International Journal of African and Asian Studies
ISSN 2409-6938 An International Peer-reviewed Journal
Vol.32, 2017

The Paradox: The Shifting Goal of Microfinance from Social Performance to Financial Performance

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Abstract
Since people with low incomes do not have access to financial institutions, and in most developing countries only public workers benefit from the services of public banks, the poor and private workers with low incomes cannot borrow from these public banks. Hence, microfinance institutions (MFIs) have become the answer to those who cannot benefit from the financial services of the public banks. The primary objective of this article is to present issues to concerned body to look on the problem which is the shifting goal of micro finance from financial sustainability to social sustainability.On my topic which is entitled the shifting goal of micro finance from social sustainability to financial sustainability, I have tried to summarize different literature and make an argument on the two contradicting ideas. Tracing the goal of microfinance I conclude that the microfinance objective has to be kept as to provide social and financial service for the poor and marginalized group. But the concern of scholars and the institution on financial sustainability of micro finance which should not be underestimated problem has to be solved. Unless otherwise the microfinance institution has to be merged with banks Shifting of the goal of microfinance from social sustainability to financial sustainability is the missing link. The scholars and the financial institutions against my idea have to answer the question of what is the reason for the existence of micro finance. Finally I recommend as strengthening the microfinance social service such as training and development on entrepreneurial skill, leader ship skill, marketing skill and others which in turn proof financial performance.
Keywords: Microfinance, Social performance, financial performance, entrepreneurial development, financial institution, banks, microcredit, saving, micro insurance, loan

Introduction

Since people with low incomes do not have access to financial institutions, and in most developing countries only public workers benefit from the services of public banks, the poor and private workers with low incomes cannot borrow from these public banks. Hence, microfinance institutions (MFIs) have become the answer to those who cannot benefit from the financial services of the public banks.

Microfinance Organizations provide small loans and other financial services to low-income, poor, and very poor self-employed people *Laura Brandt et.al* According to Daniel C. Hardy, et.al (2002).

Questions had been raised on: (1) does microfinance have an impact on the social and economic situation of the poor in developing nations; and (2) are microfinance institutions sustainable in the long term and are there a trade-off between sustainability and outreach? (Niels Hermes Robert)

On my topic which is entitled the shifting goal of micro finance from social sustainability to financial sustainability, I have tried to summarize different literature and make an argument on the two contradicting ideas. Finally conclusion and recommendation are forward

Argument

1. **The goal of microfinance**
   Providing financial and non financial service to the poor and marginalized group
2. **Issue of sustainability**
   The source of income for microfinance is NGO and government. But it is difficult to consistently secure NGO funds. Thus this force the institution and even scholar researching on the area are shifting to the goal of financial sustainability of the organization.

Literature review

An article which provides a review of the recent literature on microfinance in developing countries and a critical assessment of its effectiveness examines the experience of India, which has one of the largest microfinance sectors in the world, and particularly the unfolding of the microfinance crisis in Andhra Pradesh. It concludes that microfinance cannot be seen as a silver bullet for development and that profit-oriented microfinance institutions are problematic. To fulfill even some of its progressive goals, it must be regulated and subsidized, and other strategies for viable financial inclusion of the poor and of small producers must be more actively pursued. Cambridge J Econ (2013) 37 (6): 1203-1219.https://doi.org/10.1093/cje/bet042

Microenterprise finance has generated enormous enthusiasm among aid donors and nongovernment organizations (NGOs) as an instrument for reducing poverty in a manner that is financially self-sustaining.

Although something of a consensus has emerged concerning the principles by which such institutions should be designed, however, we know little about their impact. The paper reports on a research project which estimated the impact of 13 microfinance institutions in seven developing countries on poverty and other target variables, and attempted to relate such impact to the institutions' design features. For each of the institutions studied, the impact of lending on the recipient household's income tended to increase, at a decreasing rate, as the recipient's income and asset position improved, a relationship which can easily be explained in terms of the greater preference of the poor for consumption loans, their greater vulnerability to asset sales forced by adverse income shocks and their limited range of investment opportunities. There are significant outliers to this general pattern (in particular, very poor people who have been able to achieve significant loan impact); but they are the exception rather than the rule, and the relationship is significant at the 1% level for all the institutions studied except the Malawi Mudzi Fund. This relationship defines, in the short term, an "impact frontier" which serves as a tradeoff: lenders can either focus their lending on the poorest and accept a relatively low total impact on household income, or alternatively focus on the not-so-poor and achieve higher impact. The position and slope of the estimated impact curve vary however with the design of the institution: for "well-designed" schemes impact, at all levels of income, is higher than for ill-designed schemes. Hence for many lender institutions the tradeoff can often be moved by appropriate innovations in institutional design, in particular modifications to savings, loan collection, and incentive arrangements for borrowers and staff (Paul Mosley)

Microfinance has received a lot of attention recently, both from policy makers as well as in academic circles. Two of the main topics that have been hotly debated are explaining joint liability group lending and its implications for reducing information asymmetries, and the trade-off between the financial sustainability and outreach of microfinance programmes. This Feature contains three novel empirical contributions providing new insights with respect to why and how joint liability group lending works. It also contains the first large-scale systematic analysis of the trade-off between financial performance and outreach of microfinance institutions.

Microfinance has evolved from providing high interest rate microcredit's to respond to the furthermost financial and non-financial needs of the bottom of the pyramid category. Its original objective is to eradicate poverty and increase financial inclusion. Yet, the rapid growth of the sector during the last decades shifted the goals of microfinance institutions and a new target was set: to become financially sustainable, self-sufficient and subsidy-free. Achieving the double bottom line of social mission and profitability is the challenge of successful microfinance institutions. (By Lâma DAHER [1] and Erwan LE SAOUT [2])

A number of literatures have been indicated that microfinance is evolved to help the pro poor and the marginalized groups which have not access to saving, credit and insurance service.

According to Daniel C. Hamper (2002) what distinguishes MFIs is their orientation to fill a gap left by (larger) conventional, commercial or government-sponsored institutions in the provision of financial services to poorer households and smaller enterprises. MFIs seem to promise a means to provide an especially valuable form of assistance directly to disadvantaged sections of society in a relatively cost-effective manner.

A question has been raised by many scholars weather microfinance brings people out of poverty. This question is an indication which supports the shifting goal of micro finance from social sustainability to financial sustainability.

The work of Roodman can be taken as evidence supporting the shifting goal: Despite numerous success stories, acknowledges that there are many true tales about poor people who have used micro-loans to build up mountains of debt they could not repay. Even worse, they face the challenge of interest rates that are shockingly high by conventional standards. Why are those rates so high? "It is not easy to make loans to lots and lots of poor people without going bankrupt. You can easily spend more than $100 collecting on a $100 loan. That basic business reality strongly shapes how business is done," Roodman said.

The Shashwat Mody article on How Microfinance Institutions Can Manage Default Risk AND Build Financial Inclusion is clear indication of the concern of microfinance. Even if micro finance was a tool targeting the lower- and lower-middle class segments as a tool for economic self-empowerment. Generally, however, individual microfinance institutions (MFIs) successes – as viewed through the lens of higher valuation and other financial incentives – were based almost exclusively on **high client growth** (on average above 50 percent annually) and **low default rates** (on average below 4 percent). While sufficient for strategic evaluation and benchmark of success at the senior level, those two measures can be counterproductive for MFIs looking to achieve real social impact through financial inclusion. But for achieving low default rates and higher client growth rates together is only possible when the client's current cash flows are more than adequate to cover the average loan size of the institution, with a steadily increasing loan size being the client's incentive to borrow. According to Mody *high client growth and low default rates can only be achieved when they move away from the target population of poorer populations, inching instead toward so-called middle-class borrowers, those who are more financially secure but still not able to acquire a loan from a bank. Mody's work is the best indicator of the shifting goal of microfinance. (Shashwat Mody)*

More recently there is a major *shift* in emphasis from the *social* objective. Studies have *indicated* that majority of *microfinance* depend solely on these donors to successfully complete their *goals*. C Ambe Shu - 2014

Jan 30, 2015 - *Microfinance* Institutions (MFIs) in Zimbabwe: case study of ... Finally the research revealed that *sustainability goals* be achieved .... *shift* is the relationship between *financial sustainability* and outreach to the poor. ... Government of Zimbabwe (GoZ) in 1993 to design a *social* safety net that would cushion this ... (Z Chikaza)

Several *micro finance* institutions (MFIs) are operating with the key objective of ... between *financial sustainability* and outreach of MFIs in Nairobi. The two most usual aspects of outreach in the *literature* are its depth and breadth of outreach is more important for achieving the *social* objective of *microfinance* (JO ARODI - 2013)

As the industry has grown, the focus of *microfinance* has *shifted* from that of a *social* movement to the integration of *microfinance* into the formal financial sector ... is motivated by a *social* mission: its ultimate *goal* is overcoming poverty, em- .... ute to the *financial sustainability* of MFI, impact of *microfinance*, and outreach to. (M HAMADA - 2010)

Study conducted MJ Oudshoorn on Micro financial Performance of Dutch Microcredit indicates a so-called 'mission drift', a *shift* from *social goals* towards *financial goals*.

I have taken the recommendation of Roodman from his work on *An Impertinent Inquiry into Microfinance,* which is an indicator for shifting goal of microfinance from social service to financial service and discuss my argument on each recommendation with the underlined statement:

- Discourage efforts to lend to the very poorest people in the community, since they may be unable to repay their loans. This recommendation is not inline with the mission of microfinance which is provision of microfinance service for the poor and marginalized group .
- Deemphasize credit and move toward savings deposits, insurance and money transfer services for the poor. (Most of the time what a poor lack is finance and collateral to guarant a loan it may not be education, idea or other.)
- Look to new technologies, such as the mobile web, to reduce inefficiencies and to expand access to a wider range of services in a wider range of communities. (here my concern on availability of technology if the very mission of the micro finance is accessing microfinance product to the marginalized group)
- Roodman cautioned that "credit markets are inherently unstable, particularly when your clients are poor. I think to overcome problem of instability it need dedication of the institution to provide other microfinance service such as training on entrepreneur skill, business plan , marketing skill and how to use the borrowed finance and how to invest on worthy business to the client to start profitable business to repay the loan rather than missing the objective otherwise there are other financial institutions for the rich.
- Finally, he concluded, even if MFIs and their stakeholders ultimately judge microfinance to be a success, "It is not going to reach every [poor] person. But we should try to build resilient institutions, reliable institutions that will be there tomorrow." Still contradicting with primary objective of microfinance which is reaching the marginalized group but roadman recommends marginalizing poor among poor.

In country of us Ethiopia the interest rate charged by microfinance is higher than banks. If microfinance is established to access financial service to the poor how those poor and marginalized group pay higher interest rate?

The maximum interest rate charged by bank in Ethiopia on loan is 12percent, while the interest rate charged by micro finance on loan is 18percent.

Why financial sustainability or financial performances become an issue for microfinance?

Failures of microfinance to utilize the inputs of poor has resulted the institution and scholar to be concerned for financial performance by ignoring the primary objectives of the institutions. Poor can have a better business idea even than the rich, poor has an interest for having a job to access basic need, poor can have a better risk taking capacity than other employed and rich because he/she has no opportunity cost to calculate, Poor has his own ability to work also as labor force etc. Finance should be on the bottom line to become successful in business. If this opportunity is utilized efficiently there is no worry by microfinance about financial performance (default risk which is the major concern) if social performance is effectively achieved. As explained above failure on social performance by microfinance result for sustainability question by microfinance itself. I recommend the institutions to provide social service such as entrepreneur ship training, business development training, leadership training and training on how to market their product.

The major success factors for a business or entrepreneurs are: Daniel Goleman's study of 181 jobs in 121 organizations found that emotional intelligence was what set star performers a part from average performers. `32Author Gregg Steinberg discovered that winning athletes were able to keep their emotions in check, while athletes who failed to achieve the elite level were less able to control their emotions. A study done by University of South Florida that is published in the Journal for Research for Higher Education shows that emotional intelligence is related to academic performance. The results of a study which have been done by Tomas Chamorro-Oremuzic, a PhD at the University of London show that emotional intelligence makes a significant contribution to entrepreneurial success. Contrast this with another study where they found almost no correlation between IQ and entrepreneurship...

Conclusion

Tracing the goal of microfinance I conclude that the microfinance objective has to be kept as to provide social and financial service for the poor and marginalized group. But the concern of scholars and the institution on financial sustainability of micro finance which should not be underestimated problem has to be solved. Unless otherwise the microfinance institution has to be merged with banks

1. From this one can understand that still who can borrow from microfinance are those who can have collateral and a capacity to borrow.
2. To achieve the goal of social sustainability one has to first access the financial service with a lower interest rate and collateral request.

On the other hand, one of the institutional concerns for financial sustainability is:

1. The problem of finance for providing financial service to its clients (source of finance).

Recommendation

Shifting of the goal of microfinance from social sustainability to financial sustainability is the missing link. The scholars and the financial institutions against my idea have to answer the question of what is the reason for the existence of micro finance. Finally as strengthening the microfinance service without missing the objective I forward the following recommendation:

- Reducing the cost of capital/interest rate which intern helps the institution to compete with other biggest financial institution.
- Working on the social service and entrepreneurial development as to minimize the default rate rather than shifting the reason for the existence of microfinance.
- Working with NGO and other donors and government who can be a source of finance.
- As recommended by Joselito Gallardo on his paper *A Framework for Regulating Microfinance Institutions*, microfinance can access financial resources from commercial markets
- Expanding the range of service (financial product) based on the need of the target group.

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