Response to Microfinance APPG Inquiry call for evidence

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Questions:

a) Of all the various products and interventions that fall under the broad heading of 'microfinance', can you be specific about which of these you will focus on in regard of the remaining questions and provide a brief definition of the same?

Microfinance in its broadest sense, as the umbrella term for pro-poor financial products and associated services. Including but not limited to savings, insurance, credit, remittances, business training. I use the World Bank definition of middle-income poor as the upper limit, so "poor" refers to people living on $2 a day or less.

b) How important do you think microfinance is for achieving the Millennium Development Goals and eradicating extreme poverty in the developing world?

Very important. Consider the 8 MDGs and then consider how many of them could be achieved more rapidly by the application of mission-driven microfinance. At its best, microfinance enables people to do three things: smooth consumption to achieve a sustainable lifestyle, build a lump sum to prepare for the future and also reduce vulnerability to external shocks (bereavement, natural disaster etc.). These three outcomes affect not only poverty but health, education, empowerment and environment. Other interventions are equally important in targeting specific MDGs, but microfinance provides a foundation to achieving them all.

However, we must be realistic. The current debate on the efficacy (or not) of microfinance stems in part from the mistaken belief in some quarters that microfinance is a magic bullet which will eradicate poverty. Microfinance is a tool which *can* be used to effectively *reduce* poverty. It's efficacy is neither automatic nor absolute. Professor Muhammad Yunus once said that he foresaw a time when there would be a museum of poverty, where people would come to see what life was like. The unfortunate headline, that microfinance will 'consign poverty to the museum', continues to be unhelpful in setting expectations and realising outcomes.

c) Should the reduction of poverty be the primary goal of all microfinance programmes?

Instinctively, yes. The definition of microfinance is proving fluid though and increasingly the talk is of "access to finance" and "financial inclusion". As if just making financial products and services available to poor people will lead to a reduction in poverty. We need to look again at what "reduction of poverty" really means. Is it having three goats instead of two? Is it being able to start a business? Or send a child to school? Identifying what is possible and achievable is critical in making microfinance sustainable. CGAP now bills itself as "advancing financial access for the world's poor". The danger is that access becomes the end rather than the means.

d) How can we measure whether microfinance reduces poverty?

I think we should ask the people who are its customers. Not just once, but at intervals over a period of time. Perception is very important, not just the raw data that can prove causality. If a farmer believes that being a client of a microfinance institution has helped him improve his quality of life, can we say that microfinance has reduced his level of poverty? An academic study, a randomised controlled trial, might not find it objectively so but people make decisions and take actions based on belief and experience, not academic research. Value is subjective; things that matter or have meaning differ in the level of significance from one person to the next.

A lot of effort goes towards examining the internal structures and mechanisms of MFIs, based on the idea that getting this right is a proxy for success in the field. Is it though? We make assumptions at our peril. Many studies rely on data that is fundamentally flawed because too much effort is placed upon analysis and reporting, not enough on design and collection. Effective measurement of whether microfinance reduces poverty is as high-touch as the provision of microfinance itself. We need to place as much emphasis on the *how* of impact assessment studies as the *what*. One possibility which I am currently investigating is the use of the oral testimony methodology; allowing microfinance clients to tell their story in narrative form, recording the meaning and significance of microfinance to people whom it should be supporting. Systematising the capture of the *transformational* aspect of successful microfinance could lead to better risk management, greater and more targeted funding and a clearer understanding of what microfinance can do. The challenge is to go beyond anecdote, as microfinance has for too long depended upon the story of 'the woman who bought a cow...".

e) What factors make microfinance successful in alleviating poverty?

Product design - products that address the specific problems and needs of poor people, as opposed to standardised loans, savings etc. that are just made available via increased outreach.

Client profiling - fulfilling the requirements of "know your customer" beyond the level demanded by regulators. Understanding the lives of those you serve and therefore the value you can add through the provision of microfinance.

Longitudinal M&E - monitoring & evaluation that does more than just take occasional snapshots but seeks instead to build a rich, deep picture of life and lives over a period of time. Think "Portfolios of the Poor" rather than RCT or PPI. Also focusing less on internal operations and proxies but connecting directly with clients. Not via questionnaires delivered by foreign field workers but by engaging in real dialogue with local agents; making clients partners rather than just consumers. Microfinance should seek to empower and part of empowerment is making people feel they are sharing the journey.

f) Is microfinance still valuable even if it doesn't reduce poverty directly (or if causality can't be proved)?

Proving causality is one of the most difficult problems we face. Enormous amounts of time, money and resources have been dedicated to trying to find out. Yet we still cannot prove it. Should we agonise too much about this though? I think we should focus more on the experience of those people who microfinance aims to serve, less on the structure and operations of microfinance institutions themselves.

We do know that microfinance can reduce poverty directly, for some people. Does it actually enable people to move out of poverty completely, permanently? That is a more difficult, but necessary, question. One way of measuring it might be to find out how many people make the transition from being the client of a microfinance institution to a mainstream bank. Partnerships between MFIs and banks could help ensure the sustainability of these transitions and cement the processes that enable people to move out of poverty with less risk of falling back in.

If microfinance did not reduce poverty directly, would it still be valuable? Given my view that microfinance must have the aim of reducing poverty; if it does not achieve its aim, is it still valuable? Time is the intangible factor: how long should we observe someone who is a recipient of microfinance before deciding that they are, or are not, moving out of poverty? The journey is not a steady road, there are bumps along the way.

g) Should we be concerned about the financial sustainability of microfinance models? Is achieving financial sustainability compatible with the social goal of alleviating poverty?

Yes we should be concerned. If microfinance is "a hand up, not a hand out", promoting independence, responsibility and sustainability, then providers of microfinance must in themselves be independent, responsible and sustainable. Microfinance institutions that depend upon external funding or assistance will not achieve their full potential, they will always have attenuated performance. Just as in the mainstream financial services arena. Financial sustainability is absolutely compatible with social goals. Indeed, if a socially-motivated MFI *cannot* be financially sustainable there is a much greater risk of mission drift as financial pressures begin to bite, if sources of funding fluctuate or fashions change.

h) Which groups should or should not be targeted by microfinance programmes and why? (For example: the economically active poor, the poorest, etc).

If my definition, the World Bank definition, given at the beginning holds true then it is the population living on $2 a day or less who should be targeted. This seems to me the best way to categorise the potential market; other terms such as "working poor" or "economically active poor", "bottom of the pyramid" and so on are open to broad interpretation. Those living on $2 or less are the most vulnerable, most insecure and also those for whom microfinance can fulfil the most urgent need. To revisit the definition of "microfinance programme"; we should remember that many of those deserving of help are so poor that a loan, savings account or insurance product are incomprehensible. Education, training and other forms of help such as asset transfer are more vital and can still be counted under the (my) definition of microfinance. The BRAC graduation programme and the stepped programme implemented by Fonkoze in Haiti both aim to help the poorest people up on to the ladder where formal financial services is effective. Even serving the poorest of the poor falls within the remit of microfinance, as it should.

If financial access is the goal, as espoused in CGAP's tagline, then it is everyone who is excluded from the formal sector. Too broad, in my opinion. We better serve those living on less than $2 a day by focusing on them rather than including them in a general category.

i) How can governments and donors contribute to the poverty reducing capabilities of microfinance programmes?

Tying funding to a requirement for details and records of the experiences of the recipients of microfinance. Providing support in obtaining (for example) oral testimony from clients. In all the debate, analysis, argument and counter-argument about microfinance the voices of clients are notably absent. The stories we do hear are filtered through the MFIs themselves, the media and others who have vested interests.

Directing funding where it shown to be most effective promulgates the journey out of poverty for many more people. Finding out what is effective is key, because effectiveness does not discriminate by size or location. The smallest, most remote MFI with a social mission that directly helps hundreds may be more worthy of funding than a programme which provides millions with mobile banking. If the measure of true success, the measure of microfinance, is a reduction in poverty.

With targeted funding must also come an emphasis on building capacity and building self-sufficiency, sustainability. Governments and donors must aim for planned obsolescence as their ultimate goal.

j) What form should the UK's support for microfinance take; how should the effectiveness of UK interventions be measured?

UK support should be funding for programmes tied to education. In the same way that, in microcredit, lending should be tied to business training for microentrepreneurs, the UK should fund and train MFIs either directly or via trusted providers. Requiring evidence of effectiveness too, as in (i) above. That evidence should be expected with an approach to methodology that is agnostic; believe that no tool can provide all the answers but prepare to see the value in any one. Ultimately seek first to understand what is happening to the recipients of microfinance, then seek ways of increasing effectiveness. It's a mistake to approach measurement with the attitude of an assessor. Measurement should be a basis for enhancement because enhancement is always possible, sometimes with simple adjustments, sometimes requiring significant investment.

Above all, the UK should support microfinance with a clear social mission. Before getting involved we should find out how effectively mission is being translated into practice. Commercialised microfinance is only bad if it does not reduce poverty. Non-profit is only good if it does reduce poverty. When we go from theory to observation we should begin by observing the clients, not the processes. Once we understand the needs, lives and experiences of clients we can make better, more effective products and services that fit within the definition of microfinance.