He who chases two rabbits catches neither.

1 Conclusion and Policy Derivatives

This study examined the potential important ramifications of the transformation of MFIs in Africa. The conversion of MFIs has seen a substantial number of MFIs that previously operated as NGOs convert to a commercial, profit-seeking models of MFI that relies less on donations and state subsidies and more on internal capital and funding from capital markets. The said primary motivation for the transformation of MFIs is that financially sustainable MFIs stand a better chance of expanding financial inclusion than those MFIs that rely on donations and subsidies.

However, there are concerns in the microfinance research literature about the potential for mission drift among the transformed MFIs [1, 2]. Mission drift occurs when transformed MFIs stress financial sustainability at the expense of the social goal of offering appropriate and affordable financial services to the financially excluded [3]. However, to date, there had been a lack of consensus on the extent and direction of the transformation of MFIs, especially in Africa. Much of the extant research draws from global datasets, which could mask regional heterogeneity.

This Ph.D. work extended the existing research (literature) by examining the factors that drive the conversion of MFIs from the conventional NGO model to the commercial model. This research oversight (or gap) is surprising given that as more MFIs adopt the profit-oriented model, an appropriate policy framework should be in place to support the transformation and mitigate potential side effects of the conversion. Further, this work explored how the mutation of MFIs to the commercial model affects financial inclusion in Africa. The outcome from this objective allows researchers to assess the impacts of the transformation of MFIs on financial inclusion and, thus, guides on how to craft appropriate interventions. As noted earlier, there is a lack of consensus on the effects of MFI transformation on financial inclusion; so this objective contributes to the existing body of evidence.

Critically, the study also examined the levels of financial and social efficiency of MFIs, and the factors that determine whether or not MFIs in Africa meet their financial and social goals. In this regard, much of the literature examines the financial and social outcomes of MFIs separately, instead of evaluating them jointly as two sides of the same coin. This research goes beyond the existing research coverage by assessing the joint financial and social goals of MFIs in Africa, the extent to which MFIs achieve these goals, and the factors that drive or hinder the achievement of the dual goals.

Also, few researchers have examined the financing model of MFIs, considering that, as hybrid organisations, the mainstream capital structure theory may be deficient because it addresses the financing of traditional manufacturing and/or merchandizing firms. The outcome from this objective productively informs policies that would focus on the financing of MFIs in Africa, considering that the double bottom line objective of MFIs may necessitate trade-offs between profitability and the achievement of the social goals of reaching the unbanked.

In this regard, this work sought answers to the following questions in light of the research gaps highlighted.

1. Why do some MFIs in Africa transform into the commercial model while others retain the NGO Model?

2. To what extent has the institutional transformation of MFIs in Africa affected financial inclusion?

3. After transformation, what factors explain the joint level of sustainability and outreach by MFIs in Africa?

4. What are the drivers of financial efficiency, social efficiency and socio-financial efficiency of MFIs in Africa?

5. What are the factors that influence the choice of financing sources by transformed MFIs in Africa?

1.1 Highlight of the Results

The first research question examines factors that make MFIs adopt the commercial, profit-seeking model that gets funding primarily from capital markets instead of relying on donations and subsidies. The analysis shows that at the firm level, age and size influence transformation. Legal tradition, institutional quality, and stock market development are significant factors at the country level. Specifically, more prominent and older MFIs are less likely to operate under the NGO model. These results suggest that as MFIs mature, they tend to convert to the commercial model either due to pressure from donors or the decision by management to pursue the double bottom line as they get more financially stable and as donor support subsides. MFIs in civil law countries are also less likely to be NGOs, while MFIs in countries that follow other legal traditions are more likely to adopt the commercial model.

Again, institutional quality increases the chance of traditional NGO-based MFI conversion to the commercial-based MFI. Institutional quality reflects a wide range of governance metrics that enhance contract enforcement and property rights. Hence, countries with more robust institutions tend to attract more private investments and thus the higher rate at which MFIs adopt the commercial model. Stock market capitalisation and private credit to GDP have a negative relationship with transformation. The development of capital markets corresponds to better access to financial services, a pre-condition for financial inclusion. Hence, MFIs in countries with well-developed financial markets will likely be competing against established financial intermediaries for the existing market. The competition limits the financial viability of MFIs. Hence, MFIs in these markets will likely remain NGOs that serve a small population in the market's fringes.

The study then examined how the transformation of MFIs in Africa has affected or could potentially affect financial inclusion on the continent. The results show that the change from the NGO model to the commercial models could negatively affect the depth of financial outreach, especially given that NGOs characteristically have better outreach to women and advance smaller denomination loans on average than for-profit MFIs. Also, NGOs have higher median gross loans to assets ratio than other legal forms of MFIs except for credit unions/cooperatives. Overall, the results indicate the potential for mission drift, where MFIs that convert to the for-profit model focus more on financial sustainability to the detriment of outreach to the unbanked.

In Chapter 4, I examined the levels and drivers of the financial and social efficiency of MFIs in Africa. In this case, I captured the efficiencies by using output-oriented data envelopment analysis (DEA). Broadly, the results show a trend of declining financial efficiency by MFIs but no discernible trend in social and socio-financial efficiencies. Furthermore, NGOs have markedly better social efficiency and socio-financial efficiency scores than other legal forms of MFIs. Surprisingly, only cooperatives and rural banks consistently outperformed NGOs in terms of financial efficiency. The proxies for financial sector development, stock market capitalisation to GDP and private credit to GDP negatively affect social and socio-financial efficiencies. Financial efficiency has an inverse relationship with both the size and asset structure of MFIs. These results suggest that the commercialisation of MFIs does not necessarily improve their financial sustainability.

Related to chapter 4, chapter 5 examined the extent to which MFIs in Africa achieve financial and social goals. The chapter also sought to uncover factors that drive the achievement of the dual objectives. The results show that most MFIs in Africa attain the dual objectives, at 35.88% compared to 14.76% that fail in both missions. 23.85% fail socially but succeed financially, and 25.55% succeed socially while failing financially. In total, 61.43% of MFIs attain their social goals. 40.31% fail financially. However, these results vary across the legal status of an MFI. Rural banks and NGOs are more likely to achieve the dual goals than banks, NBFIs and credit unions.

Accordingly, the legal status of an MFI is the most significant driver of the extent of the achievement of the dual goals. NGOs have the highest likelihood of achieving both financial and social goals. This result highlights the risk of mission drift should MFIs convert to the for-profit model. Larger MFIs have a higher chance of meeting financial and social goals. Likewise, larger firms are more likely to succeed socially while failing financially, meaning that larger firms emphasise social impact. Age raises the probability that an MFI will fail financially and socially, as does stock market capitalisation to GDP that proxies capital markets development. Lastly, MFIs in countries that follow civil law and other legal traditions are more likely to meet at least one of the objectives, unlike MFIs in common law countries.

Finally, in chapter 6, I looked into the factors that drive the adoption of alternative finance sources. In this case, I examined four primary sources of finance – leverage, equity, deposits, and donations. The significant determinants of financing at the firm level are size, age, legal status, and profitability consistent with a main capital structure theory. For example, asset structure varies inversely with leverage. At the country level, institutional quality (KKM) varies inversely with deposits and donations. Interestingly, coefficients of financial development are not significant across all financial structure proxies; thus, going against stylised facts about the macro-level drivers of firms' financing structure. Moreover, the results suggest that firm-level factors are more relevant in determining the financing structure of MFIs.

1.2 Policy Implications

There are some important policy derivatives from the outcomes of the research. However, it seems sensibly systematic to first restate specific objectives and corresponding results that form the basis of the policy recommendations. The study sought to examine the possible impacts of the transformation of MFIs in

Africa on financial inclusion. The change is said to be aimed at making MFIs less reliant on donor funding and state subsidies, by making them financially sustainable. Financially sustainable MFIs would then experience mission expansion instead of mission drift [4]. This logic arose after the cold war and the rise of neo-liberalism that emphasises the financial viability of institutions. I first look at the implications of the research on the financial and social goals of MFIs in Africa and the impacts on financial inclusion.

First, the conversion of MFIs does not appear to improve the financial sustainability of MFIs in Africa, at least in the short and medium term. Overall, MFIs fare poorly financially. However, NGOs have better financial efficiency scores than banks and NBFIs. Only cooperatives and rural banks do better financially than NGOs. With cooperatives more inclined to serving their members more than offering financial services to the unbanked, it appears that the argument for financial sustainability as an enabler of mission expansion by MFIs does not hold.

Indeed, the analysis shows that NGOs form the most significant proportion of MFIs that are financially viable while still maintaining their social focus. This result indicates that NGOs are better at balancing social and financial goals more than the converted MFIs. Even where they fail financially, NGOs have the highest proportion of MFIs that succeed socially, meaning that NGOs are keener on their social mission than on financial goals. Together with donor support, the mission of NGOs could be why they can stick to their social mission [5]. The results show a high likelihood of mission drift where MFIs that seek financial sustainability focus less on availing financial services to the financially excluded. Consequently, these results call to question the coercive pressure from donors and governments for MFIs to be primarily financial oriented.

These results point to four areas for possible policy interventions. First, are there policies that would support the conversion of MFIs from NGOs to the commercial model without causing mission drift? Secondly, among the converted MFIs, what kind of support would best allow them to be financially sustainable without losing focus on their social goals? Third, what financing options are best suited to supporting the dual objectives of microfinance institutions? Fourth, a prominent proposition by Morduch [6] and Morduch [7] advocates for allowing a broad range of MFIs – from those seeking financial sustainability to those that focus on financial exclusion with donor and state support. I examine these points next.

Chapter 2 established some of the factors that drive the conversion of MFIs to the commercial model. I found that age and size influence the transformation, whereas legal tradition, institutional quality, and stock market development are significant factors at the country level. Larger MFIs and MFIs located in countries with "other" legal traditions are more likely to follow the commercial model. Institutional quality increases the likelihood of conversion, while stock market capitalisation has a negative relationship with transformation. Among the factors associated with a higher opportunity that an MFI will achieve financial and social goals are MFI age, size and legal status, country legal tradition, level of capital markets development, and institutional quality. The latter three have a negative relationship with the likelihood of achieving financial and social goals.

These results imply that MFIs located in countries with better institutions and better capital markets development are better of following the commercial model, especially given the low levels of financial exclusion in these countries. Better institutions allow MFIs in these countries to achieve their financial goals even when not meeting their social goals without extensive loss in public welfare. Conversely, MFIs located in countries with low levels of financial development and low institutional quality seem more likely to retain a greater degree of NGO-type MFIs. The substantial levels of financial exclusion in these countries mean that conversion of MFIs will considerably impact financial inclusion, which goes against the millennium development goals and the African Union Agenda 2063 on financial inclusion for all. This suggests that some donations and state subsidies are necessary for financial inclusion goals, especially in countries with sizeable financial inclusion gaps. The neo-liberal approach to coercive adoption of the commercial model of MFIs uniformly across all countries, especially in Africa, would be inappropriate, as Bateman [8] notes.

Also, Morduch [6] and Morduch [7] argue that the microfinance industry should allow for a wide range of MFIs. In this model, the NGO-type MFIs could still rely on donations and subsidies and reach out to the poorest section of the population that the mainstream financial system shuns. Then, as these customers get better off, they could join the mainstream financial institutions. This model implies that the customers of MFIs could be segmented and served based on need. This model will allow for the coexistence of different types of MFIs – profit-seeking as well as NGO type – instead of prioritizing some types of MFIs over others. To extend this argument, the microfinance model should also be different, depending on the situations in individual countries. As noted earlier, countries with low levels of financial inclusion due to low levels of capital markets development, should allow for and support more NGO-type MFIs, relative to countries with relatively lower levels of financial exclusion.

A related issue in financing hybrid organisations like MFIs is the rise of impact finance and blended finance. Impact investing relates to using corporate governance principles to generate environmental, social, and governance (ESG) gains over and above financial goals. The defining features of impact financing are as follows.

- Intentionality of impact,
- Expectation of financial returns, and
- Measurable impact along non-financial dimensions — notably, social, environmental, or governance (or two or three of these) dimensions [9].

This research has established the decline in donations to MFIs, in line with the rise of neo-liberalism. Also, most MFIs have poor financial results and may not attract capital market funding. Impact financing could bridge this deficiency by offering support without expecting financial returns as high as those demanded by mainstream capital providers. Barber, Morse, and Yasuda [10] show that impact investors derive non-pecuniary utility from investing in dual-objective Venture Capital (VC) funds, thus sacrificing pecuniary returns. The entry of impact financing into microfinance could help mitigate the administrative challenges associated with the double bottom-line objective of MFIs.

A related concept is that of "blended finance" [11], which the IFC defines as follows:

> The use of relatively small amounts of concessional donor funds to mitigate specific investment risks and help rebalance risk-reward profiles of pioneering investments that cannot proceed on strictly commercial terms. Investors typically structure these concessional funds as co-investments, with an expectation of reflows for future acquisitions or other uses [1].

Blended finance would benefit MFIs at the initial stages of conversion when financial goals may be hard to attain. Then, as MFIs adjust to the commercial model and become more financially sustainable, the blended funding could be scale down.

The providers of impact and blended financing should consider the needs of MFIs in each country or region. For instance, this research has established that MFIs in countries with high levels of financial development do not fare well financially. Still, there is a substantial number of marginalised people that would benefit from the services of MFIs. MFIs in countries with low levels of financial development have better financial prospects, as they serve a relatively large pool of clients. In this case, impact and blended finance could complement financing MFIs from the mainstream financial markets.

1.3 Possible Future Research Directions

In this section, I describe some potential areas for future research. First, it would be interesting to examine MFIs that succeed financially and socially after conversion and see what differentiates them from those that fail in one or both objectives. The study could then examine firm-level factors that drive the extent that MFIs achieve financial and social goals. These firm-level drivers may include, for example, inefficient employment of resources like human capital, which could be addressed by

[1] This definition is available `https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/bf`

increased use of Fintech or optimising the number of clients per loan officer. This examination would help inform management of MFIs as well as policymakers on the possible areas of intervention to allow MFIs to meet the double bottom line objective.

Along the same line, it would be worth examining the longer-term examination of financial sustainability vis-a-vis social performance of MFIs. This current research did not benefit from a more extended time series to track the financial and social goals of MFIs. MFIs may struggle financially at the initial stages but improve as they adjust to the commercial model of operations. This kind of research would help uncover areas transforming MFIs should address to adapt successfully and meet financial and social goals in good time.

Even as MFIs convert to the commercial model, a new reality has hit the financial services industry: the rise of Fintech. FinTech promises to deliver financial services at a lower cost than the traditional brick and mortar model. In this regard, MFIs converting to the commercial model could benefit immensely from adopting FinTech solutions, both from the financial sustainability and the social outreach perspectives. From this perspective, it would be useful to assess how transformed MFIs make investments in FinTech and how their investments in FinTech impact their investments in physical infrastructure and the resultant effects on profitability and outreach.

Perhaps the most critical issue for future research is establishing the best ways to finance MFIs that are transforming into the commercial model. Much of the literature examines the financing structures of financial intermediaries that only have a commercial goal. Thus, extant capital structure theory does not address MFIs that have dual objectives. In the mainstream capital structure (e.g., trade-off) theory, a firm's value will increase with increased debt up to when the costs of financial distress outweigh the corporate and personal tax advantage of debt. In the case of MFIs, the value of a firm is not just related to the value of debt and equity but also the intangible value arising out of meeting social goals that raise the firm's worth to stakeholders. Hence, it is paramount to establish the best financing structure to optimise the hybrid goals of MFIs.

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