ABSTRACT: To what extent is it possible for organizations to reflect honestly on their own performance, draw appropriate conclusions, and then act on them? For many microfinance organizations this is now a question of survival. This paper argues that formal impact assessment can assist in the transition from donor-controlled replication projects to autonomous and adaptable organizations—but it often fails to do so. Pitfalls include inadequate attention to methodological detail and to the links between impact assessment and wider aspects of organizational change. The paper starts by highlighting the complexity of the overall task to which impact assessment is expected to contribute. It then critically reviews methodological options—why do impact assessment, what indicators to use, how to collect data, how to analyze it, and who should be responsible for which tasks? It concludes that the key to success is the quality of the relationship between microfinance managers and impact assessment specialists. A prerequisite for this, in turn, is the transfer of greater responsibility for managing impact assessment from donor agencies to the leaders of microfinance organization themselves.
Introduction

The world of microfinance is moving fast. Financial landscapes once denuded by inflation, state regulation, and economic stagnation are showing renewed signs of life in the form of consumer credit companies, long-dormant cooperative associations, and nongovernmental organizations (NGOs) bent on scaling up as specialist financial service providers. Where once a microfinance organization (MFO) enjoyed a virtual monopoly, a growing band of rivals now compete for the loyalty of its clients. Much of the new activity has been nurtured with donor funds and remains fragile (Copestake, 2000b). Survival depends on an ability to meet more exacting conditions for donor money or to do without it altogether.

In this context, the need for reliable, cost-effective, and timely information about the impact of services on different users is increasingly important (Cheston & Reed, 1999). But there is less clarity about how to meet it because the art of impact assessment (IA) also has to adapt to rapidly changing environments. In 1999, this prompted the “Affinity Group” of staff responsible for supporting development finance initiatives within the Ford Foundation to commission an action research project into impact assessment. The first phase of this work included a methodology workshop at the Institute of Development Studies in Brighton, England, in June 2000. This article is based on one of four theme papers prepared for the workshop and is concerned specifically with the role of impact assessment at the level of individual MFOs. The other three address the themes of participation, wider impact, and networking.

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The Challenge of Impact Assessment, and an Opportunity

Both parties in the establishment of a new financial relationship incur fixed learning costs. Assume that the mission of the owners of an MFO is to maximize profits. Setting prices too high (relative to service quality and cost) will cause some clients to leave who might otherwise have remained. This reduces the return on the initial investment in establishing the relationship. But a low price also reduces the profit. To maximize overall profits, the owners need to know which combinations of price and service quality will encourage how many existing clients to leave and how many new clients to join. They also need to know what new services may be diversified and how delivery of existing services can be made more cost-effective. Ideally, they need accurate unit costs and returns for different kinds of services and different categories of clients. They also need information on client turnover. Do clients keep leaving and rejoining, or does the business rely upon a steady stream of brand-new but transient clients?

As if this is not challenging enough, the task of maximizing profits is further complicated in at least three ways. First, all this information must be collected and digested fast enough to permit the owners to adjust services and prices before market conditions change. Indeed, the owners need to be able to anticipate changes in demand. Quantitative historical data may be less useful than qualitative data to promote understanding of how different types of clients behave and why.

Second, the MFO may not be seeking to maximize profits. For example, it may be seeking to maximize some function of the flow of benefits to current and future clients. Implicit in these weights will be preferences over time between benefits now and in the future, as well as preferences within any period between, for example, richer and poorer
clients. Profitability remains an important performance indicator, inasmuch as it reveals capacity to continue to serve clients in the future and to grow (Otero, 1999). But lower profits may be justified if they indicate that more benefits are being passed on to current clients. Such judgments require accurate knowledge not only of how services are valued by different categories of client, but also of how they affect their welfare.

Third, the income of the MFO may not come exclusively from its clients. Various public-minded organizations may be subsidizing some of the services in the belief that they have benefits that go beyond the ability of clients to pay for them. They may develop their leadership skills, be weaned off welfare or crime, and so on. This goodwill must be sustained by evidence of these impacts (Morduch, 1999). Having less direct personal experience of the business and being more accountable to the public, sponsors often require more rigorous evidence of impact than the owners.

A fourth complication arises from variation in ownership structure or governance. In the case of cooperatives, for example, clients are also owners. Multiple owners also have different views regarding the weight that should be given to profitability, growth, client welfare, depth of outreach, and so on.

These complicating factors highlight that effective IA is not just about producing timely, reliable, cost-effective, and relevant information about the impact of services on clients. It is also about producing this information in a way that contributes constructively to policy debates among internal and external stakeholders. Reference to the concept of organizational learning illustrates the point (Agyris & Schon, 1978). While it refers to a self-conscious process, it stresses the importance of organizational structure and culture, over and above the caliber of individual stakeholders. The term also explicitly confronts the need for organizations to adapt, rather than remain in some fictional state of
equilibrium. Organizational learning is not just a rational process, but a struggle against those with a vested interest in the status quo.

In this respect, it is worth highlighting two major obstacles currently facing many MFOs. The first is confusion about ownership arising from the leverage of sponsors. Their support can complement income from clients and may be critical both for growth of the organization and fulfillment of wider social goals. But sponsor satisfaction must always be subordinate to client satisfaction—whether articulated through voice, willingness to pay, or exit (Hirschman, 1970). Symptoms of this problem include impact assessment which is linked too rigidly to sponsors’ project cycles and which is regarded as a condition for funding, rather than as useful in its own right. Sponsors have a legitimate interest in understanding the impact of their investments, and the bureaucracy of aid hydraulics cannot be wished away. But if they are serious about organizational development or capacity building, then the IA they promote should also serve the goals of the MFO itself.

The second obstacle is adherence to blueprint financial technologies. Much of the rapid growth of MFOs has taken the form of replication of established models: village banking, savings and credit cooperatives, farmers savings associations, solidarity groups, and so on. Imitators have thereby benefited from the experience of pioneers, and growth into new areas has been accelerated. Setting up a new financial organization has already proved a perilous activity, without the added complication of constantly changing the product. Urgent “fire-fighting” to preserve existing services, plus the myriad tasks associated with rapid scaling up, have left owners and senior managers with little time or energy for reflection on strengths, weaknesses, opportunities, and threats of existing services in relation to possible alternatives. Growing competition from other providers may reinforce a preoccupation with improving efficiency and achieving financial self-sustainability through scaling
up. But product diversification based on a detailed understanding of market opportunities is also likely to be essential to survival, particularly for pioneers who have been able to enjoy growth in spite of high client desertion rates (Calmeadow, 2000).

Putting these two obstacles together and turning them around, it is possible to see a significant historical opportunity. In many countries a transition is taking place from an era of sponsor-funded replication to an era of more open markets. MFOs that are good at learning will thrive. Others will experience more traumatic restructuring, or lose out to leaner and slicker new entrants, as did many of an earlier generation of specialist development finance agencies (Adams & Pischke, 1992). On the positive side, the diversity, cost, and quality of services received by clients should improve.

**IA Design Issues**

This section reviews methodological issues arising from the design of IA work in the light of the foregoing discussion. It starts with the question of goals—why do IA at all and for whom? It then considers how data should be collected and analyzed, what indicators should be selected, and who should be responsible for which tools. Reference to IA “tools” is avoided because the intent is to examine the logic linking IA goals, methods, and resources rather than review the relative merits of packaged solutions.

**Goals—Integrating or Separating Impact Assessment from Market Research?**

A common starting point here is the distinction between proving and improving impact assessment. While linguistically eloquent, this is also highly simplistic, given that some degree of proof or reliability is a requisite for information to be useful. Alternatively, impact assessment can
be classified according to the stakeholder interests it serves: MFO owners, sponsors, clients, etc. But this assumes a greater divergence of interests between stakeholders than may actually exist. As the opening part of this paper suggests, another approach is to distinguish impact assessment, which is concerned with welfare effects on clients, from *market research* (MR), which is primarily concerned with improving business profitability.

The contrast between these two activities can be drawn starkly. IA talks about primary stakeholders and intended beneficiaries, while MR talks of customers and clients. IA is linked to external sponsorship; MR is concerned with new product development. IA is mostly for public sponsors, MR for MFO managers. IA is carried out by trained social scientists, MR by business consultants. These distinctions, however, are not so clear cut. MFOs seeking to maximize social impact over time need both. And it is likely that in finding out about intrahousehold relations and livelihood dynamics a researcher will also learn about client satisfaction and how to secure repeat business. In contributing to improved understanding of the complexity of clients’ requirements, both IA and MR have converged in their emphasis on product diversification to support clients’ risk management, consumption smoothing, and adjustment to shocks, as well as demand for working and investment capital.

A key question resulting from this discussion is whether MR and IA goals can be served through integrated data collection and analysis. Copestake (2000a) explores the scope for doing this. Yet care must be taken in rapidly changing markets to retain flexibility by avoiding elaborate blueprints. The more general point for organizations that have both social and commercial goals (and sources of income) is that it is necessary to evaluate new products against both criteria simultaneously. The alternative is a form of schizophrenia.
Data Collection—Routine Information Systems or Ad Hoc Studies?

The idea of embedding impact assessment into organizational learning can easily be confused with that of building data collection into computerized management information systems. Most organizations routinely collect relevant information about their clients, particularly when they first join, including details of past financial transactions (loans received, savings accumulated, repayment performance, etc.). The case for adding a few extra variables may seem obvious. An example is a means test or relative poverty data (Hatch & Frederick, 1998). If clients are routinely ranked in this way, then there is considerable scope for interesting statistical analysis. For example, how do the probabilities of client retention and exit vary between richer and poorer clients? Or are relative poverty indicators useful lead indicators of repayment performance that might be incorporated into a credit-scoring system? The potential for such analysis is often unfulfilled because data collection tools are poorly designed, inadequate resources are allocated to analysis, or data is entered and coded in a way that impedes consolidation of databases. For example, many organizations are unable to do this because clients are not given a unique identification code.

Routine and joined up data collection may seem ideal, but it has a number of disadvantages. It entails collecting information about all clients all the time, whereas for many purposes sampling may be more cost-effective. It is possible to handle only a relatively small number of quantifiable or easily coded variables, and these variables need to be robust, rather than constantly having to be modified. Finally, data is restricted only to those clients who remain in the program, yet it is important to know more about those who exit too. Routine and comprehensive data collection can never substitute fully for richer, more inten-
sive, and flexible ad hoc studies. Rather, the key issue is to identify a relatively small number of variables (over and above those needed for accounting and portfolio management purposes) that can be reliably, routinely, and robustly recorded and analyzed to complement them.

**Data Analysis and the Attribution Problem—Positivist and Interpretive Solutions**

All impact assessment is based on judgments about what would have happened to clients under different conditions—if they had not received a loan, if repayment schedules were more flexible, if interest rates were lower, and so on. One way of doing this is by statistical analysis of differences between groups, in the hope that differences arising from different access to services can be separated out from incidental differences (Moffitt, 1991). Opportunities to do this empirically by randomly assigning potential clients to different treatments are rare, so selection-bias problems abound (Coleman, 1999). The approach is most feasible when new services are being introduced, and supply constraints result in arbitrary differences in access within the pool of potential clients. As the market for financial services becomes more integrated and competitive, however, such situations are likely to become rarer.

An alternative approach relies on informed explanations of impact, rather than their direct measurement. Credibility here hinges on two things. First, there is the nature of the primal encounter between client and researcher. Incentives to biased interpretation by both have to be minimized, use of leading questions avoided, and so on. There is scope for learning both from consumer research and from ethnography—in the use of focus groups and tape-recorded narrative interviews, for example. Second, there is the issue of how representative the samples are. Debate here is again often unnecessarily polarized. There is a great deal of scope for sampling systems that fall between the purely anecdotal and the for-
mally representative to known degrees of statistical significance. Quota sampling, for example, whereby a minimum number of interviews are undertaken for predetermined types of client, can help ensure that studies capture diversity while still introducing randomness into selection.

**Indicators—Industry Standards and Context Specific Benchmarks**

Microfinance has undoubtedly developed into a self-conscious global industry, and many specialists in the field take for granted that this is a good thing. The World Wide Web, cheap international travel, and the nodal policy position of Washington, D.C., all enable ideas to spread rapidly from country to country. Donors have helped to raise standards of good practice—through the AIMS program (Assessing the Impact of Microfinance Services) and through CGAP (the Consultative Group to Assist the Poorest), for example. This global dimension acts as a major spur to many organizations to improve their standards and performance, not the least in establishing criteria for public and private investors into the sector. But this process has proceeded more rapidly in relation to indicators of the financial performance of MFOs themselves, and there is a risk that the importance of less easily measurable and comparable performance indicators (such as client impact) will be correspondingly devalued (Cheston & Reed, 1999).

One response is to develop a standard set of complementary indicators. This has already happened to some degree for outreach. The MicroBanking Bulletin includes, for example, statistics on the number of active borrowers and savers, average loan balance as a percentage of GNP per capita, and the percentage of women to total borrowers. Meanwhile, CGAP has recently commissioned the International Food Policy Research Institute to develop a standard tool for measuring relative poverty of clients.
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Should we also be aiming to establish a standard set of indicators of impact? One line of argument against this is that it is unnecessary. MFOs cannot force people to use their services, and if financial indicators reveal a high willingness to pay, then positive impact can be taken for granted. In the case of subsidized programs, evidence is needed that one MFO is not expanding at the expense of others, but outreach indicators can provide some reassurance of this. This argument is based on the assumption that clients are rational and free to make individual choices. More dangerously, it assumes that people are fully informed and will not make mistakes that land them in chronic debt. High cycle-to-cycle exit rates in village banking programs have not stopped growth. In other words, growth is not necessarily incompatible with doing serious harm to a minority of customers—often the most vulnerable (Copestake, Bhalotra, & Johnson, forthcoming). This suggests a strong case for developing a standard client loyalty or retention indicator of outreach over time to complement static indicators of depth of outreach.

A second argument against universal impact indicators has been eloquently advanced under the AIMS program. In brief, impact chains are so complex that a whole battery of indicators would be needed. The appropriate choice for a particular MFO depends on its goals and also on the context. For example, some studies have taken separation of business and household accounts as a proxy indicator of business management ability. But there is an obvious downside if this practice increases the risk that relatives, tax collectors, protection squads, or debt collectors will be able to work out more precisely what the business is worth. Short of securing agreement on a universal set of human needs and rights, indicators will always need to reflect local values and development priorities. Moreover, the usefulness of an indicator cannot be evaluated in isolation from the reliability of the methodology used to calculate it.
While it would thus be inappropriate to privilege a standard set of impact indicators, there is a stronger case for seeking more limited harmonization of definitions of different kinds of impact indicator. Obvious examples are ways to calculate change in household income, business employment, and livelihood diversification. More interesting would be some convergence over how general questions are framed about client satisfaction and influence over business decisions.

Staffing—the Balance between Internalizing and Subcontracting

A final balancing act concerns the allocation of responsibility for carrying out different IA tasks between MFO staff and subcontractors. Assigning data collection to operational staff has been criticized for distracting them from core activities, and it may increase response bias. On the other hand, encouraging field staff to participate in open-ended interviews with their clients, and to discuss what they learn, may help to motivate them and enhance data quality. Better staff-client understanding also helps ensure that the wider development mission of an MFO is not lost in the rush to expand. By reducing dropout rates it also makes good business sense (Simanowitz, 1999).

Long-term employment of staff to oversee data collection and analysis is expensive, and technical specialists can easily become isolated or caught up in overcomplicated systems (Hyman & Dearden, 1998). Consequently, there is a strong case for subcontracting this work to specialist consultants, who can absorb fluctuation in demand for their expertise, and can also be more easily called to account for delivering on planned outputs.

That said, one general lesson about organizational change appears to be that it depends on the establishment of a self-sustaining group committed to the change. This group must have strong support from
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owners of the MFO and be able to build a network of alliances throughout the organization. It must be close enough to operations to understand their complexity, but avoid being co-opted too intimately into routine operations. Above all, the group must include individuals who have a clear vision of what they want to achieve, plus the competence, time, and energy to bring it about. This point should be a prime consideration in determining whether to hire consultants or rely on internal staff. Internal leadership is likely to be essential, but external consultants or researchers may be needed to provide necessary momentum, technical skills, and capacity. The contracting process can also help to ensure that a focus is maintained on changing the organization in the desired direction rather than defending or hiding its weaknesses. But it is important that MFO management play an active part in tendering and contracting processes, rather than allowing these to be taken over and made excessively complicated by external sponsors.

Conclusions

The microfinance industry is going through a period of rapid change. An organization’s ability to adapt and to learn systematically from what it is doing determines whether it will flourish or flounder. Formal impact assessment can contribute to adaptive learning. But it often fails, either because methodological weaknesses undermine the credibility of findings, or because technically proficient research has marginal influence on complex internal policy processes. Two factors are likely to be crucial in raising the standard of impact assessment. First, the leaders of microfinance organizations need to have greater ownership and control over the commissioning and management of impact assessment work. Second, the cadre of professional impact assessment researchers needs to be enhanced. Impact assessment work that is commissioned by MFOs, drawing upon a larger pool of local specialists, will benefit from and in
turn strengthen local policy networks. Aid donors have a crucial role to play in facilitating this process, particularly in relation to the new generation of MFOs that they have helped to create. They can also play an important role in continuing to facilitate the establishment of norms of good practice. This argument extends the analogy between impact assessment and financial auditing drawn in an earlier article in this journal by Cheston and Reed (1999).

References


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Notes

1. The term microfinance organization (MFO) is preferred to microfinance institution (MFI) because it sustains a useful distinction between organizations, or agencies, involved in provision of services and institutions, or rules and norms of behavior, such as marketing tie-ups and mutual liability.

2. Views expressed in the paper are those of the author alone and do not necessarily reflect those of the Ford Foundation or any other agency. I am grateful for comments on an earlier draft from Susan Johnson, Anton Simanowitz, Paul Mosley, Gary Woller, and other participants at the Brighton workshop. Those interested in more information about the workshop and the Ford Foundation action research project should consult A.Simanowitz@ids.ac.uk.

3. Aid hydraulics refers to the tendency to manage aid primarily to maximize throughput of aid funds (Bennett & Cuevas, 1996).

4. Markets are defined broadly here to include quasi-markets, in which demand for services is partially determined by public sponsorship in the belief that people have a right to access to services (whether housing, health, schooling, or basic finance services) regardless of their ability to pay.

5. An alternative approach that limits the data-handling problem is to develop the MIS at the level of village banks or solidarity groups. But even the task of entering and analyzing data per village bank per loan cycle is often far from trivial (Painter & McNelly, 1999).

6. A useful source of reports from these and other programs is the CGAP-sponsored “Microfinance Gateway” http://nt1.ids.ac.uk/cgap/index.htm

7. An important example relates to social stability and the tunnel effect (Hirschman, 1973). Hirschman argues that people are less angry (and more inclined to rebel) when all lanes of traffic are equally stuck than when one lane is moving faster than another. But the importance to be attached to an indicator of the polarizing effect of microfinance,
if one could be constructed, would clearly depend on cultural and historical context. See Gore (2000) for a more general critique of ahistorical performance measurement as a key feature of the Washington Consensus era of development practice.