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## Microfinance Services and the Clients' Socioeconomic Wellbeing: The Clients' Perspective

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## **Microfinance Services and the Clients' Socioeconomic Wellbeing: The Clients' Perspective**

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### **ABSTRACT**

**Purpose:** Microfinance gained momentum as a tool to serve the very poor and marginalized groups excluded from the formal financial institutions. Without the right type of support, the benefits of microfinance to the targeted beneficiaries become more a rhetoric than a reality. The current study set out to investigate the effect of microfinance services to the clients' socioeconomic wellbeing from the view point of the target beneficiaries themselves.

**Methodology:** A total of 108 clients purposively selected participated in the study. The microfinance services were categorized into social services and client protection services with the response variable measured on a dichotomous scale of impact (1) and no impact (0). Primary data was collected from the clients using a self-administered questionnaire and a binary logistic regression model was used to establish the existence of impact of the microfinance services studied and the clients' social economic wellbeing.

**Findings:** The logistic regression model seem to suggest that clients' socioeconomic wellbeing is better attained with the right client protection policies especially during pandemic periods.

**Recommendation:** It is recommended that in addition to the social services that most microfinance institutions are offering to clients, special attention be paid to integrating services that focus more on client protection.

**Keywords:** *Microfinance, client protection services, social services, socioeconomic wellbeing*

## INTRODUCTION

Microfinance services are rooted in the need to serve the poor excluded from financial institutions with a special focus on women (Braun & Woller, 2004; Swain & Garikipat, 2019; Meki, et al., 2021; Cull & Morduch, 2017; Sangwan, Nayak, Sangwan, & Pradhan; World Bank, 2022; Kucharski & Radow, 2021). The imperative to lift the poor out of poverty stress the need for Microfinance Institutions (MFIs) to develop tailored products that meet the needs of their targeted clientele in a given community. MFIs extend credit to their clients mainly on the basis of social collateral that focusses greatly on group lending methodologies (Swain & Garikipat, 2019; Meki, et al., 2021). The onset of Covid-19 pandemic has however challenged the smooth execution of this methodology as most countries, Uganda inclusive restricted people's movement and gatherings in an effort to combat the spread of the pandemic (Grameen Credit Agricole Foundation, 2020; Sangwan, Nayak, Sangwan, & Pradhan; Kucharski & Radow, 2021). The restrictions also cut off the informal social support networks that normally help to fill cash needs of the poor. The closure of non-essential services and trading activities negatively impacted on the performance of MFIs services as its clientele were directly impacted by these measures (Grameen Credit Agricole Foundation, 2020).

Originally, microfinance institutions were set up with a sole aim of extending credit to the poor who are even excluded from the formal institutions (Muftau, Afolabi, & Muritala, 2016). The need to expand outreach while at the same time remain financially viable led MFIs to increasingly think of a range of product offerings to their beneficiaries. The range of MFIs product offerings to date include but not limited to: savings both voluntary and mandatory, microloans, marketing assistance, money transfers, insurance, agricultural loans, leasing, standing order, consultancy and advisory services, and micro insurance (Muftau, Afolabi, & Muritala, 2016). In addition to these mainly financial services offered by MFIs, non-financial services are provided in support of the financial services. For example, before credit is extended to the clients, the MFI may organize training in enterprise development and other capacity building programs to enable them efficiently utilize the funds accessed.

MFIs service offering can therefore be broadly categorized into financial and non-financial services. Whereas financial services mainly involve money, such as savings and microloans; non-financial services mainly offer support to the efficient utilization of financial services, for example, business enterprise training. Microfinance offer savings services to the clientele which at same time act as cash collaterals. Clients can save voluntarily as a cushion for their future cash needs or save as a prerequisite to access microfinance loans (forced savings). Microcredit as already noted is key product of MFIs. Through microcredit, microloans are offered to the poor without demanding collateral from them, but social capital where lending largely follows the principles of group lending methodologies.

The concept of microfinance plus is increasingly gaining support in the microfinance literature focusing on the need to integrate microfinance with other support services such as enterprise training and health education (Braun & Woller, 2004). During the Covid-19 pandemic, the offering of these non-financial services that require a lot of close contact with the clientele became hard to implement (World Bank, 2022). The risks of defaulting on the credit extended increased as did the quality of the loan portfolio almost turning red to some MFIs. MFIs also offer insurance services to their clients to hedge against the financial risk associated with non-

payment of loans extended. During the pandemic period this risk increased, and perhaps MFIs offering the service of micro insurance were not very much affected. Given that MFIs lend to the very poor, the risk of default is high and this risk is likely to increase during crises periods like that caused by Covid -19. Micro insurance is thus useful in providing insurance cover to the poor should the crisis further limit their ability to pay the loans acquired. This as well protects the MFI from the probable increase in portfolio risk.

The focus of microfinance from the very beginning has been women and the marginalized sections of the society. To meet its mission and objectives, MFIs uses the principle of client targeting that is twofold 1) Gender targeting that offers preference to women while extending microcredit and 2) poverty targeting that prioritize lending to the very poor (Brau & Woller, 2004; Meki, et al., 2021). The key target beneficiaries of microfinance mainly operate in the informal sector whose activities were greatly constrained during the pandemic period due to being classified among the essential activities. This not only affected these vulnerable, marginalized and low income groups but also constrained the performance of MFIs whose major client base constitute of these groups.

Impact is measured in terms of self-employment, wellbeing of poor households, female empowerment, increased participation in female decision making, increased environmental awareness, household income, consumption, household expenditure, production, willingness to send children to school and general improvement in clients' economic wellbeing (Brau & Woller, 2004; Swain & Garikipat, 2019). There are contrasting views on the role microfinance plays on promoting the social objective of the marginalized such as the women and the poor. This paper attempts to differentiate between the broad categories of microfinance clients, of which the number one target would be women and the very poor, but the paper takes a sample from the client base accessing microcredit at the time of the study. Positive impacts of microfinance are associated with clients that are generally non-poor and possess relevant business skills, while the poorest of the poor may benefit if given the right type of support (Swain & Garikipat, 2019).

The economic benefits of microfinance to the poor seem to be limited with microcredit linked to the increased indebtedness of the poor (Swain & Garikipat, 2019). In their review on impact of microcredit expansion literature, a modest positive impact with minimum transformative on the beneficiaries was reported (Meki, et al., 2021; Cull & Morduch, 2017). During the Covid-19 pandemic, the restrictions on movement and social gatherings limited the source of income too many of the poor and marginalized groups. Their food consumption levels also fell thereby negatively impacting on their social wellbeing (Kucharski & Radow, 2021).

Given the very nature of microfinance clients as that of the very poor, MFIs need to take precaution that the financial services extended to the clients do not worsen their already bad state but rather lift them out of poverty. Specialists in microfinance have propounded the principle of client protection that is built of the foundation of making the client better through the accessed credit. Client protection policies or services are thus deemed essential components of microfinance service delivery systems. Client protection policies are intended at minimizing the harm clients may face as a result of securing microcredit.

Client protection which is considered a key indicator of prudent financial management is associated with six basic principles (Forste, Lahay, Clark, Koning, & McKee, 2020). These

principles include: extending credit to a client based on ability to repay the loan, clarity of terms of payment, fair treatment of clients, timely handling of clients complaints and respect for clients' privacy. Also key in client protection is the loan collection practices that be streamlined keeping in mind client at the center of the whole exercise. These principles are deemed beneficial to a client accessing microfinance funds as they focus on supporting the client to pay the monies borrowed. Unethical practices like over lending a client when you are well aware that his/her financial standing is below what you intend to advance the client are discouraged. The transparency advocated for in the process of loan appraisal, disbursement and recovery efforts discourages ambushing the client with unknown extra fees in accessing and servicing the loan. For example, if loan processing fees are charged, these should be explained to the client in advance. It is advised that client protection policies are integrated in the loan assessment tool.

Microfinance services have been advocated as a means to reach out to the majority poor that are financially excluded from the formal financial system. Most of the poor in Uganda are engaged in the informal activities that were greatly affected by the Covid-19 restrictions that led to the closure of many businesses that were categorized as non-essential. The MFIs were however left with the own decision to either stay operating fully or limit their scale of operations. Most MFIs chose to continue to operate and limited their activities especially to recovering the already advanced loans. The Covid-19 period studied is March 2020 when the first lock down was announced up to January 2022 when most of the economy was open. This means that occasionally MFIs, could extend the full range of its services when the lock down was lifted; and limit their operations whenever restrictions on movement and social gatherings were imposed. In this study, we try to establish the effect of microfinance services on the clients' socioeconomic wellbeing during the Covid-19 pandemic. This study employs the binary logistic regression model to establish whether the microfinance services have had an impact or did not have impact on the clients' socioeconomic wellbeing during the Covid-19 pandemic.

## METHODOLOGY

The study aimed to establish the effect of microfinance services on the clients' socioeconomic wellbeing for the period March 2020 to January 2022. The study sample consisted of 108 microfinance clients of whom 55(51%) were males and 53(49%) were females. A binary logistic regression model was used to establish whether the microfinance services had an impact or did not impact on the clients' socioeconomic wellbeing. The logistic regression model is recommended for analyzing data and describing relationship between various explanatory variables and a binary response variable. The binary response variable with a value of 1 states the existence of a characteristic while a value of 0 expresses the non-existence ( Agresti, 2019). The simple logistic model of one predictor variable ( $X$ ) and one outcome variable ( $Y$ ) is of the form

$$\ln \left[ \frac{\pi}{1 - \pi} \right] = \alpha + \beta x \dots\dots\dots 1$$

$$\text{Hence, } \pi = \frac{e^{\alpha + \beta x}}{1 + e^{\alpha + \beta x}} \dots\dots\dots 2$$

Where  $\pi$  is the probability of the outcome of interest under variable  $Y$ ,  $\alpha$  is the  $Y$  intercept and  $\beta$  is the slope parameter. The null hypothesis is stated as  $\beta = 0$ , where the rejection of the null would imply the existence of a relationship between  $X$  and  $Y$ . In this paper, two predictor variables are used and the logistic model is stated as a complex logistic regression of the form

$$\ln\left[\frac{\pi}{1-\pi}\right] = \alpha + \beta_1 x_1 + \beta_2 x_2 \dots\dots\dots 3$$

$$\text{Hence } \pi = \frac{e^{\alpha + \beta_1 x_1 + \beta_2 x_2}}{1 + e^{\alpha + \beta_1 x_1 + \beta_2 x_2}} \dots\dots\dots 4$$

To test for the model goodness fit, we apply the Hosmer-Lemeshow goodness of fit  $X^2$  of the form

$$W_{q(i)} = \sum_{j=1}^{q(i)} m_j \geq \frac{N}{G} \dots\dots\dots 5$$

Together with its equivalent measure of the Pearson  $X^2$  goodness of fit statistic of the form

$$X^2 = \sum_{j=1}^M \frac{(y_j - m_j p_j)^2}{m_j p_j (1 - p_j)} \dots\dots\dots 6$$

Where  $M$  is the total number of covariate patterns among the  $N$  observations. The data is assumed to be collapsed on covariate patterns  $j=1, 2, \dots, M$ ;  $m_j$  is the total number of observations having covariate pattern  $j$  and  $y_j$  as the total number of positive responses among observations with covariate pattern  $j$ .  $p_j$  is the predicted probability of a positive outcome in covariate pattern  $j$ . The  $X^2$  statistic has approximately  $M - k$  degrees of freedom for the estimation sample, where  $k$  is the number of independent variables, including the constant. The results of both equation 5 and 6 are similar. The research procedure in conducting the analysis involved obtaining the descriptive statistics, estimation of the regression parameters using maximum likelihood estimation, conducting the likelihood ratio test, interpreting the regression coefficients and the odds ratio and finally conducting a goodness of fit test for the model. The null hypothesis implies the non-existence of the relationship between two categorical variables, hence its rejection would imply the existence of a relationship between the two variables studies. Similarly, the rejection of the null and acceptance of the alternate hypothesis would imply the existence of the relationship between the two variables studies. All the analysis in this study were run in STATA 12.

### 3.0 RESULTS AND DISCUSSION

#### 3.1 Descriptive Statistics

The descriptive statistics are presented in Table 1

**Table 1: Frequency and percentage for the categorical explanatory variables**

Variable	No impact	There is impact	Overall	Chi-Square	P-value
<b>Age category</b>					
18-27	4(9.76)	9(13.43)	13(12.0)	0.49	0.974
28-37	17(41.46)	29(43.28)	46(42.6)		
38-47	11(26.83)	16(23.88)	27(25.0)		
48-57	6(14.63)	9(13.43)	15(13.9)		
57 +	3(7.32)	4(5.97)	7(6.5)		
<b>Marital status</b>					
Single	15(36.6)	26(38.81)	41(38.0)	0.06	0.972
Married	24(58.54)	38(56.72)	62(57.4)		
Divorced/separated	2(4.88)	3(4.48)	5(4.6)		
<b>Gender</b>					
Male	17(41.46)	38(56.72)	55(50.9)	2.47	0.124
Female	24(58.54)	29(43.28)	53(49.1)		
<b>Education level</b>					
Secondary	27(65.85)	51(76.12)	78(72.2)	3.80	0.150
Diploma	4(9.76)	9(13.43)	13(12.0)		
Degree	10(24.39)	7(10.45)	17(15.7)		
<b>Continuous variables</b>					
	Mean	Mean	Mean	t-value	p-value
Socio services	3.16±0.52	3.71±0.42	3.50±0.53	-6.02	<0.0001
Protection	3.31±0.38	3.80±0.33	3.61±0.42	-7.03	<0.0002

Table 1 shows the frequencies and percentage distributions of the response and explanatory variables used in the study. All the computed Chi-squared values for age, marital status, gender and education level were not significant, implying the rejection of the null and acceptance of the alternate. This means that the two categorical variables in question are dependent or related.

**Table 2: The parameter estimates and the logistic regression model**

Impact	Coef.	OR	Std. Err.	Z	P>z
Social services	1.56	4.74	0.66	2.37	0.018
Client protection services	3.32	27.70	0.92	3.62	<0.0001
Constant	-16.70	0.00	3.31	-5.04	<0.0001
Logistic regression			Number of obs	=	108
			LR chi2(2)	=	48.2
			Prob > chi2	=	<0.0001
Log likelihood = -47.599365			Pseudo R2	=	0.336

The odds of those who received socio-services was 4.74 times to improve clients' socioeconomic wellbeing compared to those who never received socio-services while the odds of those who received client protection services was 27.70 times to improve clients' socioeconomic wellbeing compared to those who never received client protection services. The Pseudo R<sup>2</sup> of 0.336 falls between the recommended range of 0.2 to 0.4 implying that our model is a good fit.

**Table 3: Test for goodness of fit**

Goodness of fit statistics using Hosmer-Lemeshow test	
Number of observations	108
Number of covariate patterns	101
Pearson chi2(98)	95.9
Prob > chi2	0.5411

Ho: the model fits the data. The test results are not significant indicating that a good fit for our model (Stata. com). The null is upheld.

### 3.2 Discussion

The results from the model have indicated that client protection services (OR=27.70) have more impact on the clients' social economic wellbeing when compared to the social services (OR=4.74). There was no significant difference between the microfinance services studied and the clients' social economic wellbeing. The results imply that much as MFIs provide varied social services to their clients, which no doubt improves their social economic welfare, more impact on clients socio-economic wellbeing would be better achieved with a focus on client protection policies. This finding reinforces the mission of MFIs that focused on the service of the



very poor and marginalized groups (Brau & Woller, 2004; Swain & Garikipat, 2019; Meki, et al., 2021; Cull & Morduch, 2017; Sangwan, Nayak, Sangwan, & Pradhan; World Bank, 2022; Kucharski & Radow, 2021).

The fact that client protection services strikingly stand out to offering more impact on the clients' social economic wellbeing, is in support of the recommendation that the right type of support be accorded to the poorest of the poor if they are to positively benefit from microfinance (Swain & Garikipat, 2019). Services such as micro insurance offered to microfinance clients should be promoted especially during crisis periods that tend to increase the clients burden of repayment (Muftau, Afolabi, & Muritala, 2016). Crises tend to hit the poor more, as such, the way the rich benefit from the protection against risk through insurance is the same way the poor should be hedged against credit risk through micro insurance.

From the analysis, social services when taken as a stand-alone from other client protections has a positive impact on the clients' social economic wellbeing though not to the level of client protection practices. This finding is in support of the microcredit plus rhetoric that advocate accompanying financial services with non-financial services (Brau & Woller, 2004). The significant positive odds in relation to client protection is in indirect support for the need to adhere to client protection policies such as transparency in microfinance dealings and advancing credit based on proper loan assessment (Swain & Garikipat, 2019; Forste, Lahay, Clark, Koning, & McKee, 2020).

#### **4.0 CONCLUSION**

The binary logistic regression model suggests that clients' socioeconomic wellbeing improves more when microfinance is augmented with the right support especially client protection services. Policies that protect clients from over indebtedness such as thorough loan appraisal, clear repayment terms, regular monitoring and a clear repayment plan need to be implemented. The concept of microcredit plus that stresses microfinance augmented with the necessary non-financial support such as training in enterprise development and health training should be part and partial of microcredit.

#### **5.0 RECOMMENDATION**

It is recommended that in addition to the social services that most microfinance institutions are offering to clients, special attention be paid to integrating services that focus more on client protection. The Government should provide a framework that guides MFIs to prioritize client protection in their bid to achieve the social objective alongside financial sustainability. The clients should be educated on their rights and duties as borrowers and provided with all the necessary information concerning a particular loan product to minimize on the possible harm that clients may face by accessing loans without clear orientation.

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