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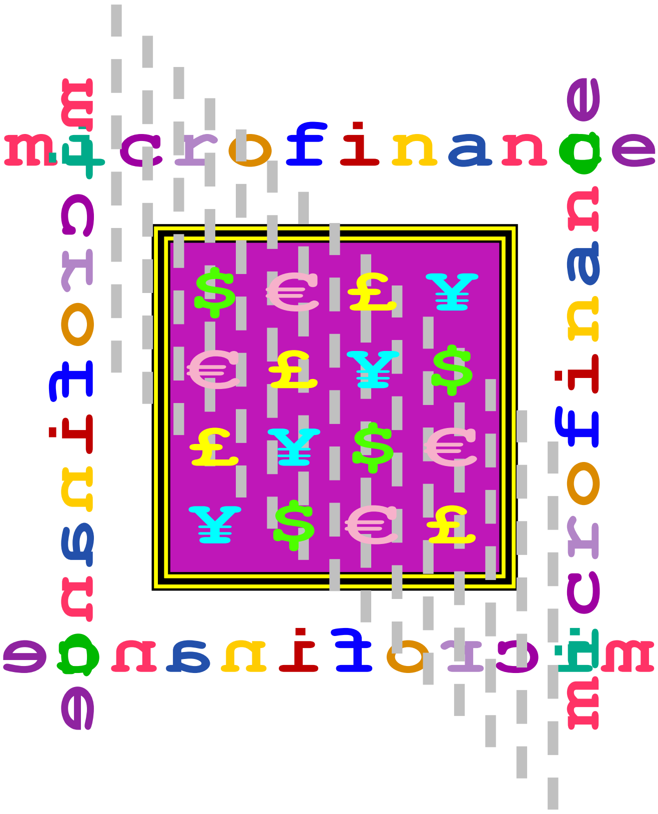

MICROFINANCE

THE WAY AHEAD

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EDITORIAL

MICRO WHAT?

In the tested way,
knowledge is inferior to certainty but above opinion.
Know that knowledge is a seeker of certainty,
and certainty is a seeker of vision
and intuition.
RUMI, *Mathnawi*, III: 4115-4121.

While Africa is plunging into nothingness and the MDGs are becoming an infant dream, we still envion a better world, a world of justice, of liberty, of peace and harmony, of spiritual and material health, and of spiritual and material wealth. An ideal world too ideal to be real. So let's blend 'ideality' and reality into a single being: unity. Again and again unity is calling us with its powerful drive. Destiny is not a quirk entity to be achieved, proscribed and unknown forever, a comet vesting our life, no, unlike fate – the immutable law of the universe, akin to *dharma* – destiny is indeed our potential becoming. "*riverrum, past Eve and Adam's, from swerve of shore to bend of bay*" as our friend would say.

When intention and action are synchronic and devoid of self-interest – not even of wanting to be or to do the 'good' – the ensuing act is pure and does not generate karma. Sooner or later the entire wheel will need to be purified before we can move further, a purifying process that does not end with our own lives, but reaches back to the beginning of our linage. To be known or unknown? The creative process shapes the boundaries of the unknown within itself, *un quantum tira l'altro, e così via.* No past, no future. If you don't bear the courage to live now, it is because of fear. Cross the threshold, leave fear behind and step in, it is urgent.

Fine, let's now shape a few small changes into the known. Micro changes into a micro world, a micro-cosmos, a micro-finance. Micro what?!? Microfinance is a seed of prosperity to reach further away, away from where Nothing is king. It is a tool to help people move on, an agent to alleviate poverty, material poverty, educational poverty, health poverty, and spiritual poverty; even though spirituality is nowadays a black hole within its engulfed morphomagnetic field.

According to UNDP findings, the far greater majority of the world's population is undeveloped and unrepresented, our 'democracy' does not take into account their rights and allows a small financial elite to govern the world. The economic, environmental, political crises, and the personal, familial, work and health stress are inherently interconnected, and are the symptoms of an

→| IN THIS ISSUE

unavoidable evolutionary breakthrough in individual and collective development. Whose *genius loco, loci, locum*, is this? Our individual, social and ecological capacity to deal with change and disturbances and nonetheless to continue to develop, in other words our resilience, is our natural and social capital, crucial in maintaining options for further human development. In complex adaptive systems, co-creation and co-management stimulates sustainable development and enhances resilience in both human and natural systems. In the current microfinance scenario, banks are pivotal instruments and hold an ethical responsibility on how the flow of monies is channelled by means of microfinance institutions to empower the poor. Since all their transactions are solidly and intentionally imbedded in profit, ignoring any sort of co-management with the end beneficiaries, their imprinting reaches down the very end of the chain bearing in itself that original 'sin'. Even though credit institutions maintain that money does not have a master, money is their own master, their sole Goal, with the financial elite as puppeteer. Money is matter, and matter is made up of the same energy of thought, being matter just a special kind of solidified thought – thoughts are matter, thoughts are things. To communicate, we need to encode our thoughts and perceptions in formal verbal symbol – at 'times' it is hard: many overlapping inputs, entropy: then stillness. Where there is no thought there is radiance. Where there is not thought there is splendour. Where there is no thought there is you, finally.

Finally, we begin to perceive that there is neither me nor you, nor he or she, nor them or thee: but only one. Vision and intuition are in sight, enough to follow the attracting radiance of the light in front of us. Peace at last, peace didn't allow us many things, but gave us more than we could have ever hoped for.

Poi cominciò: "Io dico, e non dimando,
Quel che tu vuoli udir, perch'io l'ho visto
là 've s'appunta ogni ubi e ogni quando
DANTE, *Divina Commedia*, 3, XXIX: 10-12.

All images are merely images, phantoms on the screen of consciousness, on the *mundus imaginalis*, that 'eighth climate' behind whose veil shines the light. "Hu Hu – said the father – who is there?" It's me! Your humble idiot arcing the Way, whom for a while sailed your bay. "I saw pain in your eyes before you left", I would have liked to have the nerve to say I love before.

QUALITY MICROFINANCE

SUCCESSFUL CLIENTS AND INSTITUTIONS

ANTON SIMANOWITZ

Anton Simanowitz is researcher at the Institute of Development Studies, University of Sussex, UK. He was a founder and for five years Director of the Imp-Act Consortium (www.Imp-Act.org). Imp-Act supports and promotes the management of social performance in microfinance, providing practical lessons for practice and public policy. The Consortium's Practice Guide, Putting the 'Social' into performance management' has been downloaded more than 25,000 times since its launch in December 2008, and is currently being translated into Spanish, French, Russian and Arabic. A recently launched film presents the practical experience of leading MFIs of how financial and social performance can be balanced http://www.youtube.com/watch?v=WKesX9KJ-9M and the SPM network brings together more than 1000 practitioners and supporters of microfinance www.spmnetwork.net. Anton is also Chief Development Officer and Advisor to the Board of the Small Enterprise Foundation (SEF), the largest developmental microfinance organisation in South Africa. His work with SEF focuses on improving efficiency and effectiveness through strengthening performance management and systems to balance social and financial performance.

→| OVERVIEW

"The greatest of evil and the worst of crimes is poverty."

G. B. SHOW

I RECENTLY HEARD ABOUT A TEAM OF MARKET researchers in Uganda, who were talking to clients of an MFI about what they liked and disliked about the services. The clients responded angrily about their treatment at the hands of field agents: *"they are devils [...] all they care about is getting their money back"*.

This story from one of the most competitive microfinance markets got me thinking. Microfinance is coming of age, with accelerating growth in numbers of people reached and the financial value of the industry[1]. Annual growth rates have been between 40 and 60 per cent in a number of markets, with India growing 94 per cent per annum since 2003[2]. Yet the potential market for microfinance remains vast with some 2.5 billion people lacking access to even basic financial services. Scale drives profitability and profitability drives scale, and the race is on to serve more and more people and maintain the impressive returns that attract investment. But what do these numbers mean? Are we valuing what matters, and if not then what are the consequences?

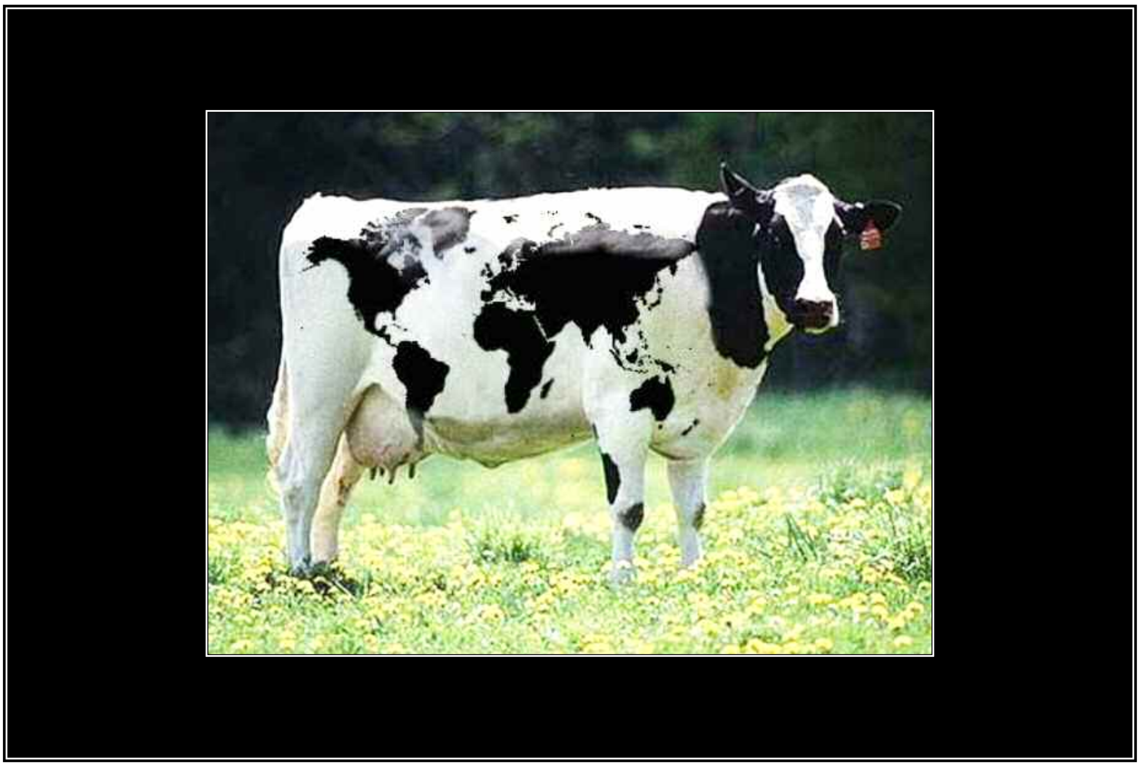
ENSURING QUALITY AND RESPONSIBLE LENDING

Increasing numbers of clients is not by itself an indicator of positive impact or the strength of an institution. The financial crisis and subsequent recession is exposing a loss of quality and inadequate systems in particular for ensuring responsible lending and collection practices in many MFIs.

Competition and a desire to generate high rates of return on equity so as to attract commercial investment and allow ever faster growth have led to multiple-lending and the pushing of credit. This combined with erosion of client livelihoods through increasing food prices, recession and retrenchment is leading to over-indebtedness and client delinquency. Severe delinquency problems are occurring or predicted in a number of countries[3], and a number of high profile, fast growing and seemly successful MFIs have run into serious problems – Zakoura (Morocco), Opportunity Bank (Montenegro), Kashf (Pakistan) and First Microfinance Bank (Afganistan). The most CSFI[4] Banana Skins report for 2009 survey concluded that credit risk is now the number one challenge for MFIs, demonstrating the impact on the very foundation of microcredit – the ability of clients to repay their loans. Like the famous pyramid schemes that feed off positive sentiment and collapse when confidence disappears, at least in some markets, it seems that in the rush for growth some of the fundamentals of responsible and quality business have been overlooked.

At the heart of these failures lies the breakdown of effective systems for managing the fundamentals of microfinance. High rates of growth put huge pressures on management systems, challenging the ability to ensure consistency and quality in service delivery. The CGAP Banana Skins 2008 survey, for example, named management weaknesses as the number one challenge for the industry. In addition to this pressure on systems a short-term prioritisation of client numbers and return on equity diverts the attention of management, Board and investors away from a double-bottom line that puts client service and success at the foundations of successful microfinance.

The need to ensure that systems and management processes can secure an effective balance between social and financial performance is illustrated by the financial incentives that many MFIs provide to their staff. These often make up a third of a field agent's salary or more. Most incentive schemes in the industry focus squarely on growth, commonly rewarding three things: number of new clients; increase in portfolio outstanding; and arrears or portfolio at risk. That is to say that staff are incentivised to bring in as many clients as possible, give out as much money as possible, and make sure that the money comes back. This leads to a potential loss of quality in terms of not bringing in target clients (who may be more time-consuming to reach), poor attention to assessing capacity to repay, and harsh debt collection methods. The recognition of these problems, reflected in a number of high profile media reports on the negative impacts of over-indebtedness, is leading to movement in the industry to be much clearer need to take action to avoid possible negative impacts of microfinance – particularly over-indebtedness and harsh debt collection practices. Client protection is thus increasingly being seen as one of the key issues for the microfinance industry in the future[5].



RESPONDING TO CLIENT NEEDS

One of the defining features of poverty is the inability of poor people to cope with the inevitable problems that life throws up – illness, natural disaster, death, creditors not repaying etc. How MFIs respond to this vulnerability in the services they offer and in delinquency management makes a huge different to their social outcomes, and is a critical consideration for MFIs that seek to be responsible lenders.

This issue is illustrated by one of my formative experiences in microfinance visiting a group of women in Kenya. After three successive failures of the rains they were on the verge of starvation (so much so that they had to apologise for falling asleep in an afternoon meeting, explaining that they had not eaten that day). Despite their desperate situation they still managed to make a full repayment on their loans… they had clubbed together and sold a chicken to raise money.

There has been huge progress in understanding the needs of different client markets and developing a range of products that respond to client needs. Increasing emphasis on savings and the development of micro-insurance build client resilience to problems and provide the means to respond to problems. However, many credit-led MFIs offer little flexibility, locking clients into a rigid system of regular loan repayments. Credit programmes that apply zero tolerance with little flexibility risk harming their clients. Most MFIs see delinquency management as being critical to success, and send out a strong message to staff that late payment should not be tolerated. This is supported by incentive schemes that often drastically cut financial incentives should the portfolio at risk rise above quite a low level. In the worst cases we see MFIs that achieve a 100 percent repayment rate through practices such as holding clients 'hostage' until all money has been collected – clients with repayment problems leave the meeting to 'find' the money and return after an hour or so. Where does the money come from? Perhaps from savings or from a friend, but more likely a money lender or selling assets. But organisational incentives do not ask this question, and just focus on whether the money is repaid rather than how it is repaid.

The issue is one of balance. I am not arguing that organisations should not emphasise repayment, rather that MFIs should understand this tension, and work to maximize their ability to be able to respond to problems that poor clients inevitably face, and structure products that are responsive to different cash flows and that promote savings as well as credit. To balance their social and financial performance MFIs need to combine appropriate services with an ability to be flexible and responsive to the problems that clients face whilst maintaining high repayment rates and a low portfolio at risk.

BEYOND ACCESS – ADDING VALUE TO MICROFINANCE SERVICES

Beyond doing no harm, microfinance seeks to have positive social impact – to add value. As a social business an MFI can focus not just at how to increase efficiency and financial returns, but how to increase effectiveness and social returns. Value can be added in a number of ways: by developing financial that are tailored to client needs; through delivery mechanisms that are cost-saving for clients (eg. doorstep services) or that build capacity or empowering (eg. working through groups or through the staff-client relationship); non-financial services can be integrated with financial services (eg. business advice, education or legal support); the infra-structure of microfinance can be used to deliver other services to microfinance clients through partnerships with other organisations that specialise in such services.

It sounds like stating the obvious, but not all microfinance is the same. Listening to the debates raging about the 'impact of microfinance' it would seem that this point needs to be heard. We have different methodologies, products, different target clients, different management systems, and these lead to different outcomes. So when we look at microfinance, surely we should be looking beyond numbers of people accessing financial services?

For example, in the push for efficiency the value-added through human relationships is often over looked. The relationship between client and staff is important not just in terms of making a good assessment as to the clients' needs and eligibility for services, but can be at the heart of the ability of microfinance to do far more than provide access to financial services and build the capacity and self-esteem of its clients. But the main drivers of growth in the microfinance industry today are efficiency rather than quality or social value-added. Management drives up targets for field staff, pares down the methodology to reduce 'wasteful' contact time between field staff and clients for example to eliminating home visits or moving from weekly to monthly group meetings, centralises services into branch offices, and introduces technology that potentially can all but eliminate the need for any human contact between the MFI and clients.

This focus on efficiency, cutting costs and reducing the human interface combined with incentives that push growth in numbers risks undermining the very foundations of effective microfinance.

The vision of microfinance is 'doing well by doing good'. As the microfinance industry attracts greater investment and achieves increasing commercial success, there is much debate as to whether microfinance is achieving this 'win-win' balance, or whether commercial focus is compromising the social mission. Whilst the economic crisis brings challenges for the clients of microfinance and MFIs, it also creates an opportunity for reflection. This is a time to take stock and ensure that microfinance sets an example for responsible lending that provides access to financial services for the billions of people excluded, and adds value to this access to help improve the lives of its clients.

We need to recognise that at its heart, microfinance is a social business, and that our performance metrics and management systems need to balance both social and financial goals. This article looks behind the numbers and discusses ways in which microfinance can continue to grow whilst maintaining quality, avoiding harming its clients, and take advantage of opportunities to add value and maximize the social returns to microfinance. We must measure and manage what we value.

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[1] The Microcredit Summit Campaign reported a growth from 19 million microfinance borrowers in 2000 to 155 million in 2007, with a growth from 1567 to 3552 MFIs reporting.

[2] Data on the Microfinance Information Exchange, www.themix.org

[3] Presentation by Xavier Reille, CGAP, at the European Microfinance Platform conference, November 2009.

[4] Centre for the Study of Financial Innovation.

[5] See the SMART campaign for client protection www.smartcampaign.org.

MICROFINANCE
AND THE PRESERVATION OF POVERTY

MALCOM HARPER

Professor Malcolm Harper is Chairman of Micro-Credit Ratings International Ltd (M-CRIL), Emeritus Professor, Cranfield School of Management, United Kingdom.
Dr Harper is a veteran in the field of microenterprises and microfinance, financial inclusion, and livelihoods promotion. His core areas of expertise include: microenterprise promotion, assessment of microfinance programmes, designing and developing microfinance and microenterprise promotion programmes and financial analysis. Prof Harper has advised on and evaluated a large number of such microenterprise programmes and microfinance institutions worldwide. He has substantial experience of leading multidisciplinary design teams in large and complex microfinance and financial inclusion programmes in the poorest regions of the world. He has worked with most international donors and governments and has experience of facilitating donors and private sector to work on enterprise and microfinance issues. Mr Harper's research and consultancy work has been supported by a wide range of national, international and non-government development agencies.

→| **CHALLENGES**

"He gives the poor man twice as much good who gives quickly."

PUBLIUS SYRUS

THE COMPARTAMOS IPO: TRIUMPH OR TRAGEDY ?

On April twentieth 2007, microfinance came of age. Compartamos, a medium sized Mexican microfinance bank with some 750,000 clients, had its initial public offering on the stock exchange. About one third of the shares were put on the market, and the institutions and individuals which were selling them cleared some 450 million dollars, valuing the whole institution at around one and a half billion dollars. Two young men had started the institution seventeen years before, with assistance from the United States Agency for International Development and other agencies. They had adopted the following mission statement:

"We are a social company committed to the people. We generate development opportunities within the lower economic segments, based on innovative and efficient models on a wide scale as well as transcending values that create external and internal culture, fulfiling permanent trusting relationships and contributing to a better world."

They each made over fifty million dollars from the flotation, and the rate of return on the six million dollars which they and others had earlier invested in the institution was around 100% per year. Compartamos was charging an annual interest rate of about 96% on its mainly very small loans to Mexican women, who had previously had no access to credit from formal financial institutions. There was a certain amount of competition from other institutions, but Compartamos had successfully maintained this high rate of interest in order to accumulate profits to finance its growth, and to attract equity shareholders as a basis for further borrowings from banks.

The extraordinarily high valuation was in part the result of global stock market euphoria, and the attractions of a new form of investment, with perceived social as well as profitable gains. Between the flotation and July 2010 the Dow Jones index fell by around 20%; in the same period the Compartamos share price had risen by about 30%. It had not, however, been a bad investment by the standards of stock market performance during that rather turbulent period.

The Compartamos IPO has been widely documented elsewhere, and there is still a fierce debate as to whether it was an unfortunate and isolated example of excessive profiteering, or a triumphant vindication of the argument that the poor were as credit-worthy customers as anyone else. My purpose, however, is to suggest that this incident was no more than a rather dramatic illustration of the exploitative everyday reality of microfinance, and that it is an indicator that that this aspect is rapidly taking over from the more benign face which the movement once had.

The trends which I shall identify are not, I hope, irreversible, and I do not want to suggest that microfinance has been wholly taken over by exploitative interests. Microfinance has brought formal financial services to many millions of disadvantaged households which previously had no access to such services. It continues to expand, and to bring these services to ever more people, for good and for ill. I would not suggest that the damaging and dependency-creating features of microfinance, which are the subject of this paper, are the result of a conspiracy to keep the poor poor, even though this does maintain the customer base of the institutions. They are an unfortunate by-product of the way the movement has evolved, which follows the normal but now accelerated centralising effect of global capitalism. They can, however, be resisted.

This short paper will point out some of the ways by which microfinance may be contributing to the perpetuation of poverty, rather than to its alleviation (or even to its elimination, as some of its more enthusiastic proponents claim that it can do). And, it will suggest ways in which these trends may be resisted, or even reversed.

These tendencies are covered under the following five broad headings:

- the types of clients reached by microfinance;
- the features of the financial products that are provided;
- the means through which they are delivered;
- the cost and the uses of micro-loans;
- the sources of funds and ownership of the microfinance institutions.

CLIENTS

One of the defining features of microfinance, which has caught the imagination of the general public more than any other, is that its clients, who today number is well over one hundred million people, are overwhelmingly women. Microfinance is not at all a women's business in the sense that the founders, owners or staff of the institutions are women; they are predominantly male, as are the leaders, owners and staff of most businesses, particularly in poorer countries, but their customers are mainly women. The Micro-credit Summit Campaign estimates that 84% of all microfinance clients are women, and Grameen Bank states that 97% of its customers, or 'members', are women. Many institutions, indeed, refuse even to accept male clients, although it is unlikely that many apply.

This strong gender bias is widely publicised as one of the main strengths of microfinance, in that it puts financial resources into the hands of women who have traditionally been deprived of influence over the use or even of legal ownership of money or other assets, world-wide. This form of discrimination is still strong, even in the so-called developed countries, and is even stronger in poorer societies. Microfinance has been widely and reasonably applauded as an important reversal of this almost universal aspect of society, everywhere, since it 'empowers' women in the most direct possible way, by putting money into their hands.

It is important, however, to examine all the reasons why women are the preferred clients for microfinance. The intention is to empower women, to enable them to play an equal role in economic decision-making, and this is right and proper. Women clients, however, play an important part in enabling microfinance institutions to achieve both aspects of the 'double bottom line', to do well as well as to do good. There are many reasons why they are more profitable customers than men: Women are physically, economically and socially weaker than men; they find it more difficult to resist pressure for repayment, they have fewer alternative sources of financial services than men and are thus less likely to risk damage to their credit rating with the only institution that will serve them, and they are less likely to have powerful social and political networks which will help them to avoid repayment obligations.

Additionally, women are more likely than men to accept routine standardised conditions of borrowing, and repayment. They have less opportunities to break away from the traditional activities and constraints of their local communities, and child bearing and child rearing, as well as the 'household duties' which are traditionally ascribed to them, make it less likely that they will be able or wish to invest in different types of activities, to borrow larger sums, or repay over longer or more irregular periods, than their peers. They fit more closely to a standard predictable pattern of customer behaviour, and this makes them less expensive and less risky to serve. They are better business.

This may be regarded as exploitation of women's disadvantaged condition, or as natural business sense, depending on the viewpoint of the observer, but the predominance of women as microfinance customers is not only an expression of micro-financiers' concern to redress social injustice. For whatever reasons, the operating methods of the industry have evolved in such a way that it is good business to work mainly with women.

Women are generally poorer than men, so that working predominantly with women presumably lowers the income profile of microfinance clients. It is now generally accepted by most well-informed authorities, however, that microfinance does not reach the very poorest people, the so-called 'poorest of the poor', and that when it does, it often does them more harm than good[1].

Many microfinance institutions, such as BRAC in Bangladesh, recognise this and have introduced a whole range of remarkable programmes which are specifically designed to reach out to destitute people.

These programmes, however, are not microfinance; they are poverty alleviation programmes. They may involve grants, in kind or in cash, or they may be based on paying poor people for their labour on civil works. They are not 'sustainable', still less profitable, and they must be heavily subsidised. Some are highly successful, and have enabled many thousands of women and men to escape from extreme poverty and to join the ranks of the 'economically active poor', the main clientele of microfinance.

The rhetoric of many other institutions, however, particularly but not only some of those in the Grameen 'family', suggests otherwise. Microfinance is still said to reach and benefit the poorest people, and, it is still widely touted as a panacea for poverty. The Grameen Bank has itself introduced a programme for beggars, with very small no-interest loans with flexible repayment, to enable them to add micro-vending to their traditional begging activity, but this is unique. Microfinance generally does of course reach many very poor people, if not the very poorest, but the claim that it reaches 'the poorest of the poor', and can on its own eliminate poverty, contributes to what is perhaps the major problem affecting microfinance: gross exaggeration of what it can achieve.

This in turn leads both 'social' and for-profit investors, as well as donors, politicians such as the President of the United States, and the general public, to believe that if they or their governments support microfinance they are addressing the root causes of extreme poverty. This is obviously an attractive proposition, since microfinance is popular in the City of London and on Wall Street as well as in Mexico and India. It amounts to an 'easy way out' the belief that poverty can be alleviated painlessly, and even profitably. This can only 'crowd' out' genuine attempts to deal with absolute poverty.

A great deal has been written about the people who are and continue to be clients for microfinance, and the literature is replete with heart-warming stories about women who have successfully started little businesses and sent their children to school. Less is known, however, about the people who are not clients, and about those who were, but have 'dropped out'. Microfinance is said to 'reach the unreached', but it can also further marginalize those most in need.

Many institutions do not know or are reluctant to reveal the numbers who drop-out from their groups, but in East Africa they are said to amount to between 25% and as much as 60% per year[2] while figures from India show an annual dropout rate of some 10% from self-help groups[3]. There is sadly little evidence to suggest that the people who drop out from microfinance groups are 'flying out', because they have graduated to an economic level where they want, and can access, a more individualised type of financial service, such as the readers of this paper, and the managers and staff of MFIs themselves enjoy. Grameen Bank, again, has introduced student loans to enable young men and women from client families to go on to higher education, but this is not a common practice; most microfinance clients either remain as microfinance clients, or drop out because they fall below the modest level of well-being that is needed to remain a group member in good standing.

Some may leave because they leave the area, or because they change to a competing supplier of microfinancial services, but most drop out, because they cannot maintain the regular savings, they cannot repay their loans or they lack the skills, the confidence and the opportunities they would need to invest in their own micro-business. The 'sustainability', or profits, of microfinance institutions depend on all their clients being in debt. Some allow clients to remain in their groups while they 'rest' for a few weeks at most between loan cycles, but if they stop borrowing for any longer they are 'balanced out', that is, their outstanding loans are set against their accumulated savings, they are given the balance, often without any interest, and they have to leave. Clients who want only to save are unprofitable, and such people tend to be the poorest; they are too poor for micro-debt.

In my own experience I have found that members of the groups themselves also want to avoid the topic of dropouts; those who have dropped out are of course unhappy to talk about their own failure, which has pushed them still further to the margins of their communities.

FINANCIAL PRODUCTS

Traditional retail banking, worldwide, has been based on clients' savings. These savings are used not mainly as a form of security for loans, or to develop and test client's ability to take small regular amounts from their day-to-day spending as 'practice' for repaying a loan. Secure, accessible and if possible remunerative savings, for their own sake, are the most important service which the institutions offer to their members. Loans come second, and are funded from the accumulated savings of those who want mainly to save.

Institutions of this type depend on the trust of their clients for their survival. They may or may not be owned in a legal sense by them, but the institutions depend on the clients, rather than the clients depending on the institutions. Microfinance institutions, which started by being called micro-credit institutions and still offer loans as their main product, depend on their clients to borrow and repay their loans, but the dependency relationship is heavily weighted in favour of the institution and its owners. The clients are bound to repay by legal and social sanctions, and the group systems strongly motivate continued indebtedness. Savings constitute independence, loans create dependence.

The size and terms of microfinance loans further strengthen the dependence of their clients. Loans are small, and for short terms, with frequent repayments, commonly spread over twelve months or less. Clients must remain in continuous contact with the institution, and the size, and the cost and terms of their loans mean that it is very difficult for them ever to become independent of their source of microfinance services. Their economic and even social survival comes to depend on remaining in the group and always being able to borrow and be in debt. There is no escape, except to fall to an even lower level.

DELIVERY CHANNELS

Most microfinance clients receive their financial services through some kind of group intermediation. The groups may, like self-help groups in India, act as financial intermediaries themselves, borrowing from a bank or MFI, or taking members' savings and on-lending themselves, or they may perform a social intermediation role, approving and guaranteeing members' loans, and facilitating transactions between members and the institution, but not actually taking title to the funds themselves.

These groups perform a valuable service to their members, under the broad heading of 'empowerment'. The services they provide to the microfinance institution, including guaranteeing or securing members' loans as well as extensive transaction assistance, are one important means which makes it possible to provide formal financial services to people who lack any collateral security and whose financial needs are not sufficient to justify the total cost of an individual account. Microfinance institutions outsource to their groups many of the normal functions performed by bankers: this assistance is unremunerated, but it can be reasonably be argued that it is the only way through which the institution can provide services to the members at all.

Group lending systems, however, can contain inherent contradictions. They do enable lenders to reduce their costs, and the financial services which are provided can be empowering for individual borrowers. But the processes of enforcing loan repayment in particular can be disempowering, particularly for the most poor and vulnerable. Group based systems, through their informal financial and risk sharing mechanisms, can reduce information asymmetries and secure high recoveries. These advantages, however, are often offset by the unequal and dependent power relations which such systems support. By building on existing informal mechanisms, microfinance institutions may be perpetuating and even reinforcing power asymmetries in a way that is completely contrary to their stated objectives of poverty alleviation and providing opportunities for the poorest and most vulnerable[4].

Like many other features of microfinance which have been introduced for good reasons, however, groups also have their downsides from the day-to-day point of view of their clients. It is unlikely that anyone who is reading this paper would be interested in a financial service which demanded attendance at a meeting for an hour or more every week, as well as open discussion of all their household's financial affairs, or where they were required to guarantee loans to other customers. Group microfinance is a second rate product, which is justified because the customers are poor.

In addition to the risk of loss and the burdens placed on members' time and their privacy, groups also have a number of other less obvious but potentially worrisome effects, which can contribute further to client dependence. Most businesses, particularly those which have the potential to grow and employ people in addition to their founders, are started by one person, or sometimes by a small team. There are of course many successful co-operative businesses, and other enterprises started, owned and managed by larger groups or even whole communities, but these are exceptional.

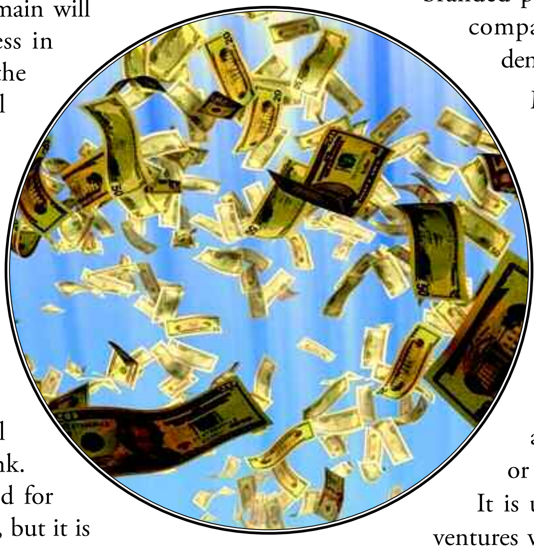
Entrepreneurship is primarily an individual phenomenon.

Group microfinance is successful because all the members of a given group, indeed of all the groups serviced by a given institution, have approximately similar financial needs. If one person wants to save larger but less regular sums than her peers, or to borrow for very different periods, it is difficult for the system to accommodate her needs. Groups can empower their members to demand and receive more than they could expect as individuals, but they also reduce all their members to the lowest common denominator: all can advance, but only at the pace of the slower. The slowest and least successful members may of course be forced to drop out, but those who remain will still have to act more or less in concert, in order to avoid the imbalances which will inevitably occur if one or a small number of members have much larger savings or loan balances than their peers.

This need not be a problem if microfinance institutions try to help their more ambitious clients to 'graduate' to individual accounts with a regular bank. Such altruism might be good for local economic development, but it is not good business for any institution to assist its best customers to close their accounts and take their business elsewhere. It makes sense to retain them, to maximize the profits to be made from their business, but not to distort the whole business model on their behalf.

Groups are also grateful, whereas individuals all too often turn and bite the hand that fed them. NGOs and other institutions which want to help the poor thrive on gratitude; it helps to raise more money from supporters, it reinforces their confidence in the merit of what they are trying to do, and if the institution's sponsors have political connections, client gratitude can be turned into votes.

Women work better in groups than men. Those microfinance institutions which admit men invariably find that male groups' repayment records are worse than women's. Men's relative inability to work effectively in groups may in part be because they are physically stronger and more able to resist group pressure, such as for repayment. Whatever may be the reasons for it, however, group delivery methods reinforce the predominance of women as microfinance clients. As we have seen, this has valuable social and business benefits, but it also reinforces the unequal power relations between microfinance institutions and their members.



THE COST AND THE USES OF LOANS

The cost of microfinance loans further strengthens clients' dependence. Microfinance interest rates are rarely as high as that charged by Compartamos, but the average annual yields on the loan portfolio are in the region of 30%. Such high rates are of little significance for an investment such as one dollar for a packet of ten cigarettes which will be sold for fifteen cents each, or a total of one and a half dollars, in half a day or less, or even for a hundred dollars worth of goods which will be sold in a week days for a profit of perhaps twenty dollars. It is possible to earn returns such as these, of fifty per cent a day, or twenty per cent a week, on petty trade, often by selling branded products from multinational companies. The nexus of dependence is neatly preserved.

More 'productive' enterprises, however, such as growing crops on a small farm or manufacturing simple items in a village workshop, require larger investments, they earn much lower rates of return, often around thirty per cent per year or less, and they may take half a year or more to realise their profits[5]. It is unprofitable to finance such ventures with microfinance loans, and this further marginalizes the borrowers, keeping them and the regions and countries from which they come in a state of continuing dependence, both on microdebt, and on foreign sources for goods to sell. The returns to capital from marketing branded consumer goods and from microfinance are generous, and the microfinance client remains dependent on whatever value she can add by her labour alone.

Most microfinance borrowers improve their financial position through their loans. They may, at the most elementary level, replace a moneylender loan which that cost perhaps ten per cent a month (similar as it happens to the rate charged by Compartamos) with a microfinance loan costing three per cent a month. The gain of seven per cent a month, even on a loan as small as one hundred dollars, is very significant for a household whose total earnings may be as low as two dollars a day or even less. The switch may involve some intangible gains, and losses. Some moneylenders demand free labour as well as interest, and their loans may be informally linked to the preservation of traditional repressive hierarchies. Many poor families, on the other hand, also rely on their local moneylender for urgent needs, such as an immediate loan to cover the cost of emergency medical care. Microfinance institutions cannot usually match immediate services of this kind, and many clients prefer to keep their informal credit lines open at the same time as they obtain access to formal financial services for the first time.

Refinancing a moneylender loan usually involves no new skills; apart from the intangible aspects mentioned above, there is usually a straight gain. Similarly, relatively low cost micro-debt for what are oddly called 'consumption' purposes such as school fees, medical care, or house repairs (as opposed to somehow more worthy 'productive' investments in stocks of goods for resale for petty trade, such as bottles of Coca-Cola or sachets of Sunsilk shampoo), can offers an immediate saving over the higher interest rate that might otherwise have been paid to an informal moneylender.

Microfinance is associated with self-employment, and although many loans are used mainly for 'consumption' (as above) most institutions expect their clients to invest their loans in micro-enterprises which can be expected to yield a high monetary return and thus to cover the interest charged on the loan, as well as to generate enough surplus in due course to pay off the principal. The rhetoric of microfinance is about promoting enterprise, empowering the poor to help themselves, 'a hand-up and not a handout'.

As we have seen, however, the scale and cost and terms of micro-loans makes them unsuitable for investment in anything but the smallest petty trading businesses, vending, small-scale service businesses and so on. This would not be too serious if there were alternative sources of finance that were more suitable for longer-term investments in job-creating businesses such as manufacturing or farming. In too many places, however, microfinance has become the dominant paradigm. The long-established commercial banks have often been drastically 'down-sized', privatized or closed, and the institutional space which they occupied has been taken over by microfinance institutions, such as the National Microfinance bank in Tanzania or Centenary Bank in Uganda.

Similarly, in some parts of the ex-Communist states of Eastern Europe and Central Asia, where there is no recent history of full-service commercial banking, the dominant banking approach is now micro-banking. These new institutions have been vigorously promoted by Western donors, with the result that long-established community or state-owned industries, or their privately owned successors, have been unable to access the type of banking services that they need to run their businesses. Whole economies are moving towards becoming micro-trading economies, dependent for finance on highly profitable microfinance institutions owned by Western European, American or Japanese interests, and similarly dependent on profitable multinational consumer goods, plantation and resource companies for the goods which they trade. These 'emerging economies' risk becoming economic satellites of the West, in the same way as they used to be political satellites of the East.

SOURCES OF FUNDS AND OWNERSHIP.

There are about eighty specialised funds seeking to invest in the equity of microfinance institutions. Very few are based in what might be called 'destination countries', where there is a major need for microfinance. The majority are in wealthier countries, and the bulk of the invested funds come from the Netherlands, Germany and the United States.

These funds haveinvested several billion dollars in the shares of microfinance institutions. Foreign shareholders control a significant proportion of the world's microfinance institutions, and this proportion is probably increasing.

We live in a globalised world, but it nevertheless seems odd that there should be so much foreign interest in the ownership of microfinance institutions, which are not usually very large, and are quintessentially local in their clientele and their staffing. Many of the investors, including some of the largest ones, are of course social investors, who expect 'reasonable' economic returns from their investments as well as social returns. These investors are now being joined and to an extent supplanted, however, by institutions such as venture funds and the large multinational commercial banks which are more concerned with profit than society, particularly when profits are becoming harder to earn in their traditional markets.

There are very good commercial reasons why international capital is being drawn to microfinance. The institutions are generally not large, but they are growing very fast, and they offer high rates of return, with limited risks, at a time when such investments are in short supply. Commercial banks which deal with retail and corporate customers in the 'developed' world usually expect to earn a net return on their total assets of between one and two per cent; the returns from microfinance are much higher.

As one specialised fund management company puts it in an advertisement:

BlueOrchard's proven track record has convinced an ever-growing number of investors to choose the quality and profitability of a win-win investment : they earn a stable and competitive financial return on their investments while delivering effective social impact in emerging markets by encouraging entrepreneurship at the micro level.

And Accion, one of the pioneers in the promotion and financing of microfinance, organises regular investment road shows in New York, London, and other financial centres, under the label *Microfinance cracking the capital markets.*

Multinational banks, such as ABN-AMRO, HSBC and Citibank and others, lend large sums to microfinance institutions, sometimes in response to government or social pressure to be seen to being concerned for the poor. Such loans have so far proved to be good business, as well as good public relations, and commercial debt of this kind has substantially supplanted clients' own savings as a source of finance. In 1998, the institutions listed in the 'Mixmarket' had about seventeen dollars of client savings for every ten dollars of commercial bank loans. By 2010 this figure had gone down to less than a third of this amount (Mixmarket, *ibid.*). The institutions not unnaturally found it more profitable to borrow large sums at low cost from commercial sources than to incur the high transaction costs associated with providing on demand pass book savings accounts at multiple locations. Clients who are in perpetual debt are more profitable than those with their own savings, for microfinance institutions as well as for informal moneylenders.

Community-owned financial institutions generally rely on their members' savings as their main source of funds. This is partly because they may not have the financial strength to justify borrowing from banks, particularly in the early stages of their existence before they have built up share capital from members' contributions. It also, however, reflects their members' priorities: more people need to save, more, and more often, than need to borrow. The balance between the savings and the loans portfolios of retail banks, such as Bank Rakhyat Indonesia, reflect this reality. Most microfinance institutions start as NGOs or as non-bank finance companies, and are therefore, quite rightly, not permitted to mobilise demand deposits from the public. They, and their multinational capital supporters, have appreciated that it is more profitable to continue to focus on providing debt, and to treat savings products as a qualification or security for loans, not as a service to their customers in its own right.

Only a small number of the institutions listed by the MicroBanking Bulletin are community owned. This is to be expected, since such institutions offer no opportunities for equity shareholdings, and they have less need for bulk debt, since they can rely on their members' savings balances. They may serve their members' interest better than their commercially driven competitors, but, as with co-operative retail shops, co-operative farms and every other type of community enterprise, the tide is running against them.

A TENTATIVE NEO-MARXIST DIAGNOSIS

Marx proposed that modern society is based on a capitalist mode of production, whereby those who have control over capital can dominate and exploit those who have to sell their labour to those who control the means of production, through their capital. He came to this view in the context of large manufacturing industries, owned by capitalists and employing vast numbers of workers. He believed that these workers would in time unite to throw off the yoke of capital, and would usher in a new form of society which was ruled by labour.

This belief was not unreasonable, and modern labour movements, which have done so much to improve the conditions of workers, have indeed had their origins in factories where large numbers of workers have to be assembled together in order to use capital efficiently. They have to work together, but they can also protest, strike or even rebel together.

Microfinance offers a more subtle and potentially more durable means whereby those who control capital can exploit those who have only their labour to sell. The means of production is no longer machines which require many workers to come together to operate them, and possibly also to unite against their employer. Microfinanciers can now provide capital, in the form of microcredit, which borrowers use to purchase the tiny amounts of stocks or simple tools, which they need to run micro-enterprises. The surplus they can earn is barely sufficient for survival, but because the investments are so small the borrowers can afford to pay very high rates of interest on their loans. Capitalists no longer have to organise and manage labour. They can extract a higher return on their capital not by directly employing people, but by financing their petty businesses under the guise of assisting them to become 'entrepreneurs'. Better still, these entrepreneurs will compete against one another rather than combining against capital.

A large proportion of the merchandise and tools which are used by these micro-entrepreneurs is made in factories which maintain the mode of production with which Marx was familiar, so that a return can be earned from both manufacturing and from money-lending. The micro-entrepreneurs are mainly women, which leaves their husbands free to migrate to other places within and outside their own countries to work in factories or service industries that must be located near to their customers. The Compartamos story with which we started seems to bear this out.

Compartamos' capital is mainly owned by investors in the United States, or by their fellow-elites in Mexico. They have already benefited hugely from the success of the institution, and they presumably aim to benefit more in the future. Compartamos charges interest rates of nearly one hundred per cent, and most of its clients are women, many of whose husbands are working for relatively low wages north of the Rio Grande, also in the United States.

The small loans from Compartamos enable these women to finance micro-businesses, often peddling consumer goods produced and marketed by multinational companies based in the United States. The amounts, the terms and the interest rates of the loans are such as to make 'productive' farming or manufacturing investments much less attractive, so the borrowers' husbands have to remain away from home, working for businesses whose owners have access to more flexible sources of finance.

The women may enjoy the ritualised ceremonies of the weekly client meetings, as some distraction from the grind of their everyday existence, and their petty businesses can earn them enough to keep themselves and their children during the periods between the arrival of remittances from the North. These remittances are most likely sent at high cost through USA-based agencies such as Western Union, or through less costly but more risky informal intermediaries, and Compartamos itself provides an international remittance service to its clients, to add to the insurance and other products which customers are encouraged to purchase[6].

Marx's proposed solution to the problem of social injustice has not worked well in practice; his diagnosis, however, seems to have stood the test of time.

REMEDIES

The main purpose of this paper is to promote self-questioning and to provoke discussion. It is easy to identify feasible remedies to most of the problems that have been identified, but it is more difficult to identify who will carry them out. It is unlikely that prospective investors, or fund managers, will want to promote community-owned institutions, or that microfinance managers will willingly hand over their best customers to their competitors, or emphasise client savings as a source of funds when they know that bulk loans from commercial banks are less expensive and less trouble.

I shall nevertheless conclude with a short list of changes which can 'make a difference', in the hope that some readers who are in a position to implement them will do so, even when this may reduce profitability or require subsidy.

CLIENTS

- Microfinance institutions should attempt to redress the gender imbalance in their client profile, by including more men, and when necessary adapting existing products and delivery methods to suit male customers better;
- the institutions should carefully monitor those who drop out from their groups, and should either themselves attempt to assist such people to improve their position or introduce them to other institutions which can offer suitable programmes for them;
- more ambitious clients should be encouraged and assisted to 'fly out' and if necessary to transfer to competing institutions which will be able to serve their needs more effectively.

Products and their delivery:

- flexible, accessible, voluntary and remunerative savings facilities should be offered to all clients, irrespective of their need or desire for loans. If the microfinance institution is not itself permitted to take demand deposits, arrangements should be made to act as agent for an institution that is a regulated savings institution;
- services should be offered to clients irrespective of whether or not they are or profess to intend to be self-employed. Clients should be allowed to use their loans as they wish, so long as they can be repaid, and the distinction between 'consumption' and 'productive' purposes should be dropped;
- clients should be allowed and encouraged to remain on the books of microfinance institutions irrespective of whether they are borrowing or not;
- group methods of intermediation should be regarded as a temporary second-rate expedient, from which clients should be encouraged to move as soon as they can to more dignified and less onerous individual services;
- the various forms of group intermediation should themselves be treated as complementary steps on a 'ladder', not as competitive products. Clients should be encouraged to climb from Grameen-type solidarity groups, to self-help groups, to smaller joint liability groups and thence to individual accounts, even if this means that they will move from one institution to another.

FUNDS AND OWNERSHIP

- Client savings should be regarded as the optimum main source of funds for microfinance institutions, even if they are more expensive to raise and manage than bulk loans from commercial banks or other sources;
- local rather than foreign equity shareholders should be preferred whenever possible;
- community-owned microfinance institutions should be promoted and assisted in preference to local private for-profit finance companies or banks.

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[1] See, for instance, Navajas, S. - Schreiner, M. - Meyer, R. - Gonzalez-Vega, C. - Rodriguez-Meza, J., "Microcredit and the Poorest of the Poor: Theory and Evidence from Bolivia", in *World Development*, 28(1): 333-346, and Islam, Tazul, *Microcredit and Poverty Alleviation*, Ashgate: London, 2007.

[2] Wright G.A.N., MicroSave Briefing Note No. 8, *Dropouts and Graduates: What Do They Mean For MFIs?*, Microsave: Nairobi, 2002.

[3] Sinha F. *et al.*, *Microfinance 'Self help groups in India: Living up to their Promise?*, PA Publishing: Rugby, 2008.

[4] Harper, A., *Microfinance Peer Lending Groups; Empowering the Poor or Perpetuating Inequality?* Unpublished MSC thesis, SOAS, London 2000.

[5] Dichter, T. - Harper, M., *What's wrong with microfinance*, PAP Rugby and Rawat Jaipur, 2007: 89.

[6] *Business Week*, 13.12.2007.

MAXIMISING THE EFFECTIVENESS

OF MICROENTERPRISE DEVELOPMENT: THE PARTNERSHIP OPTION

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Dr Brinkerhoff's applied work encompasses partnership, civil society, institutional development, development management, and training methodologies, and includes work for the Ministry of Foreign Affairs, the Netherlands; and in Africa, China, Mongolia, Central Asia, and Russia for the US Agency for International Development and the World Bank.

→ I ALTERNATIVES

> *"No stranger to trouble myself, I am learning to care for the unhappy."*
>
> VIRGIL

Despite the theoretical possibility, eradicating poverty – or even halving it by 2015 as intended by the first Millennium Development Goal[1] – is a daunting and perhaps unrealistic endeavour. Since the inception of the international development industry, systematic efforts have been made to reduce poverty. Within nation states such efforts have a much longer history. So why, with all of our technology, have we failed to eliminate poverty? The easy answers refer to contextual factors, including political will. A more nuanced response calls attention to the intractability of poverty. Specifically, Smith (2005) calls attention to sixteen poverty traps, which demonstrate the interdependence of a range of factors that contribute to poverty and prevent its escape. These factors include, among other things, illiteracy and/or low education and skills levels; lack of access to working capital, insurance, and information; high debt; poor physical and mental health; high fertility; child labour; the priority of subsistence; and powerlessness. The development industry has developed targeted approaches to respond to many of these challenges on a case-by-case basis, sometimes with highly complex assessment and response tools. So while we may not be able to eradicate poverty on a global level, we certainly do know a lot about how to maximize the efficiency and effectiveness of targeted efforts to do so. Yet a remaining question is who does what to address this broad range of factors?

The interdependence of poverty traps and the lesson that addressing only one or a few factors is too often insufficient for facilitating escape from poverty have led many development organisations to consider how best to acknowledge or include complementary services. Options include: 1) remaining specialised to maximize organisational efficiency through comparative advantage; 2) developing multi-sectoral organisations and programs; and 3) accessing complementary services through partnership with other organisations and programs. There are trade-offs to each of these options. This article explores options for organisational scope, specifically with respect to partnership approaches.

No one option will be ideal to all contexts. To best gauge the potential of the partnership option, it is first necessary to explore its advantages, as well as possible contextual constraints. Building on my previous research (Brinkerhoff, 2002a, 2002b), I will first define partnership, specify its comparative advantages especially as they concern available governance mechanisms, and present potential contextual constraints to its operationalization. Next, I will describe the experience of a range of microenterprise development experiences, as presented by US-based practitioners. I will then explore how these experiences correspond to our general knowledge of partnership practice. I conclude with recommendations for when the partnership option may be most effective in combating poverty traps.

MAKING THE CASE FOR PARTNERSHIP

PARTNERSHIP DEFINED

The potential advantages of partnership are many. The nature and scale of poverty traps are impossible to address in isolation. Partnership can provide a means of developing strategic direction and coordination in this context, affording a scale and integration of services that is impossible for any actor operating alone. Without the cooperation of multiple and diverse actors, each with their own perspective and comparative advantages, we risk treating symptoms rather than causes and becoming frustrated by systemic forces that preserve the status quo (Brown and Ashman, 1996).

Literature and experience combine to suggest that two dimensions are salient for defining partnership. Mutuality encompasses the spirit of partnership principles; and organisation identity captures the rationale for selecting particular partners, and its maintenance is the basis of partnership's value-added. Mutuality refers to mutual dependence, and entails respective rights and responsibilities of each actor to the others (see Kellner and Thackray, 1999). These rights and responsibilities seek to maximize benefits for each party, subject to limits posed by the expediency of meeting joint objectives. Embedded in mutuality is a strong mutual commitment to partnership goals and objectives, and an assumption that these joint objectives are consistent and supportive of each partner organisation mission and objectives. Mutuality means some degree of equality in decision-making, as opposed to domination of one or more partners. All partners have an opportunity to influence their shared objectives, processes, outcomes, and evaluation. Mutuality can be distinguished as horizontal, as opposed to hierarchical, coordination and accountability. The ideal-type partnership also includes principles such as jointly agreed purpose and values; and mutual trust and respect.

organisation identity generally refers to that which is distinctive and enduring in a particular organisation. It is generally believed that the creation and maintenance of organisation identity is essential to long term success (see Gioia *et al.*, 2000; see also Albert and Whetten, 1985). The key is not to maintain organisation systems, processes, and strategies over time, but to maintain their core values and constituencies. Gagliardi (1986) argues that successful organisations change in response to turbulent environments precisely in order to maintain their identity over time.

organisation identity can be examined at two levels (Brinkerhoff, 2002a). First, an individual organisation has its own mission, values, and identified constituencies to which it is accountable and responsive. *The maintenance of organisation identity is the extent to which an organisation remains consistent and committed to its mission, core values, and constituencies.Second, from a broader institutional view, organisation identity also refers to the maintenance of characteristics – particularly comparative advantages – reflective of the sector or organisational type from which the organisation originates.* A primary driver for partnerships is accessing key resources needed to reach objectives, but lacking or insufficient within one actor's individual reserves. Such assets can entail the hard resources of money and materials, as well as important soft resources, such as managerial and technical skills, information, contacts, and credibility/legitimacy.

Based on these two dimensions, partnership in practice is identified as a matter of degree. The ideal type would maximize organisation identity and mutuality, including equality of decision making. Since compromises to support and respect the identity of ones partners is inevitable, and as exact equality of power in decision making is unrealistic, partnership is a relative practice. Nevertheless, these dimensions can be used to contrast partnership (high organisation identity, high mutuality) from other types of inter-organisationalrelationships, such as contracting (high organisation identity, low mutuality), extension (low organisation identity, low mutuality), and cooptation or gradual absorption (low organisation identity, high mutuality) (Brinkerhoff, 2002a).

INTER-ORGANISATIONAL RELATIONSHIP GOVERNANCE MECHANISMS

Governance mechanism refers to the approach and enforceability of rules and associated desired behaviour. Governance requires recourse in the event that rules are broken or expectations are not met. Governance mechanisms include market, bureaucratic, or culture approaches, or some combination of all three[2]. The most effective organisations combine these three mechanisms (see, for example, Coston 1998; Peters 1998). At the same time, each has its advantages and disadvantages, as well as limits to feasibility. For example, market mechanisms (e.g., contracts) are not always possible (a price must be specifiable) and are, like any market, subject to market failures. Bureaucratic mechanisms (e.g., rules, regulations, and standard operating procedures) can be costly to monitor and enforce and often restrict flexibility. And, because they are based on trust, culture mechanisms, are not as easily enforceable. Recourse in the event of their violation is not always immediate or specifiable.

Partnerships, by definition, are not based on hierarchy. Therefore, while they may combine all three governance mechanisms, they are likely to rely more heavily on culture mechanisms than other types of inter-organisational relationships. Under culture mechanisms enforcement and compliance are based on trust and expectations rooted in a sense of belonging. Culture mechanisms can become the glue that bonds different actors, ensuring compliance not only with expected norms of behaviour, but also maximising the efficiency and effectiveness of other governance mechanisms (Coston 1998). Because they are voluntary, they also are the most flexible and lowest cost mechanism.

THE POTENTIAL ADVANTAGES OF PARTNERSHIP

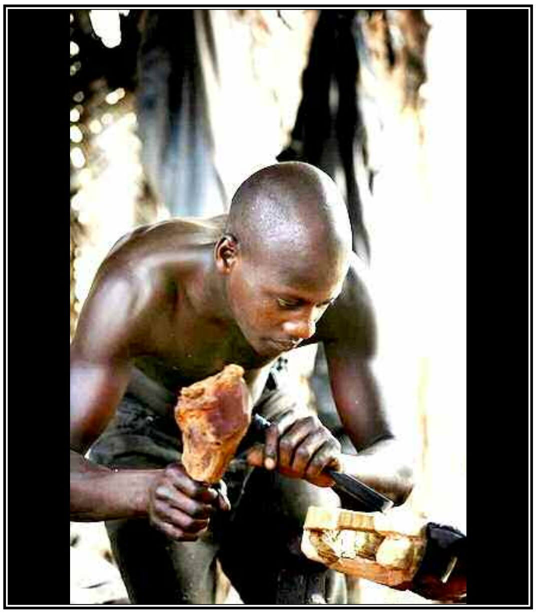
Partnership's value-added is rooted in its defining dimensions. organisation identity is the impetus for initiating a partnership strategy. Partnerships with other actors are pursued precisely because these actors have something unique to offer, whether resources, skills, relationships, or consent. If organisation identity is lost, by definition comparative advantages are lost, the organisation loses legitimacy in the eyes of its defined constituencies, and its effectiveness wanes. Mutuality can reinforce organisation identity. The opportunity to participate and influence equally means that each actor can more easily protect its organisation identity, and hence the efficiency, effectiveness, and synergistic rewards of the partnership. At the outset, no one organisation can understand the implications of its or the partnership's actions for members' organisation identity. Mutuality at least affords partner organisations the opportunity to consider and explain these implications and potentially defend their distinctive advantages, skills, and legitimacy – all of which are necessary for the partnership's success.

Reliance on culture governance mechanisms affords partnerships a greater degree of flexibility in maximising the application of comparative advantages and flexibly responding to environmental constraints (to be discussed below). organisations and alliances characterised by a strong reliance on culture mechanisms are seen to be organic in their structure, as opposed to mechanistic (see Burns and Stalker 1961). Advantages of organic structures include:

- fluid division of labour based on specialised knowledge and experience;
- emphasis on application of knowledge to contribute to organisational effectiveness (i.e., mission);
- continual redefinition and adjustment of individual tasks through interaction;
- individual responsibility for contributing to overall organisation effectiveness;
- commitment to organisation mission;
- knowledge about the organisation technical nature and effectiveness can be located anywhere in the network;
- fluid interaction, contingent on the information/skills required in the moment;
- emphasis in communications on information and advice (not instructions and decisions);
- innovation, creative thinking, and knowledge of interdependence highly valued; and
- decisions made through participation (Brinkerhoff, 2002b).

ENVIRONMENTAL CONSTRAINTS

Environmental factors influence the extent to which partnership is desirable or feasible. In development contexts, there are many factors and actors at play at various levels, each of which affects the others to greater or lesser degrees. I focus here on the immediate partnership environment rather than the broader context; that is, those features that directly impact the inputs, processes, and outputs of partnership systems.



Drawing on a decade of fieldwork consisting of case analysis and expert interviews, I delineate nine key 'environmental hostility' factors – those that can inhibit or enhance achievement of mutuality and organisational identity in partnership relations involving NGOs (Brinkerhoff, 2002b). These include factors related to the actors involved, both individuals and organisations; the specific partnership objective; stakeholders; and general contextual features. The nine factors follow:

1 ~ Partnership Champions: the possibility of dynamic, entrepreneurial, and potentially charismatic personalities with the capacity to champion the partnership effort. The immediate context may also present salient drivers to inspire such individuals to champion partnership approaches.

2 ~ Institutional Linkages: Pre-existence of strong and supportive relationships among partners; partners know and understand each other's mission and track record.

3 ~ Characteristics of Partner organisations: organisations with identified comparative advantages, requisite capacity, strong organisation identity, supportive stakeholders and constituents, perceived as legitimate and trustworthy among constituents, have strong drivers to participate in the particular partnership, share the partnership vision, and have broad support within the organisation for the partnership.

~ Partnership Objective: Does not greatly challenge vested interests or implicate a wide number of government agencies; outcomes will be directly felt at the local level and can be readily identified; and there is a ready demand for the good or service to be produced.

~ Partnership Stakeholders: Relatively homogeneous, organised, and have influencing capacity.

~ Supportive Legal Frameworks: Partnership and its chosen activities are legal, and legal framework is flexible. Partners have discretion in the design and structure of the partnership.

~ Stability: There is minimal staff turnover with the partner organisations, and stakeholder interests and demands remain relatively stable.

~ Flexibility: Partner organisations are flexible in pursuing new structures and procedures and/or making adjustments in existing ones to support the partnership and partner organisations' identity.

~ Artificiality[3]: Low levels of distortion. The partnership is characterised by local ownership and mutual agreements and relationships.

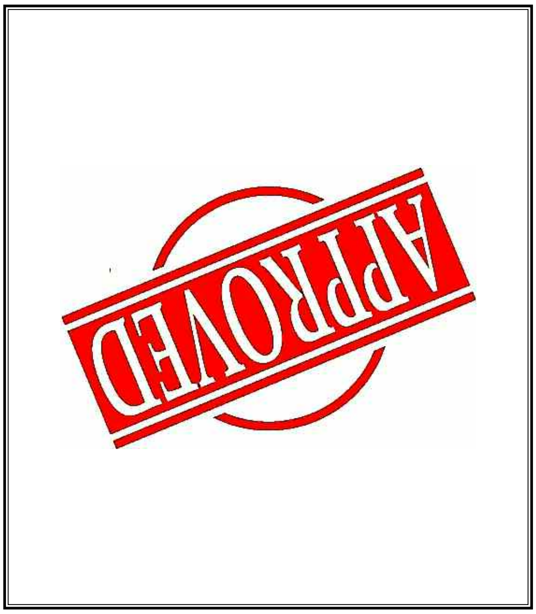
The absence of these factors contributes to environmental hostility. The lack of one or more of these factors does not, in itself, prevent effective partnership. Rather, it makes it more difficult, and, in some cases, much more costly. They are also not all of equal importance or malleability. While the characteristics of certain objectives might make partnership work very complex and challenging, the importance of those objectives and/or their beneficiaries may outweigh these difficulties. Some of these contextual features are subject to influence, others are not. The identification of these factors can inform cost-benefit analyses to determine the appropriateness of a partnership approach. However, the relative valuation of the equation will necessarily be subjective, depending, in part, on the mission of the initiating organisation and its corresponding operational values.

EXAMPLES OF MICROENTERPRISE DEVELOPMENT: THE OPTIONS IN PRACTICE

The following vignettes are taken from practitioner remarks at the George Washington University International NGO Team Roundtable on "The Effectiveness of Multiplex vs. specialised Approaches to Microenterprise Development" (April 8, 2005).

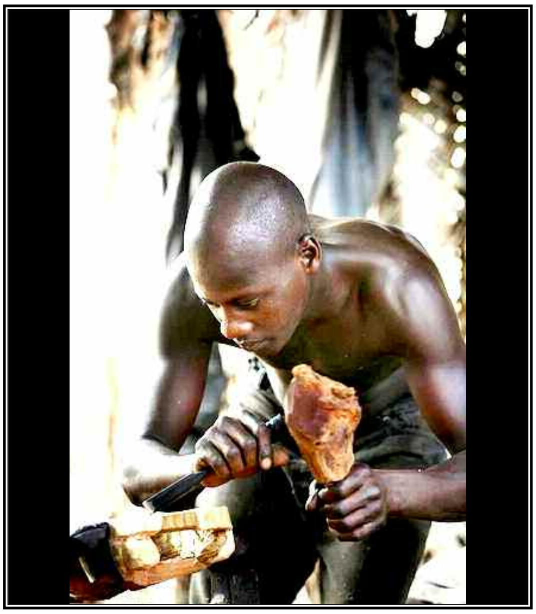
FINCA INTERNATIONAL[4]

FINCA is known as the founding organisation for village banking. Not only does it provide microcredit to the poor, "it helps to create community-run, community-focused credit and savings associations, particularly in areas untouched by the formal financial industry" (FINCA, 2005). FINCA International is a network of program affiliates in four regions



(Latin America, Africa, Eastern Europe, and Central Asia). According to 2005 estimates, 60-70% of its 2,800 employees worldwide were "children of poverty," that is, children who, having observed their mothers attending village bank meetings, eventually became credit officers. This development highlights a key priority for FINCA now and into the future: to raise awareness among microfinance institutions of the need to reach beyond the borrowing parents to expand their client bases to include the educated children of these borrowers, making available business loans and microfranchises.

In thinking about using microfinance to alleviate poverty, Hatch (2005) emphasises the importance of partnership with the poor: "If you provide resources to the poor, give them the flexibility and the responsibility for making their own decisions about how they're going to take advantage of those opportunities…. They are capable of doing incredibly effective, good stuff, in terms of fixing themselves and their own poverty…. It's the financial grease in the wheel of the household that gives them those options they didn't have before…. It's always been my feeling that the ideal integrators are



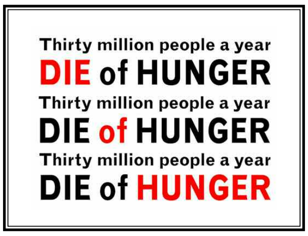
the poor families. They know what they need. As long as they have access to information about where they can get assistance, they are the ideal, least cost, and best integrator we have."

FINCA has developed an evaluation instrument to gauge improvements in the quality of life of their clients. The ten minute, palm pilot assisted interview measures seven indicators, starting with money metrics, to assess expenditure patterns in order to determine if FINCA is reaching the poorest of the poor, and moving to six social metrics: food security, health, housing, education, empowerment, and social capital. FINCA plans to use the results to assess its effectiveness in meeting a double bottom line for its clients: financial, as well as social improvements in quality of life.

SAVE THE CHILDREN[5]

Save the Children (Save) is a multi-sectoral organisation that operates in approximately fifty countries. Its programs encompass health, HIV/AIDS, education, food security, and economic opportunities, mostly in the form of microfinance. Save's approach to microfinance is group-guaranteed lending and savings. In establishing micro-finance institutions (MFIs), Save starts with a very specialised focus (i.e., a limited array of services) with an aim to attain operational sustainability. Once that is achieved, the emphasis is on financial sustainability, and, eventually, institutional independence from Save. Resulting institutions follow whatever the local legal framework allows. Hence the priority for sustainability and independence trumps any consideration of offering complementary services. The aim is to make the institution capable of operating without any subsidies into the long run.

Because of its multi-sectoral nature, Save the Children has opportunities to consider and even experiment with integrated programming. This was the subject of its 2005 Program Learning Group, an annual event to reflect on Save the Children's practice and potential paths for innovation and improvement. Staff opinions varied and official conclusions were still pending as of this writing. Conly (2005) summarised the various viewpoints. First is the perspective that the institutions should remain focused on financial services; diversification muddles the objectives and can overwhelm staff capacity/skills, damaging effectiveness and efficiency. Second, business development skills might be appropriate to integrate, given their natural fit with the objectives of the MFIs and the ambitions of their clientele. A final perspective argues for the provision of social services alongside microfinance. Preliminary conclusions support the integration of those financial services that maximize complementarity, specifically strengthening microfinance, with the caveat that these, too, must be financially sustainable; some services can be delivered in cooperation with the microfinance services, but should be under the purview of other providers, or possibly other divisions within Save; and these services should not be required, as they may detract from the clients' economic priorities pertaining to their microenterprise (e.g., requiring time and attention away from the business).



World Vision[6]

Like Save, World Vision is a multi-sectoral organisation, but it operates through specialised programs, taking advantage of complementarities across activities. This is mostly achieved through its multi-sectoral area development programs (ADPs), which include health, education, and leadership development. In 2005, World Vision introduced business development services related to access to market. The MFIs are separate legal entities, though they benefit from the World Vision reputation vis-à-vis donors and other service providers.

At the national office, the separate structure of the area development program staff and related specialists, and the microfinance staff poses opportunities and challenges for ensuring holistic service provision for combating poverty traps. ADPs often do pre-enterprise work, targeting the poorest of the poor. As long term programs (approximately 15 years in each location), the ADPs establish trust through long term relationships between local staff and targeted communities. Microfinance programming can capitalise on this trust perhaps to more quickly initiate and reach sustainability of MFIs. On the other hand, the ADP emphasis on the poorest of the poor means that often target areas for development pose the greatest challenges to microenterprise development: poverty, which limits consumption potential; environmental features, which limit agricultural production potential; and remoteness, which poses challenges to market access.

Also similar to Save's programming, World Vision's microfinance programming is driven by the "four Ss": separate, specialised, sustainable (within four years), and of significant scale. The latter seeks to capitalise on the time and energy required to establish each MFI. The provision of services is also demand driven. Other donors may be available and known to clients for their specialisation in other types of services. In some instances, World Vision may partner with these other providers, for example, under large HIV/AIDS grants. Complementarity among partners can be either geographic or sectoral.

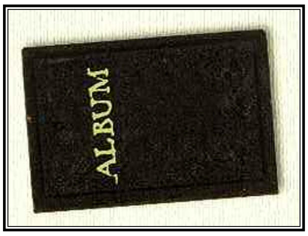
Conly (2005) summarises World Vision's perspective on the scope question with the following: MFIs should remain specialised; integration of services is most beneficial when it concerns business development services (e.g., access to markets), and where there are already multi-sectoral interventions in specific geographic zones (i.e., ADPs); and partnerships should be pursued when large grants are available (e.g., HIV/AIDS, food programming), where consortiums can maximize effectiveness.

Microfinance Network[7]

The Microfinance Network is a global MFI association. Membership is diverse, including networks and individual institutions, with different methodologies, but all are "committed to improving the lives of low-income people through provision of credit, savings, and other financial services" (Hattel, 2005). The membership represents all three scope options: 1) provision of financial and non-financial services (an holistic approach); 2) specialised MFIs that offer only financial services; and 3) specialised MFIs that build strategic alliances with other specialised institutions in order to provide a broader range of both financial and non-financial services (approximately 95% of the Network's membership). The following examples are illustrative.

SHARE MICROFIN LIMITED, INDIA

Share Microfin, a Southern NGO operating in Andhra Pradesh is a non-bank financial institution serving women in the poorest sectors of the population. Share Microfin provides financial services, as well as skills training to enable income generation. Share Microfin has achieved a 100% repayment rate. Its operational viability stems from keeping operational costs low and mobilising financial resources from development and commercial banks.



PRODEM FFP, BOLIVIA

PRODEM FFP serves micro, small, and medium businesses. It is the largest branch network in Bolivia (73 branches as of 2005), with 70% of the branches in rural areas, which also represents 30% of the loan portfolio. Their clientele represent both rural and urban areas and a range of economic backgrounds. As a regulated financial institution, PRODEM FFP offers savings services as well as loan products. Additional services include money transfer and life insurance.

COMPARTAMOS, MEXICO

Compartamos is a non-bank financial institution. Recognising the changing needs of clients over time, Compartamos seeks strategic alliances with other providers to make available a range of services corresponding to their clients' financial needs at different stages of life. For example, their needs framework begins with a working capital loan and moves to house loan, medical insurance, education loan, and, finally life insurance. The strategic alliances with other providers enable fast growth, a short learning curve, capitalisation of the expertise of other providers, and product improvement (quality and range), at less expense to clients, saving staff time and organisation financial resources.

BRAC, BANGLADESH[8]

BRAC is a "Credit Plus" model. It seeks to contribute to "people's social, economic, political, and human capacity building" (Hattel, 2005). BRAC promotes income generation for the poor through microcredit, health, education, and training programs (e.g., land rights, women's rights). Its largest component is microfinance, making it the largest microfinance delivery organisation in the world (Ahmed, 2005). As of 2005, BRAC had organised 115,840 village organisations, with a total membership of almost 4 million, and a loan repayment rate of 99.19%. In addition, approximately 2.6 million children had graduated from BRAC schools, with 1.1 million currently enrolled (Hattel, 2005).

BRAC evolved in response to listening to the needs of the poor themselves. As a result, BRAC's programming is based on the belief that microfinance cannot solve all the problems of poverty; it must be accompanied by other interventions in health, education, and empowerment through legal education (Ahmed, 2005). BRAC's programs have generated sustainably self-financing clientele, leading BRAC to establish a BRAC Bank to serve this evolving client base. BRAC's microfinance component is self-financing, with interest covering operational costs. However, programs in health and education cannot be made self-financing.

PARTNERSHIP FOR MICROENTERPRISE DEVELOPMENT

TYPES

The vignettes provide a range of examples of partnering and thinking about partnership for microenterprise development. First, microenterprise service providers who are multi-sectoral organisations might consider partnering internally with other programs/divisions of their organisation. This approach contrasts with integration in that the programs maintain separate staff, funding, and management arrangements and do not represent an added cost (and financial sustainability concern) for the microenterprise development program. Save the Children takes this approach, emphasising that the cross-sectoral services may be made available through these internal partnership arrangements, but they should not be required. World Vision pursues this approach through its area development programs.

Another type of partnership is that between the microenterprise development provider and the MFIs that it creates. World Vision illustrates this approach, where the MFIs become independent but still benefit from their association with World Vision, both by capitalising on the World Vision branding, or reputation, and by having access to multi-sectoral services available through World Vision's ADPs. World Vision's ADPs represent a sequencing of scope options, beginning with multi-sectoral approaches providing "pre-enterprise" work, extending to specialised services of MFI creation, and yielding partnerships that enable MFI clientele to access continuing multi-sectoral services of the ADPs.

Third, microenterprise development providers can partner with other service providers specialising in other sectors and/or complementary services. World Vision may pursue this approach, for example, when large grants provide incentives and other providers with geographic or sectoral complementarity exist. Compartamos partners with other providers to ensure the delivery of relevant services over the life stages of its clients. While Share Microfin chooses to integrate training with microfinance, it partners with development and commercial banks to mobilise financial resources.

Providers may also consider expanding services to meet the needs of extended clients, such as the next generation of service beneficiaries. For example, FINCA is looking to extend benefits and financial services to the children of borrowing mothers, whether through employment opportunities, or business loans. In this sense, FINCA becomes part of a growing economic sector with possibilities for meeting diverse needs through a range of services and service providers.

Finally, a theme especially championed by Hatch (2005), is the notion of partnering with the poor themselves. Here, the relationship is one of trust, where the service provider trusts that poor people know what is in their best interest; they know the best way for them to escape poverty traps. FINCA's new evaluation tool is testing the effectiveness of this approach. However, such a partnership orientation requires that the poor have the requisite information and that other providers of needed services exist, which relates to environmental constraints (discussed below). BRAC, on the other hand, is a multi-sectoral organisation providing a range of services; it partners with the poor in that it does not require microfinance clients to also partake of its health and education services.

ADVANTAGES

Partnership can provide opportunities for 1) strategic direction and coordination to meet the interdependent needs of poor people; 2) achieving greater scale and integration of services; 3) addressing these needs holistically and efficiently, by relying on the specialised knowledge and expertise of each actor; and 4) simultaneously maintaining the organisation identity of specialised program offices and organisations. Partners may share their commitment to help the poor escape from poverty, yet remain true to their particular organisation mission and values for doing so, thus maximising the contribution of each. In other words, efficiency and effectiveness are not lost by trying to reinvent staff skills and orientation to suit a broader range of service delivery requirements.

The vignettes illustrate how partnership approaches can capitalise on comparative sector advantages. National governments provide legal frameworks with which the creation of MFIs must concur and which also support the regulatory framework necessary for financial service delivery. The featured NGOs play an important intermediary and social mobilisation role vis-à-vis local communities, whether through the establishment of village banking, lending groups, or community operated MFIs. They also flexibly respond to broad needs of their clientele, whether directly or in partnership with other actors. Local communities assume ownership and operation of created MFIs and lending groups. The private sector is investing in and supporting the availability of financial and technical resources to microenterprise development. And donors and development agencies facilitate multi-sectoral partnerships and provide financial support, for example, through large grants.

Various governance mechanisms are demonstrated in the examples, confirming both the limits and opportunities each presents. Market mechanisms, such as interest rates, enable MFIs to efficiently operate and achieve financial sustainability. Contracts may also regulate multi-sectoral partnerships, especially those funded through large grants. Bureaucratic mechanisms, such as standard operating procedures and memoranda of understanding often regulate internal and external partnerships. They are also used to coordinate service delivery by multiple providers. Culture mechanisms are most apparent in the loosely organised partnership approaches, in internal and multi-organisational partnerships, as well as the partnership with the poor themselves. Here, trust in each actor's expertise, knowledge of needs, and determined approach is the guiding rule, as well as the shared commitment to see the poor escape from poverty.

World Vision's ADPs illustrate this key comparative advantage of partnership approaches, with their organic structures and reliance on cultural governance mechanisms: trust. The trust created by multi-sectoral pre-enterprise service delivery facilitates the creation of MFIs. This approach may be necessary given that World Vision's ADPs target clientele that are far from the ideal for ensuring MFI sustainability. Trust appears to be less critical, in contrast, for FFP PRODEM in Bolivia, which concentrates more heavily on specialisation in financial services to maximize efficiency and serve a diverse clientele; here, higher income clients sometimes receiving lower cost service delivery (e.g., in urban areas) can ensure financial sustainability of high cost services to lower income clients (e.g., in remote areas).

Each of the illustrated partnership approaches is organic in structure. They are not inflexible blueprints for meeting interdependent needs. The division of labour is fluid based on the available actors and their respective expertise and knowledge – whether these are internal to the organisation or beyond its boundaries. A heavy emphasis is placed on "sticking to one's knitting" in order to ensure effectiveness, efficiency, and sustainability. Each actor takes responsibility for overall success in meeting the broad needs of the poor. Communications and advice are horizontal and geared towards effectiveness, rather than hierarchical in nature.

IMPLICATIONS OF ENVIRONMENTAL CONSTRAINTS

Ironically, one of the key elements necessary for low environmental hostility for partnerships is the existence of qualified potential partner organisations. When these organisations are already in existence and accessible to the poor, a partnership with the poor becomes possible and formal inter-organisational partnerships across sectors may no longer be necessary. This finding implies that inter-organisational partnerships may be most beneficial when potential partner organisations are not already accessible to a particular clientele (whether defined by geographic region or need) or when the poor lack information about available services or face logistical barriers to accessing them. In the latter case, the inter-organisational partnership might focus on information sharing and coordination to market available services and to address access obstacles specific to microenterprise development clientele.

The potential for partnership with the poor and for inter-organisational partnership is also enhanced when there are existing institutional linkages and an understanding of what each partner or service deliverer may have to offer. Also assumed is that the various actors will share a commitment to poverty reduction without major philosophical differences as to the means. When this occurs, it is much easier to identify partnership champions who put these shared objectives first in developing coordination and information sharing mechanisms. All of these factors are much less problematic for internally-oriented partnerships.

Because the partnership stakeholders may be diverse, the variety of partnership options enables actors to flexibly respond to these needs. This is illustrated by Compartamos whose partner arrangements vary according to the life stage of the client being served. In the particular case of microenterprise development, the examples also demonstrate a range of potential hostility concerning selected objectives and stakeholders. For example, World Vision's microenterprise development programming follows the lead of the ADPs, which select regions whose characteristics are most hostile to microenterprise development. World Vision's intention to serve the poorest of the poor is a higher priority than a desire to minimise the challenges this objective poses. FFP PRODEM targets a range of incomes, with service delivery to wealthier clients supporting programming for more challenging clientele (e.g. poorer, more remote, rural). BRAC similarly uses BRAC Bank, which serves MFI graduates, to finance services that are not sustainable.

The range of partnership options poses various degrees of potential flexibility. Partnering with the poor affords the most flexibility for a service deliverer in that the poor themselves will select services or not, more or less as given. Internal partnerships may facilitate flexibility as it is likely to be easier to adjust internal processes from within organisations than between them, as is required for inter-organisational partnership. The required flexibility will also depend on the degree of integration required to meet partnership objectives, with information sharing requiring the least and joint action the most.

An additional recurrent, even universal, theme is that of avoiding artificiality. All of the organisations reviewed place a high premium on financial sustainability of MFIs, as well as the microenterprises they support. Because of this, Save the Children's microfinance program will not add new services unless they can be sustainable; and while it may internally partner, it discourages making complementary services a requirement of their microenterprise development programming. Similarly, World Vision emphasises its four Ss.

IMPLICATIONS AND CONCLUSION

Poverty traps suggest that multi-sectoral programming may be required for sustainable poverty reduction. I outlined three scope options, with partnership offered as a distinct possibility. However, a closer examination of selected experience in microenterprise development reveals that the partnership concept may, in fact, encompass components of each of these options. Partnering with the poor enables organisations to remain specialised on microenterprise development, trusting that the poor will capitalise on multi-sectoral services available from other providers. Internal partnering enables multi-sectoral organisations to provide services in coordinated, though perhaps not thoroughly integrated ways, securing at once the advantages of multi-sectoral approaches and partnership efficiency and effectiveness. The third option, inter-organisational partnership remains an important one.

By exploring environmental hostility, we can begin to identify those circumstances that call for different types of partnerships. If the ultimate objective is sustainable poverty reduction, partnering with the poor may only be appropriate when other providers are easily accessible to the poor. When this is not the case, internal or inter-organisational partnerships may be required to ensure the availability of multi-sectoral services, whether by referral and information sharing, addressing specifically identified obstacles to service access, and/or coordinating among various program units or organisations.

These prescriptions only hold when actors strategically prioritize poverty reduction, with attention to poverty traps and the services necessary to address these. Many organisations remain focused on narrow perspectives of organisation identity and comparative advantage. Such organisations can make important contributions to poverty reduction efforts. However, ensuring *sustainable* poverty reduction with this approach is likely to remain a happy accident for such organisations rather than a strategic effort. Explorations such as this article's can encourage NGOs to think more strategically about ultimate aims and the full range of options for reaching them.

[1] On September 8, 2000, the 189 member states of the United Nations adopted the UN Millennium Declaration, which includes eight Millennium Development Goals (MDGs) to address development and the eradication of poverty by 2015. See http://www.developmentgoals.org.

[2] See Ouchi (1979, 1980). The reference to bureaucracy should not be confused with structure; rather it refers to an approach for influencing behavior through established rules and procedures. These governance mechanisms have also been referred to as price, authority, and trust (Bradach and Eccles 1991).

[3] Artificiality is the extent to which resources outside the immediate environment are available; subsidies for inputs make partnerships vulnerable to their removal.

[4] This description draws from Hatch (2005).

[5] This overview draws from Conly (2005).

[6] This overview draws from Norell (2005).

[7] This overview draws from Hattel (2005).

[8] This overview draws from Ahmed (2005) and Hattel (2005).

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THE IMPACT OF MICROFINANCE

PROGRAMMES ON POVERTY REDUCTION

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INTRODUCTION

Poverty has different meanings to different people and is the source of much debate in the public arena. This is largely due to the fact there are many potential causes of poverty, ranging from those that could be categorised as causes stemming from one's personal choices and actions, causes stemming from structural constraints and inequalities in society, and causes that arise from government welfare entitlement programs. As a result of such a wide and diverse array of potential poverty causes, there are an equally large number of proposed policy interventions and solutions designed to eradicate the problem of poverty, some addressing each of the different areas mentioned above. One potential solution that has been increasing in popularity, and controversy, in recent years is the area of microfinance. However, despite the increased popularity, what is the record of such programs? Furthermore, what is the effectiveness/ ineffectiveness of such programs on reducing poverty? Finally, what are the predominant methodological approaches in the microfinance literature? As with any intervention strategy, as the number of microfinance programs instituted throughout the world continues to increase, formal investigation into the effectiveness of such programs is important.

→| ON FOCUS

"Men in great places are trice servants: servants of the sovereign or state, servant of fame, and servant of business."

FRANCIS BACON

In this paper I will provide a brief overview of evidence from the existing literature on microfinance to show the current performance record of such programs and the effectiveness/ineffectiveness of such programs on reducing poverty. Furthermore, I will discuss some criticisms of the microfinance approach to eradicating poverty and provide a critique of the methodological foundation of microfinance as a whole, as well as the increased number of impact studies that have been conducted in recent years. Finally, I will draw several conclusions on the appropriateness and effectiveness of microfinance programs in addressing the problem of world poverty, while providing several suggestions for future research directions in this developing field.

BACKGROUND TO MICROFINANCE

Poverty is a world-wide poverty epidemic. Figure 1 below illustrates that though extreme poverty rates have been declining across many regions of the world in recent decades, high rates still persist. Furthermore, it is estimated that about one-sixth (500 million of an estimated 3 billion) of poor people throughout the world have access to formal financial services (World Bank, 2005). This represents a large gap in access to such services.

One approach to reducing this gap that has increased in popularity in recent years has been the formation of microfinance institutions (an estimated 7,000 microfinance institutions serving approximately 16 million poor individuals in developing countries) (World Bank, 2005). However, Figure 2 illustrates the large gap that still persists between need and the access of microfinance services available to the world's poorest families (see Daley-Harris, 2009).

The idea of microfinance started in Bangladesh around 1976 with Muhammad Yunus and Grameen Bank (recently awarded the Nobel Peace Prize for his work). Microfinance refers to financial services offered to low SES individuals that are excluded from the traditional financial system (considered "unbankable" – lacking collateral, steady employment, and a verifiable credit history). Aspects of microfinance, such as microcredit, are designed to help lift individuals, families, and communities out of poverty by providing small amounts of start-up capital for entrepreneurial projects, which will then presumably help individuals to generate income, build wealth, and exit poverty.

One aspect of microfinance that distinguishes it from the traditional financial system is the "joint liability concept," where groups of individuals, usually women, group together to apply for loans, and hold joint accountability for repayment of the loan. The premise is that providing low SES individuals access to financial services will better enable poor households to move away from subsistence living, to a future oriented outlook on life and an increased investment in nutrition, education, and living expenses. Furthermore, microfinance is unique as a development tool because of its potential to be self-sustaining (both reducing poverty and maintaining a profitable business) (Business Week, 2005).

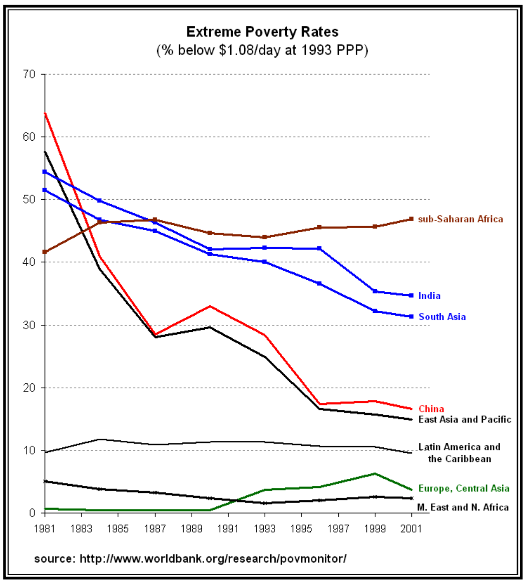

FIGURE 1: EXTREME POVERTY RATES IN WORLD REGIONS.

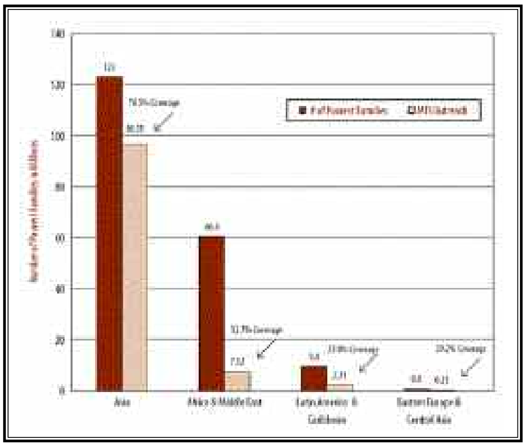

FIGURE 2: ACCESS TO MICROFINANCE SERVICES.
Source: State of the Microcredit Summit Campaign Report 2009.

REPORTED STRENGTHS/POSITIVE IMPACTS OF MICROFINANCE PROGRAMS

A variety of studies have found a few key strengths and positive impacts produced by the implementation of microfinance programs in poor and impoverished areas of the world. First, microfinance programs can be an effective way to provide low-cost financial services to poor individuals and families (Miller and Martinez, 2006; Stephens and Tazi 2006). Second, such programs have been shown to help in the development and growth of the local economy as individuals and families are able to move past subsistence living and increase disposable income levels (Khandker, 2005).

In addition, many studies (primarily microfinance institution impact studies and academic researcher qualitative or case studies) have shown that microfinance programs were able to reduce poverty through increasing individual and household income levels, as well as improving healthcare, nutrition, education, and helping to empower women. For example, standard of living increases, which help to eradicate extreme poverty and hunger, have occurred at both the individual and household levels as a result of microfinance programs (Khandker, 2005). Furthermore, it has been demonstrated by some research that microfinance programs increase access to healthcare, making preventative healthcare measures more affordable to the poor. In addition, more children are being sent to school and staying enrolled longer (Morduch, 1998). Finally, it has been shown that such programs can help borrowers to develop dignity and self-confidence in conjunction with loan repayment, and self-sufficiency as a means for sustainable income becomes available. Since microfinance services are primarily focused on women, it is argued that this leads to the empowerment of women and the breaking down of gender inequalities, through providing opportunities for women to take on leadership roles and responsibilities (Goetz and Gupta, 1995).

REPORTED PROBLEMS/NEGATIVE IMPACTS OF MICROFINANCE PROGRAMS

In contrast to the various positive impacts and strengths of microfinance programs listed above, other studies (more quantitative, with appropriate treatment/control frameworks and comparisons made across larger samples) have found several key problems and negative impacts produced by the implementation of microfinance programs in poor and impoverished areas of the world. First, some studies have shown that microfinance programs benefit the moderately poor more than the destitute, and thus impact can vary by income group (better-off benefit more from micro-credit) (Copestake *et al.*, 2001; Morduch, 1998; Dugger, 2004). Second, most microfinance programs target women (due to higher repayment rates), which may result in men requiring wife to get loans for them (Goetz and Gupta, 1995). Third, examples exist of a vicious cycle of debt, microcredit dependency, increased workloads, and domestic violence associated with participation in microfinance programs (Copestake *et al.*, 2001; Morduch, 1998). Fourth, studies have shown that there are low repayment rates in comparison with traditional financial institutions (Miller and Martinez, 2006; Stephens and Tazi, 2006), thus possibly contradicting one of the key strengths listed above, that such programs can lead to empowerment and increased self-confidence through responsible loan repayment. Fifth, there have been reports of the use of harsh and coercive methods to push for repayment and excessive interest rates (Business Week, 2005; The Financial Express, 2005). Finally, concerns have been raised that the reliance on microfinance programs to aid the poor may result in a reduction of government and charitable assistance ("privatisation of public safety-net programs") (Neff, 1996).

MICROFINANCE AS A MEANS TO ALLEVIATE POVERTY?

Based on the findings reported above, there are mixed conclusions as to the overall impact of microfinance institutions. This leads us to the key question of this paper: What is the effectiveness/ ineffectiveness of microfinance programs on reducing poverty? Some studies have found marked decreases in overall poverty levels, including declining levels of extreme poverty (Khandker, 2005), while other studies do not find the same direct effect (Morris and Barnes, 2005; Kan, Olds, and Kah, 2005; Goetz and Gupta, 1996). Still, other studies provide mixed results (Copestake, Bhalotra, and Johnson, 2001; Morduch, 1998). Thus, the academic literature is mixed in regards to the specific impact that microfinance has on alleviating poverty. Many impact studies and other similar assessments find great strengths and positive impacts of such programs on reducing poverty, while other studies report that such positive impacts may be over-reported and even inaccurate, while pointing out some fundamental flaws with such study designs.

The question is, which group of studies is correct, and to what extent? At this point in the literature, there are few statistically and methodologically sounds stringent evaluations of microcredit programs generally viewed as credible by experts. Much of the academic literature reporting positive results of the impact of microfinance programs in reducing poverty use qualitative methods, look at single cases or specific areas or regions, use cross-sectional data, analyse self-reported measures, and use non-random sampling procedures, resulting in findings that cannot be easily replicated nor generalised to all programs. In contrast to the common qualitative and case-study approaches in the less rigorous body of research, only a handful of studies use sizeable samples and appropriate treatment/control frameworks to answer the questions of real impact and effectiveness. As Morduch said in his critique of the existing literature methodology, "While strong claims are made for the ability of microfinance to reduce poverty, only a handful of studies use sizable samples and appropriate treatment/control frameworks to answer the question" (1998, p. 1). Until more such studies are conducted and findings reported, we must take the findings of less rigorous impact studies with a grain of salt and not be too quick to generalise findings of the impact and effectiveness of a specific program, in specific location, at a specific time, to other cases.

FUTURE DIRECTIONS

I am encouraged by the increasing popularity of the growing microfinance movement and recognise it as a pioneering approach to addressing the problem of poverty. There are numerous studies that demonstrate the tremendous successes of such programs throughout much of the underdeveloped world. However, despite the increase in the popularity of microfinance programs and the vast amount of research conducted to date, there are two key areas for future academic research into the effectiveness of microfinance programs.

First and foremost, more stringent evaluations of microcredit programs are needed. Various feasibility and impact studies have shown the financial viability of such programs in being self-sustainable institutions, but the question of the effectiveness and impact on the poor of such programs is still highly in question. Many studies use a case-study approach to looking at the effectiveness of a given program in a given region at a given time, but few effectively measure the impact of multiple programs. To be able to say once and for all that these programs are or are not effective at reduce poverty will require a large sample of programs with data that can be rigorously analysed, with replicable methods and generalizable findings.

Second, there are considerable practical debates surrounding the implementation of microfinance programs that have yet to be answered. These debates include a fundamental theoretical debate between large-scale, top-down funding of major development projects versus small-scale, bottom-up funding to individuals and households as a means of alleviating poverty. Additionally, there are questions surrounding the potential of microfinance programs to cannibalise other programs, including government assistance and aid. Furthermore, there are still questions as to the potential of microcredit hurting the poor and creating a kind of microcredit dependency. Finally, as microfinance programs are geared almost exclusively to woman, there is a debate about the appropriateness of such a policy and the possible exploitation of women. Therefore further research needs to be conducted to examine these facets of microfinance programs.

CONCLUSION

Despite the popularisation of microfinance in the mass media and the many positive findings that are reported in some feasibility and impact studies, there are also many studies that report some negative impacts of such programs and fail to find a direct link between microfinance program involvement and poverty reduction. Thus, at this point, NGO leaders and government policy makers must exercise caution and restraint in applying the microfinance approach universally as a means of alleviating poverty and continue to conduct rigorous research that will better answer the questions addressed in this paper. ▣

* Author's Note: *This article is adapted from a previous version of this paper, entitled "Trickle-Up Economic Development: A Critical Examination of Microfinance Programs", in* The International Journal of Environmental, Cultural, Economic and Social Sustainability, *6(4), 2010: 1-10.*

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MICROFINANCE

YESTERDAY, TODAY AND TOMORROW

SIMONA SAPIENZA

Simona Sapienza was educated at the Sawyer Business School (Pittsburgh, US), at the University of Rome «La Sapienza» where she received her MA in Law and PhD.

Ms Sapienza has held various academic positions in Italy and has been legal counsel for the Italian Institute of Research for the international protection of human and civil rights. She has been actively engaged in supporting NGOs projects associated with the Department of Public Information of the UN and in inter-cultural projects promoted by the EU Commission.

Ms Sapienza is currently Senior Associate in the International Capital Markets department of Allen & Overy (Rome), which she joined in 2000.

Ms Simona Sapienza is a Board member of the Spanda Foundation.

→| FUTURES

"Probable impossibilities are to be preferred to improbable possibilities."

ARISTOTLE

"MICROFINANCE IS *ANOTHER term for microcredit,* (1) which is defined as *the lending of small amounts of money to low interest to new business in the developing world,*" this the official definition[1].

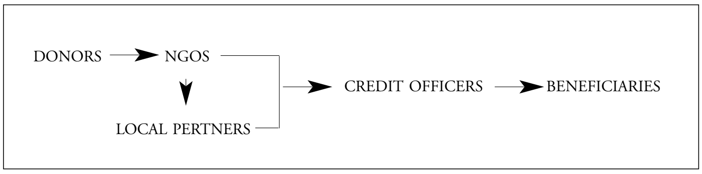
Although clear, this definition may need some revision in particular in the light of the socio-demographic changes which over the last decades have significantly altered the world economic scenario. Actually, for microfinance the new context has meant different potential beneficiaries with different financial needs and a greater involvement of financial intermediaries.

Traditionally microfinance has been associated with programmes that benefit people with serious subsistence problems in developing countries. This is why microfinance may overlap easily with microcredit: small loans, often without traditional guarantees, aimed at improving the lives of the beneficiaries and their families or at sustaining micro-economic activities. The resources, coming mainly from funds donated by states and supranational organisations or by individuals and foundations, are channelled to their recipients usually through NGOs and local partners. In this scenario NGOs and donor countries have been operating together with other locally-based organisations, such as municipalities or governments or other entities from the third sector helping to facilitate the screening and management of credit positions. In order to reduce the often cultural gap between lenders providing credit and the beneficiaries of the microloans many organisations have relied to networks of local partners visiting potential beneficiaries to gather information during the selection and monitoring phase and later to collect the different installments related to the micro-loans granted.

The traditional beneficiaries of traditional microfinance therefore have been citizens of developing countries sadly known as the "poorest of the poor". Within this category, women have been of particular importance as the group most affected by financial exclusion and, at the same time, more capable than men to repay and manage the funding received in small income initiatives [SEE GRAPH 1].

In the last few years microfinance has served a group of beneficiaries largely distinct from the one traditionally associated with microcredit. More recently microfinance has open up to self employed workers and individuals in charge of small, often family owned business, which are simply not able to access credit from banks. For micro-entrepreneurs, microfinance has become an alternative to credit given by informal lenders and a way out of the money lending system. Furthermore, actual potential microfinance beneficiaries include individuals who, although not living in poverty, may have general difficulty in gaining access to the financial system.

As a matter of fact today exclusion from the traditional credit system includes millions of people and it can be the consequence of other forms of exclusion, primarily from the socio-political system. Immigrants or ex-convicts may be, for instance, the victims of such social and political exclusion and be among the *unbankable* ones. Furthermore, a form of financial exclusion can be the one affecting customers, mainly small-scale entrepreneurs, considered marginal by credit institutions as they represent a low-value target compared with the traditional customer evaluation models. Although it may well sound a paradox, it is this very group of *unbankable* people that, despite their common distance from the credit system, are usually characterised by increasing levels of professional and managerial ability, and increasing levels of creditworthiness.



GRAPH 1 - Standard microfinance structure.

Up to yesterday the financial system regarded microfinance with suspicion. Traditional finance considered offering credit to individuals seen as *un-bankable* when not backed up by guarantees, as a too risky business. Moreover, the process of supplying small loans incurs excessive costs owing to the significant operating cost needed to deal with each loan in relation to the amount of credit supplied.

In recent microfinance experience, however, we are witnessing a cross-over movement, which is seeing a greater involvement of banks and microfinance financial intermediaries in programmes destined for the poorest of the poor, the poor and the *unbankables*, and a parallel involvement of NGOs and microfinance financial intermediaries in programmes aimed towards marginalized beneficiaries.

The continuous increase of un-bankable and marginalized people in the world is determining a greater complexity of the financial structures in microfinance programmes and, therefore, a more significant move away from the traditional patterns of microcredit.

Microfinance is no longer just a financial technique mainly offered by the non-profit sector as part of development programmes to sustain the poor in developing countries. It has become something different. Despite the challenges which remain in attracting private capital, lowering costs and interest rates and developing regulation, it has slowly become an established part of the global capital structure.

The modern microfinance market is characterised by a complex demand for financial and technical services and a complex supply, owing to a growing interaction and interest on the part of institutional donors, the non-profit sector and the financial markets.

The increasing participation in microfinance programmes of regulated financial intermediaries brings microfinance closer and closer to traditional finance. The presence of intermediaries oriented towards profit, and the use of private funds, can represent a risk of departure from the ethical nature of the social and humanitarian objectives behind traditional microfinance and of the channelling of funds through non-profit organisations lines. To prevent this and to facilitate the development of a microfinance of tomorrow linked to the values of ethical finance, the non-profit sector will still play a crucial role. NGOs especially will have the important task of safeguarding the original features of microfinance, in particular the ethicality of the business, the flexibility of the process and the proximity to the beneficiaries. They will still be the best organisations to interact with microfinance financial institutions and local governments to propose projects linked to national and local development policies.

To lower intermediation costs to manage the risks associated with microfinance project effectively, the entry in the microfinance market of non-bank financial intermediaries such as Ethical Investment Funds and Ethical Pension Funds will also be crucial. They may be an important source of low cost funding for microfinance, still much unexploited. Actually, savings collected from ethical investors could find market investment alternatives in microfinance that meet the ethical feature required. In addition, ethical savings do not incorporate a risk-return relation similar to traditional savings and, therefore, can be dedicated to investments that ensure rate of returns lower than market ones'.

NGOs are in the position to select the most appropriate beneficiaries for each project. They can offer the human resources necessary to provide technical assistance and training from the starting up of the project until the exit strategy. They will have to cooperate with financial intermediaries to implement an efficient credit process that reduces to the minimum the different costs that may arise from asymmetric information and risk management models. NGOs are already on the path and made important contributions to poverty alleviation by addressing quality of life issues such as health, education, environment and shelter, and by providing new opportunities to beneficiaries.

For the future, it is possible to foresee that microfinance programmes will be increasingly characterised by stronger cooperation among stakeholders – international donors, governmental bodies, financial intermediaries, NGOs, technology companies – using respective skills and institutional objectives to foster the effectiveness of microfinance programmes and support ethical sustainability [SEE GRAPH 2].

The next decades of microfinance will bring new players to the field and will create alliances among entities that would have been difficult to consider partners a decade ago and who together will continue to reinvent microfinance.

INSTITUTIONS	SERVICES	BENEFICIARIES	
		POOREST AND POOR	UNBANKABLES-MARGINALIZED
GOVERNMENTS	GRANTS	X	
DONORS	GIFTS	X	
NON-PROFIT NGOS	DONATIONS	X	
FINANCIAL NGOS	LOANS		X
BANKS	CREDIT/TECHNICAL SERVICES		X
MICROFINANCE INVESTORS	CREDIT/TECHNICAL SERVICES		X
FINANCIAL INTERMEDIARIES	CREDIT/TECHNICAL SERVICES		X

GRAPH 2

NGOs that gave birth to this sector, have already started to reinvent themselves, some have transformed themselves into regulated financial entities which operate principally by offering microcredit as part of development projects, often combined

with the offer of technical assistance and social intervention for beneficiaries.

Microfinance fits well in the context of the Millennium Development Goals (MDGs). Among the many important tasks that constitute the agenda for poverty eradication the UN Millennium Declaration calls for "microfinance projects which meet the local community priorities". From this point of view, the new microfinance model becomes an important component to meeting the MDGs of 2015. This places greater pressure on the new actors of microfinance to address the challenges and to seize the opportunities of the next years so that in 2016 microfinance will have realised the vision, assuring access to financial services to the world's majority

[1] *Oxford English Dictionary*, 2009.

MARKET STRATEGY DEVELOPMENT

AND 3RD GENERATION MICROFINANCE IN INDIA

ANANT JAYANT NATU

Anant Jayant Natu is an Electronics and Telecommunications Engineer with a Post Graduate Diploma in Rural Management from the Institute of Rural Management (IRMA). Throughout his career, he has played a crucial role in the incorporation of Grameen Capital India Ltd. (GCIL), IFMR Trust and IFMR Foundation, whilst working as a Manager at ICICI Bank's Social Initiatives Group (SIG). With SIG, he was responsible for monitoring the projects mandated to provide support to research and academic institutions, technical service providers and other entities in the microfinance sector. Amongst other achievements, he has co-authored a paper on NREGP and financial inclusion.

He has expertise in drawing business plans and projections, delivering training and conducting institutional assessments. Since he joined MicroSave, he has worked with over 30 MFIs and other types of financial institutions across India, the Philippines, Sri Lanka and South Africa. Recently, Anant has been spearheading critical work on market research, product development, pilot-testing and product rollout for an MFI in India. His areas of interest include rapid institutional assessment, process mapping, strategic business planning, capital structuring and equity valuation, internal audit and controls, and training for bankers.

→| NEW DIRECTIONS

"The original is unfaithful to the translation."

JORGE LUIS BORGES

INTRODUCTION

Microfinance in India has evolved over the past two decades since its inception in the early 1990s. The SHG-bank linkage model, its first prototype, was the offspring from an unlikely marriage between the social intermediation role of the civil society and the financial intermediation of banks, with RBI and NABARD acting as more than willing midwives.

As the business potential of microfinance dawned on many, microfinance institutions (MFIs) took on the task of both the social and financial intermediation. Thus an alternate channel for microfinance arrived (somewhat belatedly by comparison to elsewhere in the world). This was second-generation microfinance for India. Most of the MFIs adopted the Joint Liability Groups (JLGs) methodology and standardisation became the new mantra for achieving rapid growth. Over the past 2-3 years, NBFC-MFIs operating under predominantly JLG-based methodology have emerged as a significant and rapidly growing force.

Nonetheless, SHG-based systems still serve three quarters of the overall microfinance clients in India and have two-thirds of the total loan outstanding[1]. Some would argue that SHG-based models are still the most relevant model for certain segments of India's poor. Nonetheless, there is growing evidence of significant problems with SHG-based models' portfolios[2], and some issues within those of JLG-based MFIs, particularly in competitive areas of the country. With competition comes change.

THE CHANGING ENVIRONMENT: A TECTONIC SHIFT?

Interestingly, the formal, public sector financial institutions (Regional Rural Banks, Cooperative Banks etc.) are still not competing in the microfinance market. However, the burgeoning number of MFIs, and the relatively narrow focus of their products, has meant that intense competition has emerged, particularly in the southern states and in some limited areas of the east. This has provided microfinance borrowers with unprecedented access to credit and has been a boon for them, but not without the concomitant vices of competition. Many of the larger MFIs are now responding to the demands of their commercial equity investors for very rapid expansion by adopting a 'sales' driven approach for increasing outreach. The dash for growth has also seen several MFIs overstretch their management capabilities and systems, resulting in significant portfolio problems.

In addition, there is growing evidence of clients 'patching' loans together from several MFIs in order to meet their needs for finance. For example, a high yield heifer costs around Rs. 30,000 (USD $600) – more than any one Indian MFI will lend under a traditional group-based system. The proliferation and massive growth of MFIs has meant that (so long as they are willing to sit in the groups each week) clients can access three (or more) loans from different MFIs. Unsurprisingly, while many clients successfully take multiple loans to finance larger projects, others become over indebted – this has led to growing signs of stress in MFIs' portfolios, most dramatically evidenced in the Kolar district in Karnataka[3].

To respond to the cutthroat competition, MFIs are trying out different approaches that range from the desperate to the deliberate. The desperate measures have bordered on the unethical 'poaching' of both credit officers and even groups from rival MFIs. Other more deliberate attempts have included offering individual lending (IL) product to their old clients[4]. Nevertheless, the design of many MFIs' IL product is hardly different from their group loans – except that group guarantee is replaced by a single guarantor. Basic evaluation of the enterprise is usually performed, but the product is rarely customised to respond to cash flows, or even the financing needs, but rather reflects a pre-defined stepped loan schedule. In addition, few MFIs invest in the skill sets required for a successful IL programme[5].

In being 'reactive' to the competition (and in some cases their private equity investors), many MFIs are losing sight of the *raison d'être* of their existence - their clients. It is increasingly clear that the challenges of competition must be countered by bringing clients back as the 'focus' of their business. This shift in focus will bring a 'tectonic' change in the way MFIs do microfinance and see the emergence of 3rd Generation microfinance institutions (3G-MFIs).

3G MICROFINANCE INSTITUTIONS: 'EXPANSION' TO 'ENGAGEMENT'

A 3G-MFI is continually asking itself one basic question: *"What share of my client's financial needs is being met by us?"* It will seek to be a "one-stop-shop" for all her financial needs in a manner that "delights" her. The very mission of the 3G-MFI sets it apart from its competitors, as it no longer treats its client as a head-count, but as an individual with dynamic needs.

One distinct feature of any 3G-MFI is their long-term market strategy. They consciously choose to pursue the strategy of product modification and new product development over market penetration and geographic expansion. This shift of strategy from 'expansion' to 'engagement' is shown in the figure below[6].

PRODUCT

MARKET	EXISTING	MODIFIED	NEW
EXISTING	Sell more of our existing products to our existing customers. (Market penetration).	Modify our current products and sell more of them to our existing customers. (Product modification).	Design new products that will appeal to our existing customers. (New Product modification).
MODIFIED	Enter and sell our products in other geographic areas. (Geographic expansion).	Offer and sell modified products to new geographical markets.	Design new products for prospects in new geographic areas.
NEW	Sell our existing products to new types of customers. (Segment invasion).	Offer and sell modified products to new types of customers.	Design new products to sell to new customers. (Diversification).

3G-MFIs will see growth in terms of improvements in their clients' financial well-being, and the MFIs' ability to serve them over a long period of time. Some MFIs are even looking at using full lifetime value of customer analysis as a basis of their planning. 3G-MFIs will also grow horizontally, but this will not be their dominant strategy; and they will grow horizontally only to an extent that does not compromise their engagement with existing client segments.

3G MFI: HOW WILL THEY DO IT?

A 3G-MFI will operationalise the strategy of deepening engagement by:

1 ~ Offering clients a suite of financial services in response to their full spectrum of financial needs, including; credit, savings, remittances, insurance etc.

2 ~ Focusing on convenience for all clients, so that products respond to the needs of the client, and not just those of the institution.

3 ~ Leverage technology, particularly e-/m-banking to increase transaction efficiency and reduce costs.

~ Add supplementary services, such as 'livelihood' services or education/food security services[7] or possibly even health services.

One of the pioneers of 3rd generation microfinance has been the IFMR Trust Holdings, which provides 'wealth management' support to its clients. Wealth management is a notion that transcends product-centric thinking and the traditional focus on outreach alone. The wealth management perspective calls for institutions that are embedded within the community and growing vertically, rather than horizontally. It means they will serve a limited set of clients in a more comprehensive manner, rather than be spread across a large number of clients across geographies. It also entails that the institution offers its services to *all* people in the communities it serves[8].

CHALLENGES FOR 3G-MFI

Since 3G-MFIs look at microfinance from a different perspective, they need do things differently from other 3G-MFIs, specifically:

1 ~ Train the front-line staff intensively for them to be able to provide 'wealth management' advice.

2 ~ Offer savings services through Money Market Mutual Funds or other collaborations.

3 ~ Tie-up with other institutions to provide tailored remittances, insurance, pensions and other products and services.

4 ~ Optimise the use of technology to allow tie-ups and reduce time spent on processing and back-end operations.

CONCLUSION

Given the saturation in a growing number of geographic markets, it is imperative for the MFIs to shift from a 'product-centric' to a 'client-centric' approach. The product-centric approach worked in uncompetitive markets with a huge demand-supply gap, and where the imperative was for rapid expansion. But as the number and outreach of MFIs has grown, supply is no longer a constraint in many regions.

Clients are in a position to pick-and-choose the MFI that offers them the most value. The 3G-MFIs will be quick to sense this 'tectonic shift' in the dynamics of the highly competitive markets, and do everything they can to put the client back at the centre of their business. This focus will translate into a respect for client's time and dignity, and into making the entire spectrum of financial services for the client's livelihood available to them – a welcome prospect for both clients and those who believe in microfinance as a service for development and poverty eradication.

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1 'Bharat Microfinance Report: Quick Data-2009', Sa-Dhan.

2 See *MicroSave,* India Focus Note # 15, 'Delinquency in Self Help Groups'.

3 See *MicroSave,* India Focus Note # 25, 'Dinosaurs and Rabbits'.

4 Six of the top 50 MFIs in India are offering IL product. Refer "*India Top 50 Microfinance Institutions*; October 2009; CRISIL ratings.

5 See *MicroSave,* India Focus Note 14, 'Challenges of Introducing Individual Lending in India' and *MicroSave,* India Focus Note 34, 'Risks and Challenges in Individual Lending'.

6 Based on the 'Kotler on Marketing: How to Create Win and Dominate Markets'.

7 Equitas is building in such services.

8 *IFMR Trust Synthesis Newsletter August 2009.*

A SHARIAH-COMPLIANT MICROFINANCE FUND:

A MUCH NEEDED TOOL FOR THE ACCOMPLISHMENT OF ISLAMIC ECONOMIC'S GOALS

ALBERTO G. BRUGNONI

Alberto G. Brugnoni, a former private banker with Merrill Lynch, is an independent adviser of international finance. He has conceived, structured and implemented projects for Institutions of the European Union, International Organisations, Public Agencies, Companies, International Legal Practices, Banks, Management Companies, Universities, Associations, Private Clients, Stakeholders' Lobbies.

His practice focuses on the creation of wealth through the full implementation of the 'social capital' and 'territorial added value' concepts. An innovative use of the financial mechanisms and structures applied to ethical monies allows the emergence of new forms of governance that take on account the social, cultural and economic inclusion of all parts of society. His unique working experience combines the traditional finance, the ethical finance and the islamic finance sectors.

Alberto runs ASSAIF, an Islamic finance-tailoring consultancy out of Italy and regularly contributes to the major Social, Ethical and Islamic Investment Forums worldwide.

→| FUTURES

"Money is none of the wheels of trade: it is the oil which renders the motions of the wheels more smooth and easy."

DAVID HUME

Poverty can bring someone to a state of disbelief.
Hadith of the Prophet (PBUH).

BACKGROUND ISSUES

ISLAMIC FINANCE IS CURRENTLY EXPERIENCING A critical developmental issue with the growing divergence between the aspirations of Islamic economics and the realities of the industry. Rather than being part of the Islamic political economic thought, Islamic finance has been pursuing policies away from the theoretical underpinnings of Islamic economics and has located a surrogate financial framework in neo-classical economics. Islamic finance institutions aiming at efficiency have ignored and relegated the importance of social dimension and failed to internalise social justice into their own operational function. In that predicament, Islamic finance is perhaps best described as heterogeneous financial products deprived of their value systems and is nowadays suffering from the perception that it is simply a rebranding of conventional finance and not truly reflective of Islamic principles.

On the one hand, Islamic economics provides axioms and values that propose an ethical system of economics and finance based on the ontological and epistemological sources of Islam: the Qur'an and the hadiths. Its foundational claims are social justice, poverty alleviation and prevention of exploitation while at the same time emphasising social justice, needs' fulfilment, wealth redistribution and postulating sociotropic individuals. On the other hand, a critical analysis of today's IF institutions indicates that the pragmatic approach adopted by the industry has lead to the non-implementation of these values. The emerging wealth in the Muslim world and the staggering rate of growth of the Islamic finance institutions assets-base coupled with the weak development of the contemporary discourse of Islamic economics has forced Islamic finance to blindly adhere to the well-known precepts of a neo-classical paradigm of managing wealth. By doing so, it has weakened the entire social justice discourse of Islamic economics and has not made any significant contribution to the betterment of the lives of common Muslim individuals.

Nowhere this issue has become apparent as in the microfinance sector with the notable absence of Shariah-compliant products aiming at poverty alleviation and the empowerment of micro-entrepreneurs. Microfinance products have indeed been quite successful in Muslim majority countries with large microfinance banks operating in Indonesia, Bangladesh, Pakistan, Morocco, Egypt and India but few of them are Shariah-compliant. Though 44% of conventional microfinance clients worldwide reside in Muslim countries, the overall penetration of microfinance in these countries is indeed irrelevant. Conventional products do not fulfil the needs of many Muslim clients as Shariah compliance in some societies may be less a religious principle than a cultural one with even the less religiously observant preferring Shariah-compliant products. All available evidence hints indeed at the existence of a market of poor clients who strictly engage in Islamic transactions but also at a category of Muslim clients who reluctantly use conventional products but prefer Islamic ones and would switch over once they become available. Unlocking this potential could be the key to providing financial access to millions of Muslim poor who currently reject microfinance products that do not comply with the Shariah.

From the Islamic perspective the concern about conventional microfinance rests upon the fact that all the conventional models are interest-based which makes their application unacceptable. Interest rates, high or low, are rejected by Muslims as tantamount to *ribà*, something that is prohibited in no uncertain terms by the Shariah. Indeed, one can say that financial exclusion is exacerbated in Muslim societies by the abhorrence to interest-based microfinance that prevents the access to banking or financial services. Amongst other lacunas caused by the interest rate system there are problems of adverse selection and moral hazards.

According to the 2007 CGAP's report, *Islamic Microfinance: An Emerging Market Niche*, Islamic microfinance has a total estimated global outreach of 380,000 customers accounting for a meagre 0.5% of the total estimated microfinance outreach of 77 million. Islamic microfinance institutions reach roughly 300.000 clients through 126 institutions operating in 14 countries plus an estimated 80,000 clients through a network of Indonesian cooperatives. In all Muslim countries, Islamic microfinance is still in its infancy and accounts for a very small portion of the country's total microfinance outreach never exceeding 3% of outstanding microfinance loans. With 80% of its supply concentrated in Indonesia, Bangladesh and Afghanistan, in other countries Islamic microfinance has no scalable institutions reaching clients on a regional and national level. The average outreach of the 126 institutions is only 2,400 clients with none with more than 50,000 clients.

THE CASE FOR A FOR-PROFIT APPROACH IN ISLAMIC MICROFINANCE

Challenges in reaching a sustainable scale are mainly due to the 'not-for-profit culture' nature of the Islamic microfinance institutions that are featuring an over-dependence on grants coupled with a lack of operational efficiency and proper risk management. This, and a want of product diversification, has resulted in an industry that is overall struggling, with most institutions not economically viable and largely dependent on the availability of external funds. In this respect it should be noted that NGOs are the dominant players with 14 institutions reaching 42% and just two commercial banks reaching 29% of the market. Other players are rural, village and cooperatives banks.

The overdependence on grants obliges Islamic microfinance institutions to constantly look for injection of funds to keep running less their capital is used to cover the operating costs. In addition, they have to ration their funds and thereby limit the access of financial services to some people and geographical areas. Furthermore, as a result of this grants' addiction, Islamic microfinance institutions do not strive to collect extra saving which in turn is another reason that prevents them from attaining self reliance and growth. Microfinance should indeed aims at building permanent local financial institutions that can attract domestic deposits, recycle them into loans, and provide other financial services. The UN Capital Development Fund estimated in a recent study that there is potential for 7 million borrowers and 19 million savers, so it appears that the availability of microsavings products may be more important than microfinancing, a fact recognised only recently.

Grants should be temporary start-up support, designed to get an institution to the point where it can tap private funding sources (investor with equity/loans and deposits). External funds are needed particularly during the initial stages of operation, when the savings of members are small but with the passage of time as savings of beneficiaries accumulate and get recycled, the dependence on external funds should reduce. Though voluntary contributions to the greater public welfare are a long standing and important aspect of the Muslim culture, current Muslim philanthropy needs to become more focused and utilise the available resources to tackle the underlying causes of important social problems without confining itself to assuage the effects of social issues. Unprecedented wealth creation and gentrification should drive a new generation of actors to channel their private giving into new institutional forms such as capacity building in microfinance at the macro, micro and institutional level with the key bottleneck remaining the shortage of managers. In this respect, an innovative approach should perhaps be considered with particular reference of the obligatory *zakat*.

To be sustainable the industry must shift from a charity-based donor-dependent approach to a market-based for-profits approach and clearly separate the role of donors' funds from that of private capital. Traditionally, the private sector was viewed as a potential source of funds that would contribute to development efforts from a desire to meet corporate social responsibility objectives. More recently, it is recognised that the private sector can make a significant contribution to achieving the Islamic microfinance institutions goals when its core business focuses on profitably (=sustainably) providing quality services at reasonable price.

This for-profit approach will help addressing the issues of operational efficiency, risk management, transparency, product diversification and authenticity. It will also help establishing much needed performance benchmarks. Islamic microfinance must pay for itself if it is to reach a large numbers of people and unless microfinance providers cover their costs, they will always be limited by the scarce and uncertain supply of subsidies from governments and donors.

CONVENTIONAL MICROFINANCE AND ISLAMIC FINANCE

Available evidence shows that the conventional microfinance recipients better the quality of their lives, generate more income for their households, create job opportunities within their own communities and improve general living standards including nutrition, health, housing and education.

In spite of the current divide, conventional microfinance institutions can find Islamic finance a natural fit in their programmes, debt and equity-based alike. Microfinance the Islamic way has indeed the potential not only to respond to unmet demand but also to combine the Islamic social principle of caring for the less fortunate with microfinance's power to provide financial access to the poor. Microfinance and Islamic finance have much in common. Both emphasise the good of society as a whole. Both advocate entrepreneurship and risk sharing and believe that the poor should take part in such activities. Both focus on developmental and social goals and advocate financial inclusion. Both involve participation by the poor.

In the light of the above arguments, the need of a Shariah-compliant microfinance fund – or microfinance investment vehicle (MIV) – structured along the lines of the existent 103 funds with total assets of USD 6.6 billion, becomes apparent by the day. This vehicle should target funds looking initially at Islamic microfinance as an alternative investment, in which participants might like to engage, and subsequently as an asset class on its own, in which participants might like to invest. In this regard, the fund should appeal to Islamic investors because it will provide a convenient method of acquiring a position in a new class of assets that combine the objective of having a social impact and providing a return to the investors.

The final outcome will contribute towards the inclusiveness and integration of Islamic microfinance into the Islamic finance and conventional microfinance systems and it will initiate the journey towards the pooling of the USD21 billion needed to provide micro finance facilities to the world's poorest 100 million families.

TIME TO GET BACK TO BASICS?

MANOJ K. SHARMA ~ GRAHAM A.N. WRIGHT


Manoj K. Sharma is a development finance and SME specialist and coordinates the MicroSave India operations. As part of his responsibilities at MicroSave, he is involved in projects for downscaling commercial banks to develop sustainable savings products for the low-end market and building the institutional capacity of MFIs. He has been instrumental in enhancing the acceptance of loan portfolio audit of MFIs as a tool for banks to base their lending/investment decisions, as well as the individual lending toolkit. Manoj has conducted extensive work on strategic business planning for MFIs in India and the Philippines, and process mapping/analysis. His areas of interest include assisting microfinance institutions to start-up, product development, market research and urban microfinance.

Graham A.N. Wright helped design and establish the MicroSave programme and pioneered much of the core of the market-led approach used by MicroSave – in particular the Market Research for MicroFinance and many related tools.
Graham has provided training and technical assistance to a variety of microfinance institutions in Bangladesh, India, the Philippines and throughout Africa.
Graham has authored over 14 training toolkits and twenty-five papers, including the book Micro-finance Systems: Designing Quality Financial Services for the Poor (University Press Ltd, Dhaka and Zed Books, London and New York, 2000). He was chair of the CGAP Savings Mobilisation Working and a member of the Product Development Groups, and is a Research Associate at the Institute of Development Policy and Management at the University of Manchester, UK.

→| OUTLOOK

> ***“We may become the makers of our fate when we have ceased to pose as its prophets.”***
>
> KARL POPPER

THE RAPID GROWTH OF THE MICROFINANCE sector in the last few years has completely changed its complexion and nature. The growth has transformed microfinance: from being a sub-set of the development sector it has become a sub-set of the financial services industry. Microfinance is already pushing towards recognition as an ‘industry’ with a separate Act for regulation of microfinance institutions in the offing. This growth has put many issues and challenges before the sector and one of the major concerns voiced about the sector has been that of ‘mission drift’. Detractors of typical ‘Grameen’ replicators have been saying for a while that high rates of growth have led to mono-products and multiple lending to a vulnerable section of the population.

Similar sentiments have been voiced by other stakeholders, and also the media. Various issues have been brought out to highlight the problems in the microfinance sector and the main concerns are as follows:

“In Karnataka or AP, it appears there is aggressive pushing of loans without ascertaining repayment capacity. In the event of distress, there could be defaults and the MFIs will take a hit. If the defaults are widespread, MFIs may find it difficult to repay their bank loans. But, this is not a systemic problem. The MFIs are too small for that. The real concern is rural women. Irresponsible lending can push them into distress and impoverishment. And make banks wary of microfinance itself.” *The Economic Times*, March 8, 2010 quoting the Deputy Governor of the Reserve Bank of India, Mrs. Usha Thorat.

LACK OF TRANSPARENCY

The microfinance industry has evolved from NGO[1] roots. The push towards a ‘for-profit’ status to the industry was primarily at the behest of banks. The thinking in the early part of the decade of 2000 was that a Non-Banking Finance Company[2] format would usher in transparency and bring the institutions under the ambit of the Reserve Bank of India making them ‘supervised’ entities and in the process, giving them some regulatory legitimacy. However, NBFCs needed to fulfil capital adequacy norms and most promoters from humble NGO roots did not have the wherewithal to bring in equity capital. (In those days, a CRAR of 10% had been stipulated by RBI for NBFCs).

Working with a leading accounting firm, MFIs came up with an innovative idea and for-profit trusts were constituted which took in money as 'contributions' from a large base of 'clients' or 'members'. The corpus thus created with the trusts was invested as capital in the NBFCs. It was widely believed at that time that the clients putting money in the trusts were unaware that this was actually an equity investment. Over a period of time these trusts disappeared or reduced in size with the promoters or investors buying out the community without, and at least in some cases, sharing with them the growth and returns. Hence, while the route of forming trusts was not illegal, and was perhaps dictated by the need to bring in the much-needed equity, the sectoral grapevine was abused with tales of unethical, and in some cases illegal behaviour from MFI promoters. The way the issues were handled by the concerned MFIs and by other sectoral stakeholders, in terms of transparency and ethical/legal issues, left a lot to be desired.

While the merits of the move to a for-profit status can be debated, it is apparent that the manner in which this occurred was not always above board. "Thus the privatisation of the community owned entity was thus well on its way. The transformation of microfinance as a vehicle for personal enrichment clearly was visible"[3].

PRIVATE EQUITY PUSH

The transformation of microfinance institutions to an NBFC format, largely pushed forward by banks and supported by the Small Industries Development Bank of India through its 'Transformation Loan', helped a for-profit orientation to emerge. Large institutions were able to bring down operating costs, and the operating cost ratio[4] reduced to 8.5% in 2008 from 15.4% in 2006. Total cost ratio[5] also came down drastically to 17.6% from 23.4% in the same period. As against this, interest rates for ultimate clients continued to hover at around 30%, and the industry margins were quite attractive. The high margins and the seemingly limitless market, considering the poverty levels in India brought private equity (PE) players to the sector. The industry stakeholders and banks welcomed this move as it was seen as a coming of age of the sector. A few voices expressed their concern that the entry of PE players would lead to rapid growth and commercialisation at a scale not seen before, but these were quickly brushed aside in the initial euphoria.

"We also find that by 2006, the individuals were gradually replaced by a substantial holding by mutual benefit trusts [MBTs] – a new special purpose vehicle discovered by the microfinance sector. These for-profit MBTs – the creation of an intelligent legal brain – were actually special purpose vehicles that would aggregate the borrower-members of the microfinance organisations as members. The grant money in the not-for-profit society would find place in the MBT and this MBT in turn would contribute to the share capital in the NBFC. This had two advantages – the companies did not have to deal with a large number of retail share holders on their books – but would be dealing with blocks of shareholders in the form of MBTs. Two, the trust deed would be drawn in a way that an employee of the for-profit entity would act as a representative of these trusts in participating in the general bodies of the companies – thereby retaining complete control over the so called 'community investment' in the NBFC. Thus, by the time we come to the middle of the decade, the charade of the community participation in the capital structure of the company is also shed"[6].

The entry of PE players changed the game quite comprehensively. The money brought in was short-term and needed high returns of the order of 24-30%[7]. The only way such returns could be realised was through rapid growth. The more money that was leveraged on account of equity, and the faster it was turned around, the more profit would be gained. Growth, which till then was being supported by all stakeholders, became an end in itself and was driven by profit – the client and her needs scarcely factored. The hard capitalists and stakeholders from other industries might feel that there is nothing wrong with this, as profits are the drivers of growth. In addition, especially in a sector where clients are not getting enough services, growth is inextricably linked to clients' needs, and hence to client satisfaction.

However, this may not be the complete picture in the case of the microfinance industry as it continues to be a 'sellers-market'. As one expert repeatedly points out, "Microfinance is one of the last remaining supply led industries in the world." In this situation, the direct fall out of rapid growth has been the insular growth of the microfinance in India. Despite the presence of the plethora of institutions, most offer the same product, typically with a first cycle loan of Rs.10,000 to be repaid over a period of fifty weeks. Thus, despite all the 'we are different' postures that may be adopted, the race to 'capture' clients is very clearly visible. This race has stifled innovation and has ensured that the customer's needs are simply not the basis for the products and services offered by MFIs. It is for this reason that from the villages of Andhra Pradesh to the Gangetic belt of UP, and whether clients are in remote rural villages, urban settlements or metros, everyone is being offered the same product irrespective of his or her needs.

However, one might ask how growth could have stifled product innovation? The answer perhaps lies in the operations of the microfinance industry. One of the reasons for the rapid growth of microfinance has been its simplicity in terms of products and systems. The moment multi-product offerings are made, the systems become more complicated. Then the MIS has to be more robust, and risk in operations grows disproportionately, as does the complexity of HR, which requires better-qualified staff and more involved training. Hence, sectoral growth has been at the cost of innovation and has not factored the clients' needs.

MEANINGLESS GROWTH

The growth in coverage of microfinance is limited to pockets, and MFIs across the country have developed a tendency to congregate in specific areas. It is very common to find urban and peri-urban settlements to have between 10-20 microfinance institutions operating within a small geography. This has lead to the problem of multiple lending, which has raised the issue of client over indebtedness, default and strong-arm recovery tactics. On occasions, charges have also been made of client suicide due to repayment pressures, but this appears to be more a figment of the imagination of the vernacular press than corroborated by any evidence. Hence, multiple lending is a well-known phenomenon and the sector has continued with an ostrich-like attitude to the problem. Despite evidence from across the globe, no efforts have been made to address the shortcomings of the group-based lending product and collection methodology, which remains almost exactly as it was when imported in the late 1980s.

CONCLUSION

Overall, the need for microfinance in India cannot be understated. The government and its programmes aimed at bringing about financial inclusion, can never hope to address the needs of the large number of poor in the country. Hence, the role of private sector microfinance whether in 'for-profit' or 'not-for-profit' formats will remain. However, any business which forgets its client cannot have a bright future. In the desire to grow at double digit (and even triple digit!) rates, the microfinance sector may have forgotten the *raison d'être* for its existence – its clients. Adopting a client-responsive approach, coupled with ethics-based transparency, could take this sector to greater heights and fulfil the very strong needs of poor people in India.

[1] The early 1990 saw NGOs beginning to offer credit services in addition to other social development programmes that were already in their repertoire such as education, women empowerment, water and sanitation etc.

[2] The non-banking company format provides oversight of the Company Law Board as also the Reserve Bank of India.

[3] Sriram, M.S., "Commercialisation of Microfinance in India: A Discussion on the Emperor's Apparel", in *W.P.* No. 2010-03-04, IIM Ahmadabad, March 2010.

[4] State of the Sector Report 2009.

[5] State of the Sector Report 2009.

[6] Sriram, M.S., "Commercialisation of Microfinance in India: A Discussion on the Emperor's Apparel", in *W.P.* No. 2010-03-04, IIM Ahmadabad, March 2010.

[7] The Bharat Microfinance Report, Side by Side 2009 reports an average return on equity of 25.88% (Table 4: Operating and Financial Summary of 69 MFIs: 11).

ANTON SIMANOWITZ
QUALITY MICROFINANCE: SUCCESSFUL CLIENTS AND INSTITUTIONS

This paper assesses the best ways of dealing with the current financial crisis and balancing people needs. The author claims that microfinance institutions (MFIs) should act to ensure both quality and responsible lending, and their main focus is responding to clients' needs.
Microfinance is not only about lending and collecting money back, but is a practice with an added social value. There should be an increasing awareness in MFIs of the need for a socially targeted service, which includes both positive social and economic goals. A successful MFI is one that ensures quality and responsible lending to people in need of financial aid. There is an estimated 2.5 billion with no access to basic financial services.
The financial crisis and the recession in the turn of the century are revealing the inadequacy of the system and the need for changes towards more responsible lending policies and practices. The client's ability to repay a loan should be supported by institutions tailored to their needs. Instead of pushing for competition and high rates, the MFIs should focus more on building a reliable relationship between the client and the institution. The core advice is for client protection to be implemented.

MALCOM HARPER
MICROFINANCE AND THE PRESERVATION OF POVERTY

Microfinance was born with the purpose of giving support to millions of indigent people around the world, acting as a force for good. Nowadays, it continues to expand its services but it has been acting both for good and for bad, creating an illusion of redemption from impoverishment, which turned out to be more a vicious circle than an actual aid.
The author draws out some of the ways in which MFIs contribute to the perpetuation of poverty by acting as a real business whose ultimate aim is to make a profit. He also indicates how to reduce the bad effects of this situation.
The target clients are mainly women, as they are more reliable in terms of households, child-care and savings protection, and tend to put every effort into repaying the debt by the required time. However, women tend to be less empowered than men, from a physical, economic and social point of view, thus giving them credit makes them stronger.
Even though microfinance claims to be able to reach the poorest of the poor, it has nevertheless its own interest in maintaining poverty. Moreover, it marginalises those already in desperate situations by forcing them into quick repayments. However, most people drop out in due course because, lacking the knowledge of budget administration, they are unable to save enough to repay the loan.
The psychology of micro financing is based on the dependence of its clients, and by forcing them to remain continuously in contact with the institutions. NGOs and other organisations give advice on day-to-day planning and help improve confidence and know-how.

JENNIFER M. BRINKEREHOFF
MAXIMIZING THE EFFECTIVENESS OF MICROINTERPRISE DEVELOPMENT: THE PARTNERSHIP OPTION

The author elucidates three ways that development organisations can reduce poverty: 1) by remaining as specialised and as focused as possible to their missions and core values 2) developing programmes linked to multi-sectoral applications and 3) establishing partnership with other organisations to explore different options.
In particular, the partnership is useful because it allows coordination and a mutual strategic direction to reach strong mutual goals and objectives. The most effective organisations should combine three governance mechanisms simultaneously to succeed in their approach: by dealing with the market, and taking a bureaucratic and cultural approach. Culture in particular, can become the glue that bonds different actors, ensuring a winning strategy. Reliance on culture is one of the key necessities for an alliance to work, along with commitment to the same mission, knowledge of the technical nature of the issue, fluid interaction, innovation, creative thinking and mutual participation. Yet, there are also environmental constraints that can play a different role and lead to hostility.
FINCA International, Save the Children and World Vision are three main examples of good microenterprise development through partnering and cooperating to achieve a common goal. Another type of partnership is that between MFIs and microenterprise providers, through, for instance, large grants that provide incentives.
Partnership can offer a wide range of good positive outcomes, such as achieving the integration of services and offering expertise and knowledge to meet new challenges, and enabling NGOs and organisations to stay specialised and focused

JONATHAN H. WESTOVER
THE IMPACT OF MICROFINANCE PROGRAMMES ON POVERTY REDUCTION

Muhammad Yunus was awarded the Nobel Peace Prize in 2006 for his pioneering approach and sustained effort in addressing the problem of poverty. In addition to the growth of Kiva and other web-based micro-lending organisations, microfinance programmes have continued to grow in usage and popularity. There are numerous studies that demonstrate the tremendous successes of such programmes throughout much of the underdeveloped world. However, the universal effectiveness of microfinance institutions in alleviating poverty is still being debated. Much of the evidence cited for the successes of microfinance and microcredit are merely anecdotal or involve in-depth case study approaches. These provide vivid examples and rich details of the impact and effectiveness of specific programmes in specific locations at a specific time, but generally fail to achieve a more rigorous standard that would allow for research findings to be widely generalised. Some more rigorous studies have been conducted and more are surely to follow, but in the meantime, NGO leaders and government policy makers must exercise caution and restraint in applying the microfinance approach universally as a means of alleviating poverty. Finally, this article proposes areas for future directions in the continued research of microfinance programmes.

SIMONA SAPIENZA
MICROFINANCE YESTERDAY, TODAY AND TOMORROW

The author considers the traditional features of microfinance and microcredit and identifies a new definition of microfinance in relation to the different characteristics of supply and demand. She illustrates a possible future scenario for the microfinance market characterised by stronger cooperation among stakeholders, international donors, governmental bodies, both national and local, financial intermediaries, NGOs and MFIs. Each using its respective skills and institutional objective can play a crucial role in fostering the effectiveness of microfinance programmes and in supporting ethical sustainability.

ANAT JAYANT NATU
MARKET STRATEGY DEVELOPMENT AND 3RD GENERATION MICROFINANCE IN INDIA

Microfinance in India has passed and reached three different stages. The first took place in the 1990s, with the SHG-bank linkage model, and the second with MFIs who acted as intermediates between social and financial systems. Finally, most of the MIFs have adopted the Joint

Liability Groups (JLGs) methodology to achieve rapid growth. Yet, many of those who follow this new trend are losing sight of the original aim and are shifting their focus to profit rather than clients' needs.
This shift will bring a tectonic effect, creating a third generation of microfinance institutions (3G-MIFs). The main difference from the previous generations lays in their long-term market strategy. 3G-MFIs will operate through a full and long-lasting spectrum of financial needs, and they will try to focus more on the advantages for their clients. Moreover, they will add new services, such as those related to food supply, education and health assistance.
Since clients have the right to choose the best institution for their own needs, MFIs will need to adapt themselves to client-needs rather than business-needs, thereby producing a tectonic shift in the market.

ALBERTO BRUGNONI

A SHARIAH-COMPLIANT MICROFINANCE FUND: A MUCH NEEDED TOOL

Available evidence suggests that a strong pent-up demand for Islamic microfinance products exist across the Muslim countries. A number of market studies show potentially strong demand in Jordan, Algeria, Yemen, Syria, Indonesia, amongst many other OIC countries. Yet Islamic microfinance instruments are sporadically used, leaving the brunt of alleviating the social problems of the Ummah to charity and welfare traditional organisations. It is suggested that a more structured approach with the use of the modern financial tools, as experienced by the conventional sector with the use of mutual funds, should add credibility to the Islamic finance proposition and help eradicating poverty in the Muslim world.

MANJO K. SHARMA
GRAHAM A.N. WRIGHT

TIME TO GET BACK TO BASICS?

The nature of MIFs has changed over the years, evolving from an NGO towards a business-centred approach. It has now reached the status of an 'industry' and it has become part of the financial service system.
This is mainly due to the participation of for-profit trusts in the contribution of the MFIs. For-profit trusts disappeared or reduced in size over the years, leaving their members in the position of sharing the growth and returns amongst themselves, and thus introducing a business-oriented approach. This way of dealing with the issue worsens an already unclear situation, leading towards a lack of transparency and ethical concerns.
With the emergence of a for-profit orientation, the MFIs were able to lower costs and increase the margins. In India, this brought private equity (PE) actors into play. Then, the consequent growth and gain within the institutions thanks to PE made clear that profit became the goal in itself, and the clients' needs were put aside. Moreover, MFIs, hoping to make the most of the profit, have being widely spread across specific areas of the country, even in very small geographical zones. Overall, there is a high need for MFIs in India, especially because its government programmes will never be able to address the population as a whole. However, those institutions need to bring the role and needs of the client to the forefront otherwise they will not face a bright future. By adopting a more client-centred approach, both the poor and the overall sector of microfinance institutions could benefit from greater results.

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