STRATEGIES OF MICROFINANCE SERVICES TO REACH THE EXTREMELY POOR: OUTSTANING ISSUES AND WAY FORWARD

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1. BACKGROUND

The Millennium Development Goals (MDGs) arising from the United Nations Millennium Summit set a critical challenge of halving absolute poverty in the world by 2015.[2] Governments and donors around the world responded with plans to work towards the realising these goals. Microfinance can play an important role on eradicating poverty, particularly through the empowerment of poor people to choose when and how to access other development services such as health and education, and reducing vulnerability. Despite prospects for poverty reduction, microfinance has not been adequately places in the Millennium Development strategies.

Microfinance movement started with the vision that 'the poor are bankable'. Microfinance has been developed as a key strategy for reducing poverty. Access to micro-financial services is seen as a way of providing poor with opportunities to take an active role in their economy through entrepreneurship, income and bargaining power and building up social empowerment for poor in their communities. Over the year, there is better understanding on microfinance including its limitations and effects (positive/negative) on poverty. More attention is focused on questions: under what conditions and with what mechanism can microfinance have maximum effects on poverty?

This paper is based on the basic conviction that the poorest are bankable, the limiting factor is not the potential of very poor clients, but the ability of MFIs to deliver the right services, in a manner that is cost-effective and can lead to sustainable MFIs with sustainable long-term changes in clients' lives. The 'failures' of MFIs to reach very poor clients results both from the failure of the very poor to benefit from microfinance as well as failures to design programs to meet their needs.

This paper is organized into six sections. After this introductory section, section two discuss on role of microfinance in poverty reduction while section three covers issues related on reaching the poorest and attaining sustainability. Section four documents reasons for exclusion of the poorest and basic consideration for design and delivery of microfinance to reach the poorest are outlined in section five. The paper ends with conclusion in section six.

2. MICROFINANCE AND POVERTY REDUCTION

Microfinance services for the poor is one of the many interventions to reduce poverty and relate to a wide range of flexible, appropriate services tailored to the preference and needs of the poor provided successfully by a variety of institutions. Such services can contribute to

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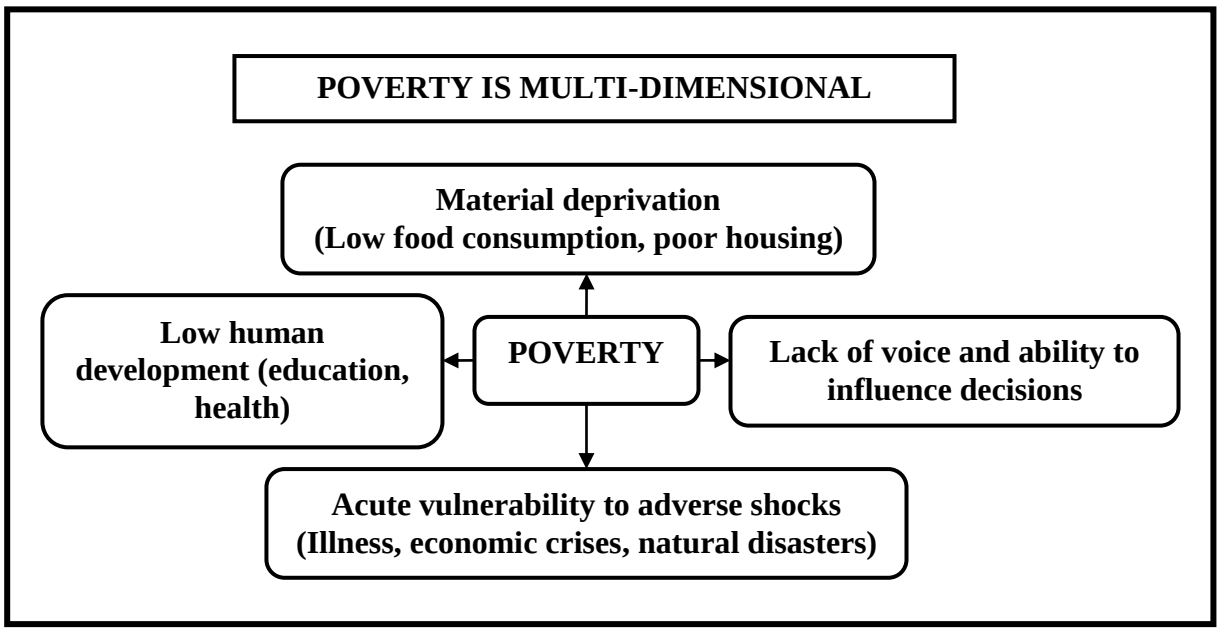
[2]Absolute poverty is defined as families living on less than $1 a day, purchasing power parity (PPP).

ongoing social returns only when providers are sustainable. Beyond microcredit, poor requires a broad variety of financial services. These services are neither a magic bullet in the war against poverty nor a short-term or one-time exercise to solve multidimensional poverty problem, nor can it be a substitute for investment in education, health or infrastructure.

In general poor has limited access to formal financial services. Their informal alternatives, such as family loans and moneylenders are usually limited by amount, rigidly administered, or available only at exorbitant interest rates. The challenge ahead is to ensure access to financial services for poor majority. Microfinance is unique among development interventions and solution to most of the capital problems. Many well-managed MFIs provide financial services to the poor and destitute in a sustainable way. It offers potential for a self-propelling cycle of sustainability and massive growth, while providing a powerful impact on lives of poor, even extremely poor. Evidence shows that this impact intensifies longer the client remains with the MFI thereby deepening power of this virtuous cycle.

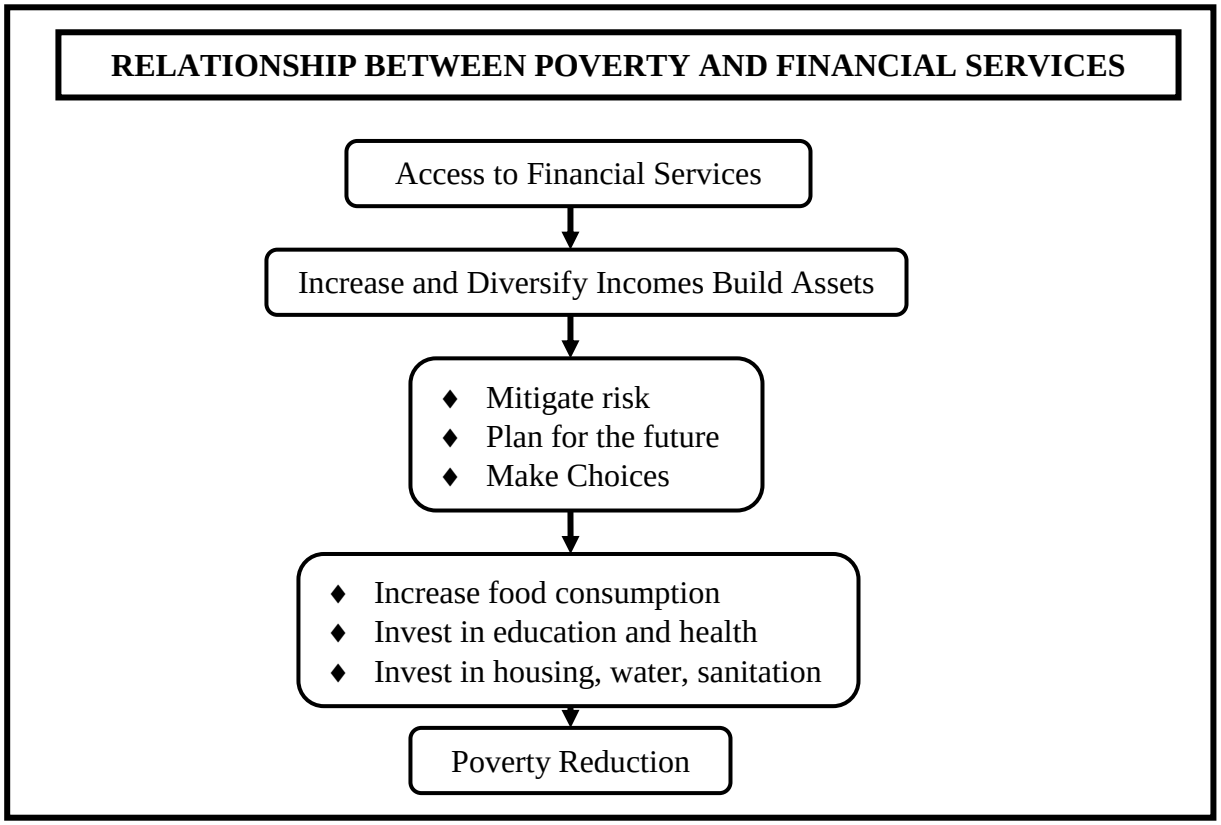


Microfinance has been developed largely outside the realm of formal financial sector. Governments and donors addressing financial sector issues talk about banking reform, averting or coping with financial crises and capital markets - not microfinance. For its part, the microfinance community has insisted that it is highly specialized with separate standards, techniques, and/or legal frameworks. These arguments have contributed to the marginalization of microfinance as a sector isolated from broader financial systems. Large-scale sustainable microfinance can be achieved only if financial services for the poor are integrated into overall financial systems. This integration allows more access to capital, better protection of poor people's savings, and increased legitimacy and professionalization of the sector. The result is opening markets to increasingly poor and geographically remote clients. The challenge is to achieve this integration without compromising social mission of microfinance.

There is extensive evidence that microfinance has a positive impact on reducing extreme poverty. There is no doubt that strong demand exists for microfinance services, among the poor. Until recently, the term "microfinance" was easily understood as a credit methodology

that employs effective collateral substitutes to deliver and recover short-term, working capital loans to micro-entrepreneurs (or potential micro entrepreneurs).

In general, impact of microfinance goes beyond business loans. Poor use financial services to invest in micro-enterprises, health, education, and household emergencies in addition to meet wide variety of other cash needs that they encounter. The financial services - savings and credit - enables clients to increase their household incomes, build assets, and reduce their vulnerability to crises, in addition to translating these services into better nutrition and improved health outcomes and higher immunization rates.



Income earned using financial services has allowed poor people to plan for their future and send their children to school for longer and enabled women clients to be more confident, assertive and better able to confront gender inequities. Microfinance clients manage their cash flows and allocate them into household priority and their own welfare. Access to flexible, convenient, and affordable financial services empowers and equips them to make their own choices and build their way out of poverty in a sustained and self-determined way.

Though MFIs can bring very poor clients into their programs, to achieve significant impact on poverty, inclusion is a necessary but insufficient goal. High levels of client drop-out and push to give larger loans to more successful clients, suggest that very often the poorest clients enter MFI whose products and services are not designed specifically to meet their needs. In some cases, this may not matter and very poor clients may succeed or fail in similar numbers to other participants. As such inappropriate products and services can result in very poor clients experiencing difficulties and not benefiting as much as other clients, or even experiencing negative impacts.

3. REACHING THE POOREST AND SUSTAINABILITY

Many have raised questions on microfinance and its importance as a means for poverty reduction. As promoters and practitioners become increasingly concerned about quality of their interventions, interest has grown in developing clear and concise mechanism that MFI simultaneously focus on very poor and face challenges of sustainability and outreach.

3.1 Achieving Poverty Outreach and Financial Self-sufficiency

Whether microfinance should be orientated to build institutions for those commonly excluded from the formal banking sector or should provide financial services to help reduce poverty are two opposite opinion regarding microfinance operation. Advocates of the latter approach contend that large-scale sustainable microfinance can be achieved *only* with financial systems approach. To be able to reach large numbers of clients, MFIs need to achieve self-sufficiency but this should not be attained at the expense of the benefits to these clients in terms of poverty impact.

3.2 Costs and Benefits of Working with the Poorest

Some MFIs have successfully achieved difficult balance of excellent financial performance, outreach to the poorest people and significant positive impacts on the lives of their clients. Poverty-focused MFIs can achieve excellent financial performance, but the process of striving towards these goals involves trade-offs between social and financial objectives. The nature of these trade-offs varies in different contexts.

3.2.1. Costs of a Poverty Focus

The process of understanding needs and targeting very poor clients demands staff time. Poorer people often live in more remote, inaccessible or less densely populated areas and active poverty targeting demands development and management, staff time and additional supervision and operational costs. Once very poor people are reached they are likely to take smaller loans, which generate less income and need greater levels of support. Increasing the flexibility of financial services and adding non-financial services can increase the effectiveness in poverty outreach and impact but costly and complicated for implementation.

3.2.2. Benefits of a Poverty Focus

There are benefits of the poverty focus. Microfinance industry has embraced targeting women as it is recognised that this creates positive financial and social benefits. One of most obvious but un-quantifiable benefits comes with offering services that are appropriate for the market. MFIs that do not differentiate according to the needs of different client groups are inefficient, and they will find that clients do not perform and they might otherwise.

If an MFI can succeed in supporting the poorest in overcoming their vulnerability and in coping with shocks as they occur, then there is a good chance that the clients will improve their position, and as they do so, have increasing need and capacity for financial services. They will be more likely to save more, take larger loans, experience fewer problems and therefore require less staff input. This in turn will lead to the financial success of the MFI. There is anecdotal evidence that very poor clients are more committed to the MFI and less

likely to default. Higher initial costs may be partly balanced by lower costs at a later stage. What is clear is that MFI sustainability very much depends on the sustainability of its clients.

4. EXCLUSION OF THE POOREST FROM MICROFINANCE SERVICES

Attracting the right people towards its products and services is one of the challenges for any MFI that wishes to impact on very poor clients. This is in part about designing services that are attractive to the poorest and understanding who is reached and why others are excluded. Poorest of the poor are excluded from microfinance due to deliberate and inadvertent processes that operate formally and informally within MFI and clients. An understanding of the issues related to exclusion of the poorest from microfinance products and services and identifying the strategies to address such issue is crucial for ensuring reaching the poorest.

4.1 Exclusion of the Poorest from Microfinance Services

Market forces operate to serve the less-poor first. Very poor people are excluded through self-exclusion, deliberate or unintentional MFI policy, exclusion by other clients, or by leaving the programme.

4.1.1. Formal exclusion by MFI:

MFIs may take a decision to provide services only to a specific group of clients. For example, many MFIs only provide loans to clients with an established micro-enterprise backed by certain eligibility criteria.

Table 1: Mechanisms for Exclusion of the Poorest from MFIs

Action	**By Whom & Why**
Formal exclusion by MFIs	
Eligibility criteria	♦ Deliberate and considered MFI policy
Informal exclusion by clients	
♦ Self-exclusion of very poor people ♦ Other clients prevent very poor joining	♦ Lack of confidence and perceptions of MFIs by clients ♦ Self-interest of existing clients to exclude `weak' people.
Exit of clients	
♦ Self-selection ♦ Pushed out by other clients	♦ Decisions by clients due to perceived lack of benefits ♦ Exclusion of "problem" clients by others
Informal exclusion by MFIs	
♦ ***Staff:*** Active exclusion by staff assumptions /practices ♦ ***Design*****:** Inappropriate products/services	♦ Response by staff at all levels to job priorities, mission and incentives ♦ Unexpected side effects of MFI policy and practice.

4.1.2. Informal Exclusion by Clients

Whilst the MFI may have a commitment to reaching the very poor, these people may both choose not to join or be prevented by other members. This is often a particular problem where there is a mix of very poor and less poor clients.
Self-exclusion: Poor people's lack of confidence constrains their capacity to believe that microfinance can be beneficial, or have the perception that the services provided by MFIs are not intended for them.

Exclusion by other members: In group-based lending there is a tendency of stronger people to exclude those who are poorer. There is often a negative perception by the community of the very poor (useless, lazy, unlikely to be able to repay a loan) resulting in other members not wanting them in their group. This is particularly apparent where group liability is operated, and group members are encouraged to exclude any person who may be a bad credit risk.

4.1.3. Client Exit

Where policies are not orientated to the needs of the very poor, it is likely that they will experience a greater proportion of problems, and therefore be more likely to choose to leave the MFI, or to be pushed out by other members.

4.1.4. Informal exclusion by MFI

Whilst intending to reach a defined set of clients, MFI unintentionally excludes people who should not be formally excluded. This is a result of a complex inter-play of factors at all levels of the organisation.

Exclusion by staff:
Motivators/loan officers may have explicit or implicit incentives to exclude the poorest. This may be based on a perception that the poorest are problematic and will create an increased work burden. This can be exacerbated by an organisational culture and incentive schemes that emphasise financial targets above the need to work effectively with the poorest. This will encourage loan officers to focus on achieving greater productivity, increasing portfolio outstanding, and reaching larger number of clients, rather than achieving greater poverty impact.

Exclusion by design:
Many aspects of the lending methodology of a MFI may deliberately or inadvertently exclude the poorest. These may include entry fees, rules that exclude people who do not have an existing business, inappropriate or inflexible loan terms, automatic loan size increases, inaccessible or compulsory savings, group liability rules, providing services from central offices rather than in community based situations, or locating the program in accessible rather than remote areas. Other aspects of program design may not exclude the poorest, but may be biased towards the less-poor.

4.2 Addressing Exclusion

It is the exclusion issues that determine the ability of the microfinance services to reach the extreme poor. This requires an understanding of the client needs and wants as well as poverty targeting as discussed hereunder.

4.2.1. Understanding Client's Needs and Wants

MFI must understand what processes of exclusion are taking place within their lending system. Products and services and the way in which they are delivered should be modified to overcome this. As microfinance in general becomes more `client-driven' and responsive to differing client needs, it is vital to hear the voices of the poorest. MFIs may undertake market research to understand their client or potential client needs, but without careful attention they will hear the needs of the less poor and not the poorest. The poorest by definition are the least vocal and least likely to express their needs within program structures or through market research.

Microfinance products and services must address clients' perceived needs and wants so that they can use and pay for. MFIs must understand underlying needs of the poorest so that microfinance services will reduce their vulnerability and poverty. In order to make a sustainable impact on poverty, MFIs need to see their work holistically, and understand how their intervention fits with patterns of their clients' livelihoods and changes that are necessary to reduce their poverty level. This is not to imply that MFIs should expect to tackle multiple dimensions of poverty themselves - simply that they should know where the provision of financial services fits into the bigger picture.

4.2.2. Poverty targeting

Careful poverty targeting is required to know the extent to which MFI are able to reach the poorest of the poor with their services. Poverty targeting should revolve on following.

Geographic targeting:
MFI should employ a rigorous process of identification of the poorest areas, and sets specific targets in terms of the balance between rural and semi-urban areas. Reliable data sources should be used that gives detailed poverty data according to a range of poverty indicators. HDI information gives useful idea.

Active program promotion:
MFI can use promoters having a good understanding of the local conditions, and knowledge of the local area, and have a sense of 'helping their own people' from the same villages as clients.

Staff commitment:
There is a strong organisational culture of poverty-focus, which is reflected in staff commitment to work with the poorest. This is supported through management, particularly at the level of branch coordinator, staff training, incentives, and through the experience of staff that very poor people are generally easier to work with and more committed to their village bank.

Product design:
MFI should be easily accessible and adopt group-based methodology that encourages more reticent women to join to minimise obstacles for joining very poor people.

5. Design and Delivery of Microfinance for the Poorest

Loan size is the most commonly used proxy for depth of poverty, which is very much criticised. Large loan size is certainly a good indicator that very poor clients are not being served, but it does not follow that small loan size implies very poor clients are being served. Loan size is often much more a reflection of institution offering loan than of borrower's characteristics.

5.1 Defining Clients – the Poorest and Most Vulnerable

Few MFIs are specifically established to meet the financial needs of the poorest. As understanding about the range of client needs increases, design of poverty-focused microfinance is changing. Previously focus was on designing products (small loans, weekly meetings, group liability and high interest rates) that would be unattractive to the less poor. These were delivered with little or no flexibility and very often these design characteristics made the services less than ideal for the poor. In a non-competitive environment, poor and less poor people made choices that a less than ideal service was better than no service. Over time circumstances changed and there is much greater pressure to MFIs on delivering flexible services that meet the needs of different client groups**.** The nature of vulnerability that constitutes livelihoods of the very poor shapes way in which financial services should be provided. MFI should identify exclusion and means to over-come exclusion of the poorest, and design and deliver services that meet their needs, highlight key areas where the poorest are disadvantaged and look at alternatives for improvements.

5.2 Access to Credit - The Myth of the 'Economically Active'

The concept of 'economically active poor' is often used to describe those poor people who are likely to benefit from credit. For microcredit to be appropriate, a pre-existing level of ongoing economic activity, entrepreneurial capacity and managerial talent is needed. If not, then clients may not be able to benefit from credit, and will simply be pushed into debt.

The concepts of 'economically active' and 'entrepreneurial capacity' need to be challenged. In reality the majority of the poorest do not have an existing enterprise but are economically active by definition (otherwise they would not survive) and have considerable experience of some kind of self-employment or income-generating activity. Very poor people survive either individually or collectively by undertaking a number of economic activities that together create an inadequate and erratic livelihood. The majority are not *entrepreneurs*, but run small businesses or other activities as part of their overall household activities. Their aim is to secure a reliable and sufficient income for their household needs, rather than to develop a business. Their strategies are therefore generally low-risk, focusing on traditional activities with which they are familiar, and certainly in early stages not venturing into new unexplored markets. Many clients do become more entrepreneurial over time, particularly as their incomes are stabilised and they have more scope for undertaking other activities.

5.3 Loan Repayment by the Poorest

When poorest of the poor borrow from MFI, there are following two options for them to repay the loans.

Repayment from future savings made from existing income streams
Most microfinance models assume that repayments will be made from savings from existing income sources and not necessarily through productive returns on loan. Clients demonstrate their ability to save and to take loans based on this saving. Where a client saves regularly for several months or years before taking a loan, she demonstrates the capacity of household to save over an extended period of time. There is a good chance that this level of saving can continue as repayment of loan instalments in the future. This is a low-risk approach to working with the poorest and is successfully applied to many MFIs

Repayment from income generated by the loan:
In many cases very poor people use credit to invest in a micro-enterprise and use profits from this investment to repay loan. Loan can be disbursed based on the capacity of the client's business to create a surplus that can be used to repay the loan, rather than existing household income streams to cover loan instalments. Lending to very poor clients 'starting-up' a new business is very different to lending to moderately poor people with a reasonably secure income with which to repay loan. If the client fails, then she will have few resources to pay back. The lending methodology therefore needs to ensure that they maximise their chances of succeeding and minimise risk of suffering negative consequences.

5.4 Lowering the Risk of Credit

Given the high vulnerability of the poorest of the poor, it is important that MFIs design delivery methodology in a way that minimises the risks and does not create an unacceptable burden if a crisis occurs. This requires consideration following features.

- Participation should not be linked to taking a loan,
- Linking loan size and instalments to clients' needs and ability to repay,
- Loan sizes should not automatically increase,
- Flexibility on loan use,
- Appropriate loan term (repayment from future savings versus business profits) and
- Providing other support services

5.5 Supporting Livelihoods and Reducing Vulnerability

Reducing poverty is much more than increasing income. Design and delivery of microfinance products and services can have a major impact on their effectiveness in reducing vulnerability and strengthening livelihoods. In order to realise it, microfinance services should be improved in following front.

5.5.1. Products and Services

The erratic nature of many very poor people's livelihoods may make it difficult for them to participate in a MFI, particularly to take the risk of a loan. MFIs need to consider providing a range of products and services in addition to credit that act to help stabilise and increase income, and are based on an understanding of how financial services are used by very poor people. Some of the services to be considered are savings, insurance, other financial service products and grants.

5.5.2. Creating a Supportive Environment and Retaining Clients with the Program

Financial services can go a long way to reduce client's vulnerability, but for the poorest and most vulnerable clients, it needs to be recognised that drop-out problems are almost certain to occur at some stage. These can lead to negative impacts on the MFI. Once clients have left, there is no opportunity for MFI to achieve positive impacts. While delivering the right products, MFI need to engage in an active process of identifying who are the people most likely to experience problems and to target support to these clients. Many MFIs use their first loan as a `testing loan' whereby `problematic' clients are weeded out. When working with the poorest, it is the first loan where inexperienced clients are likely to have problems and leave the MFI. The challenge is to retain and support the very poor, not to weed them out.

A culture of strict credit discipline may ensure that clients are kept motivated and are on the right path, with difficulties highlighted before they have time to grow into insurmountable problems or indebtedness. Lack of flexibility can create problems, which may be a cause of for relatively high exit rate. Thus, it is important for MFI staff not to be coercive but to create a supportive environment where problems are understood and clients collectively take responsibility for sorting them out, facilitated by MFI staff. Repayment policies also need to allow sufficient flexibility to deal with repayment problems in a more humane way.

5.5.3. Improving Empowerment Impact

Microfinance has an important role in women's empowerment. This impact depends to a large degree on how product is designed and delivered. Some MFI put primary emphasis on empowerment of small groups of women. Financial services are part of this empowerment process, but not the primary objective. Their sustainability is based on sustainable functioning of the group as an independent unit, and there is no long-term commercial role for organisation. MFIs that seek to deliver financial services directly to clients need to operate in a different manner from organisations with a primary goal of empowerment. However, there are many lessons that can be learned from a range of approaches used by formal MFIs, development organisations and community organisations.

Groups have potential to facilitate skills development, building of confidence and social capital. Group liability conditions often serve to undermine this positive potential of groups and leads to a more coercive and conflictual environment that discourages the participation of the very poor. Moving to individual loans risks the chances of losing potential empowering role of groups. Whilst the group guarantee can be problematic, when it works well, it does serve to create cohesion and encourage clients to take responsibility for others in their group, ensuring that appropriate loans are taken, and that support is given to members who experience problems.

5.5.4. Linking with other Development Services

A holistic view of poverty leads to the question of whether MFIs should develop an integrated range of services. In many cases paths out of poverty may be constrained by factors beyond usefulness of financial services or may even prevent people from accessing financial services available. In these cases, there may be a strong argument for interventions other than microfinance or to supplement financial services with other inputs such as health education, training, market support services etc. But recognising that poverty is multi-faceted

does not mean that MFIs should try to do everything. MFIs succeed through being focused and by doing what they do well.

There is clearly great potential to enhance the impact of microfinance through linkages to other development services, such as education and training components. MFIs can also use their existing structures and contacts with clients to create linkages with other service providers. Decisions about integrating other services into microfinance or creating linkages need to be based on a clear conceptual understanding of poverty and in the context of capacity and resources, and trade-offs between benefits and costs to the financial performance and focus.

5.6 Managing for Outreach and Impact

A poverty focus requires a deliberate effort. Successful poverty-focused MFI succeed in two areas – vision and systems. The establishment of an organisational `culture of poverty` is central to ensuring that staff and clients at all levels make decisions that are centred on improving poverty outreach and impact. Organisational vision, mission and commitment from board and senior management level are the essential ingredients to an effective poverty-focused. The message is heard by staff at all levels and by clients, and is a significant factor motivating and focusing MFI's work. The vision helps guide the systems to meet the needs of the poorest, and are implemented and monitored with this focus at the forefront. The right systems cannot work in an organisation that does not have the vision and commitment to work with the poorest. Similarly vision is not enough by itself, and must guide innovation and the development of appropriate systems.

5.6.1. Organisational Culture

MFI should create a *culture of impact* that promotes support for the very poor both within the organisation and by clients. As MFIs pursue financial sustainability, they have been effective in creating organisational cultures that emphasise efficiency and productivity, and have reinforced this culture with staff incentive schemes. If MFIs are serious about their poverty focus, they need to build a similar culture and incentives for this. Achieving commitment and understanding of front-line staff is keys to organisational effectiveness in poverty outreach and impact. Central to this is designing incentive systems that motivate staff to be effective and efficient in terms of impact, poverty outreach and financial performance. Given the active involvement of clients in supporting one another or in expelling `problematic' members, it is important that clients feel this culture too. This raises questions about how clients are involved in organisational processes in general and how many organisational objectives reflect priorities of the people they seek to serve.

5.6.2. Organisational Learning and Innovation

Poverty-focused MFIs need to be innovative and responsive to the needs of their clients. Internal learning systems should be allowed for monitoring client performance through listening to clients' experiences and views, particularly those of the very poor. Monitoring systems should be set in a way that gives information about clients' poverty level. MFI must be flexible enough to make changes in response to this learning.

6. CONCLUSIONS: STRATEGIES OF MICROFINANCE SERVICES TO REACH THE EXTREME POOR

This paper demonstrates the fallacy that microfinance cannot be an appropriate strategy for the poorest. It is not the poverty level of potential clients that determines access and impact, but the design of the services provided. Not all the people need microfinance but most groups benefit out of it. There are trade-offs between social and financial objectives, but MFIs can and do reach and impact on the poorest and achieve financial self-sufficiency.

6.1 Balancing Social and Financial Objectives

Microfinance is a compromise between social and financial objectives. So far MFI has emphasized on financial and institutional performance. This has compromised opportunities for maximizing poverty impact and client performance. Until now, microfinance industry has demonstrated what can be achieved; it has yet to demonstrate what cannot be achieved. It is now time to innovate and design services that maintain high standards of financial performance as well as set new standards in poverty impact focusing on following

- Understand costs (smaller loan size, increased demands on staff time, smaller portfolios, remote areas, etc) and benefits (lower exit rates and arrears, higher penetration rates) of working with the very poor.
- Base institutional self-sufficiency on client self-sufficiency and success. Where their vulnerability can be overcome, very poor clients can achieve significant growth and changes.
- Innovate to make poverty-focused microfinance more cost-effective;
- Improve the impact of microfinance;

6.2 Design and Delivery of Poverty-Focused Microfinance

Most MFIs do not reach large numbers of very poor people. Conventional microfinance acts through deliberate and unintentional mechanisms to exclude the poorest. MFI therefore should design its products and services to include the poorest and facilitate mechanisms that will lead to poverty impacts. By increasing their understanding of poverty, MFIs can take simple steps to improve their outreach and their effectiveness to the poorest.

Table 2: Strategies for Design and Delivery of Poverty Focused Products and Services

Focus area	Strategies
Improving outreach	▪ Understand who MFI do reach or exclude and why. ▪ Target poorer areas in the countries through rigorous geographic targeting. ▪ Motivate poorer people to be the target of MFI work ▪ Introduce a 'culture of poverty'– organizational vision and commitment felt by staff at all levels and by clients. ▪ Develop a system to work with the very poor based on vision.
Ensuring impact	▪ Undertake market research to understand clients' underlying needs and not just listen to the loudest voices. ▪ Modify the products and services and ensure proper delivery. ▪ Understand negative impacts of the microfinance and take required steps to reduce these.

Focus area	Strategies
Appropriate products	▪ Design microfinance products and services based on their potential to reduce poverty, risk and vulnerability, not their attractiveness to clients. ▪ Diversify microfinance products and services required by the very poor ▪ Link the access to credit with ability to repay[3]. ▪ Introduce a range of products such as emergency loans, insurance or educational inputs to help poor clients cope with emergencies, smooth consumption, and reduce their risk and vulnerability. ▪ Ensure a balance between flexibility and a range of products that clients' requires with MFIs' capacity to manage an increasingly complex and diverse portfolio.
Delivery	▪ Support very poor clients in coping with vulnerable and other problems experienced rather than coercing them into making loan installments. ▪ Don't compel clients to take a loan. ▪ Encourage client support and skills-sharing. ▪ Introduce an organizational culture of poverty-focus and impact in an MFI for achieving positive impact. ▪ Learn from community-based organizations and other models of microfinance. ▪ Integrate gender awareness into MFI practice at the level of field staff-client relations, and within organizations' procedures and culture.

6.3 Measuring performance

The microfinance industry has established clear best practice for measuring and reporting financial performance, but has not established comparable standards for performance in poverty outreach and impact. Systems need to be developed for transparent reporting of such data. Industry standards and reporting guidelines need to be developed using performance measures that take into account both *efficiency* and *effectiveness*.

Table 3: Strategies for Measuring MFIs Performance on Reaching the Poorest of the Poor

Focus area	Strategies
Poverty outreach	▪ Monitor and report on poverty level of new clients and who they are not reaching (data should be relative to local context and be comparable to national poverty lines). ▪ Report the 'penetration rate' (concentration of poor people reached in an area). ▪ Average and initial loan size (an inadequate proxy).
Impact	▪ Collect poverty outreach data. ▪ Dis-aggregate client loan and/or savings performance by poverty level. ▪ Initiate client monitoring (give basic, regular information about a small number of proxy indicators for impact that forms basis of industry-wide indicators). ▪ Commission poverty auditing (to monitor institutional performance in terms of design and delivery of poverty-focused microfinance and form a basis for assessing whether MFIs are likely, given their approach, to impact positively on poverty).

[3]Where loan repayment is made *from existing income sources* there is a need for flexibility in savings and loan repayments. Savings in particular should be easily accessible, both for deposits and withdrawals. Loans do not need to be tied to a particular activity. Likewise, where repayment is made *from business profits*, regular repayments and pressure from the MFI are important to encourage focus on the business activity and to develop business management skills.

6.4 Role of Donors - Creating Space for Innovation

Donors can encourage innovation, experimentation, and improved understanding on possibilities for poverty-focused microfinance. Donor supports are required in following areas for reaching the poor through microfinance services.

- Provide financial incentives towards achievement of certain goals on depth of poverty outreach and impact
- Create space for MFIs to improve their effectiveness by creating pilot schemes, or exploring different time-frames for achievement of different objectives.
- Establish clearer industry standards for good practice in poverty-focused microfinance
- Promote greater transparency in reporting on poverty outreach and impact.
- Fund research, particularly the one focused on improving operational effectiveness and understanding trade-offs involved in a poverty-focus.

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