

## **MANAGEMENT RESPONSE TO THE SPECIAL EVALUATION STUDY ON MICROFINANCE DEVELOPMENT STRATEGY 2000: CLIENT WELFARE AND SECTOR PERFORMANCE**

On 26 September 2012, the Director General, Independent Evaluation Department, received the following response from the Managing Director General on behalf of Management:

### **I. General Comments**

1. We welcome this well-structured and comprehensive Special Evaluation Study (SES). It is the first review of the microfinance portfolio, sector performance and client welfare impact of ADB operations since the adoption of the Microfinance Development Strategy (MDS) in 2000. The timing of the SES is appropriate, as we have a portfolio that provides for a robust analysis of the implementation of the MDS. The findings also seem to be generally appropriate, and in line with the attention being given at the global level to various issues covered in the SES (e.g. financial Literacy, consumer protection). The SES observes that the MDS was reasonably well thought out when it was formulated. It finds that ADB's support in microfinance has been relevant and responsive to the development needs, but less than effective in achieving the projects' intended results.

### **II. Comments on Methodology and Findings of the Study**

2. We have three specific inter-connected reservations on the SES:

- First, the SES, while noting the spillover effects, takes a fairly narrow focus on direct clients, which assumes that the hypothesis behind the poverty reduction potential of microfinance hinges on the very poor having direct access to microfinance institutions (MFIs). This appears a limited view which would underestimate the impact of our projects on poverty reduction.
- Second, the SES could have shed greater light on the microfinance-poverty reduction nexus and how ADB microfinance operations could be better structured moving forward. While ensuring inclusiveness is critical, effectiveness of microfinance in assisting the Ultra poor is inconclusive. In general, it is recognized that financial inclusion is better achieved when MFIs target a wider base of clients.
- Third, we believe that the SES could have also addressed a critical question of whether microfinance is another form of financial intermediation or a channel for subsidy delivery for poverty reduction. If the former, microfinance lending interest rates and charges for other microfinance services will be high, considering the risk involved often with the lack of collateral. More so, if the MFIs' cost of funds remains higher than those of banks. If the latter, MFIs should focus more on providing access to finance to a wider range of borrowers. In the meantime, reducing extreme poverty can be better facilitated by direct government to person transfers.

3. We agree with the SES's finding that ADB projects need to be realistic about the limit and the financial and time costs involved in reaching the poor, particularly the ultra-poor (para.40). In our view, ADB operations have sought to strike a balance between innovative approaches and the need to scale up microfinance lending. For instance, Private Sector Operations Department's projects have aimed to achieve a wider reach, by mitigating the risks faced by MFIs. In doing so, thorough capacity assessments have been undertaken.

4. In addition, we support focusing on rural and low-access areas and expanding financial inclusion for female clients. We also acknowledge the need for engaging specialized expertise on poverty and gender (paraA4), not only during design but also during implementation.

### III. Comments on the Recommendations

5. We support the general thrust of the recommendations. Our specific comments on the recommendations are highlighted below.

6. **Recommendation 1: Extend Accessibility:** We agree with the need to explore innovative approaches to deepen the outreach to the poor. In parallel, we also need to improve our understanding of the nexus between microfinance development and poverty reduction. For instance, a sizeable MF program in a rural region previously unserved (or underserved) by formal financial intermediation can alter income generation and expenditure in ways that would not only boost productivity but also farm employment. We wish to therefore note that the microfinance-poverty linkage need not be limited to whether or not our operations target the very poor. Further, it is also worth noting that targeting and monitoring process would take more time and resources, thus calling for buy-in and cooperation at various levels. Providing adequate capacity to the ultra-poor and poor with necessary business skills will also call for efforts by public and private entities. As to standard operational, financial, and social performance indicators for mandatory reporting on all microfinance projects, Financial Sector Development (FSD) CoP will work with concerned departments to determine a list of core metrics, and the way they would apply to future projects in a practical and effective manner.

7. **Recommendation 2: Demand Orientation:** We agree with this recommendation, while noting that the microfinance industry (just like the global financial sector) has been evolving rapidly. The priorities placed on financial literacy and consumer protection have emerged recently, which ADB's policy as well as lending operations have embraced. The role of the public (including that of Multilateral Development Bank) and private sectors has been evolving as well. Improved coordination and division of labor amongst development partners has resulted in institutions taking clear roles in specific areas (e.g. credit bureau work by International Finance Corporation; policy reforms and risk mitigation by ADB). Moving forward, supported by FSD CoP, ADB operations will aim to place greater focus on clients, particularly in financial literacy, consumer protection, and safe and sound approaches to have improved access to financial services.

8. **Recommendation 3: Strengthen Institutions:** We accept the premise here, but wish to note that institutional deficiency is not a problem limited only to the microfinance segment. We believe the institutional issues can be better addressed by a

broader approach for financial sector development as the role and scope of microfinance will vary depending on the role of the existing 'mainstream' financial system in each country. We note that we plan to structure ADB operations to meet country specific needs with reference to the areas noted, in coordination with other development partners.

9. **Recommendation 4: Strategic Direction:** ADB is already working on many of the suggested areas. One example is expanding insurance for the poor through micro-insurance schemes and products. Delivery improvements are being targeted in a few countries. FSD CoP will consult with the Strategy and Policy Department and other concerned departments on the best approach to follow-up on the findings and recommendations of the SES.