

Microfinance and poverty alleviation: The dangers of a development 'snake oil'

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Introduction

The current popularity of microfinance among official aid donors, including the World Bank and more recently the Asian Development Bank, sometimes gives the impression that providing very small loans to the poor is somehow new, and, secondly, that microfinance is a panacea which will empower the powerless and end poverty. Unfortunately, it runs the risk, like many development fashions of the past, of being seen as a cure to all development ills.

Microfinance, like most other development activities, works best when it is part of a broader multifaceted approach to poverty alleviation in which a number of other structural impediments that the poor face, such as a lack of health, education, and infrastructure services, are also addressed. In practice, however, microfinance is often treated as a stand-alone activity. This paper attempts to put contemporary microfinance issues in perspective. It outlines the key debates in microfinance around poverty alleviation outreach, women's empowerment, and the use of subsidies to ensure the poor are the primary beneficiaries.

It can be argued that microfinance is not new. Traditional savings and loans schemes include intergenerational and spatial loans of livestock among nomadic herders in the Sahel of Africa; and the accumulation of savings through dowry, jewellery, or even credit through the village moneylender. Microfinance in all its forms serves to smooth consumption 'lumps' and reduce economic vulnerability, particularly of people who are living on the margins of society. It can also lead to greater economic security of the household as well as capitalising on, and gaining economic leverage from, the skills that individual households may have or can obtain.

The impact of microfinance on poverty

After more than 20 years of sustained support from NGOs, and a decade of official donor investment in microfinance, what are the results? A review of the literature shows that the impact and outcomes of microfinance programmes on the poor, are mixed. In Bangladesh where there has been a large input of external funds for microfinance over some years a number of studies show that the impact of microfinance on the incidence of poverty is at best ambiguous.

For example, Khandker (1998) found that there had been an increase in household incomes which were a direct result of microfinance programmes. However, in another study using Khandker's own data, Morduch (1998) found that the income

effect was due to mistargeting of the microfinance programme and that the perceived increase in incomes was due solely to those already above the poverty line who had managed to access the programme. Khandker had made the mistake of assuming the target group were all below the poverty line when, in fact, this was not the case. Other conflicting evidence as to the income effects of microfinance has resulted in uncertainty as to whether microfinance has any effect on poverty measured in monetary terms. What is agreed, however, from most studies is more prosaic, and that is that microfinance reduces variability of income over time within households. Participants join microfinance programmes because of the reduction of the risk to household livelihoods that cheaper loans bring (Zaman 1999:4).

Likewise, if poverty is looked at in sociological terms using Amartya Sen's (1999) notions of poverty being related to a lack of entitlements and individual choices, then the studies of the impact of microfinance also identify mixed results. On the one hand, some have found that it is not empowering for women clients, arguing that such programmes increase women's burdens: they often do not control the loans, but are held responsible for them; their workloads increase; and there is increased pressure on them from within the families and from microfinance institution staff. These outcomes have the paradoxical effect of reducing the choices available to women rather than enhancing them (Goetz and Gupta 1996, Mayoux 1995, 2001, Rahman 1999).

On the other hand, there are a number of other studies, such as Pitt and Khandker's, which found that not only were households that received loans better off, but also that women's preferences in household consumption patterns indicated increased decision making by women (quoted in Kabeer 2001:65). Likewise, Hashemi and others (1996) found that, on eight indicators ranging from increased mobility, making independent purchases, through to political and legal awareness, access to credit had a positive impact on empowerment, while Mayoux (1999), looking at microfinance programmes across Africa, found a similar range of results.

Kabeer, in analysing the extent of seemingly conflicting results, argues that both the positive and the negative sets of findings are valid. She makes the point that the different conclusions reflect the different assumptions of power relations in households that inform each of the studies. She argues that the negative evaluations tend to underestimate the level of cooperation within households, while the positive evaluations tend not to privilege individual behaviours or choices as empowerment:

... in the final analysis, the plausibility of one or other set of conclusions about the transformatory impact of credit for women will rest on the credence attached to the models of power which inform the analysis. (Kabeer 2001:67)

Kabeer goes on to argue that, while many microfinance programmes are often loaded with unreasonable expectations, purposive interventions can direct resources to women which may lay the groundwork for them to tackle other aspects of injustice in their lives (2001:83). Are there characteristics of some microfinance programmes or other interventions which provide better opportunities for this process to occur?

Given the sharp differences from studies on the impact of microfinance and the substantial resources being put into the sector, there is considerable pressure for programmes to show unambiguous impacts on the very poor. If this is not shown to be happening, it is difficult for donors to use grants or heavily subsidised funds for these programmes which generally have a specific poverty alleviation objective. From a practitioner perspective it is difficult to be cost-efficient in reaching the very poor compared to other client groups. This is because of the relatively high transaction costs of the smaller loans that the very poor require, their reduced capacity to manage finance, and the fact that they are seen as higher risk. Logically, microfinance to the very poor must involve the use of subsidies, but still much of the microfinance debate centres around whether subsidies should be paid, to what extent, and how they should be phased out. The subsidy debate raises the question of the efficiency of microfinance programmes, while the poverty debate outlined above relates to their effectiveness.

Sustainability and risk management: The use of subsidies

At the heart of the subsidy debate is the issue of sustainability. At one level we can look at the institution in terms of operational and financial sustainability, or at the sustainability of the loans themselves in terms of social impact. That is, are the lives of the clients irreversibly changed? Is poverty being reduced? Are incomes being stabilised? Would the community-based group maintaining or administering the loan continue if the intermediary microfinance institution were not there? In practice, much of the current debate on microfinance tends to focus on the intermediary institution, and how it should be financed or subsidised. This is where the efficiency–effectiveness debate comes to a head.

It is almost axiomatic that if the very poor were to be reached, then the best that could be hoped for is operational sustainability of the programme. It is very hard for sufficient income to be generated from fees and interest charges, which the very poor would pay, to cover all of the institutional costs. As a result some advocates of the micro-banking forms of microfinance take the view that the focus should move away from targeting the very poor to what they call the ‘entrepreneurial’ poor. While this is valid from a commercially based micro-banking perspective, from a development perspective this approach can involve leaving out

up to one-quarter of the population of most poor countries, and so call into question the use of poverty-targeted aid funds to subsidise what are commercial financial operations. The question remains of how subsidies should be used to ensure a greater reach of microfinance to the very poor.

Due to the highly political debate around the issue of subsidies, they tend to be hidden, often in a cloud of anti-subsidy rhetoric. Morduch’s (1999) study of the Grameen Bank, for example, found an effective subsidy level of \$US15 per member per year. If that subsidy were to be removed, the bank’s target group would have to shift away from the very poor through its having to charge higher fees and interest rates to cover costs. Padmanabhan (2001:494) found that, using the Subsidy Dependence Index, some microfinance operations had an index as high as 1,146 per cent, and that less than 20 per cent of most operations had any hope of reaching financial sustainability, with the very poor as the main target group.

Another form of subsidy is the time spent by the facilitating institution, whether it be a specialist microfinance institution or an NGO, in capacity building with local groups. In order to reach the very poor and marginalised, it may take about twice as long for a microfinance programme to reach operational sustainability than when targeting the not-so-poor (up to 10 years, versus 3–5 years for the not-so-poor).

This discussion of subsidies raises the question as to why there isn’t a more open recognition that subsidies are required if there are to be transfers within and across sectors of society to reach equitable outcomes of access to services, employment, and other livelihood opportunities. This does not mean that artificially low interest rates should apply or that high repayment rates are not demanded. Both artificially low interest rates and low repayment rates will ultimately result in the erosion of the poor’s savings. But it does mean that microfinance institutions should look at their target group and consciously calculate and seek subsidised or grant funds to cover the costs in reaching these groups, rather than ignoring them.

Models of microfinance

Are there models of microfinance which lend themselves to a greater poverty reach? Linda Mayoux (1995:2) has identified two broad models of microfinance: the market model, and the empowerment model. The market model is a credit-driven model which has a reduced emphasis on client savings, except as security deposits against loans. This model has a focus on discipline and includes strong enforcement measures for compliance, including peer pressure (group members cannot get loans until all loans to the group are up-to-date), and pressure from the intermediary institutions, including legal sanctions. It provides little opportunity for client participation, or for group self-management or autonomy. Microfinance staff are the primary point of accountability (Rahman 1999). Mayoux (1995:6) argues that it is weak in reaching the very poor as it depends on very high on-time repayment rates, has high transaction costs, and little involvement of clients in decision making. It is also arguably less

cost effective in providing very small loans to the very poor for their priority needs, which tend to be consumption. The often-draconian enforcement provisions tend to discourage those who are vulnerable and risk averse.

The empowerment model is based on a mutual or self-help approach pioneered in India in the early 1980s. It involves small groups of women who collect their own savings and revolve them as credit among their members. These savings are often supplemented by external credit injections from banks or other institutions. This model is based on high levels of group ownership, control and management. The staff of the microfinance institution are more removed from individual clients, as they relate to groups rather than individuals. This model has lower transaction costs than either the market approaches or those which provide loans to individuals (Puhazhendi 1995). In addition, this model is far more reliant on members' own savings for loan capital, which in turn provides a greater sense of equity for the group members.

The advantages of the mutual model is that there are opportunities for people to save and accumulate lump sums for specific purposes (rather than to borrow externally), which suits certain groups such as indigenous or tribal people who prefer to avoid accruing personal debts outside their particular clan. Also, benefits stay with the group, with surpluses being distributed or re-invested to group members, rather than used for the expansion of the microfinance institution. As the users/savers have a greater equity in the institution, they have more ability to set policy and rules to adapt to changes in local livelihood needs or to adjust to external shocks, rather than being dictated by the external capital sources' rules. Mayoux argues that the very process of taking decisions within the group is an empowering process and so can lead to broader development outcomes, such as the greater participation of women in local government processes, and so on. My own research in India also indicates that an accountability relationship of the microfinance institution to the group likewise is an empowering process. Unfortunately, outside of India there is little large-scale promotion of these self-help mutual models, mainly because (it would seem) they are savings driven rather than credit driven.

It can be argued that, in terms of poverty reach, the mutual model provides greater opportunities. However, it is not conducive to rapid expansion, as it is savings rather than credit driven, and it has high institutional costs in start-up that in effect are a cost to the donor, which to many would be seen as a subsidy. Also, these models because they are less disciplined and more decentralised are harder to regulate and monitor, and so represent a greater risk to the donor.

Conclusion

The key to this debate is that any anti-poverty programme will involve transfers, and if the very poor are to be included in microfinance programmes, models must be adopted which suit their needs and capabilities. It must also recognise that poverty is a lack not only of monetary resources but also of what is increasingly being termed 'social capital', and the opportunity for individuals to make choices around their own and their family's future. Achieving

these outcomes is not easy and requires multifaceted approaches not only in microfinance but also in the broader social development with poor communities. Microfinance should therefore not be seen as a 'magic bullet' for poverty reduction but, rather, as being able to make at best a modest contribution. Its impact will depend to some extent on the model adopted and the resources in terms of time and money provided by donors, either local or international.

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