



Has Microfinance Lost its Moral Compass?

¹ The University of Manchester, UK
david.hulme@manchester.ac.uk

² University of Bath, UK
mathilde.maitrot@gmail.com

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David Hulme ¹ and Mathilde Maitrot ²

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Abstract

This paper argues that microfinance in South Asia, like mainstream finance in North America and Europe, “has lost its moral compass”. Our particular concern is with microloans to vulnerable clients. Microfinance institutions (MFIs) have increasingly focussed on financial performance and have neglected their declared social mission of poverty reduction and empowerment. Loans officers in the field are under enormous pressure to achieve individual financial targets and now routinely mistreat clients – especially poor women. The values of neo-liberal mainstream finance in the rich world have spread to microcredit in the villages of Bangladesh and India. This situation is hidden from western publics who are fed the lie of “the magic of microfinance” by their media, guided by the needs and interests of mainstream finance seeking to provide some “good news” about the financial sector as scandal after scandal unfold. Urgent action is needed, particularly from the leaders of the microfinance industry, to refocus their organizations and workforce on achieving both financial and social performance targets.

Keywords

Microfinance, microcredit, social performance, poverty, financial inclusion, financial scandals

Authors

David Hulme (corresponding author) is Professor of Development Studies, Executive Director of the Brooks World Poverty Institute (BWPI) and CEO of the Effective States and Inclusive Development Research Centre (ESID) at the University of Manchester, UK

Email: david.hulme@manchester.ac.uk

Tel: +44 161 306 6436/6434 (work) or +44 1625 520267 (home)

Dr Mathilde Maitrot is a research officer at the University of Bath and a post-doctoral Research Associate at the Brooks World Poverty Institute, University of Manchester.

Email: mathilde.maitrot@gmail.com; mm880@bath.ac.uk

Tel: +88 0179 353 4448 (Bangladesh) or Mathilde Maitrot (skype name)

On his first day in office in April 2014 the incoming CEO of the UK's newly-established Financial Conduct Authority reported that "finance has lost its moral compass". He was reporting from one of the world's financial capitals, London, following years of scandals in which banks and finance houses have missold products, overcharged clients and rigged markets. These scandals range from forcing clients to buy unnecessary payment protection insurance (PPI), misselling endowment mortgages, to rigging the LIBOR rate and foreign exchange rates so as to swindle money out of the finance system and, ultimately, their clients. Recently the now infamous Wonga payday lender had to write off around 330,000 customer loans because the firm failed to properly assess the repayment capacity of customers. Repetitive public scandals led the UK's Parliamentary Commission on Banking (2013:85) to report that "...for years failure has followed failure in banking, and scandal has followed scandal". One can see a similar moral malaise in the USA as people suffer from house repossessions, engineered by the sale of sub-prime mortgages, and banks are still recovering from the bank-induced financial crisis of 2008 that helped to bring the global finance system to the edge of total collapse. No wonder the Occupy movement tried to seize the streets in Manhattan and London.

In this paper we take up this theme, but we ask whether it is not just mainstream finance that has lost its moral compass...we ask, has microfinance lost its moral compass? Have the amoral and immoral attitudes and practices of mainstream finance in its global centres (particularly New York and London) contaminated the activities and behaviours of microfinance institutions (MFIs)ⁱ in developing countries? Should the Occupy movement be trying to seize the streets in Delhi and Dhaka, Hyderabad and Chittagong, to protest at what microfinance institutions are doing to their clients? Do microfinance firms lend money responsibly?

Readers in the rich world would be surprised at our concerns. In North America, Europe and Japan the media routinely presents microfinance as a great success. Indeed, journalists treat the provision of small loans to poor people as virtually synonymous with poverty reduction. Lauding microfinance was particularly common in the Western media in the mid-2000s. A classic example in the *New York Times* (NYT) of 12th April 2004 reported that one of the US's "most successful venture capitalists" was so impressed with microfinance in Andhra Pradesh, India that he was going to put his time and expertise into supporting the microfinance industry. A list of successful US financiers and high-tech entrepreneurs were identified as wanting to transform poor, unproductive, disempowered and isolated women into dynamic businesspeople through microfinance. The anecdote of Sivamma, a woman who used a \$45 loan to create assets worth \$5,000 in four years, was presented as evidence of what microfinance could achieve (NYT, 2004). The NYT and other broadsheets spread a simple message: microfinance is a "proven development strategy, expected to benefit 100 million of the world's poorest families" (NYT, 2003). The sector has regularly been presented as a remarkable opportunity for leading US entrepreneurs to play a role in as "...even philanthropy aimed at alleviating poverty can be profitable" (Forbes, 2007; also see Forbes 2011 and NYT 2010).

This narrative in the Western media continues despite the 2009-2010 crisis in Indian microfinance (Hulme and Arun 2011), microcredit 'bubbles' in Nicaragua, Bosnia-Herzegovina and Morocco (Chen et al 2010) and the scandal of the privatisation of Compartamos Banco in Mexico (which has placed high returns to shareholders above the interests of low-income clients). As Taylor (2012:601) points out, with the recent concept of "financial inclusion" promoting microfinance has been presented as a "global moral imperative". In December 2012 the Guardian – usually seen as the UK's only "left-wing" broadsheet newspaper - devoted a full page to "the magic of microfinance", lauding what microfinance was achieving and building the case for its expansion through commercialization (The Guardian 2012). In contrast to these positive accounts in the Western media, in countries where most

microfinance is implemented, such as Bangladesh and India, the media coverage is much more mixed and, quite commonly, very negative.

In this article we argue that microfinance is not “magic”. Indeed, the empirical evidence indicates that the provision of loans to poor people is far from being associated with increased incomes that prompt reduction in poverty and improvements in well-being. Just like mainstream finance - indeed by moving closer to the moral norms of mainstream finance and focussing almost exclusively on short-term financial performance - microfinance has lost its moral compass. The staff of many MFIs (and certainly all the large MFIs in Bangladesh) has personal financial performance targets to achieve: the impacts of loans on client welfare has become a secondary issue. However, the severe social performance challenges that face MFIs in South Asia are hidden from Western publics by the continued peddling of the myth of microfinance by the Western media. The tarnished reputation of mainstream finance means it energetically promotes the generation of “good news” about what finance does for society in the commercial media industry (that it is financing). Peddling a false account of the “magic of microfinance” in developing countries, and the enthusiasm and good intentions of Western banks and billionaires to support this magic, is a key component of the public relations strategy of mainstream finance.

How Mainstream Finance Lost its Moral Compass

One should clearly not see capitalist finance through rose-tinted glasses. But it is possible to go back only a few decades –the 1970s and early 1980s – and, in the UK and US, recall an era in which bank managers and employees were respected members of the local community...and when loans for housing were assessed not merely to ensure short-term bank profitability but also to protect borrowers from getting themselves into trouble. But all that changed in the 1980s with the neo-liberalisation of finance, prompted by Reagan and Thatcher. In London the “big bang” of 1986 opened up the UK’s financial markets in ways that transformed their quantity (they expanded rapidly) and their quality. Greed was declared a good thing, as it was believed to make markets efficient. This was apparently good for “everyone”, and short-term profitability became the driver of market behaviour. In the UK the mutually-owned building societies were privatised and by the early 1990s they were competing with the private banks to fool clients into taking out endowment mortgages. This created big profits for banks, and large bonuses for their staff, but ultimately turned out to be a misselling scandal. Over the 1990s and 2000s retail banking and investment finance in Europe and North America pursued a strategy of short-term profit maximisation and *caveat emptor* (buyer beware). If the client is stupid enough to buy a product – confused by the exaggerated claims of product performance and the systematic hiding of fees and commissions – then s/he deserves to take the consequences (having to reduce their living standards or be indebted for life). Often the people who are the most vulnerable to this are on low incomes, the ones who needed money mostⁱⁱ.

We do not go into detail here but what Nobel-prize winner Joseph Stiglitz (2003) calls the “Roaring Nineties” saw the mainstream finance sector lose almost any sense of moral responsibility. This has continued through to today. The old moral arguments about the social role of finance –mobilising investment, promoting widespread prosperity, creating jobs, helping people plan for their future needs – have become rhetorical. Mainstream finance is about making vast amounts of money very quickly and “getting out” at the right time. The millions who lost homes in the sub-prime mortgage scam, the near meltdown of the global financial system of 2008/09, the collapse of banks across Europe and the USA was not a problem for those who had made millions (for some billions) through such activity.

How Microfinance Lost its Moral Compass

Our research on MFIs, and personal interactions with MFI leaders since the mid-1980s, leave us in no doubt that most of the path-breaking MFIs, particularly in South Asia, did not merely have a moral compass – they had a social mission. The founders of these organisations were genuinely seeking to help poor and low-income people improve their economic and social prospects. Over time, however, organisational goals (being bigger, having higher rates of repayment and higher levels of profitability, winning international awards) and closer links with mainstream finance have displaced this social mission. As the leaders of MFIs have become international figuresⁱⁱⁱ they have increasingly become part of the simplified narrative of the Western media that presents MFIs as being the leading lights in tackling extreme poverty in South Asia, Africa and Latin America.

This narrative claims that by making small loans (\$20 to \$500) to poor women a set of innovative MFIs have allowed them to develop micro-enterprises – small shops, petty trading, raising chickens, rearing milk cows, opening beauty parlours – that have greatly improved the women’s incomes and the quality of life of their families (education, nutrition, and female empowerment amongst other things). MFIs and their staff are presented as heroic, dedicated to working in remote rural areas and filthy slums to take services to the poor and poorest, relentlessly going where mainstream banks cannot and fighting against poverty. Borrowers repay their loans with interest and their repayments are ensured by the ‘social capital’ of women being in groups that support each other and ensure financial discipline. This means that the MFIs are sustainable... even profitable...in fact so much so that some have integrated themselves into mainstream finance and borrow capital for micro-lending from Wall Street and London.^{iv}

Professor Mohammed Yunus, the Nobel-prize winner who founded Bangladesh’s Grameen Bank, has been the leading figurehead for this narrative supported by annual global Microcredit Summits. Many of his, and microfinance’s, advocates and supporters in the Western world have finance, banking and business backgrounds. They find that supporting or working in the microfinance sector helps them reconcile with their moral values - to devote themselves to doing something that has “a bigger and positive impact on the world” as the President and CEO of Women’s World Banking reported to Forbes Magazine (2011). The director of the Global Philanthropy Group, who implemented the United Nation’s Year of Microcredit initiative in 2005, claimed that microfinance is providing poor people “the same financial tools we have so that they can help themselves” and that these people “are perfectly capable of creating their own success even though they weren’t born into the same circumstances” (Forbes 2012). Such speeches are intrinsically moralistic and punctuated by altruistic statements about the transformative change that philanthropy and social investment in microfinance achieves: “You can literally change someone’s life” (Forbes 2012).

Unfortunately, the compelling narrative of the success of microfinance –of millions of heroic and entrepreneurial women lifting themselves and their children out of poverty (and into relative affluence) through small loans and self-employment- is not supported by serious evaluations of microfinance. Systematic long-term studies indicate that the impact on incomes is limited...and at times may be negative (Hulme and Mosley 1996; Morduch 1999a; Roodman 2011; Banerjee and Duflo 2012). However, the exaggerated messages of “magic”, “miracles” and “success” in the Western media makes it difficult for the public of the rich world to understand the crucial distinction between delivering microcredit to the poor and tackling poverty.

Excessive claims about what microcredit can achieve for poverty reduction were corroborated by the strong leadership of few well-meaning pioneers who believed in commercialisation as a financial

means to achieve social goals, at scale. The microfinance “formula” was passed on, often irresponsibly we think, to more narrowly commercially-minded firms (in Mexico and India especially). At the last Microcredit Summit Yunus mulled over the transformations that re-shaped the industry expressed his surprise about the profit-driven aspirations of some aggressive commercial firms entering the industry and recognizing the shortfalls of commercially-driven microfinance (Nex Billion, 2014). This follows on from events in Southern India in 2009 and 2010 when reports of MFI borrower suicides hit the headlines (Kinetz, 2012; Kumar, 2012) and a number of MFIs went bust under the strain of overly rapid and aggressive expansion supported by mainstream finance (Hulme and Arun 2012).

This led to concerns in South Asia about whether MFIs were good for poor people. The Governments of India and Bangladesh began to regulate the sector more closely and introduced caps on interest rates so that clients could not be charged ‘excessive’ rates. While newspapers in South Asia reported these problems, as well as broader issues of MFI staff abusing and mistreating vulnerable clients, the media narrative in the rich world (from the USA to Luxembourg, to the UK and on to Japan) has remained largely positive. The belief, and vested interests, in the microfinance narrative in the rich world are so strong that microfinance can avoid the growing evidence of its ‘dark side’ (Hulme, 2000) being relayed to Western publics. Could it be that the idea of profitable microfinance, supported by social investors and mainstream banks, alleviating poverty is manufactured to meet the needs of big banks and wealthy people?

From microcredit to microfinance, the evolution of the types of financial product available to poor people over the last 35 years across the world has dramatically improved. The rural poor in Bangladesh for example have an almost “routine access” to microfinance services supplied by MFIs more than they have access to basic public services - health, security, education, electricity, water, roads, information and so on (Rutherford, 2009). Micro-credit, lending small amounts of money to the poor has been transformed into a wide range of financial products and services - microfinance. Some MFIs choose to add a strong savings component (compulsory or voluntary) or a training component (on livelihood asset management or financial education for example); some collect repayments monthly and others weekly; and, some prefer to lend to individuals (men or women) and others to groups of clients. The choice of lending strategies of MFIs has strong implications for their financial performance and for their social performance and achievement.

Below we examine recent empirical evidence from Bangladesh – the heartland of the microfinance industry – demonstrating that microfinance has lost its moral compass^v. Alongside this we cite other detailed studies into the grassroots practice of microfinance (Uddin 2013; Sandberg 2012; Cons and Paprocki 2010; Hussain, 2010; Hudon 2009). Powerful figures in the western world, such as the Bills (Clinton and Gates) and mainstream bankers’ may conveniently agree that microfinance is the solution for poverty eradication but the practices of MFI credit officers on the ground are driven overwhelmingly by the need for short-term financial performance^{vi}. We explore the morally repulsive practices that a purely commercial approach to microfinance have and are triggering in MFIs and look at how these impact on clients.

Our examination indicates that most commercially-driven MFIs in the villages of South Asia^{vii} have experienced a moral drift in the same direction as mainstream finance firms in the skyscrapers of Manhattan and Canary Wharf. They have focused on financial performance and take little responsibility for the social consequences of their engagement with clients. The view that you can engage with extremely poor and vulnerable people’s lives through rigid loan-based products without

encouraging them into extreme trade-offs that may damage their well-being is erroneous. As stated earlier, the microfinance sector in Bangladesh and India (and globally) is heterogeneous with institutions offering different ranges of products to clients. Our criticisms here are about MFIs focused on microcredit and especially those with rigid repayment schedules. We recognise that other products (especially savings products and some insurance services) are not associated with the moral drift examined in this paper. It is also true that microcredit has had positive effects on particular types of households in Bangladesh. Households with low dependency ratios, relatively stable earnings, a degree of financial education, access to informal credit markets and information can often use their loans for productive purposes and draw economic and social benefits from such loans. However, when banks (mainstream or microfinance) lend aggressively there are real dangers for clients. What happened (and continues to happen) to victims of aggressive banking in the West was (is) awful... but debt is much worse if you are extremely poor as it jeopardizes your shelter, daily food consumption and medication, social networks, dignity and self-worth.

Neo-liberal microfinance in practice^{viii} – the community level

The life of a credit officer in rural Bangladesh revolves around daily, weekly and monthly financial targets set by regional and head offices. This creates an incentive structure for them to make as many loans to clients as possible, to continually push for clients to increase the size of loans and making clients repay on time. Like Khandker et al. (2014) we argue that over-indebtedness, through formal or informal loan-taking, is the result of a two-party decision (the borrower and the lender). In this paper, however, we argue that MFIs should be held accountable for monitoring levels of indebtedness to protect their clients.

While most large-scale MFIs have a manual of procedures, how financial targets are achieved is left up to credit officers guided by branch managers - it is not a concern for the head office. In some cases, when borrowers have a steady income and no problems, it is easy for field staff to follow the official manual. But, as revealed below, when clients face difficulties in making repayments they are induced to repay by “whatever means”^{ix}. Such clients should not take loans, but it is difficult for an extremely poor person to refuse a loan when offered, or induced to take one. Taking the loan will solve a whole set of immediate problems – not having any food for tonight; buying urgently needed medicine; paying off a money lender who is taking too much interest in your daughter – and the consequences are away in the future. The credit officers’ interest (shaped by financial performance targets) lies in maintaining or increasing portfolio size (by recruiting more clients or increasing loan size), regardless of whether or not households can manage credit and/or can generate income from a loan.

The main argument made here is that the lending practices of MFIs at the community level have drifted away from their declared poverty reduction mission (or even ‘do no harm’ to clients standards) because of a pure focus on the short-term financial performance of credit officers. Data collected during fieldwork from both current MFI-clients and former MFI-clients reported numerous forms of malpractice employed by credit officers to achieve targets set by head offices. Subsequently, these malpractices were confirmed in interviews with the credit officers themselves (Maitrot 2013). The malpractices related to both the recruitment of new clients and encouraging existing clients to take new and larger loans that entailed higher weekly repayments. Such problems were originally reported in Bangladesh by Montgomery (1996) while recent studies (Cons and Paprocki, 2010; Hussain 2010) confirm how credit officers’ informal practices force clients to compromise on their well-being to meet MFI financial goals. At times the pressures on clients become extreme. Maitrot (2013) and Cons and

Paprocki (2010) report loan officers requesting clients with repayment problems to: postpone burying their husband; take children out of school; and, take loans from other MFIs (to repay the loans officer's MFI). Both studies report "unauthorised, though tacitly accepted, asset confiscations" (of roofing iron and basic cooking equipment) (Cons and Paprocki 2010), arguing with clients' family members in public, advising clients to stop their medication and telling clients to sell basic assets in order to repay on time. In one leading MFI, 47percent of loan officers reported using threatening language and public humiliation to maintain high repayment rates (Maitrot 2013).

Regardless of their repayment capacity, poor and vulnerable women are commonly persuaded to take small loans that often grow into larger debts taking an increasing share of household income. Once the loan papers are signed then, after a grace period of around two weeks, borrowers are required to make weekly repayments (*kisti*). Two particular problems make paying *kisti* difficult for many women. First, a high proportion of rural households in Bangladesh do not have a regular income: income varies with time of year, demand for casual labour, the weather and a set of factors outside of household control. Second, households have high levels of exposure to shocks and hazards which affect their repayment capacity. Clients commonly report that on receipt of a loan they use the cash to solve pressing needs (food for the next week, urgent medical care, house repairs, a daughter's dowry). Addressing these needs usually has an immediate positive effect on household well-being, but it can seriously compromise long term well-being. Not uncommonly, for poor households a small loan from an MFI is the beginning of a long and winding road of increasing debt and, for some, over-indebtedness (a debt burden that cannot be serviced from household income). A majority of poor MFI clients reported through interviews and focus group discussions extreme livelihood compromises – sending children out to work, reducing quantity and quality of food and distress sales of essential productive assets. For some households weekly repayments to multiple MFIs had reached up to US\$50 a week, a staggeringly high figure for people on rural wage rates in Bangladesh (Maitrot 2013).

Notwithstanding the Western media's claims about women's empowerment through microfinance, a large body of research conducted in rural Bangladesh has found that women have little control over their loans (Balasubramanian, 2013; Maitrot, 2013; Uddin, 2013; Bhusal, 2010; Hossain et al., 2009; Karim, 2008). Sometimes loan officers meet with husbands to persuade them to use their wives to access loans. Several women reported that they were violently reprimanded by their husbands when they refused to apply for loans. In three focus group discussions (out of six) women clients reported that their credit officers had suggested to their husbands to use violence. The case of one woman was particularly distressing (Maitrot 2013). This woman reported that her husband, who does not work, forced her to borrow money from four different MFIs. He controls the money, using it mainly for drinking and betting, does not leave her with enough money to feed her children and beats her if she complains. When she spoke to fellow MFI group members they refused to lend her money for *kisti* because of worries about their group's solvency and fear that her husband would simply squander such support. When the distressed woman talked to her credit officer, showing him bruised arms and legs and begging him to reject any future loan applications her husband forced her make, the credit officer informed her husband and advised him to physically reprimand her. The woman cannot imagine escaping this trap and dreads the day that she will be excluded from her community or reduced to starvation...or submitted to the social humiliation of being abandoned by her violent husband.

Neo-liberal microfinance in practice in Bangladesh – the MFI level

The microfinance sector in Bangladesh has benefitted hundreds of thousands of households that have the capacity to meet rigid/inflexible loan repayment requirements: households with stable and reliable incomes, with good access to informal borrowing sources and with good health. After three decades of operation one might expect that these institutions would have learned how to screen financially vulnerable households (those with irregular earnings, facing health problems or with relationship problems) out of their loans programmes. But, in practice, the pursuit of organisational goals (a growing loans portfolio with more clients, increasing rates of profit or surplus, the reporting of a high repayment rate, international awards and reputation) through management systems and incentives based purely on individual and branch financial performance means that client experience is a marginal issue. In high poverty contexts, where there are large numbers of desperately poor people around who need money, this is a dangerous situation.

A purely commercial approach to microfinance has fostered the neglect of the declared social mission of MFIs (for some MFIs in South Asia “abandonment” might be more accurate) and of dis-aligning mission and practice (Copestake et al., 2005) a danger spotted long ago (Rogaly, 1996). If the incentives to frontline staff are to focus purely on financial performance indicators then, with repayment rates often above 95percent, why should senior managers, directors and even well-intentioned social investors worry about the actual practices that achieve such repayment levels? Dismissing reports of the abuse of clients as isolated incidents by a few rogue credit officers is usually sufficient...as clients have no access to regulators or the media.

Reports gathered in villages from women showed that sexual harassment, violent threat, coercion by neighbours and MFI group members, public humiliation, verbal abuse, as well as seizure of assets are common strategies used by loans officers (Maitrot 2013). The high repayment rates achieved by MFIs are not simply a product of their clients’ ability to (always) be successful entrepreneurs or of “social capital” but also coercion and threat. When weekly *kisti* cannot be paid women fear loan officer visits and sometimes hide under their beds or away from home. Villagers report that some defaulters migrate to escape their MFI debts.

Why is it like this? First, delay in repayment is never allowed. Loan officers push defaulting clients to borrow from another MFI to repay their current loan. Sometimes loan officers make a personal advance to their clients’ to ensure that the officer achieves their repayment target for that day. This ‘favour’ may be called in at some future time when the loan officer will force the client to borrow again, perhaps a larger amount this time. Loan officers are not concerned about whether clients are investing in productive assets, they do not have time for this, and they have no incentive to care about it. For most MFIs, loan officers are not development workers but moneylenders to the poor: no more...no less.

What is it like being a loan officer?

One of the under-reported benefits of Bangladesh’s microfinance industry is that it has created more than 100,000 formal jobs for credit officers – university graduates who obtain a lower middle class income in an increasingly saturated graduate employment market. However, loan officers have to work hard for their money and bear the pressures of achieving daily financial performance targets. This is particularly stressful when significant numbers of clients find it difficult to repay. Maitrot (2013) explains how the systems, structures and cultures of MFIs (limited staff training, zero-delay and zero-default policy and demanding branch managers focussed purely on financial performance) build chains of pressures not only on clients but also on staff. During fieldwork many MFI staff members

expressed anguish about the “inhuman” behaviour they adopt to meet financial targets, develop their career prospects and avoid sanctions. Many of the loan officers interviewed reported being ashamed of, or even depressed by, the ways in which they treat clients. They explained their behaviour in terms of fear their branch managers^x:

“The worst part is that in every position the subordinates suffer mental harassment from superiors.”

“The rules in this MFI and the psychological pressures faced by the employees are the worst part of this job.” (Maitrot 2013)

Some 47percent of loan officers interviewed by Maitrot (2013) agreed with the statement (from a list of positive and negative statements put in front of them) that “people get angry very often in the organisation” and 71percent reported fearing punishment from their branch manager. As mentioned, to avoid censure from their superiors credit officers sometimes make personal advances to clients: by doing this they achieve their daily financial target and keep their manager happy. One loan officer explained that if he fails to collect a *kisti* the branch manager “comes with all the staff and [they] stay in the client’s house until twelve or one at night”. In the MFI studied over 70percent of credit officers reported finishing repayment collection after 8pm, and just below 50percent of those reported working up to or after 10pm (although the official office time ends by 6pm). As another credit officer explained:

“When I do not get an instalment [...] and explain that there is a problem in this house and they cannot repay today [...] my boss orders me to sit in that house until the clients gives the money: ‘If you have to sit there throughout the night you will but do not come back without the instalment’ he says. So if I leave without the *kisti* I face this kind of mental harassment and physical exhaustion... I feel like quitting the job.”

Some poor clients are aware of the pressures credit officers are under and even feel sympathetic to their credit officers’ situation:

“It is not the officer’s fault, when you are working you are simply following orders of the top officials. I heard that if instalments are not collected then money is taken from their personal salary. They are scolded at work. [...] The managers say very bad things to them the words they use are so terrible, I feel bad for them when I go there [the MFI offices] and hear such things.”

In one instance a woman reported that her pregnant credit officer chose to spend the night in the client’s insalubrious home because the officer was too frightened to return to the MFI branch office without the expected amount. That night her waters broke and the client struggled to arrange for her to be taken to hospital. (The credit officer’s colleagues later independently confirmed this account).

Is microfinance working?

Does microfinance work in Bangladesh...or South Asia? Answering this question depends on the criteria used. If it is “can microfinance cover its costs and/or be profitable” then the answer is increasingly moving towards “yes”. But, if it is “does microfinance achieve its declared social mission (usually expressed as poverty reduction)” then the growing evidence from fieldwork with poor clients (in contrast to the public relations text turned out at MFI head offices) indicates the answer is

“probably not”. This conclusion is supported by recent rigorous quantitative analyses of the economic and social impacts of microfinance (Roodman 2011; Banerjee and Duflo 2012).

The microfinance industry may have successfully extended financial services to the rural poor – indeed the rural poor in Bangladesh have almost routine access to microfinance services, more than they have access to basic public services such as health, security, and education (Rutherford, 2009). But, for a high proportion of clients this is as a lender of last resort and/or a successful “hard sell” by highly pressured credit officers...not as a poverty reducing or empowerment promoting strategy. MFIs have focussed so much on achieving financial targets that their social mission (reducing poverty, empowering women and others) has become marginal.

Why has there been such a strong divergence between the actual social performance of MFIs in Bangladesh, and South Asia, and the goals these organisations declare...and are assumed to be achieving by the Western media? There are no doubt several reasons but this paper has highlighted the significance of MFIs increasingly focussing purely on financial performance in their management systems. In effect, many MFIs have “neo-liberalised” themselves since the late 1990s. Their activity is programmed almost entirely by market-based forces and they have abandoned their moral compass. Two specific factors can be identified as supporting this neo-liberalisation: the fostering of links between mainstream finance and microfinance and the promotion of organisational norms that focus only on financial performance.

The expansion of the microfinance industry since 2000 has been heavily dependent on commercial banks and mainstream finance (Roy, 2010). Access to finance is crucial for the microfinance market to develop. For mainstream banks a new, relatively untapped market experiencing 15 years of uninterrupted expansion is appealing (Cull et al., 2009; Karnani, 2007). Despite the global financial crisis, public expenditure austerity and low economic growth rates in developed countries, private investors remain enthusiastic to support microfinance. A recent CGAP study found that wholesale investors in microfinance funded US\$25 billion in 2011 and that overall microfinance funding continues to grow in absolute terms (Lahaye et al., 2012) despite consecutive crises and scandals emerging in the industry (Lakshmi 2013; Singh 2010). In theory, the microfinance industry could expand until it reaches an estimated one billion un-banked poor households as the biggest potential markets still have relatively low microfinance penetration rates - 13percent in Bangladesh, 3percent in India, and 2percent in Brazil and Nigeria (Dewan and Alamgir, 2009).

While some mainstream banks are directly providing microfinance products (Citibank, Deutsche Bank and ICICI Bank) others have sought to fund MFIs or refinance MFI portfolios (Dieckmann, 2007). Most mainstream financial contributions fund the refinancing of loan portfolios of MFIs (77 percent of total funding) through debt instruments (55 percent of total commitments). By contrast, strengthening MFI capacity or supporting market infrastructure and regulatory environments receive only 15 and 4percent respectively (Lahaye et al., 2012). In order to attract investors and secure mainstream finance, MFIs have concentrated on achieving “good ratios” in terms of orthodox financial indicators (client number, portfolio growth, on time repayment, portfolio at risk, interest rate spread) used by purely commercial financial institutions (Bateman 2012, 2010, Fernando 2004). Not surprisingly, this has led to the prioritisation of financial performance by MFIs and the increasing neglect of social performance (Maitrot 2013). This is not to suggest that financial performance is not important for MFIs but, for organisations claiming the reduction of poverty as their main goal, assuming that financial ratios are evidence of goal achievement is clearly inappropriate.

The second factor is the promotion of financial indicators as the only measures relevant to MFI performance. This approach dominated the industry advising Consultative Group to Assist the Poor (CGAP) in its early years with its promotion of “sustainable banking” as the goal for microfinance – based on the assumption that any financial institution making small loans that was financially sustainable was automatically helping poor people. But, it was reinforced by the introduction of international awards for MFIs in the 2000s. Forbes Magazine (2007) led the way with its identification of “the world’s top 50 microfinance institutions”. It declared, “microfinance has become a buzzword of the decade, raising the provocative notion that even philanthropy aimed at alleviating poverty can be profitable” (ibid). However, Forbes used only two measures of performance: costs per borrower as a percentage of national GNI and return on MFI assets. Social performance was not assessed in any way! Subsequently awards for microfinance have proliferated globally (eg the C5 Global Microfinance Achievement Award and the Fondazione Giordano Dell’Amore Award), regionally (eg the Microfinance Africa Awards and the Citi-CMFA Caribbean Microfinance Award) and nationally (eg the Microfinance India Award and the Paeng Microfinance Awards in the Philippines). While efforts have been made to make these awards more focussed on social impact the awards process has been developed, and largely financed, by mainstream banking.

What does mainstream finance get out of microfinance?

So mainstream finance –Barclays, CitiBank, Deutsche Bank, ICICI, bond markets in London and New York and many more– seem happy to put money into commercially successful microfinance even when the “numbers” on its social achievements (Banerjee and Duflo 2011; Morduch 1999a; Roodman 2011) are not impressive. Could there be other benefits for mainstream finance?

The answer has to be a resounding “yes”. One part of the answer is that, when done effectively, taking on a microfinance portfolio can contribute to group profits. But, it has to be recognised that this is a minor contribution from the perspective of mainstream finance. Far more important is that by taking on the narrative of working with the microfinance industry that helps poor people (especially poor women) and reduces poverty, mainstream finance can generate a positive message about its philanthropic and commercial contribution to society. Is this too cynical ... we think not? At a lavish breakfast in the House of Lords in 2012 to launch the Banking on Change programme -a Barclays Bank grant of £10 million with CARE and Plan UK for village banking groups in Africa- DFID’s Chief Economist, Professor Stefan Dercon, felt it appropriate to ask the CEO of Barclays, Antony Jenkins, how this small grant related to the hundreds of millions that Barclays had acquired by rigging the LIBOR interest rate over many years^{xi}. Mainstream finance finds microfinance very useful: it provides copy in the Western media to counterbalance reports about its constant misdemeanours; it can be highlighted in annual reports and on websites; and... if you are not too concerned about the social impacts... it may even provide a financial return. The media groups with a vested interest in keeping the good news about microfinance pumped out to the public - Forbes Magazine, the New York Times, the Financial Times and others- are useful allies.

Conclusion

And so we return to our opening question – has microfinance lost its moral compass? The recent evidence from ethnographic fieldwork in Bangladesh, supported by recent and rigorous quantitative studies of impact and alongside the meltdown of South Indian MFIs... and lots of their clients... indicates that microfinance in South Asia, like mainstream finance in North America and Western Europe, has certainly experienced a moral drift and that parts of the sector have lost their moral

compass. Many of the NGOs that have shifted to becoming MFIs started their operations as deeply committed attempts to support poor people. As they have focussed more and more on microfinance and massively expanded they have increasingly begun to compete with each other and have professionalised in financial terms (better accounting systems, better monitoring of unit costs and profit centres, individualised performance indicators for staff), adopting standards and approaches from the mainstream finance community. As MFIs have moved upstream to access funds from global financial markets then financial performance (size of portfolio, PAR, return on assets, repayment rate, profit/surplus) has shaped staff behaviour in ways that contradict the social missions MFIs proclaim. The neo-liberalisation of the mainstream finance sector that began in the London and New York in the 1980s has now contaminated microfinance in rural Bangladesh and India.

What should be done? One response would be to try to close formal microfinance down – as some South Asian politicians have argued. This would be unwise for two reasons: (i) well-designed microfinance, that is pursuing client needs and sustainability, is beneficial for many poor and low-income people (Collins et al, 2009), and (ii) the informal moneylenders that would recolonize the formal market may do no better, may do worse, than the MFIs. A second option is more effective regulation of microfinance. This is very desirable but in most countries it is very difficult to achieve. Central banks, when asked to improve MFI regulation focus on administratively intensive reporting by MFIs (which raises their costs) and/or arbitrary interest rate caps, which may reduce MFI capacity to meet client needs. But, central banks could be much more influential in pushing MFIs to be transparent (eg simple loan terms written in Hindi or Bangla in loan books that are read out at group meetings) in transmitting a message of 'buyer beware' and asking MFIs about how they screen vulnerable people out of their lending programmes.

The third option is to challenge the founders and directors of leading MFIs –Md. Shafiqul Haque Chowdhury, of ASA; Sir Fazle Abed and Shameran Abed of BRAC; Zakir Hossain, of BURO Bangladesh; Prof. Abu Nasser Muhammad Abduz Zaher, Chairman, Islami Bank Bangladesh Ltd.; and others – to re-examine their microcredit operations and ensure that social performance is at the heart of their monitoring systems and shapes the behaviour of branch managers and frontline staff. We encourage these charismatic leaders to re-balance the channels of influence and become pioneers in promoting social performance management and enforcement at the branch level. Although initiatives and systems for monitoring social performance have improved greatly over the last decade - see M-CRIL's 'social rating' methodologies and ImpAct's framework (M-CRIL, 2012; Copestake et al. 2005; Copestake 2007; Sinha, 2008), MFIs need leaders to genuinely demonstrate that social performance is as important as financial performance – visiting branches and clients unannounced, convening open meetings with clients and ex-clients, discussing the problems that credit officers face without their managers being present. Organizational cultural change will be needed to re-orient staff to a world with two bottom lines – financial and social.

These leaders could be more ambitious. Ideas from what used to be called 'developing countries' are now impacting on global thinking, most obviously in the post-2015 UN Sustainable Development Goals which have moved beyond the G7/OECD focus only on extreme poverty. Sustainability, reducing inequality and 'leave no one behind' are now on the international agenda thanks to 'Southern' voices. Could the leaders of the microfinance industry in the Global South put their voices to demands that their counterparts in mainstream finance – the CEOs and directors of HSBC (presently threatening to resign if the UK government makes directors criminally responsible for financial malfeasance), Barclays, Lloyds, Citibank - return to pursuing the common good (make a good profit while contributing to productivity growth and job creation) rather than short term

profitability at any price? We know that globally finance has lost its moral compass (see the reports of Global Financial Integrity at www.gfintegrity.org to understand how ripping off poorer countries has become routine behaviour for companies and financial institutions). Microfinance does not have to follow this drift towards short-term financial performance is all that counts. It could take on a leadership role promoting an alternative vision by ensuring it achieves its social mission and pressurizing mainstream finance to move from its predatory practices to being a member of society again.

The leaders of mainstream finance in North America and Western Europe have clearly let their institutions lose their moral compass –would either of us trust our banks in the UK or France to treat us fairly...how stupid do you think we are? The leaders of microfinance in South Asia have a choice – will they follow the lead of mainstream finance in the West and drift into amorality and immorality. Or will they chart a different path – in which social performance is a genuine pursuit and not a public relations exercise?

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ⁱ In this paper we use the term microfinance institutions (MFIs) but many of the institutions we are examining are more accurately described as microcredit institutions as they focus primarily on making small loans.

ⁱⁱ This continues to the present day in the UK. At the time of writing the UK government's Advertising Standards Authority has banned three adverts by 'payday lenders' for misinforming potential customers about their products (Reed 2014).

ⁱⁱⁱ To understand just how 'international' the leaders of big MFIs are visit their offices. Amongst the photos on the wall will be handshakes with Bill Clinton, Bill Gates and Bono...but can you spot Nelson Mandela, Angelina Jolie or Queen Elizabeth II?

^{iv} BRAC International raised more than \$75 million in 2010 from bond markets to finance its programmes in Africa.

^v This paper draws extensively on Maitrot (2013) including quotations from MFI borrowers and staff members. Maitrot investigated the social performance of MFIs in rural Bangladesh over 10 months of intensive fieldwork in a rural location with a high density of MFIs (ASA, BRAC, BURO, Grameen Bank and many others). It included a survey of 490 households, detailed ethnographic studies of four communities and institutional ethnographies of two MFIs. Maitrot's thesis can be downloaded from URL: <www.manchester.ac.uk/bwpi>.

^{vi} Debates about microfinance's morality commonly focus on the high interest rates some MFIs charge clients. This is not our focus in this article.

^{vii} And probably more widely, but this paper focuses on Bangladesh and India.

^{viii} In general we dislike the term 'neo-liberal' as it is commonly used by left-of-centre analysts as a blanket term to describe any activity that is partially market-based. However, we find it an appropriate term for summarising the mission drift in many South Asian MFIs from the pursuit of a social mission, through partially market-based activities, to becoming organisations driven purely by short-term financial performance indicators.

^{ix} A common sentiment expressed by MFI credit officers and microfinance clients and former clients (Maitrot 2013).

^x Note that in Bangladeshi organisational culture a manager commonly behaves like a dictator. The job of subordinates is to do exactly what they are told and be obedient.

^{xi} In fairness to Barclays Bank they were not alone in rigging LIBOR – it was a social norm for big banks in London to rig this rate if they had the opportunity. It should also be noted that the Banking on Change programme is savings-based in contrast to the microcredit approach that dominates microfinance.