



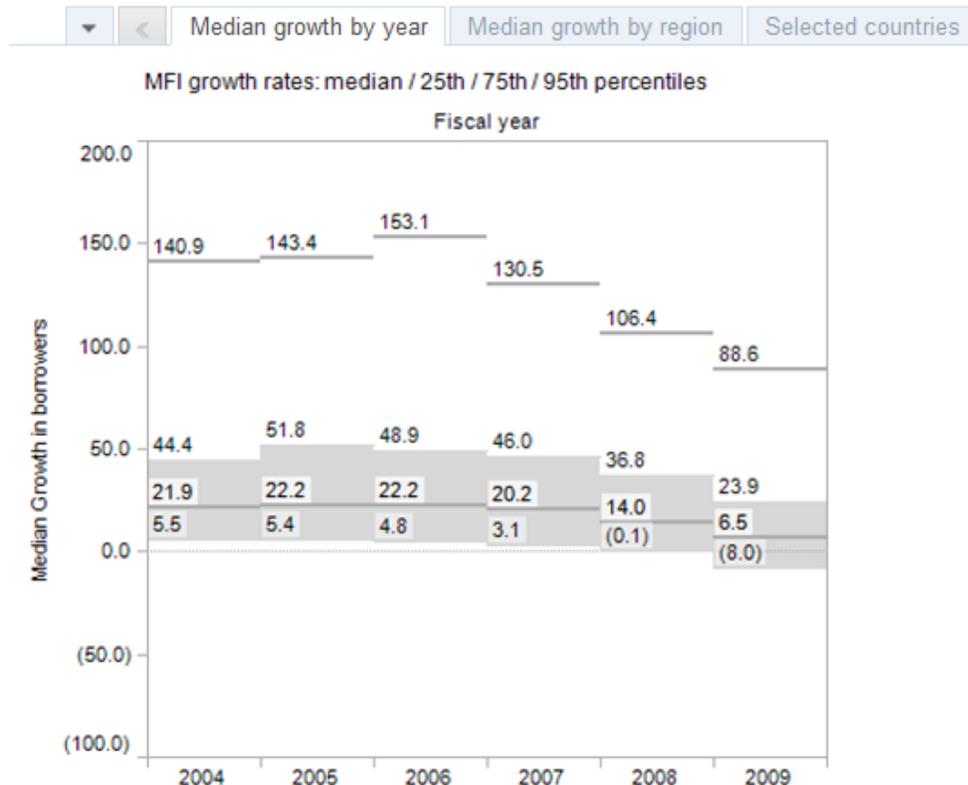
How can we define responsible financial performance? This is part one of a four-part series covering our current state of knowledge about the relationship between key financial and social performance indicators, produced as a prelude to the [annual meeting of the Social Performance Task Force](#), June 19-24 in Den Bosch, Netherlands.

The basics of growth

From 2004 to 2007, global microcredit outreach grew an average of 23 percent per year. Aggregate expansion of the sector slowed to 19 percent in 2008 and 15 percent in 2009. However, these averages oversimplify the dispersion of growth rates at the MFI level. For instance, for each year from 2004 to 2007, half of the MFIs reporting to MIX grew more than 20 percent per year (the median level), one quarter grew more than 40 percent per year, and one tenth grew more than 80 per cent per year.

Consistent with global deceleration, lower growth rates were observed in 2008-2009 for most MFIs. South Asian MFIs were the most dynamic in 2009 by all metrics, in contrast with ECA or LAC, where high growth rates were less frequently observed. The charts below display the range of growth rates for this period, and growth rates by region for 2009.

Figure 1: Annual growth rates (for number of borrowers)



The high growth rates for some MFIs and the recent crises in several countries have triggered concerns about the potential negative consequences of excessive growth. A few have argued that [uncontrolled growth](#) is one of the main reasons behind the portfolio quality problems recently observed in Bosnia and Herzegovina, Morocco, Nicaragua, and Pakistan. Others have argued that rapid growth has been fueled by funders and that the sector needs to slow the pace of investment. However, the importance of excessive growth by individual institutions as a trigger for portfolio quality problems [has been overestimated](#), while the role of market saturation has been largely ignored. Growth matters, but it matters most in context: What are the market conditions? How rapidly are other MFIs growing?

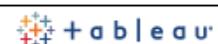
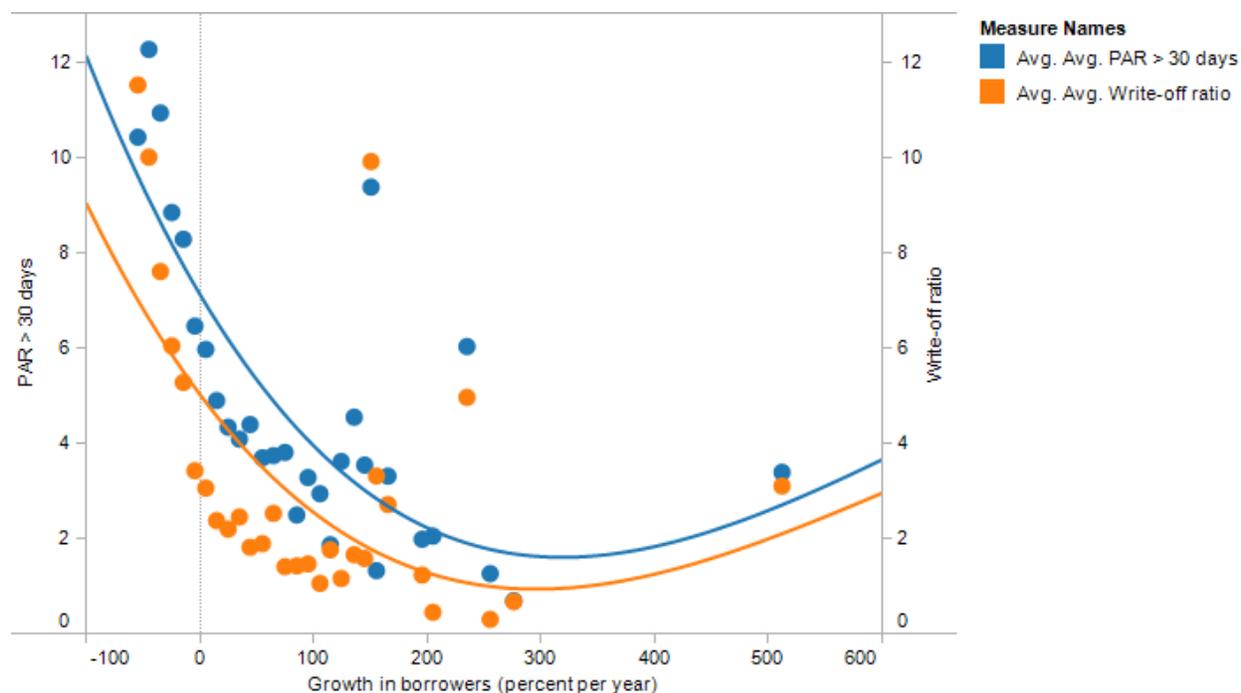
What we know about growth

What are the tradeoffs, if any, between social performance and growth? In other words, can we determine how much growth is too much, and prescribe sustainable levels of growth for particular MFIs? Probably not: the answer depends on each MFI and its operating environment.

From the point of view of social performance, there are potentially many trade-offs associated with fast-growing MFIs including: neglecting responsible finance principles and shifting from the original target populations to different markets and products. Since the main focus in recent years has been on portfolio quality problems, especially as they relate with consumer protection principles and over-indebtedness of borrowers, MIX has evaluated the connection between growth and portfolio quality, leveraging all historical data currently available on MIX Market. In addition to growth, this analysis explores the role of additional elements including: aggregate microfinance country growth, market saturation, the age and size of MFIs, different types of institutional growth, and local macroeconomic conditions. The main results are summarized here:

- **Only MFI growth rates of more than 250 percent per year are associated with worsening of portfolio quality.** This result is based on the 2010 multivariate econometric [analysis of MIX lead researcher Adrian Gonzalez](#), and visually confirmed in the chart below, where the average levels of portfolio quality are plotted versus the average growth rates for all MFIs and years reported to MIX in the 2000-2009 period. This graph clearly shows better portfolio quality for growth rates up to 250 percent per year, and worsening portfolio quality for MFIs growing more than 250 percent per year. According to this relationship, capping growth rates at any level below 250 percent per year will not help improve portfolio quality, and thus it is unlikely to have a meaningful impact on over-indebtedness or client protection. The same research also finds no relationship across periods that accelerated growth levels from previous years leads to diminished portfolio quality in later years. This result does not imply that MFIs should try to grow as close as possible to the 250 percent threshold, as many other factors should be taken into account when analyzing the opportunities for expansion of microcredit in a given market. However, if MFIs (and their funders) feel confident about their potentially ambitious expansion plans, have the right elements in place (lending policies, governance and risk management, MIS, qualified staff), and there is unsatisfied demand, there is no justification to cap growth below 250 percent per year. Additional considerations for this threshold and its relationship with portfolio quality are discussed next.

Figure 2: Average portfolio quality by growth rate, all MFIs: 2000-2009



- Countries where the total microfinance sector is growing more than 125 percent per year have higher risk of portfolio quality problems, with slightly higher risk for growth over 60 percent per year.** The portfolio quality of low-growth MFIs can deteriorate when the rest of the market is growing excessively and the overall market becomes over-heated. The critical level for market growth (in number of borrowers) is between 63 and 84 percent. However, deterioration in this range is very small, and just surpassing the 63 percent threshold will not deteriorate write-off levels notably. In particular, the data only shows that countries growing more than 125 percent per year can expect a steeper deterioration in portfolio quality. Rapid country growth raises some important questions about aggregate behavior of individual MFIs in saturated markets. In the long term, as markets become more fully saturated, country growth rates will level with growth in demand, which is largely determined by population growth and economic growth.
- Growth thresholds should take available demand into consideration, especially if the total number of borrowers is more than 10 percent of the market size.** Most discussion on the recent crises has overemphasized the importance of excessive growth and underestimated the key role of market saturation. Countries with market coverage (defined as the total number of microcredit accounts over the total population) above 10 percent have lower portfolio quality than countries with lower penetration rates. Indeed, Bosnia and Herzegovina and Nicaragua - two sectors with recent crises - passed this threshold in 2007 and 2008 respectively. Rapid microcredit growth can result in rapid market saturation, but when designing initiatives that are targeted at individual institutions we would wrongly penalize individual institutions if thresholds are only considered at that level.
- Extensive growth is healthier than intensive growth.** MFIs can adopt different growth strategies. Some MFIs may only grow ‘intensively’, by adding new borrowers within existing branches or a limited geographic market. Other can grow ‘extensively,’ by opening new branches in new markets. We expect intensive growth to deplete the pool of ‘good’ borrowers faster than extensive growth. The results from the econometric models confirm this hypothesis. Intensive growth levels over 168 percent (growth rate of number of borrowers per branch) are associated with lower portfolio quality, while only extensive growth levels over 631 (!) percent per year (growth rate of the number of branches per MFI) are associated with worsening portfolio quality. This suggests that the level of geographical diversification plays an important role in determining the riskiness of the expansion plans of MFIs. For instance, [recent research shows](#) that in Bosnia Herzegovina, the most populous sub-regions captured the most

lending and had the highest competition, as the majority of MFIs increased their presence in these areas, while other sub-regions had lower penetration rates. However, the smaller markets could not have generated the exceptional growth rates observed before 2007.

Table 1: Country watch list by high penetration and growth rates

Countries	Country Borrowers Growth ^{1/}					Penetration Rates ^{2/}				
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009
Afghanistan	87	84	23	3	-16	0.6	1.0	1.2	1.2	1.0
Armenia	29	19	41	31	-11	4.3	5.1	6.9	8.9	8.1
Azerbaijan	48	61	64	40	12	1.9	2.4	3.4	4.3	4.8
Bosnia and Herzegovina	32	38	57	20	-15	5.5	7.8	12.1	14.9	14.9
Bangladesh	23	16	13	6	-9	20.0	23.1	25.3	26.5	25.3
Bolivia	22	13	17	10	6	6.3	7.1	8.1	8.8	9.1
Cambodia	17	23	32	31	6	6.5	7.8	10.1	12.9	14.9
Ecuador	17	13	14	14	-3	7.3	8.0	8.7	9.7	10.2
Georgia	60	43	14	6	14	1.8	2.5	2.9	3.1	3.6
India	107	62	50	62	58	3.8	4.7	5.3	6.8	8.3
Kazakhstan	82	36	31	-8	-15	0.3	0.4	0.5	0.5	0.5
Kenya	44	68	51	11	31	1.4	2.1	2.8	3.2	4.0
Kosovo	44	28	35	24	6	3.9	4.9	6.6	8.1	8.6
Madagascar	9	-4	52	67	-14	0.7	0.7	0.6	0.7	0.5
Mongolia	40	28	17	12	0	9.2	11.6	13.4	14.9	14.8
Morocco	38	58	34	-6	-27	2.1	3.3	4.4	4.0	2.9
Nicaragua	33	19	12	6	-22	8.0	9.2	10.3	11.2	9.7
Nigeria	36	59	37	81	23	1.0	1.0	0.9	1.0	1.0
Pakistan	30	43	58	-1	11	0.5	0.7	1.0	1.0	1.1
Paraguay	7	15	9	23	34	4.5	5.0	5.4	6.4	8.1
Peru	16	25	27	5	14	7.0	8.3	10.0	10.5	11.6
Sri Lanka	30	11	-4	21	-5	9.0	9.8	10.1	11.4	10.9
Senegal	63	6	9	-1	16	3.3	3.2	3.6	3.5	4.1
Serbia	30	66	22	-4	-6	1.0	1.6	2.0	1.9	1.8
Tajikistan	27	53	83	23	-5	0.8	1.1	1.7	2.1	2.0
Vietnam	10	14	20	20	11	6.8	7.4	8.6	9.9	10.7
Yemen	67	37	-25	19	19	0.2	0.3	0.3	0.3	0.3

Cells highlighted in blue represent values over 58 percent for country growth and 8 percent for penetration rates, both values below their respective thresholds identified by [Gonzalez \(2010\)](#). 1/ Weighted growth rate, based on MIX MFIs. 2/ Based on data reported to MIX, Microcredit Summit Campaign and Inter American Development Bank. 2008 and 2009 are forecasts based on aggregate country growth rates.

- **All previous results are general guidelines, and for every particular MFI and market there are unique circumstances to be evaluated.** Beyond the risk drivers explored here, there are many other elements that could improve or worsen the portfolio quality of MFIs, and thus their ability to deliver services that meet their clients' needs. In addition, all previous results are general recommendations that work as general guidelines for large groups of MFIs.

Conclusions

Objective evidence suggests that for an individual MFI, high growth rates (under 250 percent per year) can be acceptable. However, further attention should be given to the growth path followed by the MFI (expansive versus intensive) and the saturation levels in the market. For practitioners, we propose three takeaway lessons:

- **Don't focus on MFI-level growth in isolation:** Growth rates for individual MFIs are not by themselves sufficient to signal problems, except at very high levels. More context is necessary.
- **Do look at where growth is occurring:** We do have evidence that MFIs that grow intensively - i.e. adding clients in the same locations, rather than expanding - are more prone to portfolio quality problems, which can be a sign of poor social performance. Looking at [sub-regional data](#) may be helpful in this regard.
- **Do look at the market as a whole:** When markets become saturated, risk increases for all participants, even those with slow growth rates. At the same time, MFIs with high growth rates in under-served markets may be reaching new clients - [a key part of current social performance](#) standards.

Growth is important, but it is equally important to look for effects in the right places. There are also many counterexamples for these patterns: this only highlights the many other elements that need to be considered when evaluating the growth plans of MFIs. Important factors include: the presence of credit bureaus, the existence and quality of financial supervision and regulation, macroeconomic and systemic shocks, and of course, the credit policies, risk management policies, and systems available for the MFI.

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