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# Can Microfinance Reach the Poorest: Evidence from a Community-Managed Microfinance Intervention☆

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**Summary.** — Reaching the poorest is an important objective in many development interventions, and microfinance is no exception. We review performance indicators for effectiveness of targeting described in the literature and suggest a new metric in order to account for extent and severity of poverty as well as the income distribution among the poor. When applying this to a panel dataset from a community-managed microfinance intervention in Northern Malawi, we find regressive targeting: Participants are less poor than the general population in the area. In addition, we provide suggestions as to when and why the poor exit the project.


*Key words* — targeting, outreach, microfinance, Africa, Malawi, savings groups

## 1. INTRODUCTION

Together with economic growth, poverty reduction is perhaps the most agreed-upon goal for development aid and is also the first of the Millennium Development Goals. While economic growth may eventually trickle down and reduce poverty, it is also generally agreed that interventions and resources must target the poorest members of the population to achieve this goal efficiently. At the same time, however, an increasing number of development interventions require the participants to have a strong capacity for involvement. As this requirement could conflict with the outreach, more information is needed about how the design and implementation of interventions might affect the outreach. In other words: Do the poorest have the ability to participate?

Microfinance, which includes the provision of loans, savings, and insurance, is a particularly interesting concept in this respect. On the one hand, funders and implementers clearly want to reach the poorest members of the population. Targeting is widely used in microfinance as a means to do this; it is used, for example, by the Grameen Bank and BRAC (Bandiera *et al.*, 2011), and there has been an increasing focus on avoiding "mission drift", whereby programs include richer people (Christen, 2001; Cull, Morduch, & Demirgüc-Kunt, 2007; Hermes, Lensink, & Meesters, 2011). At the same time, however, it is commonly believed that microfinance does not reach the poorest households, and this finding is confirmed by early studies (Hulme, 2000; Navajas, Schreiner, Meyer, Gonzalez-Vega, & Rodriguez-Meza, 2000; Zeller, Sharma, Henry, & Lapenu, 2006). The reason that is typically given for this is that both microsaving and microcredit require resources, involvement, and skills on the part of participants. Both require that participants have basic financial literacy, and additionally savers need to have sources of monetary income while borrowers need to be able to use their loans productively, keep track of their repayment schedules, and manage the risks associated with taking on debt.

In this paper, we ask whether participants in a microfinance intervention in the northern region of Malawi are poorer or richer than the general population in the same geographical area, and we address four shortcomings that are common in the literature on targeting and outreach in general and on microfinance in particular. First, many microfinance interventions do not actually try to reach the poorest members of the population. For this reason, it is difficult to know whether microfinance simply does not work for this group or whether the poorest just require services that are different from what most microfinance interventions offer. Of the four institutions analyzed by Zeller *et al.* (2006), for example, only one, an Indian organization, actually aims to reach the poorest members of the population. The microfinance method we study, the highly standardized village savings and loan associations (VSLAs), is designed particularly with the poorest in mind.

Second, the literature usually relies on cross-section data. The result is that any welfare measure for program participants reflects the sum of pre-program welfare and program effects. This is a problem if programs work, because participants may seem better off compared to nonparticipants – not because they were better off initially, but because the program has improved their status. We therefore use panel data: We solicit data on poverty status prior to participation in a VSLA as well as information on participation two years after the startup of a VSLA.

Third, we seek to overcome the simplistic approach to poverty measurement often taken in the literature, where the question asked is frequently: Is the percentage of people below the poverty line higher among participants or nonparticipants? As is well known from the poverty measurement literature, this approach is problematic because it counts poor households that are just below the poverty line the same as very poor households living on half that amount. Strangely, this observation has not found its way to discussions on targeting and outreach. To address this problem, we develop a metric that is sensitive to both the depth of poverty—how far people are

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☆ Author sequence was decided by random draw using random.org.

below the poverty line—and income distribution among the poor. We base the metric on the Foster–Greer–Thorbecke squared poverty cap.

Finally, it is common for research on outreach to investigate whether participants are poorer than nonparticipants but then to ignore the underlying question of why this is so. We address this question by analyzing the decision to participate in a VSLA as a pipeline, where each active choice that a household must make toward participation comes with the risk of the household "leaking" out of the pipeline. This approach allows us to assess whether there are particular components of the intervention that deter the poorest households from joining.

We find that the participants in VSLAs are richer than the population at large in the same area. Of course, there are participant households that are below the poverty line. Indeed, roughly half of the participants in our study are poor. Among nonparticipant households, however, the percentage below the poverty line is larger, and the targeting is therefore regressive: Participants in VSLAs are less poor than the overall population in the area, when we use measures such as number of meals per day, length of the households' so-called hungry period, or a proxy metric to measure consumption. The single exception is our estimate of a household's total consumption, [1] where the results are insignificant but with the point estimate pointing toward progressive targeting. We suspect that this exception may be due to a large measurement error.

Our results are particularly strong when we apply our own poverty metric, which allows for assessing the depth of outreach beyond simply comparing the mean consumption level among VSLA participants and nonparticipants. Asked about their reasons for not joining a VSLA, nonparticipants report a lack of cash to meet the compulsory savings requirements.

Using our sequential panel approach, we find that both poor households and those that are less poor are attracted by the initial awareness campaign for a VSLA, and that the poor households are actually more likely to join, provided that they have received information about the upcoming intervention. At a later time, however, richer households join the VSLAs, and in larger numbers. In other words, the awareness campaign seems to attract a different group of people than those who end up joining. Implementing organizations should keep this in mind when designing interventions. We believe this result about VSLAs can be extended to other types of development interventions that require active participation by households with a certain degree of initial skills and/or resources.

The rest of this article is organized as follows. The next section describes the VSLA intervention. The third section provides an overview of the methods we used, including a review of the existing targeting literature and our suggestion for an improved targeting metric based on the squared poverty gap. The fourth section explains our sequential approach. The three sections after that present the data, our empirical strategy, and our results. The final section discusses our conclusions and provides policy recommendations based on the results.

## 2. THE INTERVENTION

The microfinance intervention that we study is the community-managed microfinance VSLA program. VSLAs are a form of accumulating savings and credit associations (following the definitions used by, e.g., Bouman, 1995) where villagers meet every week and contribute a certain amount to a common pool of funds. The procedures for setting up and running these groups are thoroughly documented in a set of manuals (Allen & Staehle, 2007). No external funds are provided, so all loans are made using the participants' savings. There are lower and upper limits to the amount that it is possible to save at each meeting. Credit is provided to members at an interest rate set by the group, typically 5–10% per month with a three-month repayment period. VSLAs also include a welfare fund financed by very small weekly payments from each member. The welfare fund can be invoked on certain occasions such as a death in the family of a member, a crop failure, or a wedding.

The manner in which VSLA groups are formed is essential for the present study. In the case of our study, the formation of VSLAs was facilitated by a local organization called *SOLDEV*. The implementing organization approaches the village leaders for their approval of the project. The village leaders are asked to gather all villagers who might be interested in joining such a group for an awareness meeting at a designated time. The awareness meetings are held in the villages to inform people about the initiative. Villagers are asked to form groups with other villagers they trust. Subsequently, the implementing organization conducts training sessions. During the first three months, a field officer participates in every group meeting and trains the groups in various aspects of the methodology: electing a management committee, administering savings, giving out loans, and so on. After the first three months, the group continues to be supervised by the field officer, although with less frequency. After 12 months, the groups "mature" and are no longer supervised by the implementing organization.

## 3. METHODS

Assessments of outreach usually involve the comparison of participants and nonparticipants in a specific area with respect to a measure of interest, and the present analysis is no exception. But there are several methodological choices to be made within this overall framework. One concerns the timing of the data collection. It is common to use cross-section data collected after the program has been running for a while and to simply compare participants and nonparticipants at a single specific time. This approach was used, for example, by Mohammed, Norris, Evans Alayne, & Timothy, 1999; Navajas *et al*., 2000, and Zeller *et al*., 2006. The question asked is: Does the level of welfare affect the probability of participation? An obvious problem with using cross-section data is often ignored: Participation in the program might itself affect the welfare levels of the participants (or the variance of the welfare measure), and a comparison of nonparticipants and participants at some point after the start of the program might confuse program effects with preprogram differences.

This is a particular concern since most interventions are designed to be welfare enhancing. In a recent study of community-managed microfinance, we found the intervention to result in a 5% increase in total consumption (Ksoll, Lilleør, Lønborg, & Rasmussen, 2013). Even if participants and nonparticipants had identical profiles at the program startup time, a cross-section analysis carried out after the intervention was implemented would have shown participants to be richer, even though the outreach was neutral. In the present study we rely on panel data, which allows us to overcome this problem. We can assess the level of poverty of the households before the intervention was introduced, and combine this with information about the participation of the exact same households in the intervention two years later. This allows us to generate unbiased results on the outreach of VSLAs.