

# Impact and Social Performance:

## Seeking the double bottom line

Microfinance is promoted as a service that has the potential to make a significant impact on the reduction of poverty in all its dimensions. The facility of small savings deposits, small and increasing amounts of credit available at a reasonable cost with easy repayment installments, microinsurance for loans and life as well as for crops and health care, and transfer services all support the growth of enterprises, increase employment and incomes, smooth consumption, and strengthen coping strategies. Given the fact that women are the majority client, microfinance can promote women's empowerment in a context in which men usually are the financial agents. These aspects relate to poverty reduction, understood not only in terms of income or expenditure levels, but also in terms of social dimensions, reduced vulnerability, and new opportunities. They also relate to the Millennium Development Goals (MDGs), thus microfinance is often cited as a key part of the global strategy to meet the MDGs.

This chapter presents the evidence for such impact, briefly discusses some drawbacks in research methodology to measure impact, and considers recent trends in the approach to impact assessment and social performance assessment.

A survey of microfinance programs in South Asia yields a long list of impact studies.<sup>100</sup> But impact data used in this chapter are drawn fairly selectively with a view toward the following:

- Present *credible* evidence from studies that use fairly rigorous research methods and avoid bias in the results, impact being defined as change that can be at least plausibly associated with, if not attributed to, involvement in a microfinance program.
- Demonstrate the contribution of microfinance programs in *different countries* toward attainment of the MDGs. Much of the evidence reported here comes from India, Bangladesh, and Pakistan. There were two studies available from Sri Lanka<sup>101</sup> and one published impact study from Nepal.
- Reflect current impact findings from more *recent* research work, with the exception of some important studies from Bangladesh.

Many of the studies focus on microcredit and therefore may be seen as an assessment of the impact of loans rather than of the range of financial services now associated with microfinance. However, at the time these studies were undertaken, microcredit was the focus of most microfinance programs. Savings products were less of a service and more a compulsory feature, with withdrawals allowed only when a client left the program. Voluntary withdrawable savings, insurance, and other financial services are a relatively recent introductions. The increasing range and variety of microfinance services will indeed add to the methodological challenges of assessing and differentiating their impact.

There is also increasing interest in assessing the impact of microfinance linked to other

<sup>100</sup> A recent detailed review of microfinance impact studies worldwide can be found in a study sponsored by Grameen Foundation USA (Goldberg 2005).

<sup>101</sup> The two impact assessments from Sri Lanka cover the Agromart Microfinance Program (funded by HIVOS) and SEEDS (funded by NOVIB). Findings and limitations were similar to those discussed in this chapter.

nonfinancial services, exploring whether such services are necessary to enhance the effects of a financial service. Few studies consider this, partly because few microfinance programs have, until now, provided such services or links to a significant number of their clients. Nevertheless, it seems most likely that the deeper the outreach of a microfinance

program (the more underdeveloped its operational area and the poorer its clients), the more relevant provision of a package of services will be (such as business links and support, skill development, and health and education inputs), although such services will not necessarily be provided directly by the MFI.

## Microfinance Impact Indicators

The MDGs provide a useful framework to measure and report on impact.<sup>102</sup> Table 7.1 shows how the set of poverty reduction outcomes articulated in the MDGs can be related to commonly used indicators in microfinance impact studies. This is especially true of the first indicator (*eradicate extreme poverty and hunger*), to the extent that microfinance does reach the poor and the “extreme poor” directly or indirectly, and the third (*promote gender equality and empower women*), because the majority of microfinance clients are women. The indicators relate to direct outputs of microfinance services (*accumulation of savings, use of credit, use of special loans, insurance*) as well as to the potential effects of increased income resulting from the productive use of microfinance.

### Impact of microfinance on poverty

The poverty impact of microfinance is approached in a number of ways. One approach is to look at a *reduction* in overall household poverty by using a measure of household income or expenditure or by applying a broader measure such as wealth ranking by incorporating different indicators to reflect various dimensions of poverty. A second approach is based on an understanding of the vulnerability to risk and shock of poor households and investigates a household's

ability to maintain consumption levels despite fluctuations in overall income. Both of these approaches are important, with the first depending on a longer time frame for impact and the second able to capture shorter-term effects of microfinance. A few studies are based on examining dropouts who may represent “missed opportunities.”

Studies from the 1990s of MFIs in Bangladesh (ASA, BRAC, Grameen, and other MFIs using the Grameen model) reported that client households in both rural and urban areas improved income levels by 8 to 40 percent as a result of the use of microcredit and acquired physical assets (productive and household) and financial assets (cash savings) in significantly higher proportions than nonclients.<sup>103</sup> Similar results emerged from a World Bank study using panel data from a 1991–92 baseline followed by a 1998–99 resurvey of clients from three major microfinance programs (Grameen Bank, BRAC, and the Bangladesh Rural Development Board) to calculate increased annual household expenditure of Tk 20 on each additional Tk 100 of credit provided to women.<sup>104</sup> The same study showed (1) a small reduction in poverty, (2) an 18 percent decline in poverty in program areas compared with a 13 percent decline in nonprogram areas, and (3) a substantial contribution to consumption smoothing, with microcredit reducing variability of consumption across lean seasons for 50

<sup>102</sup> The MDGs are as follows: (1) eradicate extreme poverty and hunger; (2) achieve universal primary education; (3) promote gender equality and empower women; (4) reduce child mortality; (5) improve maternal health; (6) combat HIV/AIDS, malaria, and other diseases; (7) ensure environmental sustainability; and (8) develop a global partnership for development.

<sup>103</sup> For example, BIDS 1990, IMEC 1995, Rahman 1996.

<sup>104</sup> Khandker 2005, updating Khandker 1998. By comparison, the study found that male borrowing did not increase household expenditure at all, which seems surprising. Are men perhaps less likely than women to report their expenditure fully?

percent of clients, although the overall consumption level of clients remained the same.<sup>105</sup>

An impact study of the SEWA Bank in India compared client household incomes between 1998 and 2000. It showed that credit services

raised household income by increasing revenues of microenterprises supported by loans. Over the two years, fewer clients than nonclients reported reduction in consumption levels. Yet, while some client households moved out of poverty, some slipped back, resulting in a slightly increased poverty rate (40.9 percent

**Table 7.1. Microfinance Impact Indicators**

Levels and Indicators of Impact	Link to MDGs			
	1 eradicate poverty and hunger	2 universal primary education	3 gender equality and women's empowerment	4, 5, and 6 reduce child mortality, improve maternal health, combat other diseases
<b>Household: Economic</b>				
⇒ Increase in savings	✓			
⇒ Increase in household and housing assets <sup>a</sup>	✓			
⇒ Consumption smoothening/improved diet <sup>a</sup>	✓			
⇒ Reduced dependence on moneylenders	✓			
⇒ Reduced overall incidence of poverty	✓			
<b>Household: Social</b>				
⇒ Increased decision-making role for women			✓	[✓]
⇒ Increased participation by women in own or household enterprise			✓	
⇒ Improved school enrollment rate for children <sup>a</sup>		✓	✓	
⇒ Increased spending on health care				✓
<b>Enterprise Supported by Microcredit</b>				
⇒ Increase in productive assets	✓			
⇒ Improved profits	✓			
⇒ Increased employment (self, within client household)	✓			
<b>Wider Effects</b>				
⇒ Improved social capital network for women			✓	[✓]
⇒ Increased hired employment in enterprises	✓			
⇒ Other multiplier effects—forward and backward links from increased enterprise activity and consumption <sup>b</sup>	✓			

Source: Authors' compilation.

Note: a. These may be the direct effect of microfinance (use of a microloan, withdrawal of savings, or, in the case of health expenditure, microinsurance) or the result of increased income, or both.

b. Not yet documented.

<sup>105</sup> Pitt and Khandker 1998; Morduch 1998.

in 2000 compared to 39 percent in 1998).<sup>106</sup>

A more recent study<sup>107</sup> of 20 MFIs in India reported that on practically all indicators of a comparison with nonclients showed significant benefits to clients, with a more significant impact on poorer households (see table 7.2).

**Table 7.2. Poverty-Reducing Effects of Microfinance (poor clients of Indian MFIs)**

	Client	Nonclient	Difference
% acquired a productive asset in previous year	36%	14%	21%
% with multiple sources of income	67%	50%	17%
Dependency ratio <sup>a</sup>	2.70	2.93	-0.23
% reporting increase in household income	45%	26%	19%
% with savings	98%	28%	70%
% borrowed from money lender in previous year	36%	53%	-19%

Source: EDA 2005.

a. Total number of members per earner in the household.

In 4 of the 20 MFIs, it was possible to compare the wealth ranks of long-term clients with recent clients. The comparison indicates a movement of client households into less poor wealth rank categories. Nevertheless, 30 percent of long-term clients (averaging five years with a microfinance program) were still poor, confirming that the potential effects of moving *out of* poverty do not accrue to all clients and can take considerable time. And dropout rates were slightly higher for the very poor (8 percent) compared with other wealth ranks (less than 6 percent).

The same study, which covered different models of microfinance (SHG, Grameen, and individual banking), suggests that direct poverty-reducing effects are more evident in

the Grameen model, which combines substantial poverty outreach with a focus on credit for direct investment. In MFIs that offer larger loans through an individual banking approach catering to relatively better-off clientele, the use of microcredit in small enterprises that hire nonfamily labor can have an indirect poverty effect by supporting income-earning opportunities for nonclients. The study also found that 25 percent of supported enterprises in such MFIs were employing hired labor.

Results compiled from various impact studies of the SHG-bank link program in India report a substantial economic benefit accrued to member households, although a comparison with a control group of nonmembers is made in only one of the three studies cited.<sup>108</sup> In all three studies, SHG members reported that the average increase in family savings and household asset values was between 30 and 50 percent two to three years after joining the group. Another study of the clients of a Grameen model MFI documents a marked shift in employment patterns of clients, from irregular, low-paid daily labor to more diversified family business as a result of SHARE loans.<sup>109</sup> Using microcredit, livestock was the most widely acquired productive asset in client households.

In **Pakistan**, a survey of around 3,000 clients and nonclients of Khushhali Bank reported higher incomes and sales for rural clients dependent on agriculture and for urban clients with family-run microenterprises, compared with nonclient households. In rural nonfarm and animal enterprises, clients showed higher value assets but no increase in income.<sup>110</sup> Another survey of PPAF clients showed a small reported increase in income of borrowing households compared with nonborrowers.<sup>111</sup> Higher incomes enabled the borrowers to

<sup>106</sup> Chen and Snodgrass 2001.

<sup>107</sup> EDA 2005.

<sup>108</sup> GTZ 2005.

<sup>109</sup> Todd 2001.

<sup>110</sup> Montgomery 2004.

<sup>111</sup> PPAF 2004.

invest more in their houses and spend more than two times as much on house repairs compared with nonborrowers.

The abovementioned studies report evidence of the role of small loans in enabling clients to reduce their dependence on irregular income sources and improve their ability to sustain consumption when faced with income shocks. Thus, there is evidence for the contribution of microfinance to the reduced vulnerability of client households, although evidence for overall poverty reduction is less clear-cut.<sup>112</sup> In general, however, and this is not usually quantified, the contribution of microfinance depends on the starting point, or relative poverty level, of each client household as well as the type and quantity of microfinance accessed. Context issues affect the impact of a financial service alone, for example, risks faced by low-income households (monsoon in India's rainfed regions, floods in Bangladesh, illness and the high cost of medical care, and the high cost of social obligations, such as dowry), differences in economic sectors and market access, and the challenges of building higher earnings, especially for women.

### Impact of microfinance on gender equality and women's empowerment

MFI in South Asia have mainly targeted women, and this strategy may in part be *instrumental* in empowering women. Men are not attracted by small amounts of savings and credit, while women are interested and willing to attend group meetings, and also are perhaps more amenable to thrift and repayment discipline. Nevertheless, there is an underlying assumption that providing women, rather than men, access to financial services, especially as part of a mutually supportive group, is in and of itself a step toward gender equality, with an expectation that this can, in turn, be empowering. In the context of the poverty

reduction goal, women are seen as more likely than men to use their earnings for the benefit of their household. The latter would clearly depend on whether women do increase their “own” earnings and make decisions on the use of those earnings.

Several studies have focused on the impact of financial services on South Asian women, although with varying interpretations, reflecting a tension among different measures of empowerment. Indicators such as self-confidence, status in the family, and role in decision making are positive but difficult to assess in practice, being subjective and liable to change with age and family status. Other indicators appear to be more objective, for example, “control” over the loan and ownership of assets, but these indicators reflect a more individualized notion of women's empowerment and have less positive results in much of South Asia where a strong patriarchal culture limits women's roles.

Studies in [Bangladesh](#) have documented a positive impact for women, personally, within the household, and in terms of community participation.<sup>113</sup> Indicators of empowerment include personal mobility, ability to make small and large purchases, involvement in household decisions, communication between husband and wife, political and legal awareness, and involvement in as well as access to social networks. Generally speaking, a woman's contribution to household income and ownership of assets has been a significant contributing factor toward her increased self-worth and improved family status.

Other studies<sup>114</sup> have looked at the issue of women's “control” over loans and their involvement in microenterprises, and challenged the notion of empowerment through microcredit. This approach is reflected in a review of impact studies from [Pakistan](#) that found that most women borrowers have

<sup>112</sup> Compare Zaman 2004.

<sup>113</sup> Pitt, Khandker, and Cartwright 2003; Kabeer 1998; Hashemi, Schuler, and Riley 1996; Todd 1996.

<sup>114</sup> Goetz and Sen Gupta 1996.

only partial control over loans or hand them over entirely to male relatives.<sup>115</sup> The review also compares microcredit programs with women and men clients and comments on the much smaller number and amount of loans provided to women. This may not mean, however, that benefits are nonexistent. Some researchers emphasize the idea that household members, men as well as women, pool their investments and may jointly participate in investment and other decisions. Within existing socioeconomic structures, women benefit from being one of the channels of credit to the household, even if the credit is employed in a male-run enterprise in which women may have little involvement. Studies of Grameen and BRAC borrowers suggest that even if women do not have control over the loan amount, they are still “more empowered” than women who have not borrowed at all.<sup>116</sup> However, other researchers who define empowerment as “an expansion in the range of potential choices available to women” rule out the automatic assumption of a direct correlation between empowerment and women's access to credit.<sup>117</sup>

In India, studies of the SHG-bank link program<sup>118</sup> report an increase in the self-confidence and decision-making ability of women after participation in group credit and savings activities. More women members were self-confident after joining the groups and were able to make a greater contribution to the family income compared with nonmembers.

Similarly, a baseline study of 20 MFIs<sup>119</sup> in India comments on the supportive approach of the SHG model in which women members may develop the capacity to manage group financial transactions themselves, with opportunities for social networking. Nevertheless, cultural differences were found to affect the scope for women's empowerment and economic activity, being less restrictive in the south of the

country compared with the north, and less restrictive in urban areas. This study also comments on the fact that programs that include women and men clients lend more to men than to women, something that women clients also noted.

A study from Nepal also considers a SHG approach under the Women's Empowerment Programme (WEP), which combined savings-led microfinance with a strong literacy curriculum that covered group strengthening, business development, empowerment, and community activism. The evaluation found that more than two-thirds of women reported an increase in their household decision-making role (sending a daughter to school, buying and selling property, family planning, and children's marriage). This increased role was attributed to WEP meetings held several times a week that used literacy materials to emphasize the potential for change. The majority (90 percent) were engaged in an income-generating activity after joining WEP, usually a household enterprise rather than an individual enterprise, compared with less than one-third before membership in the group.<sup>120</sup>

Evidence of social action through women's groups comes from a forthcoming study of SHGs in India that reports examples, at the village level and across village clusters, of women who are gaining the confidence to become involved in community affairs (lobbying for and managing village infrastructure, water supply, and schools) and taking action on issues of social justice (dowry, widow remarriage, bigamy)<sup>121</sup>. Such actions are possible when the supporting agency promotes awareness on social issues, providing guidance on options and group strategies to facilitate mobilization across SHGs, as in the newly forming federations.

<sup>115</sup> Hussein and Hussain 2003.

<sup>116</sup> Hashemi, Schuler, and Riley 1996.

<sup>117</sup> Personal communication with Naila Kabeer.

<sup>118</sup> GTZ 2005; Holvoet 2004.

<sup>119</sup> EDA 2005.

<sup>120</sup> Ash and Parrott 2002.

<sup>121</sup> Frances Sinha, et al 2006a.

Studies from different countries of the region report increasing decision-making roles of women clients, and the beginning of social networking and group-based action at the community level, especially in the SHG model, although neither outcome is automatic. At the household level, earlier concerns of whether women own their savings or control (or are at least involved in) the use of their microloans are being replaced by a more fundamental realization of the barriers that women face in accessing markets and of the low returns to their labor, relative to men. In other words, microfinance is contributing to some increase in women's role within existing patriarchal limits. Gender equality will have to wait; however, if more girls are sent to school, then another useful contribution will be made.

### Impact of microfinance on children's education

Does microfinance contribute to building the human capital of the next generation by making it possible for poor families to send their children to school? Evidence that it does is by and large positive, although school attendance is affected by the proximity of schools, especially schools for girls. The available studies also predate the availability of microfinance products, specifically for education (for example, education loans or savings products).

A 1996 study of two villages in [Bangladesh](#) showed that all of the girls from Grameen Bank client households had received some schooling, compared with 60 percent in nonclient households. A longitudinal study conducted in BRAC's operational areas from 1992 to 1995 also reported a higher rate of improvement in basic competency of children in BRAC member households compared with nonmembers.

Studies from [India](#)<sup>122</sup> report slightly higher enrollment and literacy levels of sons and daughters of women borrowers, in comparison with children of nonclients. This appears to be more significant at the primary school level and for the very poor, with some evidence that women's group membership can lead, in particular, to more daughters attending school.

In [Pakistan](#), the study of microfinance clients of Khushhali Bank shows higher expenditure on schooling, especially for girls, and children of clients were more likely to remain enrolled in schools longer than their counterparts in nonclient households.<sup>123</sup> However, this positive impact was not found for all borrowers, but only for women borrowers in NGO-supported groups, where the NGO also ran an education program. This finding reflects some of the Indian studies and underlines the relevance of “microfinance plus” and the availability of a school for girls.

Although few in number, the evidence from different studies indicates that microfinance can boost children's education in low-income households, especially for girls, if schools are available. This is an indirect contribution of microfinance rather than directly linked to the provision of microloans or savings products specifically to meet the costs of schooling, although there is some “fungible” use of credit for this purpose.

<sup>122</sup> EDA 2005; Chen and Snodgrass 2001; Holvoet 2004.

<sup>123</sup> Montgomery 2004.

## Impact of microfinance on health

Assessing health outcomes is a specialized exercise that microfinance impact studies usually have not attempted. One or two studies have assessed household nutrition and a few have explored links between microfinance and the use of health services or expenditure on medical care as a proxy or strategy for improving health.

Drawing on the World Bank longitudinal data set from [Bangladesh](#) (referred to in section 7.2), an analysis of the health component showed that microcredit to women had a significant impact on two out of the three measures of nutritional status of girls and boys (height for age and upper-arm circumference)<sup>124</sup>. In another study, the number of BRAC client households using sanitary latrines increased from 9 percent in 1993 to 26 percent in 1996, compared with nonclient use staying at 9 to 10 percent.<sup>125</sup>

The study on SHGs in [India](#)<sup>126</sup> reported that SHG members accessed better health care facilities after joining the program, resulting in higher expenditure for medical care. The study of Khushhali Bank clients in [Pakistan](#) shows similar results. Client households have significantly higher expenditures to access medical services from trained doctors compared with nonclients.

In summary, the evidence shows that access to microfinance has led to a number of positive outcomes, including building financial and social capital of women clients and their families, contributing to household coping strategies in case of vulnerability or shocks, and supporting women's empowerment within existing social structures. In terms of poverty reduction, there is positive evidence on a number of dimensions, economic and social, although that evidence needs to be

strengthened through clearer analysis of different starting points, or the level of poverty of a client's household when she joins a program. Where such analysis has shown relatively lower benefits for the very poor, if not their exclusion, this has led to the development of new programs outside microfinance, for example, BRAC's IGVDG and targeting the ultrapoor (TUP) programs, as well as the design of more flexible services within microfinance.

Poverty is complex and its reduction is likely to take place only over the long term and from a combination of factors. Expectations for what microfinance can or cannot achieve should be realistic and open to the fact that microfinance may not only work directly through targeting the poor as clients, but also indirectly through building the enterprises of the relatively better-off who employ the poor and contribute to market growth, although impact studies do not show the latter largely because of the emphasis on the direct approach. In either case, contextual factors such as physical security, functioning institutions, and macroeconomic stability, even timing of monsoons in the region, can critically influence the scale of impact that can be achieved through the provision of savings and credit services. Similar contextual and cultural issues apply to the goal of gender equality, although this does not emerge from the literature as a key concern.

<sup>124</sup> Pitt, Khandker, Chowdhury, and Millimet 2003. The same positive findings were not found for men, for whom, as noted earlier, the data did not show an increase in household expenditure as a result of borrowing.

<sup>125</sup> Hussain 1998.

<sup>126</sup> GTZ 2005.

## Impact Assessment Methodologies and Drawbacks

Despite the large number of impact studies recently conducted in the region, only data from a select few have been cited in this report. Issues of methodology, analysis, and attribution continue to be the bane of most impact studies. Common pitfalls in impact research that are discussed in the literature were repeated in most studies surveyed for this paper and need not be repeated,<sup>127</sup> but in addition, the following points that can undermine analysis are often overlooked.

- **Control Group and Selection Bias**—Impact is statistically defined as the difference between a treatment group (microfinance clients) and a nontreatment group (a control group of nonclients), assuming that on all factors other than the treatment the two groups are the same. However, this “sameness” is difficult to establish given the likelihood of selection bias. Clients self-select and may have certain unobservable characteristics, such as entrepreneurial aptitude, that incline them to join a microfinance program in the first place, in addition to which there might be “nonrandom” program placement in that MFIs select the areas in which they operate. It is important to correct for selection bias and this can best be done through econometric analysis using panel data. Panel data, however, are not easy to come by. Many studies rely on a single visit, comparing clients with a control group of nonclients at one point in time, thereby increasing the risk of selection bias. Other studies rely on recall, comparing now with before joining the program, often over a long period of three years or more, which carries its own risks of inaccuracy and possible bias.
- **Statistical Analysis**—Many studies do not report tests to establish statistical validity of the results, that is, whether the difference observed between client and control groups is by chance or is a difference due to the provision of financial services.
- **Significant versus Substantial Differences**—Even when statistical tests are reported, for the results to be meaningful, one must see whether the difference is substantive. For example, a recent impact study from Pakistan reported a difference of 3 percent between the mean income of borrowers and nonborrowers. The difference may be statistically significant because of the size of the sample, but it is hardly substantial.
- **Impact versus Output**—It is important to distinguish conceptually between impact and outputs of microfinance. For example, if a client uses microcredit to purchase a buffalo, the animal is certainly a new asset and a potential source of additional income, but it represents an output, not an impact, as long as the loan is not repaid.<sup>128</sup>
- **Impact on Whom?**—A subgroup analysis of clients often reveals a more in-depth and nuanced picture. Many studies do not relate impact findings to the key parameter of interest (the household poverty level). All the clients are assumed to be poor, which, as seen in the previous chapter, is not usually true. To be meaningful, and especially to interpret the results in terms of poverty reduction, impact findings must be disaggregated to reflect differences between poor and non-poor clients and analyze reasons for observed differences. A similar disaggregation of nonclients as a comparison group also reduces selection bias.
- **What about the Utility?**—The econometric analysis in the most rigorous impact studies is complex and often disputed, is too expensive to be carried out regularly, and takes too long to have any meaningful influence on the program. Apart from this, however rigorous and robust the findings, the relationship or impact pathway mapping the various components of the microfinance process to the impact domains is not well specified or researched. Thus, rather generalized conclusions are reached about microfinance impacts that serve an important function as far as “proving” is concerned, but they fail to throw much light on what type of microfinance (model, product, and so on) is more important for which dimension of poverty alleviation and impact. The relationship between program activities and impact indicators is often not made explicitly. Thus, such research fails to be helpful in providing inputs for programmatic actions to attain the desired impacts or in enhancing them.

<sup>127</sup> Meyer 2002; Hulme 1999; Ravallion 2005.

<sup>128</sup> See conceptual framework in figure 7.1.

Recent trends in assessing the impact of microfinance point in two directions:

- **Researcher Focused**—This approach continues the tradition of external, donor-funded studies using sophisticated econometric methods. It differs from earlier studies by using a randomized study design to account for possible biases that affect study results.<sup>129</sup> This rigorous approach addresses all possible biases by randomly selecting treatment groups (those who receive microfinance) and control groups from a potential population of microfinance clients (those who are selected but delay joining to allow the study to take place). This is an important tool for assessing impact and may be particularly relevant for assessing the impact of microfinance innovations. However, a drawback is inherent in the design: it may be difficult to keep the time difference between baseline and end-line stages between one and two years. For example, a study currently under way in India is limited to one year. This will limit the extent of possible impact and will be measurable to one or two loans and some savings.
- **Practitioner Focused**—This trend reflects a break away from proving techniques to an approach that focuses on the elements that are likely to lead to improved impact. The emphasis is on practical, focused, and simpler research guided and used by the microfinance service provider to assess whether they are achieving their social objectives. It includes a client monitoring and market research approach to profile different client segments and to understand client needs and capacities, feeding into a process of tracking outreach to target specific groups and of designing services that meet client needs appropriately. This trend started with the design of the United States Agency for International Development—Assessing the Impacts of Microenterprise Interventions (USAID-AIMS) tools, continued with the development of market research tools for microfinance by MicroSave, and has developed as a framework for Social Performance Management by MFIs by the Imp-Act Consortium.<sup>130</sup>

## From Impact to Social Performance

Traditional impact studies, although still important and relevant in certain circumstances, are costly and time-consuming, and often result in findings that are too general, although they nevertheless do not go undisputed. Rather than trying to prove an end result, an alternative approach is to unpack the pathway to impact, shifting the focus to managing and reporting on the steps that are likely to lead to positive social outcomes. This idea is linked to the concept of “social performance” defined as “the effective translation of mission into practice”<sup>131</sup> and is intended to complement the now-established systems for financial performance. Initiatives around social performance and social reporting are currently somewhat experimental, but as they develop, they are

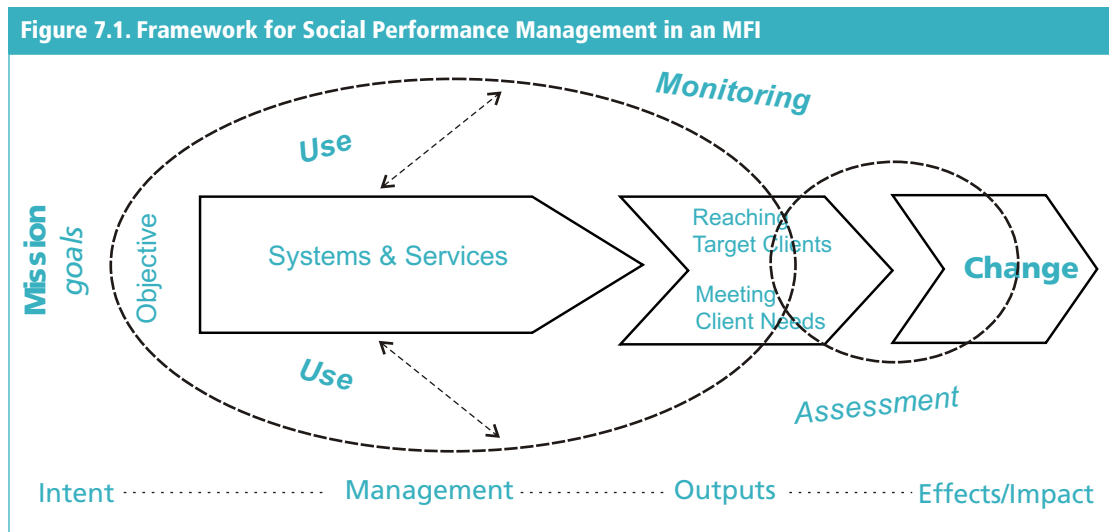
likely to provide an invaluable and relatively low-cost means of keeping track of and reporting on social mission in microfinance. Two of these recent approaches are discussed below.

A **social performance management (SPM)** system is owned and implemented by the MFI. SPM includes regular tracking of three social goals: reaching target clients, meeting client needs in line with their capacities, and achieving change, or impact, through the application of relatively simple research and monitoring tools. The information collected is reported to the organization for decision making to align procedures and policies and adapt services to improve performance if necessary (see figure 7.1).

<sup>129</sup> Duflo and Kremer 2005.

<sup>130</sup> The Imp-Act Program was supported by the Ford Foundation and CGAP, and led by the Institute of Development Studies, University of Sussex, United Kingdom, working with 30 MFIs around the world. The Imp-Act approach is currently promoted by a consortium, which includes the following: in Asia, EDA Rural Systems and Reach India in India; CARD in the Philippines and elsewhere; IDEAS and the Microfinance Centre, Warsaw.

<sup>131</sup> Sign-on letter of the Social Performance Task Force 2005.



Source: Authors

Client-level data allow an MFI to weigh its performance against its social mission and objectives. A key element of SPM involves the systematic tracking of social and economic conditions of clients at the time they join the MFI. For a poverty-focused MFI, such a system allows the organization to monitor its client entry profile. Simplified poverty measurement tools are being introduced for MFIs to assess client poverty levels at entry (for depth of outreach) and over time (for change).<sup>132</sup> In the context of rapidly scaling up MFIs, this could prove invaluable to track the mission.

A few of the more established MFIs already have this sort of tracking system in place: Cashpor is well known for its housing index, Grameen has used 10 indicators of poverty, and BRAC has a well-established research division from which a number of studies have emerged. Under the Imp-Act program, MFIs in Nepal and India have used their own client-level research to compare poverty outreach across different branches and to reassess their objectives and services with reference to their target clients' needs.<sup>133</sup> In these examples, the core social mission of the organization is poverty reduction and SPM enables them to track progress toward this goal.

## Social Rating

While SPM systems are internal to the organization, **social rating** is a recently introduced tool for external appraisal of social performance. It covers all the steps of the impact pathway shown in figure 7.1 and is based on the premise that most MFIs (and the donors and investors who support them) have a social mission. A social rating covers the steps involved in translating this social mission into practice. The different steps evaluated are the

organization's social mission and systems, depth of outreach (poverty level of clients, operations in less developed areas), and feedback from clients on MFI products and services. By covering the steps leading to change, the social rating is a good predictor of impact. Social rating also includes an assessment of "client protection" and transparency as an important dimension of social responsibility.

<sup>132</sup> For example by the Grameen Foundation, United States, through its Poverty Progress Index, derived from national household expenditure surveys in each country.

<sup>133</sup> Copestake, Greeley, Johnson, Kabeer, and Simanowitz 2005.

Together, social ratings and credit ratings allow for an assessment of performance against the so-called double bottom line. By benchmarking social mission and systems of different organizations, social ratings, alongside credit ratings, will contribute to increased transparency in the microfinance sector. Social investors and donors can use these ratings to facilitate the flow of funds to MFIs that are starting up or relatively weak on financial parameters but strong on social parameters. M-CRIL in India is the first rating agency to provide a specifically designed social rating service to MFIs. M-CRIL has now undertaken seven social ratings and is likely to undertake several more in South Asia in the near future, including in Afghanistan, Pakistan, and Sri

Lanka.<sup>134</sup> Other specialist rating agencies, including Microfinanza and Planet Rating, are developing such a service and have undertaken a few ratings in other parts of the world.<sup>135</sup>

In the future, as more MFIs introduce SPM, social rating could be used to audit the SPM process and findings to verify that it is done systematically, the information is valid, and there is effective reporting within the organization, and to advise whether the process can be improved. At present, until more MFIs introduce SPM, social rating can provide an independent assessment of poverty outreach and appropriateness of products and services based on a field sample of clients.<sup>136</sup>

## Social Protection and Safety Nets

As discussed above, financial services for low-income clients are an important tool to be used in consumption smoothing for vulnerable families and to enable the poor to take advantage of new livelihood opportunities. But microfinance by itself is not a panacea for poverty. With some notable exceptions, microfinance has been limited in its reach and usually has not provided services to the poorest and the destitute. The destitute, people without means of sustainable livelihood who are so vulnerable that they require food aid or employment, have until now mostly been excluded.

Recent efforts to increase the depth of outreach through effective targeting, better understanding of client needs, and more client

responsive products have been promising.<sup>137</sup> Yet, it is also increasingly evident that many of the very poorest may not be able to use credit effectively. Loans to those who are trapped in extreme poverty may not immediately help to establish sustainable livelihoods that generate enough earnings to meet repayments, possibly leading to further impoverishment, increased vulnerability, and overindebtedness. Savings products may be more appropriate for helping such households manage their money better, but on their own it is unlikely they would break the vicious cycle of poverty.

The poorest clients that microfinance has difficulty reaching are precisely the focus of another important development strategy, safety nets. Although considerable overlap

<sup>134</sup> Samples of M-CRIL's social ratings and the importance and impact of linking it with credit rating can be seen from the samples of the first such report undertaken for Bullockcart Workers' Development Association (BWDA), an MFI in South India, and may be found on the M-CRIL Web site (available at [www.m-cril.com](http://www.m-cril.com)).

<sup>135</sup> Various approaches for social reporting and rating have been developed separately and include those of Comite d'Echanges de Reflexion et d'Information sur les Systemes d'Epargne-credit (CERISE), Social Performance Indicators Initiative ([www.cerise.com](http://www.cerise.com)); USAID (under its Accelerated Microenterprise Advancement Project); and Accion International.

<sup>136</sup> As reflected in the Global Reporting Initiative. Available at [www.cerise.com](http://www.cerise.com).

<sup>137</sup> The evidence, however, of the promise of more client responsive products delivering on better depth of poverty outreach is sketchy. A recent study comparing the depth of poverty outreach of an urban microfinance provider in Bangladesh offering a range of flexible financial products and more traditional microfinance providers working in the same area does not find much difference (Cortijo 2005). Another recent study (Sinha et al 2006a) on poverty outreach of a set of microfinance institutions in Bangladesh, which designed new products to target the extreme poor, finds that around 11 percent of the clients are extremely poor, which is not significantly different from the industry average in Bangladesh (Matin 2006). These results could be specific to the Bangladesh context given a generally good depth of poverty outreach performances of the industry from which further deepening of poverty outreach through microfinance only route could be difficult.

exists among the people that microfinance and safety nets seek to serve, the microfinance discourse has generally ignored safety nets. Microfinance practitioners often equate safety nets to grants and subsidies that distort markets and hamper efforts to become sustainable. In turn, safety net experts commonly associate microfinance with credit that creates indebtedness and increases poor people's vulnerability. There is, however, a real possibility of harnessing the creative experiences of these two development strategies through a "link model." Microfinance from the top going down and safety nets from the bottom going up create the potential space to reach the poorest. Deliberately and carefully linking microfinance and safety nets offers some scope for reducing poverty among the absolute poor.

## The link model

The premise of the link model is that the destitute, and even the very poor, need grants for survival. These people additionally require financial services, however, just like anyone else. Although time bound, finite grants provide the "breathing space" needed for survival and exploring livelihood opportunities, and savings services build up microinvestment funds. Some programs provide skills training during this period. As the grant program phases out, participants are prepared to pursue independent economic activities and "graduate" to become clients of regular microfinance programs. The following two examples of successful links between microfinance and safety nets in Bangladesh demonstrate how the link model could work.

### Case 1: Combining Public Works Employment with Financial Services

The Rural Maintenance Program (RMP) of CARE Bangladesh was started in 1982 as a public works program that provided employment to destitute rural women. Women are recruited for a fixed four-year period. They receive wages and participate in a compulsory savings plan, setting aside a portion of their wages as savings. During the four years, women receive training in numeracy, human rights, gender equity, health, nutrition, business management, and income-generating activities. Women also receive information on microfinance and on local MFIs and are encouraged to approach MFIs for working capital and expansion needs after they complete the RMP.

CARE has successfully met the twin challenges of targeting the poorest and successfully graduating participants. The lower-than-market wage rate paid to the women serves as a screening mechanism to ensure that only the neediest apply. The intensive training coupled with the savings requirement and microfinance information prepares women to start small

business activities with appropriate skills and some seed capital.

More than 40,000 women are engaged in the RMP at any one time and around 10,000 exit every year. While not all women succeed as microentrepreneurs, the RMP has an impressive track record. Three years after the end of the program cycle, 79 percent of graduates continue to be self-employed in microenterprise activities. A CARE Bangladesh Household Security Survey, conducted in early 2005, indicates that 63 percent of RMP graduates remain members of NGOs even three years after graduation.<sup>138</sup>

Some of the key lessons learned from this program are as follows:

- Start with an employment program first, a labor-intensive public works program useful to the community
- Set wages lower than market rates to screen the target group
- Start collecting savings early in the program
- Provide complementary training/life skills

<sup>138</sup> E-mail from Dr. Phillip Tanner, Program Coordinator, RMP.

## Case 2: Linking Food Aid to Microfinance

The IGVDG Program, a collaborative food security intervention of the Government of Bangladesh, the World Food Program (WFP), and BRAC, targets destitute rural women who have little or no income-earning opportunities. The IGVDG Program is built on a government safety net program that provides free food grains for an 18-month period to destitute, female-headed households that are at the highest risk of hunger. BRAC organizes the women into groups, collects savings, and provides skills training. Program participants receive small loans (\$50) when their skill training is completed so that they can try out small income-generating activities. By the time the cycle of free food grains ends, participants have accumulated savings that can be used as capital for investment, received training, managed credit, and engaged in some kind of entrepreneurial activity. In addition, they will have gained confidence through group participation.

The results of the IGVDG Program are impressive. In all, the program has provided food grain assistance in connection with the government safety net program, savings services, and credit services to 1.6 million destitute women since its inception. Nearly two-thirds of these participants have graduated from absolute poverty to become microfinance clients who have not slipped back into requiring further government assistance. Surveys of IGVDG clients report increases in client incomes and basic material assets, and a reduction in begging.<sup>139</sup>

Some of the key lessons learned from this program are as follows:

- Use appropriate screening to ensure that only the destitute are targeted, especially female-headed households
- Start with food aid, although food aid distribution should be handled by a separate

professional distribution agency, not by a financial institution

- Start collecting savings early in the program cycle
- Provide complementary training/life skills
- Provide very small loans for simple, easy economic activities

These two cases suggest ways in which links can be established between grants and microfinance programs. They show how the appropriate sequencing of activities can lead to positive development outcomes. Starting with grants to meet immediate consumption needs and building microassets, these programs then link to financial services, enabling destitute client groups to move up a ladder of incrementally cumulative livelihood gains.

Each partner in these linked programs has its own comparative advantage. Mixing functions will compromise the effectiveness of the link model. A safety net institution or a program that provides grants would not have the technical knowledge to provide sustainable financial services. Similarly, an MFI must impose strict financial discipline to become sustainable. Providing grants that do not require repayment would send mixed signals to MFI clients, who are constantly reminded of the need for on-time repayments. The link model works only when each partner concentrates on its area of expertise, but does so with a common understanding of the needs of vulnerable and destitute clients. Success in such a program is about being operationally separate but conceptually joint.

<sup>139</sup> Matin and Yasmin 2006; Hashemi 2001.