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Improving the Impact of Microfinance on Poverty

Action Research Programme

Improving organisational learning through impact assessment

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Introduction

This paper considers impact assessment (IA) for a specific microfinance organisation working in an uncertain environment. It argues that there are significant learning points both for new clients and for the organisations who supply their services and products, which can result in improved, more targeted service provision.

The paper is divided into two parts. The first part argues that improved capacity to assess the impact of services is a necessary element of the transition of many microfinance organisations (MFOs) from externally-funded clones to autonomous, flexible and competitive businesses. The second part explores impact assessment design by discussing the need to achieve a balance in choice of goals, data collection, data analysis, choice of indicators and staffing.

Challenges and opportunities

Setting loan/price levels

There are a number of issues that need to be considered carefully by organisations, which can be assessed through an effective impact assessment process. The first question is that of setting loan or price levels.

The mission of many MFOs is to maximise profits, but setting prices too high, relative to service quality and cost, will result in some new clients leaving, who might have remained at a lower price. At the same time, a low price rate reduces the profit rate. Consequently, in order to maximise overall profits, MFOs need to know what combination of price and service quality will dissuade existing clients from leaving, and will persuade new clients to join. They also need to know what new services it might be possible to diversify into and how delivery of existing services can be made more cost-effective. Ideally, they need accurate unit costs and returns for different kinds of services and different categories of clients. They also need information on client turnover — whether clients keep leaving and rejoining, or whether the business is reliant on a steady stream of short-term clients.

The task is further complicated in at least three ways. First, the information must be collected and digested fast enough to permit the owners to adjust services and prices in tandem with shifts in market conditions and corresponding changes in demand.

Second, the MFO may not be seeking to maximise profits, but may be more concerned with ensuring the flow of benefits to current and future clients. Profitability remains an important performance indicator in as much as it reveals capacity to expand and to continue to serving clients in the future. However, lower profits may be justified if they indicate that more benefits are being passed onto current clients. Such judgements require accurate knowledge not

only of how services are valued by different categories of client, but also of how they affect their welfare.

Third, the income of the MFO may not come exclusively from its clients. Various organisations may be prepared to subsidise some of the services in the belief that they have social benefits, such as development of leadership skills or crime reduction. These sponsors require evidence of these impacts. Because they have less direct personal experience of the business and are more accountable to the public, they often require more rigorous evidence of impact than the microfinance service providers.[1]

Making strategic decisions

The challenge is to help microfinance practitioners to make strategic decisions that are grounded in timely, reliable, cost-effective and relevant information about the impact of services on clients. Use of the term *organisational learning* highlights other important considerations (Agyris and Schon, 1978). It emphasises organisational structure and culture over the imperatives of individual stakeholders. It places the emphasis on processes rather than assessment events. Finally, it explicitly confronts the need for organisations to adapt and learn both from their own experiences and from clients' needs. There are two obstructions to true organisational learning: the association of impact assessment with satisfying external donors' needs, and the tendency to apply established 'blueprint' financial approaches and assessment designs.

The support of external donors can complement income from clients, and may be critical both for growth of the organisation and fulfilment of wider social goals. Nonetheless, donor satisfaction should always be subordinate to client satisfaction (Hirschman, 1970). For example, impact assessment is often linked too rigidly to project cycles and regarded as a condition for funding, rather than as useful in its own right, as a way to learn more about clients' needs. Donors have a legitimate interest in understanding the impact of their investments, but if they are serious about organisational development or capacity building, the impact assessment they promote should also serve the goals of the MFO itself.

Adherence to blueprint financial technologies should also be avoided, if the organisation is to implement relevant, flexible and effective policies. Much of the rapid growth of MFOs has taken the form of replication of established models: village banking, savings and credit co-operatives, farmers' savings associations, solidarity groups and so on. This use of established models may save time and energy, especially in a high-pressure climate that demands improved efficiency and rapid financial self-sustainability through 'scaling up'. However, applying a 'blue-print' is neither efficient nor effective in the long term, since services that work elsewhere are not necessarily appropriate for all clients in all situations.

MFOs need to grasp the challenges presented above. In many countries a transition is taking place from an era of sponsor-funded replication, to an era of more open markets, and MFOs that are flexible enough to learn both from their

[1] A fourth complication, not explored here, arises from variation in ownership structure or governance. In the case of cooperatives, for example, clients are also owners. Multiple owners also have different views as to the weight that should be given to profitability, growth, client welfare, depth of outreach and so on.

clients and from the market will survive and thrive. The diversity and quality of services received by clients of these MFOs should also improve.

Design Issues

Goals: Integrating or separating impact assessment from market research

Much has been made of the distinction between proving and improving impact assessment. In fact, this dichotomy fails to capture the complexity of the debate, given that some degree of proof or reliability is a prerequisite for any information to be useful. A more useful approach is to distinguish impact assessment, which is concerned with welfare effects on clients, from market research (MR), which aims primarily at improving business profitability.

The contrast between these two activities can be drawn starkly (see Copestake 2000). IA terminology refers to "primary stakeholders" and "intended beneficiaries", while MR refers to "customers" and "clients". IA is linked to external sponsorship; MR is concerned with new product development. IA is mostly for public sponsors, MR is for MFO managers. IA is conducted by trained social scientists, MR by business consultants. However, there is considerable overlap between the two; for example, it is likely that in gathering information about intra-household relations and livelihood dynamics, a researcher will also learn about client satisfaction and how to secure repeat business. In fact, most organisations will need to conduct both IA and MR.

A key question resulting from this discussion is whether MR and IA goals can be achieved through integrated data collection and analysis (see Copestake 2000). An important rule is to always adapt tools and methods to specific situations, and to avoid "blueprint" analyses. In addition, the social and strategic business goals of an MFO cannot be analysed and addressed in isolation from one another. These points are expanded below.

Data collection: routine information systems or ad hoc studies

Incorporating impact assessment into organisational learning need not entail a great deal of extra work and/or data collection. Most organisations routinely collect a lot of relevant information about their clients when they first join, and in the form of financial records of loans received, savings, repayment performance etc. MFOs may wish to add a few extra variables, such as means testing or relative poverty data (Hatch and Frederick, 1998). If clients are routinely ranked in this way, there is considerable scope for interesting statistical analysis. Questions may be addressed such as the extent to which client retention and exit vary between richer and poorer clients. The potential for such analysis is often unfulfilled because data collection tools are poorly designed, inadequate resources are allocated to analysis, or data is entered and coded in a way that impedes consolidation of databases. For example, many organisations are unable to do this because clients are not given a unique identification code.

Routine, integrated data collection may seem ideal, but the drawback is that this entails collecting information about all clients all the time. For many purposes

sampling may be more cost-effective[2], while remaining effective. In fact, routine and comprehensive data collection can never substitute fully for richer, more intensive and flexible *ad hoc* studies. It should be remembered, however, that it is practical to handle only a small number of quantifiable or easily-coded variables. These variables need to be robust, so they do not have to be constantly modified. Finally, data should not be restricted to those clients who remain in the programme; it is important to also understand clients' reasons for leaving a programme.

Problems of attribution

All impact assessment is based upon judgements about what would have happened to clients under different conditions – if they had not received a loan, if repayment schedules had been more flexible or interest rates had been lower, etc. One way of achieving this is through statistical analysis of differences between groups, with the aim of drawing distinctions between changes related to access to certain services and changes that would have happened without those services. Opportunities to do this scientifically by randomly assigning clients to different treatments are rare, and consequently selection bias problems abound. The approach is most feasible where new services are being introduced, and supply constraints result in arbitrary differences in access within the pool of potential clients. However, as the market for financial services becomes more integrated and competitive, so such situations are likely to become rarer.

An alternative approach relies on informed explanations of impact, rather than their direct measurement. Credibility here hinges on two things. First, the tendency for biased interpretation in encounters between clients and researchers should be minimised, where possible. The use of focus groups and tape-recorded narrative interviews may be useful tools in screening for possible bias. Second, there is the issue of how representative samples are. Debate here is again often unnecessarily polarised. There is a great deal of scope for sampling systems that fall between the purely anecdotal and the formally representative to known degrees of statistical significance. Quota sampling, for example, consists of a minimum number of interviews undertaken for predetermined types of client, and can help ensure studies capture diversity while still introducing randomness into selection.

Choosing Indicators

Microfinance has undoubtedly developed into a global industry. A combination of the worldwide web, cheap international travel and policies encouraging globalisation have facilitated rapid, efficient information transfer across regions and countries. The Consultative Group to Assist the Poorest (CGAP) is playing a significant role in helping to define standards of good practice. This global dimension acts as a major spur to many organisations to improve their standards and performance, not least in establishing criteria for public and private investors into the sector. Nonetheless, this process has proceeded more rapidly in relation to indicators of the financial performance of MFOs themselves,

[2] An alternative approach that limits the data handling problem is to develop the MIS at the level of village banks or solidarity groups. But even the task of entering and analysing data per village bank per loan cycle is often far from trivial (Painter & McNelly, 1999).

and there is a risk that the importance of less easily measurable and comparable performance indicators such as client impact will be correspondingly devalued.

Once response is to develop a standard set of complementary indicators. This has already happened to some degree for measures of outreach. The MicroBanking Bulletin already includes, for example, statistics on numbers of active borrowers and savers, average loan balance as a percentage of spell out GNP per capita, and the percentage of women to total borrowers. Meanwhile, CGAP have recently commissioned The International Food Policy Research Institute (IFPRI) to develop a standard tool for measuring relative poverty of clients.

The question arises as to whether the microfinance industry should establish a standard set of indicators of impact. Two central arguments against this have been posited. The first is a rational liberal position, which holds that MFOs cannot force people to use their services and that if financial indicators reveal a high willingness to pay, positive impact can be taken for granted. In the case of subsidised programmes, evidence is needed that one MFO is not expanding at the expense of others, but the argument follows that outreach indicators provide some reassurance on this. This argument is based on the assumption that clients are rational and free to make individual choices. More dangerously, it assumes people are fully informed of all the facts and don't make mistakes that lead to chronic debt. Cycle-to-cycle exit rates in village banking programmes of 25% and more have not stopped them growing. This suggests that there is at a strong case for developing a standard client loyalty or retention indicator – an analysis of outreach over time – to complement static depth of outreach indicators.[3]

A second reason for arguing against standard impact indicators has been eloquently advanced under the AIMS (Assessing the Impact of Microenterprise Services) Programme. In brief, impact chains are so complex that an almost infinite number of indicators would be needed for an analysis to be relevant for all situations. Hence, the appropriate choice of indicators for a particular MFO must depend upon its goals and the specific context in which the analysis is to be conducted.[4] Moreover, the usefulness of an indicator cannot be evaluated in isolation from the reliability of the methodology used to calculate it.

While it would thus be inappropriate to privilege a standard set of impact indicators, more limited harmonisation of definitions of different kinds of impact indicator could be sought. Obvious examples are ways of calculating change in household income, business employment and livelihood diversification. More interesting would be some convergence over how general questions are framed about client satisfaction and influence over business decisions.

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[3] Developing a good indicator will not be straightforward. For example, with respect to savings it will have to discount dormant accounts. And with respect to loans it should allow for the fact that clients may not want to be in debt all the time.

[4] For example, some studies have taken separation of business and household accounts as a proxy indicator of business prowess. However, this practice may not be in the interests of the client, given that it could increase the risk that relatives, tax collectors, protection squads or debt collectors will be able to work out more precisely what the business is worth.

Staffing – the balance between internalising and sub-contracting

A final question is how far responsibility for carrying out impact assessment should be allocated to MFO staff themselves and how far sub-contractors should take on this task. A starting point is the development of a group within the organisation that is committed to achievable change. The group must include individuals who have a clear vision of what they want to achieve, in addition to the competence, time and energy to bring it about. This should motivate thinking about whether to hire in staff for impact assessment or whether to rely on internal staff. Internal leadership is likely to be essential, but external consultants or researchers may be needed to provide necessary momentum, technical skills and capacity. The contracting process can also help to ensure that a focus is maintained on changing the organisation in the desired direction.

The tendency to assign data collection to operational staff has been criticised for distracting them from core activities, and for increasing response bias. On the other hand, encouraging field staff to participate in open-ended interviews with their clients can help to motivate both clients and staff, and can enhance data quality. Improved staff-client understanding can also help to ensure that the MFO's wider poverty mission is not lost in the rush to expand, and may make good business sense, especially if it leads to reduced drop-out rates (Simanowitz 1999). On the other hand, data collection and analysis can be time-consuming, detracting from the routine work of staff. In this case there may be a strong case for sub-contracting this work to consultants, who can more easily be called to account for delivering on planned outputs. Nonetheless, it is important that MFO management play an active part in tendering and contracting processes, rather than allowing these to be taken over and over-complicated by external sponsors.

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