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Microfinance and poverty alleviation: A review

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Abstract

Microfinance is an effective development tool to reduce poverty and empower the poor especially women, economically and socially. It is recognized as an effective tool in poverty alleviation in many developing countries including Sri Lanka. There is consensus that micro finance institutions extend financial services to the poor usually ignored by traditional financial intermediaries. This study aims to evaluate the effectiveness of microfinance for poverty alleviation.A comprehensive literature survey was carried out to evaluate various dimensions relating to of the microfinance and its effectiveness to alleviate the poverty. Peer reviewed articles were gathered from various sources. The review found a mixed result about the effect of microfinance on poverty alleviation. In fact, empirical literature that supports the positive effect of microfinance on the improvement of the living condition of the poor is prominent. Thus, policy makers and relevant authorities should revisit the microfinance programmes to ensure the expected return from such programmes.

Keywords: *Microfinance, poor, poverty alleviation.*

1. Introduction

Microfinance has gained a considerable attention as an effective tool for reducing poverty and improving welfare of the poor segment of the society in recent years. Microfinance concept has been in operation for centuries in different parts of the world, for example, "*notable*" in Indonesia, "*cheetu*" in Sri Lanka, "*tontines*" in Cameroon, "*susu*" in Ghana and "*pasanaku*" in Bolivia (Boateng & Boateng, 2014). The history of Microfinance Institutions (MFIs) in developing countries started in the mid-1800s with evidence of the benefits from small credits to entrepreneurs and farmers in a bid to reduce poverty, even though significant impact only came in after the end of the Second World War with the British Marshall plan. The modern concept of microfinance was emerged in the 1970s with the efforts of Professor Mohammad Yunus, who established Grameen Bank, a special kind of bank for the poor. Since its inception in the villages of Bangladesh in the 1970s, the modern microfinance revolution is emerging in many countries of the world as a tool for poverty reduction (Robinson, 2001). The award of the Nobel Peace Prize to Yunus and the acceptance of microfinance as one of the primary tools to attack poverty seem to have galvanized its opponents (Robinson, 2001).

The goal of microfinance is to improve the welfare of the poor. Therefore, poverty reduction is good proxy to measure the impact of microfinance for fulfilment of that goal (Nghiem, 2011). The World Bank defines poverty as 'pronounced deprivation in well-being' (World Bank, 2011). However, Sen in 1987 defined poverty as deficiency due to a lack of resources, both material and nonmaterial, e.g. income, housing, health, education, knowledge and culture. Poverty has become one of the multi-dimensional issues in most developing countries of the world. World Bank reported that in 2010, over 900 million poor people (78 % of the poor) lived in rural areas, with about 750 million working in agriculture (63 % of the total poor) (World Bank, 2015).

There is no clear consensus among researchers about the impact of microfinance in reducing poverty. In reviewing these diverse views, it is timely important to assess the impact of microfinance on poverty reduction. Thus, this paper reviews the extant literature to identify the effect of microfinance on poverty alleviation. The paper contributes to present microfinance literature and provides policy directives to improve the microfinance programmes to ensure the maximum return to the target groups.

2. Literature review

Poverty reduction has become a key challenge in many regions in the world, especially in South Asia. In the case of reduction of poverty, as that of microfinance, many studies have been done internationally. Most of impact assessment studies on Microfinance have largely focused on the poverty reduction. The relationship between microfinance and poverty is still in question and empirical evidence on impact of microfinance in reducing poverty has evolved with considerable disagreements. Some writers argue that microfinance do bring about immense socio economic benefits. In contrast, some other researchers pointed the negative impacts of microfinance. Between these two extremes, there are some other writers who believe that even though, microfinance has several beneficial effects, and it does not help the poorest.

This review is divided into three parts; the first section reviews the literature supports claim that the microfinance helps to reduction of poverty, the second section reviews literature deals with the negative effects of micro finance on poverty and the third section reviews mixed effects of microfinance.

Several studies supported the idea of enabling microfinance as a poverty alleviation tool. In 2006, Muhammad Yunus won the Nobel Peace Prize for pioneered the work in helping the poor in his home country. The replication and the microcredit in Bangladesh were taken as a model in other countries. Meanwhile some NGOs (such as BRAC in Bangladesh) had provided basic education in rural areas with the innovative methods and they were all potentially positive developments for poverty reduction efforts (Hossain, 1988). Hossain (1988) studied microfinance impact assessments in Bangladesh, having used the comparison group method. The study found that the average household income of Grameen members' was to be 43 percent higher than that of targeted non-participants

in comparison villages. Holcombe (1995) studied about the impacts of microfinance on Grameen Bank in Bangladesh and the study found the positive effect of microfinance for poverty alleviation. Khandker and Pitt (1998) conducted a study on the impact of BRAC, Grameen Bank and RD-12- three microfinance institutions in Bangladesh. This study has assessed the impact of three levels, namely, household, village and institution. The survey was conducted over 1800 households, selected randomly from 86 villages in 29 Thanas. The major finding of the study was quite expected ranging for micro-credit contributes to poverty alleviation. The 5 percent of Grameen and 3 percent of BRAC households have gone beyond the poverty level, every year at the household level. In another survey by Khandker (2001) tried to assess the long-term economic effect of micro finance in Bangladesh. The study compared the results of two studies in 1991/92 and 1997 /98, with 98/99 and found that the "Microfinance participants were better position than the non-participants of both the surveys in relation to per capita income, per capita expenditure, and household net worth. Park (2001) evaluated the effect of microfinance on poverty by targeting sustainability and impact. Survey method was used for conducting the study and focused on the household level as their main unit of analysis. The stratified random sample based on three strata typified by the amount of governmental involvement in the microfinance program was assessed. A high level of repayment activity suggested profits for the lending institution and thus a high repayment rate was also necessarily suggested a sustainable microfinance program. Change in household income was observed to measure the impacts of microfinance. This change in household income was an indication that people are trying to come out of the vicious circle of poverty. Kimos et al. (2009) evaluated the contribution of Sinapi Aba Trust towards poverty reduction in Bangladesh. They used cross-sectional data from 547 respondents. The study found out that the participation by the poor people in the programme has actually achieved the objective where clients now owned the saving deposits and subscribed to welfare scheme which served as insurance to pay off debts in times of illness or death. Established clients were also found to be in a better position to contribute towards the education of their children and payment of healthcare for members of their households as well as contribution towards the purchase of household durables. Katsushi et al. (2010) in their study examined whether household access to microfinance reduces poverty. Using national household data from India, treatment effects model was employed to estimate the poverty-reducing effects of MFIs loans for productive purposes. Significant positive effect of MFI productive loans on multidimensional welfare indicator was observed. A study conducted by Nawaz, 2010 in Bangladesh found a reasonable reduction of poverty of the microfinance clients by investigating a variety of socio-economic indicators, though such opportunities many of the poorest in the village have not reached the expected outcomes. The study suggests that incorporation of other services such as skills training, technological support, education and health-related strategies would make microfinance a more effective means of poverty reduction.

Imai and Azam (2012) studied the effect of microfinance on poverty reduction in Bangladesh. They used panel data covering four rounds from 1997 to 2005 and used a treatment effects model and propensity score matching for the participants and non-participants of microfinance programmes. The study found that household access to microfinance loans from MFIs has increased per capita household income if such facilities are only taken for productive purposes. Mamun and Adaikalam (2011) investigated the effect of Amanah Ikhtiar Malaysia's (AIM) Urban Microfinance Programme on quality of life of the clients in Peninsular, Malaysia. The study employed a cross sectional design with stratified random sampling method. A quality of life index using eleven selected indicators was used in the study. The study found that access to microfinance improved quality of life of participating households in Urban Peninsular, Malaysia and concludes that microfinance helps in coming out of poverty. Charles et al. (2011) examined the impact of microfinance on poverty alleviation in Nigeria. The results revealed that there was a vital effect of MFI in reducing poverty by rising the income. It also concluded that microfinance institutions have powerful strategies for poverty reduction. Ullah et al. (2013) conducted a study in Bangladesh and examined an overview about access to microcredit for rural poor and its impact on their poverty situation by focusing 360 microcredit recipients. The findings reveal that microfinance effects on income, assets endowment, standard of living and poverty reduction.

One of the early and most cited studies by Hulme and Mosley (1996) used a cross country survey in six leading micro finance institutions in four countries. The control-group methodology had been used in looking at the differences of changes in income between the households in the villages with microfinance programmes and similar households in non-programme areas. They found evidence to suggest that the poor in upper and middle-income categories tend` to benefit more from microfinance than poor who were in lower-income category. The findings of these studies were provocative: poor households did not benefit from microfinance; it was only non-poor borrowers (with incomes above poverty lines) who could do well with microfinance and enjoy sizable positive impacts. There is a vast majority of those with starting incomes below the poverty line actually ended up with less incremental income after getting micro-loans, comparing to a control group which did not get such loans. The study implied that credit was only one factor in the generation of income or output (Hulme & Mosley, 1996). There were other complementary factors that are crucial for making credit more productive. Among them, the most important was recipient's entrepreneurial skills. They found that micro-credit helps the upper and middle income poor rather than the 'poorest of the poor'.

Morduch (1998) attempted to look specifically at the role that microfinance plays in helping the poor by focusing the Bangladesh Institute for Development Studies (BIDS). World Bank survey data with a difference-in-difference method reported mixed results, including some positive and some negative effects of microfinance in alleviating poverty and helping the poor. The study found that the microfinance programmes help the poor moderately than the destitute. Further, he found that households that are eligible to borrow and have access to the programmes do not have notably higher consumption levels than that of controlled group of the households. Moreover, he found that households eligible for programmes have substantially lower variation in consumption and labour supply across seasons, thus the most important potential impacts of microfinance programs are with reducing one's financial vulnerability, and not necessarily poverty. Weiss et al. (2003) brought together all the evidences on the impact of microfinance activities on poverty reduction. Their paper examines extent to which microfinance activities help in pulling household permanently out of poverty. Paper also tried to answer questions such as do microfinance services reach to the core poor people and how far microfinance is a cost effective mean of transferring income to the poor. The paper concludes that microfinance has a positive impact on poverty reduction and suggests that microfinance is not a simple tool which can be used to address the poor so easily. Amin et al. (2003) used two measures such as non- parametric test of average monthly consumption of members and non-members of microfinance programmes of vulnerability and Maximum likelihood test of micro-credit membership on vulnerability. They found mixed impact, that was members were poorer than non-members and micro finance programmes were more successful at reaching poor, but less successful at reaching vulnerable group. According to Adams and Von-Pischke (1992) microenterprises in low-income countries were targeted by an increasing number of credit programmes. These efforts resembled earlier problematic attempts to assist operators of small farms with credit. Similarities discussed include target group definition, assumptions, policies, and project justifications. Authors then concluded that debt was not an effective tool for helping most poor people to enhance their economic conditions, be the operators of small farms or microenterprises.

A study conducted by Menon (2006) draws a sample from eight Grameen Thanas and estimates the impact of consumption smoothing by nonlinear least squares. The results revealed that although microcredit helps improve the beneficiaries' ability to smooth seasonal shocks, its effect diminishes over time and it has virtually no impact after four years of participation. Yirsaw (2008) studied about the performance of microfinance institutions in Ethiopia and he has selected six MFIs separately as small MFIs, medium MFIs, and large MFIs. To study the performance data had been collected through annual reports, journal, text books, the balance sheets of selected MFIs, newspapers, magazines, reports of various government and nongovernmental organizations under the secondary data. The entire study went through the case studies and the data had been analyzed using different statistical tools like mean and ratio analysis. According to the results MFIs in Ethiopia regardless of their social mission, they should be financially viable and sound to achieve their missions.

Roodman and Morduch (2009) revisited the studies carried out in Bangladesh and they used Two-Stage Least-Squares regressions and found that lives of the borrowers after thirty years of microfinance did not improve. Noor and Ashraf (2010) used seven factors to evaluate the MFIs in Bangladesh. These factors were membership criteria, cost of credit, income level, religious restrictions, risk of using loan, loan repayment policy and loan use opportunity. They targeted 300 customers of three MFIs in Bangladesh. The sample was selected by using convenience sampling method. To analyze those data researches used several analytical techniques such as factor analysis, multiple regression analysis, descriptive statistics, correlation analysis and ANOVA. The results of the study revealed that the overall satisfactory level of MFIs customers is modest and cost of credit, income level and loan repayment policy in MFIs in Bangladesh were significantly lower. With the use of secondary data of the MFIs in America, Lindsay (2010) examined the performance of MFIs using seven criteria by comparing three kinds of microfinance institutions as nonprofit MFIs (Jamii Bora), quasi MFIs (KIVA), and commercial MFIs (Blue Orchard). The results revealed that nonprofit institutions were less effective than quasi and commercial MFIs. Nonprofit institutions in America were the most efficient institution and 4 percent of the effective institutions were in trouble with the economic and personal growth of their members. Yahaya et al. (2011) studied the effectiveness of microfinance institutions in Kwara state in Nigeria. The study found that the gender and working experience of the clients mediate that effect of microfinance on poverty alleviation.

3. Conclusion

Microfinance has received a considerable attention over the years as it was recognized as an effective tool in alleviating the poverty. This paper reviewed the empirical literature deals with effectiveness of microfinance in poverty alleviation. The review finds that there are mixed results regarding the underline phenomenon. Some studies confirmed that microfinance supports the poverty reduction, while others deny such claims. However, empirical literature supports the positive effect of microfinance on poverty alleviation is prominent. Thus, well-grounded studies are essential to uncover the effectiveness of microfinance in poverty alleviation. Moreover, structural divergence between the microfinance programmes would lead the mixed effects of such programmes on poverty alleviation. Thus, policy makers and relevant authorities should revisit the existing programmes to ensure the maximum benefits to the target groups.

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