THE IMPACT PATHWAY FOR MICROCREDIT

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Foreword

This publication reflects our ongoing collaboration with the IE School of Politics, Economics & Global Affairs through our participation in the Capstone Project. On this occasion, we had the privilege of working with **Giulia Colleoni, Marta Martínez Herrero, and Ana Lucía Yugueros González**, a team whose collaboration, analytical rigor, and commitment to understanding complex issues have been exceptional.

Their project focused on industry-specific product impact, building on our efforts to develop a framework for assessing the impact of financial products, in line with the draft framework co-developed under the Valuation Technical and Practitioner Committee due process, in collaboration with the International Foundation of Valuing Impacts.

On an exercise to follow the VTPC exposure draft in a practical application, the team showed a particular interest in the financial industry and in understanding how products can generate measurable value for people and businesses. From a broader perspective, they recognized that for most corporate and institutional finance products, impact varies according to their use and the activities they enable. Therefore, in such cases, impact should be attributed through the value chains these products finance, meaning that their social and environmental effects depend largely on where funds flow and how they are applied.

With that in mind, and in order to explore more direct and observable effects, the students chose to focus on financial products directed at individuals, where outcomes related to well-being can be more clearly traced. Within this scope, **microcredit** emerged as the most compelling area of analysis. As the students highlight, it represents a unique intersection between **financial inclusion, entrepreneurship, and human development**, where small loans, combined with trust and financial knowledge, can reshape economic opportunity. Their work does not ask *whether* microcredit works, but *under what conditions* it does, and which specific design features most directly influence well-being.

The result is a rich qualitative assessment that maps, with depth and clarity, an a proposal for impact pathway for microcredit. It provides a foundation for future research on impact accounting in the field and offers valuable insights for financial institutions seeking to create long-term value for their clients by integrating well-being considerations into product design and delivery.

This text presents an extract from their contribution. The full thesis can be accessed upon request. We sincerely thank the **IE School of Politics, Economics & Global Affairs, the students and Francisco Hernández** on his role as academic tutor for their outstanding contribution to this shared endeavour. Their work exemplifies what collaborative research should aspire to: clarity without simplification, and hope grounded in evidence.

Francisco Ortín Córdoba
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Mapping the impact pathway of microcredit

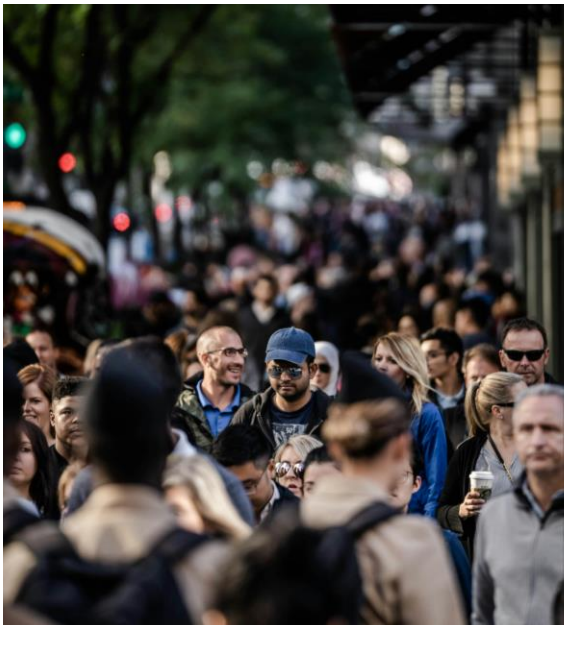
Microcredit has long been at the center of debates on financial inclusion. It has been praised as a tool to unlock opportunity for those excluded from traditional finance, and criticized for the risks it carries when poorly designed. Beyond these polarized narratives, our project set out to address a more specific question: which elements of microcredit actually determine its impact on people's lives?

Within consumer finance, microcredit is uniquely positioned for such an inquiry. It is often the first point of entry into the formal financial system for women, migrants, informal workers, and micro-entrepreneurs. Its effects are felt in daily life: the ability to pay school fees, cover medical costs, or sustain a small business. Many microfinance institutions are striving to trace the impact of their products, yet measuring how microcredit affects clients' well-being remains extremely complex. Our project contributes to this effort by identifying the features of microcredit with the greatest influence on well-being and by offering a descriptive, evidence-based account of how they translate into observable changes across different dimensions of life. It sets out a structured pathway that clarifies these causal links and lays the foundation for more consistent measurement in the future.

Our research highlighted two impact drivers as particularly decisive for clients' well-being: access to credit and financial literacy. In what follows, we focus first on the multiple dimensions of access to credit (ranging from how clients are selected, to the ease and continuity of lending, to the costs and flexibility of repayment) before turning to the role of financial literacy.

The first and most decisive driver we observed is targeting. A microloan has positive effects only when the amount requested is appropriate and the repayment terms are understood, which makes the initial client assessment the most critical step in the process. Effective targeting means identifying clients with real entrepreneurial potential while also reaching those typically excluded, such as women, rural populations, and micro-entrepreneurs without access to banking.

Credit officers play a central role here: they are interpreters of clients' realities, able to calibrate a loan based on personal knowledge of a business or household that no formal documentation can fully capture. Building this relationship is crucial, and experts noted that successful clients often engage in training programs, remain transparent with credit officers, and reinvest earnings rather than consume them immediately. These insights are gradually reshaping institutional practice. Some lenders now go beyond geography or income to segment clients by financial behaviour, using repayment histories and savings patterns as indicators of resilience, while others integrate data collection directly into the lending process to refine profiles without relying on costly surveys.



Access to credit impact drivers

Accessibility, too, emerges as a critical determinant of impact. It has two main dimensions: physical proximity and procedural ease. While the challenge of geographical proximity is increasingly being overcome through digitalization (mobile platforms and digital banking agents breaking down barriers for clients in remote areas) procedural ease has emerged as an equally, if not more, critical aspect. One entrepreneur explained that what led her to choose her current microfinance institution over others was the minimal presence of bureaucratic requirements: instead of demanding endless documents, the institution visited her shop, recognized the business she had built, and earned her trust.

Interviewed clients also emphasized the importance of speed. Receiving funds within five to seven days of the application can make the difference between capturing an opportunity and losing it. Timely disbursement is not simply a matter of efficiency, but a condition that shapes clients' ability to respond to sudden market openings and to stabilize their livelihoods.

A third driver is continuity. Microcredit does not reach its full potential when delivered as a single intervention. Its effects accumulate through a sustained relationship between client and institution, a process known as progressive lending. With each cycle of repayment and renewal, clients build a credit history that enables them to access larger amounts, and thus to invest more ambitiously. One client expressed it with clarity: the first loan was just the beginning, the second and third created a "credit life." Evidence confirms this: nearly half of clients who initially lived below the poverty line had risen above it after three consecutive credit cycles.

Figure 1: Access to Credit Impact Drivers

Obtaining a loan is only the first step. Whether that loan leads to *positive change* depends heavily on ***how*** it's given. The most successful microcredit programs don't just hand out money; they design their services with a people-first approach. So, what makes a microcredit work?

Effective Screening of Clients
The MFI's capacity to identify and reach underserved populations likely to benefit from credit, promoting inclusion and entrepreneurial potential. Proper screening ensures that the client will make an effective investment of funds in micro-activities or priority needs.

Procedural case and proximity
Streamlining the application process and quickly disbursing funds increases microloans and extends credit to previously excluded clients in rural areas.

Continuity and progression of credit

Real growth takes time. A single loan can be helpful, but a long-term relationship with access to additional loans fosters lasting success.

Fair and transparent loan terms
Microloans usually have higher interest rates than traditional bank loans, but they remain more affordable than informal loans from moneylenders. Reasonable rates support the credit cycle and encourage customer participation.

Flexibility of the loan product

Flexible loan designs are essential for accommodating the irregular cash flows of micro-entrepreneurs. Innovations like grace periods and variable instalments help alleviate liquidity constraints and promote productive investment.

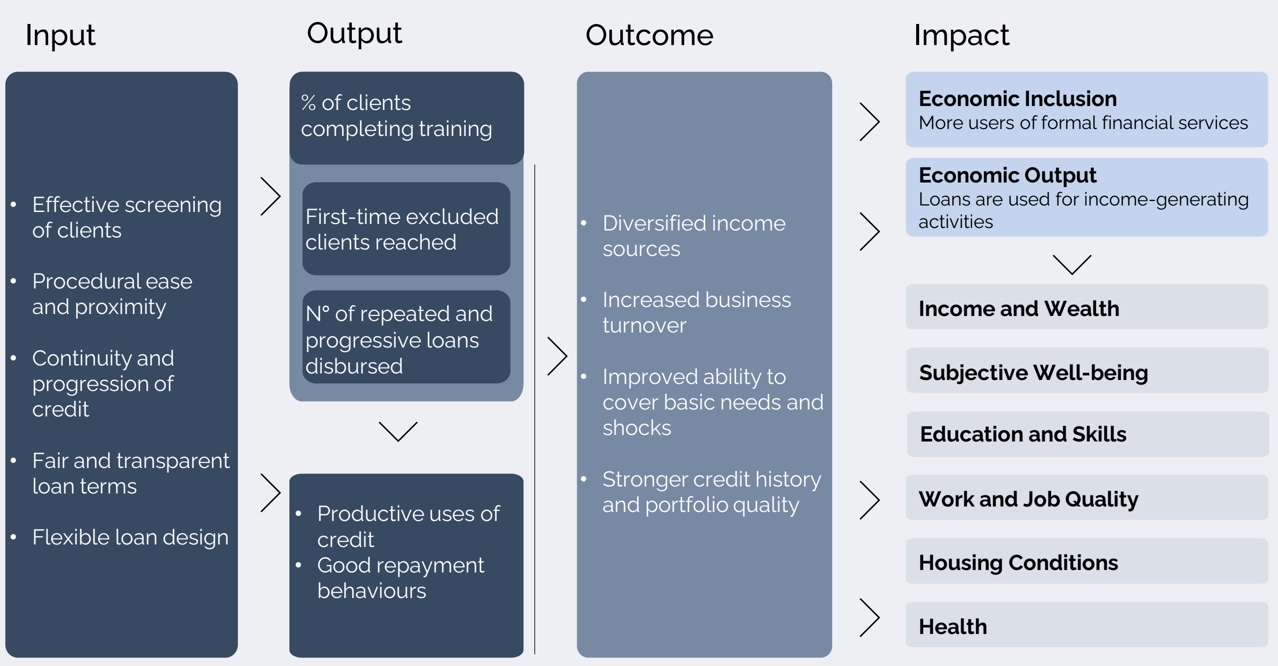
Access to credit impact pathway

The cost of credit also matters, and not simply in absolute terms. Microloans, by necessity, carry higher interest rates than conventional products, but when rates are transparent and perceived as fair, clients remain engaged and willing to invest. One practitioner observed how even modest increases in rates led to sharp declines in renewals, suggesting that affordability is both a financial and psychological threshold. Institutions are experimenting with automated scoring and mobile platforms to reduce operating costs and offer more favourable terms, though the balance between sustainability for lenders and fairness for borrowers remains delicate.

Flexibility in loan design emerged as another key factor. Rigid repayment schedules often undermine the entrepreneurs' microcredit seeks to support. Grace periods, seasonal calendars, and variable instalments have proven more effective, aligning repayment with the rhythms of actual economic activity. In India, the introduction of a two-month grace period before the first instalment led to a forty-one percent increase in business profits and a twenty percent rise in household income. Such adjustments reflect a deeper principle: financial products must adapt to the irregularity of real livelihoods, rather than forcing livelihoods into rigid financial models.

"Without this knowledge, the risk of misusing a loan and falling into a debt trap is significantly higher. With it, clients are equipped to turn a small opportunity into a foundation for a better future."

Figure 2: Access to Credit Impact Pathway



Financial literacy drivers and impact pathway

Perhaps the most relevant driver, however, is financial literacy. Several experts argued that training is “more important than credit itself.” Without it, clients may treat a microloan as an inexhaustible line of funds, falling into dependency. Effective programs are pragmatic rather than theoretical, offering simple rules for budgeting and debt management. Institutions that extend training to include digital and entrepreneurial skills help clients modernize their businesses, turning access to finance into a broader platform for growth. The consensus was clear: credit accompanied by education generates a more durable impact than either element alone.

> *“Perhaps the most relevant driver is financial literacy. Several experts argued that training is “more important than credit itself.” Without it, clients may treat a microloan as an inexhaustible line of funds, falling into dependency.”*

Figure 3: Financial Literacy Impact Drivers

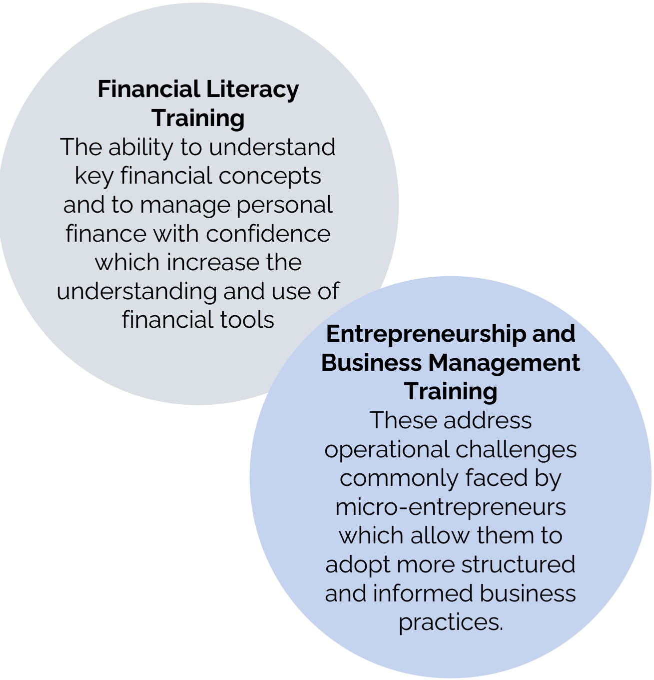
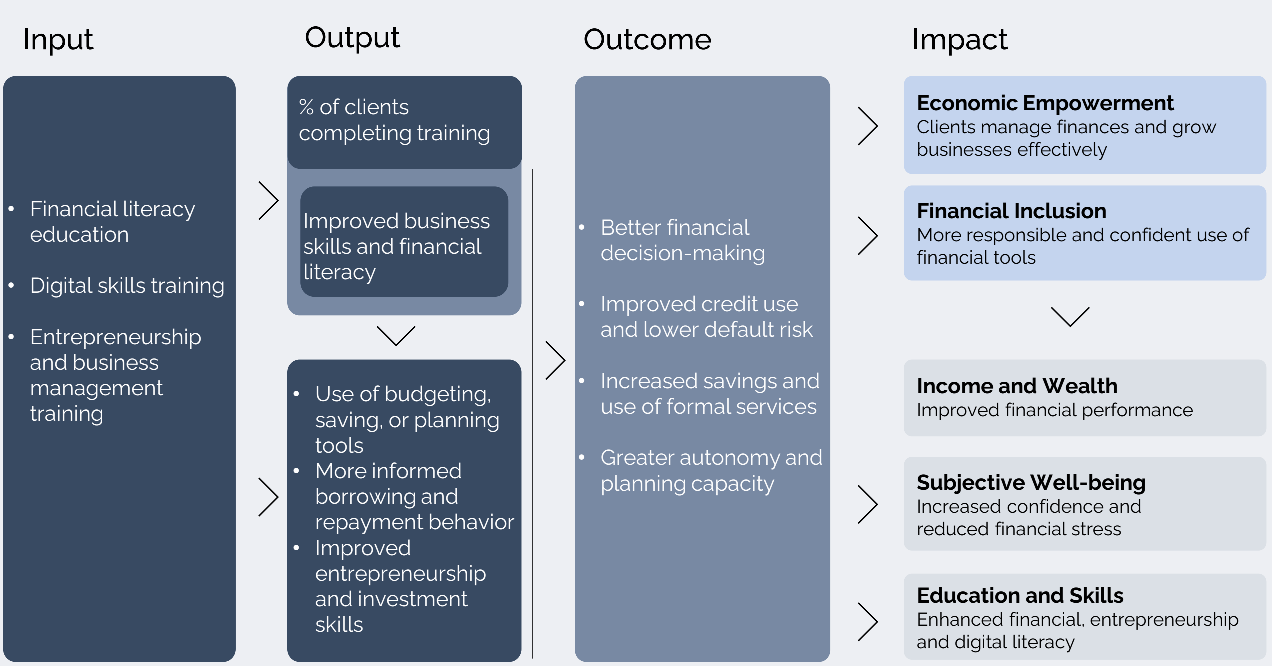


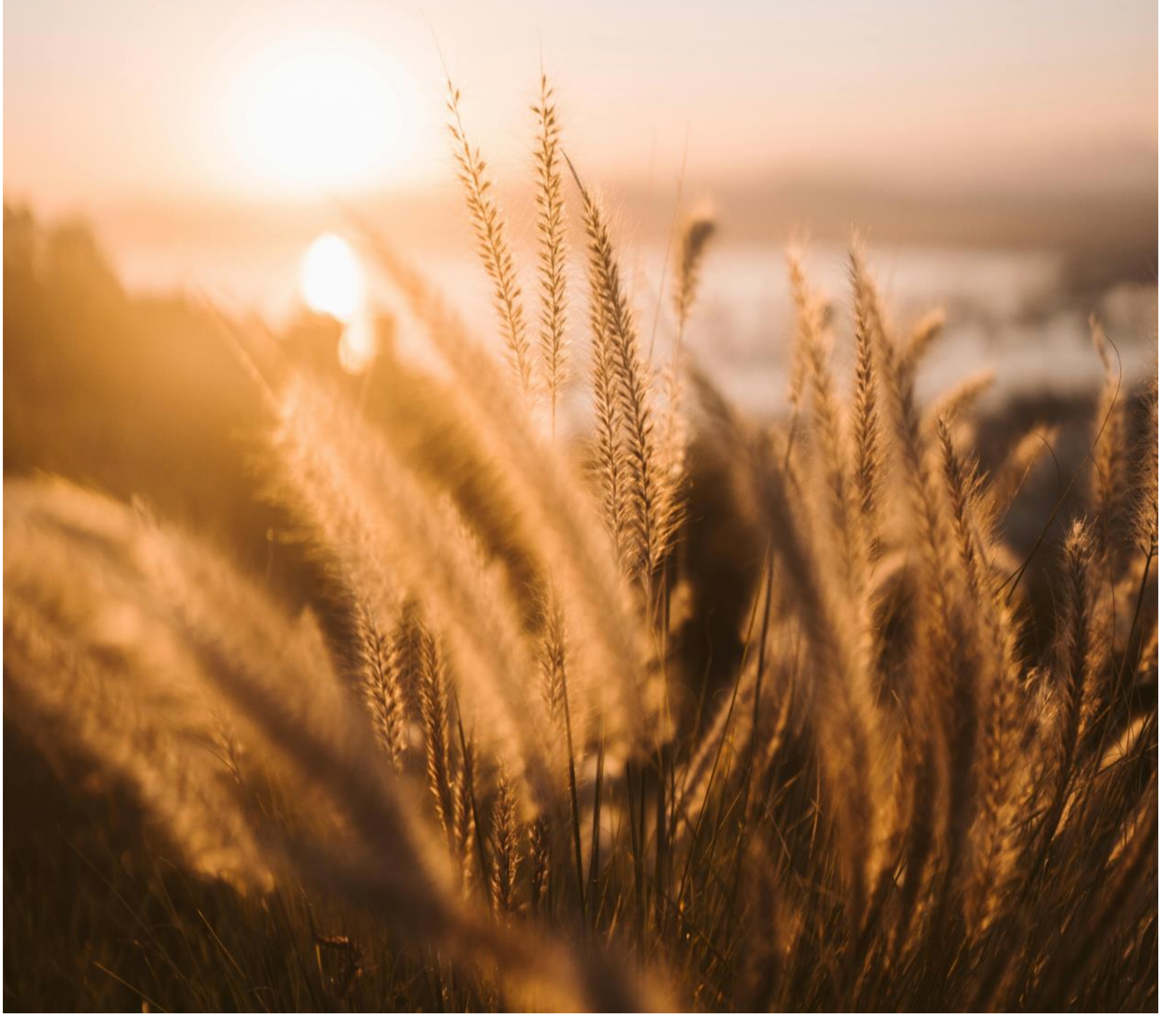
Figure 4: Financial Literacy Impact Pathway



Looking ahead

Alongside these insights, our analysis also revealed the risks. Poor targeting can push clients into over-indebtedness. Group lending models, while effective in certain contexts, may fuel anxiety and social strain. Training that is generic rather than tailored can create overconfidence rather than capability. Microcredit, in other words, is not inherently transformative; its effects depend on the careful design and execution of its drivers. Its promise lies not in the idea itself, but in the architecture of its design.

The research we conducted is qualitative, drawing on literature and interviews rather than large-scale quantitative measurement. It does not monetize impacts, nor does it claim universal validity across contexts. These are limitations, but they also highlight directions for future work: the development of standardized indicators that allow outcomes to be compared across geographies, the collection of longitudinal data to capture trajectories over time, and the integration of digital tools to lower costs while broadening reach. Just as importantly, the industry should continue to refine the pairing of credit and education, ensuring that financial access is matched by financial capability.



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Note. This publication summarizes the original work of the authors and it does not intent to represent the Value Balancing Alliance or IE School of Politics, Economics & Global Affairs' position.