MicroSave Briefing Note # 7

Are You Poor Enough? Client Selection by Microfinance Institutions

Graham A.N. Wright and Aleke Dondo

Introduction

The debate between the proponents of maximising sustainability, outreach and scale and thus serving many poor people (including poorer people) and the proponents of targeting "the poorest of the poor" continues. The debate, we should note from the outset, is essentially a healthy one – it should help all of us involved in the industry to focus clearly on what matters: providing financial services to poor people. The challenge is how to do this in the most cost-effective and efficient manner.

> "Let us begin by noting that *everyone involved in microfinance shares a basic goal: to provide credit and savings services to thousands or millions of poor people in a sustainable way.* Everyone wants to reach the poor, and everyone believes sustainability is important. This is not an either-or debate. It is about degrees of emphasis and what happens when tradeoffs appear."
>
> *- Elizabeth Rhyne*

Sustainability and Scale v. Targeting Poverty

The arguments for achieving sustainability and scale have been often and persuasively rehearsed by Robert Christen, Elizabeth Rhyne, Marguerite Robinson and many other senior figures in microfinance. Not only does sustainability allow the commercialisation of microfinance, thus increasing both its professionalism and outreach, but the scale commercialisation brings also means that, in absolute terms, more poor people are reached. However, for many of the advocates of "targeting the poorest" it is this move towards an emphasis on sustainability and commercial funding that also results in "mission drift" and the MFIs focusing increasingly on the non-poor as their preferred clients.

> *"... if priority is given to making [MFIs] profitable as quickly as possible, then the poorest will automatically be marginalized."*
>
> *- Renee Chao-Beroff*

The Vulnerable Non-Poor

Participation in MFIs' programmes is not a recreational activity. It is not an activity that people with access to alternative, formal sector financial services are generally willing to undertake. The interest rates on loans are typically 2-4 times that of the formal sector. Furthermore, despite the rhetoric often heard about the social capital generated in solidarity groups, the endless weekly meetings are typically not popular: poor (and non-poor) people have better things to do with their time – like running their businesses. The presence of the non-poor seeking services from MFIs demonstrates a clear need, an absence of alternatives and a lack of access to the formal financial system, or (at the very least) lack of access to credit facilities from the formal system. It is however, the absence of alternatives to the non-poor and their desire, yeah need, for on-going access to financial services that drives repayment. The need for on-going access to financial services arises from the fact that the non-poor without access to financial services are particularly vulnerable since they have significantly reduced opportunities for storing their wealth in good times to respond to the times of crisis. It is this vulnerability and the ever-present risk of crisis that makes poverty dynamic. Critiques of microfinance based on "not reaching the poorest" tend to overlook the dynamic nature of poverty and see it as a static state.

> *"It is scale, not exclusive focus, that determines whether significant outreach to the poor is achieved."*
>
> *– Robert P. Christen*

Non-poor households hit by a severe crisis (fire in houses and business, natural disasters, theft of business assets and chronic illness including HIV/AIDS and many others) may be transformed into "poorest" households with alarming rapidity. This is why microfinance's role in assisting with the development and maintenance of robust household economic portfolios is so important … for anyone and everyone who does not have access to financial services from the formal sector.

Crisis such as prolonged illness can leave the vulnerable non-poor very, very poor

Thus access to financial services allows these "vulnerable non-poor" to protect themselves against the risks they face and the crises which regularly engulf them. This protection is essential for vulnerable people, and, as the saying goes, "prevention is better (and cheaper) than cure". Providing financial services to the vulnerable non-poor assists them to help themselves stay out of poverty. It is a course of action that is more cost effective for both the client and the MFI.

Finally, some would suggest that the secondary income and employment effects of providing services to the vulnerable non-poor and the "missing middle" helps the poorer (usually risk adverse and non-entrepreneurial) people more effectively than requiring everyone to become business people. Certainly there is evidence that the poorest can enjoy higher daily wage labour rates in the villages of Bangladesh as a result of MFI activities. These secondary effects are indeed of tremendous importance since many of the poor are not natural entrepreneurs, and would like to be employed in preference to self-exploiting, self-employment generating marginal returns.

The "Poorest of the Poor"

It is time to pay attention both to designing products that are appropriate for poorer people and to designing systems that are more cost-effective and efficient to deliver these services. This type of innovative work should enable us to develop alternative sustainable systems that can really reach the poor on a sustainable basis.

> *"It is increasingly clear and accepted, that the majority of MFIs world-wide are not reaching the "poorest of the poor" even in the more microfinance-friendly and population-dense environments such as Bangladesh."*

What we should not be advocating is a return to perpetual subsidy for MFIs. Poor people need on-going access to financial services and should not be left dependent on the on-going beneficence of donors simply because we in the microfinance industry are too lazy or unimaginative to develop innovative products and delivery systems. In addition, it is increasingly clear that in many cases subsidies to MFIs are simply underwriting inefficient and expensive systems. And the history of agricultural credit tells us that subsidised programmes that mix grants and loans lead only to "groans".

Advocates of targeting often insist on focusing exclusively on the "poorest of the poor" and excluding the non-poor (however vulnerable they are). This results in a rather extreme position. Those that place emphasis on only serving the "poorest of the poor" are effectively saying: "*According to our survey, you are not-so-poor: go away and have a serious crisis in your household and come back to us when you are really one of the poorest of the poor, ideally destitute, then we will serve you*". By excluding the "not-so-poor" from access to financial services, the advocates of targeting are making them several times more vulnerable to such crises. And so it is probably only a matter of time before they are adequately poor to be allowed into the programme, or so destitute that it is no longer useful to them.

Furthermore, of course, when the vulnerable non-poor become poor enough to qualify for MFIs dedicated to targeting the poorest, serving them with appropriate products and delivery systems is much more difficult: group-based guarantee loans for enterprise, repayable in weekly instalments rarely suit the needs of the poorest.

> *"… while they are unquestionably important, financial services are probably not the highest priority for the truly "poorest of the poor" – they need relief."*

Conclusion

Those who are truly serious about further deepening outreach will have to look at conducting rather more careful market research to assess and understand the needs and opportunities faced by the poor[1]. Only when this is clear are the MFIs in a position to design products that can really address the special circumstances of the very poor. Targeting poor people with inappropriate products is likely to damage their interests as they join programmes hoping that they can manage their way around the product's strictures on the basis that this is all that is being offered to them. This, in part, explains some of the high drop-out rates seen in parts of the world.

The challenge for the future is to think beyond replicating standardised systems and products designed in distant countries for different cultures and financial landscapes. Appropriate products are more likely to assist the poor than targeting them with inappropriate services. It is essential to develop alternative appropriate systems (well beyond the Grameen/FINCA models) to allow MFIs to reach deeper into more remote, sparsely populated areas so typical of Africa. The eventual impact of microfinance on poverty and the sustainability of MFIs will ultimately depend on the organisations' systems and products. ***The more appropriate and the higher the quality of financial services on offer, the better business will be both for MFIs and for their clients.***

[1] For more on the product development process see Wright, Graham A.N., "Market Research and Client Responsive Product Development", ***MicroSave,*** 2001 – available on ***MicroSave'***s website: www.***MicroSave***.net under the Study Programme section.