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Impact of Microfinance: Towards Achieving Poverty Alleviation?

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Abstract: Poverty is a threat to peace and results in denial of all human rights. Microfinance spread across the globe as a means to alleviate poverty in the early seventies, invented by Bangladeshi Economist Professor Muhammad Yunus. Despite its significant contribution to help the poor worldwide, the impact of microfinance in alleviating poverty is always in question. To evaluate this prevailing issue, this study explores the linkage between microfinance and poverty alleviation and also examines the impact of microfinance on poverty alleviation. Drawing on an empirical case study, this study examines how far microfinance institution plays important role in alleviating poverty in Bangladesh. Though there are some problems regarding its operation, based on our research findings, the study concludes that microfinance can make meaningful contribution to alleviate poverty for rural people. The study also suggests that this organization needs to look more seriously at the diversified needs of the poor people and target the extremely poor.

Key words: Microfinance, Microfinance Institutions (MFIs), poverty alleviation, Non-Government Organisations (NGOs), Millennium Development Goals (MDGs), United Nations (UN)

INTRODUCTION

The world's income distribution is very revealing. Ninety four percent of the world income goes to 40% of the population, while 61% of people live on only 6% of the world income. Half of the world population lives on two dollars a day and over one billion people live on less than a dollar a day. This is not a formula for peace. Microfinance, since its inception in early seventies by Bangladeshi Economist Professor Muhammad Yunus (2006) awarded Nobel Peace Prize (2006), has spread across the globe as a means to alleviate poverty and develop micro-entrepreneurs (Lashley, 2004). Despite its recognition by world-wide and contribution to help poor people to get out of poverty (Khandaker, 2005), there exits different views on the impact of microfinance regarding poverty alleviation. That's why, the aim of the study is to explore how far microfinance institution is contributing to poverty alleviation in Bangladesh.

Microfinance and poverty alleviation: A theoretical overview

What is microfinance?: Microfinance (MF) has become a buzzword among the development practitioners. The term "microfinance" means providing very poor families with very small loans (microcredit) to help them engage in productive activities or develops their tiny businesses (The Microfinance Gateway, 2008). According to the Consultative Group to Assist the Poor (CGAP), Microfinance is the supply of loans, savings and other basic financial services to the poor, including working capital loans, consumer credit, pensions, insurance and money transfer services. Similarly, Hossain (2002) defines MF as, the practice of offering small, collateral-free loans to members of cooperatives who otherwise would not have access to the capital necessary to begin small business or other income generating activities.

The term 'microfinance' is also often used in a much narrower sense, referring principally to microcredit for tiny informal businesses of micro-entrepreneurs, delivered using methods developed since 1980 mainly by socially-oriented Non-Government Organisations (NGOs) (Christen *et al*., 2003).

Microfinance Institutions (MFIs): A microfinance institution is an organization that offers financial services to low income populations. The term microfinance institution has come to refer to a wide range of organizations dedicated to providing these services, for example, NGOs, credit unions, cooperatives, private commercial banks and non-bank financial institutions and parts of state-owned banks.

NGOs and other non-bank financial institutions have led the way in developing workable credit methodologies for the poor and reaching out to large numbers of them. Throughout the 1980s and 1990s, they have shown that the poor repay their loans and are willing and able to pay interest rates that cover the costs of providing the loans. Moreover, financial services for the poor have proved to be a powerful instrument for poverty alleviation, as they enable the poor to build assets, increase incomes and reduce their vulnerability to economic stress.

Poverty and poverty alleviation: Before discussing the contribution of microfinance towards poverty alleviation, we need to know what constitutes 'poverty'. At the UN's World Summit on Social Development, the 'Copenhagen Declaration' described poverty as …a condition characterised by severe deprivation of basic human needs, including food, safe drinking water, sanitation facilities, health, shelter, education and information. When people are unable to eat, go to school or have any access to healthcare, then they can be considered to live in poverty, regardless of their income. The Scottish Poverty Information Unit states that, It is relative to the standards of living in a society at a specific time. People live in poverty when they are denied an income sufficient for their material needs and when these circumstances exclude them from taking part in activities which are an accepted part of daily life in that society.

On the other hand, according to the World Bank Organisation, "the most commonly used way to measure poverty is based on incomes. A person is considered poor if his or her income level falls below some minimum level necessary to meet basic needs. This minimum level is usually called the 'poverty line'. What is necessary to satisfy basic needs varies across time and societies. Therefore, poverty lines vary in time and place and each country uses lines which are appropriate to its level of development, societal norms and values. However, Sen (1995 cited in Khawari, 2004) states that the point is not the irrelevance of economic variables such as personal incomes, but their severe inadequacy in measuring many of the casual influences on the quality of life and survival chances of people. It is possible to infer from this that an inadequate or inconsistent income level generates poverty; hereby depriving people of some basic human needs (Khawari, 2004).

MATERIALS AND METHODS

The author has conducted a research questionnaire survey as part of the study. Grameen Bank is a unique financial institution in Bangladesh and its head office is located in Dhaka. It works to fight against poverty by creating large-scale, poverty-focused and sustainable MFIs. An interview has been carried out on a small number of clients. Around 20 borrowers were interviewed from 2 villages of Dinajpur District. This survey research has examined the impact of microfinance from borrowers' perspectives and has helped us get a broader view of the issue. The main objective of the survey has been to examine how far Grameen Bank has achieved alleviating poverty by using microfinance programmes in Bangladesh. Although the sample size was low, the survey still provides some very useful results that contribute to our debate about whether microfinance reduces poverty.

A critical analysis on microfinance and poverty alleviation

Linkage between microfinance and poverty alleviation: The first and foremost objective of microfinance has been outlined as being poverty alleviation. It is generally believed that microfinance programmes will raise incomes and broaden financial markets by principally providing credit, among other services, to small-scale entrepreneurs (Aghion and Morduch, 2000). That's why, development NGOs and other social organizations have adopted microfinance programmes as a core component in their development interventions in several countries in Africa, Asia, Latin America and elsewhere (Hossain and Rahman, 2001). So, microfinance is a tool used to improve the quality of life of people with limited access to permanent financing. There is an almost global consensus now that microcredit to the poor with a view to achieving equitable and sustainable gains is the key element for economic and social development in the twenty-first century (Mayoux, 1999).

Positive and negative effects of microfinance: For decades microfinance has been playing an extensive and far-reaching role for poor people in the less developed countries. Widespread evidence from research around the world has proved that microfinance is an effective and innovative tool for alleviating poverty (Simanowitz *et al.*, 2000). The UN Secretary General calls it "a critical anti-poverty tool for the poorest, especially women" (Datta, 2004).

The MFIs and other MF providers have expanded their outreach from a few thousand clients in the 1970s to over 10 million in the late 1990s. The poor, especially the women, have emerged as creditworthy clients, enabling MF service delivery at low transaction costs without relying on physical collateral. It has strengthened the social and human capital of the poor, particularly women, at the household, enterprise and community level. The expansion of the outreach of savings services has a potentially significant impact on both institutional sustainability and poverty alleviation (Sharma, 2001).

Microfinance can be used for various purposes based on the priority of needs and thus productive opportunities can be made available to generate income. Evidence suggests that microfinance increases the capacity to deal with the risky situations which previously forced poor people to sell their productive assets i.e., land, livestock etc. It helps to improve the management of consumption requirements over the year in order to maintain adequate levels of food intake (Pitt and Khandker, 1998) and increases opportunities to invest in the productive enterprises (Moll, 2005). The following figure shows the overall position of MFIs in the rural financial market.

Figure 1 illustrates that the population in the lowest income quintile has a demand for savings accounts and short-term credit. Microfinance institutions focus on the low-income households in rural areas and offer savings services and short-term loans. The implication is that successful MFIs will gradually increase their share of the population by offering a range of services over time (Moll, 2005). Similarly, evidence from panel data conducted by Khandker (2005) suggests that the microfinance participants not only increase their consumption level but also escape poverty. Again, micro-credit has proved to be an important liberating force in societies where women in particular have to struggle against repressive social and economic conditions. However, there is concern that economic growth and political democracy cannot achieve their full potential unless the female half of the population participates on an equal footing with the male (Nobel Peace Prize, 2006).

Despite its rapid expansion and effectiveness, the following discussion explains why microfinance is ineffective in alleviating poverty extensively.

Empirical studies give strong evidence supporting that, although microcredit has had a positive effect on national development, it has failed to reach the poorest of the poor. Microfinance initiatives have been attacked by heavy criticism regarding high interest rates, exploitation of women, loan repayment, unchanging poverty levels and failure to effectively cater for the target groups (Mallick, 2002). Microcredit alone is not necessarily the best way to help the poorest of the poor (Datta, 2004). This is a result of lack of understanding of the specific nature and characteristics of the rural economy and of different patterns in poverty dynamics (Hasan, 2003; Lashley, 2004). Datta also finds that the extremely poor are excluded from the microcredit programmes by peer screening (i.e., group members are not willing to take an extremely poor for fear that the loans will not be repaid) or self-exclusion (i.e., strict obligations of the organisation such as regular attendance and compulsory savings do not encourage them). Furthermore, many microfinance operators have adopted the attitude that simply providing microfinance services will be an ineffective treatment for development problems, thereby ignoring the specific circumstances of the target population and society in general (Lashley, 2004).

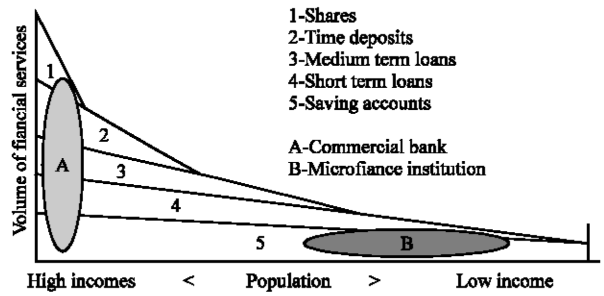

Fig. 1: Formal financial services in the rural financial market: Demand and supply (Moll, 2005)

Lashley's study, based on MFIs in the Caribbean, finds that these three different stakeholders (MFIs, governments and donors) do not work to attain a common goal. In terms of MFIs, achieving poverty reduction through microfinance must be related to identifying the poor and their microfinance needs. But MFIs seek only to encourage microenterprises to grow, thereby acting as a poverty-prevention measure rather than a strictly poverty-alleviating measure. Similarly, Datta (2004) points out that, if the objectives of achieving financial sustainability and serving the poor contradict each other, it is likely that sustainability will be sacrificed.

How far can microfinance contribute to achieving the Millennium Development Goals (MDGs)?: The new millennium began with a great global dream. World leaders gathered at the United Nations in 2000 and set a historic goal to halve poverty by 2015. Never in human history had such a bold goal with specific targets and time limits been adopted by the entire world as one. The goals address income poverty, hunger and disease; lack of education, infrastructure and shelter; gender exclusion and environmental degradation. While the MDGs do not formally set targets for financial sector access, low-income countries cannot achieve them without microfinance. On the other hand, evidence from millions of clients around the world demonstrates that access to financial services enables the poor to increase their household incomes, build assets and reduce their vulnerability. It also translates into better nutrition and improved health outcomes, such as higher immunization rates. It allows poor people to plan for their future and send more of their children to school for longer. It has made female clients more confident and assertive and thus better able to confront gender bias (Littlefield *et al.*, 2003). By emphasizing access to microfinance, the UN Millennium project seeks to focus country strategies and programmes on building inclusive financial sectors that will enable the achievement of the MDGs. Indicating the significance of microfinance, the UN Millennium project (2005) states:

> Microfinance is one of the practical development strategies and approaches that should be implemented and supported to attain the bold ambition of reducing world poverty by half.

Lack of financial support creates multiple problems, such as poverty, disease and these are interrelated. But, if the poor people are given easy access to microfinance, they are able to know how to manage and increase their assets. Microfinance has multiple effects through which it can meet the multiple needs of the poor (Littlefield *et al*., 2003).

By contrast, some argue that microfinance alone is a rather blunt tool in achieving the MDGs. It only partially relates to the MDG goal number one- "eliminate extreme poverty"-and number three-"gender equality and women's empowerment". Poverty and inequality are complex phenomena. Access to finance will not cure these, unless microfinance finds its proper place within a synergistic web of interventions. Again, microfinance programmes are only able to reach <5% of the world's one billion poor people. There is no guarantee that they are really serving the poorest, who are the main focus of the MDGs. For this reason, it is difficult to capture reliable data proving that microfinance helps to achieve the Millennium Development Goals. However, theoretical studies strongly suggest the contribution of microfinance towards poverty alleviation.

Context: Microfinance and poverty reduction in Grameen Bank, Bangladesh

About Grameen Bank: Grameen Bank is a microfinance organization, started in Bangladesh, that gives out small loans (known as microcredit) to the impoverished without requiring collateral. The system is based on the idea that the poor have skills that are under-utilized. Grameen Bank (GB) provides credit to the poorest of the poor in rural Bangladesh. Credit is a cost-effective weapon to fight poverty and it serves as a catalyst in the overall development of the socio-economic conditions for the poor, who have been kept outside the banking orbit on the grounds that they are poor and hence not bankable. GB is a specialised bank established in October 1983 as a corporate body under the Grameen Bank Ordinance 1983. The organization and its founder, Muhammad Yunus, were jointly awarded the Nobel Peace Prize (2006).

Grameen Bank: A model of microfinance: In 1974, Professor Yunus started his journey with a great vision but very few resources (US $ 27) in a very difficult period, just after the independence of Bangladesh in 1971. He challenged the formal banking system and initially launched his $ 27 project in the village Jobra, next to the Chittagong University, where he was teaching as the head of rural economy programmes. Striving against unprecedented obstacles, he was able to create a new bank called 'Grameen Bank' or 'Village Bank' in 1983. Inspired by the success of the Grameen Bank model in Bangladesh, credit programmes have become a much-favoured intervention by the NGOs around the world and are increasingly gaining support from donors and international development agencies (Newaz, 2007).

Grameen Bank and its success: Presently Grameen bank offers loans to approximately seven million people, 97% of whom are women, in 73,000 villages in Bangladesh. GB gives collateral-free income generating, housing, student and micro-enterprise loans to the poor families and offers a host of attractive savings, pension funds and insurance products for its members. Since 1984, housing loans have been used to construct 640,000 houses. The legal owners of these houses are the women themselves. Its latest project, the Grameen beggar project, offers interest-free loans to beggars without any conditions and thus aims to reach the extremely poor. Around 5,000 of them have already stopped begging completely. The total loan disbursed amount to US $ 6.0 billion with a repayment rate of 99%. GB is self-reliant and has not taken donor money since 1995. The bank's internal survey disclosed that 58% of the borrowers crossed the poverty line. In the Nobel honorary reception, Professor Yunus comments:

> I firmly believe that we can create a poverty-free world if we collectively believe in it. In a poverty-free world, the only place you would able to see poverty is in the poverty museums.

The Norwegian Nobel Committee 2006 believe that Professor Yunus and his Grameen bank developed microcredit into an ever more important instrument in the struggle against poverty. The bank's success offers many lessons for policy makers and development managers to learn in the field of rural credit for the poor (Yaron, 1992). The large workforce, comprising 18,795 employees in 2,226 branches and its high recovery rate are the reasons behind the success of the bank (Jain, 1996).

RESULTS AND DISCUSSION

All the clients interviewed were women. Serving women is one of the main objectives of microfinance since generally women are disadvantaged and poorer around the world compared with men (Khawari, 2004). The range of loan size varied depending on their needs. Some of the participants profile is shown in the following Table 1. This small amount of money creates lots of income opportunities in the rural area.

Reducing poverty through income generation: Microfinance reduces poverty through enterprise development and financial services for use in a household's income generation. Generally when poor people get financial resources, like credit, they start to use their skills and they know very well how to get involved in income-generating activities in the adverse environment of rural areas. They can invest in income-generating activities like poultry-breeding, embroidering, cultivating vegetables, weaving and running fisheries. The following Fig. 2 shows the percentage of income generating activities involved by the clients.

One of the client's comments:

> I used to work hard before at home but could not earn money. Now I have a cow and I earn money by selling milk. I can manage my family better and I am happy about that.

Microfinance also meets the needs of small and medium-scale producers and businesses (Khandker, 2005). Such short-term investments generate returns in excess of regular repayment and also alleviate poverty by increasing income and consumption level (Zaman, 2000). For example, the bank gives loans to poor women for buying mobile phones to sell phone services in the villages. These "telephone ladies" explore the ropes of the telephone business and earn social respectability as well. Today there are nearly 300,000 "telephone ladies" providing telephone services in all the villages of Bangladesh and generating 19% of the revenue of the company named Grameen Phone.

In particular, microfinance helps empower women to build social capital (i.e., women can share ideas and views with others without any fear) and this benefits the society in general (Gulli and Berger, 1999).

Improving poverty conditions gradually: Borrowers have experienced a significant difference in their lives since the loans were given to them. One of the clients made this comment:

> The radical change has brought us to enjoy a life with difference and having economic stability. As a result of the stability, three times regular meals present us a light to hope to survive in a respectful manner.

They admitted that, in the beginning, they were very confused and scared of taking out loans, did not know

Table 1: Participants profile

Name	Time with GB	Total amount borrowed
Amina Begum	4 years	9,500 Tk
Sukuri	2 years 4 months	5,800 Tk
Lilifa	3 years 6 months	13,000 Tk
Sahara Khatun	3 years 2 months	8,500 Tk
Hasina	2 years 8 months	20,000 Tk
Jamila	3 years 10 months	10,000 Tk
Mamata Begum	2 years 6 months	15,000 Tk
Tulsirani	3 years 4 months	18,000 Tk
Shirin	2 years	14,000 Tk
Rehana	1 year 3 months	11,000 Tk

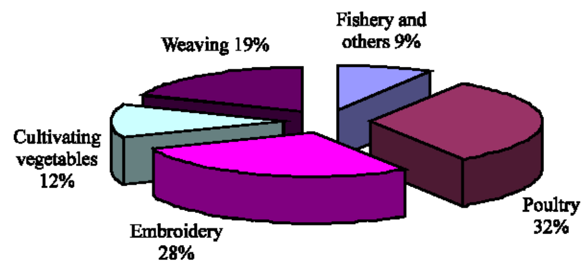

Fig. 2: Income generating activities

how to properly utilise them and pay them back with interest. As the process began, they started working hard and gained confidence, knowing that success can only be achieved by taking initiatives. But after paying off a few instalments, they found it easy to comprehend and not as hard as they imagined in the beginning. Broadly speaking, these households were very idle before taking out a loan and were depending on labour income (the head of the family, generally male, used to work on others' lands as a day labourer). With the help of microcredit, poor households were given hope and the possibility to improve their lives through their own labour (Morduch, 1999). Some of the participants claimed that microcredit helped their housing conditions (Zaman, 2000). They used to live in mud houses, but now they live in houses made of tin plate. Some of the loanees said that in the pre-GB days, they only had one tattered sari; now they possess three/four saris in good condition.

Apart from that, GB also looks at the second generation and encourages women borrowers to send their children to school. Many of these children made it to the top of their class. That's why GB introduced scholarships for talented students; 30,000 scholarships are now given each year. It is thus trying to create a completely new generation that will be well-equipped to save their families from poverty.

Increasing confidence in microfinance: Participants state that their confidence level has been growing gradually since they participated in micro-credit programmes. Their loan-taking behaviour increases if previous loans are paid and eventually they have the tendency to invest in larger and more profitable sectors to generate more revenue. Furthermore, they are presently trading in local rural markets with a low profit margin. However, if the same products are traded in urban market via local traders, the profit margin will be approximately doubled. When they become financially solvent, they will be eligible to take out bigger loans from formal financial institutions, like government or private commercial banks, to invest in large scale trading (Moll, 2005).

Increasing women's participation: In an orthodox Muslim society like Bangladesh, women historically have been harassed by many social ills, such as early marriage and excessive child-bearing, as well as illiteracy and unemployment. The most remarkable achievement of GB is that it has revolutionized the rural people's attitude towards women and work. Even today, women make up only 9.1% of the aggregate labour force in Bangladesh. However, GB has proved to be one of the most successful attempts to involve women in economic activities (Wahid, 1994).

Skill-based counselling: Depending on the situation and the nature of the activities, GB skilled staff sometimes provides assistance in the form of advising and counselling. They also provide comprehensive investment counselling and close supervision over borrowers' entrepreneurial activities, so that the borrowers can make the most productive use of the loans and succeed in their business ventures (Wahid, 1994). Similarly Khandker (2005), states that assistance through counselling is essential, as it is related to the business skills necessary for small entrepreneurs to increase productivity and also raises awareness among borrowers which empowers them. Someone comments:

> Now every week the field workers tell us about important issues of health, family planning, nutrition, education, our rights, etc and we can talk about these with other people.

Maintaining regular payments is somehow troublesome: The results indicate that the major problem is the weekly payment. Sometimes it is very difficult for the borrowers to maintain regular payments due to the ups and downs of their income level, which literally puts pressure on them. A financial penalty is imposed if they are not able to make the payment regularly. They believe that strict instalment methods that lead to unexpected penalty charges sometimes add to the burden. The empirical evidence from Zaman (2000) also suggests that small loans offered to the poor beyond general microcredit and used for non-investment purposes, such as repaying the existing burden, can make a significant impact on poverty. Participants also believe that if there is financial help or a flexible option for late payment and penalties are withdrawn, that would have a positive effect on their motivational level. They frequently face adverse situations where more financial assistance would help to overcome a recession period.

CONCLUSION

Based on the above discussion, it is proved that microfinance is an innovative step forward in the alleviation of poverty. It helps poor people to use and develop their skills and enables them to earn money through micro-enterprises, smooth their consumption level, manage unexpected risks, build assets, educate their children and have a better quality of life. Microfinance is also a crucial tool for achieving the MDGs, whose main objective is to halve poverty by 2015.

Moreover, the results from the questionnaire survey suggest that microfinance is an effective tool for alleviating poverty, particularly in the remote rural areas where poor people have no access to financial institutions and rely on informal finance. However, results also indicate that GB must fully understand the needs and demands of the poor to extensively contribute towards poverty alleviation. Finally, it can be concluded that MF play an important role in poverty alleviation and its economic and social benefits are large. Now, the challenge is to encourage good practice in MF operations and increase the outreach to the poor on a sustainable basis.

RECOMMENDATIONS

Poverty is dynamic, poor people are vulnerable to natural disasters and other unexpected situations in a country like Bangladesh. The organisation needs to consider the poor in such adverse situations and assist them financially.

- If the poor cannot repay the loan, there should be some penalties other than financial ones because they are already short of enough money to repay the loan and this would ultimately put them in a more vulnerable position
- The success of GB, to a large extent, depends upon the availability, dedication and loyalty of field-level workers. However, this degree of dedication may not continue for long, unless there is some improvement in the incentive structure. Thus, there is certainly a need for instituting higher levels of incentives and a promotion scheme for the workers. It could also use some of the funds available from the recent increase in the bank's interest rates to satisfy the workers

- If the organisation's main objective is poverty alleviation, then it needs to look more seriously at the diversified needs of the poor people and target the extremely poor

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