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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 clearly focused on what matters: providing financial services to poor people. What matters is how to do this in the most cost-effective and efficient manner. In the words of Elizabeth Rhyne (1999), "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." Nonetheless, many MFIs continue to spend a great deal of time and money ensuring that the clients they are recruiting are poor enough to warrant the organisation's services.

Scale and Sustainability

Christen et al.'s 1995 study building on the arguments of Otero and Rhyne (1994) concluded that, "Some observers have argued for an exclusive focus on the poorest clients, with the objective of poverty alleviation. The data assembled here and arguments for financial leverage, suggest that mixed programs serving a range of clients can also be highly effective in reaching the poorest. It is scale, not exclusive focus, that determines whether significant outreach to the poor is achieved."

The demand for microfinance services is huge. In the words of Marguerite Robinson, "Most people in the world do not have access to institutional financial services, either for credit or for savings. Despite widespread demand, it is estimated that institutional finance is unavailable to over 80 percent of all households in developing countries. This, of course, includes nearly all the poor people in the developing world" (Robinson, 1997). Christen et al. (1995) note that for MicroFinance Institutions to reach the scale at which they are going to make a serious impact on the demand for microfinance services of about 2.5 billion people or 500 million households, they will need to leverage commercial funds. "Programs that do not attempt to achieve large scale outreach are simply not making a dent in the global problem" … "Nationally relevant scale will generally not be met without substantial leverage. The donors' role should essentially be to underwrite the commercialisation of micro-enterprise finance and invest in specific start-up programs" (Christen et al., 1995). The move towards using commercial funds (patient equity, loans from banks and savings mobilised from clients) is well underway in Latin America, Asia, Africa and Eastern Europe.

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Targeting Poverty

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. For example, Rene Chao-Beroff (1997) argues that, "The fact is that if priority is given to making [MFIs] profitable as quickly as possible, then the poorest will automatically be marginalized in favor of populations that are supposed to be more credit worthy." More recently David Hulme, 2000 noted that "outside Bangladesh it [the microfinance industry] has not even scratched the surface of poverty" … whether nearly 15 million Bank Rakyat Indonesia clients would agree is, of course, subject to debate.

A Polarised Debate Over A Common Goal

The polarisation between the two camps of "sustainability" and "targeting the poorest" was encapsulated by the original positions of the Consultative Group to Assist the Poorest (CGAP) and the MicroCredit Summit. Initially CGAP focused almost exclusively on maximising sustainability and outreach. After an introduction to CGAP, the following three technical Focus Notes produced by the CGAP Secretariat dealt with "Maximizing the Outreach of Micro-enterprise Finance", "Missing Links: Financial Systems that Work for the Majority" and "Regulation and Supervision of Micro-finance Institutions: Stabilizing the New Financial Market". This approach was entirely appropriate at the time of CGAP's inception in 1995 when much of the industry comprised community development-oriented non government organisations taking uncertain steps toward providing financial services. By the time of the MicroCredit Summit, CGAP had established a common language for the industry and had catalysed the acceptance of "best practices" built on the principle of sustainability as a central part of any self-respecting MFI.

The MicroCredit Summit set about advocating targeting to reach the "poorest" and finding $11.6 billion to do so. With dreams of grants of that magnitude, it is small wonder that the MicroCredit Summit felt that it could place less emphasis on sustainability (and the savings services which might well have generated a substantial proportion of this colossal sum) while still achieving the outreach to "100 million of the world's poorest families". In a recent paper for and presentation to the 1999 MicroCredit Summit Meeting of Councils in Abidjan, Cote d'Ivoire, Md. Yunus, Managing Director of the Grameen Bank berated the donor community for failing to "get money into the hands of the poorest" and consultants for trying to "convince donors to avoid or de-emphasize the poverty issue."

By 1999 a wide, dangerous and unnecessary gap had emerged between CGAP and the MicroCredit Summit. It was (and still is) dangerous since it is likely to confuse policy-makers and funding agencies. It was unnecessary since the two institutions share the same goals - much of the gap is perceived rather than real. Most of the issues that divide the institutions are relatively easy to resolve with a little thoughtful discussion – however the two institutions often speak different languages: one technical, the other crusading (Wright, 2000). Despite this, the two institutions have played an important role in influencing one another. CGAP is moving towards placing a greater emphasis on addressing poverty and deepening outreach, and the MicroCredit Summit is moving towards placing greater emphasis on sustainability and appropriate financial discipline. Both these moves are necessary and desirable.

Probably the most considered, balanced and reconciliatory perspective is outlined by Elizabeth Rhyne in the 1997 MicroBanking Bulletin where she notes "…reaching the poor and sustainability are in large measure complementary, and particularly that sustainability serves outreach. Only by achieving a high degree of sustainability have microfinance programs gained access to the funding they need, over time to serve significant numbers of their poverty-level clients. This image reveals that *there is in fact only one objective -- outreach. Sustainability is but the means to achieve it.* Sustainability is in no way an end in itself; it is only valued for what it brings to the clients of microfinance."

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.

Furthermore, the non-poor often present an increased risk for the MFIs – since less poor people typically have an inferior repayment record. Indeed, it is this fact that initially formed the basis of much of the rationale for targeting the poorest (see for example Gibbons, 1992). If you lend to the better-off, the argument ran, they are more likely to have the political power and access to alternatives that allow them to default – an argument corroborated by the experience of badly designed agricultural credit programmes throughout the 1970's and 1980's. If this is indeed the case, then clearly MFIs have to be careful about "upward drift" on practical as well as philosophical grounds.

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 (Rhyne and Otero, 1994 and Wright, 2000). 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. (Readers might like to reflect on how they would deal with these issues in the absence of access to formal sector financial services: no banks, no credit cards, no pension funds, no mortgages or car loans) 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 (see for example Hulme and Mosley, 1996) and to see it as a static state. 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 formal sector.

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 (Sebstad and Cohen, 1999). 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.

In most development initiatives, the more people you serve, the greater the cost becomes; with microfinance initiatives journeying to sustainability, the costs decrease. There are also institutional advantages, even necessities, which suggest that broader targeting is desirable. The very poor are unlikely to take large enough loans to allow MFIs to achieve sustainability, thus securing the long-term existence of the MFI that provides essential financial services. Furthermore, once the MFI has the infrastructure in place and the staff travelling to serve the (perhaps non-poor) clients, the marginal cost of serving poorer clients decreases. MFIs need a broad mix of clients to allow economies of scale and cross-subsides to allow them to deepen their outreach. (To maintain the business perspective, MFIs can usefully view these cross-subsidies as "loss leaders" necessary to cultivate clients over time in broadly the same way that banks often provide loss-making services to students in the hope that they will one day become good, high-value clients).

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 all to become business people. Mosley (1999) in his study of Latin American MFIs for the World Development Report 2000/1 suggested that secondary income and employment effects were beginning to come through. 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 (Khandkar and Chowdhury, 1995). 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-exploitative, self-employment generating marginal returns.

The "Poorest of the Poor"

Sadly, "the poorest of the poor" has become a catch phrase that has been rendered essentially meaningless by abuse and repetition. Realistically, the "poorest of the poor" are rarely served by microfinance institutions – even by the people that use the catch phrase so often. 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 (Wright, 2000). This is largely a result of the dominance of the Grameen Bank/FINCA models and the (often startlingly unimaginative) replication of these – even by (or perhaps even particularly by) those ostensibly dedicated to reaching the "poorest of the poor". For the poorest households the opportunities for productive use of loans are often limited, the weekly meetings too time-consuming and the risk of taking loans that are repayable on a weekly basis are unacceptably high (Wright 2000 and Rutherford, 1998). In addition, many commentators would argue, the exclusion of the poorest is probably driven by the emphasis on credit delivery by MFIs, which pay scant attention to the needs of the poorest for somewhere safe and accessible to put their savings.

It is high time that more attention was paid 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. This is particularly challenging in Africa where the majority of rural villages remain without access to financial services. Examples of such innovative products and systems in Africa include those of the Caisses Villageoises d'Epargne et de Credit in Mali, Burkina Faso, Madagascar, Cameroon and the Gambia; the Small Enterprise Foundation in South Africa; the Financial Services Associations that have been introduced in a variety of forms in Benin, the Congo-Brazzaville, Gabon, Guinea, Mauritania, Uganda, Kenya and South Africa; and the Kenya Entrepreneurship Promotion Programme and Partnership for Productivity initiatives centred on managing Accumulating Savings and Credit Associations. However, most of these initiatives remain small and still require on-going subsidy.

What we should <u>not</u> be advocating is a return to perpetual subsidy for MFIs (as has been suggested by some – see for example Woller et al. 1999). 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".

Furthermore, while they are unquestionably important, financial services are probably not the highest priority for the truly "poorest of the poor" – they need relief. And it may well be more cost effective and appropriate to deliver relief (hand-outs) than to try to provide credit to this particularly poor part of the community. In this context, BRAC's Income Generation for the Vulnerable Group Development (IGVGD) programme is particularly enlightened and effective. The IGVGD programme provides truly poor women wheat as compensation for working on the roads and embankments of Bangladesh. At the same time BRAC helps the women save part of funds generated when they sell the wheat and by providing training in income

generation schemes (typically poultry or sericulture). After three years the women have developed the resources and skills to graduate into BRAC's mainstream rural credit programme activities. Forcing them straight into the mainstream rural credit programme would have helped neither the poor women nor BRAC as an MFI committed to sustainability.

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 rather extreme positions. At one extreme 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 (Wright 2000 and Rutherford, 1998).

At the other extreme focus exclusively on the poorest could be seen as a rationale for enforced "graduation" after a basic level of financial stability has been achieved by clients. Not only does this ignore the need for on-going access to financial services but it also undermines the incentives to repay and indeed the sustainability of the MFI itself by forcing out the most valuable clients (Wright, 2000).

Conclusion

All of the above is not, for one minute to suggest that poor do not need or should be excluded from financial services – though many of the poverty enthusiasts will chose to see it as such. The poor <u>do</u> need financial services (perhaps even more than the vulnerable non-poor) and MFIs accessing public development funds should indeed seek to offer financial services to the poor and even the poorest. But the <u>nature</u> of the services and the products that are truly useful for the poor and the poorest are likely to differ from what is currently made available to them. In particular savings services are likely to be more important than credit services, and credit services solely focused on microenterprise development are likely to be less useful than emergency loans. A fact that is indeed an amusing irony given the poverty-focused MicroCredit Summit's disregard for savings and emphasis on "credit for self-employment". This emphasis was explained to those of us at the 2nd Preparatory Meeting in held in Washington in 1996 in terms of it being easier to explain to the general public that poor people need loans to do business: another triumph of spin over substance.

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. Only when this is clear are the MFIs in a position to design products that can really address the special circumstances of the 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 very high drop-out rates seen in many parts of the world (see for example Hulme, 2000 and Wright, 2000). The damage caused to very poor people by participating in inappropriately designed microcredit programmes is becoming increasingly clear (see for example Hulme, 2000).

"For the poorest households the opportunities for productive use of loans are limited, and the risk of taking loans that are repayable on a weekly basis are unacceptably high. In preference to "targeting the poorest" and trying to persuade them to join organisations that are offering inappropriate financial services, it is the services themselves that require revision and tailoring to meet the needs of the poorest, and thus to attract them into microfinance programmes. As donors and practitioners place increasing emphasis on

microfinance as opposed to microcredit, the poor are likely to join the microfinance programmes in order to save. Over time the poor may also enjoy the benefits of scale that microfinance institutions' more affluent clients allow - in terms of interest on savings, a broader range of financial services and possibly even lower cost loans" (Wright, 1999).

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. It is for this reason that there is so much interest in the experimentation round Financial Service Associations, which may offer an alternative system that might drive the "financial frontier" further out from the densely-populated areas for which the Grameen/FINCA systems were designed.

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.

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