



GORDON INSTITUTE
OF BUSINESS SCIENCE

University of Pretoria

Achieving sustainability while delivering on the social impact: challenges facing microfinance institutions

Eric Kasenge

Student No: 10673157

A research project submitted to the Gordon Institute of Business Science,
University of Pretoria, in partial fulfilment of the requirements for the degree of
Master of Business Administration.

09 November 2011

Abstract

The aim of this study was to investigate how Microfinance Institutions (MFIs) in South Africa balance sustainability with developmental objectives. Twelve semi-structured, in-depth interviews were conducted with microfinance subject matter and microfinance institutions.

The research found that commercialisation is not compatible with social impact as it leads to mission drift, which can be managed by an inclusive stakeholder governance structure. The trade-off between sustainability and social impact (outreach) was evident for commercial MFIs; while sustainability can be achieved through scale and cost management. In addition, MFIs achieve lower delinquency rate by implementing non-financial interventions such as client training and using group lending methodology that fosters social capital in the client base.

The lack of a visible collaboration between MFIs has deprived the industry of a strong voice that can mobilise society to leverage the benefits of microfinance to help South Africa reduce inequalities. Despite the fact that regulatory restrictions concerning savings mobilisation for micro enterprise lenders are inhibiting product innovation and curtailing outreach, microfinance has proved to be a valuable tool that South Africa has not leveraged to alleviate poverty and reduce income inequalities.

Keywords: Microfinance, Microfinance Institution, Sustainability, Social Impact

Declaration

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

Eric Kasenge

Date

Acknowledgements

I would like to acknowledge the following people and sincerely express my thanks for their valuable contribution:

Zenobia Ismail, my supervisor who has been obliging as often times I did not keep to the committed deadlines while compiling the various chapters.

Barbara Calvin who has been very generous with her time, sharing her experience in microfinance, and asking probing questions that enhanced my analysis and interpretation of the findings. Also, for offering her contact list that facilitated access for the subject matter experts and institutions interviews.

Prof. Gerhard Coetzee, who provided guidance on the literature and shared his insights into microfinance and economic development.

All the interviewees who were very generous with their time, they shared their experience and insights on microfinance.

My management at the IBM Corporation who have been understanding and gave me the space to pursue the MBA qualification.

I acknowledge my wife Isabelle, for her understanding, quiet support and encouragement.

This research is a celebration of the journey on earth of my late dad, Paul Uteta Kasenge, who so much believed in education that he would not hesitate to sponsor anybody willing but who was facing obstacles to pursue their studies.

Table of contents

Chapter 1: Introduction to Research Problem	1
1.1 Background to the Research Problem	1
1.2 Research Problem	3
1.3 Research Objectives	4
1.4 Motivation for the Research	5
1.5 Research Scope	6
Chapter 2: Literature Review.....	7
2.1 Introduction	7
2.2 Social Impact	9
2.2.1 Client Perspective.....	11
2.2.2 Microfinance Institutions (MFIs) Perspective	13
2.3 Sustainability of Microfinance Institutions.....	15
2.3.1 Mission Drift.....	19
2.3.2 Factors against Sustainability	20
2.3.3 Strategies to achieve Sustainability	23
2.4 Microfinance Institutions in South Africa	25
2.5 Microfinance Institutions and Social Impact	28
2.6 Conclusion	30
Chapter 3: Research Questions.....	32
Chapter 4: Research Methodology.....	33
4.1 Proposed Research Method	33
4.2 Research Design	33
4.2.1 Qualitative Technique.....	34
4.3 Population	35
4.4 Sampling Method and Size	36
4.5 Unit of Analysis	37
4.6 Interview Schedule Design.....	37
4.7 Data Collection and Data Analysis	38
4.7.1 Data Collection	38
4.7.2 Data Analysis.....	39
4.8 Validity and Reliability	41

4.9	Research Limitations.....	42
Chapter 5: Results		43
5.1	Description of Sample.....	43
5.2	Findings	47
5.2.1	Results for Research Question 1.....	48
5.2.2	Results for Research Question 2.....	54
5.2.3	Results for Research Question 3.....	60
5.2.4	Results for Research Question 4.....	65
5.2.5	Results for Research Question 5.....	68
5.3	Conclusion of Chapter 5.....	70
Chapter 6: Discussion of Results		71
6.1	Introduction	71
6.2	Commercialisation	72
6.2.1	Funding	73
6.2.2	Mission Drift.....	75
6.3	Sustainability and Social Impact	76
6.3.1	Outreach.....	77
6.4	Business Practices to Achieve Sustainability	79
6.4.1	Scale	79
6.4.2	Managing Costs.....	79
6.4.3	Monitoring of Loans	81
6.4.4	Management Capacity.....	82
6.4.5	Patient Capital	82
6.5	Lending Methodology and Delinquency Rate.....	83
6.6	Role of Governance	85
Chapter 7: Conclusion.....		86
7.1	Research Background and Objectives.....	86
7.2	Main Findings.....	86
7.3	Research Implications.....	88
7.4	Research Limitations.....	89
7.5	Future Research Directions	89
7.6	Summary.....	90
Reference List.....		91

Appendix I - Consistency Matrix.....	101
Appendix II - Interview Guides	103
Appendix III - Microfinance Institutions Performance Indicators.....	106
Appendix IV - Interview Consent Form.....	107

List of Tables

Table 1: Suppliers of Microfinance Services in South Africa	26
Table 2: Profiles of Subject Matter Expert Interviewees	44
Table 3: Profile of Microfinance Institutions interviewed.....	46
Table 4: Research Question 1 - Commercialisation	48
Table 5: Research Question 2 – Social Impact	54
Table 6: Research Question 3 – Business Practices that impact sustainability	61
Table 7: Research Question 4 – Social Capital fosters low delinquency rate ..	66
Table 8: Research Question 5 – Importance of Governance	68

Chapter 1: Introduction to Research Problem

1.1 Background to the Research Problem

In July 2010, India's largest microfinance institution SKS Microfinance, with an estimated client base of 5.8 million, listed on the Bombay and National Stock Exchanges, with an initial public offering (IPO) that was heavily oversubscribed. The IPO was part of a growth strategy built on a transformation process from an initial non-government organisation (NGO) to a publicly listed organisation (Chen, Rasmussen, Reille & Rozas, 2010). The transformation and commercialisation raised questions as to whether the intent to deliver on shareholder expectations would dilute the social mission of Microfinance Institutions.

The need for financial access is evident, as Beshouri and Gravråk (2010) contended that the very poor in emerging economies have a surprising interest in financial services, and use them enthusiastically whenever possible. In spite of their interest, Chaia et al. (2009) estimated that over half of the world's adult population do not use any form of formal (or semi-formal) financial services. This accounts for approximately 2.5 billion people.

Indeed, microfinance has emerged as a tool to alleviate poverty, by providing access to financial services to populations located at the Base of the Pyramid (BoP). Prahalad (2006) defined the BoP as people living on far less than \$2 a day. A few narratives of cases that have seen individuals escape poverty through access to microfinance have been documented by Akula (2010) and Goldberg (2005). These accounts have mostly been through micro enterprise loans that have helped the poor build income generating micro businesses.

There are, however dissenting voices and cautions as to the simplicity of such a causal relationship established between financial access for the BoP and poverty reduction. Honohan (2008) argued that because of biases in various studies undertaken to measure whether financial access contributed directly to poverty reduction, microeconomic analyses were not conclusive. An assessment by the Grameen Foundation USA contended that the lack of consensus on 'what microfinance' is, adds to the lack of a conclusive result on the impacts of microfinance (Goldberg, 2005). Goldberg's findings suggested that microfinance programs can increase incomes and lift families out of poverty; and the benefits can take the form of improved children's nutrition and increased school enrolment rates within communities.

Rosenberg (2010) established that, microcredit (microfinance) provided a reliable source of financial access for poor households. Such reliability helps the BoP improve their lives such that they are willing to ensure accessibility by guaranteeing payments to the microfinance institutions; represented by a global average loan loss rate of below 2.5%. Rosenberg further stated that the reliability of MFIs makes it such that, the MFI becomes the first option poor households consider for their loan requirements. Increasingly, innovations and technology are providing access to financial services for the BoP through mobile banking in developing markets (Beshouri & Gravrák, 2010).

In October 2010, negative publicity against microfinance institutions (MFIs) reached a climax with suicides in Andhra Pradesh, India linked to loan collection practices, which some have attributed to the strong commercial focus that MFIs have taken (Kazmin, 2010). Commercialisation has opposed Grameen Bank

founder and 2006 Nobel peace laureate Muhammad Yunus against Banco Compartamos, following the latter's IPO that raised \$1 billion in 2007, while charging an interest rate of 79% for its loans to the poor. Banco Compartamos argued they would serve more of the poor by being financially profitable rather than depending on charity (*“Doing good,”* 2008). This position argues in favour of commercialisation as a means to achieve greater outreach, i.e. serving more clients at the bottom of the pyramid.

This state of affairs has prompted Lascelles and Mendelson (2011) to ask whether microfinance institutions are at a ‘tipping point’, as suggested in the preface of the Microfinance Banana Skins 2011 report; as a result of the pursuit for profit evidenced by commercialisation of some of the institutions.

1.2 Research Problem

In South Africa, poverty alleviation has been part of the national discourse for more than 15 years in an effort to reduce the growing inequalities in the country. The Gini coefficient had risen from 0.64 in 2002 and was estimated to be 0.68 in 2008, with an estimated 40% of the population living below the poverty line of R283 per month (Calvin & Coetzee, 2010). In 2010, about 23.5% of the South African population did not have access to financial products; as such the un-banked would keep money in a safe place at home and borrow from friends (Ndzamela, 2010). Barriers to financial inclusion ranged from structural problems, such as lack of jobs to financial illiteracy (FinMark Trust, 2010).

The purpose of this paper was to investigate the tension between the need for microfinance institutions (MFIs) to alleviate poverty while pursuing sustainability, delivered through commercialisation.

1.3 Research Objectives

This research project sought to address the following objectives:

1. Interrogate the strategies MFIs in South Africa are pursuing to achieve sustainability, including transforming into a commercial organisation.
2. Investigate the tension between the need to deliver on the social mission of the MFI to serve more of the BoP population and the profit motive as a means to achieve sustainability.
3. Identify the business practices that contribute to the MFIs achieving sustainability, both from a financial performance and social impact perspective.
4. Validate whether the social nature of MFIs group lending methodologies contribute to better portfolio quality which contributes to sustainability.

1.4 Motivation for the Research

Financial sustainability of the microfinance institution guarantees the viability of the organisation, thereby ensuring poverty alleviation. As a result, it would enrich the discourse to combat inequalities in South Africa to understand the elements that contribute to the viability of MFIs.

Having analysed the tension between depth of outreach and sustainability of MFIs, Quayes (2012) recommended a similar analysis of the possible trade-off between breadth of outreach and financial sustainability. Outreach is a measure of how many of the BoP population (breadth) and how poor (depth) the population served by MFIs are.

A further consideration in the sustainability of MFIs is the amount of subsidies most MFIs receive from donor organisations or governments, in support of the social mission to alleviate poverty. Pollinger, Outhwaite and Cordero-Guzmán (2007) suggested that the subsidies had a long term impact on the sustainability of the MFIs. This suggestion is based on the fact that subsidies tend to eclipse the true costs of operations. As a result, Pollinger et al. have suggested that *“more research is needed to ascertain whether the provision of microfinance offers societal benefit in excess of economic costs”* (2007, p. 39).

In analysing the cost efficiency and productivity of MFIs in South Africa, Baumann (2005) established the high cost structures MFIs face compared to their counterparts in other developing economies. With such high costs, he raised the question whether social capital generated by microfinance, made it a worthy substitute in poverty alleviation, compared to existing voluntary savings and credit groups.

The studies referred to above suggested the benefits of understanding the trade-off between outreach as a proxy measure of social impact, and sustainability; investigating whether subsidies received by NGO-type MFIs hid inefficiencies in operations with the corollary that commercialisation would resolve the issues; validating whether the running costs of MFIs were worthy in poverty alleviation, as a result of the social capital generated.

1.5 Research Scope

The scope of this study focuses on microfinance institutions (MFIs) operating a micro enterprise lending operation. The researcher will identify the strategies MFIs are pursuing to attain sustainability, measured through financial and social performance. The researcher will also attempt to identify business best practices that contribute to delivering a social impact while remaining financially viable.

Chapter 2: Literature Review

2.1 Introduction

This research focused on the social impact Microfinance Institutions (MFIs) seek to achieve by providing financial access to the poor. MFIs provide small loans to the base of the pyramid (BoP) population, who are left out of the financial system due to the lack of stable income and absence of collateral. The loans provided are often used to grow micro enterprises, which in turn contribute to income stability; thus alleviating poverty.

Banerjee and Duflo (2007) in their analysis of the lives of the poor identified a pattern whereby, poor families sought out economic opportunities, but did not specialise. The lack of specialisation was attributed to risk mitigation, and as such, they contended that the poor tended to have multiple occupations which, coupled with the lack of assets and access to financial markets, suggested why so many of the poor are entrepreneurs. The notion that poverty alleviation can be achieved through financial access (or financial inclusion) was the premise behind the start of the microcredit movement 30 years ago (Mendoza & Vick, 2010).

In addition, the pursuit of poverty reduction is sustained by MFIs operating with a business model that ensures longevity of the organisation as a going concern.

Although over the past 30 years, microfinance has extended financial access to the poor, Helms (2006) identified the following three challenges as inhibitors to financial inclusion of more of the poor population:

- Scale – scaling financial services access to more people;
- Depth – reaching even more poorer and remote people; and
- Cost – lowering both cost to clients and financial service providers.

In looking at the challenges facing microfinance institutions in 2011, Lascelles and Mendelson (2011) conducted a worldwide survey of MFIs and highlighted that the number one challenge faced by MFIs was credit risk default. This is primarily due to increased indebtedness of clients, fuelled by increased competition. MFIs' clients are pushed to take on more debt, often at the solicitation of MFIs who are hungry for business in a growing competitive environment. Indeed, a growing number of players entering the microlending market, including established commercial banks, often with available capital, technology and mass marketing skills have contributed to increased competition. The increased indebtedness threatens the “99 per cent” repayment rate that MFIs are known for (p. 6).

Weak corporate governance was also noted amongst the top challenges facing MFIs. This is as a result of weak internal controls as well as lack of resources for MFIs to acquire the right expertise to adopt appropriate risk management business processes.

The literature review focused on three constructs, namely the social impact through poverty alleviation, sustainability of microfinance institutions and the challenges they face, and the specifics of sustainability of MFIs in South Africa.

2.2 Social Impact

Empirical evidence has shown that financial development contributes to poverty alleviation, and reduces inequalities by accelerating the income growth of the poor (Beck, Demirgüç-Kunt & Levine, 2007; Beck & Demirgüç-kunt, 2008). The poor are often faced with transitory income shocks, of which the social consequences are exacerbated by the lack of access to financial markets. Amongst these, is the reduction on children's education, which has the long term effect of perpetuating poverty and increasing child labour, as suggested by Beck et al (2007).

Social impact is understood to be the primary benefit of microfinance to society. Manos and Yaron (2009) however noted the difficulty of isolating these benefits as they ranged from benefits accruing to clients such as income improvement and poverty alleviation as well as societal gains such as food security, economic growth and women's empowerment. Manos and Yaron consequently settled on two criteria for consideration when assessing the performance of MFIs, namely, subsidy dependence index and outreach.

In a simplistic definition of social impact, throughout this paper, poverty alleviation is noted as a social impact of microfinance.

Maes and Basou (2005) reported evidence of economic self-reliance progress, when using microfinance as a source of seed capital to fund micro-enterprise development. In addition, with training to equip the micro-entrepreneur with financial literacy and financial management skills, the micro-enterprise increased productivity and savings ability. Akula (2010) attributed the growth of his microfinance company in India to focusing on delivering value to the poor with norms based on group lending with a high social capital amongst the members. If a member was unable to repay the loan, the group lending norm was such that the other members would assist in the repayment.

However, there is caution against approaching microfinance as a silver bullet for poverty alleviation. Beck and Ogden (2007) warned organisations using microfinance institutions as a way to build social capital through Corporate Social Responsibility (CSR) funding 'poverty-reducing' projects to focus on outcomes. This warning was based on evidence that microfinance was found to not provide a statistically relevance correlation between access to financial capital and migrating upwards through the pyramid tier (Honohan, 2008). This assertion was further supported by studies conducted by the Massachusetts Institute of Technology's Poverty Action Lab (Banerjee, Duflo, Glennerster & Kinnan, 2009), which revealed that most of the BoP recipients of loans would not invest the money but spend it on basic living necessities. This perpetuates chronic indebtedness and poverty. Beck and Demirgüç-kunt (2008) suggested that the lack of adequate savings instruments was the reason why a large percentage of BoP recipients would use the loans for consumption rather than investments.

However, supporters of consumption loans contend that the reasons for consumer loans vary from medical emergency (health), education, transport to funeral assistance, and are seldom used for food.

Social impact is directly related to outreach, i.e. the number of people the MFI is able to reach. Cull, Demirgüç-Kunt and Morduch (2007) established that lending-types have a bearing on outreach in that, individual lending MFIs tend to be more profitable however provide less outreach; when measured in terms of reaching the poorest of the poor.

2.2.1 Client Perspective

Helms (2006) defined a typical microfinance client as a self-employed, often home-based entrepreneur; however a potential client constituted anyone excluded from formal financial services; also referred to as the “un-banked”.

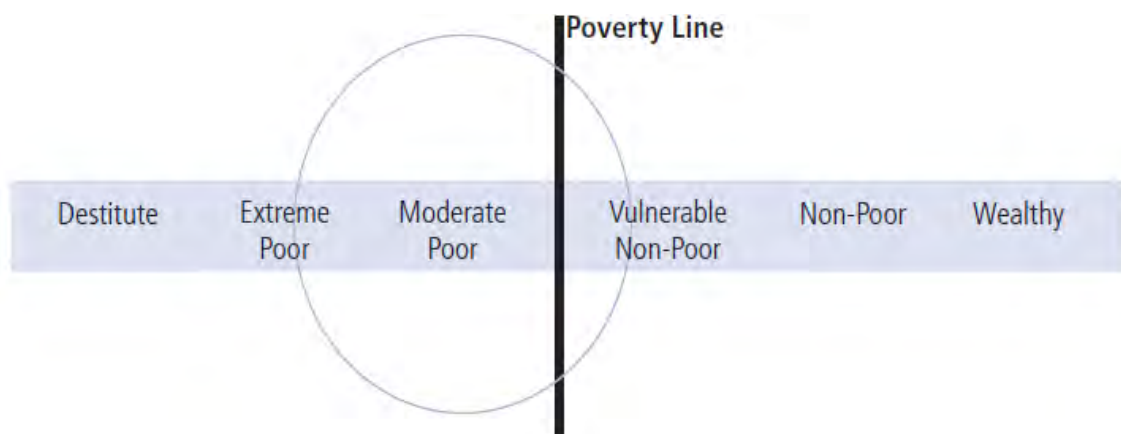


Figure 1: How Poor Are Microfinance Clients?

(Source: Helms, 2006, p. 20)

Mendoza and Vick (2010) estimated the target population worldwide of roughly 3 billion people in need of financial services (credit), while formal access provided by microfinance accounts for 16% world wide and 4.91% in Sub-Saharan Africa. Figure 1 above shows the depth microfinance institutions have achieved in extending financial access to the poorest of the poor.

Identifying the poverty levels of clients is important not only to match customers with the most appropriate financial services, but also to serve as a poverty-outreach metric that MFIs can use to communicate to socially minded investors and donors (Mendoza & Vick, 2010).

The microfinance client needs are said to go beyond credit. Helms (2006) as well as Beck and Demirgüç-kunt (2008) suggested that their needs extend to a range of options including savings, money transfer facilities, and insurance in many forms. As a result, MFIs' response to the clients should be based on a needs analysis, which in turn should frame the institutions' response in the form of product design for the poor.

Marconi and Mosley (2006) suggested that credit-only MFIs experienced worse default rates than MFIs that offered an "integrated lending model"; including training, health services, advice on legal rights and political education. Mendoza and Vick (2010) agreed that such an integrated lending model is required to incur greater client loyalty for the microfinance institution. This is evidence that pursuing social impact contributes to portfolio quality which can strengthen sustainability.

2.2.2 Microfinance Institutions (MFIs) Perspective

In order to improve financial access, Mendoza and Vick (2010) argued that both the private sector and public sector (government) have a role to play. The private sector should serve as a source of product and process innovations, while the public sector should serve as a market enabler, thus unlocking development.

The Consultative Group to Assist the Poor (CGAP) defined a microfinance institution (MFI) as an organisation that provided financial services to the poor. This definition included a wide range of organisations that vary in their legal structure, methodology and mission (*“What is a Microfinance Institution,”* 2011). The mission often determines the borrowers who participate in the MFI’s lending programmes (Pollinger et al., 2007).

Sanyal (2009) defined microfinance institutions as organisations that run programmes which include the provision of collateral-free loans and compulsory savings (not all MFIs include compulsory savings). The definitions reveal a tight link between the operational objective, which is the provision of access to finance and the social mission which is about the population targeted for the loans, i.e. the poor (Arena, 2008). Arena likened the operational objective to that of ordinary financial institutions, putting the MFIs in a position where they need enough working capital to sustain their operations. These organisations are either funded by developing countries governments, through private initiatives, or non-governmental parties funded by external agencies. Therefore, donors and investors play an important role in ensuring that MFIs have sufficient working capital.

Ayayi and Sene (2010) argued that for MFIs to stay in business and grow such that they can deliver more financial services to the poor, they need to charge higher than average interest rates. In the pursuit of profit, MFIs tend to focus on less poor clients and bigger loan sizes, which reduce the cost of delivering loans and ultimately improve profitability (Arena, 2008). In this manner sustainability is ensured as MFIs continue to deliver profits.

In an analysis of for-profit versus not-for-profit operating models used by MFIs in India, Hudon (2008) established that profit driven MFIs (commercial) set best practices for efficiency, productivity standards and interest rates; while not-for-profit MFIs influenced the ethical norms of the industry. In using the average loan size as a proxy to measure the extent that the MFI served the poorest, Quayes (2012) established that not-for-profit MFIs had an average loan size smaller than their for-profit counterparts. The corollary is that for-profit MFIs tend to migrate away from serving the poorest of the poor in the client base. The counter argument is that the average loan size may not be accurate as a proxy to assess depth of outreach, because a few big loans to a limited number of clients can eclipse the thousands of small loans to the poor.

However, the complexities related to poverty-alleviation are such that not a single operating model applies. In the pursuit of reaching out to the poor and ensuring sustainability, it is not a matter of norms (for instance, group lending methodology versus financial sufficiency), but exploring the possibilities for a sustainable operating model.

The global financial crisis that initiated the recession in 2008, revealed a positive correlation between microfinance and the local economy (El-Zoghbi, Gähwiler & Lauer, 2011). The recession caused deterioration in the repayment capacity of the MFIs' customers, resulting in the deterioration of the MFIs' portfolio quality as seen in Figure 2 below.

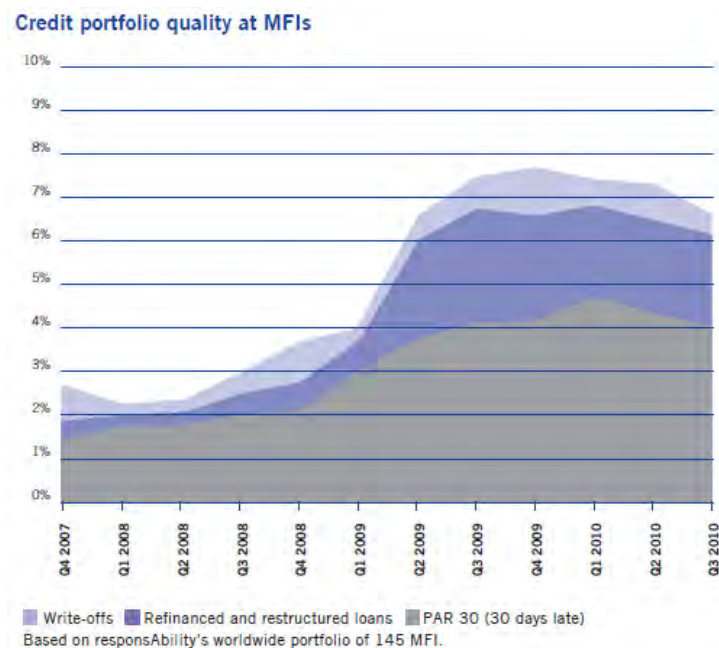


Figure 2: Deteriorating Portfolio Quality of 145 MFIs into 2011
(Source: "Microfinance Market Outlook," 2010)

2.3 Sustainability of Microfinance Institutions

According to Manos and Yaron (2009), two popular ways to measure financial sustainability of MFIs are the Subsidy Dependence Index (SDI) and the Financial Self-Sufficiency Index (FSS). They further expressed concern about the increasing reliance on FSS and argued that the FSS suffers from shortcomings as a measure of MFIs sustainability. The SDI aims to measure

the subsidies and grants that MFIs receive, thereby highlighting their opportunity costs and the MFI's dependence on subsidies. Hermes and Lensink (2007) in turn argued that SDI is considered to put too much emphasis on financial sustainability of MFIs without indicating why the subsidies are required.

Pollinger et al. (2007) defined sustainability as the ability to cover annual budgets including grants, donations, and other fundraising. In this mode of operation, the MFI is able to cover its total costs with donations, grants and income earned from lending operations. Epstein and Yuthas (2010) however, defined MFI's sustainability as the ability to generate sufficient income to cover all operating and financing expenses over time. Pollinger et al. further defined self-sufficiency as a state of operation where MFIs can survive and add to their asset base purely with income derived from their lending and related operations.

The definitions above were summarised by Ledgerwood (1999) in two levels of self-sufficiency as follows:

- **Operational Self-Sufficiency (OSS):** generating enough operating revenue to cover operating expenses, financing costs, and the provision for loan losses. It is an indication whether the MFI is earning enough revenue to cover direct costs, excluding the (adjusted) cost of capital but including any financial costs incurred. Below is the equation used to calculate OSS:

$$OSS = \frac{\text{OperatingIncome}}{\text{OperatingExpenses} + \text{FinancingCosts} + \text{ProvisionForLoanLosses}}$$

- Financial Self-Sufficiency (FSS) is about whether the MFI is generating enough revenue to cover both direct costs (financing costs, provisions for loan losses and operating expenses) and indirect costs, including the cost of capital. Below is the equation used to calculate FSS:

$$FSS = \frac{\text{Operating Income}}{\text{Operating Expenses} + \text{Financing Costs} + \text{Provision For Loan Losses} + \text{Cost Of Capital}}$$

In the context of this paper, the Microfinance Institution's sustainability was defined in terms of financial self-sufficiency (or independence). Such financial independence allows MFIs to grow the customer base, referred to as breadth of reach and grow product portfolio, referred to as depth (both of which are referred to as outreach). The aim of this definition was to encompass financial measurements as well as the social impact, which touches on the mission of the MFI. Achieving sustainability (self-sufficiency) is desirable for MFIs, as it enhances the profile and better position the MFI to raise funds from donors.

There is increasing pressure for the MFIs to become self-sufficient; to be able to self-fund their lending operations from interest and fees earned on repaid loans. Pollinger et al. (2007, p. 36) contended that self-sufficiency is attained by adopting "*business*" practices. This could be translated into MFIs operating as commercial organisations with a client focus and an operational efficiency, along with the organisational systems and processes that ensue.

Copestake (2007) highlighted the importance MFIs attached to serving more clients through growth. In support of the need for growth, Ledgerwood and White (2006) argued that MFIs are choosing to transform into deposit-taking organisations as they seek to expand their outreach through diversifying their products and services portfolio as well as restructuring their capital structure.

The latter talks to MFIs restructuring their balance sheets with debt and equity as a way of accessing additional capital required to expand their outreach. In articulating the benefits of the transformation into deposit-taking intermediaries as better governance and better ownership structure, Ledgerwood and White (2006) clarified what Pollinger et al. (2007) refer to as “business” practices. However, better business practices are not limited to governance and ownership. Copestake (2007) emphasised the need for social and financial performance monitoring. While the latter concerns constant evaluation of the extent to which MFIs are serving poorer clients with a broad range of services over a long period of time; financial performance ensures sustainability, and concerns risk management measures, technical skills (banking and organisational), the quality of board members and portfolio quality (Calvin & Coetzee, 2009).

The consequence that arises from the required transformation is the subdued tension between the need to deliver profit as a way to achieve sustainability versus the pursuit of the developmental mission to achieve poverty alleviation. This takes the form of trade-offs in the pursuit of self-sufficiency, between charging the highest legally allowed interest rate to ensure operating costs are covered from income from loans; versus relying on donor funding and keeping

interest rates low. The high interest rate the poor have to pay for financial services is evidence of the effect Mendoza (2011, p. 2) has termed the “*poverty penalty*”, which suggests that consumers at the BoP end up paying higher prices for most goods and services.

2.3.1 Mission Drift

The resulting mission drift is attributed to the fact that increasingly MFIs are being pushed to be financially self-sufficient and as a result have to choose between sustainability and a social developmental objective to alleviate poverty (Arena, 2008). Thus Cull et al. (2007, p. 126) defined mission drift as “*a shift in the composition of new clients, or a re-orientation from poorer to wealthier clients among existing clients*”. This is more evident with MFIs using individual lending methodology, though they admitted that as clients’ businesses grow, MFIs should be vigilant for new customers.

Evidence of mission drift was also confirmed by Quayes (2012) in the analysis of 702 MFIs, with not-for-profit MFIs having a better outreach (depth) than for-profit MFIs.

Epstein and Yuthas (2010) identified this tension as the basis of the mission diffusion and mission drift MFIs suffer from, in pursuing sustainability. One of the contributors to this tension is a consequence of the need to access skilled and experienced professionals for better managerial capacity and efficiency. As a result, in addition to succumbing to donor pressure, the mixture of individuals driven by the belief in the social objectives causes frictions with donors and

managers with institutional banking experience, such that board meetings are spent discussing fund raising rather than strategies to achieve the objectives (Epstein & Yuthas ,2010; Copestake, 2007).

Getu (2007) acknowledged that the ownership structure and the pursuit of delivering shareholder value as a result of commercialisation of the MFI, if not kept in check, would cause a mission drift.

2.3.2 Factors against Sustainability

2.3.2.1 Costs to the institutions

The cost of serving clients at the base of the pyramid with smaller loans lengthens the time it takes an MFI to break even. Mendoza and Vick (2010) highlighted information asymmetries for MFIs, which contribute to high screening and monitoring costs. This is often amplified by an unstable economic and political landscape as well as the presence of weak institutions in developing economies. Such a cocktail of risks increases the cost of capital. In addition, poor infrastructure (such as roads and telecommunications) in rural areas exacerbates the costs of operation for MFIs. As a result, MFIs rely on group lending methodologies to reduce the information asymmetry and foster social pressure to encourage client repayments.

Another MFIs' cost driver is compliance with regulation. Cull, Demirgüç-Kunt and Morduch (2011) defined prudential and non-prudential regulation; the former concerning protection of the financial system as a whole (e.g. institution liquidity ratio) relating to client deposits, while the latter concerns rules

governing the formation and operations of institutions, such as consumer protection, interest rate limits, tax and accounting issues. Cull et al. (2011) found evidence that compliance to prudential regulation specifically required costly specialist skilled personnel and, as a result, profit driven MFIs respond in curtailing outreach to clients that are costly to serve.

2.3.2.2 Portfolio Quality

Portfolio quality is a performance indicator that provides a forward looking view of the financial risk of MFIs based on the loans outstanding. Historically the repayment rate has represented MFI performance. ‘Portfolio at risk’ (PAR) is a ratio that measures the portfolio quality and “*refers to the outstanding balance of all loans that have an amount overdue*” (Ledgerwood, 1999, p. 206).

A known major contributor to the good repayment rate MFIs enjoy is the group lending methodology employed. Roodman and Qureshi (2006) as well as Mendoza and Vick (2010) agreed that group lending methodologies help mitigate the effects of information asymmetries, and therefore reduce risk of default to the institution, which translates into better portfolio quality.

Cull et al. (2007) found evidence to support the hypothesis that institutions that do not use group-based lending methods to address information problems, have a deteriorating “portfolio at risk” when raising interest rate to achieve better profitability; and when using individual-based lending methods the risk is exacerbated. They further suggested that individual-based lending becomes appropriate for MFI’s clients needing to invest larger loans in businesses.

Banerjee and Duflo (2007) explained that as a result, MFIs have to incur additional costs in training clients on the methodology and financial management, to ensure that their loans get repaid, which drives up interest rates. Considering that the loan amount is small, profits from operations may not be large enough to cover the cost of monitoring/screening.

2.3.2.3 Costs to Clients

Interest and fees from loans represent the income that MFIs earn from lending operations. Beck and Demirgüç-kunt (2008) described the various barriers and costs that MFI clients incur to have access to financial services. Amongst the costs clients incur are: financial costs in the form of interest, fees, transport costs, economic costs in the form of opportunity cost and agency costs. Additional costs incurred are emotional, as a result of societal changes caused by women's empowerment, for instance.

Cull et al. (2007) warned of the agency theory that can be caused by increasing interest rates, in a situation whereby lenders face informational asymmetry and borrowers lack collateral. The resulting problems are adverse selection and moral hazard. With high rates, *“only low-quality borrowers that do not expect to be able to repay would find it in their interest to borrow”* (p. 121).

2.3.3 Strategies to achieve Sustainability

2.3.3.1 Commercialisation

Commercialisation is the transformation of non-governmental organisations (NGO) and not-for-profit microfinance institutions into profit-driven commercial microfinance institutions. Getu (2007) and Quayes (2012) contended that amongst the reasons why MFIs transform into commercial banks is to mobilise deposits for on-lending purposes. The rationale being, that in order to reach out to more clients, the availability of capital is limited and hence a constraint to growth. Deposit taking is a regulated activity in most countries and therefore requires adequate licensing by the appropriate regulator.

Helms (2006) noted that “the rationale for this approach [commercialisation], often referred to as seeking sustainability, is to become independent from unpredictable donor financing and tap commercial sources of funding to fuel growth and reach more poor people” (p. 45).

The second reason, Getu (2007) purported was the mobilisation of savings, which allows the MFI to broaden its customer base to include savers.

The third reason for commercialisation stems from increased competition amongst MFIs and uncertainty about grants. These came from governments and donor agencies. With the latter placing increased pressure on MFIs such that commercialisation is seen as a way for MFIs to insulate themselves from such uncertainty, thereby increasing their independence (Quayes, 2012).

Regulatory changes are noted as the fourth reason for MFIs’ commercialisation (Getu, 2007). Increasingly, governments and central banks in developing

economies are regulating credit operations, prompted MFIs in some countries, to fear that their operations might be restricted in future, unless they register as commercial financial organisations.

2.3.3.2 Governance

Good corporate governance was highlighted in the Banana Skins report as a challenge facing MFIs in 2011 (Lascelles & Mendelson, 2011). Arena (2008) contended that good governance practices would equip an MFI to manage the trade-off between outreach and financial self-sufficiency, “*to the detriment of neither*” (p. 283). In that respect, Mersland (2011) suggested that MFIs ought to set up governance systems to mitigate agency costs, stemming from multiple stakeholders. These agency costs may be horizontal in nature, i.e. their relationships with customers and donors; hence different from the typical need to align managers’ interests with firm owners’.

Mersland and Strom (2009) used the premise that “*governance is about achieving corporate goals. The first goal of MFIs is to reach more clients in the poorer strata of the population, and the second goal is financial sustainability*” (p. 663). Mersland and Strom (2009) further established that the MFI’s financial performance improved when the board was informed by an internal auditor, had local directors and the MFI was led by a woman Chief Executive Officer (CEO). Outreach improved, i.e. the MFI was reaching more clients with a lower average loan size (proxy for poorer clients), when the MFI had a dual CEO/chairman and did not use individual lending as a lending methodology.

In considering the board composition and diversity for enriched perspective in decision making, Mersland (2011) agrees with Mori (2010), and advocated that MFIs should consider a broader stakeholder-based approach to governance. Mori (2010) further identified six types of stakeholders sitting on MFIs' boards as clients, employees, government, donors, creditors and owners. This approach is based on the Stakeholder Theory, which "*posits that an organization is a social construction made of interaction of various stakeholders*" (Mori, 2010, p. 53). This definition aligns with the double-bottom line MFIs seek to deliver, and reflects the multitude of constituencies that contribute to the MFIs' operation.

Governance, through its various mechanisms does have an impact on both outreach and financial performance of the MFI.

2.4 Microfinance Institutions in South Africa

In their review of the South African microfinance sector, Calvin and Coetzee (2010) used a broader definition of microfinance as "the provision of formal financial services to low income households". Based on this definition, MFIs in the South African context include three main microfinance products: deposit services for low income market, micro loans to salaried individuals, and micro enterprise loans.

Banerjee and Duflo (2007) established that in many countries, poor households have multiple occupations. However, this does not seem to be the case in South Africa, where Banerjee and Duflo reported that almost no one has more

than one occupation, with less than 1 percent of South Africans rural poor or extremely poor reporting multiple occupations. This assertion questions the nature of survivalist entrepreneurship amongst the poor in South Africa, or could reveal a peculiarity of the South African market.

Table 1: Suppliers of Microfinance Services in South Africa

Product	Micro Deposit Services	Salary-based Microloans	Microenterprise Loans
Suppliers	Primary Banks Alternative Banks Financial Cooperatives Stokvels Development Finance Institutions	Primary Banks Alternative Banks Financial Cooperatives Microlenders Development Finance Institutions	Primary Banks Financial Cooperatives Not-for-profit Microenterprise Lenders Development Finance Institutions
Stage of Development	Maturing	Maturing	Early Stage

(Source: Calvin & Coetzee, 2010, pg. 1)

Table 1 shows the diversity of service providers in the South African market.

Although the deposit-taking and salaried-individual lending markets are mature, the micro enterprise lending market suffers from high costs of operations (Calvin & Coetzee, 2010). Baumann (2005) argued that the cost structure of MFIs in South Africa creates an imbalance such that MFIs cannot operate from a profit motive perspective as charging higher interest rates would make the product unaffordable. As a result, the only options left to South African MFIs, other than closing, are to migrate their customer base higher up the BoP tier; innovate their product development or innovate the methods used to deliver products to their customer base.

Calvin and Coetzee (2010) confirmed this as a trend in finding that micro enterprise lenders were entering the salary-based loan market as a way to

cross-subsidise their products. The ability to cross-subsidise is also one of the reasons MFIs pursue transformation into deposit-taking institutions (Ledgerwood & White, 2006).

Baumann (2005) contended that the most compelling argument was that MFIs have to refocus from microcredit only into promoting savings as well. Baumann further concluded that the income inequality makes operating a microfinance institution in South Africa expensive relative to other developing markets. The economic structure is such that micro-enterprises have little value add in the production-to-consumption chain for wealth creation for the poor. Hence, the model for poverty alleviation takes the form of income support to the poor, rather than enforcing the BoPs production capacity. Calvin and Coetzee (2010) differed from this view, as their review of the sector showed that micro enterprise lending was still in its early stage of development, with the implication that micro-enterprises can grow provided their access to capital is enhanced. The market access was estimated at 3%.

However, with regard to sustainability, Calvin and Coetzee (2009) defined a triangular relationship between 'client service', 'Portfolio Quality' and 'Efficiency' as the challenges and trade-offs MFIs have to balance in order to achieve sustainability. The above three pillars represent the following:

- Client Service is about delivering products that meet the needs of the target market;
- Portfolio Quality is about the risk management and lending methodologies in place to ensure a low portfolio at risk (PAR) percentage;

- Efficiency is about the operational excellence that ensures the MFI is able to keep its operating costs low. This could take the form of leveraging partnerships for knowledge and distribution network.

Another ingredient that contributes to sustainability is the experience that MFIs acquire over many years of operation as confirmed by Epstein and Yuthas (2010).

2.5 Microfinance Institutions and Social Impact

Chowdhury, Mosley and Simanowitz (2004) recommend that in the assessment of the social impacts of microfinance, a wider approach beyond the direct impacts to microfinance users need to be looked at. By way of example, areas of assessment could include health, community governance, post-war reconstruction, labour and finance markets. Although Chowdhury et al. recognised the complexity of such assessment; they recommended that donors to microfinance institutions should consider doing the assessments, as MFIs themselves have limited resources for such evaluations.

In the analysis of outreach (depth and breadth) versus profitability, Cull et al. (2007); Manos and Yaron (2009) as well as Hermes and Lensink (2007) agreed that there was a trade-off between serving the poorest of the poor and generating profit in order to remain sustainable. The institutions that have managed to achieve a notable outreach to the poorest while being profitable are more the exceptions than the norm.

Most Microfinance Institutions in South Africa operate using centre-based and solidarity group lending methodologies (Calvin & Coetzee, 2009), though a few use the individual lending methodology. In assessing the dynamics of group lending on the repayment of loans, Cassar and Wydick (2010, p. 715) found that *“societal trust positively and significantly influences group loan contribution rates; that group lending appears to create as well as harness social capital, and that peer monitoring can have perverse as well as beneficial effects.”*

Bankston and Zhou (2002) argued that the difficulty in the definition and therefore measurement of social capital is a result of a philosophical concept of the language contained in the word “capital”. Capital suggests resources that can be converted into assets and held by an individual such as financial or human – related to skills acquisition. However, social capital “consists of processes of social interaction leading to constructive outcomes”.

Another definition of social capital refers to “the actual or potential resources such as trust, information, social norms and a propensity to undertake mutually beneficial collective actions, which are linked to a durable social network of more or less institutionalised relationships of mutual acquaintance and recognition” (Sanyal, 2009).

The two definitions support the notion of a shared outcome, mutual benefit as a result of social interactions, or access to networks, which represent another dimension added to the social capital metaphor.

In the pursuit of good portfolio quality, amongst the activities that enhance MFIs’ social impact, Epstein and Yuthas (2010) confirmed that the most commonly provided non-financial service, used as a mechanism to improve the probability

of loan repayment, was credit management training. Sanyal (2009) was able to establish that microfinance groups generated social capital amongst Bengali women (India). This was a result of a prolonged economic relationship which built trust and facilitated flow and share of information.

The various microfinance programs effectively created social networks, which facilitated the capacity for women to sanction and promote societal norms. The social network grounded in trust promoted a feeling of women “looking after each other”, and thereby the ability to take on community challenges by tapping into men’s networks through their individual relationships.

There is further evidence that MFI agents provide technical assistance concurrently with the loan origination, while helping the borrower to structure financial statements. Although this may form part of the broader social mandate, the extra socially oriented activities are a drag on the efficiency of the MFIs’ core lending activities (Pollinger et al., 2007).

2.6 Conclusion

The sustainability of a Microfinance Institution is taken as encompassing both the financial and social performance. Financial performance can be measured through financial self-sufficiency or the subsidy dependence index; while the social performance is measured in terms of outreach.

The literature has established a direct relationship between financial inclusion and social impact (poverty alleviation). In order for MFIs to widen financial access, they need to be able to reach a greater number of clients (scale),

poorer clients (depth) and manage costs. And microfinance innovation to mitigate information asymmetries has been the use of the group lending methodology, which enhances the repayment rate, therefore a better portfolio quality.

In the analysis of outreach (depth and breadth) versus profitability, MFIs face trade-offs between serving the poorest of the poor and generating profit in order to remain sustainable, hence drifting away from their mission. Strong governance ensures the MFI stays on course to achieve social impact.

Amongst the strategies pursued to achieve sustainability, MFIs transform into commercial entities to access wholesale funding, and (or) comply with savings mobilisation regulation. The literature suggested that governance also, has an impact on both outreach and financial performance of the MFI, i.e. sustainability.

Chapter 3: Research Questions

This research sought to gain insights into how microfinance institutions in South Africa achieved social impact, while maintaining financial self-sufficiency, thereby ensuring their going concern. The research questions addressed were:

Research Question 1: Is commercialisation the only model for MFIs to grow their outreach, hence achieve sustainability through scale?

Research Question 2: Is there a trade-off between the sustainability of an MFI and the social impact the institution seeks to achieve within the community where it operates?

Research Question 3: What business practices are important for the MFI to achieve sustainability?

Research Question 4: Do MFIs that do not operate with norms that generate social capital have a high loan delinquency rate, i.e. a deteriorating portfolio quality?

Research Question 5: What is the impact of governance on the sustainability of the MFI?

Chapter 4: Research Methodology

4.1 Proposed Research Method

Blumberg, Cooper and Schindler (2008) recommend an exploratory study be adopted when the researcher is not clear about the problems that the research will uncover. In addition, exploration also lends itself when the topic of research is new to the researcher. The research conducted was therefore exploratory as it allowed the researcher to uncover concepts and insights into the challenges faced by Microfinance Institutions in delivering on their social mission while achieving sustainability. Blumberg et al. (2008) further stated that exploratory studies rely heavily on qualitative techniques. Corbin and Strauss (2008) concurred that qualitative research takes the researcher on a discovery process that taps into the world of participants.

4.2 Research Design

A qualitative research design was used to explore the challenges MFIs face in achieving social impact. A two-stage design was adopted:

1. The initial stage was exploratory, to enable the researcher to learn about the microfinance industry;
2. The second stage comprised interviews with subject matter experts and microfinance institutions.

As part of the first stage, the researcher conducted an “*experience survey*”, which Blumberg et al. (2008, p. 203) recommended as a set of interviews to

complement the knowledge published. The researcher held two interviews with two members of the Centre for Inclusive Banking Africa (CIBA, formerly known as the Centre for Microfinance) at the University of Pretoria. The results of the above mentioned interviews helped focus the research topic, as well as drew the researcher's attention to published documents, industry trends and the status of microfinance in South Africa.

4.2.1 Qualitative Technique

In its second stage, the research study collected data through expert interviews as well as in-depth interviews with MFIs. The value of interviews as a data collection method is highlighted by Gillham (2005) in stating that "*there is a wide recognition of the special importance of narrative as a mode through which individuals express their understanding of events and experiences*" (p. 68). Narratives of interviewees were used to collect data on how the MFIs were facing sustainability challenges in SA.

Blumberg et al. (2008) as well as Gillham (2000) recommend expert interviewing as a way of gathering information from influential individuals, experts or authoritative individuals in the topic researched. The researcher made use of semi-structured interviewing to "*allow the interviewee to follow his or her own thoughts*" (Blumberg et al., 2008, p. 385), within the context of a theme related to the research questions. In-depth interviews were also conducted with individuals in senior positions in the MFIs.

Although most interviews were conducted face-to-face, some of the interviews were done via telephone calls as the researcher could not travel to locations where the interviewees reside. The corollary is such that the opportunity for vital observations inherent to qualitative research was potentially lost.

The researcher also collected performance indicators (Appendix III) on the MFIs, in order to assess how the MFIs were doing on their journey to sustainability.

4.3 Population

The universe of this study was limited to microfinance institutions understood to be providers of small loans to the poor. The population of this study included all microfinance institutions with a developmental objective to alleviate poverty by extending financial inclusion, and operating in South Africa.

In South Africa, Calvin and Coetzee (2010) identified six different types of MFIs as suppliers of microfinance services registered with the National Credit Regulator. Of the six types of MFIs, the following were qualified in the population as they service the low income market, providing collateral-free small loans:

- Microenterprise Lenders: MFIs supplying financial services and business skills to micro-enterprises;
- Cooperative Financial institutions: MFIs that are authorised to mobilise savings from their membership, providing savings accounts, as a way to

help members break away from the debt cycle. The MFIs also provide lending services to the members.

4.4 Sampling Method and Size

Through the Centre for Inclusive Banking at the University of Pretoria, the researcher gained access to interviewees in the microfinance industry in South Africa, for both the expert interviews as well as the in-depth interviews with MFIs. This type of access through referral networks is referred to as snowball sampling, which is suitable to “*sample subjects that are difficult to identify, because they are not registered as a population*” (Blumberg et al., 2000, p. 255). This sampling method was considered appropriate to access “*information-rich key informants or critical cases*” (Patton, 2002, p. 237).

The researcher held a total of 12 interviews. Patton (2002, p. 244) stated “there are no rules for sample size in qualitative inquiry”; however, it is important to describe and justify the sampling procedures and decisions fully for peer reviewers to judge the adequacy of the sample.

Each interview took approximately hour, and was mostly dependent on the availability of the interviewee.

4.5 Unit of Analysis

The unit of analysis for the research was the microfinance institution (MFI). The data collected related to the elements that contribute positively and negatively to the attainment of the MFI's sustainability.

4.6 Interview Schedule Design

Blumberg et al. (2008) suggested that the first step to an exploratory study is the search of secondary literature, which provides the researcher with background, emerging themes and patterns that help frame the research questions. The researcher reviewed published articles, documents and academic articles in the field of microfinance in order to develop the questionnaires that were used to address the research questions (Chapter 3). The research questions formed the basis for a set of open ended questions that captured correlation between constructs defined in the literature review. The two interview guidelines and the questions that were asked of the microfinance SMEs as well as the MFIs themselves are attached in Appendix II.

Separate interview schedules (guides) were developed for the subject matter experts and the microfinance institutions, adapted from Blumberg et al. (2008). Patton (2002) highlighted the benefits of the interview guide, as it allows the researcher to build a conversation within the boundaries of the research topic, and ensures all interviewees are asked the same questions. An additional advantage is that interview guides make data collection systematic.

The interview guides were piloted with CIBA. And as stated by Gillham (2000, p. 53), the aim of the pilot interview was about “*getting the questions right rather than getting the interview right*”. As a result of the pilot interview, questions related to the social impact of MFIs were highlighted for additional probing, to explore synergistic relationships between elements impacting MFIs’ sustainability.

4.7 Data Collection and Data Analysis

4.7.1 Data Collection

Using the list provided by the CIBA, the researcher drafted an email to subject matter experts (SMEs) and contact people representing the MFIs requesting interviews. The emails were followed up with telephone calls to the prospective interviewees to set up an appointment for a one hour interview. Due to the availability and accessibility of respondents, face-to-face and telephonic interviews were set up with seven SMEs and five individuals in leadership positions in the MFIs, for a total of 12 interviewees. Although the initial intent was for a sample between 15 and 25, this was not achieved due to accessibility and the researcher’s time constraints.

Expert interviews as well as in-depth interviews are two instruments used in data collection in qualitative research (Blumberg et al., 2008).

The researcher first held semi-structured interviews with SMEs so as to gain insight on the subject of microfinance as well as the challenges facing MFIs in South Africa. The interviews took the form of semi-structured interviews with

seven subject matter experts, who were individuals with experience in the field of microfinance and who had been involved in the microfinance industry in South Africa.

The choice of semi-structured interviews was appropriate for expert interviewing and allowed the researcher to gain insights from the SMEs. It also allowed the SME the opportunity to raise topics the researcher had not thought of, relating to MFIs' sustainability while allowing the researcher to apply the same interviewing framework to all SMEs (Blumberg et al., 2008). The aim was to gather insights regarding the microfinance industry in South Africa, including challenges facing MFIs in being sustainable as well as how they meet their social objectives. The themes uncovered were used to clarify areas that required probing in the subsequent in-depth interviews with the MFIs.

The second set of semi-structured in-depth interviews was held with individuals in leadership positions in five Microfinance Institutions.

4.7.2 Data Analysis

The data analysis was done iteratively while the researcher made sense of the content and defined recurring themes observed in the interviews from SMEs and MFIs.

Below are the analysis methods that will be used:

- Narrative Analysis: is a powerful analysis tool for exploratory research and appropriate for in-depth interviews as it captures the respondent's story. It affords the researcher the opportunity to gain insight into the respondent's perspective. This method was applied after the interview. (Blumberg et al., 2008)

Content Analysis: the researcher analysed notes captured from the interviews. Gillham (2000) defined it as organising the content that is of substance into categories. These are headings that emerge out of verbatim quotes, looking for recurring words, sentences and combinations that can be used to make inferences.

Identifying words and counting references to similar words allowed the researcher to establish the frequency of occurrence of specific words. In a qualitative research, content analysis seeks to extract the meaning and intention of a text. It was thus used in conjunction with other data analysis methods (Blumberg et al., 2008). It further guarded the researcher from perceptions, and helped to promote greater validity and reliability (Blumberg et al., 2008).

- Constant Comparative Method: the data collection in a qualitative study is iterative throughout the research process (Morse et al., (2002), and lends itself to a constant comparison method of analysis (Tan, 2010). The constant comparing of collected data with new data helped the researcher avoid bias stemming from pre-knowledge of the topic investigated. This method was applied after the narrative analysis after each interview.

4.8 Validity and Reliability

Morse et al. (2002) as well as Creswell and Miller (2000) contend that there is increasing demand for qualitative researchers to ensure credibility of their work. Therefore, it follows that rigor in qualitative research is the responsibility of the researcher and as such, the notions of validity and reliability should also apply to qualitative research. Morse et al. (2002) further noted that “whether quantitative or qualitative methods are used, rigor is a desired goal that is met through specific verification strategies”.

Creswell and Miller (2000) clarified that validity “*refers not to the data but to the inferences drawn from them*” (p.125) as a result of the data analysis by the researcher.

Morse et al. (2002) argued that, unlike other research strategies that promote verification after the study has been completed, as a mechanism to ensure reliability and validity, qualitative research is an iterative process rather than linear. The researcher moves throughout the research process between design and implementation, and can build within the methodology checks and balances (researcher responsiveness, methodological coherence, sampling adequacy) to ensure congruence and therefore ‘trustworthiness’ or ‘rigour’.

4.9 Research Limitations

The following were considered potential limitations to the study:

1. The researcher was not able to gather the perspective of MFIs that had gone out of business, as they do not form part of the sample. The insights on the reasons why they could not sustain the business would be lacking and therefore could highlight important considerations.
2. The choice of a qualitative research is such that the inferences made from the study may not be generalised.

Chapter 5: Results

5.1 Description of Sample

The data was collected by conducting expert, semi-structured interviews with experienced professionals in the microfinance industry in South Africa. The respondents' experience included running microfinance institutions, consulting to the MFIs, covering lending institutions and co-operatives. The researcher also interviewed the wholesale funding institution, the South African Micro Apex Fund (SAMAF), a government body that provided on-lending and capacity building funding to MFIs. The researcher held seven face-to-face interviews which lasted approximately one hour.

Table 2 below provides a summary of the experience of the expert interviewees.

The researcher held in-depth interviews with five MFIs operating in the South African market. Of the five institutions, one was registered as a Savings and Credit Co-operative (SACCO), with legal coverage to mobilise members' savings; while the remaining four were micro enterprise lending organisations. The micro enterprise lending organisations varied in incorporation, with two registered as non-profit organisations and other two organisations are registered as commercial organisations. The sample of the MFIs interviewed represented a national coverage, although most of their activities were conducted in rural setting or per-urban areas (townships). Although all the MFIs pursued a social impact, the nature of the mission varied in its intended measurement, with most of the MFIs noting that social impact measurement was a difficult task.

Table 2: Profiles of Subject Matter Expert Interviewees

Respondents	Experience	Has run an MFI
A	<ul style="list-style-type: none"> ▪ Professional with regulatory body, the Co-Operative Banks Development Agency ▪ Has 28 years experience with financial cooperatives, savings and credit cooperatives 	
B	Respondent has experience with co-operative organisation and five years with the South African Micro Apex Fund (SAMAF)	
C	<ul style="list-style-type: none"> ▪ Respondent is a member of the Centre for Inclusive Banking Africa (CIBA) ▪ Extraordinary Professor of Economics at the University of Pretoria ▪ Designed and established a Micro Enterprise Finance Unit for one of the large banks in SA ▪ Worked in more than 20 countries in Africa and internationally on developmental matters and financial inclusion 	
D	Respondent has been working in the industry for eight years, influencing and implementing policy through the South African Micro Apex Fund (SAMAF)	
E	<ul style="list-style-type: none"> ▪ Respondent has been in the industry for 25 years, most of which, building and running Microfinance Institutions ▪ Has extensive experience on four continents: Africa, Asia, in Latin America and in Eastern Europe 	✓
F	<ul style="list-style-type: none"> ▪ Respondent is a member of the Centre for Inclusive Banking Africa (CIBA) ▪ Has run microfinance institutions ▪ Currently consult to MFIs and the South African Micro Apex Fund (SAMAF) 	✓
G	<ul style="list-style-type: none"> ▪ Respondent has been in the industry for the past 18 years, starting as a loan officer, branch manager to running an MFI ▪ Also has consulting experience with MFIs in Africa 	✓

Table 3 below describes the profiles of the Microfinance Institutions interviewed. The performance indicator data was provided by the MFIs themselves following the interviews, while supplementary information was sourced from their respective websites.

The indicators were selected to measure the MFIs outreach, breadth was measured by the number of active clients (proxy); while depth of outreach used the number of women as a percentage of borrowers as well as the average disbursed loan size. Comparing the average disbursed loan size as a percentage of GDP is an indicator of the level of poverty of the clients served.

MFI J indicated a number of clients of 3,168. However, the table below only reflects the number of clients (1,200) in the micro enterprise lending operations, to allow for adequate comparison with the other MFIs.

The MFIs did not share all the data for a full comparison, hence N/A in the table, indicates that the data was not available (provided).

Table 3: Profile of Microfinance Institutions interviewed

Respondents	H	I	J	K	L
No of Years in existence	2	19	14	20	13
Incorporation	Commercial	Section 21 (NGO)	SACCO	Section 21 (NGO)	Commercial
Interviewee's position in MFI	C Level Executive	C Level Executive	General Manager	C Level Executive	Operations Manager
Number of active clients	402	74,345	1,200	42,290	20,000
% Women Clients	66%	99%	N/A	100%	90%
Lending Methodology	Individual	Centre Group	Centre Group	Centre Group	Solidarity Group
Products offered	Micro-enterprise lending	Micro-enterprise lending	Micro-enterprise lending	Micro-enterprise lending	Micro-enterprise lending
Average Loan Size Disbursed	R 3,082	R 2,143	R 2,000	R 642	R 3,001
Portfolio at risk > 30 days	12%	0.2%	10%	N/A	3%
Savings Mobilisation	Encourage savings	Encourage savings	Mobilise savings	Encourage savings	Savings as pre-requisite for loan
Geographic Coverage	Peri-urban areas (townships)	Rural areas	Peri-urban areas (townships)	Rural areas	Rural areas + peri-urban
Clients per loan officer	201	268	N/A	288	307
Operational self-sufficiency	45%	96%	85%	N/A	110%
Financial self-sufficiency	45%	96%	N/A	N/A	94%

5.2 Findings

The research process was comprised of two stages. In stage 1, primary data was collected and analysed through expert interviews to establish the challenges facing Microfinance Institutions (MFIs) in South Africa. The researcher also probed elements that contribute positively and negatively to achieve sustainability while delivering on the social mission. In stage 2, primary data was collected and analysed by in-depth interviews with MFIs operating in South Africa to gain insight into their operation as well as collect statistical data on their journey to sustainability and achievement of social impact.

The interviews provided deep insights and generated a lot of information on the status of microfinance in South Africa. Most interviewees were quite open and generous in sharing their experience and perspective on operational and financial self-sufficiency, as well as on the challenges of achieving and measuring social impact. Operating models for MFIs to deliver social impact tended to be highly labour intensive, and in the words of respondent G:

“Sustainability is not about profit, it is about continuing to provide the service, while increasing the benefits to even more people.”

The notion of MFI’s sustainability or self-sufficiency is seen as a demand imposed on the MFIs by funding organisations, arguably as a result of capital scarcity. It has been clear across the interviews that funding of the MFI’s operations is critical in achieving the social mission. Equally, funding organisations are more prepared to provide funding for on-lending operations, almost overlooking the capacity required to provide loans.

5.2.1 Results for Research Question 1

Research Question 1: Is commercialisation the only model for MFIs to grow their outreach, hence achieve sustainability through scale?

The South African regulation differentiates between Cooperatives and Microcredit organisations, in that the Co-operatives received an exemption from the South African Reserve Bank (SARB), allowing them to mobilise savings. As a result, Cooperatives registered as Savings And Credit Cooperatives (SACCOs) or Financial Services Cooperatives (FSCs) grow from a membership base, and offer microcredit amongst the services they deliver to their members. As a result, microenterprise lenders do not mobilise savings, as they do not have a banking license.

Table 4 below summarises themes that emerged from respondents with regard to Commercialisation.

Table 4: Research Question 1 - Commercialisation

Themes	A	B	C	D	E	F	G	H	I	J	K	L
Mission Drift occurs			x		✓		✓	✓	✓			
Appropriate Funding to build scale		✓			✓	✓	✓		✓		✓	✓
MFIs need to be operationally sustainable					x		✓			✓		
Break even	✓				✓	✓	✓	✓				
Donors have limited resources					✓		✓					

A x in the table above indicates that the respondent emphasized disagreement with the specific theme highlighted by literature or the other respondents.

Funding

As MFIs lend small sums of money to the poor, they rely on income generated on interest rates from repaid loans as a source of retained earnings that can be re-invested into on-lending operations. Because the profit per loan is marginal, the ability to build a bigger client base is essential as it allows MFIs to leverage economies of scale. Reliable access to funding also emerged as critical to the viability of the MFI. Quoting respondent C:

“NGO-type Microfinance Institutions have additional problems mostly the problem of access to capital where your commercial guys have an easier route.”

As a result, MFIs have to secure funding from donors and capital markets to ensure access to operational funding as well as for on-lending activities. Donors would want to see MFIs achieve self-sufficiency in three to five years.

Respondents had different views on commercialisation. A transformation of the MFI into a commercial organisation assumes a change in the shareholder profile, whom it could be argued pursue a return on their investment. The corollary is that new investors would drive the MFI to focus on return on equity rather than on poverty alleviation or the wider social impact. A further consequence of being a commercial organisation is that certain funding organisations are not prepared to support MFIs as they are wary of dividends that will be paid to shareholders, instead of benefiting the poor. This was true for one of the respondents, as they found it difficult to draw on developmental focused funding, while incorporated as a for-profit MFI. In the words of respondents G and H respectively:

“Commercialisation takes away the possibility of an institution to get donor money”;

“As much as we have a social motive we do not want to be seen as an MFI that is out to make profit and probably losing focus on the developmental element”.

However, respondent K in support of commercialisation expressed the following sentiment:

“... in South Africa MFI’s cannot mobilise savings so we cannot go that route (of offering savings products) and that is one of the things that we are saying we probably want to be a bank because, ... then it enables us to mobilise savings”.

The need for commercialisation is to be in a position to mobilise savings, and offer clients differentiated products. On the other end, opposing commercialisation (or transformation) was expressed by respondents E and G, captured respectively as:

“I don’t believe in the transformation of MFIs into banks”;

“Commercialisation does not work, I do not know if it will ever work in the long term”.

Respondent E further argued that the social nature of MFIs, is such that MFIs have to operate with a singular pursuit of achieving social impact, which defines the mission of the MFI. In the following statement, respondent E supports the above argument:

“I think that there was a reason or there is a reason why traditionally there were commercial banks on one hand and MFI’s on the other hand”.

This view emphasizes the difference in mission and organisational intent between a commercial (for-profit) organisation and a non-governmental (not-for-profit) MFI that is pursuing a social mission. While a more subdued response warns of a mission drift that is often the consequence of commercialisation, in the words of respondent I:

“Personally I do not have too many issues with it (commercialisation), I think what one has to be very careful of is the mission drift ... once you commercialise but I mean as long as you manage that it does not really matter”.

It also emerged that a closer relationship with donors does not compel the MFI to commercialise as access to funding is not restricted. Most MFIs have long standing relationships with donors, and with whom they share their growth targets. In the words of respondent I:

“Pretty much we can get all the money we need as a current structure (NGO) so there is really no pressure on any sort of commercialisation.”

Mission Drift

The majority of respondents were unanimous in the sentiment that MFIs with a developmental focus were to guard against mission drift, which curtails financial access to the very poor. Evidence of mission drift in South Africa was reported in the case of organisations that transformed into commercial organisations, as reported by respondent G:

“We have two instances where commercialisation took place and mission drift is an automatic thing”.

Respondent E affirmed that the only way to avoid the predicament faced by MFIs in managing their profit levels is to consider an innovative structure that would see government play a role in subsidising MFIs operations with provision of wholesale funding and infrastructure. In the same line of thought, the respondent K’s institution had a structure that allowed for a separate sister entity that raised funds as a commercial organisation to fund the MFI operating as an NGO. This model used to avoid mission drift was noted by respondent G as being used by other institutions outside of South Africa.

Respondent C raised the question of whether the definition of the poverty line as below \$1 a day is condescending as it renders the argument about mission drift immaterial. He posed the rhetorical question of *“who is the poor, is the poor \$2, \$1.35, \$3 a day?... and if you cannot impact on the real destitute poor, is that so wrong?... is that a bad thing If you have good impact?”*

In order to remain focused on achieving a social impact, respondent H, a commercialised institution, had elected to scrutinize their funding partners to ensure an alignment with the developmental mission. In respondent H’s words:

“We see a lot of synergies between our social mission and their social mission and thus it is easier for us to be together in this relationship because they are not driven by profit.”

In the end, the decision to commercialise has its merits, such as the ability to mobilise savings. Respondent G summarised the sentiment on commercialisation:

“I am not saying it cannot be done but the trade off is you cannot do it if you want to still reach the poorest... Your social mission is going to be compromised by commercialisation in any respect because donors do not even want to associate themselves with commercial institutions; that is for sure”.

Conclusion for Research Question 1

Mission drift is real and MFIs have to tread carefully to ensure they do not deviate from their mission. Although commercialisation is a choice that may open up other avenues of access to funding, it brings in its own challenges. It is clear that NGO MFIs can still operate and access the required funding to grow their operations and still be able to serve the very poor with assistance from donors. Respondent I’s concluding thoughts on commercialisation were:

“In a commercial sector where you have too many shareholders pressuring you for too much of your profits so I would not advise it [commercialisation] but that is my opinion”.

5.2.2 Results for Research Question 2

Research Question 2: Is there a trade-off between the sustainability of an MFI and the social impact the institution seeks to achieve within the community where it operates?

There was consensus amongst the respondents of anecdotal evidence of the social benefits MFIs achieve in poor communities; observed through clients' testimonials or cooperatives' members. This was reflected in the words of respondent A:

"There are a lot of untold stories and that, I can guarantee there are a lot of nice untold stories out there that people do not know about."

Table 5: Research Question 2 – Social Impact

Themes	A	B	C	D	E	F	G	H	I	J	K	L
Measuring social impact is difficult			✓	✓			✓					
Measuring social impact is costly (labour intensive)						✓	✓					
Poverty = smaller loan sizes (outreach)						✓	✓					
Poverty measurement												✓
Positive impact of MF is evident	✓								✓	✓		
Promote / encourage savings	✓			✓				✓	✓	✓	✓	✓
Serving rural areas is costly (transport, infrastructure)		✓				✓	✓					

Table 5 above lists the themes that emerge from respondents with regard to social impact pursued by MFIs in South Africa.

Sustainability

The majority of respondents identified with the notion that an MFI needs to be operationally and financially self-sustainable as it grows its operations. This was evident through the expression of achieving break-even point as the organisation grows, as reported by respondent J:

“The main idea is not to depend on funding; to be self-sustainable, that is actually our goal that we are working towards.”

Respondent E had a more mission driven view of the MFI, by raising the question:

“Who says MFIs need to be sustainable?”

In the question raised above, respondent E argued that MFIs become internally focused, which is reflected in their reporting metrics. These emphasise a financial view and achievements of the MFIs, instead of a socially focused reporting that highlights the social impact achieved.

Another view on sustainability took a more encompassing view, as expressed by respondent D:

“For me sustainability is very broad, it does not necessarily mean financial sustainability, it means a lot of things.”

Respondent F reported that amongst the elements that worked against sustainability are:

“Poverty targeting means loan sizes are smaller and branches take longer to break even; serving rural areas is more costly; delivery models for social performance tend to be highly labour intensive.”

The implication is that to achieve a deeper outreach in the client base, i.e. serving the poorest of the poor, the MFI has to offer smaller and smaller loans. This has an impact on the operating costs, coupled to infrastructure deficiencies in rural areas. As a result, achieving scale (broader outreach or breadth) is desirable to leverage economies of scale and break even sooner. Respondent A expressed the need for scale as follows:

“You need to have a huge population within a small area because if you go to Bangladesh, you go to India and these other places they have a huge population so within a small radius you have thousands and thousands of people living in that small area so it is easier to recruit a loan officer to go and walk within those areas.”

Another financial target that MFIs measured was the accumulated savings of their clients. Seven out of the 12 respondents mentioned the emphasis on building a culture of savings amongst the client base. Respondent L stated that a savings account is the first thing that the group would open, before a loan is granted:

“As a pre-requisite of a loan, they will go and open a group savings account, on a monthly basis each member needs to save on that account.”

Respondent L further stated that there is evidence that experienced clients save with the group as well as individually. This emphasis is also highlighted by respondent H as follows:

“We encourage them to have a savings thinking in the way that they run their businesses, no matter how small the savings can be per month but as long as you try and take a portion of your returns in your business and start to develop some form of saving.”

Measuring Social Impact

Although most respondents admitted that it was difficult and costly to measure social impact, four out of the five MFIs indicated that some sort of measurement to assess the impact on clients was used. Respondent L, from a commercial MFI, stated that although there are testimonials of clients highlighting social benefits in their lives, they did not produce elaborated social impact reporting for lack of appropriate tools.

Although two respondents (I and K) out of the five MFIs had a poverty assessment toolkit, such that they target the poorest of the poor, the two commercially registered MFIs (H and L) admitted to not pursuing poverty alleviation as a mission, but a developmental impact.

In the words of respondent L:

“We do not say as our mission that we target poverty client, our mission is to develop small business people. But we do serve the rural population.”

Respondent K described poverty assessment at three levels:

1. At the client identification level, *“We are interested in LSM1 and LSM2, so we look on the map at the South African statistics that we have and decide this is the Municipality that has high incidences of poverty.”*
2. The MFI then assesses what they term a social economic profile of the potential client. *“Social economic profile is looking at your social standing, your social information for example, how many people live in the household, how many people are working, how many people are school going children, do you have three meals a day, what do you do with health aspects, are all the children going to school, what is the highest level of education in the household?”*
3. The third step in the poverty assessment involves *“the economic side, you look at how the house is built, the roofing of the house, you go inside what sort of furniture is in there, it gives you an idea the kind of household that you are going to be involved in.”*

MFIs that measured the social impact did so through the function of the loan officer, who built a rapport with the client base. In a conversational manner, the officer collected impact measurement scores, which were re-evaluated after subsequent loans. In the words of respondent K:

“We measure impact by collecting on every loan each client is interviewed when they come back for a new loan and we measure things like food scores, housing scores.”

Financial Performance versus Social Impact (Outreach)

There was evidence of a tension between sustainability and social mission. The two commercial MFIs differentiated between developmental focus and social impact defined as poverty alleviation. As a result, they did not specifically target the poorest of the poor, and therefore admitted to not measuring the poverty level of their clients before on-boarding. However, they do measure some form of social impact; such as does increased income translate into more children getting an education in the household. One of the reasons mentioned for not assessing the poverty level is the lack of an appropriate tool.

In order to improve self-sufficiency, there was pressure on the average loan size, which revealed that MFIs start issuing bigger size loans. The increased loan size is both a result of clients growing their businesses and qualifying for larger loans; as well as a reduction in the poor client base. This is the mission drift MFIs pursuing a social impact have to guard against. In the words of respondent G:

“The interest income that you get or the money that you get from the interest becomes too small to cover the costs and there is only one reason because you are dealing with the poor people and they cannot take big loans.”

The implications are that some institutions segment the market and target those who can repay the loans rather than helping the poor migrate out of poverty. Respondent G further states:

“Some Institutions decide look we will only work with ten percent of the poorest and the majority will be the better off because we need bigger loan sizes to do

that, if you continue to focus on the poorest then you need quite a high amount of subsidies so your sustainability cannot be reached in four or five years, it can only be reached in seven or even up to ten years.”

Conclusion for Research Question 2

There was evidence that a tension between achieving sustainability and the need to achieve social impact exists. Out of the respondent MFIs, the two commercialised MFIs admitted to not working towards deeper outreach. Respondent E, who cautioned against sustainability states: *“The need to achieve the mission with the least resources reduces the quality of interaction with customers... Instead of adding value to the clients, you begin to impoverish the people.”*

5.2.3 Results for Research Question 3

Research Question 3: What business practices are important for the MFI to achieve sustainability?

Microfinance institutions operate as organisations facing the same environment as any other organisation, in that they need to manage their human resources with the appropriate incentives for retention and career development; put in place management information systems and risk management best practices.

Table 6: Research Question 3 – Business Practices that impact sustainability

Themes	A	B	C	D	E	F	G	H	I	J	K	L
Managing Costs (Salaries, Transport, etc)		✓	✓		✓	✓	✓		✓			✓
Portfolio Quality	✓	✓		✓		✓		✓		✓		
Need scale to build up sustainability	✓	✓	✓		✓		✓	✓			✓	✓
Patient Capital			✓	✓		✓						
Management Capacity	✓	✓	✓	✓		✓						
Managed / controlled growth									✓	✓		

Managing Costs

There was a wide consensus by respondents that the ability to manage costs was critical to the financial survival of the MFI, especially in relation to the size of the loans and the earnings per loan disbursed. These costs are incurred by the MFI in servicing its client base, and that includes operational costs and financial costs. Respondent I captured the challenge of managing costs as follows:

“In a South African environment it is all about cost management because we do have a very particular problem in this country where you have a third world economy running parallel side by side with a first world economy so the loan amounts that we would give are in a third world economy but our expensive salaries, things like that come from the first world.”

This sentiment was also echoed by respondents B, C, E, F, G, I and L. Respondents F and G estimated that in the South African market, salaries represent roughly 65% of operational costs; travel and transportation represent

about 20% of the costs while the rest can be split between training, office rental, and Management Information Systems (MIS).

To illustrate the cost for MFIs operating in the dual economy that characterises the South African environment, respondent G provided a comparison of the operational expenses with respect to average loan size. In his words:

“if the clients borrow R1,000 on average, the salary of a Loan Officer is R4,200”

i.e. a ratio of one to four point two. Respondent G further elaborates:

“the average loan is still R1,000 but the average salary, not of the Loan Officers but of the organisation goes to R6,000 or R7,000”, i.e. a ratio of one to six or seven times.

These averages are considered considerably higher compared to other developing countries as expressed by respondent G:

“Now if you go to Zimbabwe, India or other developing countries what you find is that when a client borrows an average of R1,000 the average salary of a Loan Officer will be R2,000; so it is one to two, the salary of the whole organisation will be one to three or one to three point five.”

Portfolio quality

Portfolio quality or the delinquency rate talks to the propensity for clients to repay their loans. Amongst the challenges MFIs have to face is the lack of financial management skills on the part of the client base. MFIs provide

additional training to their clients before their first loan to validate the understanding of the methodology. Respondent J stated that the cooperative administers a test to verify the first clients' understanding, as explained:

“Each member of each group must write a test, just a simple test just to see ... simple questions, just to see if there is an understanding so that one cannot come back and say no, I did not understand”.

Members teach each other to ensure they qualify as a group to be granted the loan, which fosters social capital within the group.

Outreach

Outreach is understood as breadth and the ability to leverage economies of scales, while profits on each loan are minimal. To achieve scale respondents acknowledged the need to serve large numbers of clients, which in turn increased the operating costs.

Respondent E expressed it as:

“I think MFI's that are really trying to be self sustainable must look at scale more than look at pricing to cover costs with a narrow volume base.”

The argument is that instead of increasing the interest rate, which translates in higher costs to client, focusing on acquiring a larger number of clients would offset the costs.

Respondent K confirmed the importance of scale as follows:

“MFI’s rely on the mass of people, the numbers, if you do not have that it becomes very difficult for you because the loans that we are giving are so small, so for you to build your sustainability on small loans you have to expand, you have to scale up your operations.”

The other consideration in the pursuit of sustainability is the time it takes to be sustainable. Respondent C introduced another element for consideration to achieve sustainability; namely patient capital:

“We talk about patient capital, these institutions need scale to build up some sort of sustainability and they need to settle their models, you cannot do that in one year or two years”

The point here is that MFIs would not become self-sufficient in their first or second year of operations. The journey could take six to seven years, possibly more, as mentioned by respondent G.

Management Capacity

The nature of the social mission pursued by MFIs, makes microfinance a field on its own, which requires specific skills and experience. Respondent C highlighted this point as follows:

“The overarching challenge of Microfinance Institutions is management capacity”

Respondent E acknowledged the importance of management skills, which he captured as follows:

“if you are not profitable then you will not be able to afford the right expertise... MFI’s are in trouble because they cannot afford the right skills but they cannot be sustained by skills that are not up to scratch.”

Conclusion for Research Question 3

A consensus emerged on the elements that contribute to sustainability of MFIs. The MFI’s ability to put in place processes and systems that help manage and control costs is critical to a MFI’s profitability. The nature of the dual economy in South Africa was noted as driving up the costs of operating in the environment from an MFI perspective.

The ability to achieve scale and keep delinquency rates in check, translates into better portfolio quality.

5.2.4 Results for Research Question 4

Research Question 4: Do MFIs that do not operate with norms that generate social capital have a high loan delinquency rate, i.e. a deteriorating portfolio quality?

Empowering clients, through lending methodology, is a way to improve information flow, using intervention to prevent market failure.

Table 7: Research Question 4 – Social Capital fosters low delinquency rate

Themes	A	B	C	D	E	F	G	H	I	J	K	L
Non-financial interventions (training, health education, etc)		✓						✓	✓	✓	✓	✓

Of the five MFIs interviewed, four used the group lending methodology popularised by the Grameen Bank in Bangladesh, which has served as a basis to mitigate risk in providing unsecured loans. One of the MFIs operating in peri-urban areas had chosen to use an individual lending methodology. The reasoning was explained by respondent D as follows:

“We thought clients were different and especially when we look at Gauteng it is difficult to setup groups in Gauteng as a Province compared to when you go to deep rural areas in Limpopo for example. People want to be individuals, people want to be independent, people are very protective about the things that they do that involve their families and their financial affairs so we opted to go purely and strictly the individual lending model”.

The pursuit of a social impact is such that the MFIs build rapport (facilitated by a loan officer) with clients, allowing MFIs to provide flexible repayment terms when clients face challenging circumstances. Respondent K supported this with the following statement:

“Rescheduling of loans when client has been hit with a crisis enhances portfolio quality”.

The loan officer was noted as playing a critical role as an interface between the MFI and the client. Respondent F highlighted the impact on the portfolio quality as:

“Loyalty bond/friendship between loan officer and client encourages better repayment; ensuring clients do not get over-indebted is critical; repayment procedures in a group setting makes it easy and provides discipline.”

The increase in delinquency rate has an impact on the portfolio quality, which translates in loan loss provisions that MFIs make in the financial report. Loan loss provisions directly impact the break-even points and impact sustainability. As reported by respondent F, *“the cost of delinquency, since an increase in the loan loss rate requires an even higher increase in the required Rate charged to the client.”*

In line with non-financial interventions that MFIs offer to clients, respondent I mentioned an informal mentoring program that the loan officer may broker between two micro-entrepreneurs as a way to transfer skills and ensure longevity of the client’s business. This in turn limited the loan delinquency rate.

Conclusion for Research Question 4

There was evidence that MFIs’ non-financial interventions work to improve portfolio quality. The lending methodology used reduced the information asymmetry, which in turn reduced the total agency cost incurred by MFIs.

5.2.5 Results for Research Question 5

Research Question 5: What is the impact of the leadership of the MFI on its sustainability?

There was consensus amongst respondents of the importance and the role that the Board plays as custodians of governance principles in guiding the MFI in delivering on its mission. A good governance structure promotes transparency and is the basis for the MFI to build a good reputation, which in turn gives rise to good relationships with the donors who guarantee funding to the MFI.

Table 8: Research Question 5 – Importance of Governance

Themes	A	B	C	H	D	E	I	J	K	G	F	L
Good corporate governance structure (Skilled Board)		✓			✓				✓			
Risk management (fraud prevention, etc)					✓							
Quality of leadership is key	✓	✓	✓					✓				
Transparency		✓										

Respondent D emphasised the importance of equipping staff and board members with the appropriate training, *“MFIs must first train their staff and their board, they must start with the board, they must have a capable board”*.

Respondent I emphasised the importance of stable management and a board free from influences to deviate from the social mission; as key ingredients to establish an organisational culture that is prepared to pursue sustainability.

In the words of respondent C, a strong leadership guarantees the MFI’s stability;

“As long as you have a very charismatic leader of the NGO, the NGO can grow but as soon as you have a problem with leadership etc, then you run into all the problems.”

In emphasising the role of the board, respondent K highlighted the fact that management would emulate the board, and as such board members’ roles were critical to the MFI.

“In terms of governance they are the custodians of the whole governance issues taking place in the organisation and they are also the role players in management who emulate what the leadership within the board is doing.”

Respondent D further elaborated on what is expected of the board and its chairperson, in the following words:

“They must have a capable board, an all rounder board and then they must have a very strong Chair, when I am talking about a very strong Chair I am not talking about the person who will run the show, I am talking about the person who will drive the institution, who will listen to other board members that is what I mean by a strong Chair and the Board itself must be firm in their decisions.”

Conclusion for Research Question 5

There is evidence that leadership at board level dictates the direction of the MFI, as well as defines the organisational culture to support the delivery of the MFI’s mission. Governance in its many aspects is a variable in the pursuit of the MFI sustainability.

5.3 Conclusion of Chapter 5

The purpose of this chapter was to present the results from the research sample, based on the research questions posed in Chapter 3. The above results as well as qualitative comments made by the research sample will be discussed in the next chapter against the theory compiled in Chapter 2.

Chapter 6: Discussion of Results

6.1 Introduction

This Chapter discusses the results of the research as presented in Chapter 5, against the body of literature on the sustainability of Microfinance Institutions and the social impact, presented in Chapter 2 as well as the objectives stated in Chapter 1.

Figure 3 below depicts elements that define a framework that captures the themes that emerged in the findings and the variables that contribute to the MFI attaining sustainability. The model has been adapted from the "*Stakeholders and Strategic Decision-making Process*" (Mori, 2010, p. 52) and the "*Relationship-Based Financing Schematic for Microfinance Institutions*" (Pollinger et al., 2007, p. 26).

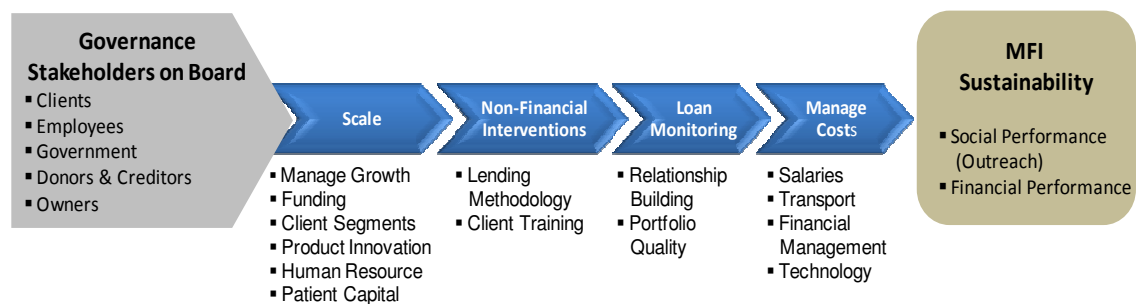


Figure 3: Microfinance Institution Sustainability Framework

The Board of Directors is the custodian of the Microfinance Institution's vision and mission, with regard to outreach and financial performance. The MFI's management team translate the mission into business processes (business model) that will grow the MFI through stages of development, to deliver financial services to the poor.

In the following sections, the results are discussed in terms of themes that emerged in the findings.

6.2 Commercialisation

In exploring the question of whether MFIs saw transformation into a commercial entity as an avenue to grow their outreach, the following themes were highlighted:

- The need to break even, in order to be operationally sustainable as a mechanism to reduce dependency on donors, who have limited resources;
- The ability to build scale and the required funding to achieve that scale, emerged as the sure way to achieve sustainability in outreach (breadth);
- The tendency for MFIs to drift towards wealthier clients as a defence mechanism to ensure profitability.

The argument for commercialisation and transformation has been advocated by the need to achieve growth in outreach (Ledgerwood & White, 2006), while reducing dependency on donor funding to become financially sustainable. The other reason to transform was as a result of restrictive regulation with regard to savings mobilisation. This would require the MFI to transform into a banking institution as savings mobilisation is regulated in South Africa and requires a banking license.

6.2.1 Funding

NGO-type Microfinance Institutions have more challenges in accessing capital compared to their commercial peers who have alternative sources of funding. This challenge is also compounded by regulation which prevents MFIs in South Africa from mobilising savings (except when they take the form of a cooperative). This removes the opportunity for intermediation and to grow the client base, with product offerings other than credit. Beck and Demirgüç-kunt (2008) as well as Helms (2006) highlighted the clients' needs beyond micro-credit. However, MFIs were not particularly focused on new products such as micro-insurance, as this implied investing in competencies that did not exist in the organisation.

In order to leverage economies of scale, MFIs need to serve large numbers of customers, grow their outreach in breadth in order for the small profits on loans to accumulate and break even operationally. Helms (2006) cited that the ability to scale financial access was a challenge facing microfinance. The lack of adequate funding emerged as the reason hampering the ability to scale. Both NGO-type MFIs as well as those incorporated as commercial MFIs admitted to having challenges in securing funding. However, those with long established donor relationships cited they could always raise the funding required for their growth.

The reasons for commercialisation as submitted by Helms (2006) and Copestake (2007) agreed with the need for alternative sources of funding, since the scarcity of capital is such that donors have limited funding capacity.

The need to transform is also driven by the desire for an efficient financial market, where savings mobilisation provides the basis for capital/resource allocation, hence intermediation. In support of commercialisation to mobilise savings, the findings supported Ledgerwood and White (2006), Getu (2007) and Quayes (2012), who promoted savings mobilisation to enable the MFI for financial intermediation. MFIs would collect savings from depositors, which they would then use as capital to lend borrowing clients. The regulatory restriction in South Africa stifle innovation in product offerings, as the MFIs cannot leverage a savings client base (depositors).

NGO-type MFIs had the largest outreach in both depth - serving poorer clients, confirming Quayes' (2012) findings; and breadth – serving more clients. This finding suggests that transformation into a commercial organisation does not necessarily mean the MFI will grow its outreach. Instead, there was evidence that suggested that the need to break even causes a migration towards less poor clients. In South Africa, commercial MFIs do not mobilise savings either, which confirms the findings are independent of regulatory constraints.

Commercialisation introduces other dynamics in the management of MFIs, such as answering to shareholders.

6.2.2 Mission Drift

The push for MFIs to be sustainable in three to five years originates from donors. The findings showed that it was difficult for MFIs to balance the pursuit of a social impact, while generating enough profit to self-sustain the cost of operations; confirming Arena's assertion (2008).

Using the average loan size as a proxy indicator of outreach (depth), it was evident that commercial MFIs had a higher average loan size, and did not focus on serving the poorest of the poor, thereby reducing depth outreach. This finding is in agreement with Quayes (2012) and Cull et al. (2011), who established that not-for-profit MFIs have a better outreach (depth) than for-profit MFIs. Additionally Arena (2008) established that for-profit MFIs tend to serve less poor clients to improve their profitability; Cull et al. (2007) defined the re-orientation to wealthier clients as evidence of mission drift.

There is however another consideration to the rise in average loan size. Clients that have grown in financial standing with the MFI have built a relationship with the institution. These clients would rather have the MFI cater for their financial needs rather than approach a commercial bank. This reality gives weight to MFIs segmenting their client base to better serve their customers and therefore increase outreach; which is in agreement with Helms (2006), who stated that repeat borrowers also cause the average loan size to rise.

The findings provided sufficient evidence to conclude that commercialisation does not guarantee increased outreach in South Africa; instead mission drift needs to be managed in such a case. This is certainly influenced by regulatory constraints around savings mobilisation. The implication is that MFIs need to be

clear about their mission and the chosen client segment, which would then define the structure of the institution (not-for-profit (NGO) or for-profit). Helms (2006) as well as Beck and Demirgüç-kunt (2008) established the varied needs of MFIs clients, could be addressed with a client segmentation model aligned with appropriate product offerings.

6.3 Sustainability and Social Impact

One of the research objectives was to investigate whether MFIs faced a trade-off between financial sustainability, which guaranteed long term viability and social impact, measured in terms of breadth and depth of outreach.

There was consensus in the findings that microfinance is alleviating poverty, with visible impact in rural South Africa; which is supportive of Maes and Basou (2005). There was also acceptance that the MFIs' loans provided financial access to the 'un-banked', where commercial banks did not venture as the poor do not have collateral. In this regard Beck and Demirgüç-kunt (2008) as well as Beck et al. (2007) confirmed that financial access improves income for the poor.

The push for MFIs to be sustainable by donors, has translated into more emphasis being on financial performance indicators, with less emphasis on the social impact. The corollary has been that MFIs have had to focus on their internal measurements at the expense of indicators that reflect the organisation's mission. This finding was in opposition to the performance assessment as advocated by Copestake (2007) as well as Manos and Yaron (2009). They emphasised the need for social and financial performance

monitoring, with financial self-sufficiency measuring financial performance, and outreach measuring the social impact.

The dual consideration of a financial and social measurement echoes the finding that sustainability should be an encompassing goal, not just financial but including social impact. However it has been acknowledged by Manos and Yaron (2009) that, it is difficult to measure social impact, when considered in the context of scarcity of resources that MFIs face.

The findings revealed that NGO-type MFIs have a broader set of measurements to assess the social impact. In this measurement activity, the loan officer assesses the house building material as a measure of progress; extend beyond just financial but focuses on improvement in the quality of life of their clients. This finding was in agreement with Chowdhury et al. (2004), who promoted the need to widen the measurement criteria of social impact.

The sections below present an analysis of the themes that emerged from the research, in assessing sustainability and the social impact.

6.3.1 Outreach

Mendoza and Vick (2010) advocated a poverty outreach metric for MFIs to assess whether they are serving the poorest of the poor. These metrics were only found with NGO-type MFIs, which had elaborated toolkit to ensure they were targeting the poor. This was further supported by lower average loan size (R 2,153 and R 642, refer to Table 3). These findings suggested that NGO-type MFIs built depth in their outreach, while for-profit MFIs serve wealthier clients.

Although NGO-type MFIs also agreed that it was important to break even, they did not necessarily see it as a trade-off between the social mission and financial performance. They positioned it as a balance that needed to be struck between the two (social mission and financial performance), which is expressed as “*managing growth*”. However, commercial MFIs had less emphasis on poverty alleviation, but focused on “*developmental*” agendas. These notions separated the MFIs in that the NGOs focused on growing their client base while serving the poorest of the poor whereas commercial MFIs focused on clients who may not qualify for loans from commercial banks.

Hermes and Lensink (2007) as well as Manos and Yaron (2009, p. 107) concurred with the above findings in stating that there was a “*poverty approach*” versus the “*self-sustainability approach*”. The former is attributed to a socially focused MFI, while a commercially focused MFI would pursue sustainability at the expense of poverty alleviation.

In assessing the role of the environment within which MFIs operate, Quayes (2012) concluded that the need to achieve sustainability whether required by donors or self-imposed by MFIs, requires support from policy makers in the country. This is as a result of the positive relationship between financial performance and outreach; as MFIs grow they increase their outreach, which in turn alleviates poverty.

The trade-off between sustainability and social impact appears evident for commercial MFIs. The implication is that in pursuing poverty alleviation, NGO-type MFIs should be encouraged and supported in pursuit of their social mission.

6.4 Business Practices to Achieve Sustainability

The section below lists the business practices that enhance the MFI's posture, contributing to achieving sustainability. Pollinger et al. (2007) contended a set of business practices enabled MFIs to break even and achieve sustainability (financial performance), whether measured through financial self-sufficiency or a subsidy dependence index (Manos & Yaron, 2009).

6.4.1 Scale

The findings emphasised the need to build scale, as a means towards achieving sustainability. This was based on the small loans that MFIs process, with very small margins on each loan. In order to benefit from economies of scale, thereby improving profitability, MFIs need to grow their outreach (breadth). Helms (2006) mentioned scale as a challenge facing microfinance, more from a perspective of improving financial inclusion but not as an element helping MFIs achieve self-sufficiency.

The implication is that it is imperative for MFIs in the early years to access working capital to support the growth phase, in building their customer base.

6.4.2 Managing Costs

The cost of managing a loan is the same irrespective of the loan amount, when considering the costs to the institution. Such costs include screening and monitoring (Mendoza & Vick, 2010), staff costs and infrastructure costs

(Management Information Systems – MIS, communication, transportation, office rental). South Africa's rural terrain and population density are such that MFIs spend money on facilitating loan officers' transportation and communication with the branch offices. The infrastructure costs prompted the question of whether the government should make provision, through tax exemptions and office rental space to MFIs, in alignment with the pursuit for the Millennium Development Goals.

Baumann (2005) referred to the salary burden MFIs are faced with in South Africa, which is a result of operating in a dual economy. Effectively, MFIs incur salaries costs in the formal sector of the economy, where costs are higher than the developing economies in Southern Africa, India or Bangladesh. The bulk of the costs were estimated to be salaries at 65% of total operating costs, while transportation carried the second share of costs, at roughly 20%.

In addition, cost of compliance (tax, National Credit Regulation [NCR]) is considered a burdened as it requires the MFIs to use specialised financial skills, which in a skill scarcity environment are increasingly expensive, confirming the assertion made by Cull et al. (2011). An innovative consideration by MFIs, would be to team up and share resources where possible, and lobby the South African government to reduce the burden of regulatory compliance.

In this environment, increasing interest rates would cause agency costs, which Baumann (2005) highlighted. Another cost driver was the result of the non-financial interventions that the MFIs delivered to their clients (Banerjee & Duflo, 2007; Pollinger et al., 2007).

6.4.3 Monitoring of Loans

The monitoring of loans concerns maintaining a high portfolio quality and minimising loan delinquency. Copestake (2007) emphasised the need for financial performance monitoring, while Mendoza and Vick (2010) highlighted the need to reduce information asymmetries for MFIs, through screening and monitoring. MFIs have to put in place efficiency driven processes, checks and balances that ensures repayment of loans. These extend from the non-financial interventions to the lending methodology, including the social capital that is fostered within client groups, the first loan size and encouraging clients to save.

In analysing the Portfolio At Risk (PAR) over 30 days, i.e. the percentage of loan amount outstanding for over 30 days, the findings suggested that it took time for the MFI to refine its collection processes. In addition, the NGO-type MFI had a better delinquency rate than the commercial MFI. This inference may not be generalised due to the small sample size, as a lower PAR would be more a reflection of the processes in place rather than the ownership structure of the MFI.

In the monitoring of loans, MFIs would benefit from an adequate Management Information System (MIS), which would enhance efficiency and minimise human error, especially as the customer base grows.

6.4.4 Management Capacity

The findings highlighted management skills and training as key to MFIs achieving self-sufficiency. The management capacity was found to be intimately linked to the quality of the Board, and was exacerbated by the shortage of skills, a permanent challenge facing businesses in South Africa (Baumann, 2005). Even more critical was the expertise in microfinance.

Management experience is imperative in managing growth with a clear focus on the social mission, and the ability to unlock performance by aligning resources to the delivery of the mission. Managerial sustainability is the ability to develop and retain critical management skills within the institution.

6.4.5 Patient Capital

Epstein and Yuthas (2010) referred to the experience that MFIs accumulate over the years as contributing to sustainability through accumulated institutional knowledge. Achieving greater outreach follows a step growth, whereby the MFI would cement its processes (loan monitoring, staff training, client training) and set up the infrastructure to support client growth in a geographical location. The growth is managed to ensure enough working capital is available and that portfolio quality is kept in check.

A consensus emerged that building scale in a controlled manner takes some time, and as such the MFI's leadership should have the necessary patient capital.

6.5 Lending Methodology and Delinquency Rate

The social nature of the MFIs' lending methodology is an innovation that aimed to address information asymmetry. The findings were in agreement with Epstein and Yuthas (2010); that MFIs provided non-financial interventions to their client base; such as credit management training, financial management and facilitating mentoring between clients. These interventions built the institutions social capital within communities, but also enhanced the repayment rate, and promoted portfolio quality. Such activities build social capital for the institution, which translate into greater client loyalty and a lower delinquency rate (Mendoza & Vick, 2010; Marconi & Mosley, 2006). Such "*integrated lending models*" are part of MFIs' operating models, as the client base often lacks basic financial literacy.

The Grameen Bank in Bangladesh pioneered the group lending methodology as an innovation to reduce information asymmetry amongst the MFI client base. Group lending methodologies promote social capital, which in turn relies on social pressure to ensure better repayment rate, and a good portfolio quality. The findings were in agreement with Cassar and Wydick (2010) in that groups of three to 10 in the solidarity group lending method, had group dynamics such that, sometimes the issues between members of the group made the group difficult to manage.

The intent of the lending methodology is to reduce information asymmetries, which is at the base of risk management. The group lending methodology brings in social dynamics between borrowers; and since the poor see in the MFI a stable source of financial access, borrowers are prepared to ensure access is

guaranteed by resolving their differences. The social pressure on the borrower compels borrowers to ensure the group's success thereby reducing information asymmetries to the MFI (Mendoza & Vick, 2010; Roodman & Qureshi, 2006).

In addition, Cassar and Wydick (2010) found that group lending methodologies foster social capital amongst the group, which causes peer monitoring, and social pressures that encourage members of the group to comply with the repayment terms.

Amongst the respondent MFIs; except the cooperative which admitted that it was facing an abnormal delinquency rate with its newly introduced micro-enterprise lending product; the group lending methodology appeared to guarantee a lower portfolio at risk. This is in line with Cull et al. (2007) findings. The MFI that used an individual lending methodology had a portfolio at risk of 12% compared to 0.2% and 3% for MFIs using group lending methodology. However, as the MFI indicated, they were pursuing a strategy to work with individuals in associations, and use the association as a mechanism for social pressure to improve repayment rate. Also, the MFI had only been in operation for less than two years, and it is expected the collection processes will be refined over time.

6.6 Role of Governance

The findings highlighted corporate governance as an imperative in ensuring that MFIs do not deviate from their social mission, but also highlighted the need for mechanisms to be put in place to guarantee sound management rigour in operations. This translates into the appropriate separation of duties to prevent revenue leakages, and enforce transparency in financial reporting.

Since by the nature of its activities the MFI has multiple stakeholders, Mersland (2011) and Mori (2010) posit that the MFI should adopt a broader stakeholder-based approach in Board composition. There was evidence that supported this approach in that MFIs have built relationships with donors, who sit on their boards, which mitigate agency costs issues. A strong and independent Board is preferred as it would enable the MFI to better manage the trade-off between outreach and financial self-sufficiency (Arena, 2008).

A strong Board is a custodian of good corporate governance principles, which help the MFI build a reputation, which stands the institution in good stead when it comes to raising funds. As such, training of Directors so that they can deliver on their fiduciary duties to the benefits of the institution and its mission is considered critical in the South African environment where a lack of microfinance skills was highlighted by the findings.

The findings did not highlight any evidence of improved financial performance, directly linked to Board activities as found by Mersland and Strom (2009), though internal auditing functions are critical in establishing financial management discipline.

Chapter 7: Conclusion

This Chapter provides highlights of the main findings of the research; recommendations for future research and the implications to the business in South Africa.

7.1 Research Background and Objectives

Microfinance has emerged as a necessary tool to alleviate poverty in developing countries, as it extends financial inclusion by providing loans to those who do not have collateral. This research investigated the tension between the need for microfinance institutions to achieve sustainability, while serving more of the poor; probe whether MFIs in South Africa are pursuing commercialisation as a strategy to achieve sustainability; identify the business practices that contribute to sustainability and validate whether the lending methodologies contribute to better portfolio quality.

7.2 Main Findings

The research found that commercialisation is not compatible with social impact as it leads to mission drift. MFIs incorporated as commercial organisations do not necessarily grow their outreach, on the premise of improved access to funding. These findings support the literature, despite the fact that regulation in South Africa prevents most MFIs from mobilising savings. As a consequence, the inability to mobilise savings gives rise to an inefficient market mechanism,

which hinders efficient economic development as it prevents financial intermediation.

The research established that the trade-off between sustainability and social impact appears evident for commercial MFIs. In addition, NGO-type MFIs have elaborated impact assessment instruments, although acknowledging that the assessment process is difficult and costly due to the scarcity of resources.

The research identified business practices that impacted financial and social performance of an MFI, through scale, cost management and patient capital. Scale or breadth of outreach enables the MFI to leverage economies of scale. South African MFIs face higher cost structures compared to other developing countries, a fact that emphasises the importance of cost management.

The research highlighted non-financial interventions MFIs carry out with their client base to enhance the repayment rate, thereby delivering an impressive portfolio quality. The research also suggested that MFIs using group lending methodology achieve a lower loan delinquency rate compared to the MFI using an individual lending methodology.

The research further highlighted the need for good governance to avoid mission drift, with stakeholders sitting on the Board of Directors to reduce agency cost. The link between financial performance and governance was not conclusive.

7.3 Research Implications

Microfinance as a tool to alleviate poverty has not been leveraged in South Africa. In order to achieve real economic impact for South Africans at the base of the pyramid, NGO-type MFIs have shown a deeper and broader outreach in rural South Africa. The structure of the South African economy with high unemployment rate is such that peri-urban populations in townships do not necessarily have permanent employment. As such, there is room for commercial MFIs, who do not have poverty alleviation as a mission but provide financial access to unemployed individual who do not have collateral.

The research process has shown a lack of collaboration amongst MFIs, which deprive the industry of a strong voice to lobby civil society as well as government. A respondent suggested the need for a social movement to promote the benefits of microfinance as a way to sensitise the society to the kind of impact cooperatives have had in Sub Saharan Africa. The collaboration can extend to MFIs sharing infrastructure where appropriate to lower the costs of operations.

The regulatory restrictions in South Africa concerning savings mobilisation for micro enterprise lenders is inhibiting product innovation and curtailing outreach, as MFIs are not able to leverage financial intermediation. Manos and Yaron (2009, p. 107) emphasised the need for innovation “*The production possibility frontier (PPF) curve can shift with innovation, thereby increasing both SDI and outreach*”. Innovation is essential, for a policy framework that removes barriers, so that MFIs can grow their outreach. An example could be in the areas of compliance to reduce the cost burden as well as tax rebates linked to outreach.

7.4 Research Limitations

The sample of MFIs that formed part of the study is weighted towards micro enterprise lenders. Hence the findings may not be inferred on cooperatives and individual lending microfinance institutions. Also, in a study about sustainability, the voice of MFIs that have folded is not reflected in the findings, as a result other dependent variables influencing sustainability may have not been uncovered in this study.

7.5 Future Research Directions

Below are areas that can be considered for future research:

1. A regression analysis can be performed to establish which of the business practices found above: scale, cost management, loan monitoring, management capacity and patient capital have a higher weight in ensuring financial and outreach performance.
2. The government supported Apex Fund has a mandate to provide funding for microfinance. A study that warrants consideration is whether it makes sense for the Apex Fund to support MFIs that are already achieving social impact in their ability to scale versus a federated approach of trying to help start and promote MFIs (cooperatives) in areas where there is a lack of microfinance skills.
3. MFIs are hampered in their journey to sustainability by a cost structure that is endemic to the dual-economy society that exists in South Africa. Future studies could explore the extent to which the use of technology by MFIs in

countries such as India has been able to lower the cost to the institution and to the client, in the provision of micro loans.

7.6 Summary

The benefits of microfinance in alleviating poverty in South Africa have been established, although MFIs face challenges in raising the right mix of capital to grow their outreach. This research has highlighted some of those challenges, and identified focus areas for MFIs to ensure they can achieve sustainability, measured in terms of financial and social performance.

Reference List

- Akula, V. (2010). Business Basics at the Base of the Pyramid. *Harvard Business Review*, 85(9), 20-22. Retrieved from [://www.cob.sjsu.edu/osland_a/bus218/articles/BusinessBasicsattheBaseofthePyramid.pdf](http://www.cob.sjsu.edu/osland_a/bus218/articles/BusinessBasicsattheBaseofthePyramid.pdf)
- Arena, T. (2008). Social Corporate Governance and the Problem of Mission Drift in Socially-Oriented Microfinance Institutions. *Columbia Journal of Law & Social Problems*, 41(3), 269-316
- Ayayi, A. G., & Sene, M. (2010). What drives microfinance institution's financial sustainability. *The Journal of Developing Areas*, 44(1), 303.
- Banerjee, A., Duflo, E., Glennerster, R. & Kinnan, C. (2009). The miracle of microfinance? Evidence from a randomized evaluation. Cambridge, Mass.: MIT Poverty Action Lab. Retrieved from [://econ-www.mit.edu/files/4162](http://econ-www.mit.edu/files/4162)
- Banerjee, A. V., & Duflo, E. (2007). The economic lives of the poor. *The Journal of Economic Perspectives*, 21(1), 141-167
- Bankston, C. L., I., & Zhou, M. (2002). Social capital as process: The meanings and problems of a theoretical metaphor. *Sociological Inquiry*, 72(2), 285-317.

Baumann, T. (2005). Pro-poor microcredit in South Africa: Cost-efficiency and productivity of South African pro-poor microfinance institutions. *ESR Review*, 7(1), 95.

Beck, S., & Ogden, T. (2007), Beware of bad microcredit. *Harvard Business Review*, 85(9), 20-22

Beck, T., & Demirgüç-kunt. (2008). Access to finance: An unfinished agenda. *The World Bank Economic Review*, 22(3), 383-396

Beck, T., Demirgüç-Kunt, A., & Levine, R. (2007). Finance, inequality and the poor. *Journal of Economic Growth*, 12(1), 27-49

Beshouri, C.P. and Gravråk, J. (2010). Capturing the promise of mobile banking in emerging markets. *McKinsey Quarterly*. Retrieved from <http://www.mckinseyquarterly.com/>

Blumberg B., Cooper D. R. & Schindler P.S. (Eds.). (2008). *Business Research Methods* (2nd European ed.). Maidenhead: McGraw-Hill Education

Calvin, B. and Coetzee, G. (2010). A review of the South African microfinance sector 2009: Successes, Challenges and Policy Issues. FinMark Trust and the Centre for Inclusive Banking Africa, University of Pretoria. Retrieved from [://web.up.ac.za/sitefiles/file/1/3841/MF Review 2009 - 21 July 2010 FINAL.pdf](http://web.up.ac.za/sitefiles/file/1/3841/MF%20Review%202009%20-%2021%20July%202010%20FINAL.pdf)

Calvin, B. and Coetzee, G. (2009). *Microenterprise Lending Fundamentals. Centre for Inclusive Banking Africa.* University of Pretoria.

Cassar, A., & Wydick, B. (2010). Does social capital matter? Evidence from a five-country group lending experiment. *Oxford Economic Papers*, 62(4), 715-739.

Chaia, A., Dalal, A., Goland, T., Gonzalez, M. J., Morduch, J. & Schiff, R. (2009). *Half the World is Unbanked. The Financial Access Initiative.* Retrieved from [://financialaccess.org/sites/default/files/110109%20HalfUnbanked_0.pdf](http://financialaccess.org/sites/default/files/110109%20HalfUnbanked_0.pdf)

Chen, G., Rasmussen, S., Reille, X. and Rozas, D. (2010). *Indian Microfinance Goes Public: The SKS Initial Public Offering.* CGAP Focus Note No 65 September 2010. Washington DC. Retrieved from <http://www.cgap.org/p/site/c/template.rc/1.9.47613/>

Chowdhury, M., Mosley, P., & Simanowitz, A. (2004). *The social impact of microfinance: Introduction.* Journal of International Development.

Copestake, J. (2007). Mission Drift - Understand it. Avoid it. *ESR Review*, 9(2), 20.

Corbin, J. & Strauss, A. (Eds.). (2008). *Basics of Qualitative Research* (3rd ed). London: Sage Publications.

Creswell, J. W., & Miller, D. L. (2000). Determining Validity in Qualitative Inquiry. *Theory Into Practice*, 39(3), 124

Cull, R., Demirgüç-Kunt, A., & Morduch, J. (2011). Does regulatory supervision curtail microfinance profitability and outreach? *World Development*, 39(6), 949-965

Cull, R., Demirgüç-Kunt, A., & Morduch, J. (2007). Financial performance and outreach: A global analysis of leading microbanks. *Economic Journal*, 117(517), 107-133

Doing good by doing very nicely indeed. (2008, June 26). *The Economist*.

Retrieved from ://www.economist.com/node/11622469

El-Zoghbi, M. Gähwiler, B. & Lauer, K. (2011, April). Cross-border Funding of Microfinance. Focus Note 70. Washington, D.C.: Consultative Group To Assist

the Poor (CGAP). Retrieved from [://www.cgap.org/gm/document-1.9.50740/FN70.pdf](http://www.cgap.org/gm/document-1.9.50740/FN70.pdf)

Epstein, M. J., & Yuthas, K. (2010). Mission impossible: Diffusion and drift in the microfinance industry. *Sustainability Accounting, Management and Policy Journal*, 1(2), 201.

FinMark Trust. (2010). Retrieved from [://www.finmark.org.za](http://www.finmark.org.za)

Getu, M. (2007). Does Commercialization of Microfinance Programs Lead to Mission Drift? *Transformation (02653788)*, 24(3/4), 169-179

Gillham, B. (2005). *Research Interviewing: The Range of Techniques*. Maidenhead: Open University Press.

Gillham, B. (2000). *The Research Interview*. London: Continuum International Publishing Group.

Goldberg, N. (2005). Measuring the Impact of Microfinance: Taking Stock of What We Know. Washington, D.C.: Grameen Foundation. Retrieved from [://www.givewell.org/files/Cause1-2/Independent research on microfinance/GFUSA-MicrofinanceImpactWhitepaper-1 .pdf](http://www.givewell.org/files/Cause1-2/Independent%20research%20on%20microfinance/GFUSA-MicrofinanceImpactWhitepaper-1.pdf)

Helms, B. (2006). *Access for all: Building inclusive financial systems*.

Washington, DC: International Bank for Reconstruction and Development

Hermes, N., & Lensink, R. (2007). The empirics of microfinance: What do we know? *Economic Journal*, 117(517), 1-10

Honohan, P. (2008). Cross-country variation in household access to financial services. *Journal of Banking and Finance*, 32(11), 2493-2500

Hudon, M. (2008). Norms and values of the various microfinance institutions. *International Journal of Social Economics*, 35(1), 35.

Kazmin, A. (2010). Debt trap leads to despair for rural poor. *Financial Times*. Retrieved from [://www.ft.com/cms/s/0/33dfa528-e378-11df-8ad3-00144feabdc0.html#axzz1K3eQsCHF](http://www.ft.com/cms/s/0/33dfa528-e378-11df-8ad3-00144feabdc0.html#axzz1K3eQsCHF)

Lascelles, D. & Mendelson, S. (2011). *Microfinance Banana Skins 2011*. New York: Centre for the Study of Financial Innovation (CSFI)

Ledgerwood, J. (1999). *Microfinance handbook: An institutional and financial perspective* Sustainable Banking with the Poor series. Washington, D.C.: World Bank

Ledgerwood, J. & White, V. (2006). Transforming Microfinance Institutions: Providing Full Financial Services to the Poor. The World Bank. Washington, DC.

Maes, J., & Basou, M. (2005). Building economic self-reliance: Trickle up's microenterprise seed capital for the extreme poor in rural India. *ESR Review*, 7(2), 71.

Manos, R., & Yaron, J. (2009). Key issues in assessing the performance of microfinance institutions. *Canadian Journal of Development Studies*, 29(1-2), 101-122

Marconi, R., & Mosley, P. (2006). Bolivia during the global crisis 1998-2004: Towards a 'macroeconomics of microfinance'. *Journal of International Development*, 18(2), 237-262

Mendoza, R. U. (2011). Why do the poor pay more? Exploring the poverty penalty concept. *Journal of International Development*, 23(1), 1-28.

Mendoza, R. U., & Vick, B. C. (2010). From revolution to evolution: Charting the main features of microfinance 2.0. *Perspectives on Global Development and Technology*, 9(3), 545

Mersland, R. (2011). The governance of non-profit micro finance institutions: Lessons from history. *Journal of Management and Governance*, 15(3), 327-348

Mersland, R. & Strom, R. O. (2009). Performance and governance in microfinance institutions. *Journal of Banking and Finance*, 33(4), 662-669

Microfinance Market Outlook. (2010). *responsAbility Social Investment AG*.

Retrieved from

[://www.responsability.com/domains/responsability_ch/data/free_docs/rA_MicrofinanceMarketOutlook2011_en.pdf](http://www.responsability.com/domains/responsability_ch/data/free_docs/rA_MicrofinanceMarketOutlook2011_en.pdf)

Mori, N. (2010). Roles of stakeholders in strategic decision-making of microfinance organizations. *The International Business & Economics Research Journal*, 9(7), 51-63

Morse, J. M., Barrett, M., Mayan, M., Olson, K., & Spiers, J. (2002). Verification Strategies for Establishing Reliability and Validity in Qualitative Research. *International Journal of Qualitative Methods*, 1(2), 1-19.

Ndzamela, P. (2010). More South Africans are using financial products.

Retrieved from

[://www.moneyweb.co.za/mw/view/mw/en/page295043?oid=520165&sn=2009](http://www.moneyweb.co.za/mw/view/mw/en/page295043?oid=520165&sn=2009)

Detail

Patton, M.Q. (Eds.). (2002). *Qualitative Research & Evaluation Methods* (3rd Edition). London: Sage Publications

Pollinger, J. J., Outhwaite, J., & Cordero-Guzmán, H. (2007). The question of sustainability for microfinance institutions. *Journal of Small Business Management*, 45(1), 23.

Prahalad, C.K. (2006). *The fortune at the bottom of the pyramid: Eradicating poverty through profits*. Upper Saddle River, NJ. Pearson Prentice Hall

Quayes, S. (2012). Depth of outreach and financial sustainability of microfinance institutions. *Applied Economics*, 44(26), 3421-3433

Roodman, D. & Qureshi, U. (2006). Microfinance as Business. *Center for Global Development*, ABN-AMRO. Retrieved from
[://www.eldis.org/vfile/upload/1/document/0708/DOC22976.pdf](http://www.eldis.org/vfile/upload/1/document/0708/DOC22976.pdf)

Rosenberg, R. (2010). Does Microcredit Really Help Poor People? Consultative Group to Assist the Poor. Focus Note No 5 January 2010. Retrieved from
[://www.cgap.org/p/site/c/template.rc/1.9.41443/](http://www.cgap.org/p/site/c/template.rc/1.9.41443/)

Sanyal, P. (2009). From credit to collective action: The role of microfinance in promoting women's social capital and normative influence. *American Sociological Review*, 74(4), 529.

Tan, J. (2010). Grounded theory in practice: Issues and discussion for new qualitative researchers. *Journal of Documentation*, 66(1), 93-112

What is a Microfinance Institution (MFI)? (2011). *Consultative Group To Assist The Poor (CGAP)*. Retrieved from
<://www.cgap.org/p/site/c/template.rc/1.11.947/1.26.1308/>

Appendix I - Consistency Matrix

Title: Consistency Matrix for Achieving sustainability while delivering on the social impact: challenges facing microfinance institutions

Research Questions	Literature Review	Data Collection Tool	Analysis
RQ1: Is commercialisation the only model for MFIs to grow their outreach, hence achieve sustainability through scale?	Quayes (2012) Ayayi and Sene (2010) Arena (2008) Beck and Demirgüç-kunt (2008) Copestake (2007) Cull, Demirgüç-Kunt and Morduch (2007) Getu (2007) Helms (2006) Ledgerwood and White (2006)	Interview guide	Narrative Analysis Constant comparison Content Analysis
RQ2: Is there a trade-off between the sustainability of an MFI and the social impact the institution seeks to achieve within the community where it operates?	Quayes (2012) Cassar and Wydick (2010) Mendoza and Vick (2010) Manos and Yaron (2009) Sanyal (2009) Beck and Demirgüç-kunt (2008) Beck, Demirgüç-Kunt and Levine (2007) Copestake (2007) Hermes and Lensink (2007) Ledgerwood and White (2006) Maes and Basou (2005) Chowdhury, Mosley, and Simanowitz (2004)	Interview Guide	Narrative Analysis Content Analysis.
RQ3: What business practices are important for the MFI to achieve sustainability?	Cull, Demirgüç-Kunt, and Morduch (2011) Epstein and Yuthas (2010) Mendoza and Vick (2010) Manos and Yaron (2009) Banerjee and Duflo (2007) Copestake (2007) Pollinger, Outhwaite, and Cordero-Guzmán, (2007) Helms (2006) Ledgerwood and White (2006); Baumann (2005)	Interview Guide	Content Analysis

Research Questions	Literature Review	Data Collection Tool	Analysis
RQ4: Do MFIs that do not operate with norms that generate social capital have a high loan delinquency rate, i.e. a deteriorating portfolio quality?	Cassar and Wydick (2010) Epstein and Yuthas (2010) Mendoza and Vick (2010) Sanyal (2009) Cull, Demirgüç-Kunt and Morduch (2007) Marconi and Mosley (2006) Roodman and Qureshi (2006)	Interview Guide	Content analysis
RQ5: What is the impact of governance on the sustainability of the MFI?	Mersland (2011) Mori (2010) Mersland and Strom (2009) Arena (2008)	Interview Guide	Narrative Analysis Content Analysis.

Appendix II - Interview Guides

The interview guide for Subject Matter Experts below has been adapted from Blumberg et al. (2008: 386).

Type of Study	Exploratory (Semi-structured)
Purpose	Learning the microfinance subject matter expert's view on the challenges facing microfinance institutions (MFIs) in achieving sustainability, with respect to achieving their social mission; the relationship between sustainability and their social mission; synergies and conflicts.
Instrument	
1. Introduction	<ul style="list-style-type: none"> • Researcher: Eric Kasenge, GIBS MBA Student • Why Study: understand to what extent sustainability of MFIs is dependent on achieving profit or the drive to deliver a social impact. • Explain what will be done with the data and agree on any anonymity • Explain data gathering process, and establish whether interview can be recorded.
2. Collect interviewee details	<ul style="list-style-type: none"> • Name • Current position related to the microfinance industry • History with the microfinance industry • Current interest in the microfinance industry
3. Challenges facing MFIs	<ul style="list-style-type: none"> • Define the microfinance industry in SA, with focus on the developmental impacts they deliver to society? • What are the challenges facing the MFIs in the SA market? • What elements contribute to MFIs sustainability? • Does the social mission play any role? – Which elements are synergistic with sustainability and which elements may work against sustainability?
4. Wrapping up the interview	<ul style="list-style-type: none"> • How do you see the industry evolving in the next five years? • How would you advise MFIs to achieve sustainability? • What advice would you give a start-up MFI? • Any other comments?
5. Thanking Interviewee	Thank interviewee and share current journey and gained insights.
6. Post interview summary	Organise notes, produce transcripts of the relevant parts of the interview.
Format	Allow for the conversation to flow, raise follow-up, probing and clarifying questions based on responses

Below is the in-depth interview guide for data collection from the Microfinance Institutions. It has been adapted from Blumberg et al. (2008: 386).

Type of Study	Exploratory (Semi-structured)
Purpose	To collect statistical data on the MFI and insights into their operations; how they balance the drive to achieve poverty alleviation as a social mission while becoming sustainable.
Instrument	
1. Introduction	<ul style="list-style-type: none"> • Researcher: Eric Kasenge, GIBS MBA Student • Why Study: understand to what extent sustainability of MFIs is dependent on achieving profit or the drive to deliver a social impact. • Explain what will be done with the data and agree on any anonymity • Explain data gathering process, and establish whether interview can be recorded.
2. Collect interviewee and MFI details	<ul style="list-style-type: none"> • Name • Current position in the microfinance institution • An indication of experience in the microfinance industry • Collect statistical data on the MFI (refer to MFI Key indicators)
3. Questions	<ol style="list-style-type: none"> 1. Could you please share how the MFI came into existence and what are its goals? 2. Who is your customer and do you measure their level of access to financial services or lack of it? 3. Could you describe the funding structure of the MFI? 4. How do you define sustainability and how do you measure it? 5. What elements are critical to your sustainability? 6. What strategies are you executing to achieve sustainability and/or self-sufficiency? 7. Do you measure the social impact your organisation achieves? And if so, how do you measure it? 8. What other services do you deliver to your client base beyond provision of loans? 9. What barriers / challenges, if any, do you face in meeting your goals and delivering on your social goals (if any)? 10. What are your thoughts on the relationship, if any, between the MFI being sustainable and its social goals? Expand on both positive and negative relationships. 11. What role does the leadership (Board of Directors) play in helping the organisation become sustainable?

4. Wrapping up the interview	12. How do you see the organisation evolving in the next five years? 13. Do you have any other thoughts you would like to share on the sustainability of the MFIs?
5. Thanking Interviewee	Thank interviewee and share current journey and gained insights, to establish a base for any follow-up or clarifications during post interview analysis.
6. Post interview summary	Organise notes, produce transcripts of the relevant parts of the interview.
Format	Allow for the conversation to flow, look for confirmation of the insights gained from interviews with subject matter experts; probing and clarifying questions based on responses.

Appendix III - Microfinance Institutions Performance Indicators

Name of MFI:		
Indicators		Data
Year of incorporation		
Section 21 (NGO)	Commercial	
Number of active clients		
% Women Clients		
Lending Methodology		
Value of Loans Outstanding		
Current Average Loan Size Disbursed		
Number of Loans disbursed since inception		
Amount disbursed since inception		
Bad Debts as % of annual disbursements		
Bad Debts as % of average Principal Outstanding		
Portfolio at risk > 30 days		
Current Re-scheduled loans (due to illness)		
Death write-offs		
Total Savings held by clients		
Total staff at year end		
Total operations staff at year end		
No of offices		
Clients per loan officer		
Clients per staff member		
Operational self-sufficiency		
Financial self-sufficiency		

Appendix IV - Interview Consent Form

I am conducting research on the sustainability of Microfinance Institutions (MFIs). The aim is to understand whether the need to grow their customer base and their product portfolio produces a tension between their social mission and the quest for financial sustainability.

Our interview is expected to last about an hour, and will help uncover the challenges the MFIs are facing in South Africa and what strategies they are executing in overcoming those challenges to be sustainable.

Your participation is voluntary and you can withdraw at any time without penalty.

All the data collected will be kept confidential. If you have any concerns, please contact me or my supervisor. Our details are provided below.

Eric Kasenge

Email: ekasenge@yahoo.com

Phone: 082 570 4051

Zenobia Ismail

Email: zismail@idasa.org.za

Phone: 084 478 3693

Signature of Participant: _____

Date: _____

Signature of Researcher: _____

Date: _____