limits of a middle range impact assessment. The data collection process involved dialogues with clients and practitioners to improve understanding of the role of financial services in reducing vulnerability and risk for poor clients and their households. The core set of questions relating to asset building, asset management, and control of assets were addressed in all of the field studies. At the same time, there was built-in flexibility that enabled the field experts to pursue other issues related to the impact of microfinance on reducing risk and vulnerability as relevant to the particular program or country context or to their research interests. Given the diverse range of people involved in this activity—practitioners, researchers and policy makers—this approach proved broad enough to allow them to work within the same framework and generate results which were compatible as well as complementary. The review of findings from the existing microfinance impact literature on the role of financial services in reducing vulnerability and risk through the lens of assets, provided quantitative and qualitative support for the exploratory field work and permitted a verification and elaboration of the results.

The field work was undertaken in Bangladesh, the Philippines, Bolivia and Uganda during January and February 1999. All were countries where a growing body of research on the impact of microfinance services either exists or is in progress. While each of the field activities addressed the common core set of issues they also explored specific aspects of the poverty alleviation process in varying degrees of detail:

- the 1998 floods in Bangladesh provided a context to look at how clients use financial services in coping with shocks;

- the role of savings and the significance of empowerment were particular to Uganda;

- in the Philippines the importance of social assets in mitigating against risk among CARD Bank clients was explored;

- the Bolivia study honed in the role of microfinance services in coping with the risk of financial loss.

Preliminary Findings

This paper is being written when the data analysis for the WDR activity is still in progress. Some brief comments on the findings are offered. The first question posed above was who are these programs reaching? In this industry the clients have been assumed to be the poor. Beyond that the client group of programs is ill defined and often viewed as homogenous.

Using a wealth ranking exercise to identify how the clients and practitioners interpret the poverty of their peers and their clients, the participants in the MFIs surveyed were differentiated among the:

- destitute - households in the bottom 0-10% of household below the poverty line;
- the extreme poor - household in the bottom 10-50% of households below the poverty line;
- moderately poor - households at the bottom of the top half of the poor; and
- vulnerable non-poor - households just above the poverty line.

While the above categories may suggest discrete categories based on income in reality they reflect a continuum along several dimensions of poverty of which income was only one.

The findings suggest that these microfinance services reach a wide range of poor people whether they use targeting or not[6]. In the four countries the majority of clients fall within

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[6] While some microfinance service providers specifically target the poor using a wide range of means test measurement systems, other organizations set loose eligibility criteria and assume that the small size of the loan will serve to self

the categories of vulnerable non-poor and moderate poor. The extremely poor are an important but not always major group of clients. None of the programs reach the destitute. These observations match those made elsewhere that while the majority of MFIs reach the poor, they are not necessarily the poorest of the poor. Rather the client groups often cluster around the poverty line or fall within the segment of the population that is within the top 50% below the poverty line

For the poor, the risks are many and unabating. Taking a loan is a risk in itself. Moreover, all groups are vulnerable. The loss of a source of household income through death or sickness is ever present and can rapidly return a new graduate into the middle class back into poverty. For many low income women, who are de facto (if not de jure) heads of households, their vulnerability may be compounded by a lack of control and ownership of assets. In Uganda many women noted the importance of using financial services to save for land and housing and to acquire utensils as a way to protect themselves should their husbands abandon them or take another wife.

The preliminary findings highlight a wide range of strategies for protecting against loss as well as responses when confronted by a shock. Three broad ex ante strategies were identified: increasing the income base, building a portfolio mix of short, medium and long term assets, and strengthening coping mechanisms. Human, physical, financial and social assets figured heavily in both the before and after risk management scenarios as did creative cash and resource management of the household economic portfolio. Once a loss is experienced adjustments are immediately made to household expenditures including the reduction and modification of consumption and an improvement in family budgeting.

MFI services are integral to this process. The investment of loan funds or earnings help clients reduce vulnerability through the accumulation of assets. To protect against loss clients may split the use of the loan among multiple uses, or ‘patch’ loans with other sources of finance. Loan management following the experience of a shock includes the rescheduling of loans and obtaining an emergency loan. Drawing down savings is a lower priority, defaulting on a loan is a last resort. A central concern of all clients was their determination to stay in the programs so that they could maintain their access to a line of credit. Financial services are highly valued and are perceived as necessary if one is to bounce back from a loss. A new loan is needed as a start up to get the client and her/his household back on their feet.

While the existing financial services offered by the MFIs surveyed are clearly useful they could be better. Many of the programs do not readily lend themselves to responding to unanticipated and anticipated shocks. A year long loan is neither timely nor flexible. At the same time for the very poor who have no assets and irregular incomes the downward pressures are continuous. The ever present demands on their scarce cash indicate the need for accessible savings and insurance as well as credit. The terms of the financial products and services offered should correspond to the poor’s priority for stabilizing their

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target the poor. The institutions covered by the study include those using poverty targeting and self targeting approaches.

income and allow them to build up assets which will help to protect their fall back positions.

## CONCLUSION

Impact assessment in the area of microfinance is a work in progress. Over the last few years there has been a movement towards developing lower cost, credible and useful approaches to impact assessment. The pressure for this has come from both the donors and the practitioners. Next the academics need to brought along –some are more resistant than others since this calls for methods which require compromise and deviation from conventional approaches.

In evolving lower cost impact assessment methods, the experience of the WDR background study suggests the value of building on previous impact work and starting with a simple conceptual framework, a small set of hypotheses, and well defined contextually meaningful variables. This process is as important for qualitative as for quantitative research. This study also shows the benefits of cross country studies. Multi-country studies that explore similar hypothesis in different places can generate findings that deepen understanding of impact processes and dynamics across programs and contexts. While the findings are not comparable in a strict sense, they do provide a perspective on similarities and differences which can feed into both the justifying and improving goals of impact assessments. The WDR study also suggests the invaluable role of methods that emphasize client perspectives on impact and the proactive involvement of clients in the assessment process. At the end of the day, clients determine the success of programs and programs can only be successful to the extent that they provide products and services that can help clients achieve their own economic goals.

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