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Johnston Wagona Makoba

Toward the Commercialization of Microfinance Institutions: A Global Phenomenon

1. Introduction

The central question to be investigated in this paper is whether the current worldwide shift in the focus of microfinance institutions (MFIs) toward commercialization is a natural evolutionary process or a result of donor pressure to achieve large-scale operations and financial sustainability. Nonprofit organizations, which include MFIs and a variety of nongovernmental organizations (NGOs), are nonmembership support organizations involved in relief, rehabilitation or development work in both developed and Third World countries. MFIs and other financial NGOs are purposely created to promote self-help activities aimed at meeting the social and financial needs of their clients. Microfinance institutions in particular, provide either only credit or "credit plus" some development program intervention designed to provide self-help solutions to empower the poor, usually women.

The massive inflow of donor funding during the 1980s provided funding for a variety of credit-oriented projects in most Third World countries. This is because MFIs and other development-oriented nongovernmental organizations (NGOs) are considered by donors to be the most effective vehicles for reaching and empowering the poor, especially women. The initial focus of the donor community was to achieve scale or outreach, rather than seeking financial sustainability. However, the end of the Cold War and declining donor funds in the 1990s contributed significantly to the shift in the donors' focus from outreach toward financial sustainability. To ensure the maximum development impact of scarce aid resources, donors increasingly "want to fund projects and programs that have a greater chance of being sustainable and of standing on their own" (Ridell 1999: 321).

2. Perspectives seeking to Explain MFI Commercialization

There are two major perspectives that seek to explain efforts aimed at transforming MFIs and financial NGOs into commercial entities operating presumably on a business-like model with a focus on profitability. The two perspectives are the Integrated Approach and the Financial Systems perspective. Proponents of the Integrated Approach[1] consider commercialization to be a donor-driven strategy to scale up activities and achieve financial sustainability. In contrast, proponents of the Financial Systems perspective[2] view the commercialization of MFIs as a natural, evolutionary outcome necessary to achieve major scale through financial sustainability. In addition to discussing the two approaches, the paper considers the possible effects of commercialization on the goals and activities of MFIs. Finally, tentative strategies aimed at reducing donor dependence of MFIs and financial NGOs are suggested.

3. The Integrated Approach

The Integrated Approach combines making loans/credit delivery with client training and technical assistance. This approach is variously referred to as the "Credit Plus" or simply the traditional welfare oriented/value-driven approach. The Integrated Approach considers development from a much broader perspective. This is because it is driven by social values or goals of empowering the poor to solve their own problems and overcome poverty. It also tends to target the 'poorest of the poor' and to focus on "alleviating poverty by providing a number of free or subsidized services" (Mutua in Othero/Rhyne 1994: 270). Critics contend that this approach has "had limited impact on the beneficiaries, was costly, and could be sustained or expanded only through grant funding (Mutua in Othero/Rhyne 1994: 268). It is also claimed that credit policies in welfare-oriented NGOs are based on humanitarian grounds rather than workable financial models. Donors, northern partners (e.g. Private Voluntary Organizations) and microfinance practitioners (such as the SEEP Network) advocate for achieving scale through financial sustainability. All these various organizations tend to exert enormous pressure on welfare-oriented NGOs to abandon their methodology in favor of a financial systems approach. In particular, big donors urge NGOs to use the finance-based approach observing that it is cost-effective, helps to achieve scale and financial self-sufficiency and above all, has worked elsewhere in the world. Donor emphasis on commercialization seems to be driven by two factors. First, is the desire "to ensure that the developmental impact of scarce aid resources is maximized" ("New Directions in Donor Assistance to Microenterprises", OECD 1993: 8; Riddell 1999: 321). Second, "the need ... to document the performance of programs they support ..." (Buckland 1996: 386) to the taxpayers in developed countries that provide the financial aid. Because many NGOs are dependent on donor funds for survival, they are vulnerable to pressure toward the transition to a finance-based system (Buckland 1996: 271; Ndegwa 1996: 24; Van de Walle 1999: 346; Dicklich 1998: 28). According to Ndegwa, "Dependency, rather than government controls, [poses] the greatest threat to [NGO] sustainability" (Ndegwa 1996: 24).

Scale, sustainability, and scarce donor funds are the three major forces behind demand for commercialization of MFIs in the Third World. It is increasingly recognized by both donors and MFIs themselves that "micro-finance can only be fully established ... by successfully combining the practices and behaviors of the business community with the social mission of the development world" (ECA 1998: 50). According to the Economic Commission for Africa (ECA), "to achieve high and sustainable rates of growth, MFIs need to expand their resources in the interest of maximizing their outreach and profitability, and at the same time minimize costs and risks involved with serving a population living in poverty" (ECA 1998: 50). As a result of declining development aid, donors have pushed implementing NGOs for the design of "microenterprise finance models that allow for continuing program expansion" (Otero/Rhyne 1994: 2) without depleting scarce resources provided to them. Recently, PlaNet Finance, the brainchild of a French banker, Jacque Attali, reported creating a rating system (similar to Moody's) "that will rate micro-banks [and MFIs] according to their ethics, how well they serve the poor and financial efficiency" (The New York Times 1999: 29A). In general, donors and proponents of the Financial Systems Perspective have been dissatisfied with small, subsidized programs and have demanded the creation of larger programs with the potential for financial self-sufficiency, within a relatively short period (usually five to seven years).

According to Otero and Rhyne, "the only way for institutions to grow and stay big [without subsidies] is to become financially self-sufficient" (Otero/Rhyne 1994). Some donor agencies such as Britain's Department for International Development (DFID) are "committed to only working with institutions which share (their) long-term vision of sustainability and independence from donor support" (FOCCAS Uganda 1999: 44). There is growing awareness among MFIs of the necessity for pursuing both financial sustainability and scale or outreach. As a result, the few microfinance institutions that have reached large numbers of people with few or no subsidies have instituted innovations in three important areas. The three areas of innovation include: group-based repayment motivation, streamlined administrative costs, and market-based pricing of the products or services delivered. Following these innovations, such microfinance institutions have transformed their relationship to clients from one based on charity or "hand-outs" to a more business like relationship. According to proponents of the Financial Systems Perspective, "the new Microenterprise finance programs look at clients as customers they wish to serve" (Otero/Rhyne 1994: 4). Because such programs perceive their clients as customers, they try to match their services with what the customers want. In other words, the services provided by these microfinance programs are perceived as demand-driven.

4. Donor Pressure and the Commercialization of MFIs

In a recent study of NGOs in the Gambia, Fyvie and Ager report that both donors and northern NGOs have exerted pressure on Gambian NGOs to "increase the scale of their existing projects" (Gyvie/Ager 1999: 1389) and to move "toward commercialization" (Gyvie/Ager 1999: 1392). Because of donor demands for achieving scale and financial sustainability, many NGOs in the Gambia and elsewhere in the Third World tend "to follow the example of their commercial counterparts, and adopt market-led strategies, measuring their overall innovative achievement ... in terms of their share of the development market, donor 'sales,' and levels of revenue generated" (Gyvie/Ager 1999: 1394–1395). It has also been reported that "... most NGOs in Sri Lanka [are] dominated by donors who set the priorities for [them]" (Sooryamoorthy 1999: 308–315). Overall, it seems that the transition to larger scale and greater self-sufficiency is donor-driven.

Critics assert that donor influence in NGO activities has greatly increased with the entry of the World Bank, USAID, and UN agencies especially UNDP, into NGO funding, program design and evaluation. The World Bank not only encourages member governments to work with NGOs on development projects, but directly funds NGO projects. It is reported that: "From 1973–88, NGOs were involved in about fifteen [World] Bank projects a year. By 1990 that number had jumped to 89, or 40 percent of all new projects approved." (Michaels 1993: 103) USAID is said to funnel about twenty percent of its funds through NGOs. Critics contend that funds from such powerful donors as the World Bank and USAID tend to compromise the independence and effectiveness of NGOs in achieving the social goals. According to Michaels: "The World Bank uses the NGO healthcare and education projects [undertaken by NGOs] to put a human face on Structural Adjustment, ... [yet it] accuses them of destroying as much as they build by subsidizing show case operations, not sustainable development." (Michaels 1993: 103) Furthermore, big donors such as the World Bank, USAID and UNDP are said to "treat NGOs as little more than cost-effective service providers for their activities in certain sectors. It saves donors money and allows them to avoid addressing implementation difficulties, while also allowing them (the donors) to retain ultimate control over activities" (Van de Walle 1999: 346).

In addition to providing funding, these major donor agencies are also involved in the development of tools for NGO program design and evaluation. The World Bank's Consultative Group to Assist the Poorest (CGAP) is targeting microfinance institutions with demonstrated capacity to achieve significant scale. CGAP has developed major capacity building initiatives for MFIs worldwide. It is reported, for example, that CGAP's Africa Capacity Building Initiative

"... contracts with local training institutes to provide affordable, fee-based training on basic technical skills such as managing [loan] delinquency and setting interest rates ... In addition to building technical skills, [the initiative] is designed to promote a more business-like approach to training." (NEXUS 1997b: 1–2)

Beyond building technical skills for MFIs, CGAP is also involved in the development of "tools for MFI analysis, strategic planning, financial projections, MIS (Management Information Systems) and auditing that [it] hopes will become standardized throughout the [microfinance] industry" (NEXUS 1997b: 3).

USAID shares the World Bank's enthusiasm for developing enterprise networks. The major goals of USAID's Microenterprise Innovation Project (MIP) are: "to expand the knowledge base of the Microenterprise field and to provide information and tools to improve the performance of financial institutions serving the microenterprise sector and microenterprise support organizations and the design and implementation of USAID and other donor-supported projects." (Microenterprise Best Practices Newsletter 1998) However, USAID's overall capacity building strategy is more diverse. The strategy has several components, which are "embedded in each of its major programs including Matching Grants, the Implementation Grant Program (IGP) and the Microenterprise Best Practices Project (MBP)" (NEXUS 1997b: 2). The Microenterprise Best Practices Project "combines research activities and capacity building grants to expand the knowledge base of the [microfinance] field and encourage application of best practices" (NEXUS 1997b: 2; Microenterprises Best Practices Newsletter 1998: 1).

To achieve the goals of MIP, USAID "through its prime fund ... co-finances Microenterprise projects with [its overseas] missions [and provides] support for local networks or centers of Best Practice [such as the USAID-PRESTO project in Uganda]" (NEXUS 1997b: 2). It also sponsors "the Microfinance Training Program in Boulder, Colorado every summer [which] offers training opportunities for NGOs and staff" (NEXUS 1997b: 2) USAID's support for local networks or centers of Best Practice entails providing a grant facility, which promotes training, a core research agenda and an information dissemination component. The USAID-PRESTO Project in Uganda, for example, operates a center for Microenterprise Finance (CMF) whose purpose "is to improve and expand the financial services offered to Microenterprises in Uganda through banks and non-bank financial institutions ... (or MFIs)" (CMF 1997). According to the CMF program guidelines:

"The CMF is implementing a program aimed at disseminating Microenterprise finance best practices to the managers and staff of participating MFIs. These best practices draw upon the lessons that have been learned from successful Microenterprise finance programs worldwide over the past decade ... Most importantly, they include an institutional commitment to achieving financial sustainability to ensure that savings and credit services that are now being developed with donor support will be available to the poor over the long term, rather than limited to the time frame of donor interventions." (CMF 1997)

In addition to involvement in enterprise programming and offering training opportunity for NGOs, USAID under its MIP project, supports networks of practitioner organizations such as the Small Enterprise Education and Promotion Network (or The SEEP Network), with its 48 participating members. It is reported that "the SEEP Network acts as MBP's (Microenterprise Best Practices Project) 'Learning Agent' ... by developing a learning agenda around grant-funded activities and disseminating that learning to the larger microenterprise community" (Microenterprise Best Practices Newsletter 1998: 6). The SEEP Network also works with the World Bank's CGAP "to extend the dissemination of the financial reporting standards embodied in its publication Financial Ratio Analysis for Microfinance Institutions" (Microenterprise Best Practices Newsletter 1998: 6). The SEEP Network Workshops conducted at the national level in several African and Latin American countries often "cover financial statements, construction and analysis of financial ratios derived from those statements and how to address common barriers to improved performance" (NEXUS 1997c: 1). According to the SEEP Network, "the goal of this activity is to increase NGO performance by improving the accuracy of financial statements and to encourage the application of ratios as a management tool"[3].

Microenterprise Best Practices, whether funded by USAID or the World Bank's CGAP, yield results and products that are often disseminated to a wide range of microenterprise practitioners-most of which are the SEEP Network members.

UNDP's MicroStart seeks to fill a gap left by USAID's MBP and the World Bank's CGAP, respectively. MicroStart tries to fill the gap by supporting "a wide range of fledgling programs drawn from the ranks of NGOs, community organizations and commercial banks" (Microenterprise Best Practices Newsletter 1998: 6). MicroStart, which now operates in twenty-five developing countries, seeks to "match capable practitioner organizations [most of them member organizations of the SEEP Network] with grantees for the purposes of technical assistance and monitoring" (NEXUS 1997b: 1). MicroStart believes in "learning by doing" and embraces diversity over standardization. In contrast to the World Bank's CGAP and USAID's MBP, MicroStart expects to develop capacity building approaches and tools that will vary by both country and organization[4] Despite the diversity of strategies and tools promoted by major donors and practitioners, all appear to stress the commercialization of microfinance services. They are unified by the desire to achieve more and better results in terms of scale and financial self-sufficiency.

5. The Financial Systems Perspective

According to a leading practitioner of an international PVO (Private Voluntary Organization): "microcredit donors in recent years have been fixated on the financial bottom line and have pushed very hard for microcredit practitioners to become fully financially self-sufficient quite quickly." (Dunford 2001: 24)

The Financial Systems Perspective represents a major departure from a view of development-oriented NGOs as charitable organizations requiring large subsidies from donor agencies. In fact the notion of linking financial self-sufficiency to no subsidies is a direct attack on traditional, charity-oriented NGOs. The Financial Systems perspective focuses on "institutions and their ability to provide services on a sustainable and widespread basis" (Dunford 2001: 3). It is also known as the "minimalist" or "modernized" approach because of its preoccupation with credit (and savings) delivery by MFIs. Its emphasis is "on measures of increased access to financial services and financial self-sufficiency of program and institutional sustainability" (Otero/Rhyne 1994: 11–12). rather than client impact. As already discussed, major donors in collaboration with practitioner organizations have taken the lead in advocating for a financial model of microenterprise development. Donors have done so by: "demanding better performance from programs they fund, promoting learning across countries, and encouraging governments to adopt more supportive interest rate and regulatory policies" (Otero/Rhyne 1994: 12).

There is a growing awareness among MFIs to strive for financial sustainability. This awareness has intensified with the decline in development aid. Furthermore, there is emerging evidence to show that microfinance organizations that adopt a business approach "have made significant financial improvements" (Otero/Rhyne 1994: 26). In particular, a few microfinance institutions such as KREP in Kenya, Banco Sol in Bolivia, and BRI and Grameen in Bangladesh, have achieved the mass production of microfinance services and possess the potential for financial sustainability.[5] It also appears that "the achievement of sustainable [financial] services reaching large numbers of poor clients has lent legitimacy to microenterprise, moving the field from welfare to business".[6] But increased access to financial services does not guarantee improved social impact. The major dilemma facing these institutions is the problem of balancing financial and social goals. Because commercialization presumes profitability or financial performance, the social goals of microfinance institutions are neither aggressively promoted nor protected. Indeed as one leading practitioner has recently observed: "the leading proponents of 'best practices' seem unconcerned about [social] impact, because they seldom talk about, much less measure, progress toward ... ultimate development objectives." (Dunford 1999: 1)

In addition to lack of concern for the very poor, the "financial systems approach ... emphasizes institutional sustainability as a crucial element in providing credit services ..." (NEXUS 1996b: 3). Emphasis on financial performance or profitability may inevitably undermine social goals. However, it is possible to pursue both social and financial goals since they are not mutually exclusive. It is possible to achieve scale and financial sustainability while seeking to alleviate poverty.

The most promising aspect of poverty-lending programs worldwide is their goal "to achieve major scale through financial sustainability" (Mutua 1994: 269). For this to be accomplished, it requires that: "Program services have to establish and expand a sustainable institutional base in order to reach a meaningful number of people in need ... [Also, if] program services really improve the lives of the people they touch, then the sustainability of [the] high-impact program is a key ingredient to improving social welfare over a large population." (MkNelly 1992: 15)

NGOs are driven by both social and financial goals of helping the poor to overcome poverty. Because microfinance is the creation of the NGO community, there is need to reconcile or balance the two goals as they are not mutually exclusive. For example, profitability resulting from commercialization can be used to achieve long-term social goals. According to the opinion expressed by participants at a recent Microfinance Network (MFN) conference: "The social mission of MFIs essentially means targeting a market niche, while their push for financial performance is rooted in their search for performance; together they represent nothing more than short and long-term goals." (NEXUS 1999: 18) It is not only possible, but also desirable for microfinance institutions to be both business-like and meet social goals of poverty alleviation. As one observer puts it: "Microfinance must be business-like. We (sic) must adopt banking standards of performance-to the extent they don't stifle the ability of the poor to really benefit." (Dunford 1999: 1; Riddell 1999: 322)

6. Efforts to Reduce Donor Dependency

Increasingly, individual microfinance institutions are seeking to reduce their dependence on donor grants and other subsidies in part because such sources of funding are declining. This is an important development within the microfinance field. There is already a remarkable movement "away from donor grants as the main source of funding toward funding from savings deposits and borrowing from local banks ..." (Otero/Rhyne 1994: 7). However, the search for "savings mobilization" and access to special financial facilities will inevitably contribute to the desire by Cnetral Banks or Government Authorities to regulate and supervise MFIs. Furthermore, many microfinance institutions that have not yet borrowed from banks have shifted from grants to loans, secured at market-based interest rates. Some "commercial banks are developing their own microenterprise programs" (Otero/Rhyne 1994: 7), while others are incorporating "microfinance as a new line of business without abandoning the poor".[7] Commercial banks and other financial institutions are increasingly attracted to the microfinance sector for two reasons. First, MFIs have effectively attracted substantial funding from international institutions such as USAID, UN and the World Bank. Secondly, these same institutions promote the participation of commercial and other financial institutions in the microfinance sector by providing them with capital and technical assistance. As a result, several urban-based banks in Third World countries have developed microcredit units that target urban-poor clients. Finally, PlaNet Finance, a new internet microfinance organization proposes to create: "PlaNet Bank, which will extend lines of credit to micro-banks and will enable anyone to come to [its] web-site, donate money to selected projects offered by the best micro-banks, and then track whom that money went to and how it is used." (The New York Times 1999: 29A) The expansion of commercial banks into microfinance may pose a threat to the traditional microfinance institutions as both compete for clients and investment capital.

7. Conclusion

The greatest donor influence on MFIs to commercialize is wielded through development assistance and conditions attached to the use of such aid. In addition to providing funding to MFIs, donor agencies provide technical assistance too. Much of the technical assistance involves the development of tools for MFI program design, monitoring and evaluation. In most cases, donors and some Northern PVOs contract networks of practitioner organizations such as SEEP to develop and disseminate Microenterprise Best Practices. And the Microenterprise Best Practices promoted by both donors and practitioners tend to stress the commercialization of microfinance services in order to achieve sustainability. However, social and financial goals are not mutually exclusive. Indeed, most MFIs-including successful ones-strive to balance or reconcile their social and financial objectives. For example, profitability resulting from commercialization can be used to achieve social impact through increased outreach.

The search for financial sustainability should go hand-in-hand with the goal of reaching substantial numbers of the poor with high impact services. To achieve sustainability and scale, MFIs need to expand their resources to increase both outreach and profitability, while continuing to serve a population living in poverty. By doing so, microfinance institutions will be in a position to achieve both their financial and social missions. And above all, such institutions "have to be explicit in both their social and financial/institutional objectives. Through appropriate incentives for managers and service staff, they must commit to managing and measuring progress toward both" (Dunford 1999: 2). In the final analysis, successful MFIs must find the right balance between achieving social and financial goals.

Abstracts

Dieser Artikel untersucht, ob die derzeit weltweite Trendwende im Bereich der Mikrofinanzierungsinstitutionen (MFIs) hin zu Kommerzialisierung oder Profitabilität ein natürlicher evolutionärer Prozess ist, oder aus dem Druck der „Geber" resultiert, die größer angelegte Operationen und mehr finanzielle Nachhaltigkeit erreichen wollen. Dieser Artikel analysiert zwei Ansätze (den integrierten Ansatz und die Finanzsystem Perspektive) zur Kommerzialisierung von Mikrofinanzierung und kommt zu dem Ergebnis, dass der Wunsch nach finanzieller Nachhaltigkeit großteils von Seiten internationaler Geberorganisationen ausgeht.

The paper investigates whether the current worldwide shift in the focus of Microfinance Institutions (MFIs) toward commercialization or profitability is a natural evolutionary process or a result of donor pressure to achieve large-scale operations and financial sustainability. The paper analyzes two approaches (i.e. integrated approach and financial systems perspective) to microfinance commercialization and concludes that the desire for financial sustainability is largely driven by international donor pressure.

Notes

1 The Integrated Approach combines traditional methods of making loans/or credit delivery with intensive client training and technical assistance. See following sources: MkNelly 1992: 15; Otero/Rhyne 1992: 15; Otero/Rhyne 1994: 11–12; and Buckland 1999: 385–386).
2 The Financial Systems Perspective focuses on financial performance, profitability and financial sustainability (or no subsidies to MFIs). See the following sources: MkNelly 1992; Otero/Rhyne 1994; and Buckland 1999.
3 NEXUS 1997c: 1. Also see NEXUS 1996b: 7, which reports that donors and practitioners such as the SEEP Network work together to debate and define both financial performance standards against which institutions (MFIs) can be evaluated and compared, and develop standardized reporting guidelines to facilitate this process.
4 NEXUS 1997b: 2. Also see NEXUS 1997a: 8.
5 Mutua 1994: 269, reports that when KREP (Kenya Rural Enterprise Program) changed its strategy from the traditional Integrated (or welfare-oriented) method to a Financial System's Approach, it significantly improved the impact and cost-effectiveness of KREP supported programs.
6 Mutua 1994: 269. See also Dunford 1998: 4; Glosser in Otero/Rhyne 1994.
7 Dunford 1998: 5 cites the experience in West Africa, with credit unions and local commercial banks like the Lower Pra Rural Bank in Ghana.

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