ERASMUS UNIVERSITEIT ROTTERDAM
ERASMUS SCHOOL OF ECONOMICS
DEPARTMENT OF ECONOMICS

Are there possibilities to save the hopes of microfinance?

Bachelor thesis

A.Gowridass
Student number 312728
Thesis supervisor: Dr .V. Karamychev

ABSTRACT

Microfinance has received a number of critics about its impact and outreach. The lack of conformity among the views on microfinance indicates that the picture about microfinance is not complete. By reviewing literature of proponents and opponents, this study investigates whether microfinance failed in its promise and if the possibilities exist for improvement. The outcome of this review is that the results in the literature are mixed and empirical research is needed to determine the true impact of microfinance. The flaws of microfinance can be improved by better regulation, more research and enhancement of the social perspectives by microfinance providers.

Table of Contents

1. Introduction

According to the Microcredit Summit Campaign Report (2012) 3652 microfinance institutions (MFIs) reported reaching 205,314,502 clients until 2010. Approximately 66 percent of these people belonged to the poorest of society, when they took their first loan. Of these poorest clients 82,3 percent is female.

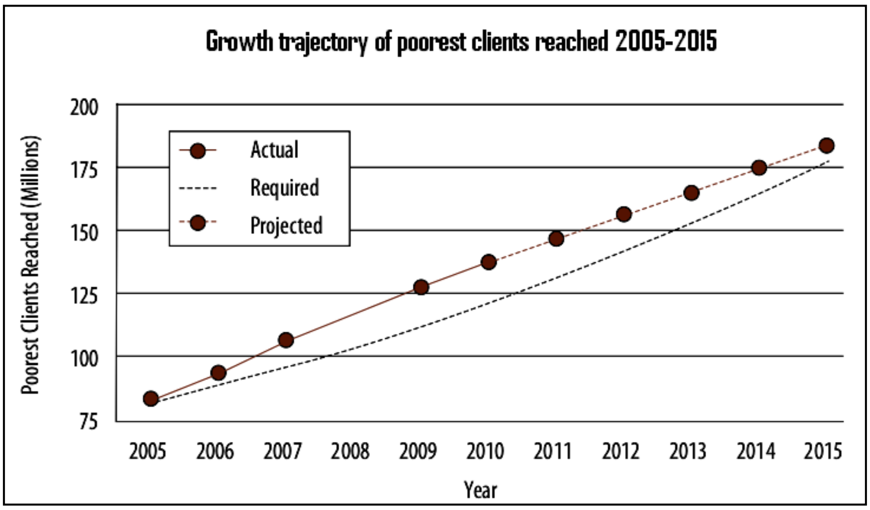

Figure 1 shows the number of poor clients reached since 2005

Source: State of the Microcredit Summit Campaign report 2012

More than three decades ago the world got shaken up by Muhammad Yunus and his promising vision about battling poverty. What started as an experiment, transformed into a widely accepted phenomena embraced by many politicians, musicians and royal family members. Unfortunately, the public debate has changed. Those who used to be in favor of this optimistic approach are now the ones who are turning against it. Decades after the founding of Yunus' Grameenbank more and more issues are starting to appear. Success stories of female empowerment and poverty reduction seemed to fuel the microfinance movement, but as time elapses more and more flaws are exposed. Some critics are even arguing that the concept of microfinance never worked at all.

The first question which arises is the question whether microfinance is effective. Does microfinance work? And if microfinance wouldn't work, the second question arises: what is wrong with it and what are the current MFIs achieving? The goal of the thesis is to review the literature to find an answer on the research question whether there is a possibility to save microfinance. This will be obtained by analyzing the literature on the advantages and disadvantages in the literature and by examining existing case studies. The second chapter discusses the advantages of microfinance and the third chapter discusses the disadvantages of microfinance. After discussing the advantages and disadvantages, chapter four provides an analysis of the found results in the previous chapter and the last chapter will give a conclusion.

2. Theoretical framework: What is microfinance?

The roots of microfinance can be found in many places. Microfinance developed in Asia and Latin-America under very different conditions. The best-known story is that of Muhammad Yunus and the founding of the Grameen Bank. The concept of modern microfinance was founded in Bangladesh during the 1974s as an experiment by the Bengal economist Muhammad Yunus. This experiment of providing credit to poor households in a village resulted in establishment of small, simple businesses of the villagers. The finding that the access to loans improved the welfare of the villagers and the high repayment rates of the villagers resulted two years later in the founding of the Grameen Bank, one of world's famous micro financial institutions (Armendariz & Morduch 2010, Weiss &Montgomery 2007). The micro financial institution BancoSol started in Latin-America as a result of unemployment problems in the urban sector.

Microfinance most commonly denotes the provision of small-scale financial services to zero or low income clients with the aim to improve their capacity to take their development in their own hands (La Torre, M, 2006; WSBI & ESBG, 2004). The perception of microfinance and the needs within the microfinance industry has evolved over time. Traditionally, microfinance is associated with programs that provide loans to clients from poor households. Whereas microfinance used to overlap microcredit- which refers specifically to small loans, often without collateral - nowadays it has been acknowledged that the poorer households need access to more financial services as savings, insurance and in some places also help in distributing and marketing output(Armendariz & Morduch,2010; La Torre, M., 2006; WSBI&ESBG 2004).

The lack of access to credit is generally seen as one of the main reasons why many people in developing countries cannot get out of poverty. These people are excluded from the banking system, because they have little or no income, lack collateral and need financial services in small quantities. Banks are unwilling to provide loans to persons who have little income and no acceptable assets as collateral, because they don't have the assurance of repayment. Also, providing loans to this target group means high costs of screening and monitoring the activities of this group and the costs involved enforcing the contracts (Hermen, N. & Lensink, R, 2007; Bubna, A. & Choudhry, B, 2010).

Microcredit was devised to provide loans to the very poor who lack collateral, resulting in reduced poverty and social change (Armendariz & Morduch, 2010). According to the Microcredit Summit, microcredit is the provision of small loans and other financial services to the very poor, so they can start entrepreneurial projects that generate income and support themselves and their families. Microcredit can be obtained by formal providers like NGOs and MFIs, but also informal providers like local moneylenders, saving clubs or even family and friends (Rutherford, 2000; Grameenbank 2011). Lending money from family and friends is usually based on reciprocity: helping now means being helped later. The available moneylenders are providing loans against high interest rates, but the emerging needs of some people forces them to agree with these exploiting conditions. The possibility exists to join a saving club like a rosca or asca. According to Calomiris & Rajaraman (1997) a rosca is a voluntary group of individuals who agreed to deposit a certain amount into a collective fund, which will be assigned by system to one or more members of the group in turn every meeting. Past recipients will be excluded from receiving the fund until everyone had his turn. After every member has received the 'pot', the group disbands or they regroup and repeat the process. Joining a Rosca provides participants a secure, insured but also structured way to save. It is also beneficial for individuals who are not impatient to join a rosca, simply for the support it provides with saving. The other way of saving through is joining an asca. An asca can be seen as a credit cooperative. It stores the savings of members and lends this to other members who are in need for a loan. Ascas are less restricted in comparison with roscas. A participant is not required to borrow while he is saving and the size of loans can vary. Also, an Asca has a broader set of objectives than a Rosca and many of them function also as an insurance company to cover situations of misfortune (Rutherford, 2000; Bouman, F.J.A., 1995).

The existence of roscas and/or ascas and their use of the group assure that financing can be done without too much external interference. In general, microfinance programs provide credit to the poor by the joint liability lending approach or by individual based lending (van Eijkel, R., Hermes, N., Lensink, R., 2009). Joint liability lending or group lending refers specifically to arrangements by individuals without collateral who get together and form groups to obtain loans from a lender. These group members often live and work together, so they know each other's reliability and reputation. The loans are for each individual, but the consequences are for the whole group (Armendariz&Morduch, 2010). Joint liability lending makes the group borrowers responsible for the repayment of the loan: if one group member does not pay her loan, others may have to contribute so they can ensure the repayment. If the other group members don't pay off and the fellow member has to default, all members will be excluded from borrowing in the future. Joint liability leads to assurance of repayment, since collateral is not required. Peer pressure has to prevent members to default, so that interference of external sources will not be necessary. It triggers individual group members to screen and monitor other members and to enforce repayment in order to reduce the risk of having to contribute to the repayment of loans of others and to ensure to future loans. If the repayments go well, borrowers can access larger loans in the next process. So the longer the cycle and the better the credit history, the larger the loan. (Armendariz & Morduch, 2000; van Eijkel, R., Hermes, N., Lensink, R., 2009). Group lending makes it possible to reduce adverse selection and moral hazard problems by using joint liability, since lenders cannot make the distinction between risky and safe borrowers (Armendariz&Morduch, 2010).

The transition from microcredit to microfinance shows the realization that low-income households can benefit from access to a broader set of financial services beyond credit (Armendariz&Morduch, 2010). The establishment of asca's, participation in group lending programs and the self-help groups show us the need for saving services. Saving can be necessary in case of occurrence of unforeseen costs like medical expenses, burial expenses or construction costs of housing. Especially in poor areas it is requisite that one is able to respond to financial setbacks, because if this is not the case, one might impoverish (Rutherford, 2000; Zeller, M. & Sharma, M., 2000). The World Savings Bank Institute and European Savings Banks Group (2004) discuss the importance of saving in developing countries. Small savings can make large differences, because these can play a critical role in buffering any emergencies. By providing saving services to those with low income it's possible to smooth their consumption over time. They argue that vulnerable groups save even more to meet the various needs of the life cycle like birth, death, marriage or to be able to cope emergencies like natural disasters. Evidence from Africa and Asia show that saving banks have been successful in holding household savings.

The demand for micro insurance comes from the need of low income customers to limit and cover the risk in case of setbacks. Natural disasters, health problems or death are events that can be dealt with by micro insurance. Micro insurance is a financial arrangement to protect low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved (2006, Churchill, C). The idea of micro insurance includes different types of insurances, but the most widely available products are health and life insurance, livestock and crop insurance (La Torre,M.,Vento,G.A.. & Trezza,S., 2006; Armendariz,B & Morduch,J. , 2010). Armendariz and Morduch (2010) discuss the different insurances and argue that life insurances are more successful than health insurances due to adverse selection and moral hazard problems. In addition, Zeller M. and Sharma M (2000) argue that weather risks are major causes of households being trapped in poverty and points out how important insurance can be for certain individuals and households. According to the paper, saving and insurance products become more important, the poorer the household or individual is. Furthermore, they discuss that financial services should be adjusted to the target group and providers should not only focus on providing credit to the poor. Some people will benefit from credit, while others benefit from other services.

As the World Savings Bank Institute and European Savings Banks Group (2004) points out: savings, credit, insurance and payment services are the four pillars in microfinance. Their experience has shown that not only credit and saving services, but also insurances have to be provided to the vulnerable. These groups are more exposed to risky situations, which can affect their livelihoods. Micro insurance may help to soften the impact of various risks, which can endanger income streams.

This section provided a description of the contents of microfinance. As this section has shown, microfinance is the provision of financial services as loans, saving services and insurances. By providing these small-scale services, the low income households get access to a tool which will improve their capacity to take their development in their own hands. Providing these services is a risky business, but by using mechanism as group lending moral hazard and adverse selection problems are being reduced. The next section will review literature about microfinance and its benefits and disadvantages.

3. The advantages and disadvantages of microfinance

There has been a lot of discussion about the impact of microfinance practices since the ‘microfinance revolution’ started. Advocates of microfinance have been promoting all the positive impacts, while the skeptics have been researching the negative impacts.

This section will discuss the advantages and disadvantages of microfinance according to the existing literature. The first part describes the literature which confirms the positive impact of microfinance and the second part describes the results in the literature which show the negative aspects of microfinance.

3.1 Advantages of microfinance

The articles which are discussed in this section provide information about the positive impacts of microfinance. The authors of the discussed articles below share the opinion that microfinance can support to substantial poverty reduction.

Hulme and Thankom (2011) argue that MFIs increases the possibilities of accessing basic financial services, so they can manage their finances more effectively. MFIs provide valuable services to clients and support local economic life by facilitating production, exchange and consumption. In addition, Lensink and Hermes (2011) argues that access to finance may contribute to a long-lasting increase in income generating activities; to a possible diversification of sources of income; it may contribute to an accumulation of assets and it may smooth consumption.

Schreiner (2002) delineate the distinction between the poverty approach and the self-sustainability approach. The poverty approach targets very poor clients and its success is measured by how well it fulfills the needs of these clients in the short term. The self-sustainability targets less-poor clients and its success is measured by how well it expands the frontier of the mainstream economy. Schreiner comments that MFIs in Latin America show a higher return than MFIs in Asia. This is due to the differences of approaches, namely MFIs in Latin America play a major role as financial providers to micro-enterprises, while MFIS in

Asia are more focusing on the poverty approach. The strong financial performance of larger MFIs in Latin America is linked with a trend towards commercialization of microfinance in the region. The commercialization of this part of the sector has unexplored disadvantages, but the advantages are clear: increased access to funding and regulatory authority, freeing the institutions from dependence on donor funds and capital constraints on growth and offering a wider range of financial services.

Hulme and Thankom (2011) and Conning and Morduch (2011) argue that the microfinance movement has contributed to democratizing global financial markets through new contacts, organizations and technology. The arise of new cooperation's like SafeSave (a cooperation which gives customers the opportunity to make financial transactions by bringing the bank to them), the provision of insurances like crop insurance and rainfall insurance and innovations like text message based services to transfer money electronically to other mobile users are a few examples of the road microfinance is heading (Hulme and Thankom, 2011; Armendariz and Morduch, 2011; Rutherford, 2000).

The acknowledgment of the importance of micro saving is also an improvement. By stimulating micro saving services, low income households are able to save lumps of money that can be spent on major purchases or events. These saving services are often preferred above borrowing, because of the fear of going into debt (Rutherford, 2000). As Collins, Morduch, Rutherford et al. (2009) describes it, the state of being poor means having less money than richer households. This also means, in practice, having less reliable and less effective ways to hold on to the money you have. So by recognizing these imperfections in saving devices progress can be made. According to Morduch and Armendariz (2010) saving and borrowing often go hand in hand: major investments and crises are typically financed by drawing down savings (if these exist) and borrowing (if it's possible). Morduch (1999) also points out that building up savings may offer important advantages to low-income households by building up assets to use as collateral, building up reserves to reduce consumption volatility over time, and they may be able to self-finance investments rather than always turning to creditors. These arguments are supported by the studies of Dupas and Robinson (2011), Bauer, Chytilova and Morduch (2010) and the financial diaries reported by Collins et. al. (2009). Dupas and Robinson (2011) found after a field experiment in rural Kenya that households would save more if they had access to more possibilities of saving services. In addition, Bauer, Chytilova and Morduch (2010) argue that microcredit contracts provide mechanisms with incorporated contractual saving devices after conducting a series of field experiments in two regions of Karnataka, a coastal state in South India. These saving devices offer structure and support for people with self-discipline issues and they argue that evidence has shown that borrowers are able to achieve a goal by contractual saving. According to these results, microcredit can serve as a substitute for structured saving devices. The financial diaries reported in Collins et al. (2009) confirms this notion by describing households at all income levels actively save and borrow.

Many microfinance schemes have a clear focus on women, because evidence has shown that women are more reliable and have higher pay-back ratios. Moreover, women use a more substantial part of their income for health and education of their children (Hermes and Lensink, 2011). The work of Dobra and Stiftung (2011) emphasize the importance of microfinance as a way to female empowerment, but share the view that programs must try to enhance their contextual adaption and should promote a balance between political forces. They argue that by giving women access to finances, microfinance institutions can reduce female fragility and reduce poverty. In contrary, Morduch (1999) argues that access to credit may have an income effect, so increased consumption associated with an increased demand for children, children's education and leisure. He argues it could also be the case that access may have an opposite effect, namely a lower fertility, education and leisure rate, driven by an increased female employment and thus higher opportunity costs. There is large empirical literature available about the role of microfinance on women empowerment. For example, several researches including Pitt and Khandker (1998) and Rai and Ravi (2011), show that the impacts have been positive. The research of Khandker (2003) found positive impact of borrowing by women on consumption and positive spill-over effects on non-program participants, especially for those in extreme poverty. In addition, Schuler and Hashemi (1994) argue that MFI group members have higher levels of contraceptive use than non-members(because they have

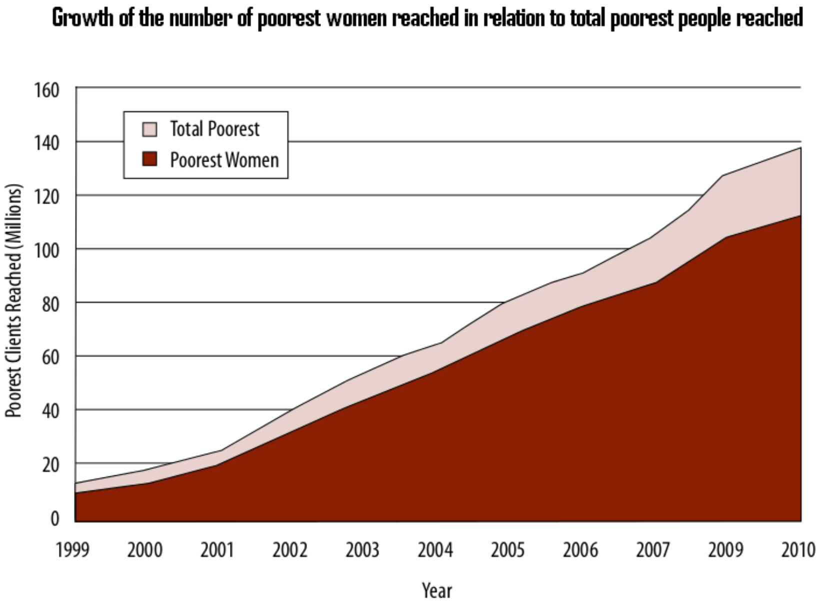

Figure 2 shows the number of poor women reached in relation to total people who have access to microfinance

Source: State of the Microcredit Summit Campaign report 2012 improved information and choice) and that joining an MFI leads to an improvement in physical mobility of women and are more allowed to visit public spaces by their husbands. Dobra and Stiftung (2011) state that women who are involved with microfinance are required to make a wider variety of choices and refer to the Women Empowerment program in Nepal which showed that 68 percent of women were taking more decisions in the fields of familial scheduling, schooling and marriages. Rai and Ravi (2011) found complementary results in their study by making use of a dataset of almost 280.000 borrowers in India who were required to obtain health insurance. The main finding of their analysis is that borrowers make more use of health insurance than their partners. Also, women who are borrowers make significantly more use of health insurance than non-borrowing women who are obtained insurance through their husbands.

The study of Becchetti and Castriota (2011) focused on the effects of microfinance as a recovery tool after a natural disaster. The findings of this study are impressive and provide strong evidence that microfinance can be effective. Becchetti and Castriota used data from before and after the 2004 tsunami in Sri Lanka and found that accessing microfinance led to income convergence among borrowers before and after the tsunami. These observations weren't found by other types of development support like subsidies or donations.

The articles discussed in this section provided information about the positive effects of access to microfinance. Several arguments like increased financial responsibility, consumption smoothing and female empowerment have been provided to emphasize the positive effects of microfinance. Little effects are proven yet by empirical research, so future research has to show the true impact. The next section will proceed by enlighten the negative effects of microfinance according to the literature.

3.2 Disadvantages of microfinance

Microfinance has also received some criticism. In particular, the critics of microfinance doubt whether access to finance contribute by the reduction of poverty as it is claimed. Hermes and Lensink (2011) discuss the main arguments against microfinance in their paper.

Hermes and Lensink argue in their work that critics often claim that microfinance programs does not reach the poorest of the poor or that the poorest are excluded from the programs. This could be the case if the so-called core poor (the poorest of the poor) are too uncertain and/or fear to borrow or because they are excluded from group lending programs by other participants or staff members of MFIs because of their risk. Hermes and Lensink also point out that the core poor benefit to a limited extent of program participation, because they are too risk averse to borrow for future investments. Weiss and Montgomery (2005) share this notion that the core poor benefit to a limited extent of microfinance schemes and mainly borrow for protection, given their low and irregular income.

According to Hermes and Lensink (2011) the way credit contracts are set up may also lead to the exclusion of the core poor. The joint liability contracts and group meetings are means to prevent moral hazard and adverse selection issues and make microcredit contracts work, but there is a downside. Rutherford (2000) and Morduch (1999) argue that borrowers must repay loans in weekly installments beginning directly after entering a contract. This contract structure means that payments have to be done, before the investment results in profit. This implies that the early installments have to be made by other income, such as wage work or savings. This also means that the very poor households, who don't have savings or little income, will be excluded from these contracts.

Critics doubt whether access to financial services has a positive impact on women. The critics argue that often women are forced to hand over the loan to men, who use the loan for their own purposes, which may lead to an additional burden (Hermes and Lensink, 2011). In addition, Dobra and Stiftung (2011) argue that the lack of correlation between microfinance and empowerment is related to female wages and lack of participation. A study of the Grameen bank by Morduch (1999) shows this issue where 95 percent of the borrowers are female, but according to the results of this study only 37 percent of the female borrowers seem to have control over loan use. These findings are also in line with the findings of

Anderson and Baland (2002) who argue based on evidence from Kenya that the commonly used argument for difficulties with saving is having disagreements with husbands.

Woolcock (1999) and Morduch (1999) argue that there are almost no studies which provide comparable and reliable evidence of the impact of programs on incomes, occupations or loan uses of clients. The research methods used to measure the impact of microfinance services on poverty reduction are also being questioned. A few studies tried to measure the impact of microfinance by comparing recipients of microfinance with a control group that has no access to microfinance. This is a costly activity, but may be also unreliable. Results of a study can be influenced by external factors instead of influenced by the microfinance program. The possibility exist that determined results are place related instead of related to the program, which means it may not occur in other environments (Hermes and Lensink, 2011; Morduch, 1999). Also, comparing subsidized programs with sustainable programs seems unreliable since subsidized programs tend to serve much poorer clients than those in sustainable programs. Sustainable programs may have advantages in achieving scale, while subsidized programs appear to have advantages in outreach. (Murdoch, 1999). Hermes and Lensink (2011) discuss in their work the problems with published evidence of showing mixed results. Hereby, they refer to the study of Pitt and Khandker (1998) who found positive impact of access to microfinance by (female) participants, while Roodman and Morduch (2009) showed that the instrumentation strategy may have failed and that results may be driven by left out variables or reverse causation problems. They also point out that some issues due to research results can be prevented by running repeated experiments, but this is very costly, time consuming and leading journals are not inclined to publish these types of research.

Another commonly used argument against microfinance is the notion that nearly all programs are substantially subsidized. Especially the programs with explicitly social objectives are dependent of these subsidies. Besides the issue that subsidized credit programs hardly survive on the long run, the issue also arises about uncertainty how long the subsidies will be received. Most programs which depend on subsidies are government run, which can lead to misuse of these subsidies by provision to better off people. The problem is that sustainable programs can function without government involvement, while subsidized programs cannot (Hermes and Lensink, 2011; Morduch, 1999). It has been acknowledged that saving devices are an important tool to mobilize the poor. Subsidized programs seem to have difficulties with this, since maintaining deposits can be expensive for programs and programs have little incentive to mobilize deposits if capital can be obtained by donors (Morduch, 1999).

According to a survey in the Microbanking Bulletin (1998) only 70 percent of the full costs are being covered by programs that target the poorest borrowers. Morduch (1999) and Hermes and Lensink (2011) even points out that some experts estimate that no more than 1-2 percent of all MFIs worldwide are financially sustainable, 8 percent of all MFIs are close to being profitable and perhaps 5 percent of NGO programs will ever become sustainable. The remaining group of approximately 70 percent of all organizations will precede requiring subsidies because the costs are too high or because the programs choose to keep costs low instead of passing it to their clients. The study by Cull, Demirguc-Kunt and Morduch (2007) provides evidence for a trade-off between sustainability and outreach. The results show that MFIs who mainly provide individual loans have less poor borrowers and female borrowers in the loan portfolio than institutions that mainly provide group loans, but the first group of MFIs is more profitable.

Morduch (1999) also notes the difficulties with accessing commercial finance. The same problem occurs as the problem to the poor borrower who wants access to formal banking services. Since a microfinance program lacks collateral to back its portfolio and can't assure creditworthiness, it will have difficulties accessing commercial credit (Woolcock, 1999). Hulme and Thankom (2011) describe another issue with commercialization, namely commercialization of microcredit could lead to a higher pressure to push the financial performance of staff members. They argue that this could result in overprovision of loans to households, which in turn leads to payment difficulties of households.

The last point which has to be addressed is the discussion about charging high interest rates. According to the work of Morduch (1999) a commonly made argument is that microfinance programs can charge high rates, because local lenders also do this. He argues that this is an empirical issue which needs to be researched in the future. Hulme and Thankom (2011) corroborate this by arguing that interest rates of local microcredit loans in Southeast Asia, Africa and Latin America equal 50 to 120 percent APR. In contrast, Weiss and Montgomery (2005) mention that most microfinance schemes charge close to market-clearing interest rates and it may be the case that these rates are unaffordable to the core poor. So by not be able to afford these rates, it could be that the core poor not take up the service or take it up and get into repayment issues

This section has focused on the literature about the negative aspects of microfinance. There is little conformity about the negative aspects, since a great variety of negative effects are being named, but little is proven. The next section will discuss the findings in the literature to find an answer on the research question.

4. Analysis

Several aspects of microfinance have been viewed in the previous section to find an answer on the research question. According to the viewed literature existing on the benefits and disadvantages of microfinance I could say that still more field research is needed to define the true impact. Notable is the large quantity of literature which is based on other existing research, but regrettably little empirical literature exist which would give more insight to the practical process.

The conception that microfinance reaches the poor, so all types of poor households are being reached, should be dropped. As the literature has shown, microfinance may have a positive impact on those who have access to these financial services, but in most cases the ones who have access don't belong to the 'core' poor, the poorest of the poor people. Besides, MFIs in Latin America seem not to focus on poverty alleviation, but on economic development of micro enterprises.

The reviewed literature does show that there is a great need for financial services, especially saving and insurance devices. The findings of Anderson and Balland (2002) and Gugerty (2007) confirm that saving services have a positive impact on women viewing the fact that programs give them grip and support, but also sense of safety and assurance.

Further, the sustainability versus outreach debate is a difficult one. Sustainable MFIs mean less people will be provided and the less poor people will have access to funds, while the poverty approach suggest that the needs of the poorest has to be fulfilled at the expense of the sustainability. My opinion is that MFIs should target sustainability so they will be less dependent of subsidies and will be able to provide in the long run also. By being independent choices can be made without external intervention from (local) governments. Morduch (1999) calculated an interest rate of 32 percent that the Grameen bank should charge to become sustainable. This does not imply immediately that borrowers will get repayment issues, viewing the fact that local lenders charge higher rates. Thus, commercialization of microfinance will have positive effects on the sustainability, but could have strong negative impact on the impact and outreach of projects. According to Weiss and Montgomery (2005) less than 10 percent of the MFIs in Latin America are targeting very poor clients, while this is less than 50 percent in Asia. It could be the case by focusing more on sustainability that these numbers will decrease substantially. In case of financial viability subsidies could be used as a backup or support for programs, but not as fuel like in most cases now. Research and empirical evidence have to show what the impacts will be during this process of commercialization. Another point of attention is the possibility of overprovision of low-income households, which in turn leads to repayment difficulties. Commercialization of the sector could lead to pressure or incentives to achieve financial targets. These issues should be prevented by monitoring and evaluating performances and keeping an eye on default rates.

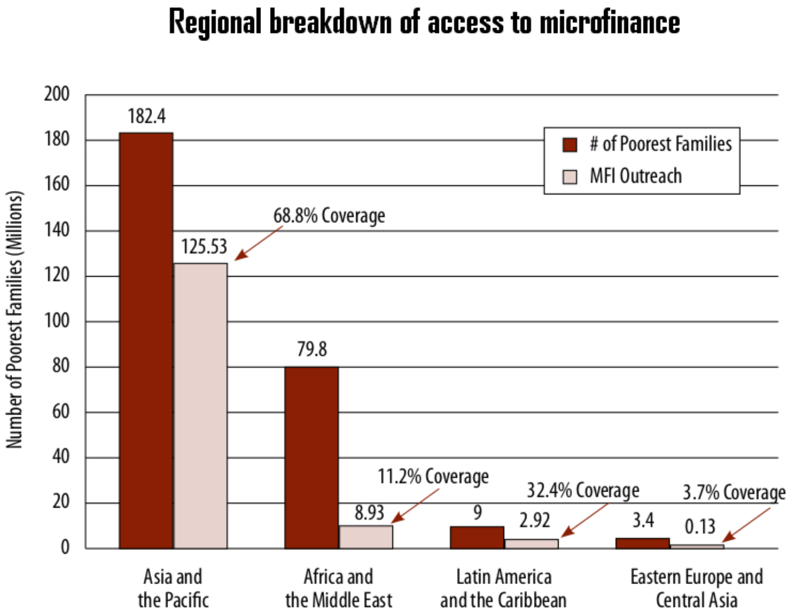

Figure 3 shows the relationship between the number of families living in absolute poverty in each region and the number of poorest families reported that were reached with a microloan in each region at the end of 2010

Source: State of the Microcredit Summit Campaign report 2012

The issues with the core poor have been recognized by several MFIs and programs have been set up to serve this type of client. I suggest this should be enhanced and programs should be adjusted to the environment of the target group. Stories of exclusion of people based on caste for example are quite common in South-Asia and for these types of groups approaches have to be different. It's almost impossible to change attitudes of these societies, so it's easier to respond on certain beliefs and needs. Most of the flaws of microfinance seem to be related to the 'core' poor, so adjusting programs to the needs and possibilities of these people would improve the impact.

Next, the idea that charging subsidized interest rates is the only way of reaching the poor should be dropped too. Microfinance should be about providing credit not providing cheap credit. Rutherford (2000) describes the case of a deposit collector who keeps savings from her customers each day and returning this after a certain period. This collector charged a fee of approximately 30 percent on an annual basis. This case shows that even the low income households are willing to pay for these services. Since there is no direct evidence that this is the case with every low-income household, research is more needed and maybe even adjusted programs for the core poor.

A point of attention is the lack of support and education to MFI members. Judging on the read case studies, it seems that MFIs and NGOs are basically focusing on providing and maintaining services. This is self-evident noting the goals of the institutions, but I wonder if performance could be improved if members would be more supported and guided. Usually staff- members are engaged with keeping the daily pursuits on track, so saddling them up with an extra task would be costly and maybe even impossible. Providing educational programs could stimulate women and/or take away prejudices or fears. This is mostly applicable on MFIs who are plying the poverty approach, since the most issues appear in that domain according to the literature. Since these MFIs are hardly sustainable and depend on subsidies, providing additional education and support should be on voluntary base.

In case of microcredit, clients get access to a loan which they have to repay on time and by repaying on time they assure themselves of accessing a larger loan in the future. The question is what the duration will be of this process. Will clients borrow and save themselves out of poverty? Or will they reach a certain point in time, where an additional loan will not make a difference anymore? If this is the case, where marginal returns are diminishing, new measures or new steps have to be taken. This suggests that empirical evidence is needed to come up with new developments and if new roads will be taken, clients will need support and guidance.

Many view the crisis in Andhra Pradesh (India) as a result triggered by the Indian government. The government provided a ‘free pass’ to micro lenders, by telling them not to repay because of the high suicide numbers and the whole situation turned into a political crisis. I share the opinion that most of the shortcomings of microfinance programs are due to weak political support. The impact and outreach of microfinance could be substantially improved if the political debate towards poverty alleviation would change more in favor of the poor.

This section discussed the results of the previous two chapters. According to the literature, large improvements have to be made and can be made. The results provided by the literature are mixed, so that determining a clear view is difficult. Little empirical evidence has shown the positive effects of microfinance the positive effects as a recovery tool by natural disasters or the increase in financial responsibility of women. On the other hand, the existing literature also contains a variety of failure cases of microfinance. More evidence and research has to show the true impact of microfinance.

5. Conclusion

The main question of this thesis is whether the possibility exist to safe the hopes of microfinance. The results of the previous chapters show that little can be stated, noting the fact that results are contradictory. Well drawn studies are too costly, so advocates and critics mainly base their opinion on theories and the outcomes of the few studies which were conducted. Thus, little can be said about the true impact, except the success and failure stories which are commonly used of both parties. Even without confirming evidence about the impact, much can be said about enhancing microfinance. Microfinance providers should try not to lose social perspectives by providing well-designed programs, prevent over-indebtedness, afford prices which are affordable to clients and allow institutions to be sustainable, are non-discriminating and keep innovating.

The results are not suggesting that microfinance doesn't work, they simply suggesting that there is not enough evidence available to generalize certain results and to claim that is does work (or not). Fortunately, there are enough cases which show success and for that, innovating new concepts is valuable. Studies like the study of Becchetti and Castriota are an example of the possibilities which can be explored to make use of microfinance for other purposes than entrepreneurial goals.

Those who think that microfinance is a mean to eliminate poverty are incorrect. Microfinance is a mean to give low- income households possibilities to help themselves to better circumstances. It's not a panacea which will solve all problems; it simply provides a way out of certain issues which are related to poverty. Microfinance doesn't need to be saved, viewing the fact that the literature contains enough success stories. It does need a renewed look, so that the concept and the flaws can be improved and innovative approaches can be developed.

6. References

Articles

Anderson, S. and J.M. Baland (2002) The Economics of Roscas and Intrahousehold Resource Allocation, *The Quarterly Journal of Economics*, vol. 117 no.3, p. 963-995

Anderson, S., J.M. Baland and K.O. Moene (2009) Enforcement in informal saving groups, *Journal of Development Economics 90,* p 14-23

Armendáriz de Aghion, B. and J. Morduch (2000) Microfinance beyond group lending, Economics of Transition, Vol. 8, p. 401-420

Bauer, M., J. Chytilova and J. Morduch (2010) Behavioral Foundations of Microcredit:Experimental and Survey Evidence from Rural India, *IZA Discussion paper No. 4901*, april 2010.

Calomiris, C.W. and I. Rajaraman (1998) *Journal of Development Economics vol. 56*, p. 207-216

Dobra, A. and F.E. Stiftung (2011) Microfinance: Champion in Poverty Alleviation and Failure in Female Empowerment, *MPRA Paper No. 32413*, july 2011

Gugerty, M.K. (2007) You can't save alone: Commitment in Rotating Savings and Credit Associations in Kenya, *Economic Development and Cultural Change 55*, p 251-282

Hulme, D (2000) Is microdebt good for poor people? A note on the dark side of microfinance, *Small Enterprise Development Vol. 11 No. 1*, march 2000

Hulme, D. (2000) Impact Assessment Methodologies for Microfinance: Theory, Experience and Better Practice, *World Development Vol. 28, No. 1*, p 79-98

Hulme, D. and A.Thankom (2011) What's wrong and right with microfinance - missing an angle on responsible finance?, BWPI Working Paper 155

Klonner, S. (2008) Private information and altruism in bidding roscas, *The Economic Journal*, p 775-800

Maes, J.P. and L.R. Reed (2012) State of the Microcredit Summit Campaign, *Microcredit Summit Campaign*

Morduch, J. (1999)The role of subsidies in microfinance: evidence from the Grameen Bank, *Journal of Development Economics vol.60*, p 229-248

Morduch, J. (1999) The microfinance promise, *Journal of Economic Literature*, vol. 37 no.4, p 1569-1614

Morduch, J. (2000) The Microfinance Schism, *World Development Vol. 28,* No. 4, p 617-629

Rajendran, K. and R.P. Raya (2011) Microfinance: Problems and Contraints in Vellore District, Tamil Nadu, India, *J Economics, 2(2),* p 109-114

Schreiner, M. (2002) Aspects of outreach: A framework for discussion of the social benefits of microfinance, *Journal of International Development 14,* p 591-603.

Weiss, J. and H. Montgomery (2005) Great Expectations: Microfinance and Poverty Reduction in Asia and Latin-America, *Oxford Development Studies*, 33:3-4, p 391-416

Woolcock, M.J.V. (1999) Learning from Failures in Microfinance: What Unsuccessful Cases Tell us About How Group-Based Programs Work, *American Journal of Economics and Sociology, Vol. 58 No. 1*, januari 1999

Books

Armendáriz, B. and J. Morduch. *The economics of Microfinance 2nd edition* (2010) Cambridge: The MIT Press

La Torre, M. and G.A. Vento. *Microfinance* (2006) Hampshire: Palgrave Macmillan

Rutherford, S. *The poor and their money* (2000) New Delhi: Oxford University Press

Kamewe, H. and A. Koning. *The provision of microfinance services by savings banks* (2005) World Savings Banks Institute and European Savings Banks Group