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Microfinance: A Review Oninstitutionalist And Welfaristapproach

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Abstract

This paper is a comparison of two opposite schools of thoughts on Microfinance viz., Institutionalist viewpoint and Welfarist viewpoint. The Institutionalist approach claims that without financial self-sufficiency, it is not possible for microfinance institutions to sustain their operations by relying mainly on government and donor aids. The Welfarist approach propounds that the ultimate goal is to reach maximum number of poor beneficiaries for their wellbeing irrespective of who bears the cost for this service. There has been a mix reactions in several studies in different time period and different parts of the world with different methodology with respect to profitability and outreach of microfinance institutions. Some literature say that outreach and profitability can be achieved together, some say they are negatively correlated where there is a need for balancing between them. Therefore, the net consolidation between institutionalist and welfarist stands for ambiguous position. Microfinance must be extended as a social and economic obligation of the fund provider to eliminate, or at least reduce poverty, to ensure a just and equitable society. Yet, it is essential that microfinance institutions serve the poverty and also attain self-sufficiency concurrently.

Keywords**:** Microfinance,Institutionalist approach, Welfarist approach Sustainability, Outreach.

Introduction

Poverty, a curse on humankind, leads to economic, social, political and moral problems across the globe. Microfinance was devised to eliminate poverty by helping marginal and poor entrepreneurs to create self-employment through lower level income generating activities. The borrowers desperately need education and training to materialize their dream that requires capital, albeit a small quantum. Microfinance plays a pivotal role in such a scenario by providing capital or seed money required to start a small business. Governments and international agencies try to eradicate poverty through various programs, services and policies. Among these initiatives, microfinance has immense potential to create new job opportunities and generate income thereby resulting in improving social and economic standards.

Institutionslist And Welfarist Approach

Institutionalists hold the view that the sustainability of microfinance institutions depends on profit maximization and welfarists emphasize on reaching out to maximum number of poor people and bring them out of poverty. Welfarists theorize that taxpayers' money could be used to meet political and social obligations. However, it can be argued that benefitting a section of the society with the money provided by another section of the society is mere transfer of wealth and no real development is being made. Studies have supported both the schools of thought viewpoints in the following paragraphs:

Haan and Lakwo (2010) observed that poverty eradication could be devised as a first-stage objective of microfinance that would lead to creation of a just and equitable society emphasizing on freedom, empowerment and wealth distribution. Microfinance lead to women beneficiaries attaining a higher level of freedom in Uganda. This is despite their finding that microfinance had not resulted in significant wealth gain among the beneficiaries and they only marginal economic gains were made. Hence, it can be contemplated that social freedom could be pursued through microfinance rather than just considering it as a tool to eliminate poverty.

The transformation of microfinance institutions into commercial banks has brought a paradigm shift in their service models, clientele and scope of work. The Institutionalists opine that service recipients must not be the poorest, but a little above the poverty line, to ensure profitability and sustainability of lenders. Rajeev and Bhatt's (2013) initial study indicated that microfinance institutions with a profit motivation had a higher chance of sustaining their business. Yet, their latter study indicated that there is insignificant difference for profit oriented microfinance institutions and their counterpart. Overall, their study does not provide conclusive evidence on whether profit motivated microfinance institutions had a higher chance of sustainability. In addition, financial statement analyses done by them indicated that ratios of profit motivated institutions showed a declining trend. To be specific, ROA (Return on Assets) and ROE (Return on Equity of profit oriented microfinance institutions had declined whereas the trend was positive for the non-profit oriented counterparts. Though sustainability could be ensured through leveraging, expense control and efficiency improvement, both profit and non-profit oriented microfinance institutions need to be diligent in credit risk and cost management. It was also noted that there was no need for additional regulations to ensure sustainability as long as microfinance institutions exhibited responsible behavior and adopted self-regulation.

In case of Ethiopia, an agro based economy, poverty reduction has been a principal development agenda. According to Balcha and Tamare (2017) 90% of the population is lacking of getting support from formal financial services and yet the service providers do not consider the poor people as worthy of availing banking service. Though the outreach of microfinance institutions was good, they were yet to reach the poorest section of the society. However, it was observed that the breadth and depth of outreach of Ethiopian microfinance institutions showed an increasing trend. Consequently, the increase in the amount of voluntary savings was remarkable and its ratio to compulsory savings rose about five times during 2005 to 2014. About half of the women population and some crop producing farmers were covered by the microfinance service providers. Though microfinance institutions' self-sufficiency and operation could be attributed to higher revenues,financial support in terms of donations and subsidies were also available. Overall, it was observed that the operational and financial sustainability of microfinance institutions could be improved by improving their efficiency.

Both achieving financial sustainability and social objective of microfinance institutions at the same time have always been a big challenge. Achieving profitability and serving poor people may be balancing the opposite scenario. Bassem (2012) studied to analyze the relationship between profitability and outreach in the North Africa and Middle East within the time frame of 2008 to 2012. He found that there is a neutral relationship between them.Butwhen microfinance institutions desire to decrease their portfolio risk, there is a symptom of trade off. But again, a higher portfolio at risk is not related with a low profile client which does not justify any tradeoff. This means both the objectives are achievable at the same time.

Initially microfinance institutions are supported by government and donor agency for the welfare of the people. But subsequently there is a need for self-sustainable model to support for a long time period. Day by day there has been a reduction of government and donor funding. This promotes a lot for the expansion of financially self-sustainable Microfinance Institutions (MFIs) without dependency from outside resources. This development has raised the questions to serve for social performance or financial performance competing with each other.Adhikary and Papachristou(2012) empirically examine to find out this relationship of outreach with financial performance of Microfinance Institutions in a panel data from 2003 to 2009 of South Asian countries. Here the methodologies they have used weregeneral method of moments (GMM) estimation and random effects modeling. It has been found that both depth andbreadth of outreach are positively correlated with profitability and efficiency but depth in contrast to breadth reducesfund risks.Finally, it is apparent thata financially sustainable microfinance institution mayreach its social objective with tolerable risk, because outreach has statistically insignificant negative relationship with financial performance.

There has been a study to find out the existence of tradeoffs amongoutreach, profitability and sustainability in East Africa considering a panel data of forty seven microfinance institutions for a time period of four years. The study found a presence of tradeoffs showing a reverse impact on outreach to the poor for profitability applying welfarist point of view whereas the findings on financial sustainability did not reveal symptom of tradeoffs with the outreach. But in line withInstitutionalists, the tradeoffs have been found among sustainability, profitability and outreach considering the variables taken with estimation model. In this case, somevariablesexpressed the presence of tradeoffs under welfarist views did do not indicate such behavior under institutionalistviews.Microfinance institutions in this region have to concentrate on financial sustainability to be independent of subsidy, ensure long term operation and prospectfor coming days. At the policy making level, it is highly suggested that there should not be any compromise with sustainability for the outreach. The policy makers shouldreconsider their policies towards microfinance institutions to make sure that the microfinance as a service industry are pointedonwards tosustainability. They should also permitmicrofinance institutions to serve other financialservices side by side toenlarge their operations to the poor (Kipesha and Zhang 2013).

Microfinance institutions have mainly three types of business models such as solely profitoriented, without profit oriented microfinanceinstitutions and social profit makingentities aiming double bottom line. In compliance with their respective model, they approach for their respective borrowers' together with loan size and pricing. A simple approach can be shownfor accommodating vast range of models to predict operational efficiency. Bos and Millone(2015) found that microfinance operating with a high depth of outreach were very efficient. They concluded that higher levels of outreach and profits are possible at the same time. This findings go with the institutionalist school of thought.

Microfinance institutions of Nepal have been studied with a view to find out financial sustainability. There are mainly four different types of modalities of microfinanceinstitutions in Nepal namelyGI-GBB, PI-MFB, FINGOs and Coop. Duwal(2015) found that financial performance of the Nepalese microfinance institutions varied with respect to modalitiesadopted by them. In addition, Nepalese microfinance institutions are financially sustainable except government initiated microfinance banks. The welfarist microfinance still need to cover the poorest section of the people and broaden their financial services.

In case of North Africa andMiddle East area, the correlation between social and financial performance has been a matter of substitution or complimentary. By studying a panel data from 1998 to 2011 with a sample of sixty four microfinance institutions in nine countries and using simultaneous equations, Adair and Berguiga(2014) found that social performance was negatively correlated with financial performance and vice versa. For the interaction between them regarding both one way and reciprocal dependency, they documented various factors with respect to information transparency, geographic issues, credit methodology, status and operating areas. Therefore it is a symptom of trade off existence.

Masood (2013) found a tradeoff exists in case of India using panel data of fifty five microfinance institutions taking the period from 2005 to 2009. They used the Hausman and Taylor panel data model for their study. The association between financial performance of microfinance institutions with poverty outreach went on opposite direction and regulation or profit orientation have

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been playing significant roles but location of the activities and method of lendingapproached by MFIs do not make impact on poverty outreach. He suggested that Group lending model as used by Grameen Bank is the best approach as compared tothe individual lending approach used otherwise.

Hermes and Lensink(2011) find that there are three stages for drawing conclusions from the lessonson the outreach versus sustainability. Firstly, sustainability compromised with respect to outreach we find there is a trade-off between them. Therefore it is not a good idea for mixing microfinance with traditional banking. This gives a useful messagefor the donors or governments for deciding to fund microfinance by subsidy, donation, grants etc.It is equally important for microfinance practitioners, commercials, academicians and current & prospective investors for their decisions to further upgrade the sustainability of their acticities. Secondly, if there could be a relationship between marginalimprovements of the financial sustainability with reducing outreach. We hardly find any literature for this type of findings.Further research is to take placein case of this size trade off to draw a convincing conclusion.

Galema and Lensink (2009) calculatedhow much social investors are accepting a decrease on returns (or an increase in the risk) to get higher outreach to the poverty. Their study was based on a small sample of 25 microfinance institutions. It is interesting that they foundwhereas the balancing is not large for average loans size (Here $180 or more) but it held true for below level loan size. This findings suggested that the trade-off/balancing is particularly severe for the lower level of the poverty. Thirdly, level of subsidy is the consideration for come up with recommendation and suggestion. It was found thatas long as subsidy level remains moderate, it does not have to compromise efficiency. Some smartly designed subsidies may have positive impact on the performance.Another focal point could be reducing cost as one of the sustainability measures to outreach the poor. A better solution could be the using social networks for both existing and future clientssayhomogenous households.

Stochastic frontier analysis has also been used to find out whether microfinance institutions have a trade-off between outreach and efficiency. There is quite strong evidence that outreach is negatively correlated with efficiency. In detail, it has been found that microfinance institutions with lower average loan (a measure of the depth of outreach) are also not efficient enough for sustain. In addition,there is evidence showing that microfinance institutions with more female clients considered (Also a measure of the depth of outreach) are notsustainable enough(Hermes, Lensink and Meesters 2011).

Table 1: Summaryof two approaches reviewed

Authors (Year)	Objectives	Scope	Findings / Conclusions
1.Haan and Lakwo (2010)	To find out at first stage the benefits of microfinance for poverty elimination and then its subsequent effect.	Methodology used consensual people-centered relevance test and studies region Uganda	Clients got only marginal well-being. But further analysis showed that the femaleborrowers achieved more emancipation in spite of these marginal well-being. It goes with the flow of welfarist view but silent about sustainability.
2.Rajeev and Bhatt (2013)	To point out whether microfinance institutions with a profit motivation had a higher chance of	Used profit and non for profit MFIs ranges from minimum of 300 MFIs to 550 MFIs representing at least 80 countries and One-way ANOVA & further year	Initially concluded that microfinance institutions with a profit motivation had a higher chance of sustaining their business. But, their latter study indicated that profit motivated institutions' sustainability were not statistically significant with its counterpart. It goes with the neutral view.

	sustaining their business.	by year differences are analyzed with the help of Post-hoc analysis.	
3.Balcha and Tamare(2017)	Aims at evaluating the outreach of Ethiopian MFIs and their sustainability.	The 14 samples of the study were selectedfrom operating 34 MFIs by using purposive sampling technique to include all categories. Quantitative as well as qualitative research methods are used in this study.	The microfinance outreach trend found promising, though they have challenges to address the disadvantaged group of the society. Sustainability indicators suggested that the operational and financial sustainability of microfinance institutions came from both increased self-generated income and donation. This makes both the views together hand by hand.
4.Been (2012)	To find outwhether there is any relationship between profitability and outreach	Study region North Africa and Middle East and study time 2008 to 2012.	There is a neutral relationship between them. But when microfinance institutions desire to decrease their fund risk, there is a symptom of trade off. But again, a higher investment risk is not related with a low profile client which does not justify any tradeoff. This means both the objectives are achievable at the same time.
5.Adhikary and Papachristou (2012)	Empirically examined to find out the associationof financial performance with outreach of microfinance institution	Methodology used Random effects modelingand general method of moments (GMM) estimation and studied region South Asia with time frame from 2003 to 2009	The study found positive correlation of Breadth and Depth of outreach with profitability and efficiency and in addition depth was mitigating risks in contrast to breadth. There was statistically insignificant negative relationship between financial performance and outreach. Therefore, a financially sustainable microfinance could achieve its social goals at tolerable risk level.
6.Kipesha and Zhang (2013)	To find out the presence of trade-offs amongprofitability sustainability, and outreach to the poor	Study region East Africa, study sample forty seven microfinance institutions and study time four years	They found a presence of trade-offs showing a reverse impact on outreach to the poor for profitability whereas the results on sustainability did not show symptom of trade-off with the outreach. In addition, the tradeoff have been found among sustainability, profitability and outreach depending on the variables and estimation model used.
7.Bos and Millone (2015)	To see by a simple approach that accommodates various type of models to measure operational efficiency	Data from the Microfinance Information Exchange Market. In total, MIX includes 1,146 MFIs, over the period 2003–2010. Used unbalanced panel with 3,880	Microfinance with a high depth of outreach were most operational efficient, showing high levels of outreach and profits for the same input mix. This findings go with the institutionalist school of thought.

		observations.	
8.Duwal (2015)	To study microfinance institutions with a view to find out financial sustainability	Not available	Financial performance of the Nepalese microfinance institutions varied with respect to modalities adopted by them.
9.Adair and Berguiga (2014)	To find out the correlation between social and financial performance	Studied a panel data from 1998 to 2011 with a sample of sixty four microfinance institutions in nine countries and used simultaneous equations	Social performance has a negative impact upon financial performance and vice versa.
10.Masood (2013)	To study the relationship between financial orientation and poverty outreach to the poor	Used an unbalanced panel data of fifty five microfinance institutions covering the period from 2005 to 2009 in India and as methodology used the Hausman and Taylor panel data model	The relationship between financial orientation of microfinance institutions with their outreach to the poor went on opposite direction
11. Hermes and Lensink (2011)	To answer the questions whether microfinance has socio-economic effect to the poverty of developing nations and whether they are sustainable for future operation	Based on a dataset of 124 microfinance institutions in 49 countries	Three stages on the outreach versus sustainability such as sustainability compromised with respect to outreach, relationship between marginal improvements of the financial sustainability with reducing outreach and level of subsidy with recommendation and suggestion
12. Galema and Lensink (2009)	To calculatethe willingness of social investors to accept a decrease on returns to achieve social objectives	Based upon a small sample of 25 MFIs	Interestingly they found, the trade-off is not big for high amount of loan but truefor small amount. This findings suggested that the balancing make distortion to social objectives.
13. Lermes, Lensinkand Meesters (2011)	To examine the relationship of outreach to the poor with efficiency	Based upon 435 MFIs from 1997 to 2007	There was a pretty wellfinding that outreach was negatively associated with efficiency.

Conclusion

It remains a very open question which option is to take to cut down poverty. Welfarist approach wants to reach the maximum poor by length and breadth even depending on subsidies and grants. There is nothing wrong as long as the purpose has been served even at the cost of tax payers' money or others. But still there is a criticism that getting donation and grants make the institutions inefficient. On the other hand,Institutionalist approach claims microfinance institutions must be financially sustain for a long time to serve the purpose for which they are devised and also must be independent of donation and subsidy. It will increase their efficiency and make them survive for long time and ultimately help to contribute poverty elimination. Hence outreach and profitability may not mutually exclusive in the context of sustainability.

There has been a mix reaction in several studies in different time period and different parts of the world with different methodology with respect to profitability and outreach of microfinance institutions. Some literature say that outreach and profitability can be achieved together, some say they are negatively correlated where there is a need for balancing between them. Therefore, the net consolidation between institutionalist and welfarist stands for ambiguous position. There could be a research in Malaysian context about this aspect and finding out the case over here.

Let's take a welfare scenario about bank to understand the depth and breadth of financing behavior by itself. One exemplary citation by a client of a bank expressed his views with satisfaction about welfare behavior of the bank as *"I grew up very poor and without education. I learned, though, that I could improve myself, and that the bank would help me. The president of Bank Dagang Bali is a great man. Why do I say that? Not because he is a bank president; there are many bank presidents. Because he taught us not to be afraid of banks. BDB taught us something important that we never knew. BDB taught us that the bank is not a king, the bank is a servant."* (Cited from Robinson 1995)

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