THE IMPACT OF MICROFINANCE

PROGRAMMES ON POVERTY REDUCTION

JONATHAN H. WESTOVER

Dr. Jonathan H. Westover is an Assistant Professor of Business at Utah Valley University. He is also a human resource development and performance management consultant. His ongoing research examines issues of global development, social entrepreneurship, work-quality characteristics, and the determinants of job satisfaction cross-nationally.

→| ON FOCUS

"Men in great places are trice servants: servants of the sovereign or state, servant of fame, and servant of business."

FRANCIS BACON

INTRODUCTION

Poverty has different meanings to different people and is the source of much debate in the public arena. This is largely due to the fact there are many potential causes of poverty, ranging from those that could be categorised as causes stemming from one's personal choices and actions, causes stemming from structural constraints and inequalities in society, and causes that arise from government welfare entitlement programs. As a result of such a wide and diverse array of potential poverty causes, there are an equally large number of proposed policy interventions and solutions designed to eradicate the problem of poverty, some addressing each of the different areas mentioned above. One potential solution that has been increasing in popularity, and controversy, in recent years is the area of microfinance. However, despite the increased popularity, what is the record of such programs? Furthermore, what is the effectiveness/ ineffectiveness of such programs on reducing poverty? Finally, what are the predominant methodological approaches in the microfinance literature? As with any intervention strategy, as the number of microfinance programs instituted throughout the world continues to increase, formal investigation into the effectiveness of such programs is important.

In this paper I will provide a brief overview of evidence from the existing literature on microfinance to show the current performance record of such programs and the effectiveness/ineffectiveness of such programs on reducing poverty. Furthermore, I will discuss some criticisms of the microfinance approach to eradicating poverty and provide a critique of the methodological foundation of microfinance as a whole, as well as the increased number of impact studies that have been conducted in recent years. Finally, I will draw several conclusions on the appropriateness and effectiveness of microfinance programs in addressing the problem of world poverty, while providing several suggestions for future research directions in this developing field.

BACKGROUND TO MICROFINANCE

Poverty is a world-wide poverty epidemic. Figure 1 below illustrates that though extreme poverty rates have been declining across many regions of the world in recent decades, high rates still persist. Furthermore, it is estimated that about one-sixth (500 million of an estimated 3 billion) of poor people throughout the world have access to formal financial services (World Bank, 2005). This represents a large gap in access to such services.

One approach to reducing this gap that has increased in popularity in recent years has been the formation of microfinance institutions (an estimated 7,000 microfinance institutions serving approximately 16 million poor individuals in developing countries) (World Bank, 2005). However, Figure 2 illustrates the large gap that still persists between need and the access of microfinance services available to the world's poorest families (see Daley-Harris, 2009).

The idea of microfinance started in Bangladesh around 1976 with Muhammad Yunus and Grameen Bank (recently awarded the Nobel Peace Prize for his work). Microfinance refers to financial services offered to low SES individuals that are excluded from the traditional financial system (considered "unbankable" – lacking collateral, steady employment, and a verifiable credit history). Aspects of microfinance, such as microcredit, are designed to help lift individuals, families, and communities out of poverty by providing small amounts of start-up capital for entrepreneurial projects, which will then presumably help individuals to generate income, build wealth, and exit poverty.

One aspect of microfinance that distinguishes it from the traditional financial system is the "joint liability concept," where groups of individuals, usually women, group together to apply for loans, and hold joint accountability for repayment of the loan. The premise is that providing low SES individuals access to financial services will better enable poor households to move away from subsistence living, to a future oriented outlook on life and an increased investment in nutrition, education, and living expenses. Furthermore, microfinance is unique as a development tool because of its potential to be self-sustaining (both reducing poverty and maintaining a profitable business) (Business Week, 2005).

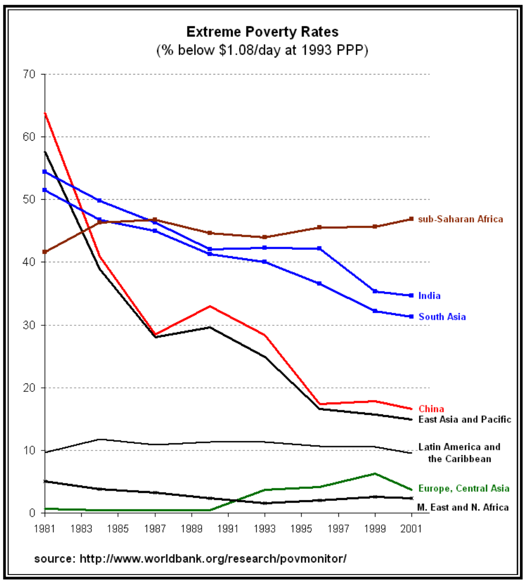

FIGURE 1: EXTREME POVERTY RATES IN WORLD REGIONS.

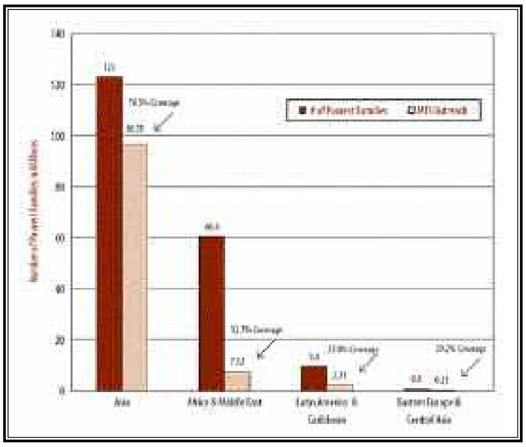

FIGURE 2: ACCESS TO MICROFINANCE SERVICES.
Source: State of the Microcredit Summit Campaign Report 2009.

REPORTED STRENGTHS/POSITIVE IMPACTS OF MICROFINANCE PROGRAMS

A variety of studies have found a few key strengths and positive impacts produced by the implementation of microfinance programs in poor and impoverished areas of the world. First, microfinance programs can be an effective way to provide low-cost financial services to poor individuals and families (Miller and Martinez, 2006; Stephens and Tazi 2006). Second, such programs have been shown to help in the development and growth of the local economy as individuals and families are able to move past subsistence living and increase disposable income levels (Khandker, 2005).

In addition, many studies (primarily microfinance institution impact studies and academic researcher qualitative or case studies) have shown that microfinance programs were able to reduce poverty through increasing individual and household income levels, as well as improving healthcare, nutrition, education, and helping to empower women. For example, standard of living increases, which help to eradicate extreme poverty and hunger, have occurred at both the individual and household levels as a result of microfinance programs (Khandker, 2005). Furthermore, it has been demonstrated by some research that microfinance programs increase access to healthcare, making preventative healthcare measures more affordable to the poor. In addition, more children are being sent to school and staying enrolled longer (Morduch, 1998). Finally, it has been shown that such programs can help borrowers to develop dignity and self-confidence in conjunction with loan repayment, and self-sufficiency as a means for sustainable income becomes available. Since microfinance services are primarily focused on women, it is argued that this leads to the empowerment of women and the breaking down of gender inequalities, through providing opportunities for women to take on leadership roles and responsibilities (Goetz and Gupta, 1995).

REPORTED PROBLEMS/NEGATIVE IMPACTS OF MICROFINANCE PROGRAMS

In contrast to the various positive impacts and strengths of microfinance programs listed above, other studies (more quantitative, with appropriate treatment/control frameworks and comparisons made across larger samples) have found several key problems and negative impacts produced by the implementation of microfinance programs in poor and impoverished areas of the world. First, some studies have shown that microfinance programs benefit the moderately poor more than the destitute, and thus impact can vary by income group (better-off benefit more from micro-credit) (Copestake *et al.*, 2001; Morduch, 1998; Dugger, 2004). Second, most microfinance programs target women (due to higher repayment rates), which may result in men requiring wife to get loans for them (Goetz and Gupta, 1995). Third, examples exist of a vicious cycle of debt, microcredit dependency, increased workloads, and domestic violence associated with participation in microfinance programs (Copestake *et al.*, 2001; Morduch, 1998). Fourth, studies have shown that there are low repayment rates in comparison with traditional financial institutions (Miller and Martinez, 2006; Stephens and Tazi, 2006), thus possibly contradicting one of the key strengths listed above, that such programs can lead to empowerment and increased self-confidence through responsible loan repayment. Fifth, there have been reports of the use of harsh and coercive methods to push for repayment and excessive interest rates (Business Week, 2005; The Financial Express, 2005). Finally, concerns have been raised that the reliance on microfinance programs to aid the poor may result in a reduction of government and charitable assistance ("privatisation of public safety-net programs") (Neff, 1996).

MICROFINANCE AS A MEANS TO ALLEVIATE POVERTY?

Based on the findings reported above, there are mixed conclusions as to the overall impact of microfinance institutions. This leads us to the key question of this paper: What is the effectiveness/ ineffectiveness of microfinance programs on reducing poverty? Some studies have found marked decreases in overall poverty levels, including declining levels of extreme poverty (Khandker, 2005), while other studies do not find the same direct effect (Morris and Barnes, 2005; Kan, Olds, and Kah, 2005; Goetz and Gupta, 1996). Still, other studies provide mixed results (Copestake, Bhalotra, and Johnson, 2001; Morduch, 1998). Thus, the academic literature is mixed in regards to the specific impact that microfinance has on alleviating poverty. Many impact studies and other similar assessments find great strengths and positive impacts of such programs on reducing poverty, while other studies report that such positive impacts may be over-reported and even inaccurate, while pointing out some fundamental flaws with such study designs.

The question is, which group of studies is correct, and to what extent? At this point in the literature, there are few statistically and methodologically sounds stringent evaluations of microcredit programs generally viewed as credible by experts. Much of the academic literature reporting positive results of the impact of microfinance programs in reducing poverty use qualitative methods, look at single cases or specific areas or regions, use cross-sectional data, analyse self-reported measures, and use non-random sampling procedures, resulting in findings that cannot be easily replicated nor generalised to all programs. In contrast to the common qualitative and case-study approaches in the less rigorous body of research, only a handful of studies use sizeable samples and appropriate treatment/control frameworks to answer the questions of real impact and effectiveness. As Morduch said in his critique of the existing literature methodology, "While strong claims are made for the ability of microfinance to reduce poverty, only a handful of studies use sizable samples and appropriate treatment/control frameworks to answer the question" (1998, p. 1). Until more such studies are conducted and findings reported, we must take the findings of less rigorous impact studies with a grain of salt and not be too quick to generalise findings of the impact and effectiveness of a specific program, in specific location, at a specific time, to other cases.

FUTURE DIRECTIONS

I am encouraged by the increasing popularity of the growing microfinance movement and recognise it as a pioneering approach to addressing the problem of poverty. There are numerous studies that demonstrate the tremendous successes of such programs throughout much of the underdeveloped world. However, despite the increase in the popularity of microfinance programs and the vast amount of research conducted to date, there are two key areas for future academic research into the effectiveness of microfinance programs.

First and foremost, more stringent evaluations of microcredit programs are needed. Various feasibility and impact studies have shown the financial viability of such programs in being self-sustainable institutions, but the question of the effectiveness and impact on the poor of such programs is still highly in question. Many studies use a case-study approach to looking at the effectiveness of a given program in a given region at a given time, but few effectively measure the impact of multiple programs. To be able to say once and for all that these programs are or are not effective at reduce poverty will require a large sample of programs with data that can be rigorously analysed, with replicable methods and generalizable findings.

Second, there are considerable practical debates surrounding the implementation of microfinance programs that have yet to be answered. These debates include a fundamental theoretical debate between large-scale, top-down funding of major development projects versus small-scale, bottom-up funding to individuals and households as a means of alleviating poverty. Additionally, there are questions surrounding the potential of microfinance programs to cannibalise other programs, including government assistance and aid. Furthermore, there are still questions as to the potential of microcredit hurting the poor and creating a kind of microcredit dependency. Finally, as microfinance programs are geared almost exclusively to woman, there is a debate about the appropriateness of such a policy and the possible exploitation of women. Therefore further research needs to be conducted to examine these facets of microfinance programs.

CONCLUSION

Despite the popularisation of microfinance in the mass media and the many positive findings that are reported in some feasibility and impact studies, there are also many studies that report some negative impacts of such programs and fail to find a direct link between microfinance program involvement and poverty reduction. Thus, at this point, NGO leaders and government policy makers must exercise caution and restraint in applying the microfinance approach universally as a means of alleviating poverty and continue to conduct rigorous research that will better answer the questions addressed in this paper.

* Author's Note: *This article is adapted from a previous version of this paper, entitled "Trickle-Up Economic Development: A Critical Examination of Microfinance Programs", in* The International Journal of Environmental, Cultural, Economic and Social Sustainability*, 6(4), 2010: 1-10.*

REFERENCES

Copestake, James ~ Bhalotra, Sonia ~ Johnson, Susan, "Assessing the Impact of Microcredit: A Zambian Case Study", in *The Journal of Development Studies*, 37(4), 2001: 81-100.

Dugger, Celia W, "Debate Stirs over Tiny Loans for World's Poorest", in *New York Times*, 2004.

Goetz, Anne Marrie ~ Gupta, Rina Sen, "Who Takes the Credit? Gender, Power and Control overLoan Use in Rural Credit Programmes in Bangladesh", in *World Development*, 24 (1) 1996: 45-63.

Kah, Jainaba M.L. ˝~ Olds, Dana L. ~ Kah, Muhammadou M. O, "Microcredit, Social Capital, andPolitics", in *Journal of Microfinance*, 7 (1) 2005: 121-151.

Khandker, Shahidur R, "Microfinance and Poverty: Data from Bangladesh", in *The World Bank Economic Review*, 19 (2) 2005: 263-286.

"Large NGOs Becoming Rockefellers", in *The Financial Express*, November 22, 2005.

"Micro Loans, Solid Returns: Microfinance Funds Lift Poor Entrepreneurs and Benefit Investors", in *Business Week,* May 9, 2005.

Miller, Jared, and Martinez, Renso, "Championship League: An Overview of 80 Leading Latin American Providers of Microfinance", in *Microbanking Bulletin*, 2006.

Morduch, Jonathan, "Does Microfinance Really Help the Poor? New Evidence from Flagship Programs in Bangladesh", in *MacArthur Network, Princeton University* 1998.

Morris, Gayle ~ Barnes, Carolyn, "An Assessment of the Impact of Microfinance", in *Journal of Microfinance*, 7 (1), 2005: 40-54.

Neff, Gina, "Microcredit, Microresults", in *The Left Business Observer* 74, 1996.

Daley-Harris, Sam, "State of the Microcredit Summit Campaign Report", in *Microcredit Summit Campaign,* 2009.

Stephens, Blaine ~ Tazi, Hind, "Performance and Transparency: A Survey of Microfinance in South Asia", in *Microbanking Bulletin,* 2006.