

The Yin and Yang of Microfinance: Reaching the Poor and Sustainability

Elisabeth Rhyne

In microfinance today the split continues between those in the "poverty" camp and those in the "sustainability" camp. A frank examination of the premises beneath each set of views can reduce the level of miscommunication. Perhaps the debate can gradually become a source of creative tension that helps drive the field forward. In that spirit this article attempts to sort through the thicket of issues, from the point of view of someone who is avowedly in the sustainability camp, but with strong sympathies for the poverty camp.

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 trade-offs appear. This commonality of aims should remind us all to debate with civility, avoiding unsubstantiated claims or criticisms.

The Mathematician's View

If microfinance were simply a mathematics problem, it would be a problem of dual maximization. There would be two objectives -- to reach the very poor and to achieve financial viability. Unfortunately, in mathematics there is no single solution to a problem of dual maximization. One objective or the other must be treated as a constraint, while the other is maximized. The mathematician derives a curve that traces the trade-off between the objectives. At every point on the curve, more of A means less of B. The choice of the best point on the curve depends on how much one values A versus B. However, *inside* the curve, both A and B can be increased until the curve is reached. In economics, this curve would be called the production possibility frontier.

In microfinance we need to know how close we are to the frontier. If we are near it, then there is a direct trade-off between reaching the poor and sustainability. If not, it should be possible to increase both outreach and sustainability. Bob Christen, Bob Vogel and I attempted to examine whether a direct trade-off exists in our 1995 study, "Maximizing Outreach", based on analysis of the performance of 11 leading microfinance institutions. The Microbanking Bulletin is compiling similar data for a great many more institutions. In 1995 we found microfinance programs that were sustainable at every level of clientele. More importantly, we found that for well-performing institutions there was no correlation between the poverty level of clients (as

measured imperfectly by loan size) and the financial viability of the institution. Undoubtedly it is more challenging to serve people with very small loans or to reach remote rural clients. However, **even in relatively unfavorable settings these institutions had developed service delivery methods so tailored to their clientele and so efficient that clients could afford to pay the full cost of the services, making the institutions financially viable.**

In other words, one of the fundamental poverty/sustainability questions is whether services can be delivered at a cost that is affordable to clients. Answering this question requires looking carefully at the cost structures and delivery methodologies of microfinance institutions, especially those claiming that their outreach to the very poor is the reason they are not becoming fully sustainable. Such institutions bear the burden of proving that they are as efficient and low-cost in their operations as it is technically possible to be. If they are not efficient, their subsidies support those inefficient operations, and concern for the poor, however earnest, can also become an excuse to avoid difficult improvements. For example, it may eventually turn out that some of the methodologies in use today prove to be more expensive than necessary, particularly methods that rely on highly educated, highly paid front line employees. Similarly, the cost of a strategy of serving exclusively the very poor can be contrasted empirically against the cost of serving the same clients through a broad-based program. If the poverty/sustainability debate drives us to analyze such relationships closely, it will have motivated a drive to improve methodology.

In order for the debate to play this progressive role, however, institutions must be willing to provide full and accurate financial data. The database project presented in the Microbanking Bulletin will gradually document exactly where the frontier is for various types of microfinance programs. It is in the interests of all types of microfinance programs, not just profitable ones, to contribute to the effort to delineate the frontier, so that we know as much as possible about the best ways to reach the poor.

Once it is evident that a program is using the most efficient methods possible, the question turns to affordability for clients. The Maximizing Outreach study found that the most financially viable programs differed from their less viable peers in their willingness to set interest rates at levels that would fully recover costs. These programs chose to be financially viable, while other programs that held interest rates down chose to

remain subsidy dependent. Although they may not have admitted it, these programs were subsidizing interest rates to clients.

For myself, the realization that pricing was such a direct determinant of viability led to other clarifications. **It became clear that the poverty/sustainability debate is ultimately about whether to subsidize interest rates.** Those who let go of sustainability in the name of reaching the poor are saying, in effect, that the poor cannot fully pay for their borrowing. If the poverty/sustainability debate were discussed in this way, it would be much more transparent. It would move away from the question of being “for the poor” or “against the poor” to the question of whether or not the poor need subsidized interest. And this question is one with an important empirical component. It is possible to determine whether clients can afford to pay full cost interest rates by charging such rates and seeing whether client demand decreases. Little or no documentation of microfinance programs reports that increasing interest rates has significantly altered client demand for their loan products.

Complementarity between Outreach and Sustainability

The image of constrained maximization captures only a portion of the relationship between poverty and sustainability in microfinance. As a mathematical concept, it leaves out the social, political, and moral dimensions that motivate us. A different kind of image pictures poverty and sustainability as the yin and yang of microfinance. They are two sides of a whole, each incomplete without the other. This view emphasizes that 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. This is a point on which the “poverty camp” frequently misstates the motives of the “sustainability camp.” It would do wonders for the state of the debate if the poverty camp more readily acknowledged that the sustainability camp valued sustainability only as a tool.

However, at this point some underlying difference in perspective surface about the role of government, donors and the private sector. **The sustainability camp views the private sector as the future home of**

microfinance, while those in the poverty camp seem wary of allowing that future to be dominated by commercial, for-profit operators. They foresee donor and government involvement in microfinance for an extended period of time. Faced with a choice between donors, governments and the private sector, they seem more comfortable keeping microfinance attached to donors and governments, perhaps because they trust donors and governments to have some ongoing concern with the poor. They also fear that for-profit operators will ignore the poorest clients.

In contrast, the sustainability group argues that any future which continues dependence on donors and governments is a future in which few microfinance clients will be served. Donors and governments, both notably prone to fads, are unlikely to continue subsidizing microfinance indefinitely and are not generous enough to do so on a major scale. This group believes that the only way to assure access by the poor to financial services is to ensure that the private sector finds it profitable to provide such services. Only the private sector has plenty of resources and will stick with a moneymaking activity even if it is not in fashion.

There is no obvious way to resolve this difference (except to observe the future as it unfolds). The predilection for one side or the other is too fundamentally a matter of political outlook. It is an irony, however, that advocates in the poverty camp do not seem to like donors any more than those in the other camp, even though they are more willing to depend on them.

Valuing the Poor and the Poorest

Finally, we come to what may be the crux of the divide. Buried in the question of whether poverty outreach and sustainability are complementary or not are complex attitudes about the value of assisting various types of people. These attitudes suggest that it is more valuable to assist a poorer person than a less poor person. **Those in the poverty camp feel strongly that it is important to reach the poorest possible people. Many in the sustainability camp are more interested in opening access to the full spectrum of the poor who lack access to financial services; although most do include the poorest in that spectrum.**

The mathematician would approach this problem by assigning weights to individuals, with larger weights going to poorer people. In this way, a program might get one point for serving a moderately poor person, two for a very poor person, and three for a severely poor person. In such a system, a program serving a great number of moderately poor people would earn more

points than one serving a few severely poor people, though the scale of weights could be shifted to produce the reverse outcome. In fact, the focus of many people in the sustainability camp on *scale* of outreach, as opposed to *depth* of outreach, reveals a weighting system in which the difference in weights between the two ends of the spectrum is not great. Thus, they often argue that mixed programs which can become large and sustainable are preferable to small, exclusively focused programs.¹

If the heart of the debate is ultimately a difference in value weights assigned to the very poor vis a vis the middle poor, it is important to look closely at why the poverty camp assigns such high weights. People in the sustainability camp have tended to dismiss the moral and political elements, because they come from a more economic and quantitative tradition. **Part of the reason for the high weight on the poorest is, of course, straightforwardly moral and humanitarian.** We believe or observe that the poorest people suffer much more than the moderately poor, particularly people who are poor enough to be chronically hungry. Helping someone who is absolutely poor contributes more to alleviation of human suffering. This reason for the weighting is widely shared.

Another reason for the weighting is political. It reflects the centuries-old struggle for dominance between the poorest and those who have climbed to the next rung, which is still being played out in many countries. The slightly better off -- *kulaks* in Russia are the classic example because they were the fodder for early Marxist analyses of this pattern -- gain control at the very local level, diverting resources to themselves, and excluding the poorest. A similar pattern appears in the treatment of women. **Thus, those in the poverty camp fear that unless they focus exclusively on the poorest and on women, the benefits of microfinance will be hijacked by the slightly better off, particularly men.**

A final reason for the weighting has been mentioned before, namely the concern that only if the focus is on the poorest will the poorest be served. This concern arises from observation of the "creaming" phenomenon in a wide variety of social programs around the world, in which people with the least difficult problems are served while the harder cases are abandoned. At least this third reason is open to empirical analysis.

Unfortunately, however, the field has made little progress on the empirical front. We still know very little about the poverty level of clients in various microfinance programs, and we still rely on loan

size as the only readily available proxy for client poverty level. An additional important voice from outside microfinance argues that the very poorest people are not reached by even the most poverty-oriented microcredit programs, and that credit is not an appropriate service for people on the margins of survival. This, too, is an important critique, and it deserves to be examined empirically.

New Year's Resolutions

The poverty/sustainability debate will not disappear, and both sides should be glad of that, as it keeps us from complacency. However, after working through the reasons behind the debate, we can perhaps agree on some future ways of debating and on some future areas that we need to examine.

- First, let us all agree to be open and civil in the debate, so that what we say is aimed at resolving or understanding differences rather than inflaming them.
- Let's ensure that programs push hard against the service delivery frontier before arguing that their clients are too poor for a sustainable program.
- Let's document more carefully whether the poorest clients are willing and able to pay cost recovery levels of interest.
- Let microfinance institutions of all types commit themselves to providing complete and accurate information on their financial performance, particularly so that more can be known about sustainability among programs serving the poorest.
- Let's document the levels of poverty of the poorest clients of large, mixed programs and of programs offered by for-profit institutions.
- Let's learn more about the levels of poverty of microfinance clients generally.
- Let the poverty camp acknowledge that the fundamental objective of the sustainability camp is reaching the poor.
- Let the sustainability camp acknowledge the validity of the social and political motivations that shape the views of the poverty camp.
- Let's use the differences among us to energize the microfinance field.

Elisabeth Rhyne has consulted on microenterprise development and financial sector reform around the world. She is the former Director of the Office of Microenterprise Development in the Global Bureau of USAID, and has published numerous books and articles relating to the microfinance field.

¹ This sets aside the additional argument that such programs actually reach more of the very poor, an argument open to empirical validation.