The implications of financial sustainability in the microfinance industry

SARA EK

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Abstract

Microfinance is a relatively young and somewhat ambiguous concept. The phenomenon has, however, proven to contribute to making the lives better for many poor people, thus the interest for the industry has grown substantially. The increased attention has stimulated the movement towards more financially sustainable organizations. Along with this transformation, concerns regarding how it affects the poor have been raised. This study aims to map the key characteristics of financially sustainable microfinance institutions (MFIs) and what features that separates them from their non-sustainable counterparts. By analyzing data from 1109 MFIs, some significant differences between sustainable and non-sustainable organizations have been found.

The study shows that for-profit MFIs are self-sufficient to a greater extent than the non-sufficient ones, which might be caused by the pressure to deliver value to shareholders. Furthermore, there are indications that self-sufficient MFIs are more efficient, which can be assumed to be caused by technological advantages, or different lending methods. The findings on outreach are somewhat contradictory; sustainable MFIs are reaching more clients on average, which discards a mission drift. On the other hand, self-sufficient MFIs have larger average loan sizes and less female borrowers, two indications that a mission drift actual exists. Self-sufficient MFIs have also proven to have lower loan loss rates and lower yields on loan portfolio. Positive findings, as they indicate that the MFIs have sound loan portfolios and that they have managed to become self-sustainable not by exploiting the poor, but by reducing costs and increasing efficiency. Financial sustainability can therefore be assumed to be achieved without forsaking the poor, if the social aims of the organizations are consistent with the financial objectives.

Key-words Microfinance, Financial sustainability, Poverty alleviation, Mission drift, Commercialization
Acknowledgements

My interest for the microfinance industry aroused when I, in my first year of studies read the book *Banker to the poor* by Nobel Peace Prize laureate, Muhammad Yunus. Since then, I have had the opportunity to study the mechanisms of microfinance through studies in Bangladesh and New York, and it is my belief that microfinance can be a powerful tool in assisting the poor. It is my great hope that this study can provide a deeper understanding of the microfinance industry as well as give an insight to the specific mechanisms that are surrounding the industry at the moment.

This study could not have been executed without the inspiration and knowledge that I have gained through field trips and interaction with microfinance actors in Bangladesh and New York, and I would like to express my appreciation to all the microfinance clients that have given me invaluable insight to how microfinance has affected their lives. Thanks also to my supervisor, Thomas Westin, for support throughout the process and to my friend, Sofia Bredberg, for reviewing the paper.

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Abbreviations

BRAC - Bangladesh Rural Advancement Committee

CGAP – Consultative Group to Assist the Poor

ICNL – the International Centre for Not-for-profit Law

MFI – Microfinance Institution

MIX – Microfinance Information eXchange

OSS – Operationally Self-Sufficient

UNDCF – the United Nations Capital Development Fund
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1 Introduction

The term microfinance is a relatively young and a bit ambiguous concept to most people. When talking about microfinance, some imagine the hundred-something dollar loan you can obtain by using a cell phone while others think of subprime loans. Some recall a picture of poor, emaciated women in the countryside of some developing country like Bangladesh. The last interpretation might be closest to the truth, but there is still much more to it. Microfinance has grown to become something much bigger and as some may say a powerful tool in reducing poverty. Microfinance has also moved beyond the poor undeveloped countries in Africa and Asia and is now represented through different shapes in almost all countries in the world. Furthermore, microfinance institutions are no longer just small charitable units with charismatic spiritual leaders whom cherish the most vulnerable people. Microfinance has grown into the commercial districts and into the trading floors.

Today, over 3 billion people in the world live in poverty\(^1\) (CGAP, 2011). Many of those people do not have access to financial services due to their small income and lack of collateral. Microfinance has thus become a concept aiming to help poor people out of poverty by providing small loans and other financial services without the requirements that a traditional bank would have. The phenomenon started in some developing countries like Bangladesh, India and Indonesia in the early 1970’s and has since then been dispersed globally (Cull et al. 2009). Even if the concept is much associated with poor people, and especially women in developing countries, the phenomenon has actually entered into the industrialized world as well, serving small-scale entrepreneurs without other sources of financing.

Microfinance has during the last decade gained more attention and awareness. In 2006, Grameen Bank in Bangladesh received the Nobel Peace Prize together with its founder, Muhammad Yunus (Cull et al. 2009), and in 2007, the IPO of the Mexican MFI Banco Compartamos was oversubscribed by 13 times (Rhyne & Guimon, 2007). These events together with other success stories have led to even more interest and the early pioneers in microfinance have managed to show that the poor people actually are creditworthy through repayment rates that usually significantly exceed those of traditional banks, often well above 90\% (Bhatt & Tang, 2001).

Now that microfinance institutions have proven to have the potential to be profitable, not only investors with social missions, but also more business-driven forces have turned their attention to the industry.

\(^1\) CGAP (2011) defines poverty as living on less than $2 per day.
As of today, the industry serves over 190 million clients globally (Reed, 2011); a major advancement from the time when the initial microfinance programs in the third world served a small amount of the poor. But given that there are still 3 billion people living in poverty, there is still a huge number of people without access to financial services, hence there seems to be a supply-demand gap on the microfinance market.

1.1 Problem formulation

Since some institutions have proved that microfinance can be executed without donors and other charitable contributions, there has become a pressure on the actors in the market to become more commercial or at least to become self-sustainable (Cull et al 2009). A vital progression some say while critiques argue that this impair the original aim of microfinance. By focus more on increasing profits and cutting costs, there is a significant risk that MFIs will forsake the very poor for the benefit of more profitable clients, thus leading to a mission drift (Hermes et al. 2011). Another implication is that commercialization might lead to exploitation of the poor in terms of higher interest rates and tough repayment conditions. Hence, there is a great need to examine the implications of the commercialization of the microfinance industry.

1.2 Purpose and question formulation

This paper aims to scrutinize on the key characteristics of financial sustainability for microfinance institutions. With the complexity of commercialization of a phenomenon, originally based on social missions, as the basis of this study, the purpose is to identify how financially self-sustainable microfinance institutions differ from non-sustainable ones. Furthermore the aim is to deliberate on what implications these differences might have for the microfinance industry and its clients. With this as the foundation, this study will serve as an attempt to answer the following questions:

- Are for-profit MFIs more self-sustainable than their non-profit counterparts?
- Are financially sustainable MFIs more efficient than non-sustainable MFIs?
- Are financially sustainable MFIs targeting the same clients as non-sustainable MFIs?
- Can financial sustainability lead to a mission drift?

1.3 Scope

This study will examine the implications of financial sustainability within the microfinance industry based on data from different MFIs in different countries. The purpose is, however, not to elaborate on differences between specific countries. Regional differences though, can be of interest if there is evidence of significant disparities. Furthermore, the aim is to examine the
effects of financial sustainability, not to analyze the different sources of funding or the ideal capital structure. As the primary purpose is to find key characteristics of sustainable MFIs and not to deliberate on variations between sustainable organizations, the only distinction, if nothing else mentioned, will be to divide MFIs into financially sustainable and non-financially sustainable.

1.4 Outline

This paper is composed in the following way;

The first chapter provides the reader with the necessary background information to understand the problem brought up in the study. In addition, the question formulation and the scope of the study are presented.

Chapter 2 is the theoretical framework where all the essential definitions and concepts are brought up and explained. The chapter provides the reader with an insight to the mechanisms of the microfinance industry and the characteristics of its institutions and clients. Furthermore does the theoretical framework give an introduction to financial sustainability and how it can be defined. Finally the dispersion of financial sustainability within microfinance around the world is illustrated and some of the challenges associated with financial sustainability and microfinance are discussed.

The following chapter of methodology describes the approach to answer the questions brought up in the first chapter. Moreover the different variables used in the study are explained. Chapter 4 contains the empirical study where all the findings are presented. Thenceforth the findings are analyzed and put into a context. Chapter 5 uses the analysis to draw more general conclusions from the findings. Finally chapter 6 gives the reader an additional dimension of the findings from this study and also gives some suggestions for future research within the area of financial sustainability and microfinance.
2 Theoretical framework

The theoretical framework will, through a review of existing literature within the microfinance field, serve as a platform for the forthcoming empirical study. The first section of this chapter contains an overview of the microfinance industry as well as an introduction to the characteristics of different microfinance programs and microfinance products. Furthermore, this chapter provides the reader with an introduction to the concept financial sustainability and tries to present a proper definition to the concept. Finally, this chapter will deal with the complexity of introducing financial sustainability in the microfinance sector and some of the most frequently debated implications of the phenomenon.

2.1 An introduction to microfinance

Microfinance started in some rural areas in developing countries like Bangladesh, India and Indonesia in the early 1970’s, serving a few thousand clients (Hermes & Lensink, 2007, Lucarelli, 2005). The industry has grown substantially since then and in the late 1990’s the number of clients were approximately 10 million (Lucarelli, 2005). Today, the Microcredit Summit Campaign (Reed, 2011) estimates that the number has grown to 190 million clients served. The acknowledgement, and thus the interest for the industry have increased and 2005 was launched as the International Year of Microcredit by the United Nations (UNCDF, 2011). The year after, 2006, the famous Grameen Bank in Bangladesh received the Nobel Peace Prize together with its founder, Muhammad Yunus (Nobel Prize, 2011). The increased knowledge does not only come from socially driven institutions any longer, but also from commercial instances, governments, academics and media as well as from individuals, whom all recognized that microfinance potentially could lead to poverty alleviation.

Before elaborating on the implications of the increased attention, it is, however, motivated to take a deeper look at the different definitions and activities surrounding microfinance to ascertain what microfinance really means and how it is performed.

2.1.1 Definitions

There is a variety of definitions to microfinance and the concept has become ambiguous as it has dispersed globally. One of the most frequently used and most recognized definition of microfinance is, however, the definition by the Consultative Group to Assist the Poor (CGAP). They define microfinance as follows:

"Microfinance offers poor people access to basic financial services" (CGAP, 2011).
Robinson (2001) offers a more detailed definition:

*Microfinance refers to small-scale financial services—primarily credit and savings—provided to people who farm or fish or herd; who operate small enterprises or microenterprises where goods are produced, recycled, repaired, or sold; who provide services; who work for wages or commissions; who gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban.* (Robinson, 2001 p.9)

Even different microfinance institutions’ definitions differ. Acción International, one of the world’s biggest microfinance institutions, for instance, defines microfinance as:

“*Banking and/or financial services targeted to low-and-moderate income businesses or households, including the provision of credit*” (Acción International, 2011)

The Bangladesh-based MFI, BRAC, defines their microfinance activities as:

“*...provide access to financial services to the poor, who are unable to obtain credit from mainstream banks due to lack of necessary assets and referrals*” (BRAC, 2011)

Grameen America, the American counterpart to the famous Grameen Bank in Bangladesh, on the other hand, state that microfinance is:

“*Microfinance is made up of a variety of financial services usually available to low-income entrepreneurs*” (Grameen America, 2011)

The definitions above differ in some senses but they all touch upon important features of microfinance. First, as CGAP’s definition implies, microfinance means giving people access to financial services. It can be interpreted, just as BRAC states, that microfinance is aimed for those that do not have access to traditional financial services (Murdoch, 1999). Furthermore, the definitions by CGAP and BRAC pin-point that microfinance is aimed for poor people while Acción, on the other hand defines the target group as low-and-moderate income businesses or households. Robinson’s as well as Acción’s definitions do also, in contrast to CGAP’s definition, refer to services that are being addressed to income-generating businesses and even though many of the organizations that provide microfinance appeal to micro-businesses, there are microfinance programs that offer financial services to individuals as well. Grameen Bank in Bangladesh for example has a special microfinance program in which they are targeting beggars
without any employment at all. Henceforth the term microfinance refers to financial services to those poor/low-income households that have not got access to the traditional financial system.

The organizations that provide the services are called microfinance institutions (MFIs) and there are a variety of different types of MFIs in respect to legal structure, mission and methodology (CGAP, 2011). In the early years of microfinance, most of the MFIs were socially-driven, non-profit organizations, but as the poor have proven to be a creditworthy pool of clients, there has been a shift towards more business-driven, for-profit organizations (Cull et al. 2009). Today even commercial banks are involved in microfinance activities (van Greuning et al. 1998). What services the MFIs can offer is by most determined by the legal structure of the MFI.

It is important to estimate if microfinance activities and MFIs are successful but it can be somewhat diffusing to do so. The success of microfinance can be viewed from two different perspectives; the success of the MFI in terms of for example profitability and repayment rates, or the success in helping the poor, often measured as improved economical situation for the clients and number of clients reached (Bhatt & Tang, 2001). Depending on the original mission of the MFI, different MFIs emphasize different measures of success.

2.1.2 Microfinance activities

As mentioned earlier, microfinance means financial services to those without access to traditional sources of finance. Microfinance is mostly associated with microcredit, but many MFIs also provide other financial services, such as savings and insurance as well. Many organizations employ mandatory savings for their clients as an additional technique to improve their clients’ personal economy and the deposits can also play an important role, as a relatively cheap source of funding for the loans (Cull et al. 2009). To be able to facilitate savings and insurance do, however, require specific legal structures, why not all MFIs can offer those services (CGAP, 2011). There is also a large amount of MFIs that facilitates non-financial services, such as business training and health education (Zaman, 1999).

The method for executing the actual lending differs between organizations and globally, but two main approaches have been identified; the individual lending technique and the group-based lending technique. While the individual approach is similar to the traditional way of lending, facilitated through direct interaction between the lender and the borrower, the group-based approach relies upon groups of borrowers that facilitate some of the tasks that are normally carried out by the lender (Giné, 2006). Group-based lending usually implies that the group members have joint liability for repayment or that the other members are not granted to anymore loans if one member fails to repay the loan (Brau & Woller, 2004). This entails that the
borrowers, when forming a group, are concerned with finding reliable group members and thus the group does some of the screening process that are traditionally carried out by the lending institution. According to Hermes and Lensink (2007) group-based lending make up a majority of all microfinance programs and Baydas et al. (1997) has found evidence that non-profit organizations use group-based lending to a greater extent than more business-driven organizations.

The microfinance clientele is diverse but constitutes mainly of self-employed individuals whom often run home-based businesses. Many MFIs, particularly in the developing world, are only targeting female borrowers and according to CGAP (2011) 67% of all clients are women. The main reason for targeting women is that they are considered poorer and have less access to credits, why they are utilizing their loans in a sounder manner (de Mel et al. 2008). As a social side-effect, especially in the developing world where women usually have a lower social standing than men, women are also considered to be empowered in the society and towards their men thanks to the loans (Bredberg & Ek, 2009).

2.1.3 Interest rates

MFIs across the world have for long been accused of charging their clients too high interest rates on the loans. While some organizations charge up to 80% interest, the global average in 2008 was approximately 35% (Kneiding & Rosenberg, 2008). In order to determine whether or not this is too high, it is motivated to look into what determines the interest rates. MFIs, just as banks, must use their interest to cover the costs of lending if they are to be sustainable in the long run. CGAP (2011) states that MFIs face three different kinds of costs that must be covered by the interest, the cost of the money lent, the cost of defaulted loans and lastly, the transaction cost. While the former two types of costs are proportional to the amount lent, the latter cost is not. As MFIs’ loans are much smaller than loans issued by traditional banks, it still takes the same amount of personnel and administration to facilitate a small loan as it does to facilitate a larger one (CGAP, 2011). Consequently, MFIs face a much higher cost per dollar lent than for example a traditional bank, hence they need to charge higher interest rates to cover the costs (Cull et al. 2009). MFIs should, according to CGAP (2001), however, strive to become more efficient and reduce their transaction costs as much as possible to ensure that the poor are not being exploited by too high interest rates.

2.2 Financial sustainability an introduction

In the following section, a brief introduction to financial sustainability will be given. Frequently used definitions will be presented as well as important demarcations. The purpose of this section
is to determine how the concept, financial sustainability, is perceived and used throughout the forthcoming empirical study. In addition, auxiliary concepts and implications associated with financial sustainability will be described.

2.2.1 Definition

Financial sustainability and financial self-sufficiency are widely used concepts without any clear definition. According to León (2001) financial sustainability means:

“ensuring the longevity of the organization” (León, 2001)

Financial Times’ Lexicon (2011) states that self-sufficiency implies managing the operations without help from outside and Microfinance Information Exchange (MIX) provides yet another definition, stating that self-sufficiency refers to the organizations ability to fully cover its cost (MIX, 2011). Throughout this study, financial sustainability will refer to the ability for an MFI to survive in the long run by means of its own income generating activities, i.e. without any contributions from donors. For this purpose, the sustainability ratio used by Microfinance Information Exchange will be used. The ratio is used as a measurement of the MFIs ability to continue to serve people in the future and is defined as:

\[ \text{Operational self-sufficiency} = \frac{\text{Financial revenue}}{\text{Financial expense} + \text{Impairment loss} + \text{Operating expense}} \]

This measurement examines how much of the total costs of the MFIs’ programs that are covered by their financial income. Consequently a ratio of 100% means that the institution is able to fully cover its costs i.e. is self-sufficient. (MIX, 2011)

2.2.2 Commercialization

As mentioned earlier, microfinance has gained increased attention from various sources lately and pressure on MFIs to become more commercial has emerged as well. It is thus motivated to examine the implications of commercialization. As the expression indicates, the movement

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2 Definitions:

Financial revenue: All interest, fees and commissions incurred on the loan portfolio and other financial assets. This amount also includes other revenues related to financial service provision.

Financial expense: All interest, fees and commissions incurred on all liabilities, including deposit accounts of clients held by the MFI, borrowings, subordinated debt, and other liabilities.

Impairment loss: The non-cash expense calculated as a percentage of the value of the loan portfolio that is at risk of default.

Operating expense: Expenses related to operations, including all personnel expense, depreciation and amortization, and administrative expense (MIX, 2011)
towards commercialization means the movement towards a more business-driven approach. Campion defines microfinance commercialization as the:

“...application of market-based principles to providing financial services to the poor”

(Campion, 2002)

As the definition indicates, MFIs are supposed to use market-based principles and thus take on a more business-driven approach in their work with microfinance. The definition does not state whether or not the organizations should work in a for-profit manner. There are, however, definitions suggesting that commercial MFIs need to be profit-seeking (Cull et al. 2009) but others argue that an MFI is commercial as long as it strives to become financially sustainable (Christen & Drake, 2001). In this study, a commercial MFI refers to an MFI that simply strives to be financially sustainable and disregards whether or not the organization is for-profit, i.e. is distributing any profit to its shareholders, or non-profit, i.e. is plowing back any excess return back in to the business operations (ICNL, 2011).

2.2.3 Microfinance funding

As of today, many MFIs depend on donors and subsidies which make the industry volatile as those sources of finance are limited and exposed to what happens in the global economy (Cull et al. 2009). There are however global differences in the standpoint towards the issue of donor dependency. While the MFIs in the Third world are striving towards becoming donor independent, some parts of the industrialized world consider donor contributions a natural and highly necessary element of the industry. Not only does this positive approach towards donors hold back microfinance from growing as funding from donors are limited, but it also jeopardizes the development of the business since donors might diminish the incentives for MFIs to become more efficient and cut costs (Schreiner & Murdoch, 2001) Nonetheless, alternative sources for financing microfinance activities have been found. Hoque et al. (2011) states, that three major sources can be identified; savings, loans and shareholder capital.

Savings have been used as funds frequently in the developed world and makes up a relatively cheap source of capital that is insensitive to market fluctuations. However, as mentioned earlier all MFIs are not allowed to facilitate savings due to their legal status or choose not to do it because of the high costs associated with becoming a deposit-taking institution (Bredberg & Ek, 2011).

 Guarantees for bank loans and improved regulatory transformations have also enabled for MFIs to attain low cost for capital. In the United States for example, traditional banks lend to MFIs at a
rather low interest rate due to federal initiative called Community Reinvestment Act, which states that banks must participate in the local economical development (Bredberg & Ek, 2011)

As a result of the success of some prominent MFIs, the increased attention towards the industry has attracted more commercial sources of capital. Nowadays, commercial banks and other business-driven investors see microfinance as a potential lucrative business. But there are various obstacles for MFIs that want to turn to the traditional financial markets for funding. Firstly, commercial actors demand a higher degree of efficiency and ability to cut costs (Campion, 2002). Secondly, as microfinance is a relatively young industry, particularly in the more developed world, it has not yet attained the standardization and accreditation that commercial actors would demand. There is thus a need for more transparency within the industry (Servon, 2006, Meehan, 2004). The movement towards turning to the traditional financial market has also led to a debate regarding whether or not the original aim of microfinance can be met simultaneously with the fulfillment of the investors business goals.

### 2.3 Microfinance financial sustainability - dispersion and implications

This section will give a brief introduction to the various views on financial sustainability and the differences when it comes to the dispersion of financial sustainability. Furthermore, some of the implications associated with transformation towards financial sustainability within the microfinance sector will be presented.

#### 2.3.1 Dispersion

The dispersion of microfinance has spread all over the world since the first initiatives started in rural areas in the Third world, and now microfinance activities, in various forms, appear in most countries even in the industrialized world. The attitudes and transformation towards financial sustainability within the microfinance industry do, however, vary. The pressure on commercialization of microfinance has increased globally and while the majority of MFIs in the developing world have the objective to become financially sustainable (Christen & Drake, 2001), some developed countries, as for example the United States, still considers microfinance as charity and many MFIs are thus heavily dependent on donors (Bredberg & Ek, 2011). Gibbons and Meehan (2000), states that MFIs in Africa and Asia are the frontiers in regard of financial sustainability and that the key characteristic for those institutions is cost-efficiency. This is supported also by the well-known Forbes Magazine’s list of the most effective MFIs in the world, where 18 out of the top 20 organizations origin from Asia and Africa (Forbes Magazine, 2011). Established institutions in the developed world have not been operating as long as their counterparts in the developing world and, not surprisingly, a study by the
Microbanking Bulletin (2009) suggests that mature institutions tend to have a higher degree of self-sufficiency than newer ones. There is, however, no difference in the level of self-sufficiency between institutions that work on a for-profit basis and non-profit ones. Cull et al. (2008) states that the success in terms of profitability for MFIs in especially South Asia can be explained by the high population density and low wages. From a global perspective, the majority of all MFIs are far from financially self-sustainable though. Hermes & Lensink (2011), estimate that roughly 70% of all MFIs are heavily dependent on donors and subsidies and are not likely to become self-sufficient within a near future. Out of all of today’s MFIs, they estimate that around approximately 1-2% are completely financially sustainable. They are, according to Hermes and Lensink (2011) larger, mature and well-known institutions, while the MFIs that are far from self-sufficiency are smaller and often start-ups. A study by Hermes et al. (2011) though, suggests that not only the increased pressure from commercial actors will stimulate the movement towards financial sustainability, but also new technology enabling the MFIs to cut their transaction costs and reformations of financial markets leading to a more stable microfinance industry.

2.3.2 Challenges for financial sustainability

*Mission drift*

Along the ongoing pressure on MFIs to become financially sustainable, concerns have been expressed regarding whether or not the original aim of microfinance actually can be reconciled with financial objectives. Some claim that there is a trade-off between the two circumstances and that focus on financial performance leads to a mission drift in which the poor are the losers as the MFIs start targeting more profitable clients and leave the poor neglected. Mission drift can be observed through looking at the MFIs outreach to clients. Outreach itself can be measured in numerous ways, but some of the most frequently used measures are number of clients reached, degree of lending in rural areas and number of female borrowers (Mersland & Ström, 2009). Furthermore, average loan size is often used as a determinant for whether mission drift exists or not. As it is cheaper to lend larger amounts, recall that the cost per dollar lent is bigger for small loan amounts (see section 2.1.3). Mission drift can be suspected when an increase in average loan size arises. A study by Hermes et al. (2011), states that more efficient institutions tend to have lower degrees of outreach, which indicates that mission drift. This conclusion is further supported by Hoque et al. (2011), who state that increased use of commercial sources of capital tends to decrease outreach. Hermes et al. (2011) also found that MFIs that were more efficient also had higher average loan sizes and less female borrowers, strongly indicating a mission drift. This is in contrast to Mersland and Ström’s study from 2010, in which they find no evidence that
there exists a trade-off between social and financial objectives. They even suggest that the more efficient the MFI becomes, the smaller the average loan size, thus the bigger the outreach.

Hermes and Lensink (2007) claim that the lending methodology used by MFIs also can be used to determine whether a mission drift exists or not. Group-based lending is targeted to the very poor as a way to lend money without requiring any collateral, while individual lending typically requires more documents and collaterals. Thus, MFIs that facilitate individual lending tend to focus on less poor clients. Cull et al. (2009) find evidence that more profitable institutions tend to use individual lending approaches and hence, strive towards financial performance might lead to more individual lending and accordingly targeting less of the really poor. Servon (2006) emphasizes the importance of setting up social and commercial goals that are compatible as she argues that today’s MFIs often have goals that are inconsistent, which might cause a mission drift as well as difficulties in obtaining self-sufficiency. Another aspect criticized by the commercialization opponents is the interest rates. Microfinance has been associated with interest rates that are usually well above traditional banks’ rates and some argue that commercial MFIs, in their effort to cover their costs, will have to charge higher rates and exploit the poor even more (Hermes & Lensink, 2007).

In addition to the increased focus on financial performance, commercialization of microfinance has lead to increasing competition, especially in the developing world. As a consequence of the augmented competition, some MFIs might focus on maximizing their number of clients, leading to a potential risk that borrowers obtain loans from several institutions and thereby become over-indebted (Mcintosh & Wydick, 2005). Eventually this might end up in an even worse situation where the client gets a bad credit record and the MFIs lower repayment rates. Rhyne and Christen (1999), point out that competition also might lead to hazardous behavior from the MFIs in their products and price-setting strategies and in their screening processes. On the other hand, competition has the potential to drive the development of microfinance forward, leading to innovations, cost-reductions and lower interest rates (Christen & Drake, 2001)

**Regulation and transparency**

Given that microfinance is a relatively new phenomenon and that many of the countries in the developing world suffer from inadequate regulation of their traditional financial sector, it is no wonder that the microfinance sector undergo lack of appropriate regulation (Campion, 2002). Van Greuning et al. (1998) states, that microfinance regulation focuses on issues corresponding to the traditional financial market and that the regulation must be adjusted to the specific needs of microfinance. This is supported also by Jansson (2001), whom stresses the need for appointing the dissimilarities between microfinance and traditional finance. According to
Jansson, there are four areas in which MFIs differ distinctively from traditional financial institutions; ownership structure, client characteristics, products and services and lending methodology. Meehan (2004) claims, that expansion of the microfinance industry might be impossible if regulation is not adjusted to suit the industry. Moreover adopting to existing regulation can be difficult and expensive. MFIs usually face extensive costs for licenses, technology and capital requirements if transforming to a regulated institution (Littlefield & Helms, 2006).

Another important aspect is how the regulating authorities view microfinance. In some developed countries, microfinance activities have not been applied for a long time and the industry has not truly received recognition. In the United States for example, microfinance is in large viewed as charity and the MFIs are not even required to do any financial reporting to the regulating authority, the Federal Reserve Bank (Bredberg & Ek, 2011). The poor regulation might discourage investors from involve in microfinance and appropriate regulation is therefore crucial to enable future growth of the industry (Meehan, 2004).

Along with regulation, transparency is an important issue for microfinance in order to attract investors and receive recognition. As of today, there are not sufficient levels of transparency within the industry and it is difficult to compare different MFIs and their performances as there is not enough standardization (Servon, 2006). Jansson (2001) claims that not only the availability of information, but also the quality of the information must be improved, and Servon (2006) states that investors require that both numerical data and information regarding the MFIs activities are presented. Moreover, the concept microfinance has, as mentioned earlier, become a bit ambiguous which further impairs the awareness and recognition of the industry.
3 Methodology

This chapter will provide a motivation and description of the method used when executing the study. Furthermore, it will present and explain the different variables used in the quantitative study as well as an introduction to the dataset and an attempt to validate the data.

3.1 Method chosen

This paper consists of the previous literature review that forms the foundation for the forthcoming empirical study. The empirical study is based primarily on processing and analysis of data from the Microfinance Information Exchange (MIX), but also on findings from previous research within the field. While the data has been processed in a quantitative manner, the analysis takes on a more qualitative approach since it does not only constitute of analysis of the processed data but also of comparisons with previous research and the author’s own experience from prior field studies.

3.1.1 Data gathering and execution

Throughout this study, data from MIX has been used. MIX is a non-profit organization which provides data and analysis on MFIs. In the study, data on the characteristics of just over 1100 MFIs have been collected and analyzed and in addition previous research on the subject has been scrutinized. The dataset is from year 2009 and constitute of all the MFIs in MIX’s database that have reported applicable information according to a set of variables that were chosen prior to the data gathering (see definition in section 3.2 below). The variables used in the study were chosen from MIX’s predefined set of variables and the selection of variables was based on their importance according to the previous theoretical framework. The findings from processing and analysis of the data have thenceforth, together with the findings from previous research, been used as an attempt to draw conclusions and answer the questions that underlie this paper.

3.1.2 Observations

In addition to the data analysis and analysis of previous research, the findings from this study have also been put in relation to the author’s experience from previous field trips. Through field trips in Bangladesh, (see Bredberg & Ek, 2009) and New York (see Bredberg & Ek, 2011), the author has gained knowledge about microfinance processes and the perception of microfinance and it is the author’s opinion that those field trips have led to excess knowledge beyond what can be found in previous research, why those experiences also are included in this study.
3.1.3 Limitations of the data

The dataset is received from Microfinance Information Exchange, MIX market. Reporting to MIX is not compulsory and the reporting MFIs decide on their own how much information they would like to share. This means that not all of the world’s MFIs are participating in the database but as of today, MIX does, however, offer data from more than 1,900 MFIs, why MIX is the largest source of data for microfinance. It can be assumed that a majority of the MFIs reporting to MIX are relatively mature organizations with some degree of standardization and not pure grass-root organizations. The implication for this study is that the data-set does not completely represent the reality in term of the structure of the organizations. The dataset does, however, consist of a great proportion of self-sufficient MFIs which makes the dataset highly eligible for the purpose of distinguishing between the key characteristics of financially sustainable MFIs and non-financially MFIs respectively.

3.2 Variable definitions

In the process of studying the key characteristics of financially sustainable MFs a number of variables have been used. Those variables are illustrated in the figure below and underneath follows a short description and motivation to the variables, followed by an explanation on how the variable is calculated according to MIX Market.

Financial sustainability

- As the underlying research questions imply this study is based on a comparison between financially sustainable and non-financially sustainable MFIs, hence the MFIs in this study has been divided into those two categories.
Operational self-sufficiency = Financial revenue / (Financial expense + Impairment loss + Operating expense)

**Profit Status** – In order to determine if there is any difference in terms of financial sustainability depending on profit status the MFIs are divided into two groups; non-profit and for-profit according to their registered profit status

**Efficiency** - Previous research indicates that the commercialization of microfinance should lead to more efficiency. To test whether this statement holds or not, the efficiency of the MFIs is measured by:

\[ \text{Efficiency} = \frac{\text{Borrowers}}{\text{Loan Officer}} \]

**Outreach** – In order to determine whether or not the different kinds of MFIs are targeting the same type of clients or if a mission drift exists for financially sustainable MFIs, the institutions’ outreach is measured. In this study outreach is measured partly by the number of active borrowers:

\[ \text{No. of Active Borrowers} = \text{No. of borrowers with loans outstanding} \]

Outreach is also determined by the average loan size:

\[ \text{Average loan balance per borrower} = \frac{\text{Gross Loan Portfolio}}{\text{No. of Active Borrowers}} \]

As much of the concerns regarding commercialization of microfinance address mission drift one additional variable for measuring outreach is used; the proportion of female borrowers.

\[ \text{Percentage of Women} = \frac{\text{No. of Active Female Borrowers}}{\text{No. of Active Borrowers}} \]

**Deposits** – Previous research has highlighted facilitation of savings as an important element in the microfinance as it is a potential cheap source of funding and also serves as a tool in improving the economic lives of the clients, thus the extent of deposits among the MFIs will be calculated in relation to their outstanding loans:

\[ \text{Deposits to loan} = \frac{\text{Deposits}}{\text{Gross Loan Portfolio}} \]

**Loan losses** – Microfinance is based upon the perception that poor people are creditworthy and records from well-known MFIs support that perception. It is therefore interesting to see how financially sustainable MFIs are performing in relation to their non-financially sustainable counterparts in terms of loan losses calculated as:

\[ \text{Loan Loss Rate} = \frac{\text{(Write Offs- Value of Loans Recovered)}}{\text{Average Gross Loan Portfolio}} \]
**Interest rates** – To examine whether or not there is a difference between the interest rates charged by non-financially sustainable MFIs and financially sustainable MFIs or not, the yield on the gross portfolio is calculated (in nominal terms):

\[ \text{Yield on Gross Portfolio} = \frac{\text{Financial Revenue from Loan Portfolio}}{\text{Average Gross Loan Portfolio}} \]

**Transparency** – MIX Market ranks the MFIs in the dataset according to their level of transparency. The ranking is grounded upon a system in which the MFIs obtain diamonds based on their transparency i.e. the amount of information about the organization that they provide. One diamond represents the lowest level of transparency and five diamonds represent the highest level.
4 Findings and analysis

The findings presented in this section are based on the data from 1109 MFIs, out which 775 have reached operational self-sufficiency, and the remaining 334 are still in need of contributions from outside the organization in order to be able to cover the costs from their operations. The findings are described and analyzed in this section, while the forthcoming section (see chapter 5), will provide the final conclusions based on the analysis. Throughout the quantitative process, the MFIs in the dataset have been divided into two groups depending on whether they are sustainable or not. The different variables have then been applied on respective group to discover any differences between the two types of MFIs. The findings are summarized and presented in the simplified table below while the complete quantitative results can be found in appendix.

<table>
<thead>
<tr>
<th>Sustainable MFIs</th>
<th>Non-sustainable MFIs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit status</td>
<td>More for-profit MFIs</td>
</tr>
<tr>
<td>Efficiency</td>
<td>More efficient</td>
</tr>
<tr>
<td>Number of borrowers</td>
<td>Larger number of borrowers</td>
</tr>
<tr>
<td>Average loan size</td>
<td>Larger average loan size</td>
</tr>
<tr>
<td>Fraction of female borrowers</td>
<td>Smaller fraction</td>
</tr>
<tr>
<td>Deposits</td>
<td>Larger part of deposits</td>
</tr>
<tr>
<td>Loan loss rate</td>
<td>Lower loan loss rate</td>
</tr>
<tr>
<td>Interest rates</td>
<td>Lower yields</td>
</tr>
<tr>
<td>Transparency</td>
<td>Fairly high level of transparency</td>
</tr>
</tbody>
</table>

Table 1 Summary of the findings

4.1 Profit Status

The MFIs in the dataset have, in the examination of how profit status affect sustainability, been divided into two groups depending on their profit status. The findings, in terms of proportion of self-sufficient institutions, show that the group consisting of MFIs with for-profit status has a higher proportion of self-sufficient MFIs than the non-profit group. While 73% of the for-profit MFIs are sustainable, only 68% of the non-profit institutions are sustainable. There are several possible explanations for this result but as for-profit organizations have the aim to deliver value to their shareholders, it is not dubious that they are under more pressure to become self-sufficient than the non-profit organizations are. Non-profit MFIs usually have few or no requirements at all in terms of deliverables and reporting from their funders, i.e. the donors. For-profit MFIs, on the other hand, will be more concerned with delivering value to their owners, as attracting investors are crucial for their survival. Without the ability to generate a surplus, a for-profit organization will soon face difficulties in attracting new investors to the organization. Furthermore for-profit
MFIs may focus more on business goals while non-profit MFIs are more likely to operate on more social missions. Emphasis on business-oriented goals is probable to result in more monitoring and evaluation of financial performance which in turn might improve the knowledge and understanding of the organization’s underlying business mechanisms. The risk is, however, that focus on financial performance leads to lack of notion regarding the social objectives why an MFI’s financial key ratios must be carefully selected and ensured not to offset the social missions of the organization.

4.2 Efficiency

Efficiency is, in this study, measured by calculating borrowers per loan officer, i.e. how many clients each loan officer serves. The results are henceforth divided in two groups; financially sustainable and non-financially sustainable MFIs. The test of efficiency among the MFIs in the study shows that self-sufficient MFIs have a significantly higher degree of efficiency, demonstrated as borrowers per loan officers, than the non-sufficient organizations. According to the findings, the group of self-sufficient MFIs serves more clients (262) per loan officer than the group of MFIs that are not self-sufficient (197 clients per loan officer). This implies that organizations that managed to increase their efficiency and serve more clients per staff member are more likely to become self-sufficient. By increasing the efficiency, the organizations can, not surprisingly, serve the same amount of clients but with lower transaction costs, i.e. costs for staff and administration. As brought up in the literature section, the commercialization of microfinance has the potential to drive the enhancement of the industry and lead to new innovations. The findings in this study support the statement as it shows that sustainability and efficiency seems to go hand in hand.

It is, however, difficult to find the explanation to the higher efficiency among self-sufficient MFIs, within the scope of this study. One possible explanation is that the more efficient MFIs have come up with technological innovations that reduce the interaction between the clients and the loan officers, enabling the loan officers to serve more clients. Another possible reason is that self-sufficient MFIs potentially use the group-based lending approach to a bigger extent than the non-sufficient MFIs. As mentioned in section 2.1.2 MFIs carrying out group-based lending can transfer parts of the screening process to the members of the groups and thus decrease the amount of time that the loan officer must spend on controlling and monitoring the clients. If group-based lending is the primary lending approach it would, however, be in contrast to previous research (e.g. Cull et al. 2009) which has shown that commercial MFIs tend to use individual lending to a greater extent than non-commercial MFIs. The relation between group-
lending and individual lending is not captured in this study, though, why it is not possible to
determine if this is the case.

4.3 Outreach

How the MFIs are performing with regard to outreach is projected by using three different
variables; number of clients, average loan size and proportion of female borrowers.

The findings on outreach, in terms of clients reached, show that self-sufficient MFIs serve more
clients on average than non-self-sufficient MFIs, the difference being relatively large with
12,500 respectively 7,600 clients. As more clients mean more revenues this figure seems
reasonable and might as well go hand in hand with the previous findings on efficiency. Given
that self-sufficient MFIs have proven to be able to serve more clients per loan officer they are
also likely to serve more clients in total than non-profit MFIs. Serving many clients might not
only be of good, though. If MFIs are too eager to maximize their number of clients they might
not consider what is actually best for the clients. The MFIs might not examine if the clients have
obtained loan from other lenders as well, causing a situation in which the client is left over-
indebted. Too aggressive search for clients may also lead to less emphasis on screening of the
potential clients which can result in a scenario in which clients who are actually not eligible, get
a loan that they later fail to repay. In that case, the MFIs will eventually face higher costs as it
generates larger loan losses, and it will as well be damaging for the client.

The number of clients served does only give an indication of how the MFIs are performing in
terms of ability to reach clients. It does, on the other hand, not give any indication on the
characteristics of the clients, why it is hard by using only that measure, to determine whether or
not self-sufficient MFIs actually serve those who are in greatest need or if an actual mission drift
exists. The findings representing the average loan size might be a better indicator for this
purpose. As mentioned earlier, as average loan size increases the organizations tend to move
away from the very poorest, serving slightly wealthier clients. The results on average loan size
show that the average loan size amount is larger for self-sustainable MFIs than for those whom
are not self-sufficient. While the median self-sufficient MFI has an average loan size of $611 the
median non-sufficient institution has an average loan size of $424. As larger loan amounts means
lower costs per dollar lent it is not surprisingly that sustainable MFIs tend to have larger average
loan sizes, but the fact might nonetheless imply that the organizations, in the efforts of becoming
more commercial, abandon their poor clients in favor of more profitable ones. The difference
between the two groups in terms of average loan size is significant, why the anticipation of a
mission drift cannot be dismissed.
When it comes to female clients, both groups have a majority of women as their clients, but the non-self-sufficient MFIs in the study have a slightly larger proportion of female borrowers than the self-sufficient MFIs. Approximately 65% of the non self-sufficient MFIs’ clients are females compared to 62% of the clients for the self-sufficient institutions. The fraction of female clients does thus also indicate a mission drift even if the difference is smaller in this estimate. Self-sufficient MFIs in the study have a lower proportion of female borrowers than the non-self-sufficient MFIs, although both groups still have a majority of female borrowers. The fraction of female borrowers has in previous research been used as a measurement of outreach since women have historically been considered poorer, and especially in many developing countries, less powerful. It is, however, hard to determine whether or not lending to female borrowers is actually better than lending to their husbands as there are strong indications that the women are just getting the money from the lender but in reality the husbands are still controlling the usage of the money (see Bredberg & Ek, 2009). It is also hard to state that lending to female borrowers would be better in terms of outreach or poverty alleviation in more developed parts of the world where men and women are considered being more equal.

4.4 Deposits

The extent of deposits among the different MFIs is calculated by using the organization’s total deposits as a fraction of their outstanding loan balance. The findings show that the self-sustainable MFIs in the study have a significantly higher degree of savings in relation to loans (12.59%), than their non-sustainable counterparts (5.31%). The exploitation of deposits is interesting as many prominent researchers (e.g. Murdoch 1999, Campion, 2004 among others) within the microfinance field highly emphasize the importance of MFIs facilitating savings. In this study there is an apparent difference between self-sufficient MFIs and their non-sufficient counterparts. Self-sufficient MFIs utilize considerably more deposits than non-sufficient MFIs and as they have proven to have more clients and also larger loan amount, it implies that they also have a larger amount of total savings than non-sufficient MFIs. This pool of deposits can, as mentioned earlier, be used as funding for loans which suggests that MFIs can, by utilizing more deposits, fund their lending with cheaper sources of capital and hence cut their financial costs, leading one step closer to becoming self-sufficient. Savings have also been viewed as a tool to further improve the lives of the poor since it helps them to create a better economy for the household as well as build a reserve for unexpected expenses. So, at the same time as deposits enable the MFIs to cut their financial costs it can also generate a positive socio-economical side-effect.
4.5 Loan losses

The difference in terms of loan loss rates between each group of MFIs shows that the median self-sufficient MFI has a lower loan loss rate (0.25%) than the median non-self-sufficient MFI (1.34%). An MFI’s loan loss rate gives a good indication of the soundness of the organization’s loan portfolio i.e. the borrowers’ ability and motivation to repay their loans. Both groups of MFIs have relatively low loan loss rates, which is quite significant for the microfinance industry. It is, however, possible to identify a considerable difference between the two groups. Self-sufficient MFIs do on average have a lower loan loss rate than non-self-sufficient ones. There are several possible reasons for this difference; the organizations might for example do better in terms of targeting creditworthy clients or in terms of creating suitable loan terms and repayment schemes. As loan losses make up a part of the costs used to calculate the degree of self-sustainability (recall the equation in section 2.2.1), it is of great interest for organizations that are striving towards self-sufficiency to keep the loan loss rate as low as possible. It could therefore be the case that those organizations have been putting more effort into the issue. The fact that sustainable MFIs do have lower loan losses does also lead to rejection of the previous anticipation that they are using too aggressive means in order to reach a large number of clients, as that would actually imply larger loan losses.

4.6 Interest Rates

The group’s interest rates are in this study represented by yield on gross portfolio (in nominal terms). According to the findings, the non self-sufficient MFIs have a slightly higher yield on their gross portfolio (29.07%) than their self-sufficient counterparts (27.45%). The interest rates in the microfinance industry have often been thought of as too high, and yet another way of taking advantage of hurdling people. But, as discussed earlier, microfinance will probably always be surrounded with higher rates than the traditional financial markets due to its higher transaction costs per loan. This is not to say, however, that MFIs should not attempt to lower their interest rates by becoming more efficient and reducing their costs. The results from this study show that sustainable MFIs demonstrate somewhat lower yields than the non-sustainable ones. The fact that the sustainable MFIs have lower yields implies a promising discovery; that the sustainable MFIs in this study have not become self-sufficient due to high interest rates and the exploitation of poor people. The findings imply that the explanation to their success, rather than high prices, lies within the cost side of the equation from section 2.2.1. This seems reasonable and one can assume that sustainable MFIs have managed better in cutting costs and
becoming more efficient, leading to sustainability and eventually the opportunity to charge their clients less.

4.7 Transparency

MIX markets ranking of the transparency of the MFIs is measured according to a ranking system where 5 diamonds represent the highest level of transparency and 1 diamond the lowest level. There is no difference between the two groups of MFIs in terms of transparency, according to the findings. Both groups have received 4 diamonds in MIX market’s ranking system. The investigation of how the two groups of MFIs are performing in terms of transparency did thus not result in any useful insights. Due to the fact that there is no difference, there are no indications implying that sustainable MFIs are more transparent than non-sustainable MFIs, as one could have assumed as commercialization is said to drive the pressure of increased transparency within the industry. It can on the other hand be presumed that the MFIs in this study on average have a higher degree of transparency than what is representative for the microfinance industry. The reason being that it is optional to report to MIX market i.e. all MFIs in this study has chosen to provide MIX market with data themselves. One can therefore assume that MFIs not reporting to MIX market have a lower degree of transparency. Simultaneously, this study contains a larger fraction of sustainable MFIs than the real proportion, which might actually indirectly indicate that sustainable MFIs are more transparent, since most of the organizations that are not reporting are assumed to be less sustainable and also less transparent.
This study contains an analysis of data from just over 1100 MFIs and although, the sample might not be completely representative for the whole microfinance industry due to the overrepresentation of sustainable MFIs, it can actually be useful for the purpose of this study, namely to map the characteristics of sustainable versus non-sustainable MFIs. The findings from this study do point out some significant differences between the two types of organizations and even if the results should not be considered as complete reflections of reality, it has the potential to be seen as indications and it can be used as guidance in order to increase the understanding of the features of financial sustainability within the microfinance sector. The conclusions are presented in the table below.

<table>
<thead>
<tr>
<th>Profit status</th>
<th>Sustainable MFIs</th>
<th>Non-sustainable MFIs</th>
<th>Indicates</th>
</tr>
</thead>
<tbody>
<tr>
<td>More for-profit MFIs</td>
<td>Less for-profit MFIs</td>
<td>For-profit status put pressure on the organization to become financially sustainable</td>
<td></td>
</tr>
<tr>
<td>Efficiency</td>
<td>More efficient</td>
<td>Less efficient</td>
<td>Sustainable MFIs either have a technological advantage or use group-based lending to a greater extent</td>
</tr>
<tr>
<td>Number of borrowers</td>
<td>Larger number of borrowers</td>
<td>Smaller number of borrowers</td>
<td>Sustainable MFIs have a larger outreach</td>
</tr>
<tr>
<td>Average loan size</td>
<td>Larger average loan size</td>
<td>Smaller average loan size</td>
<td>Sustainability might cause mission drift</td>
</tr>
<tr>
<td>Fraction of female borrowers</td>
<td>Smaller fraction</td>
<td>Larger fraction</td>
<td>Sustainability might cause mission drift</td>
</tr>
<tr>
<td>Deposits</td>
<td>Larger part of deposits</td>
<td>Smaller part of deposits</td>
<td>Deposits might be a useful tool to become financially sustainable</td>
</tr>
<tr>
<td>Loan loss rate</td>
<td>Lower loan loss rate</td>
<td>Higher loan loss rate</td>
<td>Sustainable MFIs are better at providing suitable loans/finding eligible clients</td>
</tr>
<tr>
<td>Interest rates</td>
<td>Lower yields</td>
<td>Higher yields</td>
<td>Sustainable MFIs have managed to become self-sufficient by cutting costs not by increasing prices</td>
</tr>
<tr>
<td>Transparency</td>
<td>Fairly high level of transparency</td>
<td>Fairly high level of transparency</td>
<td>No indications</td>
</tr>
</tbody>
</table>

Table 2 Summary of conclusions
Returning to the initial question formulation in section 1.2, it can be concluded that this study has been able to provide a good proposal to all of the four questions stated:

- Are for-profit MFIs more self-sustainable than their non-profit counterparts?
- Are financially sustainable MFIs more efficient than non-sustainable?
- Are financially sustainable MFIs targeting the same clients as non-sustainable?
- Can financial sustainability lead to a mission drift?

The answer to the first question, if for-profit MFIs are more self-sustainable than their non-profit counterparts, is according to the findings in this study most certainly yes. The second question regarding whether sustainable MFIs are more efficient or not, can also be answered with a relatively high degree of confidence. The answer following from this study is yes, sustainable MFIs are more efficient at least in terms of clients served per loan officer. It is worth noticing, however, that efficiency can be measured in other ways than this measurement, although this is not done within the scope of this study.

It is harder from the findings to make any general conclusion to whether or not the two types of MFIs are actually targeting the same clients, but there are some signs indicating that this would not be the case. First, there are differences within the average loan size between the two groups which indicate different kind of clients. Furthermore, there exists a difference in the proportion of female borrowers, which also signals different target groups. The evidence is, however, not that strong and in order to answer the question properly, further investigation of the characteristics of the clients would be necessary. Coherent with the third question, the answer to the fourth question is also surrounded by some degree of contingency. There are some clear signs of mission drift among sustainable institutions, such as less female borrowers and larger average loan sizes, but on the other hand there are some contradictory arguments. First, sustainable MFIs serve more clients than non-sustainable ones and second, sustainable organizations charge lower interest rates, which actually benefits the poor.

To summarize, the movement towards more commercial MFIs and thus more self-sufficient institutions have the potential to increase efficiency, reach larger number of clients and diminish interest rates and loan losses, but it must be done through careful reflection of the original aim of microfinance. If no consideration is taken to the social missions associated with microfinance, the commercialization trend jeopardizes the advantage that microfinance means for the poor and a mission drift occurs.
6 Discussion

This section provides the reader with yet another dimension of the topic of microfinance financial sustainability. It presents the author’s expectations regarding the future of microfinance and gives some suggestions for future research as well.

The microfinance sector faces an important transformation of the industry as a whole and the foundation upon which it relies is being challenged. In order to fully become a recognized and accepted industry, the actors are forced to take on business-driven actions and liberate themselves from donors, as they will otherwise just be considered ambiguous charitable organizations. To do so they must be financially sustainable, a step that is vital for all commercial organizations. It is, however, not that simple for microfinance actors due to its reputation and history of being the poor’s savior. Taking on a commercial approach challenge this image and commercial actors are suspected to be taking advantage of those whom are in greatest need. This study, along with many others, has shown that those suspicions are not groundless. Mission drift is a threat to the industry’s progression and must be handled. In this study the signs of mission drift are not immense but still significant enough to encourage further investigations. As a complement to this study, an investigation of the characteristics of each type of MFIs’ clients is recommended in order to get a better picture of whether the sustainable MFIs are omitting the poor or not. This study does, again not alone, show that commercialization might bring out some good as well. Along with business objectives comes efficiency, cost-cutting and other improvements that can gain the poor in terms of lower interest rates, more accessible financial services and more suitable products. To further increase the knowledge and understanding regarding the positive effects of commercialization it would be of interest to examine the root to the increased efficiency and ability to cut costs. Future research is therefore recommended to look scrutinize on how sustainable MFIs managed to increase their efficiency. This research can be carried out by looking at for example lending approaches and technological innovations.

Finally, based on previous studies in Bangladesh and the United State, it is my belief that the microfinance industry, in order to survive in the long term must continue striving towards financial sustainability, but while doing so, closely monitoring the outreach to ensure the poor’s gain. Some microfinance institutions have proved that this is possible and those MFIs should be used as role models. The industry must also be better at represent itself. As by now the term microfinance is too ambiguous and investors hesitate from investing, as the organizations lack
standardization and accreditation. It is my opinion that the regulating authorities in each country play an important role in the progression of recognizing microfinance as a genuine industry.
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Appendix 1 Quantitative findings

This appendix consists of the complete findings from the quantitative study. The illustrations are aimed to easily visualize any differences between sustainable and non-sustainable MFIs, why the results are presented in bar diagrams with two bars, representing respective group of MFIs. The first illustration does, however, differ from the rest as it separates the institutions according to their profit status instead of sustainability.

**Profit Status**

![Self-sufficiency and Profit status](image)

- **Non-profit MFIs**
- **For-profit MFIs**

*Fig. 2 Proportion of MFIs whom are self-sufficient*

**Efficiency**

![Efficiency](image)

- **Non-OSS**
- **OSS**

*Fig. 3 Borrowers per loan officer (median)*
Outreach

Fig. 4 Number of clients

Fig. 5 Average loan balance per borrower

Fig. 6 Percent of women borrowers (median)
**Deposits**

Fig. 7 Deposits to loans (median)

**Loan losses**

Fig. 8 Loan loss rate (median)

**Interest rates**

Fig. 9 Yield on gross portfolio (nominal) (median)
Fig. 10 Diamonds (median)