Microfinance over-indebtedness, truth or myth?

An exploratory study of market trends related to high outreach in microfinance markets.

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---- PUBLIC VERSION ----

To guard the privacy of participants, this version of this thesis has been stripped from any names and data that could reveal the identity of individual participants or the organizations they work for. To enable the reader to follow the analytical process completely, some data has been blacked out instead of fully taken out as it was an essential part of the analysis.

Preface

The copyright of the Master thesis rests with the author. The author is responsible for its contents. RSM is only responsible for the educational coaching and cannot be held liable for the content.

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Foreword

Creating this thesis has been an experience. I say creating because talking to professionals from the microfinance field, conducting interviews and visiting micro-finance organizations as well as micro-entrepreneurs' businesses in Nairobi cannot be called writing. One day I was at the office of an executive manager of one of the first Kenyan microfinance organizations and the other day I was in a coffin shop, discussing loan practices with an inspiring female entrepreneur or talking to a corn salesman whose "shop" was a pile of corn on a dusty market. It has been a life experience that I will cherish.

To be able to do all of this I owe my indefinite gratitude to quite a lot of people. And as Dutch cheesy traditions prescribe, this is the place to thank all of them. I would first of all like to thank all my participants and the kind persons that put me in touch with them. I would especially like to thank the handful of great individuals that put me in touch with the organizations I needed, you know who you are. I would gratefully like to thank the staff of the branches I visited for their kind hospitality and unconditional help. Also, I would like to thank the two experts that selflessly offered their guidance and professional insights when I needed it the most. I sincerely hope this thesis can even mean the smallest contribution to the amazing work these people do every day.

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Abstract

This case study of the Nairobi microfinance market provides an initial image of the consequences of increasing outreach in more mature microfinance markets. The data consists of interviews with the staff of four local microfinance organizations and their clients, as well as some expert interviews. The paper adds to existing microfinance literature in three ways. First of all, several microfinance markets have matured, but literature has failed to catch up with this development. This study provides an image of what happens in such a market. Participants saw outreach increase, competition intensify, clients increasingly borrow from more than one organization, clients diverting credit to non-business purposes such as household expenses, and they perceived over-indebtedness to become more common.

The second, and most important, contribution to literature is an initial image of the consequences of increasing outreach in such a market. Literature has focussed on how to create more outreach as opposed to the consequences of high outreach. Higher outreach seems to cause higher competition and increased multi-borrowing. These trends in their turn cause over-indebtedness in the views of the participants. A model is proposed which shows these relations and how they influence each other. Competition can drive MFIs to overfund clients, which causes over-indebtedness. And high outreach and competition increase multi-borrowing, which is seen as a direct cause of over-indebtedness. Additionally, the diversion of credit to non-business purposes was seen as a cause of over-indebtedness.

This then shows the third contribution of his research, as over-indebtedness is among the consequences of outreach, the study provides initial insights into the road that leads clients to over-indebtedness. Literature thus far lacks a theory on how microfinance clients become over-indebted, and has even not established that over-indebtedness is a problem in East-Africa. This contribution is vital, since it can provide early warning signals for microfinance practitioners, to prevent an over-indebtedness crisis in their work field. This study shows that microfinance over-indebtedness should no longer be seen as a myth. While the magnitude of this development is unclear among participants, there is general agreement that over-indebtedness is a problem.

Keywords: microfinance; micro-credit; outreach; access to credit; multi-borrowing; competition; diversion of funds; credit diversion; consumption of loans; over-funding; under-funding; over-indebtedness.

1. Introduction

Rama is bidis roller in Warangal, an agricultural village in Andhra Pradesh, India. By making these small cigarettes she earns about thirty-five rupees a day. This was never enough to sustain her family properly, which is why she decided to take out a loan to pay for medical treatment of a family member and to pay for household expenses. Then she took out another loan to repay the first. And before realizing the severity of the situation Rama had five loans, and did not know how to repay them. The debt collectors of the microfinance organizations stalked her day and night. Some even said she was worth more to them death than alive, since her loans included a life insurance. Rama's daughter decided to sacrifice herself to help her family, as she thought that if one of the family members died, the debt collectors would cease to harass her family and the dishonor put upon her family would be cleared. The seventeen-year-old committed suicide; because of the microfinance debt her family was in. (NPR, 2010). That is how Rama, without ever wanting any attention, became one of the famous examples of microfinance gone bad. Rama's story is one of the handful of examples (BBC, 2010; Bloomberg, 2010; NPR, 2010; The Guardian, 2011) that surfaced in press around 2010 when the often praised Indian microfinance sector began to show substantial indebtedness. Several suicides were related to microfinance in the media . Often the stories describe extreme group pressure from the loan group or extreme pressure from microfinance institutions to repay which has driven troubled borrowers into despair (BBC, 2010; Bloomberg, 2010; NPR, 2010; The Guardian, 2011). The Indian microfinance market was one the first around the world where microfinance was introduced (Yunus, 1999), currently it is one with substantial competition and saturation. On a population of 1.2 billion (World Bank, 2012c) 26.4 million people are clients of microfinance organizations (MIX Market, 2012e). Are these detrimental examples solely individual cases in India or do they indicate a new situation where microfinance is showing its downside in more saturated markets? Is Rama's situation an exception or an example? Is over-indebtedness truth or a myth?

About a decade ago, many saw microfinance as the new promise to alleviate poverty. Initially, some people attributed miraculous dimensions to its effects, expecting it to solve all income inequality problems. In this first decade of exponential growth, the microfinance institutions (MFIs) virtually functioned as monopolists. Sometimes even to the extent that MFIs divided regions in a country amongst themselves as if it were a cartel (McIntosh, de Janvry and Sadoulet, 2004).

However, the situation changed; untapped markets became more rare and new entrants started competing in existing markets. Nowadays, in many markets you can see a wide variety of MFIs competing for the same clients (Ibid). Especially in the last five years exponential growth has been observed with growth rates of 70-100% in some countries and competition skyrocketing (Assefa, Hermes and Meesters, 2010). By now there are more than 2420 MFIs in 117 countries, which serve 99 million borrowers around the globe (MIX market, 2008).

This new situation recently started to show a downside to microfinance, as the first signals of negative consequences can be viewed. As mentioned, recently stories like Rama's became more common in the press. Generally suicides related to microfinance will be exceptions but the high debt of Rama might not be. Concurrently, both the popular press and scientific research critiqued the practise of microfinance institutions (BBC, 2010; Bloomberg, 2010; Banerjee, Duflo, Glennerster, & Kinnan 2009; Karlan & Zinman 2011; Bauchet, Marshal, Starita, Thomas & Yalouris, 2011). Additionally other signs of a changed state of the market can be viewed.

A second signal comes from MFIs themselves. Increasing competition has become a rising concern for incumbent social lenders in these markets, who noticed that it is harder to use dynamic incentives to keep up repayment rates and estimate the risks involved in lending as customers have a variety of other options (McIntosh et al, 2004).

A third sign is that in several countries repayments crises occurred; clients were unable to repay their loans; earlier on in Bolivia and more recently in Nicaragua, Pakistan, Morocco, and Bosnia and Herzegovina (Chen, Rasmussen & Reille, 2010). These are the extreme cases. And of course the current situation differs substantially between markets.

Other signs noticed are for instance unethical collection practises by MFIs (Chen et al., 2010; BBC, 2010; Bloomberg, 2010). In sum, the first signs are clear, but no real measure of neither the extent of these developments nor the consequences can be found.

However, it is important to consider the tremendous potential negative consequences of high market maturation could have. Schicks (2010) argues that unsustainable financial services can lead to damage to clients as well as to the industry as a whole, as we saw in the 2008/2009 financial crisis.

On the other hand, many benefit from the services microfinance provides, as financial services become accessible to more and more people around the world (McKinsey, 2010) It provides a tool for the poor to help themselves out of poverty. However due to the cracks showing, it is becoming very hard to still see the initial perfect picture of microfinance that would save the world from poverty.

Microfinance literature traditionally focussed substantially on how to provide access to financial services for as many destitute clients as possible (e.g. Jaffer, 1999; Morduch, 2000; Karlan & Zinman, 2007; Beck, Demirguc –Kunt & Martinez Peria, 2008). Moreover, professional MFIs that pursued a social mission of increasing outreach to the unbanked and the poor drove the immense growth of microfinance in the last five years (Chen et al., 2010). Often scholars assumed that access was a positive development as the effectiveness of microfinance as a poverty alleviation tool in early research pointed towards positive effects (Hossain, 1988; Chowdhury, Mahmud & Abed, 1991; Mustafa, Ara et al. 1996;Kamal, 1996; Hashemi & Moshed, 1997). These studies however generally used indirect measures and compromised designs due to limited resources (Bauchet et al., 2011).

Recently, the effectiveness is even under debate due to new research using more profound methodology (Brau & Woller, 2004; Banerjee et al., 2009; Khavul, 2010; Bauchet et al., 2011; Bruton, Kavul and Chavez, 2011). However most research still seems to point towards positive effects. With the effectiveness of microfinance under discussion, and markets becoming more and more developed, it is worth asking the question what the consequences of the development of these markets are.

In this paper the focus will be on the growing outreach to clients, as a sign of a more developed market. Here, the term outreach is used to refer to the amount of persons reached as well as the level of poverty of those people. While many discuss outreach or use the term in their papers, not all authors define clearly what outreach means. In this paper the definition of Navajas, Schreiner, Meyer, and Gonzalez-Vega (2000) is used as the basis for defining outreach. Outreach in their framework is defined as "*the social value of the output of a microfinance organization*" (p.335). Contrary to Navajas et al.'s study, this research will look at the whole microfinance sector as a level of analysis. For the whole sector outreach will be seen as the accumulated social value of the output of all microfinance organizations in the sector. Most commonly outreach is seen to have two dimensions: breadth and depth. Breadth of outreach is the number of clients that are reached (Navajas et al, 2000; Schreiner, 2002; Brau & Woller, 2004). Depth generally concerns the poverty level of the beneficiaries. Meyer, Nagarajan and Dunn (2000, p.1) provide a relative practical definition and describe depth as: *"how far down in the income distribution do the [MFIs] reach"*?

It is important to assess what happens in high outreach markets, as still little is known about this new reality. There is a need to monitor these developments and observe whether negative trends such as extreme indebtedness actually occur. In this way a potential negative outcome can be prevented through deliberate and advised interventions or by simply informing MFIs on the effects of certain behaviour. In this way future crises might be prevented.

With regard to literature, the focus is still on markets with low outreach. This clearly needs an update to fit the current situation in several markets. Also, the existing literature regarding outreach points towards causes of the state of outreach, opposed to the consequences of this outreach, which is barely touched upon.

Therefore the main research question of this thesis is:

***RQ:* Which consequences of increasing outreach are noticed within the microfinance sector in developing countries?**

The signs of market maturation show in several markets: There is a wider variety of products, high competition, more marketing and promotion of products and services and the vast majority of consumers know about the product or service (Verhage, 2004). While it seems reasonable to assume

this goes with a higher amount of clients, as more services are delivered, we cannot know this for sure. Also, we don't know if this also means poorer clients are reached. Therefore, to be able to answer the research question it is important to consider the impact of this changed market on the outreach of microfinance, both in terms of depth and breadth.

This leads us to our first sub-question:

SQ1: How has the maturation of the microfinance sector in developing countries influenced outreach?

Since there is very limited research in highly developed microfinance markets, it is of great importance to have a general recording of what happens in a maturing market. This will enable us to identify potential consequences. Therefore, the second sub-question will attempt to provide an image of developments that prevail in a more mature market:

SQ2: **What market trends and developments are observed with increasing maturity within the microfinance sector in developing countries?**

Market trends and developments are wide concepts. However, since this research is explorative in nature, too much focus on certain types of development would influence the outcomes and prevent the findings to encompass the most salient developments in the markets. Making the sector as a whole the study object provides some focus, as it excludes developments related to the functioning of one MFI or their specific target market. Market trends could for instance be changes in the market situation such as competition but also client behavior like the habit of taking on more debt.

While many microfinance markets were studied, relatively little is know about the African market. Microfinance started in Asia and was then taken to South-America, after which it was only introduced in Africa relatively late. Within this stream of literature the case studies in East-Africa are very few.

Moreover, Africa has a very different culture than many markets where more research has been conducted. Tribal thinking still is apparent and family ties prevail, the unprivileged population is relatively used to foreign aid and colonial ties are a strong part of the history. Aside from that, some markets in East-Africa are becoming highly developed. It is interesting to see if these markets show specific trends and developments that can be attributed to reaching more and even poorer people.

Within East-Africa the researcher selected a market that appeared relatively mature. Urban markets generally appear to be ahead of rural areas and Nairobi as a city hosts a relatively high number of MFIs. Besides the area is relatively conflict free, which was an important criterion as war and conflict can hinder microfinance practice and repayment as well as the data collection process. Because the market was selected on its presumed high outreach, which had not been tested, the outreach of the

microfinance sector in Nairobi needs to be assessed first. This assessment will be used to answer the first sub-question.

Note that this outreach is relative to the total potential outreach in this market. And it can only be compared to other situations if we provide an image of outreach relative to the market potential.

While most microfinance research regarding outreach focuses on the organizational level, there has been limited attention to the industrial organization of microfinance (McIntosh & Wydick, 2005). Therefore, the main level of analysis will be the sector as a whole as opposed to one specific MFI. This will enable us in a later phase to relate outreach to the trends in the market as whole.

To answer these research questions the staff and clients of four microfinance organizations located in Nairobi, Kenya were interviewed. Additionally, experts in the field were consulted. Outreach was determined based on the participant's perceptions of the market, and as a control the perception of the functioning of their organization was analysed. Also, the limited existing statistics were compared to the outcomes. Market trends were identified in an explorative manner, identifying salient trends based on participants' perception and prioritization.

The following chapter outlines the relevant literature on the topic, creating a theoretical frame for the study. In Chapter 3 the methodological approach of this research is explained, while in Chapter 4 the empirical findings are presented. First, an assessment of the outreach of the Nairobi microfinance sector is made, which will be used to answer the first sub-question (Section 4.1). Secondly, an overview of salient market developments as described by participants is given to answer the second sub-question (Section 4.2). Thirdly, the state of outreach in Nairobi is related to the market trends and relations between market trends are described (Section 4.3). This will be the basis to answer the main research question. Note that all of these findings are mainly based on interviews and therefore consist of the joint perception of participants. In Chapter 5 the findings are discussed, limitations mentioned and future research suggested and in Chapter 6 conclusions are drawn and the main research question is answered.

2. Theoretical framework

2.1 The foundation of microfinance

Microfinance is generally described in literature as the provision of financial services to the poor (Brau & Woller, 2004). However, practitioners created definitions that provide more specificity. MIX Market (2012f), the most important data gathering organization in the sector, defines microfinance services as: *"Microfinance services – as opposed to financial services in general – are retail financial services that are relatively small in relation to the income of a typical individual. Specifically, the average outstanding balance of microfinance products is no greater than 250% of the average income per person (GNI per capita)."* It is mostly agreed that the term spans a wide range of financial instruments including credit, saving, mortgages, insurance, and retirement plans, all of which are provided in small amounts (Khavul, 2010). Each of these services target persons whom lack the credit history and collateral that is needed to borrow from traditional financial institutions (Karlan & Zinman, 2011).

53% of the world's population does not have access to formal or informal banks (Bruton et al., 2011). Microfinance aims to fuel economic growth by stimulating individual entrepreneurial initiative. MFIs provide access to credit, which can be used to grow small businesses and in that way increase household income.

MFIs are diverse: many are non-governmental, most are private or involve public-private partnerships, and an increasing amount of MFIs are for profit (Khavul, 2010). Often the terms microfinance and microcredit are used interchangeably, even though originally microcredit refers only to the credit function of microfinance. In this study the focus will be on microcredit, entailing the mechanisms used to provide loans to the poor.

2.1.1 The origin of microfinance

In 1976 Muhammad Yunus observed the problems in the small poor village close to the university where he worked. He observed the struggle of these rural poor in obtaining any form of credit and noticed how many became victim to loan sharks and were put under great pressure to repay their loans. Looking for a solution, he initially decided to personally lend a total of 27 dollars to 42 people in this village, as a test to see if they would improve their wellbeing. This effort was very successful. Therefore, he started a project based on this principle with his students and eventually founded Grameen Bank, the first microfinance bank (Yunus, 1999). This bank now holds over 8 million borrowers (Mix Market, 2012a).

The general public became increasingly engaged by the philosophy of Yunus and 2005 was even declared year of the microcredit by the United Nations (Bruton et al., 2011). In 2006, Yunus and

Grameen were awarded the Nobel Prize for Peace for their reduction of World Poverty (Banjaree et al., 2009).

Since its founding, the model of Grameen Bank has been replicated in several countries by enterprises related and not related to this bank (Yunus, 1999). Since many believed in the promise microfinance embodied, the number of microfinance institutions grew exponentially (Chen et al, 2010).

2.1.2 Microfinance models

The traditional banking sector initially failed to enter the market of small loans to less fortunate customers. They faced adverse selection, moral hazard, and monitoring problems. The informal economies, characterised by little growth, and high social control, that formed the potential market, asked for specific products and services. Additionally, potential clients act as deterrents through their lack of experience with capital and financial services (Bruton et al., 2011). MFIs managed to serve this untapped market without demanding the traditionally needed collateral from clients.

Microfinance, as initially designed, is based on a joint liability contract issued to a group of borrowers. This is the joint liability group lending model described below. Currently, two other models are also often observed: individual liability group lending, and village banking (Khavul, 2010). Within these three forms of microfinance many variations and deviations can be seen in practise.

Joint liability group lending

This was the original model of Grameen Bank, which works as follows: small groups of usually five borrowers are formed, which meet on a weekly basis under the guidance of a bank employee called the loan officer. Initially, two group members receive a loan. At the weekly meetings, these two borrowers pay off their loan. Once these two group members repaid their credit according to the agreements, the next two members receive the loan. If these two borrowers also repay their loan according to bank rules, the last borrower receives a loan. Thereafter, a second more sizeable loan is often granted to one or two members of the group (Grameen, 2012). This dynamic incentive; the promise of a bigger loan in case of no default; is an extra motivation to repay (Banerjee & Duflo, 2010). Hence, in this model borrowers take on loans for individual use, for which the group is jointly legally responsible (Khavul, 2010).

Microfinance managed to serve the untapped market of poor clients for several reasons. First of all, the group structure solves the problem of adverse selection as seen in traditional banking. Due to information asymmetry it is difficult for the lender to assess the credit worthiness of the borrower. This makes it impossible for the lender to refuse loans to risky borrowers (Guttman, 2007) or to price the risk into the cost of the loan, which forces lenders to charge identical rates for each client (Khavul, 2010). In all these microfinance models this risk is mitigated ex ante, because lenders self select groups. Sociologists have found that people living in close communities possess valuable information about

their peers that they have gathered over the years (Bruton et al., 2011). Through this intangible social information, borrowers can assess the creditworthiness of potential group members from their own community. Van Thassel (1999) found that this process leads to safe borrowers forming groups with safe borrowers. Ghatak (1999) notes that this selection enables a form of price discrimination that would be impossible in individual lending. Since risky borrowers can only participate in groups with other risky borrowers, they have to secure risky loans, which increases the cost of borrowing for them.

In this banking model the MFI also prevents moral hazard problems ex post. Borrowers incur costs to monitor each other in order to make sure that group members that have already made their profits still commit to their obligations to the group and the bank (Armendariz de Aghion & Morduch, 2005). Also, individuals are motivated to comply with their loan obligations because of the reputation cost of letting down the group in front of the community and the lender (Khavul, 2010).

Individual liability group lending

In this model, borrowers are formally not liable for the loans of other group members, but they do have to comply with the other traditional mechanisms of group lending. Primarily, like in the original microfinance model, groups come together in their local community for weekly or biweekly repayment meetings with a loan officer of the microfinance institution. In this public setting, loans have to be repaid and often the meeting does not end until all loan instalments are settled (Khavul, 2010).

Morduch (1999) stresses that the success of MFIs cannot only be accredited to peer selection and peer monitoring, other methods also cause high repayment rates. The public setting of the repayment in the group meeting is one example of such a mechanism. Morduch mentions two other important mechanisms that seem to guard repayment. First of all, regular repayment schedules are common for MFI loans. Mostly, the first repayment has to be made within a couple of weeks after disbursement of the loan and this is done on a weekly basis. This enables group members and banks to notice undisciplined lenders early on. Additionally, it creates the need for a steady flow of income for the borrower early on, which increases the chance of full repayment. Secondly, many banks use a form of collateral substitutes. This is often done in the form of compulsory savings for a group emergency fund. This fund functions as a safety net in case of default, death, or disability. Aside from the social pressure used in both forms of group lending, these mechanisms also stay in place both in joint liability- and individual group lending.

Village banking

In this model, groups are jointly given a loan and they can allocate this to their members as needed. This requires that members cross-guarantee each other's loans (Khavul, 2010). The advantages over the traditional microfinance model are the lower monitoring costs for the bank and more freedom for the

borrowers. All the previously described additional mechanisms used to guarantee repayment are left up to the borrower-group themselves to determine.

All of the participating MFIs in this study functioned with the traditional joint liability group lending model or a variation on this model, however group sizes differed substantially.

2.1.3 Limitations of the microfinance models

As every upside has a downside, the microfinance models also have their flaws and restrictions. There are, for example, costs that are encountered due to the design of the system.

Groups tend to impose high risk-aversion on clients because the group members do not experience the benefits of a risky investment, while they are liable for the costs when it goes wrong. This changes the investments micro-entrepreneurs make. Therefore, a lot of microfinance institutions nowadays, including Grameen Bank, are abandoning the joint liability in their loan practises, and move to an individual liability group lending model (Banerjee & Duflo, 2010).

Another downside of the microfinance models is the standard repayment schedule. In microfinance, the loan repayment schedule is not tailored to the cash flows of an investment. Repayments generally start the week after the loan is granted. However, most investments do not have immediate pay-off. For instance, if a client buys a calf it usually does not start to produce milk right away (Banerjee & Duflo, 2010). For clients this creates an inconvenient gap in their finances. Additionally, it influences the kind of investments clients make. Field, Pande, and Papp (2009) found, that clients who had a couple of weeks before they had to start repaying their loans, tended to make bigger initial investments in their businesses. This can be more efficient and cost effective depending on the type of business.

The third and more recently surfacing downside is the substantial social pressure used to maintain high interest rates. The question is whether or not MFIs are really helping all of their clients when using this method. Some micro-entrepreneurs still manage to pay off their loans when their businesses fail (Bruton et al, 2011), which means the money comes from other sources such as loans or family, which will limit clients livelihood.

2.1.4 Alternative sources of financing

Micro-enterprises in Africa mainly operate in the informal economy. Which can be defined as "*all market-based legal production of goods and services that are deliberately concealed from public authorities for reasons of taxation, employment, and administrative regulation*" (Schneider, 2005, p. 600). Most traditional banks see enterprises in the informal economy as too risky. However, the poor do have alternative sources of financing that they use to start businesses. Buckley (1997) looked at the financial markets in Malawi, Ghana, and Kenya, including Nairobi's biggest slum Kibera. He found that the most common source of financing for micro-entrepreneurs is family and friends. Also, rotated savings and

credit associations financed micro-enterprises in some cases. Rotated savings, in Kenya also referred to as merry-go-rounds, is a system in which participants every week come together and pay a small amount. Every time, on rotation, a different group member receives the contributions (ibid). This provides the members with the money for major expenses, but is also seen as a form of insurance (Khavul, 2010). Also, agreements with suppliers and other traders finance entrepreneurs regularly. Moneylenders are a less common form of credit supply. Some respondents in Buckley's research had a relation with formal credit institutions but this often was only for savings. Respondents mentioned commercial banks, the post office, credit unions, government and non-governmental organizations within the formal sector as sources of credit (Buckley, 1997).

2.2 Outreach

Outreach in this research will be defined as ***the social value of the output of all microfinance organizations in the sector.*** This definition is altered but based on the definition provided by Navajas, Schreiner, Meyer, and Gonzalez-Vega (2000) by lack of a clear definition in other sources.

What is outreach?

As mentioned before many studies use the concept outreach, but not many define it clearly (Osotimehin, Jegede & Akinlabi, 2011). Outreach is often assessed using indicating factors such as the amount of users, the poverty of clients, the size of the loan agreements, the sex of the clients, the financial strength of the MFI, the price and cost for borrowers, and the number of products available (Navajas et al, 2000). However a clear definition extended in a usable operationalization is lacking. The existing definitions or implicit meaning in articles generally fit into one of two categories or a combination of the two. Some focus on providing microfinance services to poor clients, others on how many microfinance clients can use a service. The first has been described as the depth of outreach and the second as the breadth of outreach by other authors (Schreiner, 2002; Brau and Woller, 2004).

Two studies (Navajas, et al., 2000; Schreiner, 2002) describe a framework of dimensions of outreach. Over all, Navajas et al. describe outreach as "*the social value of the output of a microfinance organization*" (p. 335). However Schreiner adjusts the earlier published article and defines outreach as "*the social benefits of microfinance for poor clients*" (Schreiner, 2002, p. 592). Within these definitions they define six dimensions of outreach: depth, worth, cost, breadth, length and scope. The six-dimensional framework is a very detailed way of discussing outreach. But it does not provide a measure for the dimensions nor for outreach as a whole. Also, the six dimensions will not be a very comprehensible explanation for interviewees. Therefore, it was not used in its entirety for this research.

In most research only breadth and depth are used to describe outreach (Robinson, 2001, Brau and Woller, 2004). Because of practical reasons and the comprehensiveness of the concepts for participants, outreach here will also be defined in terms of depth and breadth.

Depth of outreach

Navajas, et al. (2000) describe depth of outreach as *"the value society attaches to the net gain from the use of microcredit by a given borrower"* (p. 335). This is quite an abstract definition, which makes it hard to visualise. They see poverty as a proxy for depth. This is based on the assumption that society prefers helping the poor above helping the rich (ibid). Brau and Woller describe depth of outreach as "*servicing the very poorest of clients"* (2004, p. 7), which might be easier to visualize, but is still not easy to measure since there is substantial debate on who the poorest would be as will be discussed later. However Meyer, Nagarajan and Dunn (2000) have a more practical definition. They define depth of outreach as ***"how far down in the income distribution do the MFOs reach"?*** (Meyer, Nagarajan and

Dunn, 2000, p. 1). This definition still is hard to measure in a quantitative manner, but provides participants in this qualitative research a chance to both define what they think the income distribution looks like as well as how far the microfinance sector reaches down. This is why it will be used in this research.

Other authors have struggled to capture depth of outreach and therefore have recorded characteristics of clients as an indicator. For instance: the existence of minorities in the clientele, rurally located clientele, female or low educated clientele, bad living circumstances, and clients with low or no access to public services (Navajas et al.). Nonetheless, more frequently the size of the loan is used as an indicator for depth (Schreiner, 2002; Meyer et al., 2000). Here it is important to note that even though many only take the distributed amount into account, also the size of instalments, the term to maturity, and time period in between instalments needs to be part of this measure (Schreiner, 2002). Loan size is often used because of the lack of better measures but is commonly seen as a poor approximation (Meyer et al., 2000). Therefore, in this research it will be only used as a quantitative control for the data supplied by interviewees, for lack of better quantitative data.

In microfinance literature most studies agree that microfinance had not penetrated the poorest strata of society (Navajas et al., 2000; Murdoch & Haley, 2002; Banerjee, Duflo, Chattopadhyay & Shapiro, 2010). In 1999 Murdoch already stressed that most MFIs reach the 'better off' poor and that only a small part of subsidized MFIs might reach the vast majority of poor households (p.1572). For a sector initially designed to alleviate poverty this seems peculiar. However, with the recent increase in outreach and the rapid development of some markets, this is most probably not true anymore for some regions. Additionally, in some markets the poorest might not have been reached in big numbers, but substantial increases in terms of depth are likely. Which probably brings MFIs closer to reaching the poorest.

Breadth of outreach

There is less discussion about the definition of the breadth of outreach. Breadth of outreach is **the number of clients that is reached** (Schreiner, 2002; Brau & Woller, 2004). Brau and Woller however note that this can also include reaching the non-poor or marginally poor. While it is quantifiable, discussion prevails about how far this breadth should extend. Later different perspectives on the definitions of the target group of the microfinance sector will be discussed.

The breadth of outreach around the world increases every day. While concrete numbers are unclear, estimates show gigantic increases. The microcredit summit in 2009 estimated that over 100 million of the worlds poorest use microfinance. It is therefore not unlikely that some markets have become relatively saturated.

Outreach in this research

Because Schreiner's definition focuses heavily on the depth of outreach, more than on the breadth of outreach, the definition in this paper originates in the definition by Navajas et al. (p. 335).

Note that social value not only entails helping the people that need it most, but can also entail helping many others that need it. This shows a trade-off that was also mentioned by Robinson (2001). She described how MFIs need to balance depth and breadth, because more resources are needed to impact the poorer population, while the same resources can be used to reach more people. Schreiner (2002) also notes that reaching poorer clients usually means higher fixed cost and higher cost of assessing the risk.

Most definitions of outreach and the related dimensions, also the one provided by Navjas et al., focus on the outreach of one microfinance organization. In this research the main focus is the microfinance sector as a whole. Therefore a definition concerning the sector level will be used, which will enable a meaningful connection between outreach and market trends. The outreach of the industry as a whole is the combined outreach of all microfinance organizations in that particular market. Consequently, based on Navajas et al.'s definition, sector outreach will be defined as *the social value of the output of all microfinance organizations in the sector.*

2.3 Defining Poverty

As depth of outreach relates to how poor the person receiving microcredit is, it is important to know what is considered 'poor'. There has been a wide discussion on this topic.

The notion of poverty is as old as human history and known all around the globe. However, people mean various things when they refer to 'poor'. A person can be poor in monetary terms, poor on food, poor on health, or have poor education (Wijnbergen, 2012). Additionally the concept is relative to one's own (economic) situation and worldview. The United Nations (1998) defines poverty as "*a denial of choices and opportunities, a violation of human dignity. It means lack of basic capacity to participate effectively in society. It means not having enough to feed and clothe a family, not having a school or clinic to go to, not having the land on which to grow one's food or a job to earn one's living, not having access to credit. It means insecurity, powerlessness and exclusion of individuals, households and communities. It means susceptibility to violence, and it often implies living on marginal or fragile environments, without access to clean water or sanitation*".

Linking poverty to such specific dimensions makes it easy to observe but harder to measure. Therefore, poverty is mostly defined and measured in monetary terms, and the poor are defined as those who lack adequate income, which makes it impossible to function well in society (World Bank, 2012a). However, debate on what income makes it impossible to function in society, on where to draw the poverty line continues (Karnani, 2006).

In 1990 the World Bank started measuring poverty by standards commonly used in poorer countries, which resulted in the current widely accepted ' one-dollar-a-day' poverty line. This measure is converted to local currency for each country based on the Purchasing Power Parity (PPP) exchange rates, the local consumer index, and local inflation (Karnani, 2006). The parts of the world population that live under this 'one-dollar-a-day' poverty line are what has been described as the poorest of the poor, the hardcore poor, or simply the poorest. Around the world 1.2 billion people belong to this group. On top of that, 1.6 billion people live on between $1 and $2 a day, which can still be seen as substantially poor (Khavul, 2010).

Management scholars have not focused much on the issue of poverty. Bruton (2010) gives a short overview of poverty-related literature in major management journals, which shows only very limited attention. Most recognized in this field is the work of C. K. Prahalad (Prahalad, 2004; Prahalad and Hart, 2001; Prahalad and Hammond, 2002). He argues that there is a pronounced opportunity for business within the poorest population. His bottom-of-the-pyramid concept has drawn substantial attention to the poorest as a target group in business literature. He argues that the 4 billion poorest people in the world, located at the base of the economic pyramid, pose a profitable opportunity for economies of

scope. This is why many for-profit MFIs talk about their second bottom line. They want to make profit by tapping this huge market and helping the poor in the process.

In the daily work of MFIs it is sometimes hard to assess whether a client lives below the poverty line. Some organisations have provided short interviews or checklists that enable a loan officer or researcher to quickly determine whether someone lives below the poverty line. Some MFIs have their own measurement, which is often not publicly available, but others do provide their methodology to the public. Both USAID (2012) and Grameen Foundation (2012) provide such tools, which are tailored to specific country conditions such as inflation and the governmentally determined poverty line. Since in this research the opportunity is there to request income data from the MFIs, and limited time can be requested from clients, these poverty measurement tools will not be used. However, generally the 'one-dollar-a-day' poverty line will be applied where needed. For Kenya at the time of the research this comes down to a poverty line of 85 Kenyan Shillings per day [1].

[1] At the time of the research, **€**1 ≈ Ksh 110 ≈**$**1.20

2.4 The target group for microfinance

Within the poor as defined by the 'one-dollar-a-day' poverty line there are still divisions to be made. Among those who cannot work there are those who lack the power to do so such as the young, elderly, ill or (mentally) disabled. There are also those who do not have the means to work, who for instance have no tools, no clothes or no workplace. And there are those unemployed due to, for instance, economic stagnation, introduction of machinery or season-restricted work (Mayhew, 1861 in: Robinson, 2001).

With such a wide variety of reasons why someone is poor, the relevant question for microfinance is: who should be targeted with microfinance and who should be helped in other ways? For this research this question is important since it restricts the potential of outreach, which can help determine to what extent the microfinance market is reached.

Robinson (2001) tries to define the target group of microfinance. Her starting point is the definition by the World Bank. This institute does not only define the poor as persons living on less than one-dollar-a-day, but within that group it also defines the extremely poor as those who live on less than 75 cents a day (World bank, 1990). Robinson distinguishes therefore, the economically active poor and the extreme poor. The economically active poor are persons who do have some form of employment and are not severely deprived of food, opposed to the extreme poor who lack these sources.

Robinson notes that the difference between the economically active poor and the extreme poor as she describes it, is similar to the distinction between the poor and the core poor but is not the same. Hulme and Mosley (1996) see the difference between poor and the core poor as: "*the existence of a reliable income, freedom from pressing debt, sufficient health to avoid incapacitating illness, freedom from imminent contingencies and sufficient resources (such as savings, non-essential convertible assets and social entitlements) to cope with problems when they arise."* (Hulme & Mosley, 1996, p.132). Robinson did not approve of this separation since she experienced that many of the better off poor still only have part of the aforementioned to their disposal. Therefore, her definition of the economically active poor involves a person having some of these characteristics but not necessarily all. She includes people *"who have marketable skills or control over earning assets—and who are or could become creditworthy borrowers and savers in commercial financial institutions."* (Robinson, 2001, p. 18-19). She notes that this means her economically active poor include Hulme and Mosley's poor but also part of the core poor.

Applying this distinction, Robinson answers the question of what degree of poverty should be served by which type of assistance, with what she calls the poverty alleviation toolbox (see Figure 1). The economically active poor, who have some form of cash income, can be served by microcredit since they have the ability to repay. The extreme poor however, do not have a substantial financial stream to

manage a microloan and are burdened by too many shortages to be able to generate returns on a loan. For instance, someone that is severely short on food cannot be expected to invest a microloan in income generating activities instead of in buying food. For these types of people direct basic assistance is a better option, so Robinson argues. Many agree with her, for instance Murdoch and Haley (2002) who state that physically or mentally ill persons and people that are in another way disabled in their functioning are generally not seen as possible micro-entrepreneurs. This group is served better with direct basic assistance. This group clearly is part of the extreme poor as defined by Robinson.

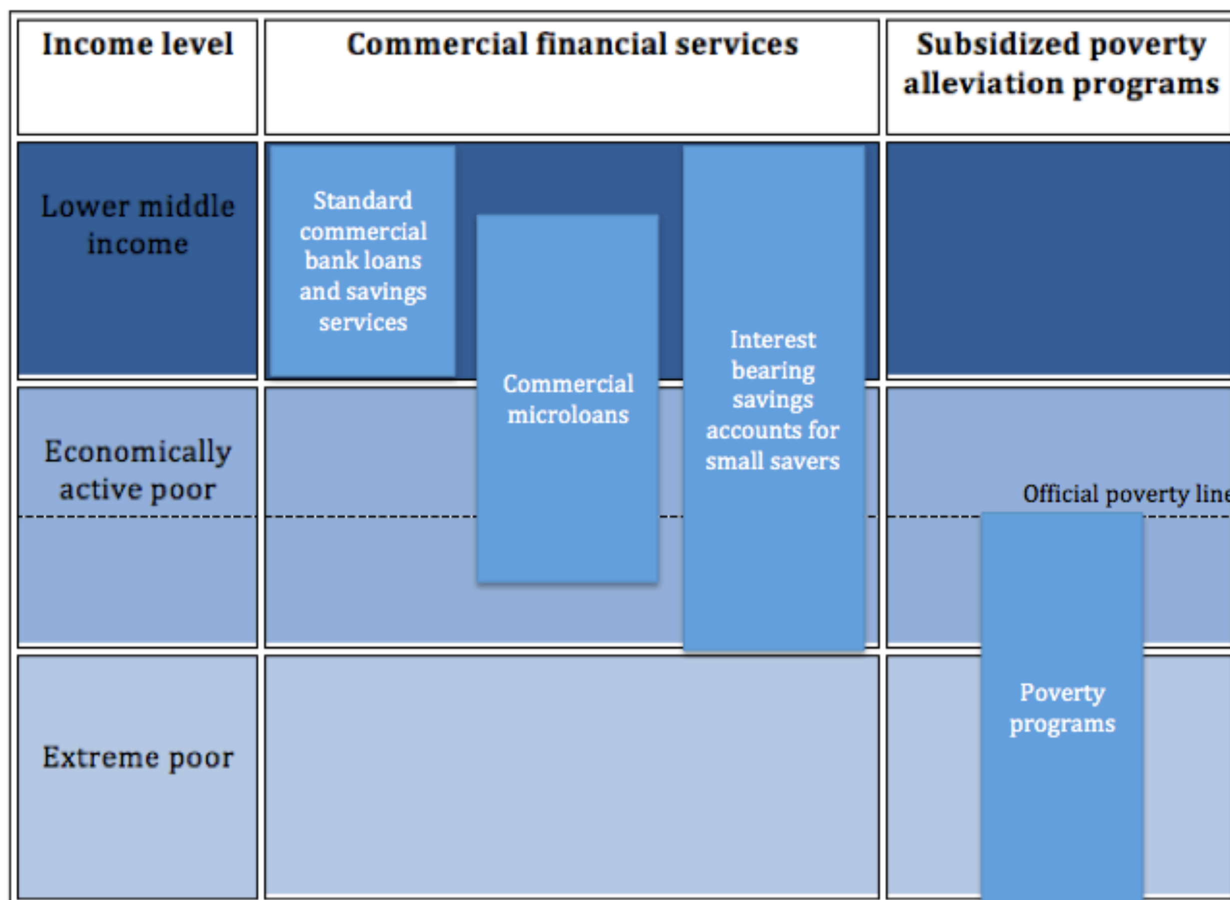

Figure 1: Robinson's (2001, p. 21) poverty alleviation toolbox, showing which tool is should be used for which income level.

However, there are also still some who argue that microfinance is a way to help the extreme poor. There are still many NGOs that provide microloans in combination with basic assistance. Also, research has not found an inverse relationship between someone's level of poverty and their entrepreneurial ability. Some literature investigated which employment groups can use microfinance. This research found that clients who manage existing microenterprises or clients who are employed are not the only group that can gain from microfinance (Murdoch & Haley, 2002).

Aside from the division between the economically active and extreme poor there are some other distinctions that are important to consider when talking about outreach. Some clients have used

microfinance before, or may even already have a loan; as opposed to others who may not even know about its existence. When a MFI reaches a new client, this does not necessarily have to mean the client is new to the sector. Two MFIs lending to the same clients will not increase the outreach of the sector. Also, clients that have used microfinance before know where and how to get it when they need it, as opposed to new clients, who might need it but lack access to it. Because this research focuses on outreach in the sense of providing access to new clients, one needs to basically deduct the non-virgin new clients from the growth in outreach. Therefore, MFI staff was asked about whether they serve virgin clients and what they think the amount of virgin clients in the market is.

There is also another division to be made in the potential client group. Many MFIs generally consider everyone at a certain income level that has not been reached a potential target. However, it is important to know if these people actually want or need microfinance. In this research several participants mentioned that many people do not want micro-credit because of the risks involved or due to an unfavourable image they have of loan collection practises. Clients that do not want credit should not be seen as a potential target for microfinance.

Figure 2 shows these divisions and who should be the target group of microfinance. All virgin clients that want microcredit should be the target group, considering the sector as a whole. While a single MFI might target the clients of other organizations, for the sector as a whole this does not increase outreach, thus it should not be the goal. Whether the marked part under the economically active line should be part of the target group is being debated.

During the interviews, participants were asked for their views on who should be the target group of microfinance and about these distinctions in order to practically overcome these multiple literature definitions. Moreover, their view of the current outreach was compared to their view of the total potential outreach to get a relative image of the market saturation.

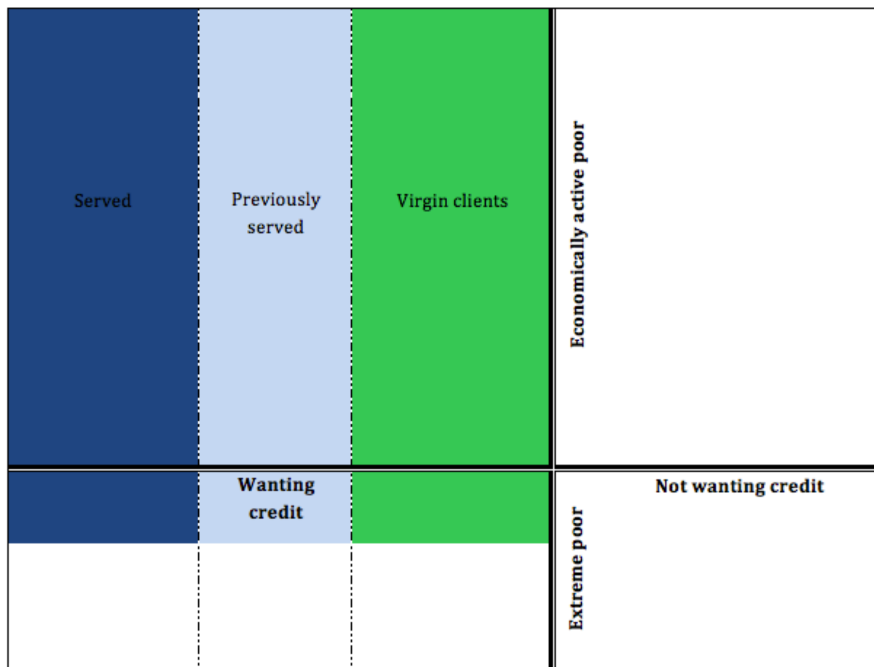

Figure 2: The division of microfinance clients according to who should be the target group. Blue parts are clients that have access already; green parts should be the target group for the sector as a whole.

2.5 Factors influencing outreach

As mentioned before, many MFIs try to increase their organization's outreach. There has been quite some research discussing factors that might influence this outreach especially when focussing on depth, or the extent to which the poor are reached. However, the research on the consequences of this outreach is limited to non-existent. In this chapter the factors that cause a certain outreach known in literature are discussed.

2.5.1 Financial structure of the MFI

A widely discussed topic in literature is whether financially self-sustainable (for-profit) MFIs still reach the poor. Some argue that for profit MFIs face a trade-off between these two goals. It seems even that microfinance is divided in two camps; the financial self-sustainable focussed MFIs and the social impact focussed MFIs.

This debate is related to the previously mentioned discussion on the target group of microfinance: only the economically active poor, or all the poor? The general assumption is that to be financially sustainable MFIs need to serve a larger part of the non-poor or marginally poor.

Navajas et al. (2000) noticed that the limited research on the topic suggests that MFIs that are financially sustainable tend to serve customers just above or just below the poverty line. Serving the poorest clients causes higher costs and lower returns per unit. This makes it harder to increase outreach and motivates several MFIs to move up market. This phenomenon of moving away from the extreme poor clientele, the initial target group of microfinance, is called mission drift (Woller, 2007).

The portrayed trade-off between social performance and financial gain is quite complex and evidence exists that the relationship is not always negative and in some cases even positive. Several studies found that MFIs targeting the poorest of the poor have comparable financial performance to those that do not aim to reach the poorest (Khandker, 1998; Gibbons & Meehan, 2000; Churchill, 2000). Additionally, Woller (2007) finds that for-profit banks do not structurally financially outperform non-profits. The comparable financial performance of for-profit and non-profit MFIs shows that mission drift stems from a choice of the MFI, more than from a financial need created by market pressures.

Woller (2007) also notes that due to the introduction of investors that do not have affiliation with the original mission of microfinance, pressure on MFIs to increase financial performance increases. It is important to consider the influence of investors in this respect, as probably their aim is financial gain above social impact. Therefore, their influence may add to mission drift.

The two sides of the financial vs. social performance trade-off correspond to the poverty approach and the self-sustainability approach on which Schreiner (2002) based his framework for outreach. There is a clear dichotomy in microfinance practice as well as in literature. One group assumes that to reach the

poorest of the poor, MFIs need to be non-profit, where a substantial part of the income is based on funding. In this way the increased cost of reaching the poorest are covered. The other camp sees self-sustainable for-profit MFIs as a solution. They reason that large and financially independent MFIs will take on a big amount of very poor customers automatically, since they have a bigger net of clients overall. In this way they can serve the same quantity of very poor people as smaller MFIs targeting the poorest solely (Woller, 2007).

Some also argue that MFIs do not have to reach the poorest at all, since to alleviate poverty the whole society needs to change. In order for this change to take place, first a strong middle class has to rise, which will take part in politics and change social structures substantially (Moyo, 2009).

2.5.2 Marketing to the poor

Only MFIs that specifically target the poorest and design their products to fit the needs of the poorest actually reach them (Morduch & Haley, 2002). If services are not specifically targeted to the poor, the poor will exclude themselves. This potential group does not think the program is for them and therefore makes assumptions such as that they do not have the correct clothes to apply for a loan (Navajas et al., 2000; Morduch & Haley, 2002). MFIs need to adjust their communication and presentation to appeal to the poorest.

To make sure the poorest get access to finance some MFIs started graduation programs. These programs help the poorest improve their conditions to a level where microfinance accepts them as clients. A common example is the Challenging the Frontiers of Poverty Reduction-Targeting the Ultra Poor (CFPR-TUP) program that was initiated by BRAC, a development organization in Bangladesh (Banerjee, Duflo, Chattopadhyay & Shapiro, 2010). This program aims at the poorest in the region and provides these households with direct asset transfers, supplementary feeding, livelihood training, and social awareness and welfare activities (Das & Misha, 2010). Eventually the participants will use microfinance to improve their situation even more. The BRAC program was subject to several non-experimental studies that generally found a positive influence on household consumption and assets (Banerjee et al., 2010). Banerjee, Duflo, Chattopadhyay, and Shapiro (2010) conducted a randomized evaluation of a similar program in West Bengal, India. Bandhan's Targeting the Hard-core Poor (THP) program increased the per capita monthly consumption by over 25% for participating households.

Important to note here is that these programs are specifically targeted at the very poorest and include new tools such as asset transfers. This is a clear not-for-profit approach, which has high costs. Still, both for-profit and non-profit MFIs can learn from their practices.

2.5.3 Conditions of the contracts

Conditions of contracts for microcredit vary widely nowadays. Our intuition would say that, all else constant, better contract conditions should attract more borrowers. But it is not that simple. The standard credit product is a yearly loan with weekly instalments of equal size (Banerjee & Duflo, 2010). Interest rates vary per country and even within countries. This is due to the adverse selection and moral hazard problems that microfinance tries to mitigate. Additionally, some MFIs use different models, as previously discussed. These and other contract terms are decisions of the MFI that can influence their attractiveness to the very poor.

Banerjee and Duflo (2010) discuss whether high interest rates discourage poor clients from borrowing from MFIs. High interest rates are often defined by benchmarking with the normal interest rates that traditional banks charge. The authors give the example of India, where generally banks sustain an interest rate of 20% or less. In slums only 6% of inhabitants had a loan agreement with a registered bank but 68% had loans from informal sources. The average interest rate that inhabitants paid was around 57%. It seems that high interest rate borrowing is something the poor do on a regular basis. Taking three case studies in Sri Lanka, Mexico, and India into account, Banerjee and Duflo conclude that the high interest rates cannot be the only reason why the poor do not borrow from MFIs. Microfinance businesses in all three countries had higher marginal returns to capital than the interest rates that financial institutions in the specific countries charged, and the entrepreneurs managing these businesses would have liked to borrow more if they were offered the chance. Which shows a need and the ability to pay. Conclusion is that high interest rates do not have to be the problem. (Banerjee & Duflo, 2010)

Some MFIs have eliminated the formal liability for the loans of other group members, as seen in the individual based group lending model. But also some microfinance institutions started to provide individual based lending. The group-lending models seem to be the most appealing to the poorest. Navajas et al. (2000) for instance, found that Bolivian MFIs using group lending reached the poorest of the poor better than their competitors that used individual based lending. However, this might not be the way to reach high breadth.

2.5.4 Perception of financial institutions of the target group

Fear of financial institutions causes clients not to join microfinance institutions and hence limit the outreach of microfinance. Dupas and Robinson (2011) conducted a case study in rural Kenya and noticed that since the bank they worked with had only recently entered the area and was not very known, clients did not open bank accounts with them. Familiar with and trust in the financial institution seems to influence the number of potential clients. Bruton et al. (2011) also describe that many borrowers have a negative image of the loan institute in their research. Some are under the impression that their house will be taken and their land confiscated in case of default, even though this is not the

case. Some borrowers cover up each other's default on purpose without informing the loan officer, because they are afraid of the consequences if someone in the group defaults. This fear shown by borrowers is likely to reflect on potential new clients. It also could be an indication of the view of the financial sector as a whole.

2.5.5 Social environment of the client

Strong kinship ties and limited resources influence business and the decision to join an MFI. Both factors can cause a lower outreach.

Khavul, Bruton, and Wood (2009) show that East African entrepreneurs use their strong family ties and community ties to start and grow their businesses. Compared with other parts of the world, East African micro-entrepreneurs can access fewer immediate resources and therefore need to rely more on their social network to enable their business to flourish. When undertaking a risky economic activity, such as starting a business, micro-entrepreneurs count on their extended family for support and resources. In Kenya, families often consist of more and different configurations than the traditional husband, wife, and children. Households often already include extended family and wards, and a family often encompasses several households. On the other hand entrepreneurs need to take measures to counter-balance the obligations that strong extended family ties carry. Grown ups are expected to take care of the family once they start making money. This often results in claims to the revenues of the business (ibid). As this influences the success of the business it is likely to result in lower repayment rates, which consequently lowers outreach as limited resources are used to achieve a certain outreach.

In terms of outreach, the strong family ties might influence the decision of the potential borrower to get a loan or not. Due to the strong community and family ties, taking on a loan also puts a burden on your loved ones, which might cause higher risk aversion towards credit.

2.6 Research frame provided by literature

Based on the discussed literature the basic frame for this research has been set.

This research necessitates a clear definition of outreach. Outreach is defined as *the social value of the output of all microfinance organizations in the sector.* This definition is altered from the definition provided by Navajas, Schreiner, Meyer, and Gonzalez-Vega (2000). Outreach has two dimensions: depth and breadth. Depth is defined as "*how far down in the income distribution do the [MFIs] reach"*? (Meyer, Nagarajan and Dunn, 2000, p. 1). Loan size can be seen as an incomplete proxy of depth (Schreiner, 2002; Meyer et al., 2000). Therefore, this proxy will only be used as a control to the qualitative indicators for depth. Breadth is defined as *the number of clients that is reached* (Schreiner, 2002; Brau & Woller, 2004). This leaves us with a two dimensional frame for outreach, showing both the level of poverty of clients as well as the number of beneficiaries.

To consider depth it is important to define poverty. Poverty will be defined by the one-dollar-a-day poverty line as suggested by the World Bank (1990). Which additionally defines the extreme poor as earning less than 75 cents per day.

To determine the extent of outreach we not only need to define outreach itself but also the potential outreach in total. Providing a relative image between these two enables us to overcome the debate concerning the target group of microfinance. Each participant will have a different view on the potential as well as the current outreach of the microfinance sector, however the two are related. If a participant for instance does not think the extreme poor are a target group, then he might mark the same extent of outreach as high, while another participant that does see the extreme poor as a target group will mark this outreach as medium or low. Therefore, one is only relevant in relation to the other.

Several divisions need to be taken into account when discussing the potential of outreach. First of all the previously mentioned distinction between the poor and the extreme poor, where people have different assumptions on what circumstances are connected to these terms. Second, it needs to be considered whether only the economic active poor (Robinson, 2001) are part of the target group or also unemployed people can be target for microfinance. Then it is important to consider that only people that want microfinance should be targeted. Last but not least, the group of non-virgin new clients need to be discussed to be able to deduct them from the target group, since they do not increase the outreach of the sector as a whole, only the outreach of one MFI. Figure 2 provides a visualization of the distinctions to take into account.

This research is focussing on the consequences of outreach, as there is a lack of knowledge on this point. However there are several studies that give hints about what causes a certain extent of outreach as has been discussed in the last chapter. In Figure 3 the gap in literature that this thesis aims to

decrease has been visualized. Potentially there are more factors that influence outreach, which is why there is also a question mark in the bottom left corner. However, to my knowledge no research has been conducted on the consequences of increased outreach, while many markets around the world seem to be growing substantially in this regards.

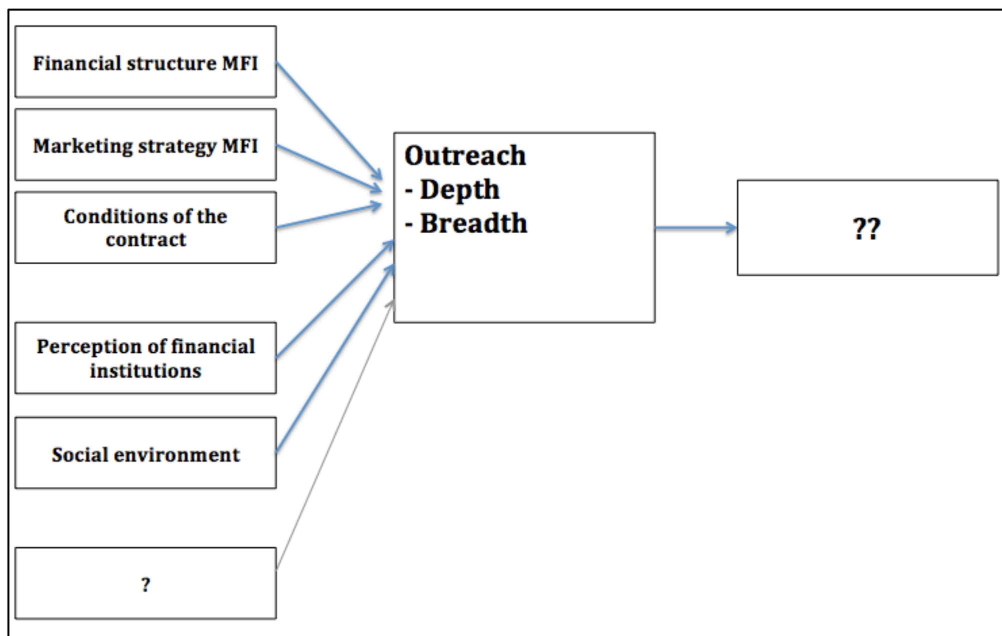

Figure 3: Visualization of the gap in literature regarding outreach.

3. Methodology

A multi-case study of the Nairobi microfinance sector was used to answer the research questions. The main level of analysis is the microfinance sector as whole. However, interviews with the staff and client of four MFIs in Nairobi were used to assess the situation in the sector. Aside from discussing the outreach and development of trends for each MFI, more importantly, participants were asked about the outreach, trends and developments of the microfinance sector as a whole. This chapter first discusses step by step the methodology of this research (section 3.1) and then introduces the MFIs to which the interviewees were connected either as staff or as a client (section 3.2).

3.1 Research methodology

Method selection

To address the research questions, an explorative multi-case study was conducted. Case study methods are especially useful in building new theory, where existing empirical proof is lacking (Eisenhardt, 1989). Since this research aims to contribute to filling the theoretical gap that exists in microfinance literature regarding the consequences of expanding outreach, a multiple case study will be used as the basis to hypothesize theory in this topic area. Case studies have the ability to generate theory and describe relations, which makes them more useful for this type of research than for instance a survey or experiment (Chetty, 1996). In selecting a research strategy to contribute to the existing literature, the type of research question, the extent of control over the researched events, and the time focus of the research need to be taken into account (Yin, 2003). Since this research aims to investigate how several socially constructed phenomena are related in a non-controlled environment with a focus on current events, a case study strategy is most valuable. Case study methods are also able to capture the dynamic complexity of social phenomena and show more in-depth backgrounds than other methods available (ibid). This is crucial since this study aims to look at propulsive market dynamics that are highly influenced by the social pressures created by income inequality. Therefore, a combination of well-selected case studies can create the profound understanding needed.

In an ideal situation, large-scale quantitative research would provide definitive answers on the extent of outreach in the microfinance market in Nairobi. However, since the funds and means for such an endeavour are rarely found, mainly qualitative measures capture the state of outreach in this study. Currently, only dated and incomplete statistics are available about outreach in this market. In this study the limited statistics available will be used to triangulate the findings from participant interviews. This does mean that the outcomes are mainly based on the perceptions of participants in or connected to the four participating organizations.

Case selection

As microfinance literature clearly focuses on the development of higher outreach and not so much on what happens in a market with higher outreach, a market that showed signs of being more developed was chosen to conduct the research in. The aim of this choice was to study the effects of outreach in a market where microfinance is in a more mature state. Within East Africa, Kenya poses as maybe the most developed market. The higher extent of financial access for its population as opposed to other countries in the region as measured in the FinScope surveys between 2004 and 2008 (FinScope, 2009; FinScope, 2009a), indicates this too. Though these statistics are dated and based on country surveys of more than one time period, they show that compared to other countries in East Africa, the use of formal or informal financial services in Kenya was already quite widespread in 2006.

Because the urban setting seems to enable MFIs to reach the clients easier, as opposed to the rural areas, this research was conducted within the setting of the urban microfinance sector of Nairobi. Nairobi houses a high number of microfinance institutions and a very high number of poor people who mainly live in the slums. Of the urban population of Kenya, 33.7% lives beneath the national poverty line (World Bank, 2012). The roughly two million people who live in the slums of Nairobi (Amnesty International, 2009) are almost certainly part of this percentage. As with any case study, the generalizability of the findings will be limited since situational factors in a specific area can always influence the results. However, several characteristics of Kenya are typical for East-Africa. In most of East-Africa the tribal culture is still very apparent even in urban environments, where people with different tribal backgrounds live together. Also, on the cultural dimensions of Hofstede (2012), the country has quite similar values to other East-African countries and does not appear to be an outlier.

To capture the state of the microfinance sector in Nairobi, four organizations were selected to participate. This enables a multi-case study design, allowing the findings from each case study to be confirmed or contradicted by the other cases (Bourgeois & Eisenhardt, 1988), as well as providing different views on the main analysis level: the microfinance market. In the selection of these cases, the intention was to create a sample with varying characteristics regarding the age of the organizations, the target group of the organizations, the use of technology, the possession of a banking licence, size represented by the number of borrowers, average loan size, and international or local origin of the organizations. These characteristics were discussed with two professionals active in the Kenyan microfinance market to establish what a representative sample would be.

Level of analysis

The primary unit of analysis is the current Nairobi microfinance market, because an assessment of the developments in this market will enable us to answer questions about the state of outreach and its developments on a wider level than most recent case studies in African microfinance did. Because of the

viability of the research, it is not possible to interview everyone involved on sector level. Therefore I asked the interviewees connected to the four selected MFIs about their views of the sector as a whole. To provide a different perspective two experts were interviewed. Each interviewee was asked in detail about the specific MFI they were involved with, which was used as example cases and to provide more depth to their statements on the market level. This data often provided great examples of concepts and relations that were apparent sector wide. The varied selection of MFIs combined with the expert knowledge collected provided a clear image of perception of the outreach and the trends related to outreach for the whole microfinance sector in Nairobi.

Data collection

The data include two orientation interviews with experts experienced with the Nairobi microfinance market - to form an initial image of the market and strengthen initial conceptual frameworks - and 20 semi-structured interviews with staff of the focal organizations and their clients over the period June – July, 2012. Selection of the staff for each organization was based on a spread across hierarchical levels. In each organization one senior management member, middle management member, and several loan officers were interviewed. Additionally, interviews and focus groups with clients were conducted. Unfortunately, the client interviews could not be conducted with one organization due to safety issues at the time the research took place.

The interviews varied widely in length due to situational factors and the opportunities provided. In general, on the higher hierarchical levels all interviews lasted between 45 and 90 minutes. Client interviews, on the other hand, were often rather short (10 min -35 min) due to certain circumstances, (most interviews were conducted at client's businesses during business hours), as well as to the limited added value of longer client interviews for this research; client aptitude limited the depth to which they could respond to certain questions or subjects of this study. To compensate for the limited insights from clients, two focus groups were conducted within microfinance borrower groups to get the views of more participants. Interviews were mostly conducted in the participant's working environment, or on the location where the regular group meetings of the MFIs took place.

Initially interview questions were based on previous knowledge of literature, but also were adjusted as participants described certain trends. Regarding outreach questions were mainly based on literature, while for the market trends the questions were more exploratory in nature. Generally more open questions were asked to discover the salient development is the market. The interviews generally first discussed the participants' previous experience, to establish their knowledge about the sector. After which the outreach and development for their own MFI was discussed. Last but not least they were asked about outreach in the market followed by questions about trends and developments. For each type of interviewee a separate interview structure was made; for top-management, middle

management, loan officers, single clients and focus groups. Interview structures were adjusted based on the tasks of the participant, relevance of the questions and understanding of certain concepts, also client interviews were shorter because of limited time usually available with them. Annex 2 provides the two interview structures that were leading for the development of the other structures; the interviews for MFI management and the interviews for clients.

The vast majority of interviews were recorded and transcribed, while for the remaining interviews and for the focus groups notes were taken. Notes during branch visits were also taken. When needed, follow-up phone calls or e-mails were used for clarification. This resulted in 168 pages of notes and transcriptions as found in Annex 4 (not included in the public version of this thesis due to participant privacy).

Mitigating biases

As should be the case in all research the most common biases were considered and as much as possible measures were taken to mitigate them. However, this study had specific circumstances, which made less common biases rise.

By choosing a qualitative research method, the perceptions of participants are captured in this cultural setting. Often in development research, the difference in perception between the (foreign) researcher and the local community is overlooked (Desai & Potter, 2006). By encompassing the perceptions of both the employees involved as well as clients, this bias is mitigated to a reasonable extent.

Allowing participants to speak freely is a prerequisite for clear interview data. Because there were hierarchical differences between participants, both within the MFI as well as between the loan officers and clients, having another participant near or present to the interview situation might influence results. During the research, I was invited by the MFIs to come to their offices. This environment was not always optimal. Within the MFIs I always requested to speak to the interviewee alone, which was never a problem. However, when visiting clients, often the loan officer had to take me to see them. Both due to safety issues and due to the relationship loan officers have with their clients, it was not always possible to speak to the client(s) alone in a quiet environment. I requested that the loan officers would introduce me and also explain that the content of the conversation was not used for the MFI itself, emphasising that the clients could speak freely. Also, I would create as much physical distance as possible. In most cases this resulted in clients feeling free to convey their answer, as their answers often also included sensitive answers with regard to the MFI.

Data analysis

The data analysis and interpretation process was three-fold. First, the concepts of outreach based on literature were used to analyse the data regarding the first sub-question of the research. Then, the data

regarding market trends and developments was analysed. After which relations among these trends and between these trends and outreach were analysed.

To analyse the outreach data, concepts were operationalized based on literature. In the interview data the fragments that related to depth, breadth and growth potential were coded. Also, a colour code was assigned for outreach related fragments that did not clearly fit into any of these categories. This was followed by the analytical procedure, explained hereafter.

Second, the analysis of the market developments was guided by sensitizing concepts as described by Bowen (2006), which are interpretive devices used as a starting point for inductive data analysis (ibid). The sensitizing concepts emerged during initial data analysis due to seeming salience and reoccurrence across participants and organizations. Operationalization of the sensitizing concepts was constructed based both on participants' explanations as well as literature where possible. Thus, first all data was re-read to get an initial picture of possible concepts, then literature was consulted on the existence of these concepts. Often, the concept was non-existent in literature, which lead to a definition of the concept based on explanations of participants. A second round of the same analytical procedure followed.

The analytical procedure for both the outreach data and the market trends data was similar. The researcher used the same analytical strategy, based on an explanation building approach per case followed by cross-case analysis (Yin, 2003). An initial theoretical statement was formulated based on the image the researcher held after conducting all interviews, the two orientation interviews, and literature where applicable. Then, relevant passages of the data were related to the concepts (Seidman, 2006) by colour codes, of which an example can be found in Annex 3. For the first case, the coded parts were subsequently compared to the initial theoretical formulation. The formulation was changed based on the observations from the case, after which the same process took place for the second, third, and fourth case. In the later stages of this process some of the concepts were combined or eliminated if the value seemed insufficient. Then the relevant passages for each concept, sensitized or literature-based, were examined for cross-case patterns.

Cross-case patterns were investigated by looking for within group similarities linked to intergroup differences as described by Eisenhardt (1989). In this way, differences and similarities for each concept within and between the cases could be identified and checked with the data to see which were salient.

This resulted in a joint image of the extent of outreach of microfinance and the trends and developments in the market. Another round of coding took place where all fragments that described a relation were gathered to make the relation between concepts. Fragments were sorted based on the relation it described. Because there was not always data for each case on each relation, the previous used procedure could not be applied. For each relation the amount of evidence was evaluated and

literature consulted to see if it provided additional support. The most salient trends were then selected and a model constructed based on those trends.

After identifying the main constructs and relations, a causal chain of evidence was constructed for each (Yin, 2003), which is supported by the relevant transcripts in Annex 4. During the process a continuous iterative consultation of the literature guarded the scientific value of the research. The subsequent new insights framed the further data analysis.

A danger of an explanation building approach, as mentioned by Yin (2003), is that the researcher may drift from the initial topic of interest. Although this study is explorative in nature, the initial research questions were reviewed often and a semi-structured interview protocol was used to guard the researcher from drifting substantially.

3.1 Selected MFIs

As described, the researcher selected four microfinance organizations that are active in Nairobi, to conduct the multi-case study. This section shortly introduces these MFIs, and presents data about their organization. In this way the reader can form an initial image of the common features and differences between the MFIs.

Nyati

Nyati was one of the first microfinance organizations in Kenya. It uses the group-based lending model to provide small loans to microfinance clients. It has a banking licence, and therefore also services more fortunate clients and offers a variety of products. The organization has 30+ branches across Kenya. The bank is locally grown and managed by Kenyans, though it receives funding from foreign commercial investors. (Nyati website; Interview data)

Ndege

Ndege is a big player in the Nairobi micro-finance market and one of the few, that targets the poorest of the poor; including people without any form of economic activity. It has a significant amount of clients who reside mostly in the slum areas. It uses a model where a few members guarantee each others' loans. The organization is mainly managed by staff recruited among its clients and is in possession of a banking licence. It has 50+ branches across Kenya. (Ndege website; Interview Data)

Pundamilia

Pundamilia is a relatively small organization that belongs to a bigger group of MFIs across East Africa. Pundamilia uses a group-based lending structure and currently has 10+ branches in Kenya. The organization is still partly foreign managed, and is a credit-only facility (Pundamilia website, 2012; Interview data).

Twiga

Twiga is a relatively young organization. It utilizes a group-based lending model. The headquarters are located in Europe and it has less than 10 branches in Kenya. The organization is still a credit-only facility. (Twinga website 2012; Interview data)

3.1.1. General statistics on the studied MFIs

Several statistics provided on MixMarket (2012d) were considered to get a general image of the functioning of the selected organizations. For Twiga, no statistics can be found on MixMarket, therefore the statistics were requested from the organization itself. These data can be found in Figure 4.

	Nyati	**Ndege**	**Pundamilia**	**Twiga**
Year				
Gross Loan Portfolio				
Number of active borrowers				
Average loan balance per borrower				
PAR >30 days				
ROA				
ROE				
Profit margin				
Established				
Source	MIXmarket	MIXmarket	MixMarket	Twiga

Figure 4: Data on the participating microfinance organizations.

Some considerable differences between the cases can be observed. We can clearly see the organizations differ in size regarding the number of borrowers and the loan portfolio. Ndege has the most clients but Nyati the biggest loan portfolio. Pundamilia and Twiga are both relatively small in terms of number of borrowers, however Pundamilia has a bigger loan portfolio. The number of active borrowers can be seen as a proxy for breadth, as more borrowers means a higher breadth of outreach, and the average loan balance per borrower as a proxy for depth, as this gives an indication of the income of clients. The lower the loan balance the deeper the outreach. These results will be discussed in the following chapters and compared to the interview data.

The Portfolio At Risk (PAR) is a commonly used number for microfinance organizations that represent the value of all loans outstanding, which currently have one or more unpaid instalments due for more than 30 days. This also includes loans that have been restructured (MixMarket, 2012c). Practically, this can quickly provide an image of an organization's loan recovery policy. What we observe in Table 4 is

that Nyati has troubles reclaiming their outstanding loans. In general a PAR of around 5% or lower is seen as acceptable. The other organizations are doing quite well in that respect. It must be noted nevertheless that the last data for Ndege on MIX Market are 4 years old. Since they stopped providing their figures since then, negative changes in this number are plausible. Return on Assets (ROA), Return on Equity (ROE), and the profit margin provide us with an image of the profitability of the organization. We clearly can see that Ndege is less profitable than the other organizations, which might have to do with their focus on helping those in need more than on profits, which also became clear in the interviews. For Twiga these numbers could not be retrieved, however since it concerns a start-up it is unlikely to be profitable after this short period of operations.

4. Empirical findings

This chapter presents the empirical findings regarding all research questions. In section 4.1 the perception of participants regarding outreach of microfinance in Nairobi will be pictured. This case study data provides an initial answer to the first sub-question, regarding the effects of a more mature market on outreach. The market in Nairobi is perceived to have a high outreach regarding depth and breadth compared to other markets in East-Africa. But most participants still see substantial potential growth. The view of the size of the potential market differed between participants. We can conclude that at least in the case of Nairobi, the maturation of the market goes with growth in outreach, both regarding depth and breadth.

In section 4.2 the salient trends in the microfinance sector in Nairobi that surfaced in participant interviews are discussed. This provides an initial answer to the second sub-question by describing what trends and developments can be observed in more mature microfinance markets. Salient trends in participants' interviews were increased competition, credit diversion, increased multi-borrowing and increased over-indebtedness. For each trend this section discusses how the trend is noticed and how it functions.

In section 4.3 these perceived market trends are related to outreach and the relations between the trends, as viewed by participants, are discussed. The data is presented on which propositions are built. These are then used to provide an answer to the main research question; *what consequences of increasing outreach are noticed within the microfinance sector in developing countries?* As this research is a case study only an initial answer can be given, which is presented in the form of a proposed model, showing the found market developments and how some of these are consequences of a growing outreach.

Throughout the empirical findings chapter parts of literature will appear. Because the study is explorative in nature, an iterative process between data analysis and literature took place. This literature added to the formulation of the propositions. To provide a full picture of the basis of the propositions, relevant parts of literature will be presented together with the findings.

4.1 The outreach of the Nairobi microfinance sector

This chapter presents data regarding the outreach of the Nairobi microfinance sector, mainly based on the interviews. Existing statistics are compared to the interview data to create a more complete image. In literature outreach has two dimension, depth and breadth. Here these two components will be first discussed separately. The chapter will describe perceptions of depth (section 4.1.1) and breadth (section 4.1.2) and their potential for further growth. During interviews it became apparent that the question whether start-ups should be funded by microfinance is closely related to the potential outreach. If start-ups are seen as a potential market, this enlarges the total potential market. This relates to the debate whether only the economically active poor should be the target group of microfinance. Therefore, start-ups are discussed in section 4.1.3. All this information combined leads to conclusions on the influence of market maturation on outreach (section 4.1.3) answering the first sub-question: *How has the maturation of the microfinance sector in developing countries influenced outreach?*

4.1.1 Depth of outreach

Depth of outreach defined as *"how far down in the income distribution do the MFOs reach*"? (Meyer, Nagarajan and Dunn, 2000, p. 1) is not easily measured. Therefore, in this section an assessment of the outreach of the microfinance sector is made based on interview data and the limited statistics available.

The selected MFIs clearly differ on their depth of outreach, as can be understood from the interview data and provided statistics. Where Nyati and Pundamilia reach mostly the higher levels of the poor, Ndege reaches the lower levels and Twiga operates somewhere in between. Looking at the outreach of these organizations provides an initial view on the sector, Also it puts the comments of participants in perspective. If a participant works for an organization with a very high depth he will probably have a different view of the depth of other organizations than in case he works for an organization that has a very low depth.

Over all, within all organizations the image exists that there is still potential growth in the depth of outreach for the sector as a whole. However, the extent differs since participants varied in their perception of the target group for microfinance. The depth of outreach in the sector was generally not seen as very high. The proof for these findings is discussed in the next paragraphs.

Depth of outreach of the four MFIs

The organizations differ clearly on their depth of outreach when considering the interview data. Where Nyati and Pundamilia reach mostly the higher levels of the poor, Ndege reaches the lower levels and Twiga is somewhere in between. The proof for these findings is twofold. There is statistical data but more importantly the interview data show these differences. In Figure 5 a summary of the findings regarding the depth of outreach of the MFIs is given.

	Nyati	Ndege	Pundamilia	Twiga
<u>Statistics</u>				
Av. Loan balance per borrower	███	███	███	███
<u>Perception of own organization</u>				
Poorest in portfolio	Yes*	Yes*	Yes*	Yes*
Substantial part of portfolio is poorest	No	Yes	No	No

Figure 5: Overview of findings regarding depth of outreach of the four MFIs. Sources: MIX Market, Twiga, interview data.

* The definition of the poorest differed across organizations. Therefore, in this table the poorest only in the case of Ndege includes the economically inactive poor.

Looking at the available statistics, it is interesting to see that there is a substantial difference in average loan balance per borrower for the organizations (see Figure 5). This number is often used as a proxy for depth (Schreiner, 2002; Meyer, Nagarajan & Dunn, 2000). What makes this proxy less accurate is that the size of instalments, term to maturity, and the time frame between instalments should be taken into account (Schreiner, 2002). This is not possible based on the data available. However, it does show us broadly the differences between the selected MFIs. According to these statistics, Nyati has the least depth, followed by Pundamilia, Twinga and Ndege on the other end of the spectrum. Interestingly, notwithstanding similar size and methodology (see Figure 4), Twiga and Pundamilia differ still quite a lot in the average loan balance per borrower. This suggests a higher depth for Twiga.

The interview data show similar results. The general perception within Ndege is that the organization reaches the extreme poor. Taking all interviews into account, Ndege seems to be the only organization that does not experience extreme competition for clients, probably due to their focus on the extreme poor. *"80% of the membership of Ndege are from the slums in Nairobi. It is the poorest of the poor."* A higher level manager argued. Participants from this organization did mention that there is a gap between the income group Ndege reaches and the income groups on which the competition focuses. "*Usually we deal with the poor people. And uh.. other microfinances deal with rich people."* Ndege focuses more on the poorest but also has a negative profit margin (see Figures 4 and 5). This is in line with literature which shows that financially sustainable MFIs tend to reach less deep down the income ladder (Navajas et al, 2000; Woller, 2007) as discussed in the literature review.
Also from the outside it seems that people perceive that Ndege is reaching the extreme poor, yet also critique is heard about their profit model, which is not strange, considering the data in Figure 4. A management level employee of another MFI told me: *"there was an institution called Ndege who tried to sort of serve the poorest of the poor and you didn't have to be in business [..] for 2 or 3 years everyone was..*

they were the darlings of the microfinance world, but now the reality has caught up with them [..] They recruited masses of customers but uh.. The last accounts that I saw they had a 70% default rate." This confirms the comments from my visit notes. They appeared to be very nice people, wanting to help others climb the financial ladder, which to them is more important than profit. The loan officers were not able to explain to me how their profit model functions, however they could elaborate very well on how to support members in a non threatening way so that they actually improve their situation. Comparing all this information with the average loan balance per borrower, we can assume that Ndege does serve the extreme poor.

The interviewees within Nyati seemed to disagree on the level of poverty they serve. On management level, both interviewees noted that there is no reason why the poorest of the economically active would not be reached. One of them estimated that the average earnings of their microfinance clients is around Ksh 333 a day. This is far above the one-dollar-a-day poverty line of 85 shilling. The loan officers of the organizations contradicted each other regarding their image of the poverty of the clients they serve. One argued "*The people we are serving live on like a dollar a day, a hundred shillings*". His colleague on the other hand answered the question about how poor her clients are with: "*They are not poor. [..] most of them are well off."* She estimated her clients' income between 300 and 10 000 shillings a day. Comparing this with the average loan balance of Nyati clients in Figure 5, we can conclude that on average the organization does not serve the lower levels of the poor, but considering the interviewees input, it does serve some very poor people on an irregular basis.

The staff of Pundamilia seemed to agree to not be not dealing with the extreme poor. A management level employee pictured it like this: *"we are not interested in trying to do something if you don't have a business. So we are probably not dealing with the poorest of the poor, we are dealing with people who are trying to do something. [..] Sadly, there are lot of people with even worse situations with their clients. So I wouldn't say we are dealing with the poorest of the poor. But we are certainly dealing with some very poor people."* However one of the loan officers answered the question whether microfinance can help the poorest with: *"Yes, because to me there is no poor man. Even with small businesses we've boosted them."* This does however incline economic activity, which shows Pundamilia only helps the economic active poor. During the interview with Pundamilia's management it became clear that in reaching the poor it is also important what one's perception is of what the depth of outreach of microfinance should be. The interviewee said *"The poorest of the poor, I don't think they are microfinance clients to be frank [..] for people who are not wanting to work or don't believe they can work, it is not microfinance's role to help those people or to assist those people."* One of the loan officers estimated that the range of annual income of her clients lies between KSh 10 000 and millions, which would be around 335 shillings a day. Combining all this with the average loan balance as pictured in Figure 5, we can assume Pundamilia

does not serve the lowest levels of the poor, but instead serves clients who are at least economically active.

Within Twiga there was a clear shared vision that microfinance should reach the poorest. But the staff also clearly saw the challenges that this brings. One of the loan officers answered the question whether they serve very poor clients: *"Yes, we have, but not many. And what we encourage is at least let's say 60% of the group are people that are well up. And well up are not all slum dwellers, but they are people at least with some formal businesses or their spouses are in some white-collar jobs. And then now they have friends who they know are good. They could be residing in such slums but they could invite them to these groups. At least to know there is a guarantor who knows such a person quite well. But when we get a whole group just from the slum it tends to become risky."* The loan officer explained that serving the poorest, who live in slums is very difficult, people move easily and many hazards make it difficult for them to be consistent in payments. Twiga only serves clients who have an existing business. A middle management employee explained to me that breadth of outreach for the lower income is closely related to the ability to pay in the market. You cannot target people who are not able to make instalments and save. She estimated that the lower band of the current clients makes around 333-500 shillings a day. One of the loan officers estimated that 60% of his clients earn between 430 and 1400 shillings a day. However, the average loan balance per borrower as shown in Figure 5 is quite low for Twiga. Therefore, though the staff does not regard most of their clients as the very poor, they do serve lower income levels than some of their peers.

This combined proof shows that where Nyati and Pundamilia reach mostly the higher levels of the poor, Ndege reaches the lower levels and Twiga serves a group in between.

Depth of outreach for the microfinance sector as a whole

The general view on the market across organizations is that there is a lot of focus on the economically active poor and even the higher income layers in this group. In general, within all organizations the image existed that there is still potential growth in the depth of outreach for the sector as a whole. However, the extent of growth differs due to differences in the perception of the target group for microfinance. The depth of outreach in the sector was generally not seen as very high, but views differed among participants, as many perceived the extreme poor as commonly unreached. Figure 6 shows the average view per organization.

	Nyati	**Ndege**	**Pundamilia**	**Twiga**
Perception of sector				
Current depth	Low	Low	Medium	Medium/high
Potential growth in depth	High	High	Contradicting views in organization	Medium, need to focus on specific segments

Figure 6: Overview of findings regarding depth of outreach of the sector.

Several participants mentioned that the poor population seems to grow. A management level employee of Nyati for instance noted: *"As the population grows I think we have seen those poverty levels graduate. I think in the informal settlements or the slum areas, we have a lot of very unemployed people."* This includes many young people. He was of the opinion that the ability of people to save and borrow in the lower income level has decreased due to the increasing cost of living in Nairobi.

Several participants in the four organizations mentioned mission drift in the sector and more than one accused their own organization of it. A member of middle management at Nyati explained clearly how MFIs face a trade of between profitability and helping the poor: "*These microfinances today, most of them are just after the money, [..] so they will not target these ones [the lower income level]. For me with my values, I know that I don't mind targeting those ones but now I also have to be sure about my targets."* A Twiga loan officer also said about microfinance serving the poorest*: "That is the purpose of microfinance! That is why it is called micro. But sometime we are greedy with the profits."*

Almost all participants from within the MFIs felt that poorer people could be helped, and it is often due to risks involved that this does not happen. As a Nyati (middle) manager noted: *"There is still that person who needs 500 shillings, who is not yet reached, and I don't think she will ever be reached, because we are all now operating on the same policy."* The higher level manager I interviewed at Nyati gave me a high estimate of the unreached market: *"If you were to ask me among that low income group I would say something in the region of about 60, 70% still doesn't have access."* Others were usually a bit more positive about the number of reached poor, however general agreement was that there was a substantial untapped market. A (middle) manager said: *"To get the numbers we have to get down there and also spread."* And many of her colleagues held similar views.

The participants that compared the market in Nairobi to other microfinance markets agreed that it has reached quite far down the income ladder. A higher management member of Twiga explains me for instance: *"Kenya is further ahead and it may be one of the reasons why the [..] the bancarization ratio here is better than it is in Tanzania and Uganda and Rwanda."* There was a clear difference in the view of the organizations on who is part of the potential target group. Nyati, Twiga and Pundamilia only target the economically active poor, as opposed to Ndege who targets anyone. It looks like most organizations in

Nairobi target the same income group. As a higher level manager of Pundamilia described: *"I think we all tend to go after the same customers and we all have the same pressure of trying to be sustainable and profitable."* Still some participants in the first three organizations held the opinion that economically inactive people could be supported in starting a business.

Most clients think that microfinance can help the poorest people, however a substantial part put the restriction that they have to be in business. The question is whether this is due to their views or due to their knowledge of the requirements of their MFIs. I almost heard the words of the loan officer when one client explained to me: "*They want to expand your business. But if you are doing practically nothing, they cannot risk giving you money, to someone who is doing nothing. So there is still those very poor people who do not have access to microfinance."* There were also extreme outliers amongst clients in their views on the use of microfinance for the extreme poor. Some clients still saw unlimited potential in microfinance: "*Yes, it can [*help the poorest*], because if you don't have money and a microfinance gives you money. This money can help this poor man or poor person to get what he did not have."* However, another client said exactly the opposite: "*I don't think that people who have nothing should be given this money. Because they can misuse it and they don't have anything to pay."* The inherent bias here is that the clients of the organization with the deepest outreach were not included in this research.

Looking at the statistics, MixMarket (2012b) can only provide a very limited image regarding the whole sector. Not all microfinance organizations provide their data on the website, which makes it impossible to give an overview of the whole sector. The highest provided average loan balance is $7978 from Summar Credit and, more importantly, the lowest is $59 by an NGO called Ebony Foundation. In theory this would mean that Ebony foundation has the lowest outreach and the income of its clients should show the depth of the sector. Because of the lack of information on all MFIs on MixMarket, we don't know if there is an MFI with more depth of outreach. Additionally, we don't know what the time frame on these loans is. So it is impossible to say if this means they reach people that live on less than one dollar a day, nor is it possible to be sure of what income exactly their clients have. Therefore regarding depth of outreach we have to solely rely on the described interview data.

Sub-conclusion

The four MFIs differ in their depth of outreach. Especially Ndege seems to have a deeper outreach than the other organizations. This also shows in the views of Ndege participants on the depth of the market as a whole, as they all viewed a tremendous potential, and very low outreach. However, other questions showed that loan officers of this organization also did not have much contact with competitors and did not have a clear view of what was happening outside their extreme poor market niche. This illustrates that in general the image of the participants about the target market of microfinance influenced their view of the outreach in the market. In all organizations, participants saw substantial potential growth

towards more depth of outreach for the sector. The current depth of outreach for the sector was generally not seen as very high, yet views differed. But, when participants compared the depth of outreach in Nairobi to other developing markets or rural areas, they unanimously describe it as relatively high.

4.1.2 Breadth of outreach

Breadth of outreach is the number of clients that is served (Schreiner, 2002). In this research the whole market is the level of analysis. Wherefore, we are looking at the total number of clients served by all MFIs. Unfortunately these exact numbers are not available; therefore the breadth of outreach is assessed based on participants' perceptions compared to broader statistics. To consider whether the potential clients are economically active, 'virgin' clients and wanting to use microfinance, questions about these features of potential clients were included in the interviews. This information determines participants' views of the potential market. Additionally, within each MFI questions were asked about the development of the number of clients of the particular organization and the growth of this number, to determine organizational breadth of outreach. After this, participants' view on the market as a whole and its growth potential was discussed.

The MFIs differ in their breadth of outreach. Nyati has a high number of clients, which is stagnating. But Ndege has a slightly higher number of clients that still grows. Pundamilia and Twiga both have a smaller number of clients and continue to show substantial growth. This indicates that as these organizations have different products and focuses, their situation does not represent the market situation. Except for that is shows the variety of MFIs. Additionally, it influences the participants' views on the market as the organizations have different priorities regarding growth. In general results indicate that the perception of the extent of outreach regarding breadth is decidedly dependent on what is understood to be the target group. But overall, the breadth of outreach in Nairobi is perceived as relatively high; nevertheless, almost all participants still saw substantial potential growth. The proof for these findings will be discussed in the next paragraphs.

Breadth of outreach of the four MFIs

The breadth of outreach for each selected MFI was assessed. Nyati has a high number of clients, which is stagnating, while Ndege has a slightly higher number of members that still grows. Pundamilia and Twiga both have a smaller breadth, however it continues to show substantial growth. An overview of the described findings regarding breadth for each case can be found in Figure 7.

For each case study organization the breadth in absolute terms can be measured by the number of borrowers it serves, which is also shown in Figure 7. Based on the numbers, Ndege and Nyati have a substantial higher breadth of outreach than the other organizations.

Within Nyati, the growth in the number of clients it services has stagnated. Participants in this organization mainly attributed this to competition and technological change in the market. Within the organization it seemed to be understood that there is a great difference in the breadth of outreach between when Nyati started, in a fairly undeveloped market, and the current situation. The other three organizations still perceive their number of clients to be growing.

Only Ndege still does see a high amount of 'virgin' clients. *" You get people who don't understand microfinance even. You get those kind of people. They come and ask, what is Ndege?"* The Ndege management level employee I interviewed remarked. According to his estimate 4 out of 10 potential clients have not had any contact with microfinance. Loan officers also said that there is part of this group that does not want microfinance. *"I think there are some people that are ignorant. People who don't want to associate themselves with microfinance or banks."*

The other organizations have very high levels of clients that either have loans with other organizations or have had those in the past. A higher management member of Pundamilia for instance said: *"In Nairobi maybe not even 10% of our borrowers have never has a relationship with a financial institution."* And a higher level manager of Twiga described it even more explicit: "*We do not lend to virgin borrowers [..] You know they have borrowed before or at least are aware of the requirements because they are in the capital city."* Assuming the new clients represent the target market, as this would increase outreach, this shows a relatively low potential for the sector.

It seems that many organizations target the same sub-markets, which are becoming quite saturated. But serving the same clients does not increase the breadth of outreach, since a multi-borrowing client does not increase the number of clients reached by the sector as a whole.

	Nyati	**Ndege**	**Pundamilia**	**Twiga**
Statistics				
Number of active borrowers	[illegible]	[illegible]	[illegible]	[illegible]
Perception of own organization				
Growth	Stagnated	High	High	High
Virgin clients	Very little	High	Very little	Very little

Figure 7: Overview of findings regarding breadth of outreach of the four MFIs. Sources: MIX Market, Twiga, interview data.

Breadth of outreach for the microfinance sector as a whole

Most participants in the four organizations consider the breadth of outreach of the whole market to be relatively high. Nevertheless all of them still see growth potential, as can be seen in Figure 8.

	Nyati	**Ndege**	**Pundamilia**	**Twiga**
Perception of sector				
Perception of current breadth in market	High	Medium	High	High
Perception of potential growth in breadth	High	High	Moderate	High in specific segments

Figure 8: Overview of findings regarding breadth of outreach for the sector

Several participants in the organizations mentioned the substantial growth of Nairobi as a city, which should supply sufficient clients to sustain the growth of the sector. What stood out is that nobody really knew how many MFIs in Nairobi service how many clients. The market is clearly characterized by low transparency. This caused many participants problems when estimating the current as well as the future outreach. A higher level manager of Pundamilia was very honest: "*To be frank I don't know how many clients all the MFIs have in Nairobi. Uhm... I don't think it's getting saturated 'cause Nairobi is growing so fast.*"

The general image of the breadth of the whole market within Nyati, was that a lot more people have been reached over the last decade but that an outreach ceiling is nowhere to be seen. Since the city of Nairobi still grows tremendously in terms of inhabitants, at all layers of the organization it is believed that the market potential is sufficient. As a higher level manager analysed it: The breadth is *" based on the population growth and the number of potential clients out there in terms of the factor that we have grown [..]we have not even reached [..] maybe about 70% still don't access or they are still unbanked so to speak."* This image contradicts with the picture clients painted.

Nyati Clients mentioned that a lot of their peers have loans already. One client estimated that out of 10 friends outside her loan group, 8 would have a loan already. This does only imply something for the area where these clients reside, however it does show that these specific markets are starting to get saturated.

Within Ndege, neither loan officers nor higher level manager provided a clear image of the market as a whole regarding breadth. But the loan officers did agree; "*There is a lot of people that use microfinances.*"

Within Pundamilia the breadth of outreach of the sector as a whole was seen as quite high. A higher level manager compared Kenya to other markets in East-Africa and concluded it is the most developed market as far as he knows. The staff of the organization held similar views.

Pundamilia clients mentioned there are still people who don't know about microfinance and who are not using loans but when asking them how many of their friends outside the loan group would have loans the estimates were quite high. One said 5/10 another said 4/10 and the third was not comfortable giving a number but stated: "In this market just a few don't have." Interestingly, a few of the clients mentioned there is also a substantial group that does not want credit at all because of fear of the consequences in case of default or because they don't want to be in debt.

In general Twiga Staff found the breadth of outreach to be relatively high. A higher level manager viewed the outreach in Kenya as a lot higher than in other countries such as Tanzania, Rwanda and Uganda. "*I suppose by definition, the breadth in Kenya has already proved that it's ahead, certainly on the Eastern African countries.*" He acknowledged that the breadth in Nairobi is particularly high. A Twiga middle level manager also noticed this: *"So the awareness, that marketing has done with aggression, marketing of convenience has lead to a lot of outreach. Nairobians, very few people will not know what this microfinance story is all about. They might not specifically know about your company but not the concept. Even churches, institutions are coming up with it. People are doing it their own way. People are in small groups either way and they know where to get money."* A mid-level manager discussed how MFIs are all targeting the same markets, which shows a certain degree of saturation. However, one of the loan officers had a different view on the situation. He stressed that there is not a very high outreach because there is still a lot of people unbanked.

In the focus group conducted with a Twiga loan group, the clients said they could not really know how many people have loans, because generally it is not something you discuss. "*You only know if they ask you to guarantee*." On the contrary, one client I interviewed gave a number; he said 20 out of 500 of the market vendors would have a loan. He saw great potential growth. Interestingly enough, these clients operated in the same area.

Potential growth of breadth outreach

The potential growth in the market was also seen as substantial. This is interesting, since in theory more breadth of outreach would mean less potential breadth of outreach. The exponential growth of Nairobi as a city was often given as an explanation. This defeats the theoretical argument as the total market grows.

Considering the market potential, most of Nyati's employees painted a similar image. Most people know about microfinance but many of them don't qualify. Clients need to have an existing business to qualify for a microfinance loan with the organization. Even though the general image is that the market has still great potential, because of the population growth, not many 'virgin' clients are seen. A mid-level manager estimated the amount of virgin clients to be very low; *"100 out of 3000 customers, they are not*

many, very few." Her loan officers also mentioned it to be few. Though one of them estimated a bit higher at 30%. One of their clients agreed: *"I think everybody is having a loan nowadays."*

Regarding the growth potential all participants at Ndege seemed to agree that it is substantial. A higher level manager noted: *"There is a lot of growth potential for the sector"*. He found this was mostly regarding reaching more people because of the rules and regulations that exclude people from services nowadays. Also the loan officers agreed that "*there is still enough people that want a loan*". Considering the occupation of this group a loan officer commented: *"Some of these are starting, but others ongoing."* The potential group consist in majority of people who have not had a loan before, according to Ndege staff.

Similarly, regarding the market potential the staff of Pundamilia seemed to think there is still potential growth. One of the loan officers confirmed that there are still new clients that have not used microfinance before, but her colleague said: *"They are there, but they are not many. Because nowadays almost everybody is servicing a loan."* He estimated the potential client group to be about 20-30%. The staff seemed to all assume potential clients to be economically active and wanting credit and clearly distinguished a 'virgin' client group within this potential.

From the viewpoint of Twiga employees there is still a potential growth in the market. A middle level manager thought that there are still unserved and not understood markets. For instance she explained that nobody is targeting the youth that come straight out of college or people that work late hours, which don't allow them to have group meetings during the day. Also the higher level manager I interviewed saw substantial potential growth in outreach for Nairobi: *"I wish I had the numbers, but my guess is that there are still thousands of small entrepreneurs who are dealing exclusively in cash. They are not receiving credit, they are entirely restricted by the amount of cash in their pocket. And that they have not yet used any financial service to expend their business, they are still there. But remember where they came from, there would be 0 penetration 15 years ago*." A loan officer shared this view and said: "*The unbanked must be reached by microfinance, which is why there is growth every day."* Clients also seemed to still envision growth, but based on the focus group stating they wouldn't know how many people have loans, it is questionable whether this is based on a clear view of the market.

In 3 out of 4 organizations the clients have to be economically active to apply, which limits the perception of not only depth but also breadth, since many participants saw the lower income as a potential target group. Additionally, during interviews it became clear that there is a group that simply does not want credit, yet some organizations do not exclude them as a potential target group.

These views give a quite complete picture, nonetheless it is merely based on perceptions. Some statistics on the breadth of outreach for the whole of Kenya are available which can be compared to the interview findings.

In 2009 The FinAccess survey (FinAccess, 2009) was conducted by interviewing 6598 persons across different demographic groups across Kenya. Unfortunately, the report mainly describes statistics for the whole of Kenya and does not contain much information about Nairobi specifically. Still, the statistics will indicate in a wide range the breadth of the outreach. In general in Kenya in 2009 22.6% of the participants used formal banking such as a bank, post-bank or insurance. 17.9% made use of services of non-bank institutions such as SACCOs and MFIs. This is a huge growth compared to 2006, when this was 7.5%. 26% made use of informal financial services and the remainder, 32.7% is excluded from any form of financial services. Nonetheless these numbers are substantially higher for the urban areas as shown in Figure 9. In 2009 35.9% was entirely excluded while an additional 16.5% made use of informal financial services such as friends and families. Here, it is assumed that people using informal credit would be better of using formal financial services, therefore the group that uses informal services is seen as unreached. Between 2006 and 2009 there has been a substantial decrease of unbanked individuals according to FinAcces. Taking that into account and considering that the market as a whole is developing quickly we can assume the number of unbanked individuals has decreased since.

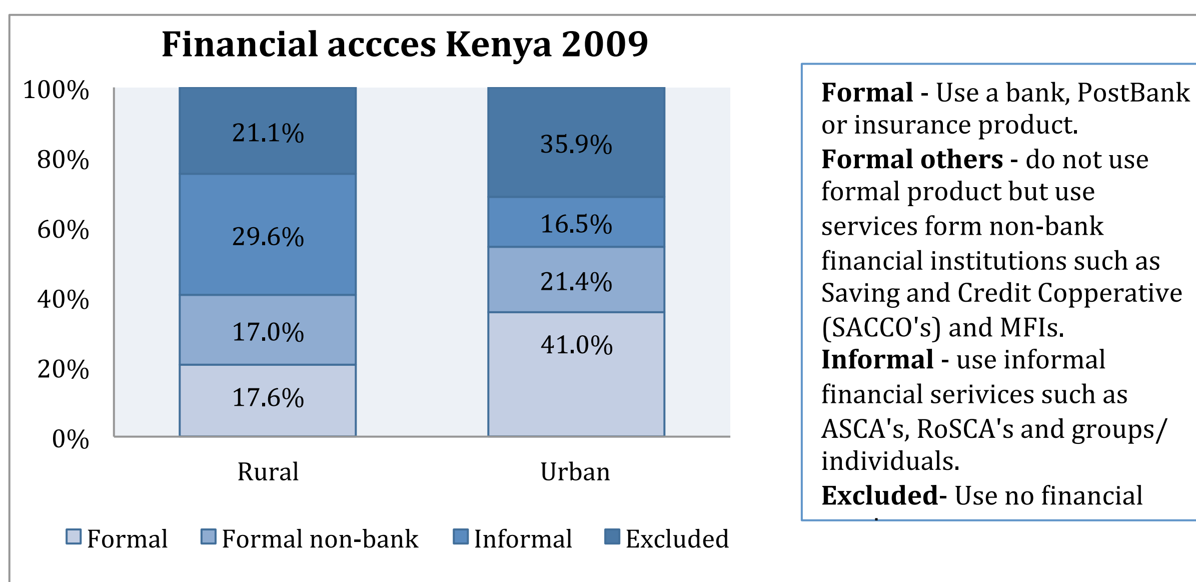

Figure 9: Financial Access in 2009 for the urban and rural areas. Source: FinAcces, 2009.

Since this research focuses on credit, it is also important to differentiate financial services in general from access to credit. In Figure 10 the access to credit for Kenya is given. 39% of the urban population never had a credit product. We can see this number has decreased by 20.8% since 2006. This makes the assumption reasonable that this number decreased substantially over the last 3 years.

	2006		**2009**	
	Rural	Urban	Rural	Urban
Currently using a credit product	30.8 %	30.2%	36.9%	41.0%
Previously ha a credit product	7.5%	10.0%	13.1%	20.0%
Never had a credit product	61.7%	59.8%	50.0%	39.0%

Figure 10: Use of credit products in Kenya 2006 and 2009. Source: FinAcces, 2009.

Considering that in 2009 39% of the urban population did not use any credit product before, that in the 3 years before 2009 the number decreased by 20.8% and that clearly in the urban areas people have more access to financial services than in rural areas, it can be estimated that at most 30% of the adult population of Nairobi does not have access to any form of credit. Which is relatively low compared to most other areas. It must be taken into account that this most likely also includes persons that do not want credit, as we cannot estimate how many persons this are.

As this is a relatively low number of unreached clients, and this still includes people that do not want credit, we can assume the outreach of microfinance is relatively high. Thus, we can conclude that these statistics confirm the views of participants on the current outreach of the market.

Sub-conclusion

The breadth of outreach in Nairobi is perceived as relatively high, which was confirmed by the limited available statistics. However, almost all participants saw still substantial potential growth. The perception of the extent of outreach regarding breadth is highly dependent on what is seen as the target group. Most participants in three of the organizations saw only economically active poor as the target, and regarded the outreach as relatively high. Within the less profit focused MFI, also the extreme poor are seen as a target group. The participants in this organization saw the potential outreach as low. However, they did acknowledge that among the moderate poor MFIs' competition for clients was fierce and many clients were reached.

4.1.3 Start-ups

A reoccurring theme in the first interviews was the potential growth that might be found in start-up funding. Therefore, all participants were asked if they saw a potential growth here. Not many microfinance organization fund start-ups at the moment in Nairobi, due to the risk and practical difficulties involved. However, providing start-up funding could lead to people moving from the extreme poor classification to the economically active classification. Consequently, if a participant sees potential in start-up funding, this means he sees the extreme poor as a potential target group, thus part of the microfinance market.

Comparing across the four MFIs, it seems that many microfinance practitioners see potential within the group of people who want to become economically active in the form of a small business, however most of them see it as financially risky.

The exception being Ndege where start-ups are funded. However, from their profit margin, we can deduct this might not be economically the most viable strategy. Also, I understood from the loan officers that the terms of payment can be renegotiated in case something goes wrong with the business. This might make it easier to accommodate start-up funding, but is probably not the most profitable strategy.

Nyati does not finance start-ups. But staff of the organization recognized that there is big group that wants start-up funding. What Nyati does now is help these people to organize themselves in groups in order to save and gather some collateral for a loan at a later stage.

In general within Pundamilia participants assumed microfinance is better for people who are already in business. A higher level manager did think there is a layer between the economically active and the economically inactive that want to start something. *"Yes for sure, and microfinance institutions can't do it because the risk of financing a start-up is too great."*

Twiga does not provide start-up funding, however within Twiga there were quite some staff members that saw potential in the group of people who want to start a business. Yet, they mentioned it is a difficult target group to serve. A higher level manager noted there are some organizations that provide start-up loans: "*There are notable exceptions, people who specifically set up only to do start-ups. But generally if you are a traditional microfinance the one area you would try to keep away from is your normal start-up."*

Clients seemed to be quite sceptical about using funding for start-ups. One Pundamilia client explained quite clearly why microfinance is better for people that have an on-going business: *"What I can say is the loan is good for someone that has already a business themselves. Because if you start a business with this money you may end up losing what you received from the microfinance, because it is a new business. Sometimes you might not have the customers at hand."* In the Nyati focus group one lady bluntly said:

"*How will they repay?*" In the Twiga focus group the clients acknowledged that microfinance is not available for start-ups but they did not see this as a major problem. A man explained: *"You can start a business with garbage even. Microfinance will give your business the boost it needs after you started."*

These reactions however, might have to do with the training that they are provided with by the MFIs. After hearing some loan officers about training it seems that there is a very clear emphasis on knowing what your business generates. This is of course quite difficult for start-ups, which also explains why most microfinance organizations see it as a risky endeavour.

Sub-conclusion

Many participants within the MFIs see potential in start-up funding. However, in the three more profit focused organizations it was emphasized that it is difficult to actually reach these clients because of the financial risks entailed. For the outreach of microfinance this means that the perceived potential growth is higher than in the situation that this group is disregarded as a target group. While compared to other markets the outreach might be high, potential growth could be found among the extreme poor, if a safe financial product can be designed to serve this client group.

4.1.4 Outreach in a more mature market

There is still potential growth in the microfinance market of Nairobi. However, compared to other East-African markets, the Nairobi Microfinance sector has reached a high level of outreach. While participants see the breadth as relatively high, the depth is seen as less developed. The general opinion of the participants seems to be that the market is nowhere near saturation or an outreach ceiling. Mostly it was argued that due to the tremendous growth of Nairobi as a cosmopolitan the growth of the microfinance sector is accommodated. Most participants see substantial growth potential both regarding breadth and depth. This potential then mainly needs to be found in the lower income groups, start-up funding and specific sub-segments such as recent graduates or people working irregular hours. Comparing all four cases and taking into account the opinion of experts, it can be concluded that while most practitioners like to emphasize the still lingering potential of this market, it has a relatively high outreach in the current situation. Which makes Nairobi an interesting research field, since it might predict the future for other (East) African markets.

Concluding, an initial answer to the question how the maturation of the microfinance sector in developing countries has influenced outreach can be provided. It seems that at least in this case, the maturation of the microfinance sector has influenced outreach in a positive manner. Of course, this case study can only answer the research question taking the specific context into account. However, participants agreed that over the last decade the outreach of microfinance had increased substantially. The limited statistics regarding the breadth of outreach, as provided by the Finscope survey (2009), confirm this belief. Therefore it seems that in a maturing market outreach will grow. This growth could mainly focus on breadth, opposed to depth. Opinions differ on whether microfinance should and could provide start-up funding. This debate influences the size of the potential outreach and thus the degree of outreach compared to its potential.

4.2 Market trends in an high outreach environment

In this chapter the most important trends in the Nairobi microfinance market discussed by participants will be described. This will provide an initial answer to the second sub-question: *What market trends and developments are observed within the increasingly mature microfinance sectors in developing countries?* Four main trends were identified based on the interviews; perceived increasing competition (section 4.2.1), perceived increasing multi-borrowing (section 4.2.2), perceived increasing credit diversion (section 4.2.3) and perceived increasing over-indebtedness (section 4.2.4). The following section discusses the evidence for these trends, as well as what the trends look like. Where applicable literature is discussed and a proposition formulated. After which an answer to the second sub-question is provided (section 4.1.5).

4.2.1 Competition

The Nairobi microfinance market was selected based on the high number of active organizations that are represented within this environment opposed to other East-African markets. Assumingly this would lead to a high amount of competition in the evaluated market, showing the potential future of other markets. Competition is a common used term in management and economics. In this paper competition will be defined as "*The effort of two or more parties acting independently to secure the business of a third party by offering the most favourable terms*" (Merriam-Webster, 2012).

Fierce competition in a maturing market

The participants unanimously confirmed the assumption that competition in the studied market was fierce, and that it has grown over time. "*There is big competition. It is not like when we were starting, with small competition. We were only 3 or 4 microfinance institutions. Now we have like 34 microfinance institutions, so that comes with a lot of competition*," a Nyati loan officer explained for instance. Also a Twiga mid-level manager described what many participants explained: "*What they do now is just compare. Who has better terms? You know, that is Nairobi for you.*" One participant referred to the change in the market as driven by *"the emergence of MFI mushrooming"*, which characterized the general view of most participants.

Ndege operates in a market niche, which is why the loan officers of this organization experience less competition in their daily work than their colleagues in other MFIs. The interviewed loan officers, when asked whether they notice in their work that there is competition of other MFIs both bluntly replied: "*No.*" The organization serves a niche by aiming to serve the poorest including the economically not active poor. One loan officer also saw this: *"Usually we deal with the poor people. And uh.. other microfinances deal with rich people."* Rich and poor is relative of course, but it does show a potential lower competition in the lower income market segments.

Aggressive marketing and sales techniques

Fierce competition shows in the aggressive marketing and sales techniques MFIs use, among which actively tracking down the other MFI's clients and offering them loans with more flexible terms. I observed this during my interview with a Nyati client. The very successful business lady's phone kept on ringing during the interview. It was another bank trying to persuade her to become a client. She explained: *"They are marketing themselves, they come to the business, they are surveying, they try to get your history and then they come and approach you to be one of their clients. Just now, I was in the bank and they offered to give an unsecured loan. So it is a competition. There is a lot of competition."* She also explained how other MFIs offer her more flexible loan terms and how this happens to others a well. She elaborated on how she was offered an unsecured loan by several organizations and that this was a negative development because of she saw the risk involved, but many others didn't. Other clients told me about similar situations.

Also, Ndege loan officers notice aggressive sales techniques from other MFIs. One of them told me that other MFIs come talk to their clients and try to recruit them. "*They want to steal our members, our clients."*

A Pundamilia (mid-level) manger told me how his employees and himself sometimes come to a group meeting and find loan officers from other organizations there to talk to the group, or even are doing business with 'your' group.

Also, Twiga staff mentioned these kinds of aggressive sales techniques. During my branch visit one of the loan officers took me to a group meeting location, in a big hall next to the market to meet her loan group. In the same hall there were other groups from other MFIs meeting. She explained how loan officers of other organizations sometimes come up to your group to offer them a loan. Her colleague had a similar story, he answered the question whether there are disadvantages of competition affirmative: *"Yes, there is because there are those institutions that take advantage of such meeting locations. They come to take the clients from there. At some point they give sweet words, sweet promises and the client feels moved."*

The competitive landscape

The competitive landscape seems wide and varied. Formal institutions such as banks are targeting the microfinance market, NGOs still run their programs and additionally there are community lending and informal lending practices in many forms. Aside from that there is a large number of MFIs in a variety of sizes and degrees of formalization. This all shows a very non-transparent field for microfinance organizations to operate in.

Many participants described parts of this competitive landscape. A higher level manager of Twiga gave me a short overview of the competition. There are the commercial banks that have started microfinance departments; *"these big players. And there is a next group down which is the [..]the Faulu's and the Kenya Women's Trust, that is another group who have become almost nation wide. They have penetrated more the rural areas and some of the others. And then you have the smaller players, lots of them. 40, 50, 60 MFIs. Each with a different specialty."* As he mentioned, the MFIs experience more and more competition from the formal banking sector. A loan officer also told me: "*Another thing I'll say is banks. They are also our competitors. For them it is harder to reach the people in the market but they are now also competing for the same loans. Most banks have a section of MFI."* His manager observed similar trends. "*The banks are coming down too, were we are. And we are where the bank is. So it's a bit of the opposite direction."*

Also, a big part of the competition comes from informal lending and community based lending according to a higher level manager of Nyati: *"You find in the estates or even in the middle of town where you have small groups that actually have a bit of funding and they lend among themselves [..] if you go look at a place [..] where they sell second hand clothing, you find that they actually have their own micro-groups around there.".*

A higher level manager of Twiga also mentioned there are still NGOs active in microfinance in Nairobi. *"Sadly, if you think that there is so many NGOs here, if end up in a situation [..] that there aren't enough clients to go around, than that means the NGOs have reached their mission or their goal and they don't need to continue."* That situation unfortunately had not occurred yet he said.

<u>Other markets</u>

Also in other mature markets competition has become fierce. Opposed to the (semi-) monopoly many MFIs had in the early years of microfinance, competition has increased rapidly in the last decade (Rhyne & Christen, 1999; Vogelgesang, 2003; McIntosh & Wydick, 2005). Some markets even show signs of saturation. Chile's and Bolivia's urban centres and many parts of Bangladesh show slowed growth and high delinquency rates.

In East-Africa this also applies to Kampala, Uganda's thriving capital city (Rhyne & Christen, 1999; Kaffu & Mutesasira, 2003). McIntosh & Wydick (2005) researched the competition in the Ugandan microfinance market and saw a similar changing competitive landscape. Two new private microfinances joined the market and are competing with the traditional socially oriented lenders. This shows that the findings on the competition in Nairobi are not a sole case but one of the precursors of other markets.

Rhyne and Christen discuss their experience in five different highly competitive markets around the world. They find that competition leads to broader geographical coverage, smaller loan amounts and

interest rates and a bigger range of products for clients to choose from. MFIs in these markets are anxiously trying to retain their clients by a high amount of promotion and adaption to the customer demand. In this study this showed in the aggressive marketing and sales techniques many participants discussed. Also, McIntosh, de Janvry and Sadoulet (2004) researched the Urgandan market and found that new entering lenders are able to identify the most promising clients. Micro-entrepreneurs with a large business and substantial cash flows proved to be more likely to leave the incumbent lender when new entrants arrive. This in line with our findings; MFIs identifying the 'good' borrowers of other organizations and trying to sell them a loan, is also common in the context of Nairobi.

Both this research as well as literature on other mature markets, show growing competition. Both also show aggressive marketing and sales techniques, where MFIs personally address clients of other MFIs and loosen contract terms. This leads to the following proposition:

P1: With the maturation of the microfinance market competition increases, which causes MFIs to use aggressive marketing and sales techniques and more flexible loan agreements.

4.2.2 Multi-borrowing

Multi-borrowing, also described as double-dipping, refers to clients taking on loans from more than one institution (McIntosh et al., 2004; Guha & Chowdhury, 2012). In the interviews several participants mentioned multi-borrowing only after being asked what was going on in the market or what the challenges of microfinance are. This clearly shows the salience of this trend. In general MFIs find it very hard to grasp the extent of multi-borrowing among clients, because clients do often not disclose the information and because clients often use informal borrowing. However, most participants saw multi-borrowing as an extensive problem for the microfinance sector and its clients.

Figure 11 show interview findings regarding multi-borrowing for each organization. In many cases participants in higher positions in the organizations perceived the magnitude of this trend to be smaller than participants that worked in the field.

	Nyati	**Ndege**	**Micor Kenya**	**Twiga**
Average perception severity	Substantial	Moderate	Substantial	Substantial
Organization tolerates multi-borrowing	Yes	No	Yes	Yes
Interviewed clients multi-borrowed	Yes	-	Yes	No
Organization knows of part of her clients having multiple loans	Yes	Yes	Yes	Yes

Figure 11: Overview of findings multi-borrowing per organization based on the view of the majority of participants.

<u>*Multi-borrowing, a problem*</u>

Multi-borrowing often was seen as a problem. One of the Nyati loan officers illustrated the vicious cycle it entails: *"you are also in another institution. And another institution. And another institution. [..] So you borrow from me, to pay [Competitor Name]. Borrow from [Competitor Name] to come and pay. So the essence remains you are not getting yourself out of the roots."*

In Pundamilia there was a different view on multi-borrowing on different hierarchical levels. On the management level, they acknowledged it happened, but did not see it as a major threat. A higher level manger said about people becoming indebted because of multiple loans: *"Not as much as everyone sort*

of expects. [..] Our feeling is that if people are over-indebted they always will pay the most efficient lender. Someone that responds to them first and says; pay me, pay me, pay me. And those that slack are those not so efficient with their collection will be the ones that will suffer from an over-indebted client. But hasn't presented a huge problem to us." In the lower ranks of the organization on the other hand it was seen as a big problem. One of the loan officers said: *"What makes it a problem? Of course when they default it becomes a problem. Because their business collapses. Especially when they take a risk. [..] There is a likelihood of groups collapsing. So one has to be a bit careful."* On both middle and higher management level participants emphasised that multiple loans do not have to be a problem if the clients manages it well. However often it makes managing credit difficult.

Also a Twiga loan officer made this point: "*We have some clients who because of the nature of their business, they require a lot of money to put in the business. Because of the size of their business they are able to pay those multiple loans. But we have others who take multiple loans because they want to clear a loan from another institution. So in the long run they get in trouble. They don't use the money, so they have difficulties in paying."* In general within Twiga, multi-borrowing was seen a substantial problem, but was not seen as decidedly bad. A higher level manager answered the question if he noticed multi-borrowing with: *"Of course there must be. Unfortunately, if you only hear about it when the loan repayment is late."* Also a middle manger and her loan officers acknowledged multi-borrowing as a negative trend.

One of the Twiga loan officers described the disadvantages for clients of having multiple loans: "*Take an example of a client who has let's say multiple loans from 3 different institutions. You find that their meeting day and time are totally different. [..] If you combine all that time, you are far away from your business. If you have people that you have employed, probably they take advantage of you when you are not there."* He added many clients lose their focus on their business because of multiple loans. Another loan officer told me a similar story. And a third colleague explained me the severity of the problems for clients, the burden it becomes to them. Often clients mismanage their loans and it becomes a headache to them. She said she saw quite a couple of times people suffering from very high stress because of it. "*They turn grey from the stress, you see them slowly dying."*

As opposed to participants of the other organizations, participants in Ndege did not see the multi-borrowing as a very big problem. This might be caused by the market niche they are serving, which is generally less saturated. Additionally, it could have to do with their policy regarding multi-borrowing. All organizations but Ndege allowed their clients to have more than one funding relationship. *"We will tell you to first go and pay the loan. When you paid the loan you can get a loan from us."* One of the Ndege loan officers explained. This might cause them not to notice when their clients multi-borrow.

In other organizations multi-borrowing was tolerated. It was more seen as an inevitable fact that clients get multiple loans, and therefore the MFIs rather know so they can guide the client in managing all those loans. In Twiga multi-borrowing is not prohibited and a manager explained why: *"It is somewhat naïve of MFIs to totally prohibit multiple lending. It isn't the multiple lending that is wrong, it is the over exposure. [..] So even if you have two loans. If you have got the income, you should be able to cope with it."* Pundamilia even tells their clients that if another MFI is willing to give them a loan, they should come back to them and they will give them the additional amount. This is to prevent that no one knows how much the client is actually borrowing. A loan officer confirmed this: *"If we can give them enough, so if a client wants a hundred thousand and I can give that client a hundred thousand then he may not have that crave to go elsewhere."*

The size of the trend

The market is extremely non-transparent. In all organizations it was mentioned that MFIs only know whether clients have multiple loans when clients themselves disclose this information, when they default or when they are already registered in the credit reference bureau. A Twiga manager explained her frustration about the lack of information on clients: *"So, what if that person is lying? Actually, I just want the 20 000 to sort out that financial who is chasing me. How are you able to establish that? What you are calling outreach here, could be that you think you are growing but you are not. [..] You are only indebting that person."* Information sharing between loan officers of different MFIs has increased, as the loan officers notice that is a good way to prevent clients from over-borrowing. What I understood this is right now solely based on the loan officers initiatives and their personal contact with loan officers of other MFIs.

The participants that dared to make an estimate usually thought multi-borrowing is a trend of substantial size. A Nyati mid-level manager estimated that of the clients who's businesses go bankrupt, 60% is due to multi-borrowing. Two Nyati loan officers both estimated that about half of their clients have more than one loan. "*I have like 600 customers, I can tell you of the 600, 300 are having loans elsewhere and they are also operating accounts elsewhere*." " *I would say 50/50*". Their colleague said it was hard to estimate because you need to find out from clients themselves, but she was certain it would be more than half of the clients. Also, a Twiga middle management member I interviewed estimated that only 30 to 40% of the clients have one loan. Which would leave 60-70% of clients having multiple loans. These estimates show it is considered a substantial trend.

A client perspective on multi-borrowing

Across organizations clients differed in whether they found themselves able to assess the extent of multi-borrowing in the market. Some mentioned that it was not something they knew, because people don't talk about their loans or because they were too unfamiliar with the market. But the ones that did

find themselves capable of assessing it, mostly said it was a substantial problem, which caused clients a lot of stress, pain and financial loss. Several clients I interviewed admitted to have multiple loans themselves and of these most found it difficult to balance loan payments and business investments.

Nyati clients did multi-borrow. In the focus group I conducted, Nyati clients were very clear about the severity of the problem of multi-borrowing. 3 out of 8 clients openly agreed that they had multiple loans. They admitted to have problems balancing their loans. Others seemed to agree it was a problem but did not openly discuss their situation. The secretary of the group explained how she had to balance her loans. *"On Tuesday I go to one loan meeting and have to pay 3000 [Ksh] then on Thursday I have another and Friday another."* When I asked them how many of their friends would have more than one loan, the secretary responded captivated: "*Out of 10 friends? 9*!" The group laughed a bit but agreed it was a very high percentage.

Clients of Pundamilia had varying views on multi-borrowing. The first two clients, from the same group, both knew it happened but did not know anyone directly who got in trouble because of it. One of the men told me his brother had two loans but managed them. In the next group I visited however, the clients had a different view. They saw it as a big problem: "*It happens a lot. What happens is I take a loan from one and then another from another and one business is paying the same loan and that is so difficult. I will pay the one from Pundamilia, but the other one I will not pay. So what happens, I will disappear*." Both clients I interviewed from this group had two loans, the gentleman said he managed, but the lady admitted to me to have difficulties balancing two loans: *"It is difficult so that is why I am trying to quit one loan and then to manage one. [..] Because at times you take this loan and the business shake, that is why you get in difficulties. And that is it. So now I decided to stick in one."*

Opposed to other clients, the Twiga's clients I interviewed were not so worried about multi-borrowing and its potential consequences. A client I interviewed said that he did not know if people had multiple loans, but that he thought it was a bad thing. *"for example I have a loan and I at time to pay I don't have the money. So I have to go to some others give the money to Twiga, you see? I know I don't have the money so I go somewhere else, try to get the money. So it becomes as circular thing. This is not very good for business, not very good"* The focus group I conducted with Twiga clients gave a slightly clearer image. The group said they see other people that pay of loans with other loans and get in financial problems because of this. The group then sees auctioneers coming to these people's homes and taking their belongings. They did not think this happens very often though.

According to a Nyati middle management member, clients start to realize multi-borrowing is not a smart thing to do: "*others have experience and they have realized multi-borrowing is bad but they have paid a lot of interest to very many institutions including mine and they are not growing their business."* This was confirmed by one of the clients I interviewed. She is a very successful entrepreneur who now

owned several shops. She said: "*No, I think one is enough. So people can be able to manage. You know if you are down, they are able to understand you, they know your history.*"

Multi-borrowing in other markets

There has not been much attention for multi-borrowing in literature so far. Several authors have created models of microfinance markets to assess the impact of competition and as part of that assessed multi-borrowing (Casini, 2009; Guha & Chowdhury, 2012). These studies however do not go into depth about the phenomena itself.

Case studies of specific markets do discuss multi-borrowing more elaborately. Rhyne and Christen (1999) noticed multi-borrowing in several highly competitive markets around the world. In East-Africa, some studies were conducted in Uganda. Wright and Rippey (2003) found that 15% of the clients there used multiple financial institutions. The main reasons for taking on multiple loans were increasing the capital to the amount that clients thought they needed, financing another loan and emergencies. McIntosh, de Janvry and Sadoulet (2004) also found that MFIs were worried about clients borrowing from multiple institutions. Loan officers from several major MFIs in Uganda were of the opinion that clients multi-borrowed to maintain cash flows, to smooth the repayment of their credit and because several smaller loans lead to a lower cost of credit due to the declining balance interest rate calculations used by many MFIs. They also were of the opinion that multi-borrowing increases the default rates. In this study in Nairobi some of these reasons were mentioned, but not all. Mainly participants mentioned multi-borrowing to settle loans with other MFIs. Also McIntosh & Wydick (2005) researched the Ugandan market. They found that Faulu, an MFI both present in Uganda and Kenya, was troubled because clients took on multiple loans without the MFI knowing this. The organization reported this behaviour and experienced it increasingly as the number of lenders in the market increased. These studies show that multi-borrowing can also be a growing problem in other East-African microfinance markets.

Based on the data on other more mature microfinance markets and the interview data the following proposition can be formulated:

P2: With the maturation of the microfinance market multi-borrowing increases.

4.2.3 Credit diversion

Many participants mention credit diversion as an important factor in failure of businesses. In literature several authors mention forms of diversion that are seen in microfinance (Karlan and Zinman, 2008; Schicks, 2010). However, a general definition is lacking. Therefore, in this research credit diversion will be defined as the use of credit for non-business purposes. Consequently this excludes the use of provided funds to pay off other business loans.

In general a similar picture was painted by the staff of all organizations and their clients; clients divert funds and this happens on a very regular basis. Within Ndege it was not seen as a salient problem, however not all participants talked about it, so their view was not represented. Common reasons to divert that were mentioned are school fee payment for children, hospital bills and the purchase of land. Kinship ties play an important role in the credit diversion, since often relatives put claims on the income and also on the credit clients have.

Credit diversion, a substantial problem

In all organizations, except for Ndege credit diversion was seen as a substantial problem. A Nyati mid-level manger explained to me how the situation is problematic: *"They buy some land, you know some asset somewhere and if you buy an asset that you are not using, you will have no income. So, definitely the business cannot support that kind of a loan. So, in the long run she is unable to pay. [..] the guarantors do co-guarantee the loan, so [this ends] even affecting the other businesses for the guarantors."* A higher level manager of Pundamilia, when asked what people use the loans for answered: *"What people use the money for? For sure, people will divert money."* And the Pundamilia manager estimated that 60% of business loans get diverted to other expenses. These are some examples of participants who found credit diversion substantially problematic.

The loan officers of Ndege also saw people diverting funds. "*like women, they buy dresses, they go to the saloon to make their hair. Most of the women. That is why we have a class. If you get the loan, don't go first buy a dress, start doing something with that money, that money will buy you a dress."* However, this was not seen as a problem as long as people are able to pay back their loan. The participants did not seem to think it was a substantial problem.

Purposes of credit diversion

In the interviews several aims of diverting credit were mentioned. A Nyati mid-level manager and her loan officers for instance described several things the clients spend their credit on; land and school fees are common, but also luxury goods, housing, or a dowry. Ndege participants mentioned luxury goods and personal items such as clothing as aims for credit diversion. Participants within Pundamilia mentioned school fees, consumption and health care as aims for the credit diversion.

Participants in Twiga mentioned similar purposes. The extension on what other cases showed laid in the explanation of the diversion of credit due to family ties. One of the loan officers explained to me: "*Ok, this is very Kenyan.. [..]we have different backgrounds. And if you look at the different traditions.. like people from the western part of the country.. they have very huge, a very high level of dependence. [..] You'll find a lot of people depending on a particular individual. Who's main source of income is the business. So, that one influences how big a loan they get. [..] While for instance a client from central Kenya, who owns a business only has his wife and children. But for me it is my wife, my children, my uncles, my grandmother, my aunties, my cousins, they know he has a business so he'll take care of us."* Often the credit supplied by a MFI for the business will end up in the extended family.

Next to the Twiga loan officer also clients mentioned family ties as a reason to divert credit. One lady who borrowed from Nyati amongst others, explained how if she just got a new loan and her sister calls to ask for money because she is sick, she would send her the credit she just received and would not be able to spend it on her business. The rest of her loan group saw this as a common thing to do.

Collins (2008) in his study of the financial spending of the lower income groups in South-Africa, also noticed that kinship ties play an important role in the credit diversion. Often money is send to a sick family member or even to unemployed family members. This is in congruence with what was described in the literature section on social ties. Grown ups are expected to take care of their family, so this results in claims from family members when they have money. Khavul, Bruton, and Wood (2009) conducted a case study of micro-entrepreneurs in Kenya and Uganda and found that family ties played an important role in the financial keeping of their interviewees. Combined with the remarks of these clients and the Twiga loan officer, this allows us to conclude that most likely African microfinance differs from microfinance in other parts of the world, due to tribal culture and kinship ties. And that in Africa requests coming from the kin are often reason to divert credit.

<u>A client perspective of credit diversion</u>

In general clients saw credit diversion as common practise. The Nyati focus group I talked to saw it as the common way to go about. They admitted that they often use loans not to fund their business. One lady described: "*When you get the first loan, you go to buy a TV and a fridge. This is the collateral they ask for other loans*." Also they used the credit to buy food, pay for school fees and goods. The secretary said: "*Maybe 75% of the loan goes to the business, the other goes to other things that we need."* Also she remarked that they need the next loan: *"If they loan stops, we stop."* "*If you are repaying one loan and then the other, you need a new loan to live from*", she said. The group agreed they need the money of the loans to live off. Which shows the money goes to household expenses not just to business investment. Also, Pundamilia clients saw the credit diversion as a common practice. Two clients told me people use it to pay bills, maybe school fees but even to enjoy themselves.

Not all clients saw the potential downside of such behaviour, but several did. A gentleman that borrowed from Pundamilia told me: *"In fact they don't know the use of the microfinance".* His co-guarantor agreed: *"They think the money is theirs."* Also, a Nyati client mentioned credit diversion as the prime reason for failure of micro-financed businesses.

Initial hints towards multi-borrowing in other research

Not many authors pay attention to the use of credit of microfinance borrowers for non-business purposes. Karlan and Zinman (2008) briefly mention its occurrence and note that data on this topic is scarce. They note that many lenders seem to apply a "no questions asked" policy, which makes it hard to gather data about it. The research duo admits that the data they have about the diversion of microfinance credit is ambiguous due to the circumstance in which they were gathered. Still these observations can provide an initial image. Several consumption smoothing and investment aims were mentioned by their participants, among which food, housing, transportation, schooling, clothing, and settling other debt. The last will be regarded as a business purpose thus not part of the credit diversion in this research. However, quite some of these factors were also mentioned in participant interviews. Schicks (2010) also mentions the use of credit for consumer goods. She argues that the use of credit for consumption needs to be taken into account by MFIs in their product development. Traditionally microfinance organizations only provided business loans because they generate income, opposed to consumption loans, which only smooth income but still entail risk. This is not feasible because there is always loan diversion. Schicks argues that MFIs should provide both business and consumer loans to prevent the credit diversion and be able to have an honest income assessment. Collins (2008) discusses a longitudinal study of household finances in South Africa. South Africa is compared to other markets also relatively developed. He noticed that business and household expenses are often not separated; it is quite hard to distinguish what expenses can be qualified as productive and which as consumptive. If it is hard for a highly educated researcher, we can assume it is also difficult for a usually low educated micro-entrepreneur, which makes credit diversion more understandable.

Based on the data and the limited literature the following proposition was formulated:

P3: In more mature microfinance markets clients divert credit for purposes such as education, health care and real estate investments such as land and housing. In Africa kinship ties play an important role in the credit diversion as relatives are expected to take care of (indirect) family.

4.2.4 Over-indebtedness

As the market is more saturated and more people take on high amounts of credit, one could expect the indebtedness among the borrowers to rise. The extent to which a person is indebted is important to consider here, since a person who has a loan already can be marked as in debt. However not every defaulter can be seen as over-indebted. Therefore, in this research the definition provided by Schicks was used: "*A microfinance customer is over-indebted if he is continuously struggling to meet repayment deadlines and repeatedly has to make unduly high sacrifices to meet his loan obligations.*" (Schicks, 2010. P. 6)

In all four organizations over-indebtedness is acknowledged as existing in the market. There was variety in perception of the extent to which it was apparent and quite some participants did not see it as a big problem. However several clients saw it as a severe problem and even might be marked as over-indebted themselves. Considering the small sample of clients in this research this points towards a substantial phenomena. Interestingly, the severity of the situation seemed to be perceived as less severe by MFI staff than by the clients themselves.

Defining over-indebtedness

While the notion of over-indebtedness within the microfinance literature is relatively young, several definitions have been used. Originally the term was only used for legal corporate entities. However, a universal definition is lacking if it comes to personal over-indebted (Schicks, 2010). Within literature there is ample ambiguity on the definition and measurement of the concept. Schicks (2010) provides an overview of the definitions and the considerations to take into account while choosing one, after which she constructs her own definition. Some researchers use measures instead of definitions out of practicality. Besides, definitions differ in their unit of reference, whether it applies single or multiple criteria, whether it is a quantitative measure or qualitative measure, the severity e.g. the timeframe of the indebtedness or severity of the repayment problems and whether it is self-reported or based on external sources. A general requirement of most over-indebtedness definition is that the person is over-indebted against their will. In Schick's definition the microfinance customer's view is the standard. Because many microfinance customers already live beneath an acceptable level of financial sufficiency, it is hard to judge as an external party what might be an acceptable level of sacrifice. With unduly high sacrifices is meant that the client has to make sacrifices bigger than expected when she took the loan and are higher than the cost she is willing to take to be able to have the loan. Also, the household level is used as the basis of analysis, because, as Schicks argues, the kinship ties should not be the reason why a microfinance client can repay a loan. Additionally, during the research it became apparent that microfinance organizations use both the business and household expenses in their assessment of the income of a loan applicant. However, aside from asking a client how many dependents he or she has, there is no practical way of assessing someone's kinship ties.

Microfinance over-indebtedness, a problem?

Participants in all organizations notice the existence of over-indebtedness. However, participants differ in their perception of the magnitude of this phenomenon, and the degree to which they see it as a problem.

Within Nyati participants noticed over-indebtedness, while not always using this term they often discussed elements of it. *"Yes, people get troubled. Big trouble."* One of the loan officers said. Several situations were described related to clients being over-indebted. In Ndege the participants said they notice over-indebtedness but only "*sometimes*". In Pundamilia the participants acknowledged that over-indebtedness is there, however the extend of it was not seen as very severe. A higher level manager for instance did not see over-indebtedness as a huge problem in the market, however he did notice it *"but not as much as everybody expects*". Within Twiga participants notice over-indebtedness and they saw it as a problem. A middle management member answered the question whether she noticed over-indebtedness with: *"Ow.. it is there."* One of her loan officers answered the same question with: "*It is not as much but it's there. What I'll say; yes it is noticeable*."

Conversely, clients in general were more extreme in their perspective on the severity of over-indebtedness.

The client perspective

Opposed to the MFI staff, client generally saw over-indebtedness as a severe problem that seemed to increase. Some clients I interviewed might even be marked as over-indebted themselves.

During my focus group with a Nyati loan group, several ladies explained their problems in repaying. The secretary explained how many of them need the next loan to pay off the previous loans. She told me how she has her household expenses and the three loans she is repaying and she is continuously struggling to make payments and provide for her family. She asked me how to get out of this continuous financial struggle, because she did not know how she can survive without taking on another loan to repay the first. She and probably many of her co-guarantors fit in the over-indebtedness definition provided by Schick's. She also thought many more people in her environment have similar problems.

Also, some of the Pundamilia clients experienced it to be a huge problem. And one lady also personally explained me the stress she experienced because of her struggle to pay her loans. Describing her situation, its seemed she was over-indebted. She had trouble repaying her loans because her business was not generating the income needed to pay off her outstanding credit, on top of that default in her loan group forced her to pay part of the outstanding balance of others. In another borrower group I asked two market vendors whether they knew people that get in trouble because of loans. *"So many"* one said. The other agreed: "*Many. Even in our group you have so many defaulters. Because of that they*

take money from one group, another group another group. Everybody disappears. [..] and then you carry the burden of paying that loan.".

Twiga clients also knew of the negative situations because of over-indebtedness, but none of the clients I interviewed experienced it themselves. One client told me that people do not want to use microfinance because of what they call harassment. *"Because if you have bought maybe a sofa set of about 20 000 and it goes because you have a loan of microfinance of about 5000 you know, you feel like he is being harassed. I wouldn't be happy."* He talked about the pressure some MFIs put on their clients. *"They don't give you time. Even we had a case where they entered someone's house without notice. They only met the kids and walked in took his cupboard an tv and dvd."*

These interviewees showed that over-indebtedness is seen a problem by clients. Interestingly, the severity of the situation was perceived as higher by clients than by MFI staff.

MFI Support

Comparing cases, it seemed that the severity of the over-indebtedness also was depended on the support provided by the MFI. Ndege's policy is to help someone that becomes over-indebted: "*Our mzungu, [white person] [..], goes to that member to look what is going on. If she is sick, she is there to pay the bill of hospital, the members should continue with their businesses. If business is not going good, we try to give you another loan, to do your job and start paying again. She usually tells us, go to that member, talk to that member, and know what is happening to that member because they are not paying the loan."* a loan officer explained.

As Ndege helps over-indebted clients by rescheduling payments and helping the client in dealing with the causes of the indebtedness, their clients might be less over-indebted or at least experiencing the negative effects of their situation less. This might mean that certain aid to indebted clients decreases the degree of over-indebtedness. Data on this however is to limited to make a clear proposition on how this might function, since no client interviews were conducted for Ndege.

Characteristics of over-indebtedness

In the interviews several characteristics of over-indebtedness were discussed. Most salient seemed to be the economic consequences such as the auctioning of household goods, emotional and relational problems such as family break-ups but also the severe stress because of pressure to repay. Additionally, many mentioned the consequences that over-indebtedness has for co-guarantors. They have to settle the outstanding loan balance of the over-indebted individual. Therefore, their economic situation suffers, sometimes even their businesses fail because of the financial burden imposed. This shows a potential domino effect in the over-indebtedness.

Economic and emotional consequences

There are economic as well as emotional consequences to over-indebtedness. Many loan officers told me similar stories about bankruptcy and spouses not knowing about the loan in the first place. As a loan officer of Nyati explained me *"You find that most wives, they are in this Kenya Women Finance Trust,[..] and they default, and the bank comes with the auctioneer and the auctioneer picks up everything and the husband in the evening comes; where is my property? We can't sit in here. And the kids are crying."* A Ndege higher level manager told me a similar story: *"What happens, I'll give you an incident of one [..] I followed up. This member had borrowed to different MFIs. What happens is that they will move from where they stay, [..] And you see it brings people family break-ups. Because you end up seeing this person selling this item, and pay that loan. They sell the other shop. That one I've seen happen, too much loans. It is not advisable."* Also a Twiga loan officer described these kinds of circumstances: *"The chance of the involvement of the auctioneer, where they risk to lose their possessions and especially.. [..] what microfinances do.. some of the clients that you deal with do not have these fixed assets to deal with, so what we do is the household goods, the fridge, the TV, the couches in the house, the cupboard inside. But you don't touch the utensils and the bedroom. So there is a risk of such items being taken away for auction, to gather for the loan balances. Of course the effect is, there are chances of family break ups, let's say it's a lady that took the loan and did not inform the husband, there will be a problem. There is sentiment in terms of.. even in the community, your esteem is quite lowered you can't.. you don't get involved with the people, business wise you are taken miles back. By the time you build your life again.. it will have to take quite some time."* MFI Staff as well as clients mentioned these kind of situations that appear in case of over-indebtedness. Many mentioned auctioning of the household items such as fridges and couches and also many mentioned family break-ups.

On my visit of a Twiga branch the loan officer showing me around told me that she really does notice over-indebtedness and quite often. She described me her view and how she notices. Clients start defaulting, you find out they have more than one loan and they have troubles supporting their family. She said: "*they turn grey and slowly die*" because of the stress they experience.

One of the loan officers of Pundamilia explained me that there is a variety of reasons why people default: "*sometimes their businesses are down. There are those that default willingly. You have that. But most of them you get that they are overfunded, maybe they have loans with other microfinances. Then it is like a pattern, so they default."*

Disappearing people

What also happens often is that people flea. Several loan officers mentioned this. A Twiga loan officer said: *"They close the shop. They stop doing business. In fact, some even run away. Some even go back to their rural areas where they came from."* One of the other loan officers shared his experience with me*: "I*

went to see a client yesterday, he has been in AREAS [measure of default on a loan] *for the last week. So I went to ask for a total AREAS of around 4000 shillings. So in that process, of course I went with the group leaders because I can't go alone. So when we arrived at the shop we found a lady, who was requesting the guy to pay up some 100 shillings. And the guy was saying; I don't have the money. [..] So what I did, so we walked around, talked to some neighbours. It turned out that this guys has so many loans. And you are not sure he'll be able to pay your loan. Then we went to ask for the 4000 shillings. You know before that he had chased away the lady, literally, can you go away I have a bigger problem then you think. [..] So he told us, let me close the shop and I go and look for the money and then I'll repay. So he closes the shop, the shop has an exit door. So we stood in front of the shop for like 2 minutes and then we noticed that he was not coming out, and he was gone."*

Also, one of the loan officers at Ndege told me that some people take a loan and just disappear: *"Some can take loan and disappear. But even if they disappear you go there and stay long, and you come back to your senses and see that you have done something wrong. But sometimes we have a credit finance that goes and finds those people where they are. [..] But some people disappear forever."* She also acknowledged the burden this leaves on co-guarantors, with having to clear the outstanding balance.

Collection methods

A higher level manager of Nyati mentioned that there are MFIs that use very harsh collection methods in case of default "*They will beat you to the payment. [..] you tend to repay the ones who is putting you under a lot of pressure and who is a bit unorthodox in terms of collections."* This of course also damages the over-indebted client.

However, a higher level manager of Pundamilia did not have the impression that clients get pressured too much or in inappropriate manners by (other) MFIs when they are defaulting. *"Putting too much pressure on their clients? I don't think so."*

Credit reference bureau

Several participants told me how clients that are unable to pay off their loans are put on a black list at the credit reference bureau, which as a loan officer explained to me, makes it harder to revive their business, since they lack funds to do so and cannot get a loan anymore.

Co-guarantors

A Nyati mid-level manager told me that sometimes a situation arises where guarantors don't want to guarantee a person anymore and the person has to leave the group. This causes this person to end up with substantial debt, not being able to borrow again.

A Nyati client told me it happens quite regularly that co-guarantors have to pay the outstanding balance of other clients: *"Yes, some take loans and they disappear. Yeah. After they pay once or they don't even*

pay. Like now there is one we paid for. We took a loan, top-up and then he paid two times and then he disappeared. So we paid for him." Also, one of the Pundamilia loan officers said: *"In a group they guarantee each other so if one cannot pay the loan, and has less money the others contribute for him or her. So the others pay for him. Maybe it is big money, then we take their securities, household goods, for the balance. But in case a client disappears, because there are those who disappear so in those cases we take the savings of the rest of the members to pay it all. To set of those balances."* Also some Twiga staff and their clients mentioned the negative consequences for co-guarantors when a person becomes over-indebted. A loan officer shared his experience: "*When you enter into the market you are trying to market to some good client and there they give you the encounters of how they were cheated, their money was used to pay other defaulters loans."*

What stood out when I interviewed Pundamilia clients is the statements of the one lady that was struggling to make her loan instalments. She told me she would really like to have more information about other clients in her group before she guarantees them, since knowing someone on a personal level does not mean knowing their current financial situation. Her group had to pay for other clients already on several occasions, which was a burden on top of her own struggle.

Additionally, clients are unable to get loans for their own business if another client cannot make the instalments and they have been unable to pay the other client's debt. *"Yes and you see, if one is not paying, others will not get loans. Because you have guaranteed someone and the loan is not being repaid."* a Nyati loan officer explained.

All these descriptions show that over-indebtedness of one client trough the co-guarantee mechanism also impairs other clients.

Based on the interview findings and the described consequences of over-indebtedness the following proposition was phrased:

P4: With the maturation of the microfinance market over-indebtedness increasingly becomes a problem for micro-finance clients.

4.2.5 Market trends and developments in an increasingly mature market

The data only provide an initial answer to the second sub-question; *What market trends and developments are observed within the increasingly mature microfinance sectors in developing countries?* As this study only looks at the case of the Nairobi sector, other trends might be found in other maturing markets. However, participants mentioned several market trends in Nairobi. The most salient ones were increasing competition, increasing multi-borrowing, the credit diversion to non-business purposes and growing over-indebtedness of clients. The functioning of these phenomena was described by participants, which adds to existing literature as these trends are generally little researched thus far. Other trends mentioned by participants were the increasing client sophistication and technological changes, which seemed less salient and did not seem to have relations to other trends or outreach.

4.3 Relationships between outreach and the trends in the market

To answer the main question of this research - *Which consequences of increasing outreach are noticed within the microfinance sector in developing countries?* -The relations between mentioned trends in Nairobi were discussed with participants and based on these data a model was constructed. As this study is exploratory in nature not all participants discussed every relationship possible in our model. However, in this way the most salient relationships were mentioned most. Relationships that were observed by participants were between competition and outreach (section 4.3.1), outreach and multi-borrowing (section 4.3.2), competition and multi-borrowing (section 4.3.3), multi-borrowing and over-indebtedness (section 4.3.4), competition and over-indebtedness (section 4.3.5) and credit diversion and over-indebtedness (section 4.3.6). The proof found for the relationship and the nature of each relation will be discussed in this chapter. After which the over-all picture is shown in the form of a proposed model (section 4.3.7).

4.3.1 Competition and Outreach

The vast majority of participants on the organizational level saw a relation between competition and outreach. Many said they had seen an increase in outreach caused by the increase in the number of microfinance organizations and the competition that accompanied this growth. Many saw the competition as a pressure on MFIs to reach more clients but also to reach even lower income levels. When the market gets saturated MFIs tend to search for new markets and are more willing to go an extra mile to attract customers. A higher level manager of Pundamilia described this relation clearly for the less competitive markets his organization is in: *"if you are able to lend on a higher rate and you don't have to work very hard to get that business, to have a nice business, you won't push harder to go to places were no one else is."*

However, as was found in regard to the first sub-question, the general opinion was that the lowest income levels have not been reached. Many described how most MFIs are fishing in the same pool of clients. A Pundamilia mid-level manager for instance said: *"We are all targeting the same customers and everyone feels these are the customers who need the assistance or the loans so with that we just end up swimming in the same pool [..] because we all operate within the same brackets of the starting loans of maybe 10,000 to maybe a maximum of half a million there is still that person who needs 500 shillings who is not yet reached and I don't think she will ever be reached because we are all now operating on the same policy*." Targeting the same clients does not increase the outreach for the whole sector.

The competition causes MFIs to set profitable targets. One of the participants that had more than 10 years of work experience in the field told me: "*For me with my values I know that I don't mind targeting those ones but now I also have to be sure about my target [...]. If I'm told I have to disperse something like, I have a target of 230 million to disperse you know if I start targeting the very low 5, 000 2,000 shillings*

1,000 I'll never achieve my target so I also go for the big market." Therefore, it is likely that the increase in outreach caused by competition has been more focused on the breadth of outreach, then on the depth of outreach. Some literature even states that competition between MFIs for profitable borrowers lowers the ability of socially engaged lenders to cross-subsidize (McIntosh & Wydick, 2005). This means they cannot generate a profitable portfolio containing very profitable clients but also the poorest, and thus least profitable borrowers. Higher competition is associated with higher default rates, thus higher cost for MFIs. Working with limited resources and higher costs means that the least profitable borrowers suffer. This means that the poorest borrowers are not targeted anymore when competition intensifies (McIntosh & Wydick, 2005; Navajas, Conning & Gonzalez-Vega, 2003; Assefa, Hermes & Meesters, 2010). Navajas, Conning and Gonzales-Vega (2003) justly note however that there are also signs that increased competition lowers the cost of borrowing and increases innovation and thus makes loans more widely available to the poor.

Likewise, among the participants many still held the opinion that also the depth of outreach has increased and will increase with higher competition. A loan officer of Twiga for instance said: "*you see because of increasing competition, people will strive to go deeper. Because it is that you want to ensure that you are the first person to reach this person."* As the market will become more saturated MFIs will have to go into different segments, including the lower incomes, to fill their targets. Which makes it probable that competition stimulates outreach less, if MFIs continue to target the same saturated market segments. Also, even further in time, when the market becomes totally saturated, competition will not stimulate more outreach anymore. As outreach an outreach ceiling will show.
This leads to the following proposition:

P5: Competition and outreach are positively related; this is mitigated by the market saturation of certain market segments.

Imaginable when this relation will be tested is, that an increasing slope with a declining growth in the later stages can be found, due to market saturation.

4.3.2 Outreach and multi-borrowing

Several participants mentioned that they saw a relation between higher outreach and multi-borrowing. First of all there is the simple reasoning that more outreach means more availability of credit, which makes it easier for clients to get access to several loans. A higher level manager I interviewed at Nyati for instance explained: *"I know that sector deepening has happened [..] so it's no longer restricted. Anybody who has a small micro business and wants access to credit, I think that is much more easily available than it was there previously."* Additionally, there is the problem of under-funding; MFIs are bound by their policies in the amount they supply to a borrower. Therefore, often people receive less then would be ideal for their business. This situation was referred to as under-funding by several

participants. Also, many clients receive less than what they perceive is good for their business, however their perception of what they need might be off; in which case it is not under-funding, but it will lead the client to search for additional funds. Under-funding was seen a salient phenomena within Nyati, Pundamilia and Twiga. A Nyati middle management member for instance described the situation in which someone had a certain loan at anther institution and came to her for a loan. But because the client was a first borrower to this organization she had to give this client a smaller loan than actually needed. "*So, we just have to agree with them that they have to start with a lower [loan] at 50,000 to start with but you realize she is beyond the 50,000. I'm talking about maybe that's a weekly sale. So, fit her there and then after she pays the 50 you give her 75 up to 85 like that. [..] they then pay within a very short time; three months."* Clients that do not receive the funding they need, tend to take on more than one loan. A Twiga middle management member also discussed this mechanism elaborately. She painted the picture clearly*: "My business has grown. [..]I'm five years older, so is my business. So that is why now the issue of multi-funding in the market comes in. So, yes the new [microfinance] company comes in with the new products and the markets appreciates it, but where do you start from. [..] I have already done my 20 [000 Ksh] elsewhere. But if you insist, I'll do it your way, but be informed until you reach where I am, I'll seek friendlier terms and conditions until you reach where I am in my growth."* She, as many others contributed this to the procedures they have to follow. *"Why am I under-funding? Because of my loans and procedures. Yes, I don't know you, I don't have your credit history, so I won't give you a 100 000 straight. But I could be under-funding your business.*" Since microfinance needs specific mechanisms that substitute the collateral in regular banking lending, it will be hard, though not impossible, to change these systems. In my view these systems are in place because the MFI needs to protect itself from defaulters but also to guard the capital it has and establish a substantial outreach. The described relation was not found in literature, therefore based on the interview data the following proposition was formulated:

P6: A higher degree of outreach in the market is accompanied by under-funding which will lead to more multi-borrowing.

Potentially this relations exits because clients can switch institutions more in a market with a higher degree of outreach which leads to shorter relations between the MFI and the clients. This would make it harder for an MFI to assess the clients credit worthiness, thus makes the MFI provide lower amounts. However, the data does not substantially support this assumption, so it would need to be tested in further research.

In theory an MFI with a certain amount of capital, can have many small loans or fewer big loans or anything in between. However, a bigger outreach would mean more and potentially smaller loans, which would restrain the MFI in the amount it can provide per loan. On the sector level the same could

apply, if one assumes there is a limited amount of capital available in the sector as a whole. Which means more multi-borrowing, thus supplying higher amounts to one individual would limit the outreach of the MFI sector.

Therefore, the relationship between outreach and multi-borrowing also works the other way. Also more multi-borrowing will increase the costs of the assessment of the income of a business, as well as the default rates. This will restrain the available capital in the market, which will restrict MFIs in increasing their outreach. As discussed in section 4.2.2 multi-borrowing is associated with higher default rates. This relation was not seen as definite by participants but it was seen as the often logical consequence of multi-borrowing. Higher default increases the costs. A higher management member of Nyati related the increase in the Portfolio at Risk (PAR) to multi-borrowing: "*"the fact that a lot of people in groups both want to borrow from Nyati and also go to the local one you find that actually the portfolio at risk in that sector is growing whereas before it was actually a very small proportion and acceptable 2, 3% you find that now it grows to 10 and 11%"* Which, simply put means an increase in loses due to bad repayment.

While MFIs already have high cost concerning the assessment of the income of potential borrowers, due to multi-borrowing these costs increase. As previously discussed it is hard to find out whether a client is multi-borrowing which means MFIs have to invest extra time to do so.

P7: Multi-borrowing will decrease outreach, because the added cost caused by multi-borrowing will decrease the available funds for new credit relationships.

4.3.3 Competition and multi-borrowing

About half of the participants mentioned a positive relation between competition and multi-borrowing, often in a direct manner. A loan officer of Nyati for instance stressed: *"Because of the introduction of this competition, the same same client tends to multi-borrow. If the client multi-borrows, what happens you still have the same one business and you have multiple loans. The business collapses."* Even a client of Pundamilia mentioned multi-borrowing as a disadvantage of competition. As discussed in 4.2.1 competition shows in the substantial marketing and sales efforts MFIs make. Sometimes techniques can be very aggressive, as for instance loan officers actively contact the clients of another loan officer. For instance one loan officer described how she would target the customers from an organization she previously worked at, because she knew what this organization offers. While it is easy to argue that having more MFIs enables clients to multi-borrow, the relation is slightly more complicated because of the aggressive and often personal sales techniques some MFIs use.

Additionally, because of competition the market has become less transparent which makes it harder for MFIs to track their clients outstanding loans. This also enables clients to multi-borrow, even if the MFI does not allow it. Many of the loan officers explained to me how it is very hard to know about multi-

borrowing and how they often only find out when a client defaults. A Twiga manager I interviewed explained to me how they can sometimes find out anyway: *"They don't disclose but there are various ways of establishing that. One, if for example you meet a group and it is already registered, if you dig into their history they can disclose, we were forming this group to be funded by maybe a competitor. That is how you find out. But very few really will disclose. Others are straight. They say; This is me. But I would say that is 10 not more than 20 per cent."* One of her loan officers told me how he tries to find out. *"Maybe I'll pass by your business later after the meeting or I say it's not a group meeting today just to have a chat with you. Just do an inquiry; Are you aware that so-and-so might be having a loan elsewhere? And you find they open up. Not necessarily that they want to set up this person, but also it is for the benefit of the group. Because if you are a member, you know if this loan goes through, if such a person defaults than it's up to you to pay. So you find them opening up."* A multitude of similar stories were told. This shows a low transparency in the market caused by rapidly increased competition. While the number of MFIs and therefore the alternative sources of credit for clients increased no sufficient measures have been taken to prevent clients from taking on to much debt with several organizations.

McIntosh and Wydick (2005) found similar trends in their model of a competitive microfinance market. Their study showed that a negative effect of MFI competition is that the market becomes less transparent as competition increases. Information asymmetries between borrower and lender increase as the information sharing between lenders becomes harder. This creates an incentive for clients to multi-borrow. Which increases debt levels amongst borrowers as well as the repayment rates, causing increased costs for MFIs. This leads to the poorer borrowers being dropped from the portfolio and makes all lenders who are faithful to one institution worse off because MFIs are more restrained in their resources. Also in the Kenyan market this situation showed. In their study of the Uganda microfinance market McIntosh, de Janvry and Sadoulet (2004) found that increased competition combined with lacking information sharing leads to a weakening of repayment performance and lower savings. They suggested this was caused by an increase in multi-borrowing.

Back in Kenya, several participants told me that because of multi-borrowing the information sharing between organizations already increased: *"Nowadays, it is very usual to meet an officer or a staff member of another company and share notes. Discuss even an area portfolio, and area's coverage, discuss client trends. [..] So there is a lot of openness, which has come because we were discovering that many clients were double funded"* However it is all very time consuming and based on the loan officers network, hence not efficient enough to make a substantial impact. Some participants however wanted to emphasize that the will to cooperate with competitors had grown.

Based on interview findings as well as literature, the following proposition can be formulated:

P8: Increased competition causes more multi-borrowing.

4.3.4 Multi-borrowing and over-indebtedness

Participants described a clear relation showing that multi-borrowing leads to over-indebtedness. Some even considered the two concepts to be the same thing. A middle management member of Nyati clearly explained how the relationship functions: *"But for this person who is multi-packed she will borrow from left right and centre. Remember these loans have interest rates. It's the same business that's supposed to pay these loans and there is still one problem with the customers, they don't take the money to the business, so you can imagine what happens to the business, it pays so many loans which it was not fed with, so it collapses."* Many clients multi-borrow to pay off loans. A loan officer of Nyati told me: *"Today you can meet me and you are in a group. You borrow 200 000 from me today. But you are also in another institution. And another institution. And another institution. So you are totally over-banked and much borrowed. And you have no income. So you borrow from me, to pay Equity. Borrow from equity to come and pay. So the essence remains you are not getting yourself out of the roots. You are still stuck in the same grounds. Year after year."* showing a tremendous vicious cycle. I also spoke to clients who were in this situation. One asked me what to do to get out of this cycle. And I could not answer her.

Loan officers seemed to grasp the severity of the situation best, one even told me: *"In fact these microfinance institutions make they are poorer persons".* She elaborated explaining how too many have debts because of multi-borrowing. Even at Ndege were the members borrow on the basis of a personal relation with the people in the organization multi-borrowing is seen. A higher level manager had a clear opinion about it: "*I don't think it is a good thing, because it does not assist the poor, because when you lend so much, you don't end up climbing anywhere."*

However in this research it was found that it is not only the person who takes on multiple loans that can become indebted because of it. Due to the co-guarantee mechanism, a person taking on multiple loans can force group members to pay substantial outstanding loan balances. A Pundamilia loan officer explained me: *"There the aspect of co-guaranteeing comes in. It is very hard to make others pay for the loan if they know, he took the loan. For somebody that you never shared anything with. It becomes very hard. But the aspect of co-guaranteeing, we need to enforce it."* This also can involve substantial amounts, which can ruin someone else's business. *"So the others pay for him. Maybe it is big money, then we take their securities, household goods, for the balance. But in case a client disappears, because there are those who disappear so in those cases we take the savings of the rest of the members to pay it all."* Another loan officer explained.

For the MFIs aside from that they do no reach their social mission they also suffer financial consequences. A higher level manager of Nyati explained: *"multiple loans actually have been the biggest problem [..] previously you could find that, like I said, the none performing portfolio for micro was very insignificant it was really about 1 or 2 I think maximum was 3%. There are some, some of these the earlier organizations that did zero none performing, [..] Now that you have people borrowing from multiple*

organizations and stretching their capacity to finance that, that is increasing. And a lot of the people who actually fail to pay are actually those ones [..] that are borrowing from different organizations or different groups." McIntosh and Wydick (2005) in their model of a highly competitive microfinance market showed the same. Repayment rates decline, which limits the MFI's resources. This also means that single loan holders are worse of since there are less resources to serve them.

Most participants, especially on the lower hierarchical levels saw the situation in the market as quite severe. The Pundamilia mid-level manager I talked to estimated that "around 60% of the microfinance business is dead due to multi borrowing." A Twiga colleague did not mention a number but being asked whether clients get in problems because they have multiple loans, she answered: *"Most of the time they will. Most of the time."* A higher level manager of Twiga did not think it was a massive threat but did see a relation. When asked if multi-borrowing leads to over-indebtedness he said: *"It doesn't necessarily. It does not automatically follow. But I'm sure that if statistically you would be able to count.. .. there is a correlation."* Many participants, among whom several micro-entrepreneurs, vocalized a whish or need for information sharing on a substantial scale, so that the MFIs would be able to prevent over-indebtedness due to multi-borrowing.

Studies in other markets report findings in congruence with these views. Vogelgesang (2003) in her study of the repayment determinants of the Bolivian Microfinance lender Caja Los Andes, also found that competition is accompanied by over-indebtedness, mainly due to multi-borrowing. She found that because new entering credit companies supplied relatively high additional credit to micro-borrowers, repayment practices of many clients worsened. McIntosh et al. (2004) interviewed credit officers from several major MFIs in Uganda. These participants shared unanimous the view that double-dipping leads to higher default rates. These were related to a lack of information sharing and therefore knowledge of the clients' credit history. Also, Guha (2007) in her study in India found that in absence of sufficient income generating activities, clients that have multi-borrowed are unable to stick to their loan repayments. Which shows a high likelihood of over-indebtedness.

The Consultative Group to Assist the Poor (CGAP) conducts research in microfinance on a substantial scale. In one of its reports Chen, Rasmussen and Reille (2010) discuss the recent repayment crisis, after a period of exponential growth, in four different microfinance markets; Nicaragua, Morocco, Bosnia and Herzegovina, and Pakistan. Correspondingly to the findings in this research, it discusses how concentrated market competition and multi-borrowing played an important role in the development of the crises. They found that MFIs did not spread their service delivery to different markets but often competed aggressively in specific areas. This increased the likelihood of multi-borrowing. In Morocco for instance the central bank provided an estimate of 40% of borrowers having credit with more than one microfinance organization just before the crisis. In the other researched countries similar numbers

became apparent (Chen at al., 2010). This potentially indicates a relation between multi-borrowing and the inability to repay such as seen with over-indebtedness. Chen et al. stress that there are some deliberate decisions by MFIs that stimulate this relationship. MFIs often purposely target markets with high economic activity, as do most of their competitors. Also, there have even been MFIs who's strategy it was to target other MFIs borrower groups, so said to save on financial training of clients. This falls under the aggressive marketing and sales techniques that were described by the participants in this study.

Also, Chen et al. discuss how this wide range of options borrowers have, can lead them to take on repayment schedules that surpass their cash flows. The authors find it hard to indicate whether these clients were over-indebted or not, however they found clear evidence that for many clients the total debt exposure grew substantially in the researched markets.

Based on all these responses and findings in other microfinance markets, the following proposition can be formulated:

P9: Multi-borrowing leads in most cases to over-indebtedness.

4.3.5 Competition and over-indebtedness

Some participants discussed that next to multi-borrowing there is another reason for over-indebtedness that relates more to the behaviour of MFIs than to the behaviour of clients; over-funding. Some microfinance banks, for a variety of reasons, issue a loan that is too big for the clients to repay. Therefore, default and often bankruptcy of the clients follow. There are several reasons for this.

First of all, there is the bank wrongly assessing the income streams of the clients. As previously discussed and explained by almost every loan officer I talked to, it is difficult to assess the income of the client. A wrong assessment can mean that a client receives credit that she cannot afford. Resulting in weekly instalments that the business does not generate. A Nyati loan officer explained to me: *"if I am giving you a loan of 50 000 and I am not going to visit your business. If you are dealing with, maybe you have a small hotel, just started, you don't need that kind of huge capital. You need like 30 000 so, that could be a delay or something that is caused by the officers who don't attend, who don't go to the meeting or do not visit the customers in their business premises."* A Twiga loan officer explained that sometimes it also is caused by deception of the clients*: "A client and the group might decide to play tricks on you, maybe make you give a big loan, they can decide to use assets that are not his or hers, or even the business."*

Some organizations especially start-ups are not professional enough to estimate the risks, for them and the client. A Nyati mid-level manager explained*: "They do overfund more, they are not familiar with the market. They just think microfinance is giving. [..] once they are beaten they come to us now to research*

what really happens here. So, they over finance due to lack of proper research before they do it." The more you have new entrants in the market the higher the chances these situations come to exits.

Direct competitive pressures can drive MFIs to overfund more than in a normal situation. A lady with a very successful mortuary business that I visited told me about the competitive pressures and the irresponsible loans that banks give out because of them. When I was interviewing her, the phone kept on ringing, but she did not pick up. She said *"Like [name] bank now, they were in fact trying to call me now. They say if you go to their bank, they give you unsecured loan. I think it is from 50 000 up to 2 million, unsecured loan. So that is a lot of money, without any security."* She then explained why you should never take an unsecured loan and how working with more than one bank can make your finances very complicated. Fortunately, she was smart and understood the dangers, but many others do not see this and end up bankrupt and homeless. A Nyati loan officer described how other MFIs come to offer their clients high loan amounts and how some organizations respond by increasing the loan size for this client: *"Because you still don't want to lose the client, the client tells you make it better. Give me 1,2. That 200 000 will be a total diversion of funds. But you will find that people have fear of losing the client. But experienced officers will tell you, if they offered you one million. Let me see it, let me analyse it."* Also a Twiga loan officer noticed some organizations over-funding because of competition*: "If you are competing in an area, let's say Kawangware, you want to concur the market. What will you do? You will give customers more money."* He did not agree with the practice but did notice it. Rhyne & Christen (1999) noted the same in the highly competitive microfinance markets they studied. Good clients that are repetitively on time with their payments are a valuable commodity in highly competitive markets and the basis for a healthy loan portfolio. Therefore, some MFIs offer larger loans to their best clients, which can result in irresponsible lending. Aside from providing too much credit, competition makes MFIs loosen other relevant contract terms, as was already touched upon in the literature study. Kaffu and Mutesasira (2003) did a longitudinal study of the Ugandan microfinance sector. In this research, among other changes, they noticed that because of substantially rising competition MFIs started to lower collateral requirements and extend the loan term of their loan contracts. This shows that because of competition MFIs start taking more risks than they initially saw as safe. This can also potentially lead to more over-indebtedness.

Additionally, there are organizations that put their profit over their social goals, which shows some immoral practices. For instance some are just negligent in their business assessments on purpose. A higher level manager of Nyati described how some organizations directly overfund clients and can do so because they do get their money back no matter what, because of the extreme recovery techniques they use*: "they could over fund because they know they could go out and they will beat you to the payment."* These situations can be contributed to high competition where the social aims of microfinance lose grounds over the financial aims of for-profit MFIs. Likewise, a Nyati client told me that some

organizations use inappropriate practices to recover their loans. They treat clients badly; *"Some, you hear people say, they shout at you. If I default one or two weeks. When I come to talk to you, you don't have to shout at me. So that everybody will know I have a loan I didn't pay*." Or make unreasonable demands; *"Some of them, if you take a loan with them, when you default, one week or two weeks. They will demand the whole amount from you."*

All these causes lead to the same relationship:

P10: Competition leads to over-indebtedness due to over-funding of clients.

4.3.6 Credit diversion and over-indebtedness

Some interviewees mentioned that credit diversion often leads to clients being unable to pay their loan and over-indebtedness. A higher level manager of Nyati for instance said: *" And where you have people taking micro loans to consume then you find that, that actually makes it difficult for them to service whatever small loan that they have gotten."* A mid-level manger of Nyati also saw this relation: *"They don't take the money to the business, so you can imagine what happens to the business, it pays so many loans which it was not fed with, so it collapses."* One of her loan officers reasoned the other way around, mentioning the reasons for default: *"There are a lot of people who cannot repay their loan, especially people who diverted or who were overfunded or underfunded also."* A middle management member of Twiga I talked to explained why credit diversion is common among her clients: *"Life in the city is expensive for them since they have to pay for everything. The current economic status contributes to these clients living from hand to mouth. Which means that some buy their food on credit and plan to pay at a later date. The majority live in continuous rent arrears and school fees debts. They rarely divert money to buy household goods as these are considered as luxuries. Another challenge is that they are not on medical cover neither do they have any form of insurance. Which means that when they need medical care they again have to borrow or get treatment in a cheap facility with a promise to pay when they get the money. Hospital admissions for any member of their family tends to hit them very hard thus the loan diversion in case of such an eventuality. Finally, being a communal society the older children, hence our clients, are expected to take responsibility of their siblings even if they are struggling to take care of their nuclear family."* She told me in a follow-up call that she did see a clear relation between credit diversion and over-indebtedness. *"Yes, there is a relationship between loan diversion and over-indebtedness. How we notice this is when your business assessment and cashflow shows the business ability to pay a loan. Yet from the on-set the client begins to lapse in their loan repayment or after a few weeks you can tell they are struggling to pay the full instalment. On closer follow-up, they will open up and disclose one of the reasons I mentioned. Let me also mention that when they are desperate they will borrow from the shylocks. [Informal lenders who charge unreasonable interest rates and usually lend for very short periods]."*

Clients of the four microfinance organizations also often mentioned credit diversion leading to problems. A Twiga client put it very straightforward: "*Because if you get a loan and you put in other uses, you definitely will have a problem paying."* A Nyati client and another Twiga client had similar statements. Also when asked why others got in trouble people usually mentioned credit diversion, related to stories of auctioneers collecting collateral. The focus group I conducted at Nyati also had some over-indebted individuals in it. One lady told me about her struggle to pay three different loans and how she needed the money from one loan to pay off the next and to live from. This group seemed to agree credit diversion was a common and accepted practice.

Collins (2008) discusses causes of over-indebtedness that came out of a longitudinal study in South Africa. This involves not necessarily micro-credit but also other sources of credit. Similar stories as the ones told by the participants become apparent in his research. He gives the examples of participants that become over-indebted because of funeral costs and unexpected illness. If these problems cause over-indebtedness for people on payroll or with only family loans, it is not strange the situation is more intense for micro-entrepreneurs working with small margins on their business investments.

In conclusion, the following proposition can be formulated:

P11: Credit diversion leads in the many cases to over-indebtedness.

4.3.7 Salient trends lead to over-indebtedness

Based on the propositions the model in Figure 12 can be proposed. It seems to be that in a high outreach market, several trends lead to more over-indebtedness of clients. Some clients directly saw a relationship between high outreach and over-indebtedness. A Twiga loan officer for instance said: *"it is directly proportional. The higher number of people you reach the higher the chance of meeting with such defaulters."* Most participants however mentioned it to be a consequence of the other trends.

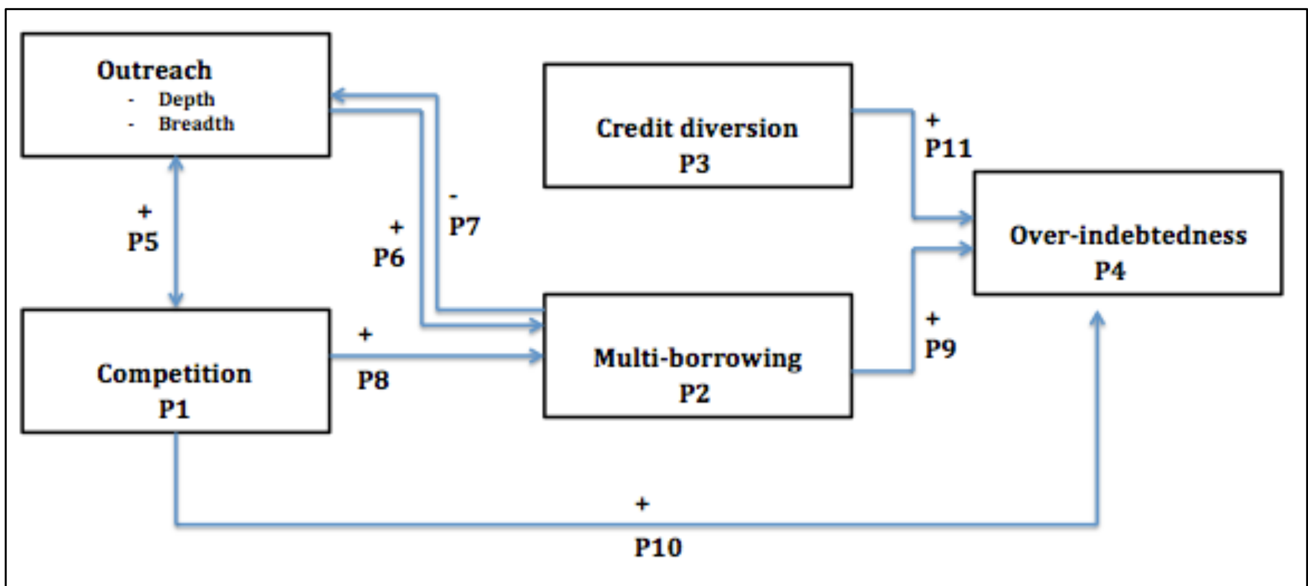

Figure 12: Proposed model regarding trends related to the outreach of microfinance.

While credit diversion did not show as a direct consequence of higher outreach, it is seen as an important cause of over-indebtedness. Since we cannot say whether there is a relation between the two concepts, it was not included in the proposed model. This does not mean however, that there is no such relation.

To answer the main research question of this paper, the consequences of outreach need to be assessed. Not all factors presented in the proposed model can be directly or solely marked as a consequence of increasing outreach as we clearly see in Figure 12. However, the propositions provide a context for the concepts in relations to outreach, which can be used as a start of theory building on the consequences of outreach. Competition and outreach are perceived to be positively related, while both are believed to influence multi-borrowing. For outreach this is through under-funding. Competition itself is seen as influencing over-indebtedness because it drives over-funding. These are the relations that could be marked as consequences of outreach.

The other relations show more the context in which over-indebtedness comes to exist. While this was not the main research question, we can argue that over-indebtedness is seen as an indirect consequence of outreach.

5. Discussion

This research adds to existing literature in three ways. Firstly, it paints a picture of what can happen in a more mature microfinance market. As in an increasing number of markets increased maturation has become reality, it is time for scientific literature to extend its focus. Secondly, the study adds to literature which focussed on how to create more outreach rather than on the consequences of high outreach. This study provides propositions about the potential consequences of outreach and the context these consequences are in. Thirdly, this study provides a starting point in identifying the causes of over-indebtedness, as this is an indirect consequence of increased outreach.

The more mature microfinance market

The first addition to existing literature is the image of a more mature microfinance market. Outreach seems to grow as the market matures, mainly regarding breadth of outreach. Participants were divided on the topic of whether start-ups should and could be targets for microfinance. The point of view on this topic influences the market potential and thus the perception of the extent of outreach.

Participants saw competition increase over time. The number of MFIs has grown substantially, also referred to as MFI mushrooming. However, competition not only stems from MFI mushrooming, but also from formal banks entering the microfinance market and an increase in community based lending. It seems that everyone in Kenya is giving out microfinance loans, as one participant shrewdly observed. Aside from community groups and trade co-operations, even churches provide microfinance loans. MFIs seem to use aggressive marketing and sales techniques and provide more flexible contract terms to compete in this environment. This includes contacting clients of other organizations and offering them another loan.

All participants mentioned multi-borrowing as a growing trend in this more mature market. While the magnitude of this trend is hard to estimate both for MFIs and clients, due to non-transparency in the market, general agreement is that it is a growing phenomenon.

Microfinance clients divert credit to non-business purposes for several reasons. Common aims are education, health care and real estate investments such as housing or land. Kinship ties also play an important part in the diversion of credit as relatives in several tribes are expected to take care of extended family and distant relatives. Most participants were not clear on whether this was a growing trend or just a phenomenon that existed for quite some time. However, the vast majority marked it as a main cause for over-indebtedness.

Over all, over-indebtedness is seen as an increasing problem. Participants believe over-indebtedness to cause economic problems, emotional and relationship problems and severe stress for the indebted client. It is often noticed because of the auctioning of household goods. Also, many emphasised the

burden it puts on co-guarantors, whose financial position is disturbed because of the joint liability. Interestingly, MFI staff, especially on the higher hierarchical levels, estimated the magnitude of over-indebtedness as less severe than clients and field staff. In the comparison between cases it also seemed that the level of support provided by an MFI positively influenced the severity of over-indebtedness. Rescheduling loans and financial support in case of health problems seemed to smoothen the repayment problems. However, the data on this was very limited.

Literature thus far has only provided limited parts of this broad image of a mature microfinance market. In congruency with these findings, literature also shows an increase in competition in other markets around the world where similar signs are noticed (Rhyne & Christen, 1999; Kaffu & Mutesasira, 2003; McIntosh & Wydick, 2005). MFIs in other highly competitive markets are also anxiously trying to retain their clients with a high amount of promotion and adaption to customer demands (Rhyne & Christen, 1999; McIntosh, de Janvry and Sadoulet, 2004). This is similar to the view of the participants in this study. Participant indicated that competition causes aggressive marketing and sales techniques and more flexible contract terms.

The limited research available on multi-borrowing indicates that it also exists in other markets (Rhyne & Christen, 1999; McIntosh, de Janvry & Sadoulet, 2004; McIntosh & Wydick, 2005). However, opposed to existing literature, the outcomes of this study show its context and consequences.

No research has specifically focussed on the diversion of credit to non-business purposes. Karlan and Zinman (2008) briefly mention its occurrence and note that data on this topic is scarce, naming a couple of examples. Also, Collins (2008) does note that it is often hard to distinguish between business and household expenses. Potentially this makes it hard for clients to not divert credit. The addition of this study on this point is the discussion of purposes of credit diversion and the connection found between kinship ties and credit diversion.

There is little literature regarding the occurrence of over-indebtedness in more mature markets, which is surprising, considering the attention over-indebted clients in India received in the popular press in 2010 (BBC, 2010; Bloomberg, 2010). In several countries such as South Africa, Bolivia, Bosnia, Pakistan, Morocco, and Nicaragua, repayment crises have occurred (Chen, Rasmussen and Reille, 2010), which may have been accompanied by over-indebtedness. However, a real assessment of over-indebtedness and its existence in a wider extent is lacking. This study shows that it exists and is perceived as a problem by clients, but unfortunately, due to the research design, the extent of it cannot be appropriately grasped.

Potential consequences of increased outreach

Additionally, the study adds to literature by providing propositions about the potential consequences of outreach and the context these consequences are in. Literature has focussed on how to create more outreach, as opposed to the consequences of this high outreach, which provides an opportunity for this study to present some initial propositions.

Participants believed competition and outreach to be positively related, however this is mitigated by the market saturation of specific market segments. As MFIs target the same geographic areas and segments, they are fishing in the same pool of clients. This does not increase outreach for the sector as a whole as the additional clients already had access to loans from other MFIs. Therefore, high saturation in certain segments mitigates this positive relation.

Literature on competition and outreach is often based on models of markets as opposed to data and does not show a clear causal relation. Regarding the depth of outreach, some studies show that the poorest borrowers are not targeted anymore when competition intensifies (Navajas, Conning & Gonzalez-Vega, 2003; McIntosh & Wydick, 2005; Assefa, Hermes & Meesters, 2010). Navajas, Conning and Gonzales-Vega (2003) justly note however that there are also signs that increased competition lowers the cost of borrowing and increases innovation and thus makes loans more widely available to the poor. Generally, literature has not shown agreement on the relation between outreach and competition. But this study does point towards a more elaborate explanation: the existence of saturated sub-markets changes the relation.

Participants believed multi-borrowing to decrease outreach. Multi-borrowing seems to increase costs for the MFIs, because of lower repayment rates and the additional costs incurred in assessing the income of clients. In this way, available funds for new credit relations decrease. Thus far there is no literature on this relation. If this relation statistically exists, it could mean that by regulating multi-borrowing or prohibiting it, microfinance can extend its outreach.

Increased competition is believed to cause multi-borrowing. Aside from the simple argument that the presence of more MFIs allows clients to multi-borrow, several participants mentioned that due to the non-transparent market in which MFIs operate, it is hard to prevent multi-borrowing. MFIs often only find out about the multi-borrowing of their clients when clients start defaulting. Aside from informal assessments with the client and her loan group, conversations with relatives and neighbours and visits to the business and home of the client, not many tools are available to uncover multi-borrowing.

McIntosh and Wydick (2005) discovered similar relations in their model of a competitive microfinance market. An effect of MFI competition is that the market becomes less transparent. Information asymmetries between MFI and client increase and the information sharing between MFIs becomes

harder. This forms an incentive for clients to multi-borrow. This multi-borrowing increases debt levels amongst borrowers and decreases repayment rates, which means higher costs for the lender. MFIs then drop the poorest borrowers from the portfolio, because of the higher costs involved in serving them. This also leaves clients that only borrow from one MFI worse off because of the strain it puts on MFI resources. McIntosh, de Janvry and Sadoulet (2004) found corresponding results in their case study of the Ugandan market. This study on the Kenyan market, however, puts this relation in a broader context as shown in the proposed model in Figure 12.

Participants in this study saw multi-borrowing as a cause of over-indebtedness. Studies in other markets report findings in congruence with these views. Vogelgesang (2003) found that over-indebtedness accompanies competition, mainly due to multi-borrowing. She found that because newly-entered credit companies supplied relatively high additional credit to micro-borrowers, repayment practices of many clients worsened. McIntosh et al. (2004) interviewed loan officers who worked for MFIs in Uganda. These loan officers unanimously shared the view that multi-borrowing caused higher default rates. They related this to a lack of information sharing and therefore a lack of knowledge of the clients' credit history. This makes it even more likely that there is a relationship between multi-borrowing and over-indebtedness.

Furthermore, competition by itself leads to over-indebtedness according to interviewees, because competitive pressures cause MFIs to over-fund clients. Thus far, literature has not described a direct relation between multi-borrowing and over-indebtedness in such a way. Kaffu and Mutesasira (2003), however, did find that because of rising competition MFIs started to lower collateral requirements and lengthened the loan terms of their contracts. These results show that MFIs start taking more risks due to competition, which might also result in over-funding. This study however, finds that in the perception of some microfinance practitioners and borrowers, competition does lead to over-funding and thus to more over-indebtedness.

The majority of participants believed credit diversion to cause over-indebtedness. This does not apply to all cases of credit diversion, but chances of over-indebtedness increase substantially when clients divert funds to other purposes. There is barely literature on this topic, however Collins (2008) discusses causes of over-indebtedness based on a longitudinal study in South Africa. The study concerns not only micro-credit but also other sources of credit. His participants tell similar stories as the participants in this study. Examples from his paper show over-indebtedness because of credit diversion for funeral costs or health care.

The causes of over-indebtedness

Reasoned from the other side of the proposed model, this study also provides a start to identifying the causes of over-indebtedness. While this is the other end of our model, it is relevant to also approach the findings in this way because the causes of over-indebtedness are barely studied in literature. In this study, diversion of credit, multi-borrowing and competition are seen as causes of over-indebtedness. Indirectly, this also means outreach can lead to over-indebtedness by causing more multi-borrowing or increasing competition.

To my knowledge, only Schicks (2010) intended to construct a model that describes the causes of over-indebtedness. However her model is not so much focused on the road to over-indebtedness but more on the social, environmental, or political situations that foster over-indebtedness. Her model is mostly based on consumer over-indebtedness literature regarding traditional banking, which is often researched in Western-Europe or the USA. She sees a triangle of elements that jointly cause over-indebtedness: 1) lender behaviour, 2) borrower behaviour or 3) external factors. The lender behaviour has many overlapping elements with the causes of proposition 10 in this study. Lenders start showing certain behaviour such as aggressive marketing and sales techniques when the market becomes highly competitive. Schicks does not include lender behaviour that causes multi-borrowing. The borrower behaviour in her model can be seen as causes of clients' tendency to divert funds or multi-borrow. However, her model does not show the actual behaviour (credit diversion, multi-borrowing) inbetween the psychological background and the result, over-indebtedness. Therefore, the theoretical explanation Schicks provides can be used as a start for researchers looking at why certain trends in the proposed model exist in more mature markets. The model proposed in this paper however, is more practical and provides a warning for MFIs regarding over-indebtedness when they start noticing the particular trends described.

Limitations

Of course as with any explorative qualitative study, the findings can only provide an initial gateway to a scientifically valid and generalizable answer. Many perceptions form the basis of this study, but they remain perceptions. As in many studies in developing countries, this research was conducted by a foreign researcher. While every effort was made to prevent miscommunication due to the researcher's cultural background, this could have influenced the interpretation of data. That said, there are some limitations specific to this research that need to be mentioned.

The view of the participants on what the most important goal of an MFI should be, profit or social impact, influenced what they perceived to be the target group for MFIs. Profit focused participants did only see economically active, business minded persons as eligible for microfinance. Socially oriented participants however saw basically anyone as the potential target group. Of course these are two extremes of a continuum of views of the participants. These different views are in line with the debate

in literature on financial sustainability vs. social impact, also mentioned in the literature section (e.g. Khandker, 1998; Gibbons & Meehan, 2000; Churchill, 2000). The view on this topic is also crucial to determine the state of outreach of the sector. This is because a high breadth of outreach, for instance, means you reached almost all the potential clients. An important limitation therefore of this research is that the assessment of outreach is mainly based on participants' perceptions, while their views on what the basic target group of microfinance is differs. If participants have a different view of how far outreach should go, then their perception of the extent to which this is reached is influenced. While for every participant the two views were compared in this research, this might not provide the most reliable image of the state of outreach.

This study focused on microfinance credit. Although participants mentioned other types of credit such as informal lending, the identification of trends was focused around microfinance organizations and their credit supply. While this makes this research more comprehensible and focused, trends might differ when focusing on persons using informal credit or systems such as merry-go-rounds. Since microfinance and these informal lending structures do not completely function in separate markets, and compete for the same borrower, this might restrict the findings.

As mentioned in the literature study, some have noted that a negative perception of financial institutions can influence the decision of clients to join an MFI. This means this perception would restrict outreach. A few participants in this study also mentioned that people have a negative image of the MFIs and therefore do not want to join an MFI. However, the data on this relation was too limited to construct a proposition. This relation might be existent but is missing in the model. Also other relations might exist that did not appear in our specific case data, which might be a limitation to the model.

The sample did not include the clients of one of the organizations due to security issues at the time of data collection. Unfortunately, this was the only organization that put its social objective over its profit goal. It was also the only one that did not have the requirement for clients to be economically active before they received a loan. It is imaginable that this influenced the data since their clients might have expressed a different view on market trends and their relations, especially regarding over-indebtedness.

While this study has many limitations, it does provide an initial glimpse at the situation of microfinance in relatively high outreach markets in East-Africa. And it can provide a clear starting point for further research on microfinance in mature markets.

Future research
Since the research on the topic is still limited, a variety of future research suggestions can be given.

It is of the greatest importance that the magnitudes of the trends that lead to over-indebtedness and over-indebtedness itself are measured in a quantitative research study of substantial scale. This could be done in a comparable manner to the Financial Access surveys, FinScope conducts to gather general information on financial access (FinAccess, 2009). While this necessitates a high amount of resources, the consequences for clients but equally so for the microfinance sector can be tremendous if this is neglected. The microfinance market in Nairobi and most likely other mature markets, are very non-transparent, which makes it almost impossible for practitioners and researchers to grasp the scale and impact of new developments. Not spotting negative trends in an early stage and acting on them can be detrimental as was also seen in the 2008/2009 global financial crises (Schicks, 2010). Also, the financial and reputational damage for microfinance in East-Africa could damage the sector as we have seen in Bolivia and more recently in Morocco, Bosnia and Herzegovina, Pakistan, and Nicaragua.

Participants did not directly mention effectiveness to be related to or to be a driver of outreach. Some noted that a good product would attract more clients. Nonetheless, a good product in the perception of a client can be anything. It might simply mean that it relieves their immediate need and not that it is an effective poverty alleviation tool. Further research into this relation might be able to connect the current effectiveness debate to outreach. For now it seems that the two are not directly related as many of the participants noted that access is more important to clients than the conditions of the loan, which is illustrated by the still widespread use of loan sharks. The question is: if high outreach does not go with effective poverty alleviation, is higher outreach something MFIs should want? In this research it was shown that high outreach even has adverse effects regarding effectiveness, due to competition leading to multi-borrowing and over-indebtedness. If the scale of this effect is substantial, it might be advisable for MFIs to select markets where there is limited competition only.

In the initial analysis of the data, client sophistication was one of the trends that became apparent. Many interviewees mentioned an increase in the financial aptitude of clients. There is already a substantial amount of research on 'financial literacy' of clients. It would be interesting to see the relation between the amount of outreach and the behaviour of clients, since financial literacy literature seems to suggest that practical financial rules-of-thumb improves the success rate of borrowers (Drexle, Fischer & Schoar, 2011). Do more experienced borrowers also have better economic outcomes for their business? While the interviews here seemed to suggest that more outreach is accompanied by more sophisticated and financially literate clients, the effects of this trend are unclear. Unfortunately the trend could not be directly related to the factors in the proposed model in Figure 12, based on the collected data. It is however crucial for the microfinance practitioners to know the influence of financial literacy on actions like credit diversion and multi-borrowing. If more outreach causes more financial

literate clients but also goes hand in hand with more multi-borrowing and credit diversion, what the results seem to suggest, it could mean that investing in client education will not prevent over-indebtedness.

Several participants mentioned the introduction of technology in the market as an interesting new trend. In Kenya mobile banking is starting to be introduced in microfinance. One MFI I encountered did not have any cash in their branches and all transactions were done through M-Pesa, the most commonly used mobile banking system. In addition, organizations are starting to use technology to process their granted loans. Researching what the influence is of such technology on microfinance organizations and their functioning could provide a glimpse into the future of microfinance.

Some participants also mentioned that more and more MFIs are starting to provide individual loans, and that it seems that clients prefer that system. It would be important to see if this trend is significant and if so, if it leads to more and greater over-indebtedness. Chen, Rasmussen, and Reille (2010) noted that in Morocco and Nicaragua, individual lending became a trend before a repayment crisis came into being. This might mean that the careless introduction of individual lending can have negative effects in the market.

Some participants accused the majority of MFIs in the market of Nairobi to have drifted from their mission. As discussed, in literature there is still a continuing debate on whether for-profit MFIs are less likely to reach the poor (Khandker, 1998; Gibbons & Meehan, 2000; Churchill, 2000; Woller, 2007). Considering that it also seems that many MFIs loosen their contract terms in order to compete in the market, this suggests that more competitive markets foster a profit focus. It would be interesting to investigate to what extent the state of market outreach influences mission drift.

All these suggestions for potential valuable research show how little is yet known about mature microfinance markets and the developments that originate in them.

6. Conclusion

This study shows that some consequences of increasing outreach can be noticed within the microfinance sector of a developing country. Higher outreach seems to cause higher competition and increased multi-borrowing. Increased competitive pressures drive MFI behaviour such as aggressive and personalized sales techniques and over-funding of clients, which lead to more over-indebted clients. Multi-borrowing in turn is influenced by competition as well as outreach, but causes over-indebtedness because clients take on more debt than they can manage. These trends, therefore, cause over-indebtedness in the views of the participants in this research. Over-indebtedness also seems to be caused by clients diverting credit to non-business purposes, such as household expenses and real estate investments. By providing initial insights into these developments in more mature markets, this study aims to help microfinance practitioners discover and improve their work field. The proposed model, based on interviews with staff and clients of four MFIs operating in Nairobi, as shown in Figure 12, also provides a starting point for further research into these trends, which leads to some initial recommendations for microfinance practitioners.

Over-indebtedness is not a myth. Many participants mentioned direct examples of over-indebted persons and especially clients often saw this as a problem. While the extent of over-indebtedness in Nairobi is unclear among microfinance managers, loan officers, and clients, it is certainly existent and it seems to have increased over the last decade. This currently still confined problem is bound to escalate. MFIs need to take proper measures to make sure these dynamics do not influence the client's situation and their own performance negatively.

As this research suggests that a major driver of over-indebtedness is multi-borrowing, action needs to be taken to prevent clients from taking on credit they cannot afford. There are some initiatives to increase information sharing in Nairobi. Considering the findings of this study, more urgency should be given to these projects and information sharing should be increased in other markets as well. Here, MFIs should not only blacklist defaulters, but also positive information needs to be shared. Ideally this should include the whole credit sector, from cooperative lending organizations to the formal banks, in order to be sure that clients cannot deceive the lender. Only when MFIs know how much debt a potential client has, they can practise responsible lending. One important side note is that when information sharing is established, it is important to find a solution for current over-indebted multi-borrowers. As one client told me *"When the loans stop, we stop."* This means that many families will have no economic existence if they cannot access a new loan to pay the old ones. Possibly these clients can be supported in making a solid financial plan and, for the worst cases, a fund can be created so their loans can be remitted.

While competition is increasing, MFIs should cooperate not only in information sharing but also by adjusting their activities in a way that does not damage the clients. By actively targeting clients of other microfinance institutions, multi-borrowing is fostered. Aggressive marketing techniques to unreached clients might also make it hard for clients that do not necessarily need a loan to resist the urge to borrow. A professional code of conduct can possibly help at this level.

When it comes to credit diversion, MFIs need to take this behaviour into account in their product design. I will not go as far as to say that MFIs should provide loans for any consumption purpose like Schicks (2010) does. I do however think that by providing clients assistance in the management of important household expenses, such as providing loans for school fees next to the microfinance loan, diversion can be limited. In some countries savings can also provide a solution, but with the current inflation in Kenya this might not be a fair solution.

Microfinance markets are changing and practises are still being designed. Practitioners learn by doing but scientific research can help them by providing insights into their business field. This study provides an initial start in doing so for a more mature microfinance market. Hopefully it will inspire more management scholars to focus their efforts on this field.

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Annexes

Annex 1: Advice to MFIs
Annex 2: Interview protocol
Annex 3: Example coding
Annex 4: Interview data

Annex 1: Advice to MFIs

Recommendations for the participating MFIs and the Nairobi microfinance sector as a whole

Research summary: Ever since microfinance was in its baby shoes it has focussed on providing access to financial services to as many poor as possible. In the same period, markets have matured. In some markets the outreach has become quite high and the first repayment crises have occurred in for instance Bolivia, Morocco, Bosnia and Herzegovina, Pakistan and Nicaragua (CGAP, 2010). It is important to observe what trends prevail in such a high outreach environment, so that microfinance organizations and market supervisors can respond adequately and prevent negative effects for the clients and the sector itself. During my research it became clear that the microfinance market in Nairobi is non-transparent and information is often segregated and scarce, which makes it hard for individual microfinance practitioners to oversee the extent of new trends and developments. A case study was conducted of the microfinance market of Nairobi, Kenya. Through interviews with the staff of four local microfinance organizations and their clients, as well as some experts from the field, an assessment of the outreach of this market was made and relevant market trends identified. Outreach was defined as composed of depth (how far down the income ladder do all MFIs together reach) and breadth (how many clients do all MFIs reach). The outreach of microfinance in Nairobi is relatively high, however, most participants still saw substantial growth potential. Salient trends in the interviews were: increased competition, increased multi-borrowing, more clients diverting credit to not agreed-upon utilizations, and increased over-indebtedness. Based on the interviews, the presence of over-indebtedness in the Nairobi market can no longer be denied. While the extent of over-indebtedness is unclear among microfinance managers, loan officers and clients, almost every participant told me a story of an over-indebted person. And clients clearly noticed over-indebtedness in the market and in some cases even their own position can be classified as over-indebted. There are several trends that cause clients to become over-indebted; 1) Clients increasingly divert funds, 2) clients increasingly borrow from several MFIs and 3) clients are victim of competitive pressures driving MFI behaviour; such as aggressive and personalized sales techniques and riskier contract terms. These trends are generally related to a high outreach and high competition in the market. The interview findings were used as a basis to construct a model shown in Figure 1 and propositions were written, which can be found below. However, since this is based merely on interviews this model needs to be tested in a wide scale quantitative research to confirm whether the relations are significant.

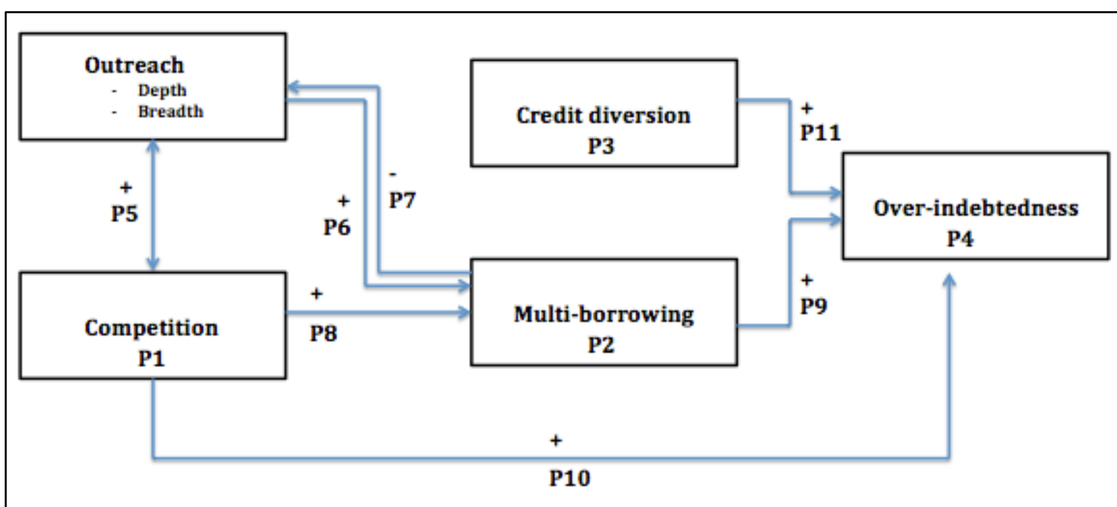

Figure 1: proposed model

Propositions, based on interviews with managers, loan officers and clients in four Kenyan MFIs:

P1: *With the maturation of the microfinance market competition increases, which causes MFIs to use aggressive marketing and sales techniques and more flexible loan agreements.*

P2: *With the maturation of the microfinance market multi-borrowing increases.*

P3: *In more mature microfinance markets clients divert credit for purposes such as education, health care and real estate investments such as land and housing. In Africa kinship ties play an important role in the credit diversion as relatives are expected to take care of (indirect) family.*

P4: *With the maturation of the microfinance market over-indebtedness increasingly becomes a problem for microfinance clients.*

P5*: Competition and outreach are positively related; this is mitigated by the market saturation of certain market segments. By fishing in the same pool of clients, the outreach of the sector does not grow.*

P6: *A higher degree of outreach in the market is accompanied by under-funding which will lead to more multi-borrowing.*

P7: *Multi-borrowing will decrease outreach, because the added cost caused by multi-borrowing will decrease the available funds for new credit relationships.*

P8: *Increased competition causes more multi-borrowing.*

P9: *Multi-borrowing leads in most cases to over-indebtedness.*

P10: *Competition leads to over-indebtedness due to over-funding of clients.*

P11: *Credit diversion leads in the many cases to over-indebtedness.*

Please note that these propositions have not been statistically proven, they are merely based on the combined views of my participants.

Key-take aways for MFIs:

- There are some initiatives that aim to increase information sharing in Kenya. These efforts should receive higher priority. As this research suggests that a major driver of over-indebtedness is multi-borrowing, action needs to be taken to prevent clients from taking on credit they cannot afford. MFIs should not only blacklist defaulters, but also positive information needs to be shared. Ideally this should include the whole credit sector, from cooperative lending organizations to the formal banks to be sure clients cannot deceive the lender. Only if MFIs know how much credit a potential client has outstanding, responsible lending can be practiced.
- One important additional note is that when information sharing is put in place, it is important to find a solution for current over-indebted multi-borrowers. As one client told me *"When the loans stop, we stop."* Which means many families will have no economic existence if they cannot access a new loan to pay the old ones. Possibly these clients can be supported in making a solid financial plan and for the worst cases a fund can be created so their loans can be remitted.
- Several clients that I interviewed expressed the wish for more information on their group members. As one lady explained me, knowing your neighbour on a personal level, does not mean you know about other outstanding loans or their business capabilities. Also, sometimes

groups are formed by the MFI and clients don't know at all what the financial history of the other members is. Again, information sharing could facilitate this need.

- Many MFIs are fishing in the same pond of clients, while at the same time other markets remain untouched. Because lower repayment and multi-borrowing seem to go with these highly competitive markets, it might be better to focus growth strategies on unreached markets, since the first negative effects of this high competition are starting to show in these segments.
- Several participants told me about MFIs pursuing the clients of other organizations. While this might entail a short term, easy win, it makes it hard for clients to stay with one loan and not take on too much credit. MFIs should try to foster agreement to avoid this.
- Many participants also saw a trend of clients becoming more sophisticated, both in understanding their financial situation and MFI practices as well as in the way they make use of rules and regulations to benefit themselves. It is important to be cautious about this, since it is not proved that higher 'financial literacy' means less multi-borrowing or default.
- Many clients I interviewed seemed to have a preference for individual loans and some MFIs have started to provide those. There is a need to be particular cautious in designing and providing these types of loans. In the CGAP research I mentioned earlier it was found that in two markets that experienced a repayment crisis, Morocco and Nicaragua individual lending became a trend before a repayment crisis came to being. This might mean that the careless introduction of individual lending can have very negative effects in the market.

If you have any questions about my research please feel free to contact me:

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Advised readings:

CGAP (2010) Chen, G. Rasmussen, S. and Reille, X. *Growth and Vulnerabilities in Microfinance*. CGAP focus note. Consult: http://www.cgap.org/publications/growth-and-vulnerabilities-microfinance

Bauchet, J., Marshall, C., Starita, L., Thomas, J. and Yalouris, A. (2011) Latest Findings from Randomized Evaluations of Microfinance. Access to Finance Forum *Reports by CGAP and Its Partners*. No. 2, December 2011 Consult: http://www.povertyactionlab.org/publication/latest-findings-randomized-evaluations-microfinance

Schicks, J. (2010) Microfinance Over-Indebtedness: Understanding its drivers and challenging the common myths. CEB Working Paper N° 10/048 (note this paper is mainly based on literature on over-indebtedness in a European contexts)

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Annex 2: Interview protocol

Interview structure MFI Staff

Introduction to research
- Topic: state of MF outreach in Nairobi
- Confidentiality/anonymous?
- Recording ok?

Professional experience participant
- Previous work experience
- Experience within this MFI

Company characteristics
MFI characteristics, size, target group, customer characteristics.
What makes your MFI different from others?

Phenomena
-How has the market developed in the last 10 years? Are there new things you are noticing?
- Have you seen changes in the type of client and their behavior?
- Have you seen changes in the way people use their loans?
- Have you seen changes in what is offered by all MFIs?
- Have you seen changes in how MFIs work?

Outreach
What is outreach in your definition?
→Provide used definition of breadth and depth.

What degrees of poverty do you see? (Depth)
Which does your org. reach? How do you notice this?
Can you give me a range of the income of your clients?

Do you still see growth in the amount of clients? (Breath)

Do you think there are still unreached potential clients? (Potential growth)
Client that are:
- New to microfinance?
- Economically active?
- Wanting credit?
- Inactive but wanting to become active?

Are there clients that apply that you do not want to serve? Why not? Where do you draw the line?

What state of outreach do you think the MFIs in Nairobi have reached?
(In terms of depth and breadth)

Which MFIs serve which levels of poverty?

What part of the potential market is reached?

Trends

Ask about trends that other participants described, do you also notice this?

Examples of questions that evolved during the interview process:

How do you perceive the competition?
How does this influence your work?
How does this influence clients?
How does this influence outreach?
Do you think the existing extend of outreach influences the competition?

Do you know of clients having loans with multiple institutions? Do you keep track of this?
Are these clients different from other clients?
Do clients get in trouble because of this?
If clients get in trouble what happens usually?

Do you notice over-indebtedness? If yes: How?

Do you notice clients becoming more sophisticated in their financial management? If yes: How?

Do you see clients diverting funds?
What do clients use credit for?

Relations

Do you see relations between mentioned market developments and the level of outreach?
Do you see other trends of phenomena that relate to outreach?
How do the mentioned phenomena relate to each other?
How do you notice this? Where do you notice this?

Other remarks/questions?

Are there other things that might be relevant to my research that we haven't discussed?
Do you have questions for me?

Interview structure clients

Introduction to research
- Topic: Which people are reached by microfinance and the things that happen because this group is reached and others not.
- Confidentiality/anonymous?
- Recording ok?

Client experience
How long have you been using microfinance?
What was you experience with MF?

Trends/developments
Have you seen changes since you started using microfinance?

Have you seen changes in the way people use these loans?
Have you seen changes in the loans that are offered?
Do you see changes in how the MFIs work?

Outreach
Do you know other people that still would like a loan but do not have one?
If yes,
- are this people that did not have a loan before?
- are these people working or do they have a business?
- do they want to start a business?

How many of your friends outside your loan group have microfinance loans? Can you think of one group of friends? How many are they? How many have loans? (breath)

Can you think of some people that are very very poor? Do they use microfinance? (Why not?) (What people do use microfinance?) (depth)

Trends
How many MFIs work in your neighborhood?
How did you decide to choose for this MFI?

Do you have more than one loan?
Do you know if other people have more than one loan?

Do you think it is a good thing there are many MFIs? Why?

What do people use their microcredit for?

Do you know of people that got in trouble because of microfinance loans? What happened?

Questions/remarks
Do you have other things you think I should hear about microfinance in this neighborhood for my research?
Do you have questions for me?

Annex 3: Example coding

Based on the orientation interviews and the themes that seemed salient after conducting all interviews a list of potential trends was made and a color code assigned. For outreach the categories were based on the definitions as provided in the theoretical framework. During the coding new categories also evolved, which required re-reading the transcripts to establish the appearance in previous interviews. Below the list eventually used to code is provided, each with their assigned color. Below an example text of one of the interviews shows how the coding was done. At this stage all relations between trends or between trends and outreach factors were collared grey. When all coding was done these relations were analyzed. Based on this analysis and the salience of concepts, some trends were eliminated, from the research. In this way a model showing relations between concepts as perceived by participants was designed.

Color codes:

Trends
Multi lending – purple
Over-indebtedness – brown
Client sophistication – orange
Competition – green
Over-funding – red
Under-funding – pink
Loophole searching clients – yellow
Credit diversion – bright green
Information sharing – mint
Technology - bright yellow

Outreach
Debth – blue
Breadth – turquoise
General – light blue

Relations → grey

Example of coding:
INTERVIEWER: Do you talk to loan officers of other microfinance organizations?

PARTICIPANT: Yes, we have links, we have their phone numbers, we talk over the phone when I client wants a loan and I realize this client is in ████, I call. I have friends in ████. [..] If they have loans there, or they are multiple- borrowers, we need to confirm exactly.

INTERVIEWER: Do you see a lot of multi-borrowing?

PARTICIPANT: Yes, a lot of that. That is the cause why the market is so much saturated.

INTERVIEWER: You see this as a consequence of market saturation?

PARTICIPANT: Yes, when they multi-borrow, than they will default in one institution or another. So all kinds of multi-borrowing.

INTERVIEWER: So you think it is a bad thing?

PARTICIPANT: It's a bad thing.

INTERVIEWER: Can you give me an estimate of how many of your clients are multi-borrowing?

PARTICIPANT: I would say 50/50

INTERVIEWER: 50%? That is quite a lot.

PARTICIPANT: mm [in a confirming way]

INTERVIEWER: And what happens when people do multi-borrowing?

PARTICIPANT: They default or they say they cannot service their loan with ██████, or service with ████████████████████, rather than other microfinance institutions. It is the default that comes in. And when default comes in the customer will be enlisted with the credit referencing bureau. And then they are stopped from borrowing in any institution. They cannot borrow here, they cannot borrow in ██████. So there is a link between the banks. Most of these clients they service a LOT. It is a consequence of multi-borrowing. And then the savings trend goes down. So if someone defaults their business must go down. Someone that you've grown with for some time will automatically come down, the business will come down, the business will come down, so it is that you've been doing all this work with this client.

INTERVIEWER: Does the number of clients that you serve still grow?

PARTICIPANT: Yes. The number of clients grows day by day. Others leave the bank. So it is a come in come out thing. Others that come in because we market to them. And there are others that maybe they have written the way they wanted to be. Or they are migrating for the areas around here so it is a come in come out thing.

INTERVIEWER: Do you think net, there is more people coming or more people going?

PARTICIPANT: There is more people coming than going out.

INTERVIEWER: Do you still find clients that want new loans?

PARTICIPANT: Yes.

INTERVIEWER: Are those clients that have used microfinance before?

PARTICIPANT: Yes there are some but the percentage is small. You can find they have borrowed somewhere, maybe they found the conditions hard and there are those that are just fresh in the system. But they are not many

INTERVIEWER: Are those clients that still want microfinances, do they have a business?

PARTICIPANT: All of them have a business.

Annex 4: Interview transcripts

To protect the privacy of participants the interview transcripts have not been included in the public version of this thesis.