

# Why set a threshold for service orientation to the very poor?

Discussion paper by Chris Dunford

April 4, 2002

## Political Context

Why does USAID support MED at the level it does now? Because the U.S. Congress said USAID “shall” do so. And why was that? At the risk of revising history and ignoring the significant contributions of a great many people on and off Capitol Hill, I’ll cite three people with powerful visions and voices: Muhammad Yunus, John Hatch and Sam Harris. And three people with enormous skill and perseverance: Lawrence Yanovitch, Maria Otero and Alex Counts.

What gave the voices of the first three such power? It was their simple—yes, simplistic—message that microcredit offers an effective, self-help-supporting and even sustainable service to the poor. Not just the poor, the very poor as well, which gave their message the kind of “moral” power that moves volunteers from many backgrounds and from all over the U.S.A. to corner and cajole their representatives in government to “do the right thing.” A real citizens’ movement, led by RESULTS.

Those of us steeped in the technical details of MED work may scoff at these “know nothings,” but their efforts are buttering our bread, and at some level, we know it. I came to realize the true power of these citizens when I sat in a meeting between a group of RESULTS volunteers from Maryland and the legislative director for their Congressman. As the tough-minded, young Hill staffer listened patiently, the spokesperson for the group, a timorous fiftyish mother, visibly summoned her courage to present her brief, rehearsed speech. It was a good speech about the needs of people just barely keeping their kids alive by their efforts to earn a little here and there and do their best with what they have. What made the speech particularly effective, however, were the tears that welled up in the speaker’s eyes as the emotional impact of what she felt she had to say swept over her. I watched the face of the staffer, who looked like she hadn’t been moved to tears in a long time, and half expected her to yield to a patronizing smile. But she didn’t, if only because this was one of her boss’s constituents in front of her. I knew this was one meeting the boss would hear about. It’s the moral power of the message that *even the very poor can be helped by microcredit* that moved both those women to do the right thing.

Beyond the simplicity of the powerful moral message, however, were some harder, colder, no-less-important (morally as well as technically) facts: the moderately poor and the vulnerable non-poor also need microcredit and seem to take better advantage of it, too, in terms of impact on their businesses and the larger local economy. And all of the poor and not-so-poor need other (non-credit) financial services, like safe savings opportunities, and non-financial services as well, to develop their microenterprises.

Those whose skill and patience brought the Microenterprise Initiative to life in 1994, displayed the mundane genius of ordinary people moved to do extraordinary things. They forged what might be called a Grand Compromise.

They agreed that the original “Microenterprise Initiative” would be about **Microenterprise Development, not just microcredit, and while at least half the money allocated for MED support would be reserved for the very poor** (the bottom 50 percent of the poor), **up to a half would go to the moderately poor and vulnerable non-poor.**

Like all grand compromises, this one included a flaw—two of them, in fact. The first was the lack of a credible system of measurement of the poverty level of MED service clients, so that USAID could assess the outreach of its grantees to the very poor, in contrast to the less poor. The second was the lack of direct linkage of the poverty profile of grant applicants and grantees to grant-making decisions. In short, there was no credible way to verify that the Congressional mandate is achieved or to provide real incentives to grant-seekers to innovate for outreach to the very poor.

The second flaw was no doubt related to the first. It was recognized at the start that **loan size could discriminate between microenterprises and small- to medium-sized enterprises but not between very poor borrowers and moderately poor borrowers.** Furthermore, it only described borrowers, not other MED service clients. **Loan size as a proxy for client poverty was seen as a kind of “place holder” solution that would clearly have to be fixed.** Until it was fixed, there was no point in linking funding decisions to such an imperfect measure. **But this interim solution was never fixed.** One can only speculate why not.

#### A Bit More on Poverty Measurement

**Drawing data and analysis from its Microenterprise Results Reporting (MRR) system,** USAID has reported to Congress that it has met the mandate that half of the funds for MED go to support the very poor. In fiscal year 1999 (latest report I could find on the relevant USAID website), on the basis of apparently voluntary loan-size reporting by grantees, USAID reported that **58 percent of that year’s resources spent in support of microfinance institutions benefited clients taking poverty loans.** Microfinance support represents 70 percent of the total of that year’s expenditure in support of all MED (including BDS, etc.). It is not clear what percentage of total MED assistance is directed toward very poor clients. But given the benefit of doubt, USAID seems to have met the Congressional mandate (measured in terms of loan sizes in FY 1999).

**What is the percentage of the very poor among the total clientele of the USAID’s supported MFIs?** The value of “poverty loans” (defined in terms of loan size only) was 19.8 percent of the total value of loans from USAID’s MFI grantees in FY 1999 (from the “grand total” line in the annex of MRR 1999: divide the dollar sum of all USAID-supported loan portfolios into the total “Poverty Lending Amount” in these same

portfolios). On the other hand, **two-thirds of the clients of these same institutions were taking poverty loans**. The difference, of course, reflects the small size of poverty loans.

**However, when in-depth investigations of grantee MFIs have looked at the poverty profile of their clients (which is seldom done and without benefit of agreed definitions, much less measures, of poverty), they generate much lower estimates of the percentage of very poor clients.** For example, “Microfinance, Risk Management, and Poverty” by Jennefer Sebstad and Monique Cohen (March 2000, available from AIMS Publications section of [www.mip.org](http://www.mip.org)) summarizes four separate World Bank studies (for the World Development Report) of MFI clients in Bangladesh (BRAC), Bolivia (BancoSol, Pro Mujer, PRODEM, and Sartawi), the Philippines (CARD Bank), and Uganda (Uganda Women’s Finance Trust). They also analyze literature regarding clients of 13 other MFIs. Defining poverty in terms of “vulnerability to risk” as well as current income or consumption, the Sebstad and Cohen analyze the studies’ findings regarding the poverty levels of the MFI clients. For all the studied MFIs, they roughly divide clients into the

- “destitute”
- “extreme poor” (together with the “destitute” this level corresponds to the “very poor” as defined by the legislation (bottom 50 percent of the poor))
- “moderate poor” (corresponding to the top 50 percent of the poor) and
- “vulnerable non-poor” (those just above the poverty line).

They found virtually no destitute clients and a mix of extreme poor, moderate poor and vulnerable non-poor clients in all of the microfinance programs, including those specifically targeted to the poor. The findings suggest that the majority of microfinance clients are from moderate poor households. The largest minority is the vulnerable non-poor, followed by extreme poor households. The operative word is “suggest,” because few of these studies were explicitly investigating the proportions of MFI clients living at various levels of poverty or non-poverty. But it seems clear that **the large majority of MFI clients fall into the moderately poor and vulnerable non-poor categories.**

**The proportion of *extreme poor* (bottom 50 percent of the poor) in the four World Bank studies ranged from “almost none” in Bolivia to “some” in the Philippines to “few” in Uganda to “~ 40%” in Bangladesh.** Contrast the “some” extreme poor clients of CARD Bank in the World Bank’s study to the “poverty lending rating” of 100 percent (based on loans no more than \$300) for CARD in the MRR 1999 (Annex on “Poverty Lending Ratings by Location of Institution, 1999”). And the “almost none” for the four Bolivian institutions contrasts with the poverty lending ratings ranging from 3.41% to 73.61% for three of the institutions in the MRR 1999. Sebstad and Cohen are indirectly but clearly indicating that **USAID reports to Congress are vastly over-rating the outreach of its MFI grantees to the very poor (“destitute” and “extreme poor” together).**

The (more accurate?) estimates from the World Bank’s studies are not encouraging for those trying to reach the very poor with microfinance (much less with non-financial

services, like BDS). But in truth, eight years after the passing of the first Microenterprise Initiative (which created the MED Office), we don't have the measurement tools or the studies that we need in order to know. We are still "legally blind" on the issue of outreach to the very poor.

If in fact the proportion of "very poor" among the clientele of MFIs is so low after eight years, I conclude that **we lack true incentives for down-reach to the very poor**. I do not accept the "conclusion" that microfinance (and more generally MED services) cannot be sustainably offered to the very poor. They are not all "destitute" as some imply. Their vast majority is "economically active," at least at a "survival enterprise" level. Some say that there are sustainable institutions already offering such services to such people. Depending on how we define "sustainably," that assertion may or may not be true. Either way, it seems safe to say that **we (USAID, its grantees and the industry as a whole) are not mounting sufficiently concerted efforts to discover or nurture existing or potential models of sustainable MED service delivery to the very poor**.

Is this simply a measurement problem? What if the poverty measurement problem were solved by developing practical, modestly accurate measurement methods and what if these methods were actually used by grantees? Would that solve the incentive problem?

#### Linkage of Measured Progress to Resources and/or Prestige

What seems to provide reliable incentive to managers and staff of institutions are

- measurement of progress toward specific objectives and
- linkage of measured progress to allocation of either financial resources (budget for their activities; salary and benefits for themselves) and/or professional recognition (status among peers; career opportunities; sense of "doing good").

If we measure without reference to specific objectives and/or we don't link progress toward objectives to resources and/or recognition, we cannot expect a reliable incentive effect. In short, **solving the measurement problem, by itself, won't provide an incentive for an industry to change**.

A key problem (beyond the lack of suitable measurement methods) of our MED industry vis-à-vis outreach to the poor in general and the very poor in particular is lack of a clear objective—a standard, a threshold, a benchmark—for success in outreach to the very poor. All the guidance we have right now is:

1. We cannot reach the very poor, only those just above and just below the poverty line.
2. We can reach the very poor, but only by excluding everybody else.

The first translates to managers and staff of institutions as a permit to not worry about reaching the very poor. The second translates to an objective of 100% very poor clients. Neither practitioners, nor donors, nor academics have articulated specific objectives in between, other than two poorly tested hypotheses:

- a mix of poor and not-so-poor clients is better for a poverty-oriented institution's bottom line than a purely poor clientele

- commercial financial institutions that only incidentally reach the very poor can achieve sufficiently large portfolios of clients that even a very small percentage of very poor clients would be a larger absolute number than the total outreach of most poverty-oriented institutions.

But what is an appropriate mix for an institution that claims to be providing MED services to the poor? Congress is mandating that the mix include the “very poor,” but what percentage of very poor clients is good enough?

Rhetorically, the three core values of the MED industry are scale, sustainability and outreach to the poor. In practice, however, the industry seems to value only the first two enough to set standards for practitioner performance. **There is ongoing debate over the most effective definitions or numerical levels for standards of MFI financial performance, but there is no substantive dispute about their importance to the industry.** There are less clear standards for scale, but it is pretty well accepted that an MFI should be reaching 10,000 clients in order to be taken seriously. Analysts ask why village banking programs find it so hard to exceed 30,000 clients and why some Asian MFIs are reaching millions while African and Latin American MFIs struggle to reach 100,000 clients. These are informal standards but still influential on industry behavior. We know from experience how benchmarks drive institutional behavior: donors, investors, professional associations and academics evaluate institutions and their managers in terms of their achievement of these standards. **Why are such standards and benchmarks not equally important for depth of outreach to the poor?**

To illustrate that measurement of poverty profiles per se is insufficient to drive the industry in a valued direction, take a look at the now famous research of Navajas et al (Ohio State University Rural Finance Program). They found that the client profiles of five highly-regarded Bolivian MFIs included surprisingly few very poor clients, especially so for the three urban MFIs. What is even more surprising is how little real debate, much less call for action (measurement and standards) this and the few similar studies have generated in our MED industry. In fact, the authors of the Bolivian study indicated that such limited outreach to the very poor (even to the moderately poor in the urban areas) was no problem. Why? Because the portfolios of these sustainable institutions were relatively large and therefore the small percentage of very poor served translated to absolute numbers in the thousands. This conclusion reflects the low value placed by the authors (reflecting the dominant worldview in our industry) on ACTIVE effort to reach out to the poor.

**Without placing high value on surpassing some (even a relatively arbitrary) threshold of achievement, we are not motivated to strive harder and more creatively by the measurement of client poverty.** We can (and many of us do) talk ourselves into being content with just about any depth of poverty outreach, no matter how shallow.

**The question is not whether there should be standards for outreach to the very poor, but at what percentage of the clientele the standard should be set.**

That is where the debate should be. The now historic lack of interest in having this debate has moved RESULTS and others, including me, to support a change in the MED legislation to force us to have this debate. Given the lack of motivation within our industry on this point, **I'm now convinced that Congress**, which has already resolved that MED should help “the very poor,” **should** use the opportunity provided by reauthorization of its MED legislation to **set a clear standard for outreach to the “very poor.”**

#### Why Set the Threshold for “Orientation to the Very Poor” at 50% of Clients?

A figure of 50 percent may not be the appropriate percentage, but it gets the debate rolling. Here is my analysis of the objections that have been raised so far in relation to the 50 percent proposal:

1. 50% is too low. If we require that only 50% of the clients of poverty-oriented MED service providers are “very poor” and that only half the MED assistance of USAID goes to poverty-oriented programs or lines of service, then as little as 25 percent of USAID assistance could end up serving the very poor. The current legislative language calls for 50 percent of assistance to the very poor. Surely this is a step in the wrong direction.

Good point – but it assumes that current legislation is effective in setting an achievable standard toward which USAID can push practitioners. Given good poverty measurement methods and no other change, would we see progress toward the 50% goal? By not setting a standard to be achieved by individual institutions and making it clear which institutions are expected to meet that standard, **USAID does not make it clear who is responsible for getting USAID’s total portfolio of clients up the level of 50 percent “very poor.” Therefore, no institution is responsible.** Why should an institution whose clients are only 40% very poor strive harder to make up for an institution whose clients are only 10% very poor? No institution feels the incentive to try harder. An opportunity for meaningful incentive is lost.

There’s another problem for USAID. Let’s assume that the little information we have about the real percentage of very poor clients is close to accurate. If poverty measurement were to become substantially more accurate than the current loan size proxy and the percentage of USAID MED funds assisting “very poor” clients was thereby calculated, then USAID would probably fall far short of the Congressional mandate of 50 percent. The reasons are not all USAID’s “fault” (practitioners are as culpable as donors in their resistance to deeper poverty outreach). And it is likely to take a few years to change the percentage of grantees “oriented to the very poor” in the USAID funding portfolio. The purpose of mandating more accurate measurement of poverty of MED clients is not to put USAID on the spot with Congress, but to set in motion some measurement-based incentives for future improvements.

If Congress sets **a reasonable standard of achievement for USAID grantees claiming to be “oriented to the very poor”** and specifies that 50 percent of MED assistance be

directed to such institutions or lines of service, USAID actually has a good chance of achieving the mandate in the near future.

2. 50% is too high. If we require that at least 50% of the clients must be “very poor” for an institution or line of service to be classified as “oriented to the very poor,” what about a program which has a clientele with only 40% very poor? It is doing a good job of outreach to the very poor, but it would not qualify as “oriented to the very poor.” Furthermore, its clients would not count toward USAID’s total “very poor” percentage.

Another good point – but based on some misunderstandings of the language proposed for the reauthorization bill and its probable impact. First, no matter what standard or threshold is set, some institutions will fall just shy of the threshold percentage. Just as many good, sustainability-oriented MFIs fall in the 90-100% range just below full “operational self-sufficiency.” If such institutions care enough about the standard (for internal or external reasons), they will be motivated (by their being tantalizingly close to the standard) to work harder and more creatively to move up. Sometimes they will fall short due to simple measurement error, or a temporary situation will depress their performance below standard. The next time the measurement is made, they may well exceed the standard. This is what happens when standards are set.

Second, **not all institutions (or all of an institution’s lines of service) are expected to be “oriented to the very poor.”** Even if 40 percent of its clientele are “very poor,” an institution or a particular line of service may not be trying to reach the very poor at all. This means its percentage of “very poor” is as likely to fall as to rise, because reaching the very poor is not the objective. USAID can and should count these very poor clients (and would do so under the proposed new language of the reauthorization bill, because every MED grantee would have to identify the “very poor” among a sample of its clientele). But this institution or line of service should *not* be classified as “oriented to the very poor.” That is, USAID should not be giving a grant to *this* institution or line of service because of its commitment to reach the very poor. It should give the grant because of its commitment to other worthy objectives.

People concerned that some institutions or lines of service would not qualify as “oriented to the very poor” seem to believe that “failure” to pass the test would disqualify the institution or line of service from any form of USAID’s MED assistance. Let’s remember that **only one half of the resources for MED assistance would be targeted to institutions oriented to the very poor. The other half, fully \$100 million per annum, would be targeted to support institutions trying to reach the moderately poor and the vulnerable non-poor** (who come perilously close to the poverty line and could slip below it due to the slightest mishap). These latter institutions could reach *no very poor* clients and still qualify for USAID assistance (as they can do now).

There is a very interesting reluctance on the part of those *not* specifically trying to reach the very poor (and willing to say so privately or at well-insulated professional meetings) to be labeled publicly as *not* “oriented to the very poor.” I think this reluctance reflects

the public relations power of the argument for reaching out to the very poor. There is apparently some fear of publicly losing this “moral high ground.” In reality, this gives us an important opportunity to provide some needed education to donors, policy makers and the general public about the need, and even moral imperative, for interventions at various levels of poverty. We know that offering a variety of services to a variety of poor and not-so-poor people (by one or two or more different institutions) is very important for producing the highest impact in developing and transition nations.

In the interest of transparency about objectives, **I would welcome more self-confident, public articulation of the case for focusing on the people just below and just above the poverty line (without denigration of those committed to reaching the very poor).** An admirable example of this kind of transparency about true objectives and the underlying rationale for commitment to the not-so-poor is TechnoServe. **The purpose of targeting half of the MED assistance resources to institutions or lines of service “oriented to the very poor” is to create new incentive for institutions rhetorically and truly committed to this objective to work harder and more creatively in this desirable direction. The purpose is not to punish those institutions that prefer to target a somewhat better-off clientele.** Each orientation is offered \$100 million per annum by the proposed reauthorization bill language.

#### Linkage to Grant Making Decisions

What the proposed reauthorization bill language *does not do* is specify what mechanism USAID should use to link its grant making to measured achievement of or progress toward the chosen standard for programs or lines of service “oriented to the very poor.”

The proposed language purposely steers clear of direct intervention in the inner machinery of USAID, if only to make this bill almost palatable to USAID. The proposed bill would, like the earlier, flawed legislation, attempt to level the playing field and give adherents of both orientations (toward the very poor and toward the not-so-poor) equal opportunity to do their best with what USAID can offer. **The bill would stop short of prescribing two separate pots of money, one designated exclusively for the institutions or lines of service that are measurably “oriented to the very poor.”** Instead the bill gives USAID the mandate to develop and use some tools that should enable the agency to level the playing field in its own way.

This is a compromise based on a level of trust in the skill and commitment of the agency leaders. Is that wise? Maybe, maybe not. More grist for our debate mill.