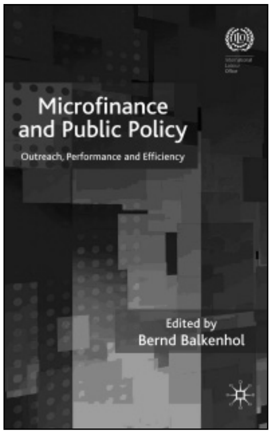
Reviews and resources



Microfinance and Public Policy: Outreach, Performance and Efficiency
Bernd Balkenhol (Ed.)
2007, Palgrave Macmillan / ILO, pp263, ISBN: 978-92-2-119347-0

Public policy makers are asking serious questions of the microfinance sector. What has been achieved with the extensive funds invested in the sector to build financially viable institutions and extend outreach to poor people with impact given at least 10 years of strong support? Should continued funding be provided? In the current context of financial crisis, the provision of subsidies in the form of bail outs is well understood to create moral hazards for financial institutions – are microfinance institutions another such example?

With increasing emphasis from major stakeholders such as CGAP and the World Bank on working with a wide range of institutions and in particular the private sector, to develop 'inclusive financial systems' that provide 'finance for all', the more 'traditional' MFI sector is at risk of going out of donor fashion, and the subsidies it is used to receiving being allocated elsewhere – including to other sectors given the increasing questioning of not just outreach and performance but also impact. Obviously microfinance policy makers and practitioners have a stake in answering these questions.

This is the context for this timely contribution focusing on public policy and efficiency. It asks the question as to how public policy makers should distribute the subsidies at their disposal in order to incentivize and reward performance. In doing so it also seeks to ensure that the social dimensions of microfinance performance are brought into the assessment. This is an important aspect that has been inadequately dealt with to date as social performance has tended to be less specifically measured and assessed by donors than financial performance.

The book therefore argues that donors should focus on assessing efficiency along both these dimensions. In particular it highlights the prospect of using a particular means of analysis called data envelopment analysis to enable comparisons to be made by identifying institutions that are most efficient within a particular context (for example national) or type of provider (for example NGO, bank). This allows relative as-

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sessments of the efficiency of institutions to be made and used as benchmarks for setting performance targets.

The book is based on a collaborative research project run by the Geneva Institute of Development Studies at the University of Geneva in collaboration with Cambridge University and the ILO.

The book is an edited collection of chapters organized into three main sections with overall introduction and conclusion by the editor. The first sets up the conceptual framework with chapters covering relatively well-known ground on poverty focus and inequality (Diop, Hillenkamp, Servet); using a capability perspective to focus on the multidimensional contribution of microfinance to addressing poverty (Comin); measuring social as well as financial sustainability (Simanowitz); and 'smart subsidies' (Morduch). The last of these argues that the issue for subsidies is how to use them effectively to maximize social benefits while minimizing distortions and mistargeting, also pointing out that they can often lead to 'crowding in' rather than 'crowding out' of other investments, especially, for example, where they offer the under-writing of risks on new and poorly understood ventures for private investors, or broad oversight of institutions that other investors might deem too unknown.

The second empirical section presents the quantitative analysis. The first chapter on MFIs in Peru (Fluckiger and Vassiliev) is the only chapter that actually uses Data Envelopment Analysis to demonstrate the construction of an efficiency frontier and identify a 'best in class' MFI. However, the chapter also acknowledges the limitations of data sets, especially of social performance, and the fact that the relationship may be determined by other variables such as those related to the wider operating environment, funding structure and management practices. This suggests that although the method may take us in the right direction, there is still a long way to go in availing adequate data with which to carry out such analyses. In the next chapter a more general assessment of the efficiency of intermediation across the financial sector is the focus using interest rate spreads in Kenya as an indicator (Beck). An examination of efficiency drivers and constraints is then conducted on the 45 MFIs that were core to the research project (Hamed). This explores the clustering of MFIs combining financial and social performance in different ways (whether or not poverty focussed/whether or not financially sustainable) and the results demonstrate that neither approach necessarily leads to more efficient performance. Thus efficiency can be used independently of these dimensions as a useful criterion. The final chapter in this section used factor analysis to better understand performance (Luzzi and Weber). Again the data limitations appeared rather important – in this case perhaps a lack of quantity – but a lack that the resources of this research project did not overcome and suggests that data are still a binding constraint for the further analysis of these issues.

The earlier analyses recognize the importance of the operating environment and context for performance, and the limitations of pooling data across institutions and contexts. Therefore the third section turns to investigate country case studies as a means to untangle some of the issues. The case studies are of Mali (Serra, Botti and Cherel-Robson); Morocco (Meknassi); Eastern Europe and Central Asia (Pytowska) and Chile (Merino). The Mali case shows how tricky the balancing of financial and social performance decisions are when donors are wanting to withdraw and MFIs face difficult conditions in reaching poor people. This suggests that donors face a range of pressures in justifying ongoing support in the face of institutions that have not 'solved' the trade-off. The Chilean case discusses the government-funded Access to Credit Program started in 1992, which used competitive tendering to allocate subsidies to both bank and non-bank institutions *after* they made loans to microenterprises. This appears to have interested banks in this sector and by subsidizing their transaction costs for up to three loans, enabled them to build up relationships with microenterprises and lower their costs through learning over time.

Overall, this reviewer felt that the issues raised were important and timely but that the volume demonstrated the difficulty of making significant progress on them. Certainly it made clear the difficulty of operating with the data available even where specific efforts have been made to collect it. It importantly recognized the difficulties of cross-country comparison given the multiplicity of operating environments, institutional forms and so on to be taken into account, and subsets to deal with this inevitably lead to small samples that limit the usefulness of quantitative analysis.

The idea of using efficiency as a criterion is clearly ideal but one is left with the view that it is far from straightforward. However, it seems hard to discount the fact that donors have perhaps been using a rather more 'quick and dirty' version of Data Envelopment Analysis as they go along – comparing the performance of different institutions in particular contexts and putting pressure on the less-well-performing ones to do better. That is not to say that they do not suffer path-dependence in their relationships of support to institutions and may need more data to make the tough decisions they face to withdraw or restructure their subsidies. But it also leads one to wonder whether aid and subsidies are not about those relationships in any case. In this light, the discussion by Balkenhol in the final chapter of the variety of donor approaches and interests in the sector leads one to be rather pessimistic as to the political feasibility of getting donors to adopt efficiency measures although increasing donor harmonization may lead them in that direction.

The book is a useful read for researchers in the area, and while it raises interesting issues for policy makers and practitioners, they may be deterred by the quite technical exposition of Section 3.

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