THE ROLE OF NON-GOVERNMENT ORGANISATIONS IN MICROFINANCE

BARCLAY O'BRIEN*

Abstract

This paper contends that international Non-Governmental Organisations (NGOs) have played a substantial role in developing financial services for the poor (or microfinance). Their influence has been greatest in:

- *Pursuing a broader common vision and mission, particularly towards the poorest;*
- *Offering clients a larger range of products and services;*
- *Better engaging with industry regulators;*
- *Advocating for microfinance generally and conducting research.*

Furthermore, even in cases where the role of these NGO Networks is no greater than other microfinance network support organizations, it appears the former are more willing to subsidise the costs of these benefits, such as with respect to innovation and creativity.

Secondly, the financial performance of the NGO networks and the NGO microfinance institutions themselves do not suffer as a result. Based on the available evidence, there is no significant variation in the performance of NGO MFIs around the world compared to the average for all MFIs. In Asia, the NGOs perform slightly worse than the average in three out of four indicators.

Therefore, whilst the long-term trend is likely to see more formal and regulated financial institutions delivering microfinance, the NGO Networks themselves will retain a crucial role in the sector as a whole.

1. INTRODUCTION

1.1 Background

The role played by Non Governmental Organisations (NGOs) in develop-

* Opportunity International. The views expressed here are those of the author. The author would like to thank Nimal Fernando, for suggesting the topic, and the following for their comments and contributions: Jamie Bedson, Suzy Cheston, Dana DeKanter, Adrian Gonzales, Ruth Goodwin-Groen, Paul Greener, Stuart Mathison, Rich Rosenberg and Blaine Stephens.

ing financial services for the poor (or microfinance) is widely recognized in a number of areas including:

- The vision and mission of their microfinance institutions;
- The range of products and services offered;
- Government regulation;
- Industry best practice;
- Innovation and creativity;
- Advocacy and research.

However, one question that arises is where does the influence of the NGOs, as the originator, funding agent and supporter for many key microfinance institutions (MFIs), bring the most to bear.

A second question is whether performing these services has impacted on the financial performance of the MFIs to the detriment of their long-term viability.

1.2 Definition of NGO Networks

In addressing the topic, I have sought to make two distinctions. Firstly, it is recognized that there is a "bewildering variety of types and combinations of delivery systems and institutional structures" for providing microfinance (Dunford, 1998). Adopting the charter types used by the Mix market[1], I distinguish between NGOs providing microfinance services and other microfinance institutions (MFIs), which can include banks, rural banks, credit unions and Non-Bank Financial Institutions (NBFIs).

Secondly, I draw a contrast between members of NGO networks and those that are owned or operated by other interests. To make this categorization, I have relied on the analysis conducted by the Consultative Group to Assist the Poor (CGAP, 2004) based on self-classifications provided by microfinance network support organizations (NSOs).

Five of the NSOs responding to the CGAP survey, namely Catholic Relief Services (CRS), GRET, Pro-Mujer, Save the Children and World Vision, were classified as multi-sector development agencies. All these five and another four, namely Ecumenical Church Loan Fund International (ECLOF), FINCA, Friends of Women's World Banking (FWWB) and Opportunity International (Opportunity), had the characteristic that over half of their microfinance partners were not regulated or formal financial institutions (FFIs). All nine except FWWB were part of the broader grouping of twelve organizations that CGAP called "ownership plus", the characteristics of which are that they all own up

[1] www.themix.org.

to 100% of their partners, including those that are launched by the NSO themselves, and they often provide other services, especially technical assistance.

The CGAP categorization is not exhaustive, as there are many other networks matching the characteristics of those nine that also have microfinance operations, for example American Refugee Committee, CARE, Food for the Hungry, Mercy Corps, PLAN International, World Education and World Relief. However, in this article, "NGO Networks" refers to those nine networks or similar types of organisations, i.e. multi-sector development agencies or others with a majority of NGOs as their operating partners.

2. ROLE OF NGOS

2.1 Two Approaches

The two schools of thought that exist today among MFIs can be summarized as: those focused on sustainability (or financial self sufficiency); and those with a greater depth of outreach (or focus on assisting the poorest[2]). The former is generally seen as having a greater emphasis on banking, which also allows the MFI to offer the poor other financial services, such as savings, insurance and remittances and receive additional income streams from these products.

The other relevant issue that is much debated today is whether to provide non-financial services (such as business development training, literacy, education and health) along with financial services (Bedson and Renzaho, 2006). The 'minimalist' approach that provides financial services only is generally adopted in order to reduce operating costs and improve the potential for sustainability.

Lured by the attraction of an MFI becoming sustainable, increasing numbers of NSO partners are transforming into formal regulated financial institutions (CGAP, 2004), meaning that there are very few networks that contain only unregulated partners[3]. Although the transformed institutions

[2] This also raises the issue of defining the "poor" and the "poorest". Sebstad and Cohen (2000) separate those living above and below the poverty line into poor and non-poor. The category of poor are further divided into *destitute* (bottom 10% below the poverty-line), *extreme poor* (those in the bottom 10 to 50 percentile of households below the poverty line), and *moderate poor* (the top 50% of households living below the poverty line).

[3] Just five (Africa Microfinance Network, CERISE, FINCA, FWWB and Pro-Mujer) according to CGAP (2004) and at least one of these (FINCA) now includes FFIs: see CGAP (2004), page 6 for more detail.

that remain members of their original NGO Network will retain many of their characteristics, I also look at individual NGOs in reaching my conclusions.

Whilst the article comments on NGO Networks and NGOs around the world, I pay particular attention to the Asian Region. Of the 24 NSOs covered by CGAP (2004) it is interesting to note that all have implementing partners in the Asian region and that the number of network members in Asia, namely 704, is larger than in any other region, with Sub-Saharan Africa next with 552 partners.

2.2 The Areas of Influence

What then are the roles that NGO Networks and NGOs have played in the field of microfinance? I have classified their major influences under six separate headings.

2.2.1 Broader Vision and Mission

By being linked through a network, the partners share a common vision and mission. Moreover, it is likely that these objectives will be broader than the financial health of the MFIs, such as to build a more inclusive financial sector in the countries in which they operate. NGO Networks have been at the forefront of the debate about how deep down into "the poorest of the poor" microfinance services should be offered.

With the broader development focus possessed by many NGO Networks, they will also bring a more objective perspective. NGO Networks may have a fuller understanding of the needs of their clients, particularly the disadvantaged that they serve in many ways, asking questions such as:

- Is microfinance the best intervention in these particular circumstances?
- Will microfinance alleviate poverty and how does its impact compare to other programs?
- Can microfinance bring extensive benefits to the economic environment?
- Can institutional sustainability and social goals be compatible? (See Bedson and Renzaho, 2006).

As CGAP (2004) commented, unregulated partners were more likely to have a "majority of clients below US$1 a day", whereas networks with more regulated partners tend to have a "diverse range of clients". Moreover, NGO Networks often take the time and commit the resources to determining the impact of their microfinance programs on clients, families and local communities, given their broader mission.

2.2.2 Offer Clients a Larger Range of Products and Services

Partly as a result of the above factor, the NGO Network MFIs may offer a range of services including those outside what is traditionally considered microfinance, namely loans, savings, insurance and remittances. Because 'paths out of poverty' may be constrained by factors or obstacles beyond the simple access to financial services, NGOs may also provide health education, business training and marketing.

However, Simanowitz (2002) notes that recognizing poverty as multi-faceted does not mean that MFIs should try to do everything. Rather than being 'all things to all people' MFIs can enhance the impact of microfinance by providing appropriate linkages for clients. This may cover business areas, such as the supply of raw materials or buyers for clients' products and services, or more generally, through linkages to other development services.

Because they offer a range of social and economic programs, NGO Networks will often integrate these activities with their MFIs. Even if the microfinance products and services are offered through a separate institution, the clients may be common to both. This can take a number of forms: on one hand, loan officers will inform clients about other programs offered by the NGO Network; on the other hand, the recipients of the social and economic programs will provide fertile ground for marketing of microfinance products.

By taking an integrated approach, NGO Networks can also share overheads and operating costs across both its microfinance and general development activities. There is considerable evidence[4] to suggest that offering microfinance in partnership with other non-financial services, such as health and education, provides broader impacts on children's diet and nutritional status, women's empowerment, immunization, diarrhoea treatment and maternal health status.

2.2.3 Influence Government Regulation

Paul Greener and Stuart Mathison from the Foundation for Development Cooperation (FDC) summarised this point and others with their comments that NGO Networks can essentially act as an apex organization for its member MFIs, by:

- Linking a 'family' of MFIs that have a common sense of vision and objectives;
- Pursuing a broader agenda, by promoting "big pictures themes" such as electronic banking for the poor;

[4] See Bedson and Renzaho (2006), page 43 for a summary of six such studies.

- Engaging with commercial banks and regulators;
- Acting as a point of accountability with respect to MFI performance; and
- Providing mutual support and knowledge sharing, with greater openness between the MFIs.

On the question of regulation, the influence of the NGO Network comes from their greater objectivity. Because of their broader agenda, such as poverty alleviation in general, any approach to the central bank by a NGO network may be received more favourably.

The perception that NGO MFIs are not wedded only to sustainability may allow their petitions, say for microfinance providers not to be regulated in the same way as commercial banks, to be more successful than if the same issues, such as minimum capital requirements and interest rate caps, were raised by the more commercially focused MFIs.

2.2.4 Best Practice

The NGO Network can influence the performance of its member partners through the services that it offers them, such as providing capital, wholesale debt and technical assistance. However, these services could be provided by all NSOs, regardless of whether or not they are NGO Networks. The other role of networks is to impose certain membership criteria, such as regular reporting, financial transparency and performance and governance standards. It is here that the NGO Networks can take a broader, more holistic approach.

The distinction between the philosophies of different NSOs is sometimes (see Bedson and Renzaho, 2006) compared to what two prominent industry bodies, namely CGAP and the Microcredit Summit Campaign (the Campaign), consider best practice.

CGAP's guidelines for best practice are based on the belief that: financial services should include credit, savings, transfers, payments and insurance; microfinance requires a sustainable, financial system approach to reach large numbers of poor people; and micro-credit cannot always reach the poorest (CGAP, 2004a).

The Campaign has set various targets to reach the poor, most notably the new goal of providing 175 million clients with credit services by 2015. Its four core themes are: reaching the poorest; reaching and empowering women; building financially self-sufficient institutions; and ensuring a positive, measurable impact on the lives of clients and their families.

The Campaign's themes can be seen as being more closely aligned with those of NGO Networks. They can also be regarded as both complementary with, and a challenge to, the key principles of CGAP: Bedson and Renzaho (2006). In fact, a holistic assessment of best practice needs to recognise that these positions are not necessarily diametrically opposed. Indeed, one of the three 'myths' that the Campaign seeks to overthrow is that a microfinance institution reaching the poorest of the poor cannot be self-sufficient (Daley-Harris 2005).

2.2.5 Innovation and Creativity

The role of NGO Networks in regard to product development is debatable. Some have suggested that MFIs within such a Network become rather insular and perhaps miss opportunities to take on innovations and advances from outside the NGO Network. On the other hand, NGO Networks are often more willing to take on difficult problems, such as creating products and methodologies to serve the very poor or operating in remote rural or post-conflict environments[5].

Regardless of their effectiveness in the area of innovation and creativity, it seems clear that NGO Networks are more willing to absorb the costs of providing assistance to their partners. CGAP (2004) noted that all of the NSOs responding to their survey, which were multi-sector development agencies, subsidized either all (in the case of GRET and Save the Children) or a proportion (CRS, Pro-Mujer and World Vision) of the cost of technical services provided to their partners.

2.2.6 Advocacy and Research

Finally, NGO Networks can play a role in promoting issues of general interest to the microfinance sector, including support for appropriate central bank regulation and legal structures and avoiding the imposition of industry constraints such as interest rate caps. It is arguable that, not being driven exclusively by financial goals, the NGO Networks may be more active in this regard.

However, the evidence from the CGAP (2004) survey is not indicative of such a trend. Of the 33 NSOs profiled in the report, policy advocacy is a key activity of all but four. (Pro-Mujer is one of the four but the fact that it is the smallest of the nine NSOs categorized as a NGO Network may explain its inability to fund such activity.)

Dana DeKanter, CEO of the Small Enterprise Education and Promotion (SEEP) Network (www.seepnetwork.org), commented to the author that NGOs and their networks have a crucial role to play in microfinance because:

5 Based on views expressed by Paul Greener and Stuart Mathison of FDC.

- NGOs have influenced central banks to take a broader, less formal approach to the regulation of MFIs, in areas such capital requirements.
- NGOs also promote benchmarking and transparency among peers.
- NGOs are often more creative in how they establish and fund MicroFinance banks.
- NGOs recognise that best practice requires a business approach but NGOs are able to provide grant funding to Tier 2 and Tier 3 MFIs to enable them to migrate to the stage of being able to receive equity and wholesale debt.
- Whilst they must compete in terms of funding, NGOs are often more prepared to set up discussion groups or conduct research projects, to the benefit of the industry as a whole.

3. PERFORMANCE OF NGOS COMPARED TO FFIS

3.1 The Common View

There is a popular perception that NGO MFIs are too driven by non-commercial goals, such as reaching the very poor with a range of services, to be sustainable. In response, Bedson and Renzaho (2006) comment:

> Building on a more nuanced understanding of the needs of the poor, a demand-side view of providing financial services holds strong possibilities for both reaching the poorest of the poor and working towards financial sustainability. Both sustainability and poverty-focused practitioners are finding that a focus on products and markets is needed. As a result, MFIs need to expand services to increase demand and tailor products to those that still find themselves outside both the formal and semi-formal financial sectors.

However, there is still the risk that the provision of these additional services, or focusing on making smaller loans to poorer clients, can result in subsidies to the microfinance institution, from either the NGO Network or donors. This can have two potentially damaging results: firstly, it will undermine the MFI's ability to achieve true sustainability; and, secondly, it distorts the market to the extent that other more commercial operations or funders will be 'crowded out'.

3.2 The Main Indicators

In examining the question of how the performance of NGOs compares to more commercially driven MFIs, the primary indicator is sustainability, which incorporates two key statistics. Operational self-sufficiency (OSS) refers to the ability of an MFI's income to cover all its financial and administrative costs, while MFIs that have achieved full financial self-sufficiency (FSS) are able to meet all costs without the need for donor or subsidized funds.

In the discussion on the subject to date, many point to the evidence suggesting that very few MFIs, especially in the semi-formal sector, reach sustainability, often due to the developmental goals pursued by many NGOs (Morduch, 2000). Others believe that there is an inevitable trade-off between sustainability and outreach.

There are, of course, exceptions where MFIs can achieve excellent performance in the combined objectives of poverty impact and self-sufficiency (Simanowitz 2002). By the same token, many argue that it is also possible for most MFIs to transform into regulated financial institutions and still expand their outreach to the poor (Fernando 2004).

Some interesting work has been done on this topic by Gonzalez and Rosenberg (2006). The authors examined the connection between average MFI loan size and return on assets on the one hand and the percentage of clients that were amongst the "poorest" and OSS on the other hand. They found that neither a reduction in loan size nor an increase in poorer clients affected MFI profitability greatly, with a very weak correlation between each of the variables.

3.3 Further Analysis

To what extent then, can NGO Networks or NGOs provide microfinance on a sustainable basis? In other words, is it possible to adopt the 'credit plus' strategy of the nine NGO Networks identified through the CGAP (2004) study, or that of other NGO MFIs, and still be sustainable? I have examined this question in three areas.

3.3.1 NGO MFIs

The Mix Market provides detailed operating data for over 700 MFIs, divided into many different peer groups, including those determined by charter type and geographic region. For the latest figures available, there is no significant variation in performance between the NGO MFIs and the average for all MFIs, except in relation to Return on Assets although the figure is still positive for NGOs.

Table 1. Performance of NGOs and other MFIs in 2006 (median)

Charter Type (number of MFIs)	Return on Assets	Return on Equity	Operational Self Sufficiency	Financial Self Sufficiency
All (704)	0.9%	4.0%	115%	106%
Banks (56)	0.8%	4.4%	113%	107%
NGOs (282)	0.2%	2.6%	113%	101%

Source: Mix market

3.3.2 NGO Networks

Consolidated performance numbers for NGO networks can be derived from the MIX and individual websites. The Operational Self-Sufficiency figures compiled for the Networks, and other additional data, are set out in Table 2.

Table 2. Performance of Selected NGO Networks

Network	Client Numbers ('000)	Number of Partners	NGOs as % of Total[6]	Average OSS (for MFIs reporting to the MIX)
CRS	287	236	56%	138%
GRET	130	11	54%	n/a
Pro-Mujer	135	4	50%	124%
Save the Children	193	19	95%	147%
World Vision	390	43	67%	116%
ECLOF	70	40	98%	n/a
FINCA	326	22	100%	100%
FWWB	800	87	80%	n/a
Opportunity	1,132	42	73%	105%

Source: SEEP, The MIX, MFI websites

The OSS figures for the six Networks who report such figures to the MIX (in respect of a meaningful sample of their partners) average 122%. This is better than the averages for all MFIs and NGOs reporting to the Mix (115% and 113%, respectively) by a substantial margin.

[6] Plus in some cases, "other" unregulated MFIs.

3.3.3 Asia

The performance of MFIs in Asia is generally worse than the world as a whole, as shown in Table 3.

Table 3. Performance of Asian MFIs in 2006 (median)

Region (number of MFIs)	Return on Assets	Return on Equity	Operational Self Sufficiency	Financial Self Sufficiency
All (704)	0.9%	4.0%	115%	106%
All Asia (194)	0.1%	2.5%	115%	102%
Asian NGOs (82)	0.2%	3.5%	109%	101%

Source: Mix market

However, Asian NGOs perform better than the region as a whole in terms of Return on Assets and Return on Equity and at around the same level for FSS. Secondly, three of the four indicators for Asian NGOs are close to those for all MFIs around the world.

4. CONCLUSION

Multi-sector development agencies with microfinance operations and other networks, with a majority of unregulated MFIs as members, have a role to play in developing financial services for the poor. Particular areas where the influence of NGO Networks is recognised as being the greatest include:

- The benefits of a broader common vision and mission;
- Offering clients a larger range of products and services;
- Better engaging with industry regulators;
- Advocating for microfinance generally and conducting research.

Even where the role of these NGO Networks is no greater than other microfinance network support organizations, it appears the former are more willing to subsidise the costs of these benefits, such as with respect to innovation and creativity.

It also appears that the financial performance of the NGO networks and the NGO MFIs themselves do not suffer as a result. Based on the available evidence, there is no significant variation in the performance of four key financial performance indicators for the NGO MFIs compared to the average for all MFIs. The Return on Assets for all NGOs is worse than for all MFIs, although the NGO MFIs in Asia perform better than all Asian MFIs. Under the other three indicators, the Asian NGOs produce results that are close to those for all MFIs around the world. Looking at NGO Networks, their MFIs exhibit much better sustainability than the averages for all MFIs and NGOs.

Returning to the debate between the two schools of thought about the priorities of MFIs and the ideal goal of a 'double bottom line' of outreach and sustainability, the most appropriate position is to strike a balance. There will be some situations where MFIs can become sustainable and serve the poorest of the poor, such as in dense urban areas. However, bringing financial services to the very poor in other situations, such as remote rural areas, will require donor funding or subsidization.

As Simanowitz (2002) put it:

"[Essential are] the establishment of clearer industry standards for good practice in poverty-focused microfinance, and much greater transparency in terms of reporting on poverty outreach and impact. However, balance needs to be struck between providing greater space for innovation, for example, by allowing pilot phases in MFI development, and ensuring that innovation is not used as an excuse for poor practice and inefficiency."

The NGO Networks actually embody this principle and offer an avenue to achieve the balance. In fact, the way most of them operate, through a mixture of NGOs and FFIs, with the more sustainable institutions allowing non-profitable clients to be served in more difficult geographic areas, is one major reason for the Networks' existence in the first place.

The long-term trend is likely to see more FFIs delivering microfinance, particularly if the ambitious client goals established by the Microcredit Summit Campaign and others are to be achieved. Nonetheless, NGO Networks themselves will retain a crucial role in the sector as a whole.

References

Bedson J. and A. M. N. Renzaho, 2006, "Microfinance Good Practice and World Vision Australia: The Challenge of a Poverty Focus in an Evolving Industry", *Working Paper*, No. 2006/001PE, World Vision.

CGAP, 2004, "What is a Network? The Diversity of Networks in Microfinance Today", *Focus Note*, No. 26, Washington, D.C.: CGAP.

CGAP, 2004a, "Key Principles of Microfinance", principles endorsed by CGAP and its 31 member donors, and further endorsed by the Group of Eight leaders at the G8 Summit on 10 June 2004.

Daley-Harris S., 2005, "State of the Microcredit Summit Campaign Report 2005", Microcredit Summit Campaign, Washington D.C.

Dunford C., 1998, "Microfinance: A Means to What End?", presented to the Dialogue on Microfinance and Human Development, 1-3 April 1998, Stockholm, Sweden: available at 'www.gdrc.org/icm/dunford-ffh.html'.

Fernando N.A., 2004, *Micro Success Story? Transformation of Nongovernment Organisations into Regulated Financial Institutions*, Asian Development Bank.

Gonzalez A. and R. Rosenberg, 2006, *The State of Microcredit – Outreach, Profitability, and Poverty,* presented in the conference "Access to Finance: Building Inclusive Financial Systems" organized by the World Bank and Brookings Institution, March 2006, Washington D.C.

Morduch J., 2000, "The Microfinance Schism", *World Development*, Vol. 28, No. 4, pp. 617-629.

Sebstab J. and M. Cohen, 2000, "Microfinance, Risk Management and Poverty", AIMS paper, Office of Microenterprise Development, USAID, Washington D.C.

Simanowitz A., 2002, *Ensuring Impact: Reaching the Poorest while Building Financially Self-Sufficient Institutions, and Showing Improvement in the Lives of the Poorest Women and Their Families*, Institute of Development Studies, UK, Bloomfield: Connecticut.

Résumé

Cet article présente l'idée que les organisations non gouvernementales (ONG) internationales ont joué un rôle substantiel dans le développement des services financiers pour le pauvres. Leur influence à été particulièrement importante dans la poursuite d'une vision et d'une mission plus amples et partagées vers les pauvres, dans l'offre d'une plus vaste gamme de produits et services, dans l'engagement des autorités de réglementation, supporter la microfinance et la recherche dans le secteur. En plus, même quand le rôle des ONG n'est pas plus important de ce des réseaux de microfinance, il paraît que les ONG soutiennent plus volontiers les coûts lié aux effets positifs, tels que l'innovation et la créativité. En outre, la performance ne souffre pas pour cela. Basé sur l'évidence empirique, il n'y a pas de variation significative dans la performance des intermédiaires de microfinance qui sont ONG par rapports aux autres intermédiaires de microfinance. In Asia, les ONG ont des indicateurs légèrement plus mauvais dans trois cas sur quatre. Il en descend que, même si les intermédiaires formels de microfinance auront une croissance, les réseaux de microfinance auront aussi un rôle crucial dans le secteur.