**Has Microfinance Lost its Moral Compass?**

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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” following years of scandals and the rise of the Occupy movement to seize the streets in Manhattan and London.

But it is not just mainstream finance that has lost its moral compass; microfinance has lost its moral compass. The amoral and immoral attitudes and practices of mainstream finance in its global centres has contaminated the activities and behaviours of microfinance institutions in developing countries. The Occupy movement should be trying to seize the streets in Delhi and Dhaka, Hyderabad and Chittagong as well, to protest at what microfinance institutions are doing to their clients.

Our research on MFIs and interactions with MFI leaders since the mid-1980s leave us in no doubt that most of the path-breaking MFIs, particularly in South Asia had a social mission. 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 they have expanded, MFIs 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). As MFIs have moved upstream to access funds from global financial markets then financial performance (size of portfolio, portfolio at risk (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 has now captured microfinance in rural Bangladesh and India.

Our research found that the staff of many MFIs (and all the large MFIs in Bangladesh) have personal financial performance targets to achieve: the impacts of loans on client welfare has become a secondary issue. And, systematic long-term studies indicate that the impact on incomes is limited and at times may be negative.

The image of the heroic MFI was partly blemished by events in Southern India in 2009 and 2010 when reports of MFI borrower suicides hit the headlines. But continued positive reporting on the magic of microfinance in the West led us to consider: 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 the wealthy?

Mainstream finance seem happy to put money into microfinance even when the ‘numbers’ on its social achievements are not impressive, are misleading or non-existent. So what are the benefits for mainstream finance? One part of the answer is that, when done effectively, taking on a microfinance portfolio can contribute to group profits. But 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.

Does microfinance work in Bangladesh…or South Asia? Answering this question depends on the criteria that are applied. 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 that the answer is “probably not”. This conclusion is supported by recent rigorous quantitative analyses of economic and social impacts

The microfinance industry may have successfully extended financial services to the rural poor 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.

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, can be useful for poor and low-income people, and (ii) the informal moneylenders that might recolonize the formal market may do no better than the MFIs. A second option is more effective regulation of microfinance. This is very desirable but in most countries it is, at present, very difficult to achieve. Central banks, when asked to improve regulation of MFIs usually 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 (or other local languages) in loan books that are read out at group meetings) and in transmitting a message of ’buyer beware’. The third option is to challenge the founders and directors of leading MFIs to move away from treating social performance as public relations and to reform the monitoring systems that their organisations apply to branches and to staff. Systems for monitoring social performance have improved greatly over the last decade but MFIs needs 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.

The leaders of microfinance in South Asia have a choice – will they follow the lead of mainstream finance and drift into amorality and immorality. Or will they make a serious effort to chart a different path – in which social performance is a genuine pursuit and not merely something managed as a public relations exercise?