Micro financing and their “Mission Drift “orientation The MENA region case

Gretta Saab

University of Balamand, Qelhat, AMIOUN33, Balamand, Lebanon

Abstract

Exclusion from the financial systems is widely spread in all developing and less developed economies and only recently efforts have been made to formalize financial services to the poor. This article studies the impact of growth of microfinance on the economies of less developed countries and if the micro financing sector proved to be beneficial for developing countries in terms of poverty alleviation, creating more opportunities and better standards of living. Even though recent findings show that the impact of micro financing on economic performance was far below expectations and did not contribute to the attainment of the MDGs, this article will try to introduce new nuances to the findings on Mission Drift orientation of these financial institutions.

Our analysis will focus on factors that are vital to determine the extent of micro financing mission drift issue. The article will also attempt to isolate country specificities in this respect as well as the role of cultural and political factors in shifting these institutions from their original mission which is serving the poor.

Keywords: Mission Drift; Microfinance; Poverty alleviation

1. Introduction

Since 1997 academic journals published hundreds of peer-reviewed articles on the role of Microfinance in the alleviation of poverty as well as its evolution from serving the poor to reach new markets and compete with already established banking sector. The role of MFI in providing for the poor has shown recently some kind of “Mission Drift” as they start losing their original mission i.e. focus on the poor. In addition, numerous studies such as Cull et al (2009) have shown that MFI that offer higher loan sizes are by all means “Mission Drift”. This idea suggests that the role of MFI has shifted gradually from financing the poor to compete with a more developed banking sector.

For this reason, few MFI are considered successful while most of them failed to provide for the basic services as to offer small loans for the poor. This evolution has led to question the role of MFI in places where the traditional banking
system is well established and if they can deliver by using different lending methodologies, knowing very well that the banking sector is more active and flexible in adapting new technologies and serving different groups of people. One advantage of the MFI over the banking system is that they serve clients considered too risky for the bank as well as concentrate on people that are not served by banks. Armendariz and Szafarz (2009) argued that that the development of the financial sector is an important factor to take into account which MFIs are actually serving and they argue that if MFIs are offering higher size loans, it does not necessarily mean that these institutions are “mission drift”. Hermes et al. (2009) predicted a negative relationship between microfinance and the development of the banking sector as in well-developed banking systems, commercial banks are more efficient and can profit from scale advantages and diversification.

In this prospect, many studies have been conducted but few remain conclusive if the MFI are actually serving their original mission and which objectives they are pursuing. As per Armendariz and Morduch (2010) the MFI are currently trying to fulfill a double objective, reach for the poor and become self-sustainable institutions.

For this reason the debate on the performance of MFI is still under scrutiny and no final conclusions have been made as to their importance in reducing poverty and providing for the basic needs of the poor. Therefore, highlighting the relationship between the MFI and the banking sector can help frame the debate on the ‘mission drift’ issue and evaluate in a better way this distinction.

The macroeconomic environment in general and the state of development of the financial system in particular should be taken into account when evaluating MFI performance and the mission drift phenomena if existing. The countries taken into consideration are Egypt, Iraq, Lebanon, Jordan, Morocco, Tunisia, Palestine, Sudan, Syria and Yemen. These countries showed sign of maturity in recent years in terms of increased financial service diversity, improved credit risk systems, supportive infrastructure and legal and regulatory framework.

The remainder of this article is structured as follows: in the second section a literature review linking the role of the MFI and their “mission drift” if any is analyzed. In the third section the data, model and results are presented and in the fourth section conclusions and implications are given. Much of the Middle East and North Africa region continues to be influenced by political developments and the fallouts of the Arab spring and the microfinance sector continue to operate in very difficult circumstances.

2. Literature review

As it was documented in many articles, namely Mersland and Strom (2009) about the dual mission of financial institutions as financial sustainability and providing services to micro-enterprises and low income families, it is worth noting that in many instances the MFI drifted from the second objective in order to fulfill the first. Christen and Drake (2002) mentioned this when “less poor clients crowd out poorer clients…..”

Armendariz and Szafarz (2011) said that this phenomenon is not driven by transaction cost minimization alone but by the interplay between their own mission and the cost differentials between poor and unbanked wealthier clients. In order to pin down the conditions under which microfinance institutions has deviated from its original mission, Armendariz and Szafarz (2009) showed also that there is a thin line between mission drift and cross-subsidization which makes it more difficult for researchers to show if MFI have really deviated from their original mission which is providing for the poor.

Also the focus of MFI on making profits at the expense of outreach to poorer customers was contested by Rhyne (1998) and Christen and Drake (2002) who say that the profit motives of MFI lead them to be more efficient and more willing to seek out new markets for their loans.

However no full investigation has been undertaken and the world experience showed sometimes that there is no mission drift as in Cull et al. (2007) and in different times a lack of mission drift as per the work of Paxton et al. (2000), Christen (2001) and Fernando (2004). The work of Hishigsuren (2007) on Bangladesh showed that no significant mission drift but higher efficiency. For these reasons, the growing literature seeking to discover the ingredients of MFI success and their failure as they are mission drift proved to be a critical exercise and no final conclusion has been reached.
The self-sufficiency and sustainability, synonymous in microfinance literature, of the majority of MFI has been debated and many authors like Morduch (2000), Woller et al. (1999a) asserted that an MFI should be able to cover its operating and financing costs with program revenues.

The question remains if the Microfinance institutions accomplish their mission, if they are operating efficiently and how much profitability is needed for the viability of their programs. In other terms MFI attempt to fulfill a dual objective i.e. to reach poor people as well as to become self-sustainable or self-sufficient. The increase in average profit and average cost, two hypotheses from Freixas and Rochet (2008), altogether with the uncertainty make it sure that the mission drift will occur and the deviation from original mission is looming.

Schreiner (2002) talk about average loan as one proxy for the depth dimension of outreach (outreach means reaching more woman) while most of the studies showed average loan increase as the common indicator among microfinance investors and donors to measure the occurrence of the “mission drift symptom”. Our hypothesis is that all MFI need to be sustainable and any drift from the initial mission is guided by consideration of profit. In line with Ryhne (1998) and Christen and Drake (2002) conjecture that profits and costs may outweigh each other and this will not lead to mission drift or lower outreach, Mersland and Strom’s (2010) findings confirm that there is no evidence of mission drift. Their results confirm the findings of previous studies done in this context and deter the concerns of Yunus. Ghosh and Van Tassel (2008) suggest that the most accurate approach to deal with the mission drift issue is the poverty gap ratio, based on poverty line estimates which are still controversial among economists.

However a study done by Armendariz and Szafarz (2011) pointed out to the fact that outreach-maximizing MFIs can deviate from their mission as a result of the interplay of MFI specific parameters and from country specific parameters.

3. Methodology

In the case of the MENA region, two variables of utmost importance will be tackled: the EDB (Ease of doing business) which will be used as a proxy for stability and corruption and the Gini coefficient measuring the inequality of income shares in a country, since most of the countries in the MENA region are developing countries. However the Gini coefficient is time invariant and a good proxy for poverty could be the average loan size (ALS) as detailed in the studies of Cull et al. (2008) and Mosley (1996). Mission drift is observed when an MFI transits from being an NGO to an institution seeking profit. The interest rate differential between the banking sector and the MFI is used to tackle the chances that the institution is deviating from its original mission which is helping the poor, they are usually lower in countries with well-established banking system. The interest rates are much higher for MFI loans than for conventional bank loans. The financial sector development will be measured by the ratio of credit to GDP.

Our variables are led by the Gross loan portfolio of the MFI that will allow testing for the mission drift argument and will be used as a proxy for the mission drift phenomena. It is the dependent variable in our panel data analysis. This variable will allow us to test for the impact of the different independent variables on the loan size in the MFI.

We will run a panel data analysis with dependent variable the Gross loan portfolio and independent variables the development of the financial sector (credit/GDP), the interest rate differential (ird). The higher the difference between the interest rates in the banking sector and the MFI, the greater is the possibility to drift from its original mission. The Ease of doing business (EDB) which is considered as a dummy variable between 0 for low index (below 100) and 1 for high index (above 100) and the average loan size (ALS)

\[
\text{Loan portfolio} = F (\frac{\text{Credit}}{\text{GDP}} + \text{ird} + \text{EDB} + \text{ALS})
\]

4. Data

The discrepancy among the MENA market occurs at their development level as some are showing high levels of outreach and scale like in Egypt and Morocco while some others are still at the early stages like in Iraq, Sudan and Syria. The latest data showed good improvements in terms of the amount borrowed as well as the number of borrowers. If Morocco and Egypt have the biggest number of MFI we can notice that Morocco is ranking first in terms of number of borrowers as well as the Gross loan portfolio. In terms of percentage of number of borrowers to population, Morocco
exceeds Egypt by far, which highlight the importance of the role of MFI in the economy of Morocco. Microfinance institution data on the MENA region comes mainly from the Mix market.org and the World Development Indicators (WDI) however this region continues to be one of the smallest markets in terms of MFI and loan portfolio. Running the model with the EDB variable showed no particular significance so we removed the EDB from the model and we studied the impact of Interest rate spread, Credit to GDP on the Gross loan to the MFI and the Average loan size in order to see if they can lead to a mission drift phenomena.

5. Pooled OLS

Dependent Variable: GROSS_LOAN_PORTFOLIO
Method: Least Squares
Date: 03/27/15   Time: 10:41
Sample (adjusted): 129 260
Included observations: 71 after adjustments

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>AVERAGE_LOAN_SIZE</td>
<td>101251.3</td>
<td>23124.85</td>
<td>4.378464</td>
<td>0.0000</td>
</tr>
<tr>
<td>DOMESTIC_CREDIT_TO_PRIV</td>
<td>-354243.3</td>
<td>307615.7</td>
<td>-1.151578</td>
<td>0.2536</td>
</tr>
<tr>
<td>DUMMY</td>
<td>15558839</td>
<td>30542220</td>
<td>0.509421</td>
<td>0.6122</td>
</tr>
<tr>
<td>INTEREST_RATE_SPREAD__LE</td>
<td>11177038</td>
<td>3821479.</td>
<td>2.924794</td>
<td>0.0047</td>
</tr>
<tr>
<td>C</td>
<td>-45640533</td>
<td>26815840</td>
<td>-1.701999</td>
<td>0.0935</td>
</tr>
</tbody>
</table>

R-squared: 0.260990  Mean dependent var: 55124711
Adjusted R-squared: 0.216202  S.D. dependent var: 66882454
S.E. of regression: 2.31E+17  Akaike info criterion: 38.69899
Sum squared resid: -1368.814  Schwarz criterion: 38.85833
Log likelihood: 5.827181  Hannan-Quinn criter.: 38.76235
F-statistic: 5.827181  Durbin-Watson stat: 1.330774
Prob(F-statistic): 0.000445

Estimation Command:
LS GROSS_LOAN_PORTFOLIO  AVERAGE_LOAN_SIZE  DOMESTIC_CREDIT_TO_PRIVA  DUMMY  INTEREST_RATE_SPREAD__LE  C

Estimation Equation:
GROSS_LOAN_PORTFOLIO = C(1)*AVERAGE_LOAN_SIZE + C(2)*DOMESTIC_CREDIT_TO_PRIVA + C(3)*DUMMY + C(4)*INTEREST_RATE_SPREAD__LE + C(5)

Substituted Coefficients:
GROSS_LOAN_PORTFOLIO = 101251.299564*AVERAGE_LOAN_SIZE - 354243.333593*DOMESTIC_CREDIT_TO_PRIVA + 15558839.4404*DUMMY + 11177037.7972*INTEREST_RATE_SPREAD__LE - 45640532.7885

Another approach could be the fixed effect estimation. The fixed effect estimation does not accept an explanatory variable that is constant over time, dummy variable. We fix this by removing dummy from the regression, and running it again. This will improve our model: both the average loan size and interested rate spread are significant while the
domestic credit is not significant. Also there is an improvement in the $R^2$. **In our case we removed the dummy variable; The Fixed Effect method which assumes different intercepts for each country.**

6. Fixed effect without dummy

Method: Panel Least Squares  
Date: 03/27/15   Time: 10:48  
Sample: 1 272  
Periods included: 6  
Cross-sections included: 17  
Total panel (unbalanced) observations: 71

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>-82967208</td>
<td>25335729</td>
<td>-3.274712</td>
<td>0.0019</td>
</tr>
<tr>
<td>AVERAGE_LOAN_SIZE</td>
<td>79825.45</td>
<td>23217.48</td>
<td>3.438162</td>
<td>0.0012</td>
</tr>
<tr>
<td>DOMESTIC_CREDIT_TO_PRIV</td>
<td>104471.0</td>
<td>297941.5</td>
<td>0.350643</td>
<td>0.7273</td>
</tr>
<tr>
<td>INTEREST_RATE_SPREAD__L</td>
<td>17170559</td>
<td>3646388.</td>
<td>4.708923</td>
<td>0.0000</td>
</tr>
</tbody>
</table>

**Effects Specification**

| R-squared                      | 0.581453    | Mean dependent var | 55124711   |
| Adjusted R-squared             | 0.425524    | S.D. dependent var | 66882454   |
| S.E. of regression             | 50693012    | Akaike info criterion | 38.55300  |
| Sum squared resid              | 1.31E+17    | Schwarz criterion  | 39.19037  |
| Log likelihood                 | -1348.632   | Hannan-Quinn criter. | 38.80646  |
| F-statistic                    | 3.728958    | Durbin-Watson stat | 2.163333  |
| Prob(F-statistic)              | 0.000091    |                     |          |

***the study in the Annex shows that causality runs in both directions exception AVERAGE_LOAN_SIZE which does not Granger Cause INTEREST_RATE_SPREAD__L_E

7. Conclusion

The purpose of this paper has been to examine the link between financial development, Microfinance borrowing and the interest rate spreads and the average loan size among others. We have tried to help answer the question if micro financing could be absorbed by the banking sector in the MENA region, a completely new young region in the microfinance sector. There are limitations in the data available in terms of loans, borrowing and activity in the microfinance institutions. Nevertheless, the results reported in this paper are not all consistent with the fact that the MFI have less space to move in countries where the banking sector is developed. The interest rate spread highly affect this sector and could lead to a mission drift in case the change is unfavorable.
Appendix A.

Pairwise Granger Causality Tests
Date: 03/27/15   Time: 10:43
Sample: 1 272
Lags: 2

<table>
<thead>
<tr>
<th>Null Hypothesis</th>
<th>Obs</th>
<th>F-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>DOMESTIC_CREDIT_TO_PRIVA does not Granger Cause AVERAGE_LOAN_SIZE</td>
<td>66</td>
<td>5.35884</td>
<td>0.0072</td>
</tr>
<tr>
<td>AVERAGE_LOAN_SIZE does not Granger Cause DOMESTIC_CREDIT_TO_PRIVA</td>
<td>8.11802</td>
<td>0.0007</td>
<td></td>
</tr>
<tr>
<td>GROSS_LOAN_PORTFOLIO does not Granger Cause AVERAGE_LOAN_SIZE</td>
<td>93</td>
<td>59.9592</td>
<td>4.E-17</td>
</tr>
<tr>
<td>AVERAGE_LOAN_SIZE does not Granger Cause GROSS_LOAN_PORTFOLIO</td>
<td>9.69404</td>
<td>0.0002</td>
<td></td>
</tr>
<tr>
<td>INTEREST_RATE_SPREAD__LE does not Granger Cause AVERAGE_LOAN_SIZE</td>
<td>30</td>
<td>10.6834</td>
<td>0.0004</td>
</tr>
<tr>
<td>AVERAGE_LOAN_SIZE does not Granger Cause INTEREST_RATE_SPREAD__LE</td>
<td>2.18088</td>
<td>0.1340</td>
<td></td>
</tr>
<tr>
<td>GROSS_LOAN_PORTFOLIO does not Granger Cause DOMESTIC_CREDIT_TO_PRIVA</td>
<td>59</td>
<td>8.45394</td>
<td>0.0006</td>
</tr>
<tr>
<td>DOMESTIC_CREDIT_TO_PRIVA does not Granger Cause GROSS_LOAN_PORTFOLIO</td>
<td>47.0638</td>
<td>1.E-12</td>
<td></td>
</tr>
<tr>
<td>INTEREST_RATE_SPREAD__LE does not Granger Cause DOMESTIC_CREDIT_TO_PRIVA</td>
<td>54</td>
<td>1.21955</td>
<td>0.3042</td>
</tr>
<tr>
<td>DOMESTIC_CREDIT_TO_PRIVA does not Granger Cause INTEREST_RATE_SPREAD__LE</td>
<td>3.46632</td>
<td>0.0391</td>
<td></td>
</tr>
<tr>
<td>INTEREST_RATE_SPREAD__LE does not Granger Cause DOMESTIC_CREDIT_TO_PRIVA</td>
<td>29</td>
<td>5.12899</td>
<td>0.0140</td>
</tr>
<tr>
<td>GROSS_LOAN_PORTFOLIO does not Granger Cause INTEREST_RATE_SPREAD__LE</td>
<td>18.3837</td>
<td>1.E-05</td>
<td></td>
</tr>
</tbody>
</table>

References

CER Mi, University College London, Harvard University.