Chapter-6

Conclusion and Policy Implications

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CONCLUSIONS AND POLICY IMPLICATIONS

This chapter discusses the most important findings and new contributions of the current study. It also provides a summary of the main results and policy implications of the study as well as a number of directions for future research.

Three goals are generally pursued by MFIs: outreach to the poor, sustainability of the institution and impact on clients. Outreach can be distinguished into the breadth and depth of outreach. Breadth is defined as the total number of active clients and is important because the demand for credit by the poor is likely to exceed the funds available for lending to the poor. The objective is therefore to reach as much of the under-served as possible with the given funds. However, a large client base does not necessarily mean that the poorest are served. For that reason it is critical to consider the institutions' depth of outreach, which refers to the poverty level of clients. Sustainability relates to the viability of institutions in the future. It is an important criterion for successful MFIs as only permanent institutions can assist future generations and improve the situation of the poor borrowers in the long-term. Persistence of the MFI is often related to its financial performance. A financially sustainable MFI is independent of donor subsidies. Finally, the impact is the sum of all positive and negative changes that take place in the clients' and their families' lives, in their enterprises and in their communities due to the services provided by the MFI. To justify allocation of scarce donor funds, there is a need of strong evidence that MFIs have positive effects on poverty reduction.

The concept of microfinance has come to be influenced by two major schools of thought: The Institutionalist School (also known as the financial sustainability approach) and Welfarist School (also known as the poverty lending approach). Though both schools agree that the ultimate goal of microfinance is poverty alleviation, they are of different opinion on how the institutional structure of MFIs should be. Institutionalist school focuses on building financially sustainable MFIs in order to serve the poor but Welfarist School pays more attention to the outreach and impact of the program. Institutionalists advocate "win-win" proposition which suggests that following the principle of good banking MFIs will also serve their mission of poverty alleviation. In their opinion, MFIs should totally discard subsidies, donor funds in order to achieve financial sustainability. Financial sustainability will allow MFIs to extend financial serves to larger population of poor on a long term basis. Welfarists on the other hand believe that commercial orientation will reduce focus on reaching the poorest. Shifting the emphasis toward financial sustainability has raised concerns with respect to the consequences of this shift for the outreach of microfinance, that is, the number (breadth) and socioeconomic level (depth) of the clients that are served by MFIs. As discussed, the above proponents of the poverty lending approach claim focusing on financial sustainability goes at the cost of lending to the poor. Lending to poor borrowers can be very costly, which means that outreach and sustainability goals are conflicting.

It is generally argued that microfinance emerged as one of the most innovative tool for fighting poverty. Such enthusiasm behind microfinance is only due to its holistic objective of poverty reduction. But there is a belief in the academic circle that we still know little about the depth of outreach and the impact of microfinance on poverty. Answering these questions is critical for justifying large scale subsidies and investment of public funds. To answer these questions, what is required is some rigorous quantitative method, as naïve approaches give biased results. Conclusions drawn on the basis of the result of such naïve approaches are generally misleading.

Commercialization has become the mainstream approach on microfinance practices. It is said that the success of MFIs to serve poor people hinges on their ability to implement sound financial practices, operational efficiency, and profitability. If MFIs cannot cover operational costs, their capital base would soon be depleted, and the sustainability of MFIs to serve the poor will be in a state of doubt. As mentioned, increased focus toward commercialization may also divert the original mission of MFIs. From a policy making perspective, it is very important to know whether there is a trade-off between sustainability and outreach. Given that there is hardly any solid evidence on the existence of a trade-off, there is much room for expanding our knowledge on this issue.

The current research has three core objectives:

1. To assess how well the microfinance program reaches the poor, i.e. the poverty targeting of the Microfinance Institutions.

2. To assess the extent the microfinance reduces poverty of the recipient clients in India, i.e. to measure the impact of microfinance on poverty.
3. To examine the trade-off between financial sustainability and outreach to the poor in India.

The current research tries to understand who is participating in microfinance and also aims at ascertaining the impact of microfinance on poverty by using large scale household level data by applying rigorous statistical methods. For accessing poverty outreach of MFIs and impact of microfinance on poverty the study relies on nationally representative household level data collected by EDA-rural for longitudinal impact assessment study conducted by SIDBI in 2002-03.

Our analysis indicates that the poverty outreach of rural market is low but participation of women is satisfactory. Schedule castes and tribes have a low probability of participation in the rural microfinance market. The result of the Rural-SHG model also gives similar results, where participation of wealthier clients is high in the programme. Estimation results of Rural-Grameen model gives an optimistic picture as far as poverty outreach is concerned. There is no significant difference in probability of participation of various wealth rank categories in Rural- Grameen model. Looking at the overall urban market results, we can conclude poverty outreach is unsatisfactory. For Urban-SHG model estimated coefficients of two wealth rank categories are positive and highly significant; which shows a higher probability of participation of less poor households.For Urban- Grameen MFIs, there is no significant difference in the participation of different wealth rank category households in microfinance. The estimated coefficient of the two included wealth rank categories is negative (even though it is insignificant) which means the poorest of the poor are participating more than others. The study concluded the Grameen model is the best as far as poverty outreach is concerned. Better outreach of Grameen model may be due to the proper targeting mechanism adopted by these MFI. MFIs following Grameen approach generally uses some targeting criterion for screening poor clients. Grameen model exclusively focuses on the targeting poor clients and ultimately reducing poverty of targeted groups.

Expansion of MFIs during recent years is due to the large scale involvement of Development Institutions, NGOs, Donors, Government, etc., who believe microfinance is an effective way of reducing poverty. A Lot of funds are poured into the sector in the form of donation and subsidies to propel the holistic mission of microfinance. There is a need of strong evidences suggesting the impact of microfinance on the economic and social well-being to justify subsidies and donations. If microfinance does not improve the condition of the poor such fund must be used in other approaches directed towards poverty alleviation.

Impact analysis shows there is a significant positive impact of microfinancial services on the overall economic wellbeing of the households. The result remains the same for different market contexts. It can be concluded that microfinance is an effective means of reducing poverty of beneficiary households. Further, analysis of the impact of microfinance on household multidimensional poverty index by credit delivery methodologies of MFIs shows Grameen model does not perform well when it comes to impact on poverty. Microfinance provided through two other models of MFIs (SHG and Individual) has been an effective instrument for reducing poverty.

The study shows Grameen model performs well in terms of depth of outreach both in rural and urban areas but the impact of the Grameen model based microfinance is week. It can be concluded that there is a trade-off in depth of outreach and impact. Institutions targeting hard core poor are making less impact.

During the last two decades microfinance has made tremendous quantitative achievement and has emerged as one of the most effective ways of providing financial services on a sustainable basis to the bottom of the pyramid. Various innovative concepts developed by the practitioners of microfinance like group based lending, progressive lending, targeting of women clients, etc. work efficiently to address the issues of asymmetric information faced by the formal financial system in serving the poor. During the early stages of development microfinance was predominantly a private sector initiative with the involvement of NGOs, donors, development organizations for providing financial services to the poor in pursuit of reducing mass poverty prevalent in developing countries. Over the time, a large number of MFIs adopted commercial approaches for financing their activities as they found donations, grants and subsidized fund inadequate for serving larger masses. Two different schools of thought emerged for functioning of MFIs. The first school known as 'Institutionalist' or 'Financial System Approach' emphasizes the root of commercialization for financing microfinance activities. The Institutionalist believes that only commercially oriented and financially self-sufficient MFIs can serve the poor sustainable over a longer period of time. Another approach known as 'Welfarist' or 'Poverty Lending Approach' believes in serving the poor clients and reducing poverty. Though both schools share the common goal of serving the poor, they differ widely on the path adopted for the mission. In policy circle there is a wide disagreement over the appropriateness of these models. It is argued by the poverty lending approach that commercialization alters the mission of targeting the poor clients. The debate and discourse on the issue of trade-off between poverty outreach and financial sustainability is continuing in the absence of rigorous empirical evidence on this particular issue. The current study attempts to explore the trade-off between poverty outreach and financial sustainability in Indian context by using a large panel data set of 55 MFIs over the period 2005-09. The study sample includes a small number of MFIs in comparison to total MFIs operating in the country but the client outreach of sample MFIs is a large portion of total microfinance outreach. It is believed that an element of randomness in the selection of MFIs is present in the sample.

The study relied mostly on Hausman Taylor estimation framework due to the likely presence of correlation between unobserved firm characteristics such as managerial quality with the explanatory variables included in the model. This makes the application of random effect unfeasible and inclusion of time invariant variables in the model rules out application of fixed effect model. Two different measures of poverty outreach (average loan size and share of female clients) have been utilized due to the different proxy measures suggested by the existing literature.

By using average loan size as a measure for poverty outreach of MFIs, the study explores the trade-off between financial sustainability and poverty outreach. Separate regression models with a different set of financial performance indicator variable used, suggests the existence of trade-off. Regulation or profit orientation seems to play significant role in the trade-off. Geographical location and lending approach followed by MFIs does not affect poverty outreach.

By using share of female clients in total clients as a measure of social orientation of MFIs, empirical analysis conducted shows the existence of trade-off.

MFI achieving financial sustainability are drifting away from female clients. It is also found that Grameen model is the best approach as far as targeting of females is concerned while the individual lending approache has least targeting of female clients. Also the legal status of MFIs also differentiates the targeting of female clients and NBFCs are found to be targeting fewer females.

In brief the findings of the research are as follows:

1. The depth of outreach of MFIs in India is low and the poorest of the poor are mostly excluded from the ambit of these Institutions. Further, it is found the Grameen model has deepest outreach among other prevalent models in India.
2. Microfinance has a positive and significant impact on the multidimensional poverty of beneficiary households. The results are the same both for rural and urban areas. Evidences of impact are weak in case of Grameen model based MFIs.
3. There is strong evidence of trade-off between financial performance and depth of outreach of MFIs. MFIs are diverting from their original mission of serving the poor in the rush towards commercialisation.

Policy implications emanating from the research are as follows:

1. Study shows the poorest of the poor have been excluded from the microfinance sector and wealthier households have a high chance of participation into the programme. Only Grameen model performs well. As the whole enthusiasm behind microfinance is due to its holistic objective of serving the poor, the findings of the study are a cause of worry. Through the proper regulatory framework, the Government must ensure that these institutions are reaching the bottom of the pyramid. As the Grameen model has better depth of outreach, other models of MFI must follow certain targeting criterion at the time of screening as used by Grameen model based MFIs.
2. As the study found strong evidences of trade-off between financial performance and depth of outreach there is a need to check the rush towards commercialisation. Government must act in this direction and only those institutions should be promoted which are targeting the poor.