TECHNICAL NOTE 3

CAN MFIS ACHIEVE THE DOUBLE BOTTOM LINE?

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The purpose of this technical note is to analyse whether microfinance programmes can achieve the 'double bottom line' - maintain profitable operations while also serving a high number of poor clients. Key factors which have enabled at least some of the South Asian MFIs to achieve this include efficiency and portfolio quality, combined with operations in poorer areas. The note also shows that only a weak correlation exists between household poverty and commonly used proxy indicators in the microfinance literature.

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M-CRIL is an international rural finance consultancy providing specialised services like credit rating of MFIs, monitoring, evaluation and sectoral research services for the microfinance industry. **M-CRIL is the world leader in MFI ratings and assessments.**

The issue of the double bottom line

The question has been long debated – whether MFIs face a trade-off between providing services to the poor and achieving financial sustainability. As MFIs commercialise, the debate becomes more focussed around concerns of mission drift.[1] In other words, as MFIs pursue financial sustainability, does this mean that they necessarily shift up-market – reducing their costs by providing larger products (loans/savings deposits) in more accessible areas, instead of the smaller, more flexible, products needed by poorer, maybe less accessible, clients? Are financially sustainable MFIs therefore less likely to target and serve poor clients?

Responses to this question are limited by the data available for outreach. Financial sustainability is clearly defined and the data to measure it is available and is maintained over time. On the other side of the question, however, definitions and measures of poverty are not so clear. Analysis has relied on proxy indicators (such as loan size) or rested on the assumption that all those outside the formal financial sector are the target group for microfinance.

In this paper we draw on data for 27 MFIs in Asia (India, Bangladesh and Myanmar) for which we have field level poverty assessment data for a sample of recent clients[2] and financial data for the same period as the field research. We use the data to

- compare MFI financial performance with outreach to poor clients
- analyse what factors enable some MFIs to have 'deeper' outreach (larger number of poor clients), and a few to combine deeper outreach with financial sustainability, and
- compare results from client poverty assessment at field-level with other proxy indicators.

Field level data was collected as part of baseline studies for impact assessment undertaken by M-CRIL's parent organisation, EDA Rural Systems, during 2002-2004. The same methodology was used for all the

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[1] Elisabeth Rhyne (2005) 'Maintaining the bottom-line in investor owned Microfinance', *The Microbanking Bulletin,* No. 11, available at www.mixmbb.org

[2] Recent clients – those who have been with the programme for less than two years – are selected to reflect economic level around the time of joining a microfinance programme.

studies. The poverty level of clients was assessed at the household level using a combination of qualitative (PRA wealth ranking) and quantitative (index based ranking, income estimate) methods. The quantitative approach enables benchmarking against a poverty line. 'Poor' households were defined as all those living below the local poverty line in India[3], and the international $1-a-day at PPP line in Bangladesh and Myanmar. Poverty outreach data is for 'recent clients', with an average sample of 90 recent clients at each MFI. Data for financial sustainability (FSS)[4] is drawn from the M-CRIL data base.

Financial and poverty outreach data for the 27 MFIs is summarised in **Table 1**. The sample covers three models of microfinance – Grameen, Self Help Group (SHG) and Individual Banking. Eighteen are mainly rural programmes (including four with some urban operations), nine are mainly urban programmes. All have been operational for at least 4 years with an average age of 8-9 years.

Table 1
Data for 27 MFIs

Model	N	Country			Average/MFI					
		India	Bangla -desh	Myan -mar	Age (yrs)	Number of Borrowers	Outstanding Portfolio [a] (million $)	FSS [a]	% poor of recent clients [b]	Est. number of poor – total programme [c]
Grameen	13	6	6	1	8.6	21,700	1.36	83%	31%	5,830
SHG	9	9			9.6	8,000	0.58	57%	42%	3,130
Individual Banking	5	4	1		8.1	11,600	1.78	103%	18%	860
Overall	**27**	**19**	**7**	**1**	**8.4**	**13,800**	**1.24**	**81%**	**30%**	**3,270**

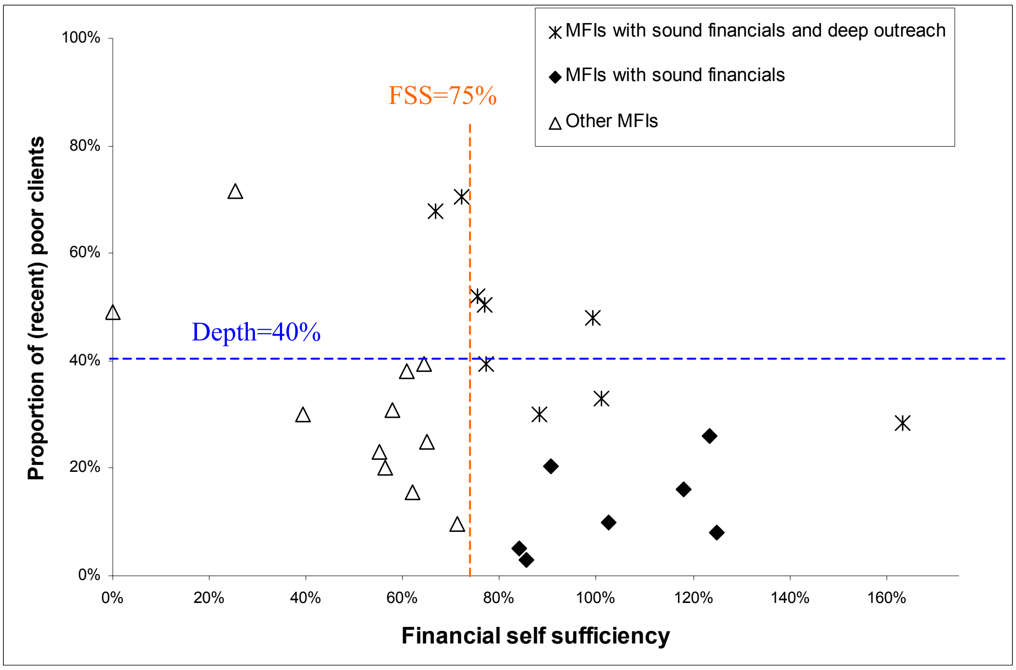
[a] M-CRIL Database (2004) [b] Sample survey [c] Extrapolating from the sample survey to the total programme

Weak inverse correlation between financial performance (FSS) and poverty outreach

Figure 1 plots financial performance and poverty outreach data. Poverty outreach is shown in percentage terms (as proportion of recent clients). The quadrants are shown with FSS at 75% or 'near financial sustainability' and poverty outreach at 40%. Around one-third of the MFIs have >40% poverty outreach, with two MFIs having 70% poverty outreach. A half have FSS >75%, and mostly fall below the poverty outreach line, although some reach substantial numbers of the poor (>5,000) as shown in the Figure. Data for 23 MFIs, whose FSS lies in the range 50%-125%, has been taken for trend analysis.[5] The data, excluding the outliers, does not show a significant correlation between FSS and depth of outreach.

[3] The local poverty line is defined by the Planning Commission of the Government of India and is roughly equivalent to the international 'dollar-a-day at PPP' poverty line.
[4] FSS is calculated as the ratio of total income to total adjusted expenses for the year. Adjustments have been made for subsidised cost of funds (w.r.t. market interest rate), equity (w.r.t. inflation) and in-kind donations.
[5] Four MFIs in the sample are treated as outliers: 3 MFIs had FSS<40% and 1 MFI had FSS>125%. These are interesting cases in themselves, but would bias the trend analysis. The M-CRIL average FSS of 'typical' MFIs is 70% and the MBB reported average FSS for all MFIs is 108%. This validates the choice of cut-offs for outliers in our dataset.

Figure 1
Comparing depth of outreach and financial sustainability



'deep outreach' = 40% poor or estimated total number of poor clients >5,000

Based on **Figure 1**, the total sample of 27 MFIs can be classified as shown in **Table 2**.

Table 2
Classification of MFIs based on Figure 1

Classification	Definition	No. in sample
Strong financials and deep outreach	FSS>75% and proportion of recent clients who are poor >40% (and/or number of poor >5,000)	9
Strong financials only	FSS >75%	7
Other MFIs	All other MFIs	11

Extending financial services to the poor does not appear to affect FSS adversely, as there are at least nine out of 27 MFIs which are approaching financial sustainability and have deep outreach. The depth of outreach of the organisations ranges from 30-70%, combined with reasonably good FSS (70-100%, up to 163% in one organisation). Six of these MFIs are Grameen model MFIs (four from India and one each from Bangladesh and Myanmar). The remaining three are SHG model MFIs from India.

Combining depth of outreach with sound financial performance

What are some of the factors that support an effective combination of poverty outreach and sound financial performance? Some of the MFIs in the sample have client poverty targeting criteria, but we did not find these consistently implemented at the field level. Rather, we found that the economic profile of an MFI's clientele tends to reflect the local community profile (for example in a sample village, where one-third of the households are poor, around 30% of the MFI's clients in that village are poor). MFIs with a high proportion of poor clients are located in poorer regions or, though located in a more developed region (such as the south of India), their focus is on poorer rural areas or urban slums. The two MFIs with the deepest outreach are located in two of the poorest regions of north/north-east India (Eastern Uttar Pradesh and Assam).

Alternately, large-scale MFIs (>50,000 borrowers in our sample) serve substantial numbers of poor clients (>5,000) by virtue of their size of operations. These MFIs may not have specific targeting criteria but succeed in including poor as well as non-poor amongst their clients. In our sample, three such organisations (two Grameen model, one SHG model) have 9-15,000 poor clients.

Table 3 summarises key operational parameters for the three categories of MFIs in our sample. The data clearly establishes that MFIs which combine more efficient operations (high staff productivity ratio and, consequently, lower operating expense ratio with a larger clientele) with excellent portfolio quality are able to maintain strong financials as well as deepen their outreach. Such MFIs also charge higher interest rates to their clients (with average APR of 28% compared to an average APR of 22% for other MFIs), though the efficiency improvement of 10% is greater than the 6% difference in APR.

For two organisations (both SHG model MFIs from India), their low OER is also supported by their building on an association with NGO partners. Through such an association, the NGOs bear the main cost of SHG group promotion and ongoing support, thereby reducing the operational costs of the MFI.

Table 3
Comparing key operational parameters

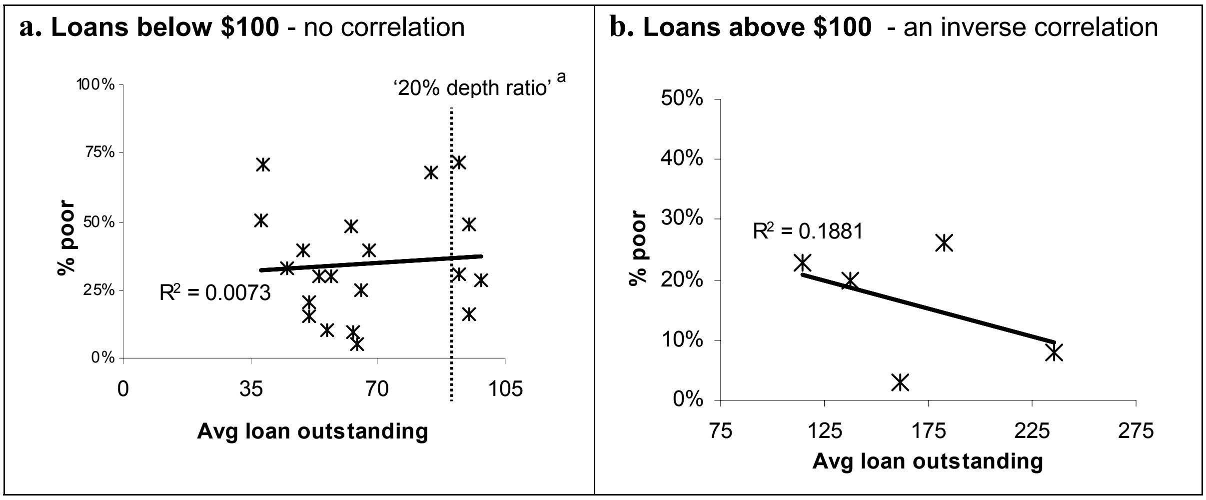
Parameters	Overall	MFIs with strong financials and deep outreach	MFIs with strong financials	Other MFIs
No. of MFIs	27	9	7	11
Number of borrowers	14,825	26,350	15,285	5,104
Staff productivity ratio	178	308	132	101
Operating expense ratio (OER)	20.2%	16.1%	17.0%	26.1%
Portfolio at risk>60 days (PAR)	10.0%	3.9%	8.9%	15.8%
Annual Percentage Rate (APR)	25.9%	27.9%	29.9%	21.8%

Weak proxy indicators of client poverty

In the absence of field level data about clients and their households, average outstanding loan size continues to be used generally as a proxy for client poverty level by most MFIs and in microfinance research.[6] Our data enables a comparison between average loan size and client poverty level determined through a field-level household survey. The comparison shows that for loans below $100 (and most MFIs in the region offer such loans)[7] there is no correlation (**Figure 2a**). Although, for loans above $100 there is an inverse correlation, as expected (**Figure 2b**). We interpret this to mean that the non-poor do want larger loans, but are not deterred from accessing smaller loans, if these are available.

Dunford[8] and others have suggested the use of 'first loan size' as a proxy for client poverty level. This would appear to be a more logical approach. But, in practice we find that very small first loans may be used by an MFI to 'test' the client (and, by the client to 'test' the MFI) and does not necessarily ensure poverty targeting. This is confirmed in our data which does not show a correlation between first loan sizes and client poverty.

Figure 2
<u>Client poverty level and average loan outstanding</u>



[a] The dotted line shows roughly the *20% depth ratio*. The 'depth ratio' refers to the average loan balance as a percentage of GNP per capita. A depth ratio of <20% is taken to represent outreach to 'poor or low-end clientele'. For India, the GNP in 2002 was $460, for Bangladesh the GNP in 2003 was $400.

In discussions of banking and microfinance, those outside the formal banking sector are often assumed to be poor. The converse – that those with formal accounts are usually better off – is more than likely.[9] However, the assumption that all those without formal accounts are poor cannot be the case. Given the very limited outreach of the banking sector in most countries of Asia, Africa and Latin America, those outside the sector are likely to be from a range of economic levels. Thus, in our sample, the majority of microfinance clients do not have a bank loan or savings account (which is why they join a microfinance programme), and the data shows that under one third of them can strictly be defined as poor (**Figure 3**).

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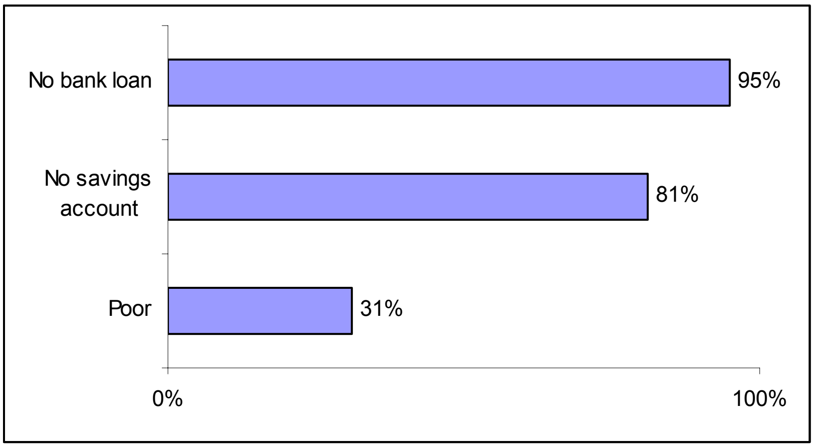
[6] Blaine Stephens (2005) 'Sustainability in sight: An analysis of MFIs that become sustainable', *The Microbanking Bulletin No. 10*. Francisco Olivares-Polanco (2004) 'Commercializing microfinance and deepening outreach: evidence from Latin America', available at www.microfinancegateway.org
[7] In the M-CRIL database of 110 MFIs in S Asia, the average loan size is $70.
[8] Christopher Dunford (2002), 'What's wrong with loan size?', available at www.ffhtechnical.org
[9] This is clear from a number of studies in India, including the All India Debt and Investment Survey (1991), NCAER/World Bank Survey of Rural Financial Access (2004)

Figure 3
Microfinance clients without access to formal financial services
[n = 1,800]



Conclusions

1 Our data does not support a trade-off between sustainability and poverty outreach. A number of MFIs are close to financial sustainability without achieving significant levels of poverty outreach. But at least an equal number have achieved – or are close to achieving – both, especially if we include the numbers of poor likely to be served by larger scale programmes.

2 Two different MFI strategies appear to enhance depth of outreach: the location of operations in poorer areas and scaling up so as to be able to include a substantial number of poor clients within a large overall programme; (criteria for household targeting does not appear to be implemented consistently enough to make a difference).

3 Small loan sizes and lower interest rates do not ensure poverty outreach; and, since the majority of households in S Asia and other developing economies do not have access to formal financial services, this lack of access by itself is not a strong indicator of poverty.

4 MFIs that are balancing poverty outreach with sound financial performance run efficient operations with excellent portfolio quality.

We have used available data to provide a 'snapshot' of different MFIs, based on a sample at a particular point in time. This method is useful, and relatively quick, but would be improved if MFIs themselves maintain poverty-related information about their clients, enabling a comprehensive client profile. This need not be limited to when clients join the microfinance programme, but would provide a basis for monitoring changes over time, as well as tracking adherence to mission, or drift. This would be an important component of social performance management by an MFI, to balance the financial and social goals of microfinance.[10]

[10] See the Imp-Act programme: Improving the impact of microfinance on poverty www.imp-act.org