

# Microfinance mission drift?

## Description and explanation

Roy Mersland<sup>1</sup>   R. Øystein Strøm<sup>2</sup>

<sup>1</sup>Agder University  
Kristiansand, Norway

<sup>2</sup>Østfold University College  
Halden, Norway

EFM Symposium on Risk Management in Financial Institutions  
April 23-25, 2009  
Audencia Nantes School of Management, France

# Overview

- 1 Mission drift?
- 2 Method
- 3 Data
- 4 Descriptive evidence
- 5 Econometric evidence
- 6 Conclusions

# Mission and mission drift

The microfinance institutions' (MFIs) dual missions are:

- Financial sustainability; and
- providing banking services to micro-enterprises and low-income families.

Is the MFI drifting from the second objective in order to fulfill the first?

*Mohamad Yunus: Less poor clients crowd out poorer clients in any credit scheme (Christen and Drake, 2002, p. 10).*

Rhyne (1998); Christen and Drake (2002): The MFIs' profit motive leads them to be more efficient, thus counteracting the drift to better situated customers.

## Mission and mission drift

The microfinance institutions' (MFIs) dual missions are:

- Financial sustainability; and
- providing banking services to micro-enterprises and low-income families.

Is the MFI drifting from the second objective in order to fulfill the first?

*Mohamad Yunus: Less poor clients crowd out poorer clients in any credit scheme (Christen and Drake, 2002, p. 10).*

Rhyne (1998); Christen and Drake (2002): The MFIs' profit motive leads them to be more efficient, thus counteracting the drift to better situated customers.

# Mission and mission drift

The microfinance institutions' (MFIs) dual missions are:

- Financial sustainability; and
- providing banking services to micro-enterprises and low-income families.

Is the MFI drifting from the second objective in order to fulfill the first?

*Mohamad Yunus: Less poor clients crowd out poorer clients in any credit scheme (Christen and Drake, 2002, p. 10).*

Rhyne (1998); Christen and Drake (2002): The MFIs' profit motive leads them to be more efficient, thus counteracting the drift to better situated customers.

# Mission and mission drift

The microfinance institutions' (MFIs) dual missions are:

- Financial sustainability; and
- providing banking services to micro-enterprises and low-income families.

Is the MFI drifting from the second objective in order to fulfill the first?

*Mohamad Yunus: Less poor clients crowd out poorer clients in any credit scheme (Christen and Drake, 2002, p. 10).*

Rhyne (1998); Christen and Drake (2002): The MFIs' profit motive leads them to be more efficient, thus counteracting the drift to better situated customers.

## Mission drift definition and measures

**Mission drift** is taken to occur when an MFI leaves the poor customer segment (Woller et al., 1999; Woller, 2002).

We measure mission drift first as an increase in the average loan.

$$\text{Average loan} = \bar{L} = \frac{\text{MFI's loan portfolio}}{\text{Credit clients}} \quad (1)$$

Throughout, we adjust average loan and other monetary variables for GDP per person in PPP terms.

From Schreiner (2002) we extract further mission drift measures:

- The greater use of individual loans instead of group loans.
- The smaller extent of lending to rural communities.
- The less emphasis on lending to female customers.

# Hypotheses

Mission drift will occur when

- average profits increase,
- average costs increase,
- risk of repayment increases (uncertain),
- the MFI becomes older.

The two first hypotheses from Freixas and Rochet (2008).

## Former literature

- Cull et al. (2007): World-wide, but on (not transparently) selected MFIs. Smaller sample than ours. No instruments. No mission drift, but profits increase mission drift.
- Country studies: Paxton et al. (2000); Christen (2001); Littlefield et al. (2003); Fernando (2004): Lack of mission drift related to higher efficiency
- Hishigsuren (2007) case study in Bangladesh: No statistically significant mission drift, but higher efficiency.

No full-scale investigation into this question has been undertaken.

# GMM estimations

We estimate:

$$\begin{aligned} \bar{L}_{it} = & \beta_1 \text{Average profit}_{it} + \beta_2 \text{Average cost}_{it} + \beta_3 \text{Risk}_{it} \\ & + \beta_4 \text{MFlage}_{it} + \beta_5 \text{Size}_{it} + \text{Constant} + \varepsilon_i + u_{it} \end{aligned} \quad (2)$$

Instruments to remove endogeneity bias:

- Yearly country variables:
  - GDPcap-PPP, GDPgrowth
  - Inflation, current account balance
  - Heritage Foundation index on economic freedom.
- Raw and lagged explanatory variables
- Constant

## Third-party MFI data

- Data on 379 MFIs in 74 countries. A maximum of six years of data on each MFI.
- Data span the years 1998 to 2008.
- Data are collected from specially designated rating agencies.
- The collection leaves out the very large and the endless number of small savings and credit cooperatives as well as development programmes.
- MFIs in the dataset represent commercial and professionally oriented institutions.
- Balance sheet and income statement data together with qualitative data.

Thus, our time-stamped data are well suited to answer the mission drift questions.

## Panel data, 1998-2008, each MFI at most 6 years

yr	case	registration	agency	rategrade	ratemo	rateyr
1998	1					
1999	1					
2000	1					
2001	1	1	1	0.90	12	2004
2002	1	1	1	0.90	12	2004
2003	1	1	1	0.90	12	2004
2004	1	1	1	0.90	12	2004
2005	1					
2006	1					
2007	1					
2008	1					
1998	2					

The data are strongly balanced.

# Average loan decreases with MFI age

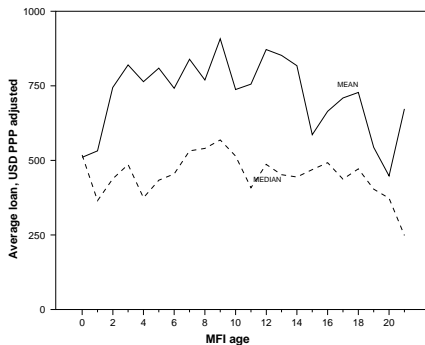


Figure: Average and median average loan

## Depth outreach characteristics on average MFI

	Avg.loan	Group	Rural	Gender
Mean	747.4	2.322	2.123	0.441
Median	332.3	3	2	0
Standard Deviation	1318.1	0.807	0.848	0.497
Minimum	18.3	1	1	0
Maximum	14663.0	4	4	1
Observations	371	358	367	372
Growth 99-07 (%)	-2.2	-3.3	9.5	-35.0

Are average profit, cost, and risk related to the MFI's average loan size? Data: 1998 to 2008.

	Fixed effects		Random	First
	Unstand.	Stand.	effects	difference
Constant			-0.133	
Average profit	3.032 <sup>5</sup>	0.537 <sup>5</sup>	5.756 <sup>2</sup>	1.180
Average cost	3.870 <sup>2</sup>	0.851 <sup>2</sup>	4.050 <sup>2</sup>	2.826 <sup>1</sup>
PaR30	2.733	0.269	0.554	0.783
MFI age	0.021	0.147	0.009	0.040 <sup>1</sup>
Assets	0.001	0.010	-0.001	0.001
Wald (F) test sign.	0.000	0.000	0.000	0.000
Hansen <i>J</i> test	0.771	0.771	0.936	0.802
<i>N</i> (MFI years)	741	741	741	736

## Robustness with pooled logistic regressions

	Lending methodology	Main market	Gender bias
Average profits	0.002 <sup>4</sup>	0.000	-0.001
Average costs	0.004 <sup>1</sup>	0.001 <sup>1</sup>	-0.004 <sup>1</sup>
Risk	4.513 <sup>1</sup>	0.089	-2.181 <sup>1</sup>
MFI age	0.024 <sup>5</sup>	-0.025 <sup>1</sup>	0.006
Assets	0.000 <sup>7</sup>	0.000	0.000 <sup>1</sup>
Pseudo $R^2$	0.153	0.095	0.095
LR test (sign.)	0.000	0.000	0.000
Observations	1015	1033	1040

- Lending methodology: 1 if individual loans, 0 otherwise.
- Main market: 1 if mainly to urban customers, 0 otherwise.
- Gender bias: 1 if the MFI targets female customers.

# Microfinance mission drift?

Mission drift tends to increase when:

- The MFI seeks higher profitability.
- The MFI's average cost becomes higher.

If the MFI becomes more efficient, it is able to uphold lending to the poorest customers.

Rhyne (1998); Christen and Drake (2002) are confirmed, Yunus is not.

# Microfinance mission drift?

Mission drift tends to increase when:

- The MFI seeks higher profitability.
- The MFI's average cost becomes higher.

If the MFI becomes more efficient, it is able to uphold lending to the poorest customers.

Rhyne (1998); Christen and Drake (2002) are confirmed, Yunus is not.

# Microfinance mission drift?

Mission drift tends to increase when:

- The MFI seeks higher profitability.
- The MFI's average cost becomes higher.

If the MFI becomes more efficient, it is able to uphold lending to the poorest customers.

Rhyne (1998); Christen and Drake (2002) are confirmed, Yunus is not.

# Implications

- More focus should be placed upon cost aspects of MFI.
- Higher cost efficiency should be attainable as the MFI gains experience and fine-tunes its business model.

## References

- R. P. Christen. Commercialization and mission drift. Occasional Paper, CGAP, Washington DC, 2001.
- R.P. Christen and D. Drake. Commercialization. The new reality of microfinance. In D. Drake and E. Rhyne, editors, *The Commercialization of Microfinance. Balancing Business and Development*, chapter 1, pages 2–22. Kumarian Press, Bloomfield, 2002.
- Robert Cull, Asli Demigüç-Kunt, and Jonathan Morduch. Financial performance and outreach: A global analysis of leading microbanks. *Economic Journal*, 117(517):107–133, 2007.
- N. A. Fernando. Micro success story, transformation of nongovernmental organizations into regulated financial institutions. Asian Development Bank, Manila, 2004.
- Xavier Freixas and Jean-Charles Rochet. *Microeconomics of Banking*. MIT Press, Cambridge, Mass., 2nd edition, 2008.
- Gaamaa Hishigsuren. Evaluating Mission Drift in Microfinance: Lessons