

Is microfinance a good
poverty alleviation strategy?

Evidence from Impact Assessment



MAKING FINANCIAL MARKETS WORK FOR THE POOR



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Executive Summary

Microfinance has been widely accepted as a viable policy option for poverty alleviation by the donor community, international organizations, governments and non-governmental organizations. In order to investigate this underlying premise, the paper examines empirical evidence to check if microfinance is a good poverty alleviation strategy. In addition to the effects of microfinance at the micro (enterprise, household and individual), meso (regional) and macro (national) level, the long-term ability of microfinance to reduce poverty is also evaluated by investigating its sustainability. Finally, to evaluate the effectiveness of microfinance vis-à-vis other poverty-alleviation interventions, the evidence related to the comparative cost-effectiveness of these strategies is analysed. In addition, the paper also presents a brief discussion on impact assessment methodologies.

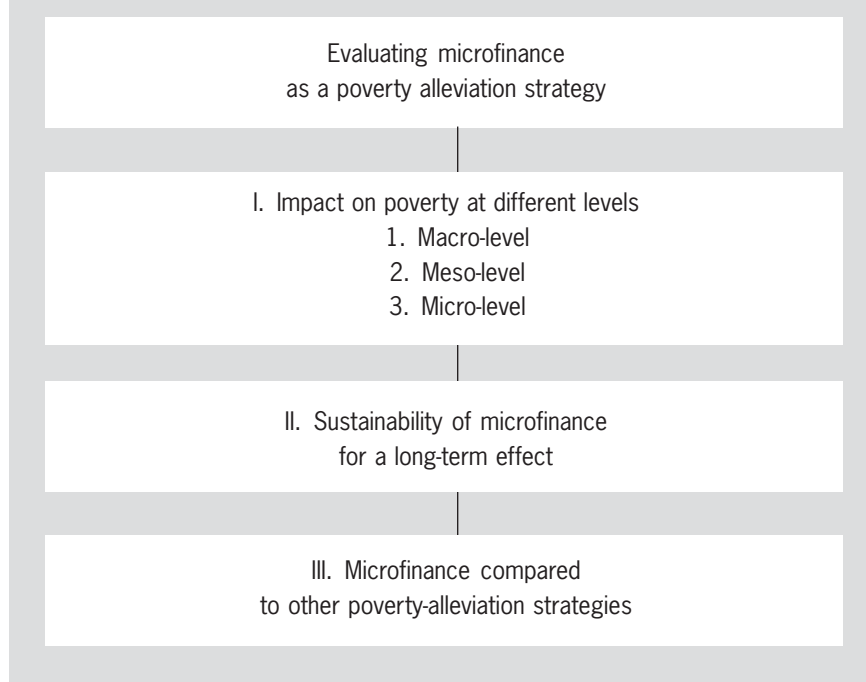
The review of the existing impact assessment literature does find some impact on the poverty level of households, especially on female borrowers, schooling, nutrition, health, fertility and women empowerment. The evidence suggests that microfinance has a higher impact for households closer to the poverty line, rather than the poorest of the poor. There is clear support for reduction in the vulnerability of households through consumption and labour smoothing. However, the large proportion of microfinance loans that are being used for consumption-smoothing purposes raise additional concern about long-term improvement for the participating households. An added concern is the general lack of sustainable and cost-effective microfinance programmes that are necessary for the long-term contribution to income expansion and poverty reduction. Finally, the literature also suggests that if the economic growth in the economy is sluggish, microfinance programmes might result in redistribution, rather than an increase in income and employment. Thus, microfinance is better used as an instrument along with other policies for poverty alleviation rather than a poverty reduction strategy in isolation.

1. Introduction

Various institutional initiatives, including the World Bank-based Consultative Group to Assist the Poorest (CGAP), the Microcredit Summit held in Washington DC in February 1997¹, Grameen Trust based in Bangladesh and Asia's CASHPOR network, have been diffusing microcredit, on the premise that by doing so they will make a large contribution to reducing the level of poverty in the world (Hulme and Mosley, 1998). Sida's Guidelines on Microfinance (Sida, 2004) also place microfinance on the broader agenda for poverty alleviation. The main objective of this paper is to investigate if such a premise is supported by evidence from impact assessment. It further aims to explore if microfinance is a good poverty alleviation strategy by presenting a scientific but simple and clear discussion. In addition, it tries to provide a comprehensive overview of the existing impact assessment literature and methodologies, while evaluating the evidence along several relevant dimensions.

The framework presented in Figure 1 will be used for a systematic analysis of the existing evidence of the impact of microfinance on poverty. At the micro-level the focus is on the evidence at the individual, household or enterprise level. This includes evaluating the evidence of consumption, income and net-worth of the households. It also takes into account the effect of household vulnerability, the impact on employment at the enterprise and household level and changes in the welfare of women and children. However, evidence of positive direct impact at the micro-level is not sufficient proof of an impact of microfinance on poverty. In order to confirm that the positive impact is not just a result of redistribution within different households, the evidence needs to be examined at the meso-level. By investigating evidence at the village, regional or economic sector level and by taking into account the externalities and the indirect benefits, it is easier to evaluate the net impact. This helps determine whether the positive impact is a result of redistribution where the participating households and enterprises benefit by taking away from the non-participants. The overall impact of microfinance on poverty in a country is measured at the macro-level. If the economy lacks economic growth, it becomes important to assess if the long-term poverty impacts of microfinance are due to sustained income impact or simple income redistribution in the country.

Figure 1.
Framework for Evaluating Microfinance as a Poverty-Alleviation Strategy



For microfinance to be an effective poverty-alleviation policy that reaches an increasing number of individuals over a long period of time, it should also be sustainable. To further investigate this, the second step is to examine the evidence related to the sustainability and cost-effectiveness of microfinance programmes. As a final step, the evidence related to comparative cost-benefit analysis of microfinance with alternate poverty alleviation strategies is evaluated. There are several existing strategies for reducing poverty. By comparing microfinance vis-à-vis other strategies, it is possible to infer if microfinance is an effective policy in itself or if it should be used along with other poverty alleviation strategies to be more effective.

Since the objective of this paper is to present ‘a scientific but simple and clear discussion’ in an evaluation of the impact literature, the author concentrates on presenting the evidence from scientifically rigorous and robust studies. However, this does not in any way undermine the importance of the huge body of empirical literature that uses only qualitative or participatory methodologies and/or are programme specific in nature.

The following section offers a brief discussion on the scale of microfinance followed by a brief review of the impact assessment methodologies. Section 4, examines the empirical evidence of the effect of microfinance on poverty alleviation at the micro, meso and macro levels. The sustainability of microfinance programmes is discussed in Section 5. Evidence of the effectiveness of microfinance as an alternative to other poverty alleviation strategies is analysed in Section 6, whereas the final section discusses the conclusions.

2. Scale of microfinance

Microfinance is increasingly becoming a consistent force to reckon with. It provides small-scale financial services for those who are excluded from the formal financial system (Sida, 2004).² There is no complete or reliable information on the number or scale of microfinance service providers worldwide but in order to get some idea we rely on a few interesting sources. According to the report on “A Worldwide Inventory of Microfinance Institutions. Sustainable Banking with the Poor”, 101 microfinance programmes were surveyed in 101 developing countries. These microfinance programmes had more than 1000 microfinance institutions – made up of commercial banks, savings banks, credit unions, and non-governmental organizations (NGOs) – providing microcredit to women and the poor. This report further suggests that microfinance activity is much more widespread in Asia compared to other regions in the world. Almost 76 per cent of the total loans are disbursed in Asia, 21 per cent in Latin America and 3 per cent in Africa. Furthermore, a large part of the total funding is provided by external donors. Almost 55 per cent in Latin America, 47 per cent in Asia and 39 per cent in Africa is provided by foreign donors (World Bank, 1996).

Another database compiled by the International Food Policy Research Institute (IFPRI) in 1999, includes almost 1,500³ microfinance institutions supported by international organizations in 85 developing countries.⁴ They reach 54 million members, of which 44 million save and 23 million borrow. The total volume of outstanding credit stands at USD 18 billion and the total savings volume is around USD 13 billion, or 72 per cent of the volume of the outstanding loans (Lapenu, 2000a). According to this database, Asia is an important region for microfinance activity and accounts for 70 per cent of the institutions, 77 per cent of the members, 55 per cent of the savings volume and 65 per cent of the loan volume. However, if Indonesia is excluded, microfinance activity in Asia is comparable with Africa (Lapenu, 2000b).

3. A review of impact assessment methodologies

In spite of the perceived popularity of the microfinance programmes and the huge amounts of subsidised resources that go into supporting them, there has been a general lack of rigorous scientific research to check the impact of such programmes. As Hulme (2000) states, "...knowledge about the achievements of such initiatives remain only partial and is contested." Proper and scientifically robust impact assessment and statistical evaluations have been limited due to the view that evaluations are a waste of time and money and a diversion from running the programmes themselves. Besides this, detailed evaluations pose difficult statistical issues such as selection bias, non-random programme placement, lack of instrument variables and paucity of properly collected data.

Some of these methodological problems are listed in Box 1. One of the major problems in impact assessment of microfinance programmes relates to the attribution of specific effects (impacts) to specific causes (microfinance interventions). Another problem in assessment of impact is the fungibility of loans. Fungibility of loans implies the use of loan by someone else than the borrower or use of loan for a purpose other than the one for which the loan was given in the first place. Bias in measuring the impact of microfinance programmes can also be introduced by the non-random placement of the programmes. If the programmes are deliberately set up in areas with a history of weak financial service, it might introduce a downward bias on the impact results. Alternatively, if the programmes are set up in areas with good existing infrastructure, it might result in an upward bias on the impact.⁵ In order to control for non-random participation (resulting in what is referred to as "selection bias") and non-random programme placement, data can be collected before and after programme participation. However, potential biases due to time-varying unobservables still remain (Heckman and Smith, 1995).

Box 1:

Common Bias and Methodological Problems in Impact Assessment

- Attribution
- Fungibility
- Non-random programme placement
- Non-random participation

Some studies have tried to determine the benefits of microcredit by using measures of income, employment, and other socioeconomic outcomes. However, evidence of the causal relation between programme participation and reduction in poverty has proved elusive. In some of these studies village characteristics are not taken into consideration and these unmeasured characteristics may strongly affect decisions on the location of programmes.

Researchers often use the level of loan recovery as a common measure of success of microcredit programmes. Hulme and Mosley (1998) explain that many impact studies avoid calculations of poverty impact, often treating the fact that small loans are being provided as proof in itself that the poor are being reached and the fact that loans are being repaid as proof that incomes have increased. This measure is problematic, because programmes use social, peer, and other forms of pressure to maintain high loan recovery rates. Moreover, these high repayment rates reflect the prospect of receiving future loans, not the fact that the benefits of the loans have been great. For the poor who usually have no financial alternative, lower drop-out rates may in fact indicate dependency on programmes. Even more troubling would be evidence that the poor actually use moneylenders to maintain their good standing with the microfinance lenders (Brahm, 2000).

Hulme (2000) explains three different paradigms by which different impact studies seek to demonstrate attribution (see Box 2). The first of these is the scientific methodology that seeks to ensure that effects can be attributed to causes through experimentation. Since in social sciences an experimental design⁶ is virtually unfeasible, there is an increasing use of quasi-experimental approaches. Quasi-experiments seek to compare the outcomes of an intervention with a simulation of what the outcomes would have been, had there been no intervention. Mosley (1997) explains that one method of doing this is by multiple regressions, which are rarely used due to enormous demand for data, underlying assumptions and other possible causal factors. An increasingly popular and much used second approach is the control group method where a “before and after” comparison is made between a group that receives the treatment (microfinance intervention) and an identical population that does not receive the treatment (control group). Comparisons between the two groups are then explained as the impact of the treatment (microfinance intervention).

Box 2:**Methodologies for Impact Assessment**

- Scientific Methodology (Experimental and Quasi-experimental)
- Qualitative Methodologies
- Participatory Learning and Action

However, even scientific methods suffer from problems of sample selection bias⁷, errors in the specification of underlying causal relationships⁸ and motivation of the respondents.

The second group of methodologies, as specified by Hulme (2000), is qualitative in nature and belongs to the sociological, anthropological and geographic tradition. Qualitative methodologies emphasise the importance of observation and the value of subjective human interpretation in the evaluation process. Their main features are an inductive approach, a focus on key informants, recording by notes or images, and usually the direct (and deep) involvement of the data analyst in the data collection. Using these methods it is not possible to “prove” impact within statistically definable limits of probability. However, they provide an interpretation of the processes involved in interventions and of the impacts that have a high level of plausibility. The validity of specific impact assessments by this methodology has to be judged by the reader on the basis of logical consistency of arguments and materials presented, the strength and the quality of the evidence provided, the quality of methodology and the reputation of the researcher.

A major problem with this methodology is that it cannot demonstrate attribution of cause and effect. Causality is inferred from the information collected from intended beneficiaries and key informants, and by comparisons with data from secondary sources. Moreover, if the research is done in an ad-hoc manner, for instance, basing data collection only in programme areas that are performing well and surveying the best clients, and generalising results from one area to the whole programme – the results of the assessment can be misleading. However, Hulme (2000) states that “...my personal judgement is that in many cases their (qualitative impact assessment’s) conclusions are more valid than survey-based impact assessment work that masquerades as science but has not collected data with scientific rigour.”

The third group of Participatory Learning and Action (PLA) gives central importance to the evaluation participants, especially clients and users of the programmes. For instance, case studies rely on extensive narrative descriptions and other evidence to assert that the programme has caused certain observed outcomes. Usually, they involve multiple sources of information including direct observation, interviews, documents, etc.

This approach argues that scientific methods ignore the complexity, diversity and contingency of winning a livelihood by reducing causality to simple unidirectional chains, rather than complex networks, and it empowers professionals, policy-makers and elites thus reinforcing the status quo and directly retarding the achievement of development goals. However, participation methodology does not fully address the issue of attribution and, being subjective and pluralistic in nature, it may lead to a number of mutually conflicting results about causality.

Apart from the basic concern about attribution, any impact assessment study is also concerned about the type of skills needed for data collection and analysis and implications for skill requirements, costs and generalisability. Table 1 (Appendix) gives a fairly comprehensive synthesis of these different methodologies and their constraints.⁹ Although these three main methodologies have been presented separately here, it is becoming increasingly common to combine these approaches in a balanced and scientifically rigorous way to present a holistic picture and gauge the full impact of the microfinance programme. One example of this is an on-going Sida-sponsored research project that is studying the impact of

the Self Help Group Programme of the National Bank for Agriculture and Rural Development (NABARD) in India (Bali Swain 2002).

Apart from the methodological concerns, constraints in terms of time, resources, skills and implementation are increasingly resulting in the integration of impact assessment methodologies into existing monitoring systems of the microfinance programmes. Given the constraints there is an added interest in a search for regional indicators that can be used to infer the impact of the microfinance programmes. For a comprehensive and exhaustive review of different impact assessment tools and methodologies, see Simanowitz, 2001.¹⁰

4. Evaluating empirical evidence of poverty reduction at different levels

4.1 Introduction

Alleviating poverty by “reaching 100 million of the world’s poorest families ... with microcredit for self-employment by 2005”, as stated by the Microcredit Summit, is a very simplistic way of addressing the problem of poverty. Poverty is a multi-dimensional problem that extends beyond the economic, socio-cultural and political situation of an individual or household in society. ‘The poor’ are a heterogeneous group of individuals with different levels of severity of poverty and duration of poverty, and with a number of different dimensions of poverty that they experience. Poverty can range from being transient to chronic in nature. Since microfinance is increasingly being projected as a “win-win strategy” (Morduch, 1999; Hulme, 2000) for poverty alleviation, we will start by evaluating the existing evidence from the literature of the impact of microfinance programmes at the micro-level – on income, employment, vulnerability, consumption and poverty situation of the household and individuals. The socio-cultural impact that is offered as an additional benefit of using microfinance as a development strategy for poverty alleviation will also be studied.

The following sub-sections will further investigate the evidence or externalities and indirect benefits to evaluate the net benefits at the meso-level (regional or sector level). This is essential to confirm that the impact is not just a result of redistribution at the regional level. The subsequent section investigates the evidence at the macro-level (economy-wide level) to examine the long-term impact of poverty and the importance of economic growth.

4.2 Evidence of poverty reduction at micro-level

Although several microfinance institutions have income and employment generation as their explicit objective, poverty reduction remains their prime goal. Poverty reduction is often judged in terms of the impact of programme participation on the income, consumption and net worth of the households. It also takes into account the effect of the household’s vulnerability and the impact on employment at the enterprise or household level. In order to capture the additional impact at the micro-level we also focus on the evidence of vulnerability and the impact on the welfare of women and children.

Consumption, Income and Net Worth

Khandker's analysis (1998) of the three microlending institutions in Bangladesh (Grameen Bank; Bangladesh Rural Advancement Committee, BRAC; and Bangladesh Rural Development Board's (BRDB) Rural Development RD-12 programme) was one of the first systematic studies of poverty alleviation by microlenders.¹¹ Pitt and Khandker (1998) find that household consumption increases by 18 taka for every 100 taka lent to a woman, whereas for a man this increase is 11 taka. This implies that loans given to women have higher marginal impacts than loans given to men. However, using the same data as Pitt and Khandker (1998), Morduch (1998) does not find similar evidence of an impact on poverty.

Using the 'World Bank' data, Khandker, Samad and Khan (1998) find that microcredit has a positive impact on income, production, and employment, particularly in the rural non-farm sector. Some selected microfinance programmes in Bangladesh show increases in self-employment income which were sufficient to raise overall household income in programme villages. Khandker (1998) also finds that households headed by women are more likely to participate in microfinance programmes. Moreover, families who own land are also more likely to participate, thus raising doubts about the reach of the microfinance programmes in Bangladesh, to the poorest of the poor.

Zeller et. al (2001) presents evidence that credit access has a significant and strong effect on income generation and food and calorie consumption. According to his study, every 100 taka of credit access generates an additional 37 taka of annual household income for Association for Social Advancement (ASA) and BRAC members.

In a study of thirteen microfinance institutions in seven developing countries, Mosley and Hulme (1998) find evidence of a trade-off between reaching the very poor and having substantial impact on household income. They found that programmes that targeted higher-income households (those near the poverty level) had a greater impact on household income. Those below the poverty line were not helped much and the very poorest were somewhat negatively affected. The poorest tended to be more averse to risk-taking. They also used their loans for working capital or to maintain consumption levels rather than for fixed capital or improved technology. Since, microcredit programmes typically require loan repayment on a weekly basis, some critics argue that repayment comes from selling assets rather than from profits of micro-enterprises. In order to examine this, one must also study if borrowing actually increases household assets. Khandker (1998) finds that, for all the three programmes in Bangladesh that they surveyed, household net worth did increase, and the impact was much stronger for men than for women. He further finds that Grameen Bank's practice of providing larger loans allowed the bank to gain higher returns on capital and the effect of borrowing on household net worth was greater. This implies that the size of loans matters and that larger loans may be needed for sustained poverty reduction. Based on a selection of microfinance institutions in Bolivia¹², Mosley (1999) states that microfinance makes a considerable contribution to the reduction of poverty through its impact on income and also has a positive impact on asset level. But the mechanism through

which poverty reduction works varies between institutions. Generally, institutions that give, on average, smaller loans reduce poverty much more by lifting borrowers above the poverty line, whilst institutions giving larger loans reduce it much more by expanding the demand for labour amongst poor people.

Vulnerability

According to the “resource profile” approach to vulnerability, all households have a range of material, human, social, cultural and political resources. Weakness in any one dimension of this resource profile triggers weakness in another, thereby affecting overall livelihood security. For instance, poverty, seasonality of incomes and food availability, nutrition levels, morbidity, acute illness and loss of employment are usually expected to go together, leading to loss of assets and further deterioration in the situation of the household. The poor are especially vulnerable to the multiple and covariant risk that arises due to the lack of social options to manage risk¹³. They have to rely more heavily upon their immediate family and less upon transactions with others with whom they are less intimate (Wood, 2003).

The World Development Report 2000/2001 (World Bank, 2000) lists the idiosyncratic risks faced by the poor, such as illness, injury, old age, violence, harvest failure, unemployment and food prices. Furthermore, the poor face an additional chronic risk induced by inequality, class relations, exploitation, concentrations of unaccountable power and social exclusion such as absence of “community” membership.

In evaluating the evidence of the effect of microfinance on vulnerability, Pitt and Khandker (1998) and Morduch (1998) find a positive impact. They find signs of consumption-smoothing across seasons, a result that can be traced to increased smoothing of labour across seasons. According to the World Bank (2001), however, the evidence of the poverty-reducing impact of microfinance is inconclusive – targeting has not been universally successful, and studies have documented barriers to participation in programmes for the very poor. A large proportion of microcredit loans are being used for consumption-smoothing, especially for extremely poor households. Although consumption-smoothing is used as a form of insurance and is crucial for the very poor households, credit used for non-investment purposes does not generate income. This suggests that, for the very poor households, consumption-smoothing occurs at the expense of long-term improvements in economic status. Moreover, microfinance turns out to be completely inadequate if a disaster strikes the whole community, as was the case with the floods in Bangladesh in 1998. The trade-off between the long-term objectives of microfinance and its short-term use for consumption-smoothing suggests that providing alternative means for reducing risk in the form of insurance and saving schemes would enable microfinance to achieve its long-term poverty reduction objectives.

In general, it is safe to say that microfinance helps smooth the seasonal characteristics of much of the rural economic activity. By combining loans with savings and insurance products, microfinance can further help to minimize the use of loans for consumption. Montgomery (1996)

suggests that financial products such as saving facilities, insurance (against, for example, natural disasters) and small consumption loans with flexible repayment periods might be more suitable to the needs of the poorest. They would increase the short term impact, in terms of the productivity of the asset which the loan finances. In addition, by gradually reducing the income vulnerability of the poor households, they would also encourage them to take riskier investments in working capital, hiring non-family labour and increasing fixed capital. Sharma (2000) emphasizes that access provides good returns to poor households only when complementary inputs such as seeds or irrigation water, or market access are present. Sharma further explains that this is also true for increases in food security of the household via increases in household productivity and income. However, unlike investment benefits, insurance benefit studies show a consistent positive impact.

In a recent study, Amin, Rai and Topa (2003) use a unique panel dataset from northern Bangladesh with monthly consumption and income data for 229 households before they received loans. They find that while microcredit is successful in reaching the poor, it is less successful in reaching the vulnerable, especially the group most prone to destitution (the vulnerable poor). Coleman (1999) also finds little evidence of an impact on the programme participants. The results, Coleman further explains, are consistent with Adams and von Pischke's assertion that "debt is not an effective tool for helping most poor people enhance their economic condition" and that the poor are poor because of reasons other than lack of access to credit.

Despite the growth of microfinance, programmes specifically designed to target the poor are still not very widespread. It is still being debated whether reaching the poorest with these programmes is even desirable. An added concern is that funds are targeted to help the poor and/or landless, but there is generally little available to help small and medium-size farmers from falling deeper into poverty. The ability of microcredit programmes to help the poorest is limited, because they lack the necessary skills, such as accounting ability and entrepreneurship, to create and sustain a business. To make the programmes effective for the poorest would require greater resources for literacy and basic training programmes. Therefore, credit-based programmes should be one component of a poverty reduction strategy. An argument could also be made that focusing on those near the poverty line would still help society as a whole and, at the same time, increase the programme's chances of becoming self-sufficient (Brahm, 2000). Zaman (2000) finds that the impact on poverty tends to be dependent on reaching a certain economic threshold and, to a lesser extent, on how poor the household is to start with. He further finds that households that join microlending programmes a few years after they have been established in a village tend to be less poor than the initial members.

Matin and Hulme (2003), examine evidence from BRAC's (Bangladesh Rural Advancement Committee) IGVGD programme (Income Generation for Vulnerable Group Development Program), that seeks to reach Bangladesh's "hardcore poor" by combining elements of livelihood protection (food aid) with livelihood promotion (skills training

and microfinance). Although they do find evidence that the IGVD can reach deeper than purely promotional schemes and can benefit the chronic poor, it cannot totally replace programmes of pure social protection. A small proportion of the population will always need more traditional “social welfare” support to avoid persistent deprivation.

Employment

Many micro-enterprises are engaged in rudimentary activities such as food or craft production for sale at the market or establishing a service business. Such enterprises do not generate many jobs outside the family.

Employment is a reflection of both the supply of and demand for labour. It can rise or fall depending on how much and in what ways programmes affect farm and non-farm production. If, for example, increased production is attained through improved technology of rural non-farm activities, then it is unlikely to have a positive and significant impact on village-level employment. However, if production technology does not change, an overall increase in production can lead to employment expansion. Pitt and Khandker (1998) reason that given the small loan size and the type of activities undertaken by micro-entrepreneurs, it is unlikely that capital intensity has increased. Given that the labour and the capital intensity of rural non-farm production is unchanged, increased micro-finance implies that employment can be expected to rise. However, if increased income as a result of microfinance programmes results in a decrease in labour supply (income effect), it can negatively affect labour supply of particular type, for example male labour supply. As a result employment may decline, given the demand for labour. Therefore, the net impact cannot be determined a priori.

Microcredit programmes seem to reduce wage-employment and income, but raise self-employment and corresponding income for programme-participating households. One might expect that a reduction of employment in the wage market might increase wages, but this may not happen because the wage-employment gap may be filled by previously unemployed or underemployed wage workers.¹⁴ Khandker et. al. (1998) find mixed results for the effect of microfinance on wage rates in the farm and non-farm sector. They find that growth in self-employment has been achieved at the expense of wage-employment, which implies an increase in rural wages. They emphasise that an upward shift in the labour demand curve is required for both improved productivity and wage gains on a sustainable basis, which can only be supported through structural transformation of the rural economy. Evidence from their study on three microfinance institutions in Bangladesh suggests that only the Grameen Bank made a positive and significant impact on rural male wages by inducing an increase of 13.5 per cent.

Impact on Women and Children

Several studies show that women are more reliable in repaying loans (Hulme and Mosley, 1997), so microlenders concerned about sustainability would improve their financial situation by targeting female borrowers. Some studies have shown that loans to women are actually under the control of men (Goetz and Gupta, 1996; Hulme and Mosley, 1996). It is

also argued that microcredit programmes make the poor economically dependent on the programme itself (Bouman and Hospes, 1994).

Furthermore, Pitt and Khandker (1998), using World Bank data, find that lending to women has little effect on labour supply, but increases leisure (time taken off from market work) for men. Moreover, non-land assets increase substantially when borrowing is done by women, but not by men. Schooling of boys is increased, irrespective of the gender of the borrower. However, the schooling of girls increases only when the women borrow from the Grameen Bank, suggesting that women borrowers in other programmes use their daughters for household and family chores while they engage in income-generating activities as a consequence of the loan.

Microcredit programmes make it possible for participants (mostly women), who were unemployed before, or involved in household chores, to become self-employed in microcredit-financed small enterprises. Moreover, even if loans are given to women, many small enterprises require male labour for marketing and other purposes. It is also common that women take loans to finance their husbands' self-employed activities. As micro-enterprises grow, more and more family members become involved. Research also indicates that self-employment may lead to an increased incidence of child labour. On a community-wide basis, the presence of a microfinance programme had a broader impact on employment patterns with an increase in female labour force participation and an increase in the number of non-farm jobs.

The impact of microfinance programmes extends beyond the economic and employment situation of the households. There is increasing evidence of effects of microfinance on schooling, health, fertility, child labour and women's empowerment. Evidence from Khandker (1998) shows that programme participation had a significant impact on children's schooling, especially for boys. Credit given to women also increases the nutritional well-being of both male and female children.

Schuler and Hashemi (1994) use contraceptive use and incidence of abuse as measures of women's empowerment and find that, although women are empowered by the microcredit using the first indicator; it fails on the second measure. In contrast, Khandker (1998) finds a decline in the use of contraceptives among participants but suggests that participants were more likely to have higher levels of contraceptive use before entering the programme. Although evidence of empowerment of women is unclear, there is clear evidence that microcredit programmes do reduce the isolation of women through the group activities and networking that the programmes facilitate (Brahm, 2000). Women tend to have control when the loans are used for what are seen as traditional women's activities, which serves to reinforce traditional gender roles.

Anderson, Locker and Nugent (2002) suggest that microfinance creates opportunities for social capital to lower the costs of collective action and hence the costs of managing common pool resources. Results from their survey of Microcredit Summit members suggest that some of the microfinance institutions (MFIs) have intentionally linked their financial services to environmental resource goals and that many more MFIs may be having inadvertent effects upon the environment. However, on the

authors' own admission, the evidence regarding the strength and direction of these relationships is still very thin and must be augmented before strong conclusions can be drawn.

Several microcredit institutions combine credit with health, education, or other programmes. Studying such programmes in Honduras and Ecuador¹⁵, Smith (2002) finds evidence that, for both countries, health bank participation significantly raises subsequent healthcare over credit-only participation, and at least reduces the tendency to switch from breast-feeding to bottle-feeding as income rises. Given these results, the author concludes that tie-ins cannot be dismissed as unproductive interference. However, he also cautions that the form of the intervention depends crucially on the objective.

4.3 Evidence at meso-level

If the objective of microfinance programmes is to promote the welfare of society, the impact needs to be evaluated for both the targeted and non-targeted members. It is especially important to cover programme externalities. For instance, an evaluation of formal financial institutions in India finds that although credit programmes were targeted to reach farmers, agriculture is not the principal beneficiary; it is the rural non-farm economy that benefits most from targeted agricultural credit programmes because credit is fungible across activities and households (Binswanger and Khandker 1995). Therefore, in order to find whether programme placement has a net positive impact on the rural economy, one needs an evaluation of changes in income and employment at the village or regional level rather than participant or household level.

The full benefits of programme placement at village level are the sum of direct and indirect effects of programme interventions and must be evaluated in order to measure the 'net' aggregate programme effect. An evaluation of aggregate-level impact is necessary to justify programme interventions because sometimes programmes may only help distribute income and not contribute much to economic growth (World Bank, 1994).

Khandker's (1998) study found that 3–6 per cent of participating households rise above the poverty line each year as a result of their borrowing. It also found that gains were greater among those who had recently joined a programme. On a village-wide basis, even non-participants receive some benefits of poverty reduction. Grameen Bank villages, for instance, exhibited a reduction in moderate poverty of 21 per cent among programme participants and of 12 per cent for the villages. In spite of these optimistic numbers, Khandker puts the Bangladeshi situation in context.

Empirical evidence from the three main programmes in Bangladesh (Khandker et. al., 1998) finds that overall village employment in Grameen Bank villages increased by 7 per cent only. Although self-employment in non-farm activities grew by 51 per cent there was a decrease in wage-employment in farm activities of 39 per cent. BRAC and the RD-12 villages also showed a net reduction in village employment. Thus, even though these programmes did show a substantial positive effect at the micro-level, the impact on overall village employment

was not that significant. This conclusion is further confirmed by the evidence which shows that the total income of the villages with the Grameen Bank and BRAC did increase, but it did not in the RD-12 villages. Furthermore, the income or consumption disparity among village households also did not change as a result of programme placement.

Given the fact that microfinance programmes promote self-employment (largely non-farm self-employment) and reduce wage-employment (largely in agricultural activities), the increase in self-employment is higher than the reduction in wage-employment, which results in overall higher aggregate employment. According to Khandker, Samad and Khan (1998) evidence from Bangladesh suggests that there was an increase in total production of the village economy – mainly through improving rural non-farm production. However, they also find that the effects of rural electrification and commercial banks are higher than those of microcredit programmes, perhaps because of larger (positive) externalities associated with electrification and large-scale credit operations.

4.4 Evidence at macro-level

Aghion and Aghion (2002) describe how the challenge of “empowering the poor” in the growth process is assisted by microfinance. By inducing mutual insurance and cross subsidisation, both across individuals and across regions, MFIs can potentially encourage risk-taking by potential borrowers. By replacing tangible collateral by “social collateral”, MFIs facilitate access to credit by individuals who otherwise could not take advantage of investment opportunities. And finally, MFIs allow poor individuals when reaching adulthood to acquire skills and knowledge through “learning collectively on the job” (by acquiring the credit culture and investment experience through the guarantee of a long-term relationship with the MFIs).

However, the extent of the impact of microfinance is also connected to economic growth. When economic growth is lacking, the increase in income and pay off of loans is achieved by taking business away from competitors. Therefore, even if participant-level (household or enterprise) impact is positive, the impact on the region might be negative. However, Bruno, Squire and Ravallion (1995) indicate that, although there is ample evidence that policies designed to foster economic growth significantly reduce poverty, policies aimed specifically at alleviating poverty are also important.

In the case of economies such as Bangladesh, which do not show much growth, it is especially important to assess the long-term poverty impacts of microfinance to know whether the accrued benefits at borrower level are due to sustained income impact or simple income redistribution. Using unique panel data on Bangladesh, based on household surveys made in 1991/92 (World Bank data) and 1998/99, Khandker (2003) investigates the poverty reduction capacity of microfinance. He finds that microfinance matters a lot for the very poor borrowers and also the local economy. At the micro-level, it raises per capita consumption, mainly in respect of non-food and household non-land assets, which increases the probability that the programme participants may be able to lift themselves above the poverty line. The welfare impact of micro-

finance is also positive for all households, including non-participants, indicating that these programmes are helping the poor beyond income redistribution with contributions to local income growth. Programmes also have spill-over effects in the local economies, which lead to an increase in local village welfare. Khandker (2003) also finds evidence that microfinance helps reduce extreme poverty more than moderate poverty at the village level. However, even though microfinance programmes show a significant impact at the micro and meso-level, the aggregate poverty reduction effects are not substantial enough to make a large dent in national level aggregate poverty. However, on a note of caution, the author admits that microfinance should find ways to improve the skills of its poor borrowers to improve their productivity and income. It should also assist its borrowers in marketing and improving the quality of their products.

Morduch (1999) also agrees that the best evidence to date suggests that making a real dent in poverty rates will require increasing overall levels of economic growth and employment generation. Microfinance may be able to help some households take advantage of these processes, but there is hardly much evidence to suggest that it will ever drive them.

Programmes are likely to make sizeable impacts on rural poverty reduction and income growth if they are able to promote strong backward and forward linkages between agriculture and the rural non-farm sector. The possibility of such linkages is high if the programmes promote high productivity rural non-farm activities based on skills development among their borrowers. Moreover, as microcredit programmes mostly support rural non-farm activities, the growth registered in the rural non-farm sector must be accompanied by a similar growth in the crop sector. Thus, in order to have a larger impact on income, employment, and poverty reduction in the rural sector, concentrated efforts must promote both crop sector growth and rural non-farm growth in the local and regional economy.

Of the 50 per cent of the poor people in Bangladesh that are eligible to participate in microcredit programmes – only about 45 per cent participate. This indicates that only 20 per cent of the eligible population benefit from the microcredit programmes. And only 1 per cent of the eligible population (5 per cent of 45 per cent of 50 per cent) can escape poverty each year through such programmes. However, these calculations assume that the number of poor in Bangladesh is fixed. Given that the annual population growth rate in Bangladesh is 1.8 per cent per annum – if the poor grow at the rate of more than 1 per cent per year the number of poor will increase despite the reductions in poverty brought about by microcredit (Khandker et. al. 1998).

For Bangladesh, it appears that Grameen and other programmes have managed to increase employment and production in rural non-farm activities where technology is traditional. Unless technological changes occur that lead to productivity growth, a large reduction in overall rural poverty and income growth may be impossible with this kind of intervention. However, unless structural transformation of the rural non-farm economy occurs, gains in poverty-reduction will be short-lived, and programmes such as Grameen Bank will only be able to alleviate poverty on a short-term basis.

In many countries, the development of a rural non-farm sector helped economic growth largely through modernization of agriculture. As a means of economic development for rural areas, however, the effect of microcredits is minimized by the lack of skills among the poor to make use of more advanced technologies. In fact, when microcredit programmes support the landless workers who make a living from the rural non-farm sector which is dependent upon agricultural growth, there is not much one may expect from such programmes (Osmani, 1989).

5. Sustainability of microfinance programmes

There is a growing emphasis on sustainability and it is now typical that microfinance programmes must justify deviations from sustainability (Johnson, 1998). It is increasingly recommended by World Bank and CGAP (among other international organizations) that MFIs attain operational and financial sustainability¹⁶. The anti-subsidy view is based on the following issues: first, donors can be fickle and programmes that aim to continue in the future feel the need for independence. Second, donors' budgets are limited, restricting the scale of operations to the amount of the funds provided. Self-sufficient programmes, on the other hand, can expand to meet demand. Third, subsidized programmes run the risk of becoming inefficient without firm bottom lines. Fourth, in the past subsidies have ended up in the wrong hands, rather than helping poor households (Morduch, 1999).

The vast majority of microfinance programmes created by NGOs have yet to reach self-sufficiency (Christen et al. 1995). In fact, it is estimated that only 5 per cent of all programmes will ever become self-sufficient (Morduch, 2000). Morduch (1999) mentions that some observers speculate that if subsidies are withdrawn and costs cannot be reduced, as many as 95 per cent of the current programmes will eventually have to close down. The remaining 5 per cent will be drawn from the larger programmes, and they will help fill gaps in financial markets. One survey shows that even poverty-focused programmes with a "commitment" to achieving financial sustainability cover only 70 per cent of their full costs (MicroBanking Bulletin, 1998). According to the World Bank (1996), NGOs involved in microcredit activities receive 70 per cent of their funds from donors.

Those advocating sustainability for microlending programmes argue that the poor need access to credit, not cheap credit. Many credit programmes are criticized because they set interest rates below market rates and provide credit without mobilizing savings (Adams, Graham, and von Pischke, 1984). Rather than passing on credit from governments or donors, credit programmes should be designed to be true financial institutions (Cho and Khatkhate, 1989). The demand for informal lenders, whether money lenders or microfinance programmes, was and continues to be strong because the poor prefer the informality, flexibility, and low transaction costs of informal institutions (Wai, 1992). Others suggest

that, to become self-sustaining, microcredit programmes would have to maintain interest rates that would be too great a burden on borrowers given the rate of profit they could expect to gain from the loan (Khandker, 1998; Morduch, 2000). However, raising the interest rate may not be a suitable solution anyway. Research has pointed to the fact that rural credit markets are often ridden by a lack of information and erratic regulation. Therefore, raising interest rates will not necessarily improve loan recovery rates, and targeted loans may not reach target households even if the interest rate is right (Stiglitz and Weiss 1981, 1983).

Morduch suggests that subsidies may be strategically used in such a way that they may be targeted at those at 50 per cent of the poverty level (for example those close to the poverty line would not have their loans subsidized). Others argue that in order to make microfinance programmes sustainable, greater emphasis should be placed on savings deposits. Many microfinance programmes typically depend on external donors because they have not legally been established to attract savings and meeting government regulations can be costly. Of those microfinance programmes that do attract savings, many programmes do not target micro-savings. The experience of the credit unions tells us that the poor often have a greater demand for savings than they do for lending (Richardson, 2000).

Having access to banking services allows the poor to have savings that are more secure, liquid and usually offer better returns. Generating savings is also important to microfinance institutions because it increases their security and allows for the expansion of lending. At the community level, development is better aided by making better use of capital when institutions use such deposits to lend to micro-enterprises.

Emphasising sustainability also might affect development patterns. Given the need for frequent repayments, the borrowers might be encouraged to choose activities that result in high profit margins, quick turnaround investments (such as restaurants or tailors) etc., rather than choosing activities that do not generate immediate returns (Morduch, 2000).

Microfinance programmes have an explicit social agenda, but face the challenge of keeping the financial and social missions from becoming muddled. Taking on a social mission often entails sacrificing self-sufficiency because interest rates are subsidized in exchange for greater outreach. As more competition enters microfinance markets and donors demand greater accountability, costs are a prime concern. Increased competition has also resulted in over-lending, which has caused delinquency rates to rise. Scaling up operations will sacrifice the prime benefits of being small, which include being able to supply the services and support that many poor need. Moreover, as large commercial banks increasingly see microlending as a profitable market niche, there is a danger that they will entice the best borrowers to leave microcredit programmes, thereby taking away those who could support microfinance institutions through increased deposits (Richardson, 2000).

Some argue that, with the growing emphasis on making microlenders self-sustainable, microcredit institutions will shift to larger loans, which are more cost effective (Hulme and Mosley, 1996; Johnson and Rogaly, 1997). However, they would then abandon their original mission to help the poorest. One suggestion is that profits from services to the better-off

can be used to subsidize services for the poor. Another possibility is that micro-enterprises may also create jobs, which can be filled by those who lack the ability to benefit directly from microlending.

The assumption of efficient financial institutions might however be questioned since, under certain conditions, an inefficient and unsustainable financial system can generate benefits that exceed the costs of the government of sustaining this system. For instance, the formal financial intermediaries in India, which are unsustainable without government subsidies, are nevertheless contributing to the growth of the rural economy (Binswanger and Khandker, 1995). On the other hand, even if micro-finance institutions are self-sustainable and effective in reaching target clients, they may generate benefits that are neither sustainable nor marginal. Therefore, they might not result in an overall growth impact (Bouman and Hospes, 1994). In other words, simple outreach of a self-sustainable financial institution does not guarantee that participants and society benefit from such investments. If microcredit programmes are to attain financial self-sustainability at an earlier stage of operation, they require access to market resources to break even through expansion.

6. Comparing cost-effectiveness of microfinance with alternative poverty alleviation strategies

Microfinance is one of the poverty reduction instruments. Economic growth, investment in human capital and other means to empower the poor are also important tools for alleviating poverty. In order to evaluate whether microfinance programmes are more cost-effective at delivering services to the poor than alternative redistributive measures, it is essential to examine the evidence of the comparative cost-benefit analysis.

In Bangladesh, the cost of supporting microcredit programmes is estimated to be USD 11 per household per year. Khandker (1998) reports a cost-benefit ratio of 0.91 with respect to improvements in household consumption via borrowing by women from the Grameen Bank. This implies that it costs society 91 cents for every dollar of benefit to clients. For borrowing by men the cost benefit ratio is 1.48. The ratio is higher, since lending to men appears to have a smaller impact on household consumption (Mark Pitt and Khandker, 1998). Khandker stressed that even this was not too bad compared to the cost-benefit ratio of alternative poverty alleviation programmes in Bangladesh, such as the World Food Programme's Food-for-Work scheme (1.71) and CARE's similar programme (2.62). However, there are some other microfinance programmes such as the Bangladesh Rural Advancement Committee (BRAC) that report ratios of 3.53 and 2.59 for borrowing by women and men, respectively (Khandker, 1998).

Such figures show that microfinance is not always the best poverty-alleviation strategy to follow. Simple cost-benefit ratios, however, do not capture the dynamics as they do not take future impacts into consideration. The costs of group formation, training, and adherence to group discipline also remain unaccounted for. Additional costs, particularly for women in certain rural societies, who have to challenge traditional norms, the social stigma associated with female participation and the backlash from traditional elites are also ignored (Brahm, 2000). Another difficulty with simple cost-benefit ratios arises from the fact that they might be improved (or worsened) by reducing subsidies slightly. Thus, although it might be true that a dollar used to subsidize an existing microfinance programme helps poor households more than other users, it also might be true that the microfinance programme would ultimately help more poor people if it was subsidized at a much higher level (Morduch, 1999). Social benefits such as "gender empowerment" are also ignored. A fur-

ther limitation is how the measurable impacts are quantified. For instance, the cost-benefit ratio of 0.91 for lending to women by Grameen Bank is calculated on an estimated 18 cent increase in household consumption for every additional dollar borrowed by the women from Grameen Bank (Pitt and Khandker, 1998). This is the marginal impact of an additional dollar lent, which is better for evaluating the expansion of scale, but for evaluating the whole project it might be more appropriate to calculate the average impact. According to Morduch (1999), if the average benefits were calculated, assuming that the marginal returns diminish with amounts borrowed, the cost-benefit ratio will be overstated. However, if there are large fixed costs in production technologies, the marginal returns may well be higher than average returns. Morduch (1998) finds evidence that the average impacts estimated for Grameen Bank are actually close to zero.

7. Conclusions

Microfinance programmes are still not very widespread and the literature not only questions whether the poorest are being reached but whether reaching the poorest is even desirable. A review of the existing impact assessment literature does find some impact on the poverty level of the households, especially for female borrowers. It is found that microfinance has a higher impact for households closer to the poverty line, rather than for the poorest of the poor. A large proportion of microcredit loans seem to be going towards consumption-smoothing, especially for the very poor households. This raises additional concerns about the long-term improvements in the economic status of the participating households. Evidence suggests clear support for declining vulnerability through consumption and labour-smoothing that protects the households from seasonal fluctuations. Although microfinance by its very nature leads to an increase in self-employment, it might also reduce wage-employment and income, thereby leading to only a slight increase in the employment levels. Besides the economic impacts on the households, microfinance leads to positive effects on schooling, nutrition, health, fertility and women's empowerment. Overall, the evidence for microfinance shows a limited impact on poverty. Lack of sustainable and cost-effective microfinance programmes as suggested by existing evidence also raises doubts about the long-term contribution of microfinance programmes to income expansion and poverty reduction. Results drawn from the literature also suggest that, in a sluggish economic growth scenario, microfinance programmes might result in redistribution of income and employment rather than increase and growth.

However, understanding the constraints faced by microfinance programmes leads to several policy recommendations that would lead to a reduction in poverty and an increase in growth. Focusing on the households closer to the poverty line might be a better strategy, as it would result in a greater impact and still help society as a whole while increasing the chances of the programme to become sustainable. Use of microfinance for consumption loans can be reduced by introducing new products and by combining loans with savings and insurance. Besides credit, the poor lack skills, accounting ability and the education to create and sustain a business. Therefore, more effective microfinance programmes would require greater commitment of funds and resources to literacy and

basic training programmes. Furthermore, an improvement in the skills of the poor should be used to encourage adaptation of more advanced technologies, especially in the rural non-farm sector. A major part of the increase in employment is due to this sector and, without structural transformation of the rural economy and improved technological adaptation in production, poverty reduction through microfinance will be short-term. Skills development and high productivity in rural non-farm activities will promote strong backward and forward linkages between agriculture and the rural non-farm sector and are likely to have a sizeable impact on rural poverty.

At the global level, the World Bank devoted the “World Development Report 2000/2001: Attacking Poverty” to the subject, based on new evidence and a deeper understanding of the meaning and causes of poverty. The report argues that major reductions in world poverty are indeed possible. It shows that economic development continues to be central to success in reducing poverty. Without economic growth and development of infrastructure, microfinance alone is not an effective poverty-alleviating strategy.

Poverty is an outcome of economic, social and political processes that interact with and reinforce each other in ways that can ease or exacerbate the state of deprivation in which poor people live. To conquer poverty requires actions at the local, national and global levels – to expand poor people’s opportunities, empower them, and increase their security (World Bank, 2000/2001). Thus, the social and non-financial impacts of microfinance go a long way towards contributing to improving the situation of the poor.

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Appendix:

Table 1: Relationship between the evaluation design and analysis*

Evaluation of Design	Types of Analysis	Data requirements	Skill requirements	Costs	Generalisability	Strength of causal inference
Experimental	Descriptive statistics Differences in means and proportions** Regression analysis	Large sample of participating and similar non-participating enterprises	High – quantitative	High	High	High
Quasi-experimental	Descriptive statistics Differences in means and proportions** Regression analysis	Large sample of participating and similar non-participating companies	High – quantitative	High	High	High
Non-experimental and Qualitative	Descriptive statistics Simple hypothesis testing	Small or large sample of participating enterprises	Medium – quantitative	Low	Low	Moderate
Participant-oriented methods	Subjective description Pattern matching and time-series analysis based on logic model	A small number of selected enterprises	Medium/high	Moderate	Low	High

* Compiled in tabular form and further modified from Nexus Associates, Inc. 1998, Evaluation system for non-financial business assistance programs for SMEs in Mexico

Endnotes

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- ¹ In 1997, a consortium of policymakers, charitable foundations and practitioners started a drive to raise USD 20 billion for microfinance start-ups in the next ten years (Microcredit Summit Report, 1997).
- ² For a broader discussion on microfinance programmes, refer to Brugger and Rajapatirana (1995), Hulme and Mosley (1996), Morduch (1999) and Robinson (2001).
- ³ 688 in Indonesia and 790 in other countries
- ⁴ In 1999 IFPRI conducted a systematically sampled survey on microfinance institutions (MFIs) in Asia, Africa and Latin America to offer a new in-depth analysis of the distribution and performance of MFIs at the international level. The survey adopted an average loan size of USD 1000 as the ceiling in defining MFIs. The richest countries in Asia (with per capita gross domestic products exceeding USD 5000) have been excluded. The mode of sampling by IFPRI underestimates local initiatives and national programmes (as all the MFIs received some form of international support), but it does offer an overview of the role of the donors in the development of MFIs.
- ⁵ As Morduch (1999) explains, an inherent problem in finding the impact is also in finding the answer to the question: Do programmes create entrepreneurship or a propensity for education or do programmes choose communities that have these characteristics? Programmes tend to locate at the extremes – either in the poorest areas or where infrastructure is best, which skews the true effect of the programme.
- ⁶ The crucial element of experimental design is random selection of the treatment and the control groups. “Random” implies that every one has an equal chance of being selected in getting the program intervention. Although this approach strengthens the causal inferences, it creates operational and procedural complexities, because of which it is very difficult to implement. (See Bali Swain, 2001, Impact Assessment of BDS Interventions on Employment: A Guide to Methodologies for Conducting Impact Assessment, unpublished draft, SEED, ILO)
- ⁷ Hulme (2000) explains that selection bias may occur because of: (1) difficulties in finding a control group that matches the economic, physical and social environment of the treatment group; (2) the treatment group systematically possesses an invisible attribute which the control group lacks (for instance, entrepreneurial drive and ability); (3) receiving any form of intervention may result in short-term positive response from the treatment group; (4) the control group becomes contaminated due to contact with the treatment group; and (5) the fungibility of the treatment (for instance, when a loan is transferred from a borrower to someone else or when a loan is not used in a planned way. However, most of these problems (1 to 4) can be controlled through careful selection of the control group.
- ⁸ Misspecification of underlying causal relationships mostly arises through the assumption that causality is a one-way process. However in human activity causation can also run from impact back to intervention. Mosley (1997) illustrates this with an example. A programme where the field staff puts pressure on the borrower to repay loan may succeed in the short-run by making the borrower to sell assets and repay, which may result in the borrower's long-term inability to repay. Such problems can be avoided by adoption of models that conceptualise causation as a two-way process by the use of two-stage least squares technique and regression analysis. However, they are demanding in terms of data requirements, technical expertise and costs.

- ⁹ For a more detailed comparison see Table 3 in Hulme (2000).
- ¹⁰ Some of the other resources that might be interesting for the readers, refer to: Dfid EDIAIS website (<http://www.enterprise-impact.org.uk>) for quantitative, qualitative and participatory methods and tools; Micro-Save Africa tool-kit for focus group discussions; AIMS Practitioner Tool kit which provides a detailed study of various aspects of and key issues in impact assessment, methodological assessments, monitoring and assessment tools in several regions of the world; MSA Tool-Kit which provides an increased understanding of clients' needs through qualitative market research; and IKM manual from PlaNet Finance that outlines a process whereby organisations can develop a set of techniques, combining impact assessment and market research into client-centred monitoring systems useful for institutional management.
- ¹¹ This data is referred to as the 'World Bank data' in the rest of this paper.
- ¹² Bolivian microfinance institutions account for 41% of all borrowers in the country and present an extraordinary range of solutions to the problem of how to lend to poor, individuals without collateral (Mosley, 1999).
- ¹³ The poor have relatively few opportunities to mitigate risks. Since they are predominantly to be found in the informal sector, which is isolated from markets and formal institutions, the poor have little access to formal risk-mitigating instruments. The market failures in insurance and credit markets that arise mainly from information gaps can be overcome only through the use of collateral. The poor however, lack the ability to provide suitable collateral. Thus, to cope with shocks, poor households often adopt strategies with possible long-term adverse consequences, such as withdrawing children from school to contribute their labour to the family, selling crucial assets or crop inventories or borrowing from moneylenders at usurious rates of interest. Diversification in livelihoods or informal kingship-based arrangements is also used. However, such opportunities are limited for poor households.
- ¹⁴ This would depend on the slope of the labour demand and supply curves. With elastic demand and supply curves, it is possible to show an increase in market wages as a result of micro-credit programmes placement, even if the demand for wage labour does not increase (see Khandker et. al., 1998)
- ¹⁵ In Honduras the programme is an urban slum programme whereas in Ecuador it was mainly a rural and village programme.
- ¹⁶ Operational sustainability refers to the ability of the institutions to generate enough revenue to cover operating costs but not necessarily the full cost of capital. Financial sustainability is defined as whether or not the institution requires subsidized inputs in order to operate.

Halving poverty by 2015 is one of the greatest challenges of our time, requiring cooperation and sustainability. The partner countries are responsible for their own development. Sida provides resources and develops knowledge and expertise, making the world a richer place.



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