BALANCING FINANCIAL SUSTAINABILITY AND OUTREACH IN MICROFINANCE INSTITUTIONS: A SYSTEMATIC REVIEW OF DETERMINANTS, TRADE-OFFS, AND PERFORMANCE DRIVERS

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DOI: 10.5958/2319-1422.2025.00003.0

ABSTRACT

The transition of microfinance institutions (MFIs) from a non-profit orientation to a commercially driven model has enabled the sector to expand and better serve low-income populations. Financially sustainable MFIs can significantly improve financial inclusion outcomes. To answer the research questions, a systematic review of previous studies was conducted by examining scholarly articles listed on Google Scholar from 2000 to 2025. Keywords such as sustainability, outreach, grants, donations, and microfinance institutions were used. Out of 120 identified research papers, 72 were considered appropriate for analysis based on relevance. Findings suggest that MFIs face a clear trade-off between outreach and financial sustainability, and excessive reliance on donations adversely affects their long-term financial health.

KEYWORDS: *Sustainability, Microfinance Institutions, Outreach, Financial Sustainability, Grants and Donations.*

1. INTRODUCTION

World Bank statistics reveal that nearly three billion people survive on less than $2.5 a day, with about one billion living on less than $1. Microfinance has emerged as a crucial mechanism for poverty alleviation (Rubana, 2008; Daley-Harris, 2002; Lalitha, 2008, cited in Soreze, 2010). Governments and international agencies have designed the microfinance ecosystem to reduce poverty. Despite MFIs expanding their customer base by nearly 23% annually, they are still unable to satisfy more than a small proportion of potential borrowers (Dieckmann et al., 2007; Cull et al., 2009).

MFIs provide small-scale savings, credit, and financial services to low-income households in rural, semi-urban, and urban regions (Mohanty, 2010). Outstanding portfolios of development finance institutions supporting MFIs have grown annually by more than 55% (Bresnyan, 2004). These institutions mainly extend credit to people excluded from traditional banking systems. However, lending to poorer communities involves high operational costs, which affects institutional sustainability. Many MFIs survive due to support from donors and NGOs who supply funds at concessional interest rates (Hermes et al., 2011).

The sector is gradually moving away from dependence on grants and subsidies toward greater financial sustainability and efficiency. Competitive pressures, commercialization, regulatory reforms, and technological advancements are key forces driving this shift (Rhyne & Otero, 2006). Financial sustainability signifies an organization's ability to meet operational and financing obligations over time, while outreach refers to the number of clients served (Zellers & Meyer, 2002).

Reports from the Asian Development Bank highlight that weak financial viability and operational inefficiencies are major challenges for MFIs across Asia. Inadequate financial infrastructure, adverse policy environments, low investment in rural development, and insufficient social intermediation contribute to these problems. The World Bank (2000) emphasizes that MFIs were created to address poverty reduction—one of the central development goals of nations. Although institutions receive grants and subsidized loans (Agarwal & Sinha, 2010), excessive dependence often results in high levels of non-performing assets.

2. Methodology

The study relies on internationally recognized scholarly journals and publications related to sustainability and microfinance. A structured search was conducted on Google Scholar for publications from 2000 to 2025 using keywords such as *sustainable microfinance*, *outreach*, *financial sustainability*, *grants*, and *donations*. From 120 papers identified, 72 were finally selected based on relevance to the research objectives.

A systematic review was carried out to answer the following questions:

2.1 Research Questions

1. Is there a trade-off between financial sustainability and outreach in MFIs?
2. How can the efficiency of MFIs be evaluated?
3. Do grants, donations, and subsidies promote financial sustainability in MFIs?

2.2 Variables

Financial Sustainability: Ability of an MFI to meet its operating and financial commitments over time (Zellers & Meyer, 2002).

Operational Self-Sufficiency (OSS): Measures the extent to which an organization can cover operational costs using its internal revenues rather than external support (Woller & Schreiner, 2002).

Outreach: Morduch (1999) explains outreach by the number of active borrowers (breadth) and the socio-economic characteristics of clients served (depth).

Breadth of Outreach: Number of clients served.

Depth of Outreach: Quality or intensity of outreach based on poverty level or vulnerability of beneficiaries.

Managerial Effectiveness: Ability of leadership to utilize resources efficiently and achieve organizational goals (Mintzberg, 1973).

3. Literature Review

3.1 Trade-off between Financial Sustainability and Outreach

Both operational and financial sustainability are essential for MFIs, and outreach is often linked to sustainability. However, whether outreach improves sustainability remains debated. Meyer (2002) highlights that accurate financial reporting and transparency is critical for measuring

sustainability.

Some studies argue that outreach and sustainability complement each other, as larger outreach can lower costs through economies of scale (Christen et al., 1995; Otero & Rhyne, 1994). Other studies find an inverse relationship. Hulme and Mosely (1996) noted a positive correlation between active clients and profitability, but Kereta (2007) emphasized that heavy subsidization distorts sustainability measurements.

Multiple studies provide mixed conclusions, showing that factors such as age of MFIs, type of institution, region, lending methodology, and borrower characteristics influence this relationship. Many researchers conclude that although outreach enhances access to financial services, it often comes at the cost of financial sustainability.

Proposition 1

A trade-off exists between financial sustainability and depth of outreach. Factors such as organizational size, age, region, and institutional type affect both outreach and sustainability. Smaller or younger MFIs, NGO-based MFIs, and institutions operating in Asia, Africa, and Latin America must balance sustainability with outreach. Older MFIs and those with larger client bases tend to perform better financially.

3.2 Assessing Efficiency of MFIs

Farrell (1957) introduced a method for evaluating economic efficiency, which includes:

- **Technical efficiency:** Ability to maximize output with given inputs
- **Allocative efficiency:** Ability to use inputs optimally given their prices

Efficiency is central to MFI performance, particularly because inefficient operations limit outreach to the poor. Morduch (1999) calls for more empirical work on MFI sustainability, emphasizing that high demand for microfinance services does not guarantee sustainability unless costs are recovered.

Studies show that age positively influences efficiency, but factors like debt-equity ratio, regional differences, and type of institution also play significant roles. Many MFIs in South Asia perform poorly due to managerial inefficiencies, limited technology adoption, and low portfolio quality.

Proposition 2:

Operational self-sufficiency, return on assets, return on equity, debt-equity ratio, debt-loan ratio, and breadth of outreach all contribute to financial sustainability. Donations help operations but weaken repayment culture. Efficiency improves when MFIs have strong management, quality borrowers, higher interest margins, and economies of scale.

3.3 Do Grants, Donations, and Subsidies Lead to Sustainability?

Commercially funded MFIs generally aim to increase income and reduce costs, enhancing sustainability. A sustainable microfinance system is marked by stable returns, low default rates, and resilience to market fluctuations (Dieckmann et al., 2007).

Many researchers have analyzed how capital structure influences sustainability. The life-cycle theory suggests that while MFI age may not directly affect sustainability, funding structure plays a crucial role. Some studies find that excessive reliance on grants weakens operational self-sufficiency and creates dependency. Others acknowledge that subsidies are sometimes essential, especially for young MFIs or those targeting very poor clients.

Proposition 3:

The impact of donations on sustainability depends on donor characteristics, intentions, and alignment with the MFI's mission. Diversified funding sources, effective management, and responsible use of donor funds can enhance sustainability. However, over-reliance on subsidies decreases self-sufficiency and may distort organizational priorities.

Table of Key Studies

Year	Author(s)	Key Findings	Identified Gap
1999	Morduch	Outreach defined as depth & breadth	Digital outreach not considered
2002	Meyer	Sustainability linked to transparency	Lacks modern efficiency indicators
2007	Bogan et al.	Capital structure influences sustainability	No regional comparison
2010	Hermes et al.	Donor subsidies distort performance	Does not study donor intent
2014	Awaworyi & Marr	Trade-off between outreach & sustainability	No managerial variables included
2015	Wijesiri et al.	Age improves performance but reduces outreach	Lack of digital data
2018	Bayai & Ikhide	Risk management affects sustainability	No technological factors
2021	Ponce et al.	Trade-off varies by region	Lacks institutional characteristics
2022	Cozarenco et al.	Subsidy mixes may cause mission drift	No operational efficiency focus
2023	Recent studies	Digital lending rising	Long-term impact still unknown

4. Conceptual Framework

After identifying the research gaps through the literature review and shaping the study's objectives accordingly, a conceptual framework linking financial sustainability and outreach performance was developed. In this framework, *FS* refers to **Financial Sustainability**, *DO* to **Depth of Outreach**, *LSO* to **Large-Scale Organizations**, *DC* to **Donor Characteristics**, *MC* to **Managerial Characteristics**, and *IC* to **Institutional Characteristics**.

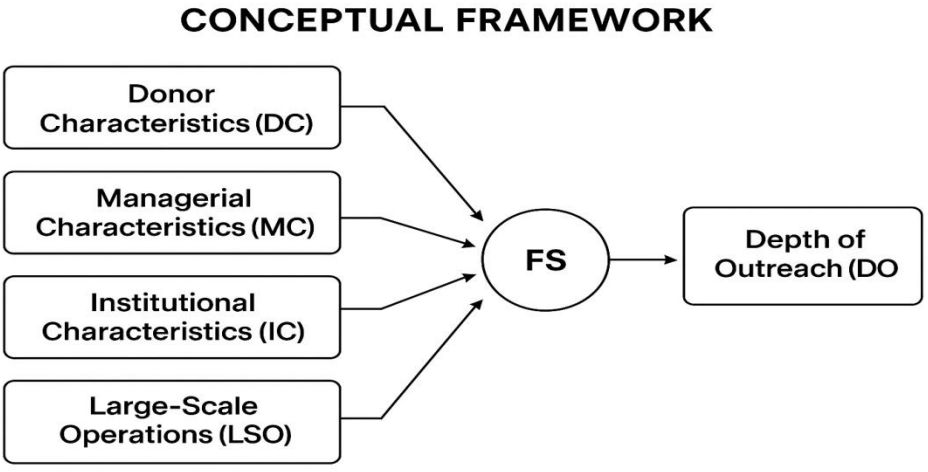

Fig 1: **Conceptual framework of financial sustainability of micro financing institutions**

Based on theoretical propositions, responses to the research questions, and the evaluation of financial sustainability indicators, the study concludes that achieving both financial sustainability and depth of outreach requires a careful balance. However, expanding the **breadth** of outreach is

more compatible with financial sustainability. Existing studies further highlight that institutional factors that strengthen sustainability often reduce the depth of outreach, and the reverse is also true.

The framework attempts to identify how various variables jointly influence financial sustainability and depth of outreach. The study emphasizes that *operational self-sufficiency* is the minimum requirement for any MFI to survive and move toward its mission. Even though MFIs operate with social goals such as financial inclusion and poverty reduction, these objectives should not undermine the need for achieving operational self-sufficiency. Financial sustainability goes beyond OSS and enables MFIs to withstand crises, operate independently of grants, and navigate emergencies.

Although the term "financial sustainability" is more commonly used for commercial institutions, MFIs also rely on grants and donations to build reserves and expand their scale. To secure such support, MFIs must develop an effective capital structure that attracts diverse funding sources. Multiple donors, private equity investments, and concessional loans are preferable to relying on a single donor. Therefore, the intent, ideology, and operational focus of donor agencies should be carefully evaluated. If donors' priorities align with an MFI's vision, the partnership can be beneficial; otherwise, heavy reliance on a misaligned donor can create significant challenges.

Managerial characteristics also play a central role in determining financial sustainability. Ethical leadership, strong managerial competencies, commitment to the institution's mission, and performance-driven attitudes contribute significantly to achieving both sustainability and outreach goals. Dedicated managers enhance overall performance and help target the right beneficiaries.

From an operational perspective, MFIs functioning at a larger scale tend to reach sustainability and outreach targets more quickly. Larger institutions enjoy better resilience during crises, possess stronger brand recognition, and can extend services to people below the poverty line more effectively.

The conceptual model therefore illustrates that Donor Characteristics, Managerial Characteristics, and Large-Scale Organizational Structure collectively drive both financial sustainability and depth of outreach. When these factors work in harmony, they positively influence both outcomes despite their inherent trade-off. However, misalignment among these factors can lead to negative consequences for both sustainability and outreach.

For instance, a donor committed to poverty-reduction initiatives can strengthen both outreach and sustainability by offering focused financial support. Conversely, a donor who is merely seeking a place to deploy surplus funds without a social mandate may not contribute meaningfully to either goal.

Institutional characteristics—such as age, financial health, capital structure, and portfolio quality—affect sustainability and outreach based on their trade-off tendencies. For example, older institutions may demonstrate better outreach but lower sustainability, while a robust capital structure may enhance sustainability but limit depth of outreach.

5. CONCLUSION

This study examines commercially oriented MFIs and explores strategies that help them achieve financial sustainability. While doing so, it recognizes that MFIs are fundamentally rooted in social missions, particularly promoting financial inclusion and reducing poverty. Therefore, the analysis balances financial sustainability considerations with the need to maintain meaningful outreach.

The results indicate that MFIs must strike a trade-off between financial sustainability and depth of outreach. Grants and donations can be strategically used to reduce operating costs, offer more

affordable interest rates, and reach a larger number of borrowers. Such funds are especially useful for redesigning loan products, lowering lending rates, and relaxing terms and conditions—all of which contribute positively to outreach and sustainability.

Because of this, donor agencies must be selected with care. Their experience, ideology, and commitment to the social purpose of MFIs should align with the institution's mission. Additionally, factors such as managerial efficiency, operational self-sufficiency, reduced dependence on women-only borrower portfolios, loan intensity, loan installment flexibility, return on assets, and portfolio at risk emerge as key determinants of financial sustainability.

Capable managers—those with the right intentions, skills, ethics, and expertise—significantly influence team performance and ground-level outcomes. Hiring effective managers helps reduce costs, expand the client base, and improve repayment behavior.

The study concludes that Donor Characteristics, Managerial Characteristics, and Organizational Scale together enhance outreach, strengthen financial inclusion efforts, and improve financial sustainability. MFIs can further strengthen their sustainability by diversifying funding sources, improving transparency, adopting modern financial instruments, and embracing new technologies to manage costs.

Technological innovation and advanced financial tools can enable MFIs to improve efficiency and reduce expenses, creating a strong foundation for long-term financial sustainability. Ultimately, MFIs should adopt a balanced approach that secures financial strength while maintaining their social mission. Future research could examine how sustainability models differ across regions and evaluate the long-term role of digital transformation in improving financial performance.

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