Mission Drift of large MFIs?

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Since the Mexican Microfinance Institution (MFI) Compartamos went public in 2007 – whereby promoting NGOs and private investors earned about USD 425 million – leading journals and magazines have repeatedly run rather sceptical articles about microfinance.[i] They are mostly inspired by antagonists of MFIs growing into market driven enterprises. This antagonism has been blended with contemplation about assumed "subprime issues" of microfinance. However, the sector showed a steady performance, different from most other segments of the financial sector. The unholy blend of these two lines of thought risks to create an unwarranted image of microfinance. As Gonzales-Vega (2009) put it: "[T]he larger numbers of poor household-firms have been reached by organizations that care about sustainability imply a substantially greater social welfare impact than the effects associated with weak, transitory, non-sustainable efforts of organizations with limited breadth of outreach. Thus, sustainability has done more for achieving social goals than any other effort in this area. […] The number of those among the poor still without access to finance are so huge, that one should be very worried about experts who preach against growth and sustainability."

Indeed, the vast majority of microfinance clients around the world is reached by 300 or so large MFIs. Large MFIs offer a wider choice of microfinance products at lower cost, and thus lower interest rates and fees (**annex 1**). They serve a larger proportion of women than smaller MFIs. They pay their staff better and offer them better prospects of a professional career (see Schmidt 2010, in this volume).

Large MFIs are able to do so because economies of scale diffuse fixed costs, and thus allow investment in robust, IT-driven back offices, which again drives standardising of processes and thus realises further economies of scale.

Large MFIs are able to do so because professional acumen and convincing business models – largely replica of market leaders' models, particularly Bangladesh's Grameen Bank – attract commercial capital, i. e. private equity and commercial credit. This fuels steady growth of the organization to reach ever more poor household-firms (widening) and to offer them a wider choice of microfinance products (deepening).

Exemplary, for a sample of 223 Indian MFIs, it is found that large MFIs charge less per client (interest plus other charges) than medium MFIs and access funding at lower cost than medium and small MFIs. They channel more funding from banks – i. e. MFI-borrowing from banks – to their average client than the average client of small and medium MFIs. For large MFIs, the financial cost per client – i. e. the rate at which the average client accesses bank-funding – equals 6.5%, as compared to 8.9% for medium MFIs and 11.5% for small MFIs. Reason being that large MFIs operate more efficiently, mainly for economies of scale, and borrow at up to 5%-points more favorable rates than small and medium MFIs.[ii]

There is no evidence of mission drift, as far as the indicators "female clients", "loan size" or "staff pay" are concerned. It is true, though, that "till very recently, there was little rigorous evidence on either side — is microcredit transformative or ruinous? However this is changing now, thanks to the courage and vision of a few leading MFIs […] at one level the results are remarkably similar. The effect on businesses is not dramatic but some clearly benefit. […] to actually blame microcredit for not promoting the immunization of children is no different

from blaming immunization campaigns for not generating new businesses." (Banerjee/Duflo/Karlan, 2009).

Leading practitioners have, with different nuances, come to argue that it takes about 8-10 years for microfinance clients to move to considerably improved levels of wellbeing. Over this period, clients are faced with socio-economic choices – health care, settling old debts, schooling and/or marrying off children, improving housing, participating in issues of the community, acquiring skills and establishing household-firms – each of which must be complemented by specific microfinance products (see exemplary Sa-Dhan 2009).

This points to the dire need of innovation of a much larger range of microfinance products, much beyond "one-size-fits-all", "meant-to-be-for-business" loans. MFIs have not done enough to diversify their credit products, and they have not been enabled enough by governments and regulators to offer savings, money-transfers and insurance products, including access to equity-based products. However, large MFIs have done more than others in these areas.

Sure, large MFIs will always only reach a certain segment of the unbanked and poor, which may not be "the poorest". Through the equity and commercial credit that large MFIs, the segment served benefits indirectly from the opportunities of capital markets. As more MFIs will be listed at the stock market, they may consider flowing some "micro-equity" directly into the portfolios of their clients.

If this admittedly still thin access to the capital markets was capped, it would be a gross disservice to the huge number of unbanked households. To avoid such, it is the responsibility of MFIs to avoid undue risk of growing wide without growing deep; as it is the responsibility of experts (and/or jornalists) to avoid undue risk of painting an image of microfinance that is not validated by facts.

Annex 1:

a) Mean of selected characteristics for large and small MFIs[1]

Indicator	Large MFIs	Total Sample	Small MFIs
Number of MFIs	273	1,084	553
Number of active borrowers	248,232	69,277	3,194
Total Assets (US-$)	150.9m	47.6m	6m
Gross Loan Portfolio (US-$)	118.3m	34.9m	3.5m
Number of depositors	250,112	72,133	7,552
Voluntary deposits (US-$)	76.1m	21.9m	2m

b) Mean of selected performance indicators for large and small MFIs[1]

Indicator	Large MFIs	Total Sample	Small MFIs
Portfolio at Risk, >30days (%)	4.4	5.7	6.5
Cost per borrower (US-$)	148	267	389
Yield on Gross Loan Portfolio (%)[2]	24.8	29.1	27.4
Number of staff	1,280	391	47
Average Salary/GNI per capita[3]	6.4	5.9	5.0
Female borrowers[4]	69.8	61.4	55.8
Loan over GNI[5]	95.5	81.4	59.3

1 Large MFIs: > 30,000 active borrowers; small MFIs: < 10,000 active borrowers.
2 Financial Revenue (interest and fees) from the loan portfolio, divided by gross loan portfolio, corrected for inflation.
3 Multiplying factor; i. e. how many times of Gross National Income (GNI) per capita of the respective country represents average salary of MFI-staff.
4 Women as % of all active borrowers.
5 %, calculated by dividing Average Loan Balance per Borrower through GNI per capita.
Source: *MixMarket* (2009)

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[i] In 2008, *The New Yorker* discussed "What Microloans Miss" (by J. Surowiecki, 17th March). The *New York Times* documented that "Microfinance's Success Sets Off a Debate in Mexico" (by E. Malkin, 5th April), which was also reflected in *The Economist* "Doing Good by Doing Very Nicely Indeed" (28th June). The *Financial Times* reviewed "The Battle for the Soul of Microfinance" (by T. Harford, 6th Dec.). In 2009, *the Economist* noted cautious findings of the latest random-trial findings as "A partial marvel" (16th July). The *Wall Street Journal* reported "A Global Surge in Tiny Loans Spurs Credit Bubble in a Slum" (by K. Gokhake, Aug.), which caused a heated debate, among other documented by *The Economist* as "Froth at the Bottom of the Pyramid" (25th Aug.).

[ii] Analysis based on portfolio yield, financial cost and volumes that MFIs borrowed from commercial banks; in relation to the number of clients served by respective MFI peer group. Peer groups based on portfolio volume: <1.25m US$ = small; >1.25m<12.5m US$ = medium; >12.5m US$ = large (Exchange Rate of 31st March 2008, US-$:INR 39.9:1). Data source: Sa-Dhan Quick Survey 2008; for details on the dataset, see Sa-Dhan's *The Bharat Microfinance Report – Quick Data 2008*, New Delhi.