Helping or hurting:

What role for microfinance in the fight against poverty?

The All-Party Parliamentary Group on Microfinance

Summary report on the All-Party Parliamentary Group on Microfinance's inquiry into the UK's role in supporting the microfinance sector worldwide

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Summary Report

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The document you are reading is a summary report covering the main findings and recommendations from the APPG on Microfinance's 2010-2011 inquiry into the impact of microfinance on poverty and how the UK Government should support the sector. A full report has also been produced, and is available in electronic form on the APPG's website: www.appg-microfinance.org/inquiry.php A limited number of printed copies of the full report are also available on request from the APPG Coordinator Julia Modern: julia.modern@results.org.uk

This report was researched and written by the APPG secretariat (Lottie Heales, Louise Holly and Julia Modern) in close consultation with the APPG Chair and other Officers. RESULTS UK (a charity) acts as the APPG secretariat.

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Cover image kindly provided by CARE International.

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Foreword from the APPG officers

The All-Party Parliamentary Group on Microfinance, established by Annette Brooke MP in 2002, is a leading UK forum for Parliamentarians, practitioners, academics and non-governmental organisations interested in microfinance. What attracted the members of the APPG to the issue of microfinance in the first place was a belief that poor people should have the opportunity and support to tackle their own poverty, no matter where in the world they live. Part of what is needed in order to do this is access to fair financial services. We therefore come to this debate with the desire to see the best social outcomes possible for the world's poor.

In these times of change and reflection for the microfinance community we feel that we have a strong role to play in providing a forum for debate and challenging some of the orthodoxies around microfinance. The purpose of the inquiry on which this summary report is based was to use the evidence submitted to us by academics, practitioners and funders in order to build up a picture of what microfinance is now and to provide recommendations for how the sector should progress from here in order to live up to its promise of providing a substantial boost to poverty reduction. We hope that this will provide both a major contribution to the debate, and also a stimulus for further discussion.

Our inquiry did not conclude that any one form of microfinance is illegitimate. There have clearly been problems in the sector, most obviously in commercial microfinance although the problems we discuss in this report do occur in the not-for-profit sector as well. Professor Muhammad Yunus has recently argued that microfinance has a 'branding problem', which makes it appear that profit-maximising commercial organisations are providing the same services as socially-focused microfinance, hence attracting a 'socially responsible' reputation that they may not deserve. In this report we have tried to offer practical suggestions for how to take a more nuanced approach to the sector which will allow investors, donors and other stakeholders to make better decisions on how to engage with microfinance. We hope and believe that this will help to drive an increased focus on the social role of microfinance, with the ultimate aim of strengthening the ability of microfinance to alleviate poverty.

The officers of the APPG would like to thank all those who submitted written and oral evidence to this inquiry, the panellists who gave evidence at our oral evidence hearings held in March and April 2011, and the secretariat of the APPG for facilitating this process and creating the report.

Annette Brooke MP, Chair

Stephen Lloyd MP, Secretary

Robert Syms MP, Treasurer

Summary Report

"58% of the poor who borrowed from Grameen are now out of poverty. There are over 100 million people now involved with microcredit schemes. At the rate we're heading, we'll halve total poverty by 2015. We'll create a poverty museum in 2030." – Professor Muhammad Yunus, speaking to Time Magazine in 2006

"The microfinance movement has been in operation now for some 30 years and in that time it has failed to provide robust evidence that it is meaningfully associated with sustainable poverty reduction and 'bottom-up' economic and social development…But even worse, many economists and development specialists are now of the firm opinion that MF actually UNDERMINES the process of sustainable poverty reduction and 'bottom-up' economic and social development." Dr Milford Bateman, written response to this inquiry, 2011

SKS Microfinance Client, photo by Kalyan3

These two quotes are illustrative of two extremes in the debate over the impact of microfinance on poverty. Currently the microfinance sector is undergoing a massive period of upheaval. After 30 years of growth, the sector has diversified to include a wide breadth of different interventions, products and business models. We believe this diversification is probably a good thing, ensuring that there are a variety of different models available to clients – particularly where it has resulted in access to a variety of financial services, including savings and insurance as well as the traditional credit. However, there are clearly also big problems: while microfinance models have adapted and grown the environment in which they operate has been left relatively unchanged and regulatory frameworks have been slow to develop. Out of this 'free' environment where investment is in many cases abundant and regulation is sparse there have emerged concerning stories of exploitation as well as suggestions of significant progress out of poverty.

The Microcredit Summit Campaign Report is produced every year and is traditionally a place for celebration of the rapid growth of the industry. In 2011, it took a step back and examined the divisions that have come to light, highlighting these through the story of two microcredit clients.

Rita in Ghana received an $80 loan, along with technical education and membership of a solidarity group, which has enabled her to diversify her income, save, pay school fees and get her family through the traditional "hungry season" before the crops ripen. Rita has big dreams for the future: "The biggest thing for me was starting to save. I had never saved before. Now I have savings to tap when it's time for the school fees and other needs, including more food. My family is better now. We eat better. I want to save more, so I can use my own money for the farm instead of taking out loans. I want to meet people who earn more money, so I can learn from them."

Zaheera from Andhra Pradesh in India, on the other hand, was caught in a tragedy unfolding across the state. She died in an apparent suicide on September 13th, 2010. At the time of her death, she had loans outstanding from eight different microfinance institutions totalling Rs. 160,000 (US$3,500).[1] She had no regular income, just odd jobs in town paying about Rs. 600 ($13) a week. She used most of the loan money for her daughter's wedding. Zaheera's husband explained "This is what drove my wife to suicide…she did not have the courage to face the group members, leaders and loan staff without making payments and there was nowhere from which we could repay all the money".

It is our thesis that the approach to microfinance taken by donors, practitioners and even many critics, has so far been inadequate. In order to ensure that no microfinance client finds themselves in the position that Zaheera did, and that ever larger number of clients are able to use financial tools to help them move out of poverty like Rita, it is absolutely essential that we recognise two facts: firstly, that credit services can cause harm as well as good because they induce debt; and secondly that the sector is now so diverse that we have to assess individual microfinance interventions on their own merits and relate to them in appropriate ways rather than as a universally positive social force. We must cut through the hype and take a reasoned approach to how the UK government and other stakeholders should support the sector. For not-for-profit, socially focused microfinance this may mean continuing subsidies, along with encouraging increased focus on the evaluation of social outcomes, but for commercial microfinance it is more likely to involve appropriate, rigorous, but not overly onerous, regulation.

The strongest message we want to send with this report is that in many (though not all) regions the sector is currently unbalanced. While access to loans has expanded massively, other financial services have lagged. Where the only product available is a loan, customers will take a loan even if it is not the most appropriate solution to their financial needs. Poor people need access to savings, perhaps even more than access to loans, as well as insurance, safe remittances and other services. Until we extend comprehensive financial services to all we cannot truly claim to be 'democratising financial services', let alone contributing fully to the fight against poverty. DFID and other donors must play a central part in refocusing the industry. As Mark Napier, the incoming Director of Investment Innovation at CDC stated during an oral evidence session for this inquiry, donors should act as the 'conscience of the market'.

[1] It is likely that Zaheera, like many women in Andhra Pradesh, also had outstanding loans from informal sources that increased the pressure on her repayments, however we cannot know for sure.

Recommendations

This report makes 9 key recommendations. More detail on each of these recommendations is included in the text of the main report, an electronic copy of which is available on the APPG website.

1. More investment is needed in the research base to develop evidence about what microfinance interventions work the best to reduce poverty. Donors and investors have a big role to play here because most academically rigorous studies can be expensive, take many years, and many MFIs may need support to engage in rigorous data-gathering.
2. The approach to commercial microcredit needs to change dramatically. We must recognise the limitations of this intervention and the abuses that have in some cases been committed in the name of microfinance. More effective and appropriate regulation (not necessarily simply more regulation) and oversight of commercial MFIs is needed, including the establishment of credit bureaux to help reduce cases of over-indebtedness. Donors should not support commercial MFIs with loan-fund capital, but could play a critical role in offering financial and technical support to partner countries in order to develop better regulatory systems and institutions for commercial and not-for-profit MFIs alike.
3. Investors must recognise that investing in microfinance does not always automatically mean the investment is socially responsible. Where they wish to invest in a socially responsible manner they should ensure that sufficient information and research is produced by the MFI or fund in order to judge the social impact of the investment. We recommend that CDC in particular takes this on board and develops an investment code for commercial microfinance.
4. Socially-focused microfinance which genuinely aims to tackle poverty and improve the quality of life of clients should be widely promoted, and in some cases it should be recognised that programmes may not need to be financially sustainable without addition support from donors or from cross-subsidisation. The UK and other donors should be willing to support 'non-sustainable' programmes – directly or indirectly – where they offer a broad range of services to the poorest segment of the population and can demonstrate an impact on reducing poverty and vulnerability. In addition, the UK should work with CGAP and other knowledge leaders in the sector to develop ways that MFIs can be incentivised to offer more in-depth services including savings and 'graduation programmes'.
5. All MFIs that are supported by donors – directly or indirectly – should be pushed to implement independently-verified social performance monitoring (SPM) systems in order to clearly demonstrate their impact on poverty and vulnerability, which should include a systematic assessment of gender impacts. This can be achieved for example through offering capacity-building support, funds for product innovation conditioned on including SPM, and/or rewards for MFIs that engage with academics for the purposes of research. Innovation is needed on how best to encourage MFIs (particularly commercial MFIs) to embrace SPM. These activities should form a central part of DFID and the World Bank's MICFAC initiative.

6. Product diversification must be increased. In particular measures must be taken to ensure that clients are able to access more than just a single one-size-fits-all credit product. Savings are particularly important, and donors including DFID should support regulatory bodies to develop ways in which MFIs can be encouraged to either become appropriately regulated deposit-taking organisations themselves, or to set up partnerships with other organisations to facilitate deposit-taking.

Medhin Reda, 45, with her daughter Tekleweini, 7, tending to their crops in Adi Ha, Ethiopia. Reda is a client of Oxfam's HARITA micro-crop insurance pilot, photo by the One Campaign

7. There are exciting areas of innovation across the microfinance sector, including mobile banking which significantly reduces costs for clients, making products cheaper; and microinsurance, which can provide a vital lifeline for poor people when disaster strikes. Investment is urgently needed to develop these innovations. Donors have played a major role already (for example DFID's investment in the M-PESA mobile banking system) and should continue to seek out new areas in which to invest. A particularly promising area is micro crop insurance, an exciting development that has promise in also addressing the effects of climate change, but requires infrastructure improvements such as effective weather data systems in order to become widely available.
8. It was repeatedly stressed in evidence to this inquiry that microfinance does not and cannot operate in a vacuum. It will never eliminate poverty on its own, although it can make a contribution as part of a broader strategy. Enthusiasm for microfinance should not 'crowd out' investment in other financial sectors, particularly support for small and medium-sized enterprises. In evidence to this inquiry DFID representatives have indicated that they plan to fund microfinance as part of a larger financial sector strategy. The APPG supports this. It is the recommendation of this inquiry that SME financing be included in this strategy and that more focus be placed on linking micro, small and medium producers with markets for their products and services.
9. DFID have also stated that they plan to focus more of their microfinance portfolio in fragile states. We welcome this focus as we believe that donor assistance should target the poorest and most marginalised people wherever they live. While there are examples of successful microfinance in fragile states, there is a paucity of knowledge on the best practices in these contexts. In addition, 'Fragile states' is a term that covers a huge variety of situations, sometimes including issues such as mobile populations and conflict which raise particular challenges for microfinance. We therefore recommend that DFID approach microfinance in fragile states cautiously, recognising that it may not always be the best intervention for the situation, and that they either conduct a consultation or support another body to undertake a consultation to gather disparate knowledge from those who are operating in similar environments across the microfinance sector.

Appendix: Evidence provided to this inquiry

This inquiry solicited both written and oral evidence from a wide range of stakeholders in the microfinance sector. Below are a list of written contributions and a list of the oral evidence sessions held in the House of Lords in March and April 2011.

Written Submissions:

Milford Bateman, ODI
Nigel Biggar, Grameen Foundation
Ian Boyd-Livingston
Maren Duvendack, School of International Development, University of East Anglia
Marcus Fedder, Agora Microfinance
Deborah Foy, Opportunity International
Nathanael Goldberg, Innovations for Poverty Action
Hand in Hand International
Malcolm Harper, Emeritus Professor Cranfield School of Management
Karishma Huda, BRAC
Assadul Islam, Monash University
Artiful Islam, Muslim Aid
K.G. Karmakar, NABARD
Geoffrey Kebbell, Maxwell Stamp
Michaela Kelly, Plan International
Kevin Kennedy, Clearcape Consultancy
Kevin Kilty, Young Ambassadors for Opportunity
Richard Leftley, MicroEnsure
Paul Mosley, University of Sheffield
Ben Ovio, ENDIP
Peter Ryan, Microloan Foundation
Carolina Sanchez, Coffey International Development
Tom Sanderson, Five Talents
Anton Simanowitz, Imp-Act Consortium, Institute of Development Studies
Graham Wrigley

Oral Evidence Sessions:

23rd March 2011: Academic Evidence Session

Panellists:

Dr Kate Maclean	Kings College London
Professor Thankom Arun	University of Central Lancashire and University of Manchester
Professor Paul Mosley	University of Sheffield

29th March 2011: Implementers and DFID Evidence Session

Panellists:

Maude Massu	CARE International
Rosalind Copisarow	Founder of Constellation Communities and Fundusz Mikro[2]
Roger Witcomb	Opportunity International
Claire Innes	Department for International Developemt

4th April 2011: Funders Session

Panellists:

Chris Bold	CGAP
Sukhwinder Arora	Oxford Policy Management
Marcus Fedder	Agora Microfinance

[2] On 1 July 2011 Rosalind Copisarow will take up the role of Managing Directorship at Oikocredit

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