Poverty Outreach Progress Brief

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Moving the World's Poorest Families Out of Poverty

How Will Microfinance and Microenterprise Development Meet the Challenge?

The Challenge of Reaching the Very Poor

In the year 2000, the United Nations created the Millennium Declaration based on the principles of freedom, equality, solidarity, tolerance, respect for nature, and shared responsibility, with a resolution to "halve, between 1990 and 2015, the proportion of the world's people whose income is less than one dollar a day and the proportion of people who suffer from hunger."[1] The most recent edition (2007) of the "Millennium Development Goals Report" states that 980 million people are still living on less than US$ 1 per day—down from 1.25 billion in 1990.[2] For this goal to be accomplished in the next seven years, by 2015, the number of very poor people needs to further decline by at least 355 million people.

Since its inception, microfinance has aimed to make a significant contribution to poverty eradication, with a vision of achieving both massive scale and deep sustainability. Nobel Peace Prize winner Muhammad Yunus declared that "we can create a poverty-free world if we collectively believe in it."[3] This notion that microfinance and enterprise development are powerful tools for poverty eradication has been embraced by governments, donors, development practitioners, and citizens around the globe with an energy and commitment of resources never before witnessed.

Microfinance and microenterprise development agencies have established targets for poverty outreach and poverty eradication. The U.S. Congress, in response to advocacy campaigns, passed the Microenterprise for Self-Reliance Act[4] in 2000. This law mandates that one-half of all U.S. Agency for International Development (USAID) microenterprise development funds must benefit very poor people. The law also required USAID to develop and certify tools for assessing the poverty level of microenterprise development beneficiaries so that the agency would be able to determine whether or not its development partners are achieving the mandate of assisting the very poor.

DEFINITION OF EXTREME POVERTY

This brief defines **very poor** people using the United Nations, the Microcredit Summit Campaign, and USAID definition: those who live below the international poverty line (US$ 1/day at 1993 purchasing power parity, PPP) or who fall in the bottom 50% of those under their national poverty line. Note that very recently the new threshold for extreme poverty has been revised upwards to $1.25 a day in 2005 prices, increasing the estimated number of people living in extreme poverty to 1.4 billion.

The Microcredit Summit Campaign (MSC) has taken its goal of reaching very high numbers of very poor people one step further by aiming to lift the majority of them out of poverty. In order to do so, MSC has adapted the following two goals to be achieved by the microfinance industry by 2015:[5]

1. Reaching 175 million of the world's poorest families, especially the women of these families, with credit for self-employment and other financial and business services
2. Ensuring that 100 million families rise above the US$ 1-per-day threshold.

Many other organizations and member networks, including **The SEEP Network**, are committed to reducing poverty using enterprise development and financial services as their main weapons.[6]

1. United Nations, Millennium Declaration, September 2000, http://www.un.org/millennium/declaration/ares552e.htm.
2. United Nations, "Millennium Development Goals Report 2007," online source (2007), http://www.un.org/millenniumgoals/docs/UNSD_MDG_Report_2007e.pdf
3. M. Yunus, "2006 Nobel Peace Prize Lecture (Oslo, Norway)," online source (September 24, 2008), http://nobelprize.org/nobel_prizes/peace/laureates/2006/yunus-lecture-en.html
4. Microenterprise for Self-Reliance Act of 2000, Public Law 106 309. The act was amended in 2003 and 2004. The Amendment to the Microenterprise for Self Reliance and International Corruption Act in 2003 requires that 50% of all USAID microenterprise resources benefit the very poor. The legislation was further amended in 2004 (Microenterprise Results and Accountability Act of 2004).
5. Sam Daley Harris, "State of the Microcredit Summit Campaign Report 2007" (Washington, DC: Microcredit Summit Campaign), http://www.microcreditsummit.org/pubs/reports/socr/EngSOCR2007.pdf. These goals were adapted as part of Phase II of the Microcredit Summit launched in Halifax in 2006.
6. The SEEP Network, online source, http://www.seepnetwork.org/section/about/

Is Microfinance Meeting This Challenge?

The microfinance and microenterprise development (MED) industry has received mixed reviews on its performance of reaching the poor and helping them work their way out of poverty.

Despite its mission and best intentions, the microfinance industry has been critiqued as not serving the poor, as leaving them out, or at worst, indebting them or leading them into exploitative market relationships. For example, in 2007, the Center for Global Liberty and Prosperity published a scathing article about microfinance, written by microfinance expert Thomas Dichter:

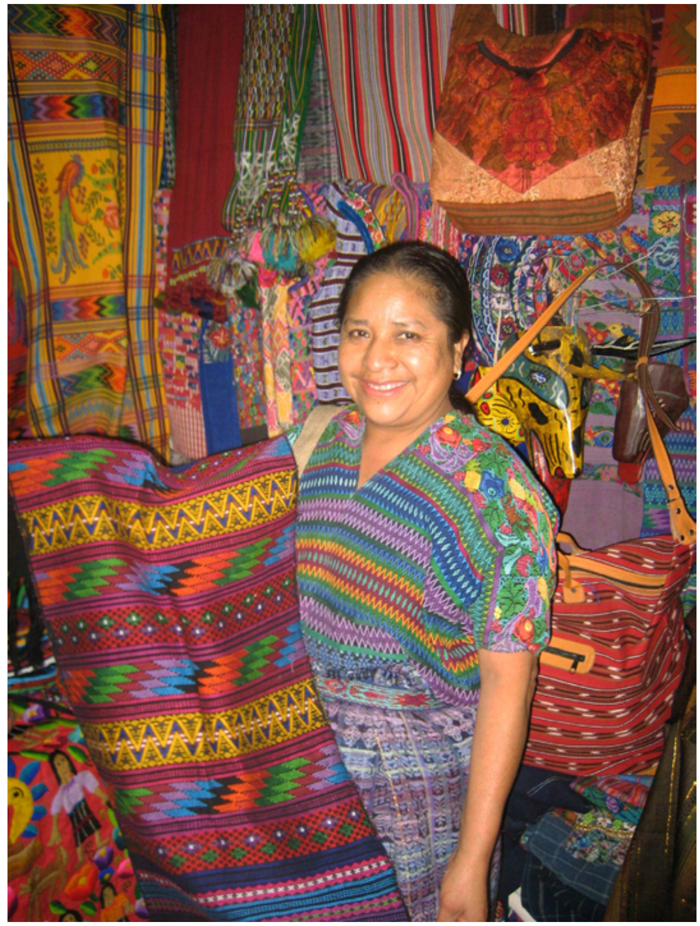
> Classical microcredit start-ups are not working. There's a feel-good factor for lenders, but no solid evidence that [microcredit] makes a difference, either in developing the economy or reducing poverty.[7]

In April 2007, an article in *Newsweek* cited four other articles critical of the microfinance industry for its poor track record in reaching and serving the poor. [8] Enterprise development, meanwhile, is not prominent enough to attract media attention, but nonetheless is often criticized by other development practitioners for not reaching the poor.

However, supporters of microfinance and poverty targeting present a different view. In a paper presented at the Microcredit Summit in 2006, Christopher Dunford, president of Freedom From Hunger,[9] summarized existing reviews of research on the impact of microfinance and concluded that there is substantial evidence (despite certain flaws in the research that generated it) that microfinance has contributed to the Millennium Development Goals, and that microfinance, especially when offered to relatively poorer women, increases incomes and savings, improves nutrition and health, and empowers women.

Unfortunately, most studies do not disaggregate microfinance clients by poverty status or do not measure poverty of clients in such a way that it can be compared to either national or international poverty lines. Dunford points out, however, that one of the most credible large-scale microfinance impact assessments until now (conducted in the 1990s by Khandker in Bangladesh) shows that the impact of microfinance on poverty is greater for those starting in extreme poverty than in those in moderate poverty.

7. Thomas Dichter, "A Second Look at Microfinance: The Sequence of Growth and Credit in Economic History," Development Briefing Paper No. 1 (Washington, DC: The Center for Global Liberty and Prosperity, February, 2007), http://www.cato.org/pub_display.php?pub_id=7517.
8. *Newsweek,* "The Microcredit Backlash," (2007), online source, http://povertynewsblog.blogspot.com/2007/04/microcredit-backlash.html.
9. Chris Dunford, "Evidence of Microfinance's Contribution to Achieving the Millennium Development Goals" (Davis, CA,USA: Freeedom from Hunger, 2006).



Guatemalan microentrepreneur selling her handmade wares in the Antiguan market (2008)

In contrast, Jonathan Murdoch[10] cites studies in David Hulme's and Paul Mosley's *Finance against Poverty* (1996) that suggest the exact opposite, that microfinance tends to generate positive outcomes only for people above the poverty line. Murdoch goes on, however, to show that these studies suffer from serious methodological problems, rendering their findings invalid. He argues that more research is needed to measure the economic return to capital by borrowers and whether there is a difference in this return between the very poor and the moderate poor, in order to answer the question whether the very poor benefit from microfinance services or not.

In order to make an impact on the lives of very poor people, they need to be reached in the first place. Are microfinance institutions (MFI) and microenterprise development programs reaching the very poor? The data is mixed. In 2006, the Microcredit Summit Campaign reported that the original goal to reach 100 million of the world's poorest people had been achieved. However, MSC acknowledges that very few MFIs would have provided reliable absolute poverty data comparable to international or

10. Jonathan Murdoch, cited in *Finance against Poverty*, vol. 2, ed. D. Hulme and P. Mosley (London: Routledge, 1996).

national poverty lines, given the lack of such tools (much less standardized tools), until 2006.[11]

Since 2006, the use of new tools has made more data available, but results do not satisfy the U.S. legislation's requirement that 50 percent of microenterprise funds be used to help very poor people. USAID's most recent "Microenterprise Results Reporting Annual Report" to Congress (fiscal year 2007)[12] for the first time provides results from 31 reporting institutions obtained by using the new tools, representing approximately one-fifth of USAID microenterprise funding for that year. There was only one MFI that reached the USAID target—that 50 percent of clients served be very poor. *The average proportion of very poor clients served by MFIs and MED programs supported by USAID was only 21.6 percent, far below the 50 percent target demanded by the U.S. Congress.*

USAID (through the IRIS center at the University of Maryland) and the Grameen Foundation have developed new poverty measurement tools. IRIS has so far developed and certified USAID Poverty Assessment Tools (PATs) for 22 countries,* with the main objective to measure the share of clients of USAID microenterprise partners who are very poor. Grameen Foundation's similar tool, the "Progress out of Poverty Index"™ (PPI™), developed by Mark Schreiner of Microfinance Risk Management, has been produced for nine countries so far.** If used correctly, both sets of poverty measurement tools can be used to track client poverty over time as well.

* "Poverty Tools," online resource, http://www.povertytools.org.
** "Progress out of Poverty," online resource, http://www.progressoutofpoverty.org.

USAID's report indicates their view that the goals of reaching significant proportions of the very poor and achieving institutional sustainability are incompatible. Meanwhile, some challenge the accuracy and relevance of the poverty definition of the new poverty tools. Is household consumption (expenditures) all that matters? What about assets? Access to services? What about (often gender-related) intra-household differences in poverty? Are these legitimate challenges to global poverty measurement tools or excuses for the inability to reach the very poor? Some practitioners even argue that the investment in measurement is a waste of resources that would better be used in serving the poor, whom local organizations recognize and know. Outlined below are examples of strategies that practitioners are using to reach and serve the very poor.

11. Daley-Harris, "State of the Microcredit Summit Campaign Report 2007."
12. USAID, "Microenterprise Results Reporting Annual Report to Congress" (Washington, DC: USAID, 2007).

How Are Practitioners Meeting This Challenge?

The SEEP Network's Poverty Outreach Working Group has been investigating the challenge of providing sustainable microfinance and enterprise development services to the very poor since 2006 by focusing on the following key questions:

- How can we measure whether or not we are reaching the very poor?
- How can we better reach the very poor?
- How can we better serve the very poor and help them work their way out of poverty?
- How can the microfinance and enterprise development industry be encouraged to live up to its vision of poverty eradication?

In 2007, the Poverty Outreach Working Group (POWG) set out to identify and document good practices in reaching and serving the very poor. With USAID funding, POWG commissioned twelve case studies[13] on different categories of microfinance and enterprise development programs that were recommended by donors, experts, and other practitioners for their perceived strong performance in reaching and serving the very poor. The programs were purposefully selected to represent microfinance, savings-led finance, livelihood security, and value chain development approaches. These programs were conducted before USAID's poverty measurement tools had been developed, so comparable data about each of these programs' poverty outreach are not available. The case studies present startling findings—some of which challenge long-established approaches to microfinance.

Practitioners use a range of strategies to target the poor, but do not specifically target the very poor.

The majority of practitioners studied employ some type of geographic targeting (i.e., placing programs in poor, often remote rural areas with high poverty incidence within a given country). Several programs admit new clients based on selection criteria—targeting socially excluded women, bonded laborers, members of discriminated castes, etc. Only a few subject candidate clients to a means test, such as an assessment of specific household assets, income, or expenditures. Instead of screening potential clients based on their poverty level, several programs target poor people by adapting microenterprise development products and services to their needs and circumstances. Some niche marketing approaches include

13. Trickle Up (Mali), Freedom From Hunger with Réseau des Caisses Populaires du Burkina (Burkina Faso), CARE Village Savings and Loans programs (Rwanda), Kenya BDS (Kenya), Alexandria Business Association (Egypt), Nirdhan (Nepal), Activists for Social Alternatives (India), Christian Children's Fund/LEEP (India), PACT/WORTH (Nepal), MEDA (Pakistan), Pro Mujer (Peru), Friendship Bridge (Guatemala).

- adapting loan size: generally offering very small first loans and building in more flexible repayment terms—in one case offering a very large loan coupled with intensive technical assistance and market linkages—to help people significantly and rapidly increase their income;
- offering savings products and seed capital rather than credit (which some believe is an inappropriate first product for very poor people); and
- offering a comprehensive package of services including finance, technical training, input supply, and market access.

No practitioners in the study made an attempt to reach the very poor as a niche market separate from less poor client markets.

Practitioners did not have rigorous strategies for measuring their poverty outreach.

Confirming industry trends in more than half of the programs, institutions had no system in place to identify their clients' poverty levels. These are two reasons they did not measure income or expenditure poverty of their clients:

- The poverty measure does not fully capture their definition of poverty (livelihood asset status, housing status, severe gender discrimination, or social marginalization, food insecurity).
- Such tools are either non-existent or too expensive. (*Note*: Low-cost poverty tools developed by USAID and Grameen Foundation were not yet available when the case studies were conducted.)

Without income-based poverty outreach data available for more than half of the studied programs, no conclusions can be drawn about their poverty outreach. *Confirming trends reported by USAID for those five programs[14] that did measure their clients' poverty levels (at least once)—comparable to national or international poverty lines—showed that the proportion of very poor people among incoming clients was less than one-third in all cases.* The existing poverty outreach results for those five case studies seem to suggest that these programs neither achieve, nor in most cases intend to reach exclusively very poor clients. This also implies that the model (product, service, delivery system, etc.) employed by each of these case studies makes little if any distinction between very poor and not very poor clients.

Microfinance services alone are not sufficient for very poor people.

Most programs featured in the case studies address the non-financial needs of their clients. This more comprehensive approach not only includes enterprise-related services (e.g., training, technical advice, marketing assistance, and so on), but

A Ghanian market vendor selling roasted banana plantains (2002)

even more commonly includes assistance meeting basic needs, such as literacy, healthcare, food production, nutrition, and safe water. Awareness-raising sessions focusing on health issues are offered in a majority of the case studies and most programs also feature program activities aimed to empower and build confidence among very poor people, especially women. Sometimes such non-financial services are built into the service package offered by so-called microfinance plus programs.

Some value-chain development programs offer a comprehensive package of microenterprise development services. In one instance, microenterprise development services and broader development services are offered by the same agency, but through different programs. In other cases, enterprise development or broad development services are provided separately by partner organizations. In all cases, there was recognition that microfinance and enterprise development services are specialized technical areas and should be provided by MED experts in focused institutions or programs. Thus, *partnerships* were mentioned as key elements of successful delivery strategies.

Can microfinance and microenterprise development services for the very poor be financially sustainable?

The POWG case studies rely in a varying degree on subsidies, including for the financial product (two approaches use seed capital grants), but many programs offer innovative strategies to achieve long-term sustainability:

- Focus on financial sustainability of the MFI or enterprise development initiative, then reach down market, using resources generated by the mainstream program.
- Cross-subsidize products/services for very poor clients with profits from products or services offered to less poor clients.
- Separate financially viable services from non-financially viable services and commit to sustainability for the financially viable services.

14. These programs include Activists for Social Alternatives (India), Friendship Bridge (Guatemala), Nirdhan (Nepal), Pro Mujer (Peru), and RCPB (Burkina Faso).

- Facilitate community-based sustainability (without high institutional costs of MFIs or other programs), for example, the formation of informal savings and loan groups (savings-led approach) or embedding MED services into market relationships.

Once again, many practitioners suggested forming partnerships to help clients access a wide range of services with different potential for sustainability.

Controversial Issues

The ability of microfinance institutions and enterprise development programs to reach the very poor and help them work their way out of poverty is one of the biggest challenges to the microfinance and enterprise development community. It challenges us to fulfill our mission. It challenges us to think and work in new ways, with new partners. It may be an opportunity for the field to achieve significant impact. Or, it may be the demise of microfinance and enterprise development—if we cannot successfully demonstrate outreach and impact on poverty eradication. Today's microfinance and enterprise development leaders are facing the following dilemmas:

a) ***The problem:*** If it is the mission of microfinance (and enterprise development) to reach and serve the very poor, how can practitioners not be measuring this? How can they not have systems in place to measure impact?

b) ***Targeting vs. mainstreaming:*** Can practitioners reach the very poor most effectively by targeting them (thus implying small-scale operations) *or* by expanding mainstream microfinance programs? If the latter, then should they continue to invest in a multitude of smaller MFIs or only the largest? As an MFI scales up, it can reduce operating costs and reach very poor clients more cost-effectively, but there are those who argue that their services are incomplete and inappropriate for the very poor. Comprehensive programs are needed to lift people out of poverty. Targeted programs offer an array of non-financial services, but they may be limited in scale and sustainability.

c) ***Comprehensive services vs. continuing specialization:*** To prevent and mitigate extreme poverty, communities need an integrated approach and a variety of services. It seems clear from these case studies that one-dimensional programs or services are not sufficient. However, should MFIs and enterprise development programs bother with, and be concerned about, these broader services and issues? Is it feasible to design all-inclusive programs within the MFI or enterprise development program? Is this sustainable? Are MFIs suited to providing comprehensive services? If they are not, should they partner with an enterprise development or broader development organization to deliver comprehensive services? Partnership is easy to talk about and hard to implement.

d) ***What is the role of subsidies?*** When are grants appropriate? Never? What types of smart subsidies exist? If MFIs will not give grants, then who will? How can practitioners fill the gap between livelihood security approaches (heavily subsidized) and microfinance and enterprise development approaches (commercial and focused on sustainable)?

The answers to these dilemmas will be critical to the future of microfinance and enterprise development and, indeed, to the very goal of poverty eradication.

The SEEP Network welcomes diverse comments and perspectives on the above or other related questions. Join this ground-breaking dialogue at the following venues:

- The SEEP Network's open, ongoing dialogue at http://communities.seepnetwork.org/community
- An in-person debate and discussion, featuring leaders with different perspectives and open discussion with all participants at the 2008 SEEP Annual Conference (November 4–7 in Arlington, VA). http://seepnetwork.org/conference/index.html
- Register at the SEEP Network Enterprise Development Exchange to receive announcements: http://edexchange.seepnetwork.org

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