Evaluation and Impact Assessment

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1. What this Module Covers

Evaluation and impact assessment are essential components to improving the operational efficiency of any microfinance organization. This module offers practical guidance for evaluating organizational performance using both qualitative and quantitative data. Evaluation is a critical component in the development and growth of any organization, but it is especially important in the microfinance field. A key component of evaluation is impact assessment – assessing the impact of microfinance on the client. When conducting evaluation and impact assessments, microfinance organizations (MFOs) want to know if their activities are furthering their mission and if they are operating in the most efficient and effective way – for clients, staff, and for donors. By the end of this module, students should have a basic understanding of how to conduct an overall program evaluation. They will also be equipped to assess the impact of microfinance on borrowers.

This module is divided into two sections. The first defines program evaluation and impact assessment, along with important considerations for selecting an evaluation design. The second section offers detailed information on how to conduct an impact assessment.

2. What is an Evaluation?

Evaluation is a participatory process designed to determine how well a program or project has accomplished its goals. Evaluation is always based on the examination of some established, empirical variable or indicator, and how current practices compare to that standard. The results of evaluation provide managers with information about whether to expand a program, to
continue a program at its current level, to reduce spending, or to cut it entirely. The term “evaluation” describes different models that suit different purposes at different stages in the life of a project. Outside consultants are often hired to conduct a formal program evaluation of a microfinance organization. As a result, evaluation has frequently been viewed as an external imposition – a process that is not very helpful to project staff. Program staff can also conduct an internal program evaluation, however. When conducted appropriately, evaluation should be a tool that not only measures success, but can contribute to it, as well.

3. Why Conduct an Evaluation?

Microfinance is believed to be an important tool in the fight against poverty. In recent years there has been a huge growth in the number and size of microfinance organizations and their clients around the world. Before the early 1980s, only a handful of MFOs existed, while today these institutions number more than 7,000 worldwide. As the numbers of MFOs grows, evaluation is an essential component in the development, maintenance, and performance of an organization. It helps to ensure that the MFO is meeting its service mission and to demonstrate measurable outcomes to donors. Self-financed MFOs, which are committed to covering the cost of capital without any subsidization, rely on the market to evaluate their services. For these MFOs, financial indicators document the stability and risk levels of the loan portfolio and serve to evaluate the financial health of the organization. Evaluation, therefore, is a reflective process requiring a critical look at business processes and organizational activity. Regular evaluation measures progress toward a specific goal and is a vital component of any effort to manage for results.

When a microfinance organization is established, the organization determines, through strategic planning, what the mission and goals are for the organization, and the framework that will be

used to implement them. This framework needs to be tested, which ensures that the MFO is performing as planned, or if the organization needs to reevaluate its processes.

4. Types of Evaluation

4.1 Formative Evaluation

There are two basic types of evaluation: formative and summative. Formative evaluation is a tool used from the beginning to the end of a project. Typically, a formative evaluation is conducted at several points in the cycle of a project and is used to continually “form” or modify the project to make sure that its program activities match program goals and the overall mission. A summative evaluation assesses the project’s success. This type of evaluation takes place after the project is up and running, in order to judge its impact. Impact assessment can be considered synonymous with summative evaluation.

Formative evaluation is used to assess ongoing project activities. For micro-finance organizations, formative evaluation begins at the start of a project and continues throughout the life of the project. In general, formative evaluation consists of two segments: implementation evaluation and progress evaluation. The purpose of an implementation evaluation is to assess whether the project is being conducted as planned. As noted in the EHR/NSF Evaluation Handbook, implementation evaluation collects information to determine if the program or project is being delivered as planned. The following questions can help guide an implementation evaluation:

- Do the activities and strategies match those described in the proposal? If not, are the changes to the proposal justifiable?
- Were the appropriate staff members hired, trained, and are they working in accordance with the proposed plan? Were the appropriate materials and equipment obtained?
- Were activities conducted according to the proposed timeline? Did appropriate personnel conduct those activities?
- Were the appropriate participants selected and involved in the activities?
- Was a management plan developed and followed?

6 Ibid.
Project staff should use implementation evaluation as an internal check to see if all the essential elements of the project are in place and operating.

The other aspect of formative evaluation is progress evaluation. This type of evaluation is used to assess progress in meeting the project’s goals. Progress evaluation should be thought of as an interim outcome measurement. Typically, a progress evaluation will measure a series of indicators that are designed to show progress towards program goals. These indicators could include participant ratings of training seminars or services provided through an MFO, opinions and attitudes of participants and staff, as well as key financial indicators from the loan portfolio. By analyzing interim outcomes, project staff eliminate the risk of waiting until participants have experienced the entire treatment to assess outcomes.  

Financial performance indicators are a critical component of an MFO’s formative evaluation. See Attachment 1 for a description of some of the main financial indicators that help MFOs determine their financial health.

The results of an evaluation can be used broadly in an organization. The results are not only a good source of ideas for organizational improvement, but also a source of information for the organization’s stakeholders, such as the Board of Directors, donors, host government, collaborators, clients or shareholders.

4.2 Summative Evaluation or Impact Assessment

A large proportion of MFOs state poverty reduction as their mission, and have received donor funding for this mission. Even MFOs primarily interested in financial self-sustainability may have poverty reduction as part of their mission statement. At the most basic level, therefore, there is a need to understand how or if MFOs are affecting borrowers. Impact assessments can be used as “management tools for aiding practitioners to better attain program goals.”

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In addition to the benefits that an impact assessment offers an MFO, donors have an obligation to ensure that they are making the right choices in terms of their objectives. MFOs are also accountable to their funders – usually governments, shareholders and taxpayers, and therefore, they have a strong interest in obtaining measures of the effectiveness of their funds. Donors may use impact assessment results to make resource allocation decisions for individual organizations, or for broad strategic funding decisions. For self-sustainable MFOs, financial indicators provide data on the loan portfolio and help facilitate outside investment and financial reporting. For these MFOs, it is the market that ultimately decides whether the MFO stays or goes out of business.

Summative evaluation is devoted to assessing the project’s impact or success. Typically a summative evaluation takes place after the project cycle has been completed and when it is possible that the impact of the project has been realized. It answers these basic questions:

- Was the project successful? What were its strengths and weaknesses?
- Did the participants benefit from the project? If so, how and in what ways?
- What project components were most effective?
- Were the results worth the costs?
- Can the project be replicated in other locations?

Specific impacts that may be looked for include health, nutrition, reproduction, child schooling, income, employment, etc. In addition, practitioners may want to know if microfinance had any impact on poverty, women, empowerment, and domestic violence. Social science evaluators are challenged to construct impact assessments capable of measuring whether or not microfinance contributed to any gains in individual or family welfare.

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Nevertheless, a well-conducted summative evaluation helps decisions makers – program managers, donors, agencies – determine if the project is worth continuing. An honest evaluation recognizes unanticipated outcomes, both positive and negative, that come to light as a result of a program. In the microfinance field, being aware of possible unanticipated outcomes can help program managers better target their programs to meet the needs of constituents.

5. Types of Impact Assessments

When an impact assessment is planned, the type of assessment that should be used depends on the needs of the various stakeholders. Determining these needs will define the type of tools and impact assessment that should be performed. Below are the two most common types of impact assessments.

5.1 Donor-Led Impact Assessment

As mentioned earlier, donors require some evidence that their money is being used to effectively further their stated goals. A donor-led impact assessment examines the impact of a MFO from the perspective of the lender. Results of a donor-led impact assessment are often shared with the donor’s funders, which are usually government agencies or foundations. Future funding decisions are often made based on this assessment.\(^{11}\)

5.2 Practitioner-Led Impact Assessment

While donor-led assessments have been the most commonly conducted assessments, there has been a shift towards practitioner-led assessments, which have a different focus. These assessments focus more on “how the impact assessment process can fit into existing work patterns, build on existing knowledge and experience, and produce results that can be easily used by management.”\(^{12}\)

5.3 Proving vs. Improving

According to David Hulme at the Institute for Development Policy and Management, donor-led impact assessment methods can be thought of as needing to “prove impact,” while practitioner-

led impact assessment is meant to “improve practice” of an organization.\textsuperscript{13} Using the schematic created by Hulme in Figure 5.1 below, you can begin to visualize this idea.

**Figure 5.1**

<table>
<thead>
<tr>
<th>PROVING</th>
<th>IMPROVING</th>
</tr>
</thead>
<tbody>
<tr>
<td>IMPACTS</td>
<td>PRACTICE</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Primary Goal</th>
<th>Measuring as accurately as possible</th>
<th>Understanding the processes of intervention and their impacts so as to improve those processes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Main Audiences</td>
<td>Academics and researchers</td>
<td>Program Managers</td>
</tr>
<tr>
<td></td>
<td>Policymakers</td>
<td>Donor field staff</td>
</tr>
<tr>
<td></td>
<td>Evaluation departments</td>
<td>NGO personnel</td>
</tr>
<tr>
<td></td>
<td>Program Managers</td>
<td>Intended beneficiaries</td>
</tr>
<tr>
<td>Associated Factors</td>
<td>Objectivity</td>
<td>Subjectivity</td>
</tr>
<tr>
<td></td>
<td>Theory</td>
<td>Practice</td>
</tr>
<tr>
<td></td>
<td>External</td>
<td>Internal</td>
</tr>
<tr>
<td></td>
<td>Top down</td>
<td>Bottom up</td>
</tr>
<tr>
<td></td>
<td>Generalization</td>
<td>Contextualization</td>
</tr>
<tr>
<td></td>
<td>Academic research</td>
<td>Market research</td>
</tr>
<tr>
<td></td>
<td>Long timescales</td>
<td>Short timescales</td>
</tr>
<tr>
<td></td>
<td>Degree of confidence</td>
<td>Level of plausibility</td>
</tr>
</tbody>
</table>

6. **Important Considerations for Microfinance Impact Assessment**

Effective evaluation depends on the ability of evaluators to establish linkages between the changes identified during and after the course of the project, which are specifically attributable to

\textsuperscript{12} Ibid.
\textsuperscript{13} Economists and statisticians will say that you cannot “prove” impact. Rather, one can only refute alternative hypotheses.
the intervention. It is not possible to conduct an evaluation without having any measures or indicators. Therefore, three standards for impact assessments have been established. They are credibility, usefulness and cost-effectiveness. This framework is designed to be flexible enough to take into account different types of programs and different contexts. It also recognizes that there are necessary tradeoffs with these standards when conducting an evaluation.

6.1 Standards for Microfinance Impact Assessments

6.1.1 Credibility

*Credibility* implies the trustworthiness of the entire evaluation process. It begins with clearly stated objectives that indicate the type of impacts that will be examined, the intended use of the findings, and the focused audience. The impact assessment should formulate a set of key hypotheses and seek to test them using quantitative and qualitative studies. The evaluation should establish and test a plausible relationship between the microfinance intervention and changes as a result of participating in the program. Credibility can be improved by using data-gathering instruments that are well designed and clearly documented.

6.1.2 Usefulness

In order to be useful, an impact assessment must be designed to address the key questions and concerns of the intended audience. The usefulness of the assessment is enhanced when those who are expected to use the findings are involved in the planning, design, and analysis stage. Involvement by the main users of the data helps to ensure that their concerns are reflected in the impact assessment process. A key element of usefulness is the timeliness of the data. Impact assessment data also can be used to define strategic objectives, design and deliver appropriate products, and suggest new products. Finally, it can be useful for developing strategies to improve portfolio performance by reducing turnover, expanding outreach, and improving portfolio quality.

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6.1.3 Cost Effectiveness

Designing a worthwhile impact assessment that provides the donor or practitioner with valuable information is often challenging, particularly when working with a limited operating budget. According to Carolyn Barnes and Jennefer Sebstad, an impact assessment can be more cost-effective if there is a good “fit” between the objectives, methods, and resources available to those assessing impact. If possible, relying on the successes or failures of past impact assessments can help in creating greater efficiency for an MFO. By learning which methods worked well and which did not, evaluators can learn from past mistakes to achieve greater efficiencies in the evaluation. These past experiences, or other examples in the literature, can be especially helpful in identifying meaningful and valid impact hypotheses and variables, developing data-collection strategies for obtaining reliable and valid data, and selecting appropriate analytical techniques.

7. Evaluation Design

Under the best circumstances a well-designed evaluation enables the evaluator to say with confidence that the program impacts were due to the program interventions and not some series of outside factors, which happened to coincide at the same time. The ability of the evaluator to do this is based on the internal and external validity of the evaluation. Internal validity is the accuracy in concluding that the outcome of an experiment is due to the intervention. External validity is the extent to which the result of an intervention can be generalized. Good evaluation design controls for external factors that comprise threats to validity.

Threats to internal validity include:

- **History** – uncontrolled outside influences on participants during an evaluation;
- **Maturation** – processes within the respondents that may change their responses over time;
- **Selection** – biased selection of participants;
- **Testing** – the effect of testing on the results in an evaluation;

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16 Ibid.
17 This discussion is drawn largely from a case study “Public Sector Program Evaluation (B), Selecting a Method, Collecting Data and Analyzing Results,” Kennedy School of Government.
• *Experimental mortality* – changes in a group because some have left the evaluation study.

Threats to external validity include:

• *Multiple intervention interference* – several projects or interventions occurring simultaneously
• *Hawthorne effect* – knowledge about the evaluation
• *Experimenter effect* – changes in the respondent due to the presence of an evaluator
• *Sensitization* – sensitization due to the pre-test or any part of the evaluation

It is not possible to control for all outside factors when conducting an evaluation. However, it is possible to increase internal validity by randomly selecting participants, randomly assigning them to groups and using a control group. A control group does not receive the intervention (for our purposes, they would not have participated in the microfinance program) so that the effect of the intervention can be determined on the test group, which has received the intervention.

External validity can be improved by careful adherence to good experimental research practices.

Evaluators can chose from several types of evaluation designs to minimize threats to internal and external validity. In choosing the right evaluation design, evaluators will typically try to find a balance between internal and external validity, and cost-effectiveness. Figure 7.1 presents an overview of experimental design.

### 7.1 Pre-Experimental Designs

This type of evaluation design controls for very few external factors. Pre-experimental designs usually focus on a single program and attempt to discover whether or not it has achieved its objectives. As a result, it is difficult to draw strong conclusions about the impact resulting directly from the program, because evaluators cannot be confident if changes were caused by the intervention, or by a host of external factors. Even though pre-experimental design evaluations lack the sophistication of more advanced evaluation research, they are inexpensive and easy to use. Often evaluators are faced with situations where there is no baseline data and no control
group. In these cases, pre-experimental design affords the best possible evaluation under the circumstances.

### 7.1.1 Before/After Comparison

This design compares the same subjects before and after the program intervention. There is no random selection of participants to the test group and no control group in this design. The before/after comparison is represented visually below, where X is the intervention (microfinance project) and O is each observation.

\[
\begin{array}{ccc}
O_1 & X & O_2 \\
\end{array}
\]

This design is simple to use and inexpensive, but it does not control for threats to validity. Because there is no control group, it is difficult to determine if any changes to the clients were a result of the intervention, (i.e., microfinance training seminar), or some other factor, such as maturation.

### 7.1.2 After Only One Shot Design

This design is used when the evaluator has no baseline data on the participants. The evaluator simply measures and observes how program participants score after the program has operated for a set period of time. This design is represented visually below, where X is the intervention (microfinance project) and O is the observation

\[
\begin{array}{cc}
X & O_1 \\
\end{array}
\]

The major limitation of this design is that the lack of an initial observation leaves little ground to infer whether the participants changed as a result of the microfinance intervention. There is no random selection of participants. Evaluators, however, can strengthen this design by developing simple control groups.
Figure 7.1 Overview of Experimental Designs

<table>
<thead>
<tr>
<th></th>
<th>Pre-Experimental Design</th>
<th>Quasi-Experimental Design</th>
<th>Experimental Designs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Presence of a control group?</td>
<td>In some cases, but usually not</td>
<td>Often</td>
<td>Always</td>
</tr>
<tr>
<td>Random selection of subjects from the population?</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Random assignments of subjects to groups?</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Random assignment of treatments to groups?</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Degree of control over external factors?</td>
<td>None</td>
<td>Some</td>
<td>Yes</td>
</tr>
</tbody>
</table>

7.2 Quasi-Experimental Designs

Quasi-experimental design is one that looks like an experimental design, but lacks the key ingredient – randomization. These types of evaluation designs are an improvement over pre-experimental designs because they attempt to control for and minimize threats to validity. In almost all cases, quasi-experimental designs incorporate control groups and thus, provide some standard of comparison to determine if the intervention (i.e. microfinance loan or training) had the desired impact. Some common characteristics of quasi-experimental designs include:

- **Matching** instead of randomization is used. Evaluators try to find a group in a neighboring town or region that would have similar citizen demographics to the experimental group.
- **Time series** analysis is often involved. These designs are organized over time (longitudinal) to examine changes in the participants over time.
One of the intended purposes for doing quasi-experimental research is to capture events over an extended period of time, as well as a large number of different events to control for various threats to validity.

### 7.2.1 Time Series Design

The time series design helps to overcome the weakness of the one-shot, before/after pre-experimental design. In this design, the evaluator looks at the data over a longer period of time, both before and after the intervention. The idea with time series data is to understand whether the program caused a break in a more established pattern of trends, such as income levels or education and literacy levels.

The graphic above is a representation of a multiple time series design. A matching control group is selected and observations are made to both the control and experiment group. Selection of participants in a random manner is critical to the validity of this design. If gains are made in the experiment group which do not show up in the control group, the evaluator needs to eliminate all other plausible explanations before determining if the intervention (microfinance) caused the change.

### 7.2.2 Non-Equivalent Control Group

This design is typically used when it is not possible to randomly assign subjects to groups, for political, ethical or other reasons. For example, it may not be possible to deny some clients a microfinance loan, while giving it to others just for the purpose of creating control group. With a non-equivalent control group, an attempt is made to find a control group, which although not randomly selected, has similar socio-economic characteristics. This design is represented visually below, where X is the intervention (microfinance project) and O is the observation.
Evaluators using this design collect pre and post-test data and examine the results. This allows the evaluator to compare the two groups: if no differences are found after the program, the evaluator can be skeptical about the effects of the program. However, if there are differences, it is important for the evaluator to determine if the differences are due to the program or some other reason.

### 7.3 Experimental Design

True experimental design utilizes random selection and control groups to ensure internal validity. It is often touted as the most rigorous of all research designs because the results are more “valid” than other designs, i.e., the data from the experiment measures what it is intended to measure – in this case the effect of credit for poor families. The key to success for experimental design is the random assignment of participants to both the control and experiment groups. While no two groups of people will ever be exactly the same, random selection of participants improves what can be inferred from the intervention.

Randomization means that each member of the population being studied has the same probability of being selected. This ensures that the population does not contain individuals with a characteristic that could influence the experiments results. For example, individuals who choose to become part of microfinance groups may have some difficult-to-measure characteristic, such as personal risk levels or entrepreneurship. Therefore, to understand the impact of microfinance on personal incomes it would be incorrect to only sample participants within the microfinance groups. The result would overstate the actual impact of micro-credit on personal income as the participants may be individuals whose incomes would have risen over time anyway because of their entrepreneurship skills.

While experimental design may be the most desirable form of evaluation from a scientific perspective, it is likely to be difficult to carry out in most real world context. In Russia, there are numerous challenges associated with experimental design. These are described in Box 6.1.
Evaluation is often intrusive and time consuming and may not be possible in all social science evaluations.

### 7.3.1 Pretest/Post-test Control Group Experiment

Evaluators using this design select a random group of participants and assign them to an experimental and control group. Random selection is the process of drawing a sample of people for the experiment. In order to obtain a random selection of MFO clients, an evaluator might pick every 4th borrower from an alphabetical listing to get a random sample of 100 clients. 50 of these clients could be randomly assigned in a similar manner to the experiment and control group. In the following graphic, both the control group and the experiment group have been randomly chosen and assigned.

\[
\begin{array}{ccc}
O_1 & X & O_2 \\
O_3 & & O_4 \\
\end{array}
\]

Participants receive the same pre-test and post test checks. The goal of the evaluator is to determine if there were any differences in test results that could be attributed to the specific intervention. Random selection helps to control for factors like selection, as well as maturation and history.

### 7.3.2 Randomized Two Group Post-Test Only Design

Since some groups may show gains due to repeated testing, an evaluator might want to conduct an experiment where no pre-test is given. In this case, participants are randomly selected to an experiment and control group. In the graphic below, the intervention is administered (microfinance program) and the results are tested to identify differences in outcomes for both groups.

\[
\begin{array}{cc}
X & O_1 \\
& O_2 \\
\end{array}
\]
The advantage of this design is that it is cheaper than a pretest/post-test design. The addition of a randomly selected comparison group helps prevent threats to validity including history, maturation, and testing effects.

**Box 7.1 Challenges to Survey Research in Russia**

During the summer of 2002, a group of Russian and American students conducted field research in Novosibirsk and Irkutsk. The goal of the research was to better understand the demand for and supply of capital in Siberia. While significant social science research has been conducted in Moscow and St. Petersburg, the regions remain relatively unexplored, at least to western audiences.

The Russian and American students set out to survey 500 individuals in both the Novosibirsk and Irkutsk Oblasts. 300 of the surveys were designated for residents of the city, while 100 were for villagers. An additional 100 surveys were to be filled out by small-business owners in either cities or villages.

Using western survey methodology, the researchers ran into numerous difficulties, including:

* **Randomized survey:** Accurate city lists and telephone books are not available in many Russian cities. Not all residents have telephones, especially in the villages. This led to the decision to self-administer the survey.

* **The non-response problem:** Respondents were less willing to participate based on research being an end in itself. Many people in the villages questioned the purpose of the survey and wanted nothing to do with it. They were suspicious of the American students asking questions and felt that the survey would not help them personally.

* **Translation challenge:** It was difficult to translate a survey with culturally specific terms like “community,” “small-business owner,” and “civil society.” The Russian term for business, for example, carries a negative connotation. Small business owners are defined differently in the U.S. and Russia.

* **Gender differences:** It was difficult to locate men between the ages of 30-50 years who were willing to answer the survey. Unemployment and alcoholism create problems for men, especially in the villages. Women of all ages were more likely to answer the survey.

* **Center-periphery challenges:** Financial and personnel resources are typically concentrated in the regional capitals. Just as Moscow is different from Novosibirsk or Irkutsk, so too are the regional capitals different from the provinces. There often exists a mutual antagonism or lack of respect, so that one research method that might work in the city may not work in a village.
8. How to Conduct an Evaluation and Impact Assessment

We have now discussed the importance and scientific rationale behind evaluation and impact assessments, as well as the factors that should be considered when approaching an impact assessment. Next we examine the steps involved in conducting an evaluation.

8.1 Qualitative vs. Quantitative Methods

Cost effective evaluation and impact assessments employ methods that are appropriate to answer the key questions to the degree and precision needed. The choice of the method to use for evaluation and impact assessment also depends on the purpose of the assessment and its audience. The typical evaluation or impact assessment can be conducted using two basic divisions of methods: qualitative and quantitative.

Common quantitative methods include sample surveys and semi-structured interviews. Common qualitative methods include focus groups, case studies, individual interviews based on key open-ended questions, participatory appraisals, and participatory learning activities. Qualitative approaches can inform quantitative approaches and vice versa. The combination of qualitative and quantitative approaches clearly can enhance an impact assessment. Table 8.1 below lists key features and strengths of each of these methods and offer guidance in choosing the right method. It is only one list of possible evaluation methods that could be conceivably employed. Most likely the evaluation method will be a mix of the various methods discussed below.

Qualitative methods address questions related to how and why and are best at uncovering reasons behind unanticipated results. Results are generalizable to theoretic propositions, not to populations. Quantitative methods address questions related to what, who, where, how many, how much, and the incidence or prevalence of a phenomena. The results may be generalizable to a larger population, depending on the sampling technique used.

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18 Barnes and Sebestad, “Guidelines for Microfinance Impact Assessments.”
19 This discussion of these two methods is taken from “Guidelines for Microfinance Impact Assessments” written by Carolyn Barnes and Jennefer Sebstad:
### Table 8.1 Evaluation and Impact Assessment Methods and When to Use Them

<table>
<thead>
<tr>
<th>Method</th>
<th>When Appropriate</th>
<th>When Not Appropriate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sample surveys</td>
<td>- Project affects a large number of clients - Audience requires accurate estimates of project impacts - Users need statistical comparisons between groups over time or between geographic locations – Project delivery/implementation mechanisms working well over time, thereby justifying investment in assessment - Target and/or client population is heterogeneous and it is important to isolate the influence of factors unrelated to the project</td>
<td>- Project has a small number of people – Audience is concerned primarily with project outcomes - Project implementation is recent and untested and likely to have little impact - The purpose of the assessment is to understand whether the project is meeting the felt needs of the project clientele</td>
</tr>
<tr>
<td>Semi structured interviews or mix of closed and open ended questions</td>
<td>- Purpose is to explore or document what changes are due to the MFO program - Purpose is to explore questions and measures in order to develop a survey instrument - Users want timely information on specific issues or questions, such as reasons for arrears - Time limited for development and testing of a survey based largely on close-ended questions - Users require both quantitative data and information that helps to explain the data</td>
<td>- Users want information from a large number of individuals - Users want statistical comparisons between groups or locations – Clients are to be active participants in the process</td>
</tr>
<tr>
<td>Focus groups</td>
<td>- Priority is to understand motivations and perceptions of clients - Want to stimulate reflection and discussion on client satisfaction or group dynamics - Need information to interpret quantitative data - Need information quickly to address an issue – Participatory principles are a priority for the MFO - Need to understand the causal impact</td>
<td>- Need information based on representativeness and to generalize information from participants to a larger population - Want to understand the socioeconomic level of project participants - Local culture prevents individuals from feeling relatively free to express their opinions in a group situation</td>
</tr>
<tr>
<td>Case studies</td>
<td>- Need to understand the causal impact process - Want to search out rival explanations for change and unexpected or negative impacts - Need to illuminate and put a human face on quantitative data - Want to understand changes over a long period of time - Need to identify reasons for lack of change in survey impact variables</td>
<td>- Need information about a large number of clients and want to generalize the information gathered to a larger population - When indicators of program impact are clear and easily measurable, and negative impacts unlikely - When information is needed quickly</td>
</tr>
<tr>
<td>Participatory self learning</td>
<td>- Program promotes participatory principles - Program’s objectives include empowering clients - Want to establish structure for linking participatory learning to program improvement - Attention given to community impacts - Understanding client motivations and perceptions a priority</td>
<td>- Do not have access to highly skilled persons to facilitate discussion - When planners not concerned about participants learning from the assessment process - Sole priority is standardized and statistically representative data for a large and diverse program population - Existing tools inappropriate and do not have time to develop and adequately test new ones</td>
</tr>
</tbody>
</table>

Below is a brief outline of the steps that should be followed in both qualitative and quantitative impact assessments.

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20 Barnes and Sebestad.
8.2 Planning Stage

Before an MFO begins an evaluation or impact assessment, there is generally a planning stage that ensures it is approached in the most logical way. Some general recommendations for the planning stage include:

- When selecting a program to evaluate, be sure that it is relatively stable. This will increase the likelihood that the evaluator will accurately examine the impact of the program.\(^{21}\)

- Clearly state the **goals and targets** of the evaluation or impact assessment. The motivation for conducting the assessment will inform the process. In addition, the intended audience (donors, government agency, MFO) should be made explicit as this will drive the types of questions that are asked.

- Identifying the **type of evaluation design** that will be employed is appropriate at this stage. The choice of methods should be based upon the objectives of the evaluation, the key research questions, the availability of resources (time, money and people), and the degree of precision required and the possible application of results.\(^{22}\)

- State the **key research questions**. Again, these questions will be developed based on what information is to be collected and the intended user. The type of research questions will inform many of the other decisions that need to be made, including the cost of the assessment, and may also help influence the type of methods mix that are selected.

At this early point in the process, consider whether control groups or a random sample is possible. It is also useful to think about the **sample size** needed to conduct an assessment.\(^{23}\) Researchers require a large enough sample size to make sure that survey results closely resemble

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\(^{21}\) Barnes and Sebstad


\(^{23}\) The sample size depend on several variables, including how much sampling error can be tolerated, population size, how varied the population is, and the smallest subgroup within the sample for which estimates are needed.
those of the true population. If not enough people are sampled or the sampling is not conducted randomly, then the survey will have a sampling error. An example of this would be conducting a telephone survey during normal working hours, from 9 – 5. A significant portion of working people would be missing from the survey thereby introducing error.

It is also essential to consider the unit of analysis – the individual, household, or institution. When conducting an impact assessment based on microfinance, the individual borrowers or households are likely to be the unit of assessment.24

- **Anticipate the level of effort and timeframe** needed to perform an evaluation. Allow enough time for designing the assessment, staff training, data analysis, as well interpretation and presentation of the results to various stakeholders.

After planning is complete, the next stage is the research design and implementation stages of the evaluation or impact assessment. These sections are divided into two major branches: qualitative and quantitative. The differences between these two approaches are emphasized in the next section.

### 8.3 Qualitative Methods

Qualitative methods are useful when it is necessary to understand relationships between variables. These methods promote in-depth examination of topics and are particularly useful to:

- Facilitate a better understanding impacts and processes (why and how changes occur);
- Give a client perspective of changes due to program participation and their value of these;
- Illuminate intangible or difficult to measure changes such as in gender relationships, self-esteem and confidence;
- Reveal unanticipated consequences of the program;
- Help clarify hard to interpret findings from a survey; and
- Allow clients to examine, explain and learn from their experience.

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Qualitative methods generally involve interviews and other fieldwork that do not necessarily result in uniform data that can easily entered into a computer and analyzed. When designing qualitative research it is important to involve the person(s) requesting the evaluation, as well as the key program managers and other stakeholders who will be using the information. This helps make sure that the interview questions and other tools are addressing their concerns. In addition, encouraging staff participation in the design of the assessment improves employee morale and provides a sense of ownership of the process.  

- **Identify tools to conduct the qualitative portion of the impact assessment.** For example, these tools may include:
  
  - Focus group discussions with guided discussion topics to elicit information;
  - In-depth "case-study" research looking at a range of impact questions or focused on specific issues (e.g. savings, empowerment, social capital, asset building, business development, intra-household relationships etc);
  - Specific tools (e.g. interviews) to understand reasons for client drop-out; and
  - Participant observation.

- **Establish criteria for selecting participants.** Select participants who are appropriate for the questions that need to be answered. The ability to read and write may be a pre-requisite for some qualitative methods, such as a written evaluation. The location of a focus group meeting or interview may influence whether or not someone can participate in evaluation.

- **Design a data analysis plan.** Once the qualitative data collection is completed, it will be necessary to analyze the information. It is important to have a clear plan in place to facilitate the analysis as soon as possible. The analysis plan ought to include a framework for organizing the information from the specific records following a format

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that reflects the underlying purpose of the qualitative study. This serves to summarize information across a number of interviews, focus groups or participatory sessions.²⁸

### 8.4 Quantitative Methods

As mentioned above, quantitative methods focus on numbers rather than words. Depending on the sampling technique and sample size used, the findings should be representative of the population beyond the individuals involved in the study.

When the goal of the impact assessment is to show that a program caused certain changes in the target population, quantitative methods is an appropriate research design. Using quantitative methods enables an organization to understand and track the impact of its programs across a broad spectrum of clients.²⁹ Quantitative techniques help to measure actual impacts of an MFO, while qualitative methods are meant to tell help understand how and why these impacts are occurring.³⁰

There are several key steps involved in designing a quantitative evaluation or impact assessment.

- **Form the hypothesis**: The hypothesis should be refutable, that is a statement made in order to draw out and test its logical or empirical consequences.
- **Select the variables**: In order to measure the hypothesis, variables need to be accurately identified and measurable. Examples of variables include income, education levels, marital status and number of children. Even a variable as straightforward as income will have measurement issues. Is in-kind income counted, for example, such as home grown food sources or barter activity?
- **Design the questionnaire**: When designing the questionnaire, it is essential to keep the intended audience in mind. Long and complicated questionnaires often frustrate respondents. Some questionnaires use a mix of open- and close-ended. Include

²⁹ Ibid.
standardized instructions for all field workers to establish some sense of uniformity to the data collection and recording.\textsuperscript{31} It is best to refer to a survey book for instructions as designing a useful survey is complicated.

- **Determine the sample:** The larger the sample, the more confident evaluators can be that the survey truly reflects the population. The sample size depends on two things: confidence level and confidence interval. The confidence interval is the plus-or minus figure usually reported in opinion polls. The confidence level is expressed as a percentage and represents the percentage of the population within the confidence interval.\textsuperscript{32}

### 8.5 Implementation Stage

#### 8.5.1 For Qualitative Methods

The next step in the evaluation process is the implementation stage. In order to ensure that the evaluation goes smoothly, make sure that all logistics, such as transportation and materials are organized. For example, a focus group experience can be improved when the participants feel comfortable at a neutral location. When considering where to hold focus group meetings, Sebstad and Barnes suggest the following:\textsuperscript{33}

- A setting that provides privacy for participants;
- A location where there are no distractions;
- A non-threatening environment;
- A location that is easily accessible for respondents; and
- A place where seating can be arranged to encourage involvement and interaction.

Conduct a training session for those who will serve as facilitators, interviewers and/or recorders prior to the focus group. Training typically includes a mock interview to acquaint the interviewer with the types of questions and answers that may arise.


\textsuperscript{32} Please see the sample size calculator for further description at http://www.surveysystem.com/sscalc.htm.

\textsuperscript{33} Ibid.
The final step in the implementation process would be the initial analysis of the data, as well as a write-up of the notes taken during the session. This should be done as soon as possible, to ensure that the information is accurately recorded.

8.5.2 For Quantitative Methods

As with qualitative assessment methods, some initial steps prior to implementation help facilitate the process. These include:

Step 1: **Plan logistics**: This helps ensure research credibility, the timeline, and a cost effective evaluation. Examples of things to think about ahead of time include:

- Schedule and arrange transportation for the data collectors;
- Coordinate the amount of time needed in each field site;
- Locate a place to train the enumerators;
- Arrange a place where core team members and enumerators can meet daily; and
- Ensure that supplies (paper, pens, clipboards) and photocopying facilities are available.

Step 2: Selection of **enumerators** should be based on their previous survey experience, knowledge of the local language, ability to understand and write in the language used in the assessment, and their availability during the survey period and willingness to work outside normal business hours. Their objectivity is important for collecting credible data. The gender of the enumerators should be roughly proportionate to the respondents, but quality and experience should not be sacrificed for gender balance. However, it is also important to consider if the gender, age, or ethnicity of the enumerators will affect response rates. In countries with a history of inter-ethnic hostilities, this is an especially sensitive issue and it should be thoughtfully addressed.

Step 3: **Train enumerators** to understand the purpose and objectives of the survey, how to introduce the survey to respondents, and the meaning of each question. They also should learn best interview techniques and how to record the answers.
Step 4: **Pilot test the questionnaire**, with a small number of both clients and non-clients who are not part of the sample, following (or as part of) enumerator training. Close monitoring and coaching of the enumerators by core team members during the pilot test helps to ensure that the questions are clearly understood by the data collectors and respondents, the survey is introduced properly, and responses are recorded properly. A pilot test may reveal problems with the questionnaire that require changes. After this, the questionnaire and the instruction manual can be fine-tuned and, finally, photocopied for field use.

Step 5: **Supervision of enumerators** is critical for valid and reliable data. An impact assessment core team member should meet with enumerators on a daily basis to review their work, discuss problems, and provide feedback on the previous day’s questionnaires. This needs to be done irrespective of whether or not the enumerators are program staff.

Step 6: **Data entry** should begin as early as possible, ideally after the pilot test of the questionnaire. If a computer and electricity are available in the field, data entry can start after the first day of survey work and problems with the questionnaire and/or enumerators can be detected and rectified quickly. If data are being entered on more than one computer, it is important to establish that the files can be merged early in the process. Involvement of core impact assessment team members in data entry is an effective way for them to check the validity of the data and facilitate coding. This also precludes the need to train and monitor data entry personnel.

It is important to document problems encountered during the implementation stage and how they were dealt with. This makes the process more transparent and provides a stronger basis for establishing the credibility of the study.

8.6 Data Analysis

Good analysis requires a dataset that is manageable in terms of quantity and ease of manipulation. It further requires sufficient resources (time, money and people) that have been planned for ahead of time.
The **analysis of quantitative survey data** should focus on the key research questions and hypotheses and follow the initial data analysis plan. The first rounds of analysis should explore descriptive data, such as averages, and frequency counts and distributions for all variables by key analytic categories. The next round should involve simple statistical tests on data showing differences in the characteristics of the sample and in the impact variables. Subsequent analysis should look at clusters or dis-aggregations of interest (such as location, gender, and client poverty levels) to determine the extent to which impacts vary by group. If the quantitative survey data do not fit with the hypotheses, the analysis should proceed to explore what the data do reveal.

The **qualitative analysis** should be guided by the initial plan, but additional information and analysis that would illuminate the underlying purpose of the qualitative component should be included. After summarizing the findings, the information should be organized and meaningfully reduced by selecting and focusing on:

a) patterns and common themes on specific items;

b) deviations from the patterns and factors that might explain these; and

c) interesting stories that help illuminate the broader study questions.

Analysis of the quantitative data is likely to reveal issues to explore further through qualitative methods. Similarly, the qualitative findings also may suggest certain questions or variables to probe further in the quantitative analysis. **Triangulating** the quantitative findings and the qualitative findings deepens understanding of impacts and helps to establish the reliability of the findings. Triangulation is a term borrowed from the study of experimental methods and refers to any attempt to investigate a phenomenon using more than one method. It can be thought as a way to crosscheck the research. By combining research methods, threats to the internal validity of the data are reduced.

**8.7 Presenting and Interpreting the Findings**

Presenting and interpreting quantitative and qualitative impact assessment findings should center on key research questions, evaluation hypotheses, and questions that address rival hypotheses. It is important to define key terms and concepts and avoid the use of overly technical terms.
Information on key features of the program and context should be woven in to illuminate and interpret the findings.

In presenting and interpreting **quantitative findings**:  
✓ Provide a profile of the sample;  
✓ Organize the other data to address the hypotheses and key research questions;  
✓ Simplify the presentation by using a select number of tables, graphs, or charts;  
✓ Present the data clearly and accurately, and use averages complemented with distributional data to provide a fuller picture and identify outliers;  
✓ Make it easy to see differences between clients and non-clients.

In presenting and interpreting **findings from qualitative components**, the purpose of the impact assessment should guide the approach. In general, qualitative findings should be integrated as appropriate with the quantitative data to illuminate and explain quantitative findings, address questions that complement the quantitative findings, and provide a human face and tell a story. In some cases discussion of qualitative findings may dominate, with the quantitative data used to generalize these findings to a larger population.

In interpreting the findings, never draw conclusions without data to support them. Always support conclusions with data.

Finally, at a minimum the impact assessment report should include:  
   a) A clear statement of the objective of the impact assessment;  
   b) A description of the program including its objectives, products, methods, drop-out rates and financial data;  
   c) A description of the methodology used for qualitative and quantitative components, especially criteria and process for selecting participants;  
   d) Findings, interpretation of results, conclusions, and when appropriate, recommendations for program improvement;  
   e) Difficulties encountered, how these were addressed, and lessons learned; and  
   f) Appendices with more detailed information.
8.8 Dissemination

To be useful for decision-making, evaluations and impact assessments must be disseminated in a timely manner to the intended audience. Dissemination strategies may include bullet point summaries, power-point presentations, and strategic cups of coffee or tea (Hulme 1997). The time lag between data collection and presentation should be reduced to a minimum. While some assessors recommend a period not exceeding nine months, others argue for the advantages of more immediate feedback. In fact, having program staff directly involved in all of the stages is one way to ensure immediate feedback. In addition, an impact assessment linked to a larger program evaluation is likely to reach a wider audience.

8.9 Additional Issues

For rapidly growing MFOs, staff resources will have to keep pace with growth and expansion pressures. Rapid growth requires the hiring of more impact monitoring officers. As it moves forward, MFO managers will have to continue fine-tuning the balance between the organization’s evaluation and impact assessment needs and its staff resources.

Similarly, MFOs will have to seek the optimal balance between conducting in-house evaluations and monitoring or outsourcing these functions to consultants. Bringing everything in-house is an attractive, short-term way to lower costs.

Also, standards that help an MFO measure its performance are crucial. Financial audits can compare internal financial practices against established external standards. Microfinance organizations can benefit from a set of common standards for “good practice” that would help assess impact performance just as they assess financial performance.

Finally, as the organization presents its findings to clients it should ask for feedback through a combination of reports and focus group discussions. Maintaining a focus on clients’ participation and feedback is critical if the findings are to be useful to them as well as to other decision-makers. Creating opportunities for client input and reflection throughout the impact assessment and monitoring process is an important task for everyone involved.
Attachment 1: Financial Performance Indicators

Performance indicators may be used in an MFO formative evaluation. These indicators measure the financial viability of an organization as well as its efficiency and productivity. Other quantitative measures look at the MFOs client base, outreach and demographic information. 34 Regardless of the specific performance standard employed by an organization, “the emphasis is on MFOs achieving minimum agreed performance standards and taking significant incremental steps to improve performance.” 35

Quantitative Indicators:

- Portfolio size and quality
- Financial Management
- Key Demographic Data on Clients
- Efficiency and Productivity
- Profitability
- Interest Rates

Portfolio Size and Quality

The largest source of risk for any financial institution (public or private) is its loan portfolio. The loan portfolio is typically the largest asset of a microfinance organization, yet it is often quite difficult to measure the risk that the loan portfolio represents for the MFO. Microfinance organizations usually lack bankable collateral; therefore the quality of the loan portfolio is an important tool for MFOs to demonstrate fiscal responsibility. 36

There are several key ratios that microfinance managers must pay attention to from beginning to end of the project. These are listed below in table 1.1.

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34 Performance Indicators for Microfinance Institutions
<table>
<thead>
<tr>
<th><strong>Table 1.1 Key Portfolio Ratios</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Portfolio at Risk (PaR)</strong></td>
</tr>
</tbody>
</table>
| PaR = (Outstanding Balance on Arrears over 30 days + Total Gross Outstanding Refinanced (restructured) Portfolio) / Total Outstanding Gross Portfolio | • Measures outstanding balance arrears as percentage of total portfolio.
• A microfinance loan is usually considered to be at risk if a payment is more than 30 days late.
• A PaR greater than 10% is cause for concern.
• PaR is a more conservative measure of risk than other ratios.
• PaR considers the risk that the entire amount of outstanding loan balance will not be repaid. In other words, “it measures the complete risk and not only the immediate threat.” |

<table>
<thead>
<tr>
<th><strong>Provision Expense Ratio</strong></th>
</tr>
</thead>
</table>
| Provision Expense Ratio = Loan Loss Provision Expenses / Average Gross Portfolio | • Used to determine and understand expenses than MFO can safely incur as it anticipates future loan losses.
• Generally viewed together with PaR ratios to make determinations about the portfolio quality. |

<table>
<thead>
<tr>
<th><strong>Loan Loss Reserve Ratio</strong></th>
</tr>
</thead>
</table>
| Loan Loss Reserve Ratio = Loan Loss Reserves / Total Outstanding Gross Portfolio | • Measure of an MFO’s accrued provision expenses, and a general indicator of projected future loan losses.
• LLRR gives a rough estimate of the overall health and quality of loan portfolio, but should be used in tandem with other indicators.
• It provides information on the amount of outstanding principal that an MFO does not expect to recover. |

<table>
<thead>
<tr>
<th><strong>Risk Coverage Ratio</strong></th>
</tr>
</thead>
</table>
| Risk Coverage Ratio = Loan Loss Reserves / Outstanding Balance on Arrears over 30 days + Refinanced Loans | • This ratio measures the percent of Portfolio at Risk that can be covered by loan loss reserves.
• By using this ratio, an MFO can determine if it is prepared for an emergency.
• It is important that the Risk Coverage Ratio be analyzed along with the Portfolio at Risk measure, as well as any write-offs than an institution is making, to accurately determine portfolio quality. |

<table>
<thead>
<tr>
<th><strong>Write-Off Ratio</strong></th>
</tr>
</thead>
</table>
| Write-Off Ratio = Write-Offs / Average Gross Portfolio | • A loan becomes a write-off when an organization determines that there is a small chance that it will be repaid.
• Writing off a loan does not usually impact total assets, net loan portfolios, expenses or net incomes.
• Whether an organization writes off a loan or not varies widely. Some will write-off loans regularly, while others may never write-off a loan.
• Because write-off practices vary, the ratio is often considered along with other ratios, to accurately assess the state of the portfolio.
• Even though a loan is written off, it does not mean that an organization should stop pursuing the funds, if it is not cost-prohibitive to do so. |

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40 Ibid.
Efficiency and Productivity

Efficiency and productivity indicators provide information about the institution’s operations. Efficiency indicators demonstrate whether an organization serves as many clients as possible, while keeping costs low. Productivity indicators demonstrate the amount of output produced per unit of input.

Efficiency rates of microfinance organizations are generally lower than traditional, commercial banks, because microcredit is generally considered highly labor intensive. Further, “economies of scale have much less impact on efficiency in MFOs than is usually believed because of the high variable costs of the microcredit technology.”

Like the performance indicators discussed above, there are several ratios used to evaluate both the efficiency and productivity of a microfinance organization. They include the operating expense ratio and borrowers per staff ration. Please see table 1.2 for a list of these ratios.

Table 1.2: Efficiency and Productivity Ratios

<table>
<thead>
<tr>
<th>Operating Expense Ratio</th>
<th>Borrowers Per Staff</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating Expense Ratio =</strong>&lt;br&gt;Operating Expenses / Average Gross Portfolio</td>
<td><strong>Borrowers Per Staff = Number of Borrowers (excluding Consumer and Pawn Loans) / Total Staff</strong></td>
</tr>
<tr>
<td>• This ratio is a good indicator of the organization’s efficiency. It calculates the amount of revenue, as a percentage, that is required to cover the operating costs of the organization. The lower this ratio, the more efficient the institution is.</td>
<td>• Calculating the number of borrowers per staff is another way to assess the productivity of the organization’s staff.</td>
</tr>
<tr>
<td></td>
<td>• Consequently, the higher the value of the ratio the more productive the organization is. In other words, it indicates how well the organization has developed and implemented procedures and processes.</td>
</tr>
<tr>
<td></td>
<td>• Low staff productivity does not always mean that they are working less than they should be.</td>
</tr>
<tr>
<td></td>
<td>• This could also be an indication of overly cumbersome and time-consuming paperwork and other administrative tasks.</td>
</tr>
</tbody>
</table>

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48 Ibid.
Financial Management

Financial management measures the organization’s ability to meet its obligations: namely to provide clients with loans and to repay loans to the organization’s creditors. Decisions in this area are very important and can directly affect the bottom line of the organization. For example, careful financial management is necessary when making decisions about investment of an organization’s funds. In addition, sound financial management is important for creditors and other lenders who will be funding the organization’s operations.\(^{49}\)

The following ratios in Table 1.3 are often used in assessing financial management:

### Table 1.3: Financial Management Indicators

<table>
<thead>
<tr>
<th>Financial Expense Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial Expense Ratio</strong> = Interest and Fee Expenses / Average Gross Portfolio</td>
</tr>
<tr>
<td>• This is used to determine the minimum lending rate that an organization must charge its clients in order to cover the costs of operation.</td>
</tr>
<tr>
<td>• Once you have calculated this ratio, use it in combination with the Provision Expense Ratio and the Operating Expense Ratio to get more information about the lending rate that your organization should use.</td>
</tr>
<tr>
<td>• Financial Expense Ratios say little about the financial state of the organization. Rather, it is more of an indication of how a microfinance organization finances its operations, either through debt or through equity.(^{50})</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cost of Funds Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cost of Funds Ratio</strong> = Interest and Fee Expenses on Funding Liabilities / Average Funding Liabilities</td>
</tr>
<tr>
<td>• This measures the average cost of the borrowed funds that an organization has. It indicates whether the organization has access to low cost funding sources that can include savings.</td>
</tr>
<tr>
<td>• Those organizations that have access to savings and who can liquidate them tend to have lower costs than organizations that must rely on creditors. Yet, there are some administrative costs associated with using savings.(^{51})</td>
</tr>
</tbody>
</table>

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\(^{50}\) Ibid.

### Liquidity Ratio

*Liquidity Ratio = (Cash and Bank Current Accounts + Readily Marketable Investments) / Total Assets*

- Liquidity is defined as “the ability of a business to meet the immediate demands for cash, for example, loan disbursement, bill payments, and debt repayment.”
- This ratio indicates the ability of an organization to ensure that enough cash is available to meet its financial obligations.
- An MFO “may prefer to maintain a very high liquidity ratio (>25%) because it foresees high demand for it loans, or because it worries about instability.
- But high levels of liquidity can also indicate that an MFO is manages its funds poorly. A low liquidity ratio (<5%) often indicates that an MFO has outgrown its funding sources and is facing a cash crunch.”

### Debt / Equity Ratio

*Debt/Equity Ratio = Total Liabilities / Total Equity*

- The debt/equity ratio is important to the lender because it shows how much “safety” in the form of equity there is in the organization in the event it experiences a loss.
- Microfinance organizations traditionally have low debt to equity ratios because their ability to borrow money is limited.
- Changes in this ratio are often more telling about the financial situation of an organization than the absolute ratio.
- For example, if the debt to equity ratio increases, the organization may be reaching its borrowing limits.
- A high debt to equity ratio is less of a risk, however, if the organization’s liabilities are largely from long-term funding sources.

### Profitability

Profitability indicators are designed to summarize the overall performance of an organization. Profitability indicators are often difficult to interpret because there are many factors that affect profitability. If portfolio quality is poor or efficiency is low, profitability will also be affected. Profitability indicators should not be analyzed and interpreted separately, as all performance indicators tend to be of limited use if studied in isolation, and this is particularly the case for profitability indicators. To understand how an institution achieves its profits or losses, “the analysis also has to take into account other indicators that illuminate the operational performance of the institution, such as operational efficiency and portfolio quality.”

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54 Ibid.
The following indicators are usually analyzed when profitability of an organization is measured:

**Table 1.4: Profitability**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Return on Equity</strong></td>
<td>Return on Equity = Net Income / Average Equity</td>
</tr>
<tr>
<td>This is the main indicator that demonstrates the profitability of an organization.</td>
<td></td>
</tr>
<tr>
<td>Examining Return on Equity is especially important for for-profit organizations that have actual owners. For microfinance organizations, and other not-for-profits, this ratio is used as a measure of their commercial viability.</td>
<td></td>
</tr>
<tr>
<td>If one were to examine only a single year analysis of Return on Equity, it may not provide much information.</td>
<td></td>
</tr>
<tr>
<td>Significant and extreme income or losses can distort the true ratio.</td>
<td></td>
</tr>
<tr>
<td>So, it is important, when considering this ratio, to consider that multi-year analysis may provide a more accurate picture of an organization’s profitability.</td>
<td></td>
</tr>
<tr>
<td><strong>Return on Assets</strong></td>
<td>Return on Assets = Net Income / Average Assets</td>
</tr>
<tr>
<td>ROA measures how well a microfinance organization uses its assets. It does so by essentially measuring the profitability of an organization and reflecting both the profit margin and efficiency of an organization.</td>
<td></td>
</tr>
<tr>
<td><strong>Portfolio Yield</strong></td>
<td>Portfolio Yield = Interest and Fee income / Average Gross Portfolio</td>
</tr>
<tr>
<td>Portfolio Yield shows how much interest an organization received from its borrowers during a certain period of time.</td>
<td></td>
</tr>
<tr>
<td>Comparing the Portfolio Yield with the average effective lending rate, an organization can learn how efficient it is in collecting fees.</td>
<td></td>
</tr>
<tr>
<td>In order for this ratio to be useful, it must be examined in light of the average lending rate. Only by comparing these two indicators can an organization understand its own operations relative to the environment in which it operates.</td>
<td></td>
</tr>
</tbody>
</table>

**Demographic Information**

**Demographic Information and Client Base**

The indicators discussed above provide a picture of various aspects of a microfinance organization. By examining performance indicators, a microfinance organization can begin to determine those areas of its organization that are working well, and those that need to be improved upon. As an organization goes through the process of evaluation, it is also important

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56 Ibid.
57 Ibid.
58 Ibid.
to consider the demographic information of the area and clients served. These indicators are listed in Table 1.5.

Table 1.5: Demographic Information

| • Average loan size                  | • Percentage of loans below a certain amount |
| • Number of active borrowers         | • Percentage of borrowers below the poverty line |
| • Percentage of credit clients that were repeat clients for previous years | • Total deposits at the beginning and end of the period |
| • Percentage of borrowers who are women | • Percentage of board members who are women |
| • Percentage of total staff that are women |                                                |

These criteria are not used to determine whether an organization is doing better than another organization. Rather, the information should be used to determine how best to maximize the demographics of its clients, as an organization works towards financial self-sufficiency. 59

Qualitative Indicators

Client Base and Organizational Outreach
Aside from the financial indicators that were discussed earlier, another important component of organizational evaluation includes an assessment of the client base and how effectively the organization is in its client outreach. Using these indicators will provide your organization with valuable information about your organization’s outreach. When considering the client base and organizational outreach of an organization, it is important to consider the following elements:

- Does the MFO focus on serving customers that match the organization’s mission - for example, those with low incomes? It is not necessary for this focus to be exclusive, but it is important to consider that the mission of the organization is being fulfilled.
- Is the organization using an individual approach when serving its customers?

59 CARE Savings and Credit Sourcebook. Chapter 11
• Are your clients making attempts to save? If so, your clients could be depositing their money into microsaving accounts sponsored by your organization that would allow them to save for larger emergencies. Both your organization and your clients can benefit from such a service, though additional research is necessary before you establish this type of service.\textsuperscript{60}

• What is the method of outreach that the organization employs? Does this method work with the stated goals and mission of the organization?

• Do your clients generally rely on collateral substitutes? If so, do you have a method in place for collecting repayment in case of default? Often times, the only course of punishment that an organization can employ is denying future credit to clients. The degree to which this punishment serves as a deterrent to default is dependent on the needs of the clientele. The bottom line is that you should be considering what your clients are using for collateral, and how this influences the ability of your organization to continue providing services.\textsuperscript{61}

MFO Management, Structures and Systems

Along with the qualitative indicators discussed above, there are additional elements that you should be considering when performing an organizational evaluation. These can include studying the competitive advantages of an organization, as well as its financial viability, in order to determine if the organization is growing. The steps necessary to evaluate the organization from a financial perspective have been discussed earlier in this module. The following elements should be considered when conducting an evaluation of the management, structures, and systems within a microfinance organization.

• Culture, structure, and systems of the organization’s work. This includes a stable system of organizational management, freedom from political interference,


appropriateness to local conditions, competent employees, a stable business plan, and precise determination of applicability and vision of perspectives.  

- Adequate and complete systems in place, ensuring competitive management information systems.
- An appropriate methodology, that is also sustainable, and that permits the MFO to effectively deliver its services.  
- Transparent financial reporting, that adheres to corresponding international standards and that allows prospective donors to adequately measure the organization’s work.
- Sound business plan and accurate financial projections
- Effective operating systems

Evaluation is also important in determining competitive advantages of an organization. The financial viability of an organization can be assessed on the basis of these declared indicators. However, financial viability is not the only organizational advantage. Other competitive considerations revolve around the product mix. They include the following:

- Market share and customer retention. What percentage of the market is receiving an organization’s services? Are customers returning for additional loans?
- Product mix: do new products complement or dilute existing ones?
- Position in the marketplace: is it likely that the organization can maintain or even enhance their position in the market?

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62 CARE Savings and Credit Sourcebook.
63 Ibid.