

Microfinance Development Strategy: Sector Performance and Client Welfare

The study emphasizes the twin goals of microfinance—reaching the poor and being financially sustainable. With microfinance becoming increasingly commercialized in the region, the study stresses the role of government and agencies such as ADB in addressing the financial needs of the poor, while ensuring the institutional sustainability of microfinance providers.

The microfinance industry is rapidly evolving, becoming more commercialized at a time when financial inclusion is a crucial goal of development. Against this backdrop are two ongoing debates on the role of microfinance in economic development and poverty reduction. The first is whether integrating microfinance into the formal financial system by transforming nongovernment organizations into regulated, commercial microfinance institutions has improved access to finance for the poor or, on the contrary, caused microfinance institutions to deviate from serving the poor. The second debate is whether microfinance really improves the welfare of clients. Findings on this had been generally positive, but more skeptical views are emerging based on improved impact evaluation methods and data quality.

The Evaluation

The special evaluation study had two objectives: assess the performance of the Asian Development Bank's (ADB) microfinance assistance, and build knowledge on the effectiveness of microfinance in reducing poverty based on ADB's experiences. The study was based on ADB's microfinance portfolio of 78 loans, grants, technical assistance operations, and private sector investments totaling \$2.5 billion provided to 21 developing countries during 2000–2010. The study assessed the portfolio's relevance, responsiveness, and results. In addition to country studies for Cambodia, Pakistan, Papua New Guinea, the Philippines, Uzbekistan, and Viet Nam, the study conducted impact evaluations on the Microfinance Sector Development Program in Pakistan and the Rural Enterprise Finance Project in Viet Nam. The impact evaluations assessed the degree to which these programs improved the welfare of clients.

Key Findings

Overall Portfolio Assessment. ADB's microfinance operations were relevant and responsive but less than effective in achieving results. ADB's support was concentrated on addressing policy environment issues and supply-side constraints to building sustainable financial systems. It was less focused on institutional development and demand-side issues to make microfinance more inclusive and effective for the poor. These include issues associated with consumer protection, the financial literacy of borrowers, the social performance of microfinance providers, and products and technology for financial inclusion.

Creating policy environments. ADB's support worked most effectively in countries where the government is committed to reforms, and where institutions, policies, and operating frameworks have been allowed to flourish. Of the 21 countries receiving ADB microfinance support, efforts were effective in Cambodia, Pakistan, the Philippines, and Tajikistan, where they contributed to notable improvements in the policy, legal, regulatory, and supervisory frameworks.

Building viable institutions. The institutional strength and service capacity of microfinance institutions were significantly strengthened in Cambodia, the Philippines, and Tajikistan, where ADB's assistance addressed key constraints to the expansion of microfinance with appropriate choices of financing instruments. In other countries, improving service capacity and institutional strength were generally not realized.

QUICK LINKS

Special Evaluation Study: Microfinance Development Strategy 2000: Sector Performance and Client Welfare (Main Report)

www.adb.org/documents/adbs-microfinance-development-strategy-2000

ADB Management Response

www.adb.org/documents/management-response-special-evaluation-study-microfinance-development-strategy-2000-client

Chair's Summary of the Development Effectiveness Committee (DEC)

www.adb.org/documents/chairs-summary-committee-discussion-1-october-2012

Promoting pro-poor innovations in the financial sector. ADB's support for this was very limited. Clients surveyed in the six case countries said they had regular access to credit, but far less access to other financial services, such as savings, money transfer, and microinsurance.

Developing financial infrastructure and social intermediation. Few interventions in ADB's microfinance support were aimed at developing financial infrastructure, such as credit information and performance standards for microfinance institutions, to develop sound retail business models for the underserved. As for social intermediation, ADB's microfinance support was concentrated mostly on building sustainable financial systems and less on developing the capacity of the poor to access and use financial services. Project designs focused on financial performance, but little attention was paid to the social performance of microfinance operations.

Outreach to the poor. The penetration of microfinance among the poor remains low. As of the end of 2010, average penetration in the 21 countries was 20% of the population living below the poverty level of \$1.25 per day. Surveys in the six case countries showed that fewer than 9% of microfinance clients lived below \$1.25 per day and fewer than 22% lived below \$2 per day.

Client welfare. Findings from the impact evaluations for Pakistan and Viet Nam point to an apparent tradeoff between targeting and the effectiveness of microfinance. Smaller loans were better at targeting the poor, but less effective than larger loans in producing welfare benefits. Overall, the estimated client welfare impacts were relatively more positive under the Viet Nam program, where client households were typically not poor and they borrowed more, with much larger loans, compared with their Pakistan counterparts. In the Viet Nam program, the average loan was \$1,972 and 1.3% of the borrowers lived below the national poverty line. The respective figures for the Pakistan program were \$195 and nearly 15%.

Key Recommendations

ADB's microfinance support needs to strengthen efforts toward financial inclusion, with an increased focus on demand-side interventions. Specific recommendations are:

- Target poor and low-income households using deliberate and innovative approaches, and closely monitor the poverty and income levels of clients.
- Focus on client needs and demands to make microfinance more beneficial for users.
- When the policy environment is in place, support market infrastructure development to ensure a strong and sustainable expansion of microfinance operations.
- Refine ADB's Microfinance Development Strategy 2000 to support (i) developing financial infrastructure for microfinance through, among other things, training and credit reporting systems; (ii) new products and delivery mechanisms to increase the use of financial technologies (e.g., mobile banking, agent networks, smart cards); (iii) responsible financial practices among service providers and consumer protection; and (iv) regular monitoring of supply and demand-side data for improved policy making.

Feedback

ADB Management welcomed the well-structured and comprehensive evaluation of ADB's Microfinance Development Strategy. Management appreciated the appropriateness of the timing of the study given the portfolio that provides for a robust analysis of the implementation of the strategy. Management supported the general thrust of the study's recommendations.

The Chair's Summary of the Development Effectiveness Committee (DEC) of the Board noted with satisfaction that ADB had a portfolio allocation of \$2.8 billion in this sector during 2000–2010. The interventions have achieved reasonably good results in addressing regulatory and policy constraints in many countries. However, the study showed that the results have been less effective in market and institutional development, sustainability of microfinance operations, and outreach to the poor. DEC members noted that interventions need to be sharpened with greater focus on clients, the use of financial innovations, and technology-based solutions to achieve desired outcomes.

The study recommends that future ADB microfinance interventions target poor and low-income households using "deliberate and innovative approaches," the close monitoring of beneficiaries' poverty levels, and the empowerment of women. It also recommends a more demand-side orientation in microfinance interventions that focuses on client needs to make microfinance more beneficial for borrowers.

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