MICRO-FINANCE
Literature Review

Based on work by Eoin Wrenn for Trócaire, 2005

What Is Microfinance?

Microfinance, according to Otero (1999, p.8) is "the provision of financial services to low-income poor and very poor self-employed people". These financial services according to Ledgerwood (1999) generally include savings and credit but can also include other financial services such as insurance and payment services. Schreiner and Colombet (2001, p.339) define microfinance as "the attempt to improve access to small deposits and small loans for poor households neglected by banks." Therefore, microfinance involves the provision of financial services such as savings, loans and insurance to poor people living in both urban and rural settings who are unable to obtain such services from the formal financial sector.

1. Microfinance and microcredit.

In the literature, the terms microcredit and microfinance are often used interchangeably, but it is important to highlight the difference between them because both terms are often confused. Sinha (1998, p.2) states "microcredit refers to small loans, whereas microfinance is appropriate where NGOs and MFIs[1] supplement the loans with other financial services (savings, insurance, etc)". Therefore microcredit is a component of microfinance in that it involves providing credit to the poor, but microfinance also involves additional non-credit financial services such as savings, insurance, pensions and payment services (Okiocredit, 2005).

2. The History of Microfinance

Microcredit and microfinance are relatively new terms in the field of development, first coming to prominence in the 1970s, according to Robinson (2001) and Otero (1999). Prior to then, from the 1950s through to the 1970s, the provision of financial services by donors or governments was mainly in the form of subsidised rural credit programmes. These often resulted in high loan defaults, high loses and an inability to reach poor rural households (Robinson, 2001).

Robinson states that the 1980s represented a turning point in the history of microfinance in that MFIs such as Grameen Bank and BRI[2] began to show that they could provide small loans and savings services profitably on a large scale. They received no continuing subsidies, were commercially funded and fully sustainable, and could attain wide outreach to clients (Robinson, 2001). It was also at this time that the term "microcredit" came to prominence in development (MIX[3], 2005). The difference between microcredit and the subsidised rural credit programmes of the 1950s and 1960s was that microcredit insisted on repayment, on charging interest rates that covered the cost of credit delivery and by focusing on clients who were dependent on the informal sector for credit (ibid.). It was now clear for the first time that microcredit could provide large-scale outreach profitably.

The 1990s "saw accelerated growth in the number of microfinance institutions created and an increased emphasis on reaching scale" (Robinson, 2001, p.54). Dichter (1999, p.12) refers to the 1990s as "the microfinance decade". Microfinance had now turned into an industry according to Robinson (2001). Along with the growth in microcredit institutions, attention changed from just the provision of credit to the poor (microcredit), to the provision of other financial services such as savings and pensions (microfinance) when it became clear that the poor had a demand for these other services (MIX, 2005).

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[1] Microfinance Institutions
[2] Bank Raykat Indonesia
[3] Microfinance Information eXchange

The importance of microfinance in the field of development was reinforced with the launch of the Microcredit Summit in 1997. The Summit aims to reach 175 million of the world's poorest families, especially the women of those families, with credit for the self-employed and other financial and business services, by the end of 2015[4] (Microcredit Summit, 2005). More recently, the UN, as previously stated, declared 2005 as the International Year of Microcredit.

3. Providers and models of microfinance interventions

MIX defines an MFI as "an organisation that offers financial services to the very poor." (MIX, 2005). According to the UNCDF (2004) there are approximately 10,000 MFIs in the world but they only reach four percent of potential clients, about 30 million people. On the other hand, according to the Microcredit Summit Campaign Report (Microcredit Summit, 2004) as of December 31st 2003, the 2,931 microcredit institutions that they have data on, have reported reaching "80,868,343 clients, 54,785,433 of whom were the poorest when they took their first loan". Even though they refer to microcredit institutions, they explain that they include "programs that provide credit for self-employment and other financial and business services to very poor persons" (Microcredit Summit, 2004).

The differences between these sources highlight a number of points. Firstly, how the two terms, microcredit and microfinance are often confused and used interchangeably, though in the strictest sense microcredit should refer only to the provision of credit to the poor. Secondly, the difference between the statistics shows how difficult it is to get a true picture of how many MFIs are in existence today and how many clients they are reaching. The IMF[5] state that "no systematic and comprehensive data on MFIs is collected and there are no authoritative figures on key characteristics of the microfinance industry, such as the number and size of MFIs, their financial situation, or the population served" (2005, p.6).

Despite the lack of data on the sector, it is clear that a wide variety of implementation methods are employed by different MFIs. The Grameen Bank (2000a) has identified fourteen different microfinance models[6] of which I will focus on three; Rotating Savings and Credit Association (ROSCAs), the Grameen Bank and the Village Banking models, as these are the three microfinance models that I encountered during my field research.

- **Rotating Savings and Credit Associations**

These are formed when a group of people come together to make regular cyclical contributions to a common fund, which is then given as a lump sum to one member of the group in each cycle (Grameen Bank, 2000a). According to Harper (2002), this model is a very common form of savings and credit. He states that the members of the group are usually neighbours and friends, and the group provides an opportunity for social interaction and are very popular with women. They are also called merry-go-rounds or Self-Help Groups (Fisher and Sriram, 2002).

- **The Grameen Solidarity Group model**

This model is based on group peer pressure whereby loans are made to individuals in groups of four to seven (Berenbach and Guzman, 1994). Group members collectively guarantee loan repayment, and access to subsequent loans is dependent on successful repayment by all group members. Payments are usually made weekly (Ledgerwood, 1999). According to Berenbach and Guzman (1994), solidarity groups have proved effective in deterring defaults as evidenced by loan repayment rates attained by organisations such as the Grameen Bank, who use this type of microfinance model[7]. They also

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[4] The initial objective was to reach 100 million people by 2005 but at the Latin America/Caribbean Microcredit Summit in April 2005 these objectives were changed (Microcredit Summit, 2005).

[5] International Monetary Fund

[6] Associations, Bank Guarantees, Community Banking, Co-operatives, Credit Unions, Grameen, Group, Individual, Intermediaries, NGOs, Peer Pressure, Rotating Savings and Credit Associations, Small Business and Village Banking.

[7] Under the Grameen Bank variation of this model, groups contain five members and savings must be contributed for four to eight weeks prior to receiving a loan. Savings must also continue for the duration of the loan term. Only two of the group members receive a loan initially. After a period of successful repayment, two

highlight the fact that this model has contributed to broader social benefits because of the mutual trust arrangement at the heart of the group guarantee system. The group itself often becomes the building block to a broader social network (1994, p.121).

♦ **Village Banking Model**

Village banks are community-managed credit and savings associations established by NGOs to provide access to financial services, build community self-help groups, and help members accumulate savings (Holt, 1994). They have been in existence since the mid-1980s. They usually have 25 to 50 members who are low-income individuals seeking to improve their lives through self-employment activities. These members run the bank, elect their own officers, establish their own by-laws, distribute loans to individuals and collect payments and services (Grameen Bank, 2000a). The loans are backed by moral collateral; the promise that the group stands behind each loan (Global Development Research Centre, 2005).

The sponsoring MFI lends loan capital to the village bank, who in turn lend to the members. All members sign a loan agreement with the village bank to offer a collective guarantee. Members are usually requested to save twenty percent of the loan amount per cycle (Ledgerwood, 1999). Members' savings are tied to loan amounts and are used to finance new loans or collective income generating activities and so they stay within the village bank. No interest is paid on savings but members receive a share of profits from the village bank's re-lending activities.Many village banks target women predominantly, as according to Holt (1994, p.158) "the model anticipates that female participation in village banks will enhance social status and intrahousehold bargaining power".

4. Microfinance and its impact in development

Microfinance has a very important role to play in development according to proponents of microfinance. UNCDF (2004) states that studies have shown that microfinance plays three key roles in development. It:

- helps very poor households meet basic needs and protects against risks,
- is associated with improvements in household economic welfare,
- helps to empower women by supporting women's economic participation and so promotes gender equity.

Otero (1999, p.10) illustrates the various ways in which "microfinance, at its core combats poverty[8]". She states that microfinance creates access to productive capital for the poor, which together with human capital, addressed through education and training, and social capital, achieved through local organisation building, enables people to move out of poverty (1999). By providing material capital to a poor person, their sense of dignity is strengthened and this can help to empower the person to participate in the economy and society (Otero, 1999).

The aim of microfinance according to Otero (1999) is not just about providing capital to the poor to combat poverty on an individual level, it also has a role at an institutional level. It seeks to create institutions that deliver financial services to the poor, who are continuously ignored by the formal banking sector. Littlefield and Rosenberg (2004) state that the poor are generally excluded from the financial services sector of the economy so MFIs have emerged to address this market failure. By addressing this gap in the market in a financially sustainable manner, an MFI can become part of the formal financial system of a country and so can access capital markets to fund their lending portfolios, allowing them to dramatically increase the number of poor people they can reach (Otero, 1999).

More recently, commentators such as Littlefield, Murduch and Hashemi (2003), Simanowitz and Brody (2004) and the IMF (2005) have commented on the critical role of microfinance in achieving the Millennium Development Goals[9]. Simanowitz and Brody (2004, p.1) state, "Microfinance is a key

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more members receive loans and after another period of successful repayment, the final member receives a loan (Ledgerwood, 1999).

[8] The concept of poverty and the impact of microfinance in combating poverty are examined in more detail in the following section of this chapter.

[9] The MDGs are (i) eradicate extreme poverty and hunger; (ii) achieve universal primary education; (iii) promote gender equality and empower women; (iv) reduce child mortality; (v) improve maternal health; (vi) combat

strategy in reaching the MDGs and in building global financial systems that meet the needs of the most poor people." Littlefield, Murduch and Hashemi (2003) state "microfinance is a critical contextual factor with strong impact on the achievements of the MDGs…microfinance is unique among development interventions: it can deliver social benefits on an ongoing, permanent basis and on a large scale". Referring to various case studies, they show how microfinance has played a role in eradicating poverty, promoting education, improving health and empowering women (2003).

However, not all commentators are as enthusiastic about the role of microfinance in development and it is important to realise that microfinance is not a silver bullet when it comes to fighting poverty. Hulme and Mosley (1996), while acknowledging the role microfinance can have in helping to reduce poverty, concluded from their research on microfinance that "most contemporary schemes are less effective than they might be" (1996, p.134). They state that microfinance is not a panacea for poverty-alleviation and that in some cases the poorest people have been made worse-off by microfinance. Rogaly (1996, p.109/110) finds five major faults with MFIs. He argues that:

- they encourage a single-sector approach to the allocation of resources to fight poverty,
- microcredit is irrelevant to the poorest people,
- an over-simplistic notion of poverty is used,
- there is an over-emphasis on scale,
- there is inadequate learning and change taking place.

Wright (2000,p.6) states that much of the scepticism of MFIs stems from the argument that microfinance projects "fail to reach the poorest, generally have a limited effect on income…drive women into greater dependence on their husbands and fail to provide additional services desperately needed by the poor". In addition, Wright says that many development practitioners not only find microfinance inadequate, but that it actually diverts funding from "more pressing or important interventions" such as health and education (2000, p.6). As argued by Navajas et al (2000), there is a danger that microfinance may siphon funds from other projects that might help the poor more. They state that governments and donors should know whether the poor gain more from microfinance, than from more health care or food aid for example. Therefore, there is a need for all involved in microfinance and development to ascertain what exactly has been the impact of microfinance in combating poverty.

Considerable debate remains about the effectiveness of microfinance as a tool for directly reducing poverty, and about the characteristics of the people it benefits (Chowdhury, Mosley and Simanowitz, 2004). Sinha (1998) argues that it is notoriously difficult to measure the impact of microfinance programmes on poverty. This is so she argues, because money is fungible and therefore it is difficult to isolate credit impact, but also because the definition of 'poverty', how it is measured and who constitute the 'poor' "are fiercely contested issues" (1998, p.3).

Poverty is a complex issue and is difficult to define, as there are various dimensions to poverty. For some, such as World Bank, poverty relates to income, and poverty measures are based on the percentage of people living below a fixed amount of money, such as US$1 dollar a day (World Bank, 2003).

5. The impact of microfinance on poverty

There is a certain amount of debate about whether impact assessment of microfinance projects is necessary or not according to Simanowitz (2001b). The argument is that if the market can provide adequate proxies[10] for impact, showing that clients are happy to pay for a service, assessments are a waste of resources (ibid.). However, this is too simplistic a rationale as market proxies mask the range of client responses and benefits to the MFI (ibid.) Therefore, impact assessment of microfinance interventions is necessary, not just to demonstrate to donors that their interventions are having a positive impact, but to allow for learning within MFIs so that they can improve their services and the impact of their projects (Simanowitz, 2001b, p.11).

Poverty is more than just a lack of income. Wright (1999) highlights the shortcomings of focusing solely on increased income as a measure of the impact of microfinance on poverty. He states that there is a

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HIV/AIDS, malaria and other diseases; (vii) ensure environmental sustainability; and (viii) develop a global partnership for development (Littlefield, Murduch and Hashemi, 2003).

[10] Such as good client retention and repayment rates.

significant difference between increasing income and reducing poverty (1999). He argues that by increasing the income of the poor, MFIs are not necessarily reducing poverty. It depends what the poor do with this money, oftentimes it is gambled away or spent on alcohol (1999), so focusing solely on increasing incomes is not enough. The focus needs to be on helping the poor to “sustain a specified level of well-being” (Wright, 1999, p.40) by offering them a variety of financial services tailored to their needs so that their net wealth and income security can be improved.

It is commonly asserted that MFIs are not reaching the poorest in society. However, despite some commentators’ scepticism of the impact of microfinance on poverty, studies have shown that microfinance has been successful in many situations. According to Littlefield, Murduch and Hashemi (2003, p.2) “various studies…document increases in income and assets, and decreases in vulnerability of microfinance clients”. They refer to projects in India, Indonesia, Zimbabwe, Bangladesh and Uganda which all show very positive impacts of microfinance in reducing poverty. For instance, a report on a SHARE project in India showed that three-quarters of clients saw “significant improvements in their economic well-being and that half of the clients graduated out of poverty” (2003, p.2).
Dichter (1999, p.26) states that microfinance is a tool for poverty reduction and while arguing that the record of MFIs in microfinance is “generally well below expectation” he does concede that some positive impacts do take place. From a study of a number of MFIs he states that findings show that consumption smoothing effects, signs of redistribution of wealth and influence within the household are the most common impact of MFI programmes (ibid.).

Hulme and Mosley (1996, p.109) in a comprehensive study on the use of microfinance to combat poverty, argue that well-designed programmes can improve the incomes of the poor and can move them out of poverty. They state that “there is clear evidence that the impact of a loan on a borrower’s income is related to the level of income” as those with higher incomes have a greater range of investment opportunities and so credit schemes are more likely to benefit the “middle and upper poor” (1996, pp109-112). However, they also show that when MFIs such as the Grameen Bank and BRAC provided credit to very poor households, those households were able to raise their incomes and their assets (1996, p.118).

Mayoux (2001, p.52) states that while microfinance has much potential[11] the main effects on poverty have been:

- credit making a significant contribution to increasing incomes of the better-off poor, including women,
- microfinance services contributing to the smoothing out of peaks and troughs in income and expenditure thereby enabling the poor to cope with unpredictable shocks and emergencies.

Hulme and Mosley (1996) show that when loans are associated with an increase in assets, when borrowers are encouraged to invest in low-risk income generating activities and when the very poor are encouraged to save; the vulnerability of the very poor is reduced and their poverty situation improves. Johnson and Rogaly (1997, p.12) also refer to examples whereby savings and credit schemes were able to meet the needs of the very poor. They state that microfinance specialists are beginning to view improvements in economic security, rather than income promotion, as the first step in poverty reduction (ibid.) as this reduces beneficiaries’ overall vulnerability.

Therefore, while much debate remains about the impact of microfinance projects on poverty, we have seen that when MFIs understand the needs of the poor and try to meet these needs, projects can have a positive impact on reducing the vulnerability, not just of the poor, but also of the poorest in society.

Current debates on the impact of microfinance in development

6. Livelihood security and microfinance

[11] (i) to smooth out peaks and troughs in income and expenditure; (ii) to invest in businesses/assets including new technology, capital and assets such as land or housing; (iii) to cope with unpredictable shocks and emergencies such as death and natural disasters; (iv) to make socially required contributions to lifecycle or community events like marriages, funerals and religious festivals (Mayoux, 2001).

Carney (1998, p.4) defines a livelihood as comprising "…the capabilities, assets (including both material and social resources) and activities required for a means of living." Chambers (1997, p.10) states that livelihood security is "basic to well-being" and that security "refers to secure rights and reliable access to resources, food, income and basic services. It includes tangible and intangible assets to offset risk, ease shocks and meet contingencies." Lindenberg (2002, p.304) defines livelihood security as "a family's or community's ability to maintain and improve its income, assets and social well-being from year to year." Concern also state that livelihood security is more than just economic well-being as they define livelihood security as "the adequate and sustainable access to and control over resources, both material and social, to enable households to achieve their rights without undermining the natural resource base" (Concern, 2003). Livelihood security therefore, like poverty, is not just about income, but includes tangible and intangible assets, and social well being.

Johnson and Rogaly (1997, p.122) state that "NGOs aiming for poverty reduction need to assess the impact of their services on user's livelihoods." They argue (1997) that in addressing the question of the impact of microfinance, NGOs must go beyond analysing quantitative data detailing the numbers of users, and volumes and size of loans disbursed, to understanding how their projects are impacting on clients' livelihoods. They state (1997, p. 118) that the provision of microfinance can give poor people "the means to protect their livelihoods against shocks as well as to build up and diversify their livelihood activities". Therefore when analysing the impact of microfinance the overall impact of the microfinance services on the livelihoods of the poor needs to be taken into consideration. That is the focus of this study.

A livelihood security approach according to Concern (2003) aims for a holistic analysis and understanding of the root causes of poverty and how people cope with poverty. They identify livelihood shocks such as natural disasters and drought, the social, political and economic context, and people's livelihood resources such as education and local infrastructure as factors affecting people's livelihood security (ibid.). Therefore, when analysing the impact microfinance is having on livelihood security, as is the objective of this dissertation, an holistic analysis of people's livelihood security must be conducted, rather than just focusing on the material/economic impact microfinance is having on the livelihoods of the poor.

7. Social impact analysis

Traditionally, the impact of microfinance projects was assessed by the changes in the income or well being of the clients. Mansell-Carstens, cited in Rogaly (1996, p.103) argues that such a focus is flawed because respondents may give false information. It is also very difficult to ascertain all the sources of income of a client, so a causal effect is difficult to establish, and it is also difficult to establish what would have happened if the loan was not given. Therefore a broader analysis is needed that takes more than economic impact into consideration.

We have seen that poverty and livelihood security consist of economic and social conditions, therefore, when analysing the impact of microfinance, social impact must be assessed. Kabeer (2003, p.106) states that wider social impact assessment is important for an organisation's internal learning process, as an MFI should be aware of the "full range of changes associated with its efforts and uses these to improve its performance". She considers social impact to relate to human capital such as nutrition, health and education, as well as social networks (2003). Impact must be assessed on each of these issues if a true picture of the impact of microfinance is to be obtained.

However, Kabeer moves beyond individual or household analysis to state that analysis should also be conducted at community, market/economy and national/state levels (2003). She refers to these as "domains of impact" because societies are comprised of different institutional domains each with their own rules, norms and practices which can be influenced by microfinance interventions in different ways (2003, p.109). Kabeer (2003, p.110) not only refers to domains of impact but also highlights dimensions of change that should be assessed. She lists cognitive change[12], behavioural change[13], material change[14], relational change[15] and institutional change[16] as dimensions of change that need to be taken into account if the wider effects of microfinance interventions are to be understood.

[12] Changes in the way in which people understand and make sense of the world around them.
[13] The different types of actions that people undertake in order to achieve their goals.
[14] Changes in access to a variety of tangible resources.

Zohir and Matin (2004, p.301) make a similar point when they state that the impact of microfinance interventions is being under-estimated by “conventional impact studies which do not take into account the possible positive externalities on spheres beyond households”. They propose that impact should be examined from cultural, economic, social and political domains at individual, enterprise and household levels (2004).

McGregor et al. (2000, p.3) states that wider social and economic impacts can occur through the labour market, the capital market, the market for goods consumed by poor people, through production linkages and through clients participation in social and political processes.

Chowdhury, Mosley and Simanowitz (2004) argue that if microfinance is to fulfil its social objectives of bringing financial services to the poor it is important to know the extent to which its wider impacts contribute to poverty reduction. In the following sections I will examine the findings from wider assessments of microfinance interventions at a household and community level, to show what learning can be gained when impact assessments have a broad scope of analysis.

8. Impacts at a household level

Health and education are two key areas of non-financial impact of microfinance at a household level. Wright (2000, p.31) states that from the little research that has been conducted on the impact of microfinance interventions on health and education, nutritional indicators seem to improve where MFIs have been working. Research on the Grameen Bank shows that members are statistically more likely to use contraceptives than non-members thereby impacting on family size (ibid.). Littlefield, Murduch and Hashemi (2003, p.3) also acknowledge the sparse specific evidence of the impact of microfinance on health but where studies have been conducted they conclude, “households of microfinance clients appear to have better nutrition, health practices and health education than comparable non-client households”. Among the examples they give is of FOCCAS, a Ugandan MFI whose clients were given health care instructions on breastfeeding and family planning. They were seen to have much better health care practices than non-clients, with 95% of clients engaged in improved health and nutrition practices for their children, as opposed to 72% for non-clients (Littlefield, Murduch and Hashemi, 2003).

Microfinance interventions have also been shown to have a positive impact on the education of clients’ children. Littlefield, Murduch and Hashemi (2003, p.4) state that one of the first things that poor people do with new income from microenterprise activities is to invest in their children’s education. Studies show that children of microfinance clients are more likely to go to school and stay longer in school than for children of non-clients. Again, in their study of FOCCAS, client households were found to be investing more in education than non-client households. Similar findings were seen for projects in Zimbabwe, India, Honduras and Bangladesh (ibid.).

Robinson (2001) in a study of 16 different MFIs from all over the world shows that having access to microfinance services has led to an enhancement in the quality of life of clients, an increase in their self-confidence, and has helped them to diversify their livelihood security strategies and thereby increase their income.
Following a three-year study of 906 clients, ASA[17] an MFI working with 60,000 rural women in Tamil Nadu, India, found that their project had many positive impacts on their clients (Noponen, 2005). The programme was having a “positive impact on livelihoods, social status, treatment in the home and community, living conditions and consumption standards” (2005, p.202). Compared with new members, some of the findings showed that long-term members were more likely to live in tile roofed and concrete houses, to have a higher percentage of their children in school, to have lower incidence of child labour, to be the largest income provider or joint provider in the home, and to make decisions on their own as regards major purchases (Noponen, 2005). Clients also reflected significant increases in ownership of livelihood assets such as livestock, equipment and land (ibid.).

In 2002, FINRURAL, a microfinance networking organisation in Bolivia, carried out impact assessments on eight of its partner MFIs focusing on economic and social impacts at an individual, household and

[15] Changes in the terms on which people interact with one another.
[16] Changes in the rules, norms and behaviour at an institutional level.
[17] Activists for Social Alternatives

community level on both clients and non-clients (Marconi and Mosley, 2004). Many of the impacts on income were positive for the less poor and negative for the poorer clients, a trend that we have already seen. Marconi and Mosley (2004) state that this should not be surprising as poorer clients are more risk adverse and less likely to invest in fixed capital and so are more vulnerable to having to sell productive assets in the event of a shock. However, it was found that social networks played an important part in helping clients escape from poverty. Access to social networks provided clients with a defence against having to sell physical and human assets and so protected household assets (ibid.).

Chowdhury and Bhuiya (2004, p.377) assessed impact of BRAC's poverty alleviation programme from a "human well-being" perspective in a programme in Bangladesh where they examined seven dimensions of 'human-well being'[18]. The project included the provision of microfinance and training of clients on human and legal rights (ibid.). They noted that the project led to better child survival rates, higher nutritional status, improvement in the basic level of education, and increased networking in the community. Children of BRAC clients suffered from far less protein-energy malnutrition than children of non-members, and the educational performance of BRAC member's children was also higher than that of children in non-BRAC households (ibid.). BRAC member households spent significantly more on consumption of food items than poor non-members did and per capita calorie intake was also significantly higher.

Therefore, various studies and findings indicate that microfinance can, and is having very positive and diverse impacts at a beneficiary level.

9. Empowering Women

A key objective of many microfinance interventions is to empower women. Mosedale (2003, p.1) states that if we want to see people empowered it means we currently see them as being disempowered, disadvantaged by the way power relations shape their choices, opportunities and well-being. She states that empowerment cannot be bestowed by a third party but must be claimed by those seeking empowerment through an ongoing process of reflection, analysis and action (2003).

Kabeer, quoted in Mosedale (2003, p.2) states that women need empowerment as they are constrained by "the norms, beliefs, customs and values through which societies differentiate between women and men". She also states that empowerment refers to the "process by which those who have been denied the ability to make strategic life choices acquire such an ability", where strategic choices are "critical for people to live the lives they want (such as choice of livelihood, whether and who to marry, whether to have children, etc)" (Kabeer, 1999, p.437). Therefore MFIs cannot empower women directly but can help them through training and awareness-raising to challenge the existing norms, cultures and values which place them at a disadvantage in relation to men, and to help them have greater control over resources and their lives.

Littlefield, Murduch and Hashemi (2003, p.4) state that access to MFIs can empower women to become more confident, more assertive, more likely to take part in family and community decisions and better able to confront gender inequities. However, they also state that just because women are clients of MFIs does not mean they will automatically become empowered. Hulme and Mosley (1996, p.128) also make this point when they refer to the "naivety of the belief that every loan made to a woman contributes to the strengthening of the economic and social position of women". However, with careful planning and design women's position in the household and community can indeed be improved. According to Littlefield, Murduch and Hashemi (2003), the Women's Empowerment Program in Nepal found that 68% of its members were making decisions on buying and selling property, sending their daughters to school and planning their family, all decisions that in the past were made by husbands. They refer to studies in Ghana and Bolivia, which indicated that women involved in microfinance projects, had increased self-confidence and had an improved status in the community (ibid.).

Hulme and Mosley (1996) state that microfinance projects can reduce the isolation of women as when they come together in groups they have an opportunity to share information and discuss ideas and develop a bond that wasn't there previously. From studies of the Grameen Bank and BRAC they show that clients of these programmes suffered from significantly fewer beatings from their husbands than

[18] Increased income, improved women's lives, control over fertility, sustainable environment, decreased mortality, decreased morbidity and increased nutritional status (Chowdhury and Bhuiya, 2004, p.377)

they did before they joined the MFI (ibid.). However, in a separate study of a BRAC project Chowdhury and Bhuiya (2004, p.383) found that violence against women actually increased when women joined the programme, as not all men were ready to accept the change in power relations, and so resorted to violence to express their anger. This violence did decrease over time. The study found that when the violence did rise, the members, because of their increased awareness, reported back to the group on their martial life and got support from the group (ibid.).

Jeffery Sachs (2005) in a visit to a BRAC project was amazed to find that women he spoke to had only one or two children, when he was expecting them to have five or six as he had become accustomed to for Bangladeshi women. When he asked those with no or one child how many children they'd like to have, the majority replied two. He calls this a "demonstration of a change of outlook" (2005, p.14). He refers to a new spirit of women's rights, independence and empowerment among clients, showing the positive empowerment effects the project has had on the women (ibid.).

Osmani (1998) analysed the impact of credit on the well being[19] of Grameen Bank women clients. The project was found to have increased their autonomy in that they were able to spend family income more freely than non-clients. They had greater control over family planning, but the project was not shown to have had an impact on clients' control over other decision-making but they were found to have greater access to household resources than non-clients did.

However, Johnson (2004, p.5) states that having women as key participants in microfinance projects does not automatically lead to empowerment, sometimes negative impacts can be witnessed. She refers to increased workloads, increased domestic violence and abuse. This leads her to ask a crucial question of whether targeting women is just an efficient way of getting credit into the household, since women are more likely than men to be available in the home, attend meetings, be manageable by field staff and take repayment more seriously, even if they do not invest or control the loan themselves? Or on the other hand, if such targeting is fully justified on the grounds of enhancing gender equity. She claims the answer is probably somewhere between the two alternatives (ibid.). She argues that MFIs must analyse both the positive and negative impacts their interventions are having on women, and that MFIs need to work with men to help pave the way for a change in attitudes to women's enhanced contribution to the household (2004, p.6).

10. Impacts beyond the household

In this section I will refer to various findings that show the positive impacts microfinance interventions can have beyond client households. Imp-Act (2004b) gives examples where the impact of microfinance projects goes beyond clients. They refer to studies on CERUDEB, an MFI in Uganda, which show that loans given to small farmers have resulted in substantial increases in part-time and permanent wage labour of non-clients (ibid.). Even though the clients themselves were usually above the poverty line, the people they employed were not, thereby showing the positive knock-on effects of such an intervention, even if the poorest were not targeted. Mosley and Rock (2004, p.467) in a study of six African MFIs found similar results. They concluded from their study that MFI services provided to the non-poor can reduce poverty by "sucking very poor people into the labour market as employees of microfinance clients". They also state that microfinance services often enhance human capital through increased spending on education and health that may extend to poor households through intrahousehold and inter-generational effects (ibid.).

Zohir and Matin (2004, p.318) state that many MFI loans are used for agricultural production, trading, processing and transport, resulting in an increase in the use of agricultural inputs and increased output of agricultural production. This leads to enhanced employment opportunities in these sectors for the wider community and a reduction in the prices of such produce due to increased supply. They also state that trading activities financed by MFIs can help to establish new marketing links and increase the income of traders, and this can lead to reduced migration due to increased employment opportunities and increased income (Zohir and Matin, 2004). From a social perspective, they state that reduced migration increases family cohesion and greatly contributes towards improving child-upbringing (ibid.).

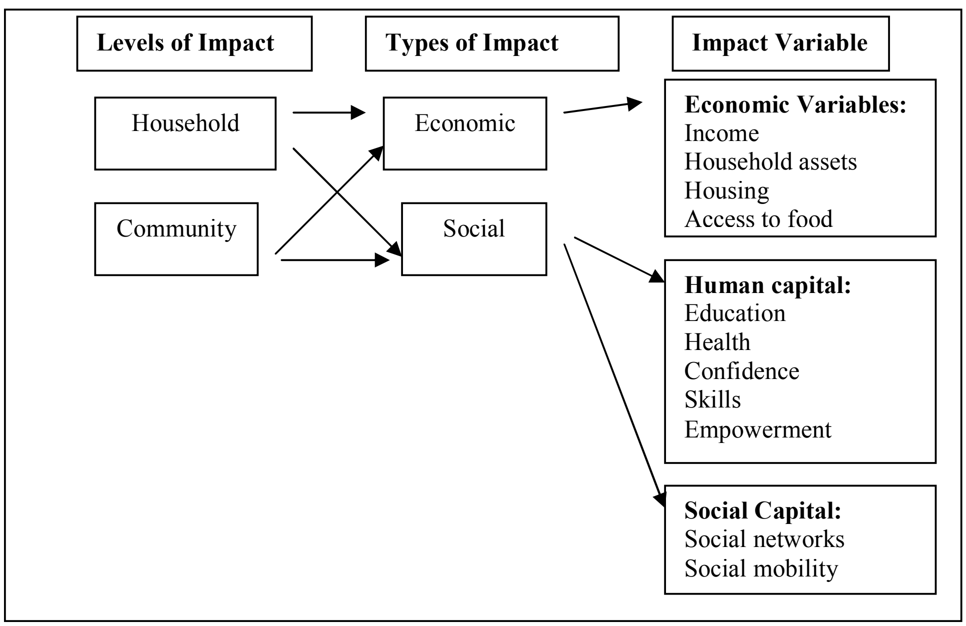
[19] Women's well-being is defined in terms of three sets of capabilities: (i) the degree of autonomy with which women can live their lives, (ii) their ability to control decision making within the family and (iii) their relative access to household resources such as food, education, etc. (Osmani, 1998, p.31)

Kabeer (2003, p.110) refers to a study conducted by the Grameen Bank which showed that non-members of a Grameen village were significantly more likely to use contraception than non-members in a non-Grameen village. This was due to a diffusion of the "small family norm" of Grameen women through social networks within the village as the Grameen Bank emphasises women's productive roles, as opposed to their reproductive role, and non-members picked up this norm from members. Studies have also shown that Grameen-style projects, based on collective activism, can lead to a greater level of legal and political awareness among clients, with a greater likelihood of clients taking part in political campaigns the longer they had been a member (Kabeer, 2003, p.111).

Zohir and Matin (2004) state that the interaction within MFI groups can create co-operation and trust that not only facilitates the microfinance activities, but also contributes benefits beyond the service provided, such as a greater sense of community, trust and reliance on the group in times of crisis. These networks can lay the foundations for other social capital developments in the community. They state that examples of cultural impacts of social intermediation that affect the greater community could be a change in attitude of society towards the acceptable age of women's marriage, domestic violence, dowry, etc. (ibid.).

Therefore, impact of microfinance projects should not just focus on the individual and household levels if the true impact is to be assessed. Microfinance can have a far wider impact than the household level, as shown in Figure 2.1, and this must be assessed if a true representation of microfinance projects is sought.

Fig. 1. Potential impact of microfinance at a household and community level:



11. The use of the Sustainable Livelihoods Framework in impact measurement

We have seen that microfinance can have a wide range of impacts on households involved in the project, but also can have wider social impacts. There are different ways of measuring impact such as using Social Performance Assessments (SPAs) (Copestake, 2004), AIMS[20] toolkit (Simanowitz, 2001c) and Internal Learning Systems (Noponen, 2005). Most assessments use quantitative research tools such as surveys, financial ratios and participatory tools, and qualitative tools such as focus group discussions and participant observation (Simanowitz, 2001c).

This research is focused on the impact of microfinance on livelihood security. Hussein (2000, p.5) states that a livelihoods impact assessment highlights the need to understand the significance of a

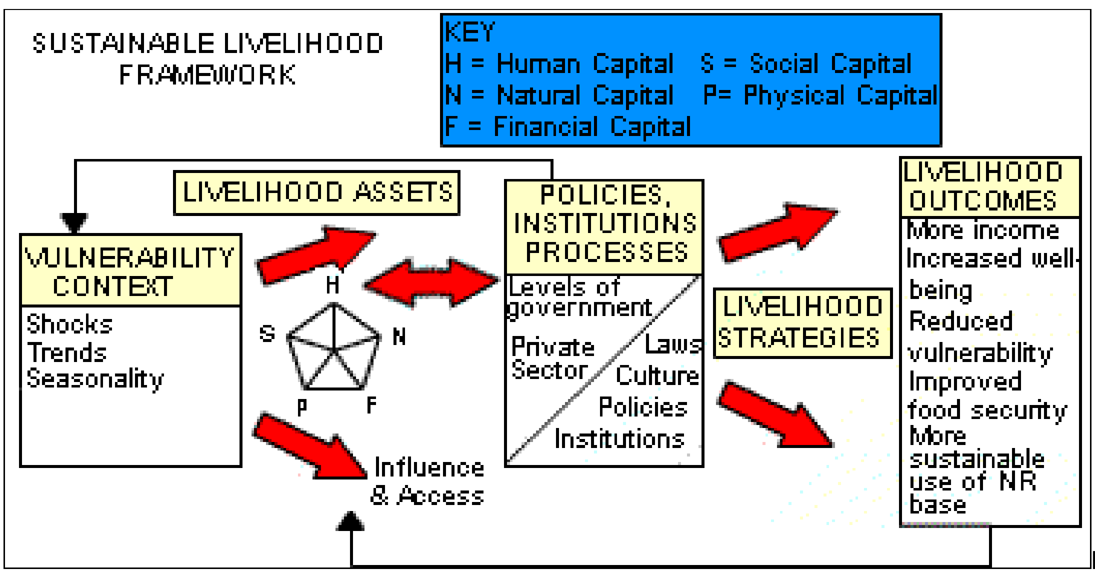
[20] Assessing the Impact of Microenterprise Services - uses household surveys, client exit surveys, loan/savings use tools and focus group discussions on client satisfaction and empowerment (Simanowitz, 2001c).

project to the livelihoods of project beneficiaries and other local people. This is the objective of this dissertation. Simanowitz (2001b, p.17), states that impact assessment must be based on a "sound conceptual framework that can be used for developing hypothesis about possible impact channels, and as a framework for analysis and understanding. Particularly useful is a livelihoods analysis that helps contextualise specific interventions in a broader understanding of poverty". One such livelihood analysis approach is a livelihoods framework.

According to Neefjes (2000, p.82) a livelihoods framework is "people centred and aims to explain the relationships between people, their livelihoods, (macro) policies and all kinds of institutions." Brocklesby and Fisher (2003, p.187) explain the four main components of the livelihoods framework, as used by DFID[21] which has been widely adopted in the development field. These are:

- people live within a vulnerability context i.e. they are exposed to risks such as sudden shocks, trends over time and seasonal change;
- people have a number of capital assets[22] which they draw upon to make their livelihoods;
- these assets are drawn upon within people's livelihood strategies;
- policies, institutions and processes help to shape people's assets, livelihood activities and the vulnerability context within which they live.

Carney (1998) states that an examination of the five capital assets offers a holistic analysis of people's livelihoods. These capital assets form the centrepiece of people's livelihoods as these assets dictate the level of vulnerability of beneficiaries to shocks and trends. Policies and institutions also have an impact on these assets. These policies and institutions, and beneficiaries' own vulnerability context influence their livelihood strategies which in turn dictate their livelihood outcomes as indicated in Figure 2.2 (ibid.). IDS (2004) also states that such a framework allows investigation into the ways in which a project directly and indirectly affects people's livelihoods. This framework therefore will be used in this study to assess the impact of microfinance on the beneficiaries' livelihoods by focusing on its impact on their five capital assets.



Figur

fig. 2. Sustainable Livelihood Framework.
Taken from DFID Sustainable Livelihoods Guidance Sheets, Section Two.

[21] Department for International Development
[22] Financial capital, physical capital, human capital, natural capital and social capita.

12. Current debates about MFIs and their role in development

When examining the impact microfinance has on livelihood security and poverty it is important to be aware of the current debates that are taking place in the field of microfinance. One of those debates, as we have seen, is on impact measurement. However, there are two other major issues that will be examined in this section of the study, reaching the poor and financial sustainability.

Reaching the Poor

As highlighted, one of the key roles microfinance has to play in development is in bringing access to financial services to the poor, to those who are neglected by the formal banking sector. This is their social mission. Mainstream banks target clients that have collateral. The poor do not have assets to act as collateral, therefore they are ignored by the formal financial sector. These banks tend to be found in urban centres while the majority of the poor in the developing world live in rural areas, where financial services are not provided. Therefore, if MFIs are to fill this void they must reach the rural poor. However, according to most studies, microfinance is only reaching a small fraction of the estimated demand of the poor for financial services (Littlefield and Rosenberg, 2004).

MFIs do not have the depth of outreach that is needed to meet the demands of the rural poor. Serving the rural poor in the developing world involves a major financial commitment, as it is expensive to run rural microfinance projects. Claessens (2005) states that high transaction costs, small volumes and the high costs of expanding outreach, make it unprofitable to serve the rural poor. It is for this reason that commercial banks are positioned in areas of high population density. However, if MFIs are to meet their social mission of serving the poor then financial services need to reach the rural poor.

Another common criticism of the current operational procedures of MFIs, for instance, peer group self selection and the drive for self-sustainability, is that they end up working with the moderately poor, and marginalising the poorest of the poor. Simanowitz (2001a, p.5) highlights a number of factors leading to the marginalisation of the poorest, which lessens the impact microfinance is having on poverty; self-exclusion[23], exclusion by other members[24], exclusion by MFI staff[25] and exclusion by design[26]. Markowski (2002) and Rogaly (1996) argue that MFIs in their project designs are failing to meet the needs of the very poor and destitute, who do have a demand for microfinance services, especially for savings (Littlefield and Rosenberg, 2004 and Dichter, 1999). They are ignored, yet an objective of the Microcredit Summit is to reach 175 million poor people by 2015 but MFIs do not seem to be on target for meeting this objective.

Organisations such as BRAC with their IGVGD[27] and CFPR[28] programmes have shown that the poorest people can be targeted in a sustainable manner (Halder and Mosley, 2004). Johnson and Rogaly (1997) state that some features of savings and credit schemes are able to meet the needs of the very poor. In relation to reaching those living in extreme poverty, Littlefield, Murduch and Hashemi (2003, p.5) refer to a study of 62 MFIs that have reached full financial self-sufficiency with 18 MFIs that targeted what they defined as “the poorest clients” averaging better profitability than the others. This shows that when properly managed, programmes that target the very poor can become financially sustainable. The onus is therefore on other MFIs to develop products and services that will meet the needs of the very poorest if the social mission of microfinance is to be achieved.

MFIs therefore need to improve their depth and breath of outreach. They must design appropriate products based on the needs of the poorest and they must ensure such products are delivered in a cost-effective manner (Simanowitz with Walter, 2002).

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[23] Many poor people do not see microfinance projects as being relevant or beneficial to them.

[24] In group-based lending in particular there can often be an incentive for stronger people in the community to exclude the very poor, especially when group guarantee systems are in place.

[25] Loan officers may have incentives to exclude the poorest if they see them as problematic, as increasing their workload or impacting on their sustainability targets.

[26] The design of services may exclude the poorest e.g. having entry fees and inappropriate loan terms.

[27] Income Generation for Vulnerable Group Development

[28] Challenging the Frontiers of Poverty

Financial sustainability versus serving the poor

MFIs have more than just a social mission. Markowski (2002, p.117) states they have a dual mission: a social mission " to provide financial services to large numbers of low-income persons to improve their welfare", and a commercial mission "to provide those financial services in a financially viable manner". We have already seen that MFIs are not fulfilling their social mission to the extent needed to meet the demands of the poor for financial services. Simanowitz with Walter (2002) argue that microfinance is a compromise between this social mission and commercial mission. As there is more emphasis on financial and institutional performance, opportunities for maximising poverty impact and depth of outreach have been compromised. They call for a balancing of social and financial/commercial objectives because the current focus on financial objectives means fewer of those most in need of microfinance services are being targeted. To do this they argue "it is now time to innovate and design services that maintain high standards of financial performance, but which set new standards in poverty impact" (2002, p.3).
Markowski (2002) states that CGAP[29] estimates that only about 5% of MFIs worldwide are financially sustainable while the IMF (2005) puts the figure at only 1%, so this is a huge issue for the microfinance sector. To achieve financial sustainability according to Havers (1996), an MFI must cover the cost of funds, operating costs, loan write-offs and inflation with the income it receives from fees and interest. According to the IMF (2005) the MFIs that have become self-sustainable tend to be larger and more efficient. They also tend not to target the very poor, as targeting the less poor leads to increases in loan size and improved efficiency indicators, whereas MFIs focusing on the poorest tend to remain dependent on donor funds (IMF, 2005). This is where the compromise exists. In order to achieve such sustainability, while at the same time reaching those most in need, microfinance programmes need to be managed in a rigorous and professional manner, subsidises must be removed[30], and tight credit control procedures and follow-up on defaulters needs to be in place (Havers, 1996). There is no doubt that sustainability is also very important from clients' perspectives, as they place a high value on continued access to credit, and if they feel that the MFI will not survive it reduces their incentive to repay loans (Von Pischke, 1999).

Appropriate loan sizes for clients matching their needs, realistic interest rates, savings as a prerequisite, regular, short and immediate repayment periods and achieving scale can contribute to sustainability (Havers, 1996). If these measures to achieve sustainability are put in place, while focusing on the needs of the poorest, then both the social and financial objectives can be achieved. In simple terms, the trade off between financial and social objectives can be balanced if the MFI is well managed and understands the market and its clients (Morduch, 2004) and by combining both objectives, financial returns can potentially be increased in the long run (Pawlak and Matul, 2004). Imp-Act (2004a) states it when assessing the performance of an MFI, both its financial and social performance must be assessed, as both are needed for the successful running of an MFI. Simanowitz, quoted in Imp-Act (2004a) refers to this as an MFI's "double bottom line". As stated by Morduch "achieving profitability and strong social performance is the ultimate promise of microfinance. It is not impossible but neither is it easy" (2004a, p.3) and this is the challenge facing all MFIs.

Therefore the current challenges facing MFIs are threefold, it concerns, not only, financial sustainability, but also outreach - extending the services to greater numbers of poor, and depth of outreach - trying to reach the poorest members of society.

13. Conclusion

In this chapter I have reviewed the evolution of microfinance over the past thirty years and examined briefly three of the MFI models that exist today. The role of MFIs in development, specifically in relation to alleviating poverty was also examined. Key challenges facing MFIs today that are affecting their impact on poverty alleviation were seen to be an over-emphasis on financial sustainability over social objectives, and a failure of many MFIs to work with the poorest in society. Therefore, there is a greater need for MFIs to carefully design services that meet the needs of the poor and this can only be done

[29] Consultative Group to Assist the Poor – a multi donor effort of 25 western donor countries and international agencies formed by the World Bank to address the problems facing microfinance (Grameen Bank, 2000b).
[30] Subsidies create incentives for the capture of funds by those who are better off and therefore better able to gain access to the funds because of their social, economic and political status (Von Pischke, 1999).

when MFIs understand their needs and the context within which the poor are working (Morduch, 2004). If MFIs are to meet their overall development objectives then they need to ensure financial sustainability and outreach of financial services designed to meet the needs of those most in need of such services.

The impact of microfinance on poverty alleviation is a keenly debated issue as we have seen and it is generally accepted that it is not a silver bullet, it has not lived up in general to its expectation (Hulme and Mosley, 1996). However, when implemented and managed carefully, and when services are designed to meet the needs of clients, microfinance has had positive impacts, not just on clients, but on their families and on the wider community. There is however a need for greater assessment of these wider impacts if the true value of microfinance to development is to be understood (Zohir and Matin, 2004). One such tool for measuring wider impact is a livelihood security analysis based on a livelihoods framework which analyses how a project impacts on the livelihoods of beneficiaries.

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