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About Microfinance

This page is my final project for Economics/Sociology 5808 at Fordham University, June 2012.

For this project I took the existing Kiva "About Microfinance" page and updated it with the latest research as of June 2012. The page design and layout - including development photos, wikipedia maps and the about microfinance Youtube video (basically anything that links back to the real Kiva page) - are from Kiva.org, and are not mine.

What I did do was update all of the text to better reflect current debates over microfinance while adding additional tables, graphs and figures. In the process, the explanation of microfinace presented here becomes significantly more technical as the page progresses and is more in depth than what Kiva initially produced for a mass market audience less familiar with the issue. The key ideas are explained early on, with the technicalities and the deeper academic research presented towards the end. The tables and evidence become a bit technical, but I hope this updated summary is both useful and constructive. All of my sources are linked directly in the text, and are also presented at the bottom of the page in the Additional Resources section.

This page and its original content are NOT sanctioned by, supported by, or in any other way representative of, or related to, the views of Kiva. This is soley an academic project and done wholly without Kiva's knowledge or consent. That said, thank you to Kiva for all the good work.

Kevin Lynch, Fordham University, June 2012

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I. Overview

What is Microfinance?

Florinda Agustina Garcia Lopez sells aprons in Guatemala. She takes out micro-loans to grow her business and hopes to provide improved living conditions for her children.

Microfinance, in its most traditional and popularly-understood form, is the provision of banking services to the very poor, primarily women, who are outside the range of conventional financial markets. Initially the focus was on the dispersal of microloans to provide increased capital to minor entrepreneurial efforts and small home businesses, but microfinance has since grown to encompass all areas of traditional financial services to the underbanked such as savings and insurance.

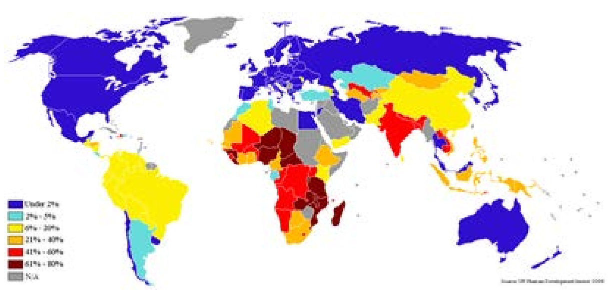
To borrow from an article in Armendáriz and Labie's Handbook of Microfinance (2011) written by Karlan and Goldberg, titled Microfinance Evaluation Strategies: Notes on Methodology and Findings, microfinance for loans is "the provision of small-scale financial services to people who lack access to traditional banking servies," characterized by the following nine loosely shared aspects (page 21):

- Focus on small transactions and minimum balances.
- Loans intended for entrepreneurial activity.
- Loans dispersed without collateral guarantees.
- Lenders employ group lending strategies.
- Efforts focused on poor clients.
- Efforts focused on female clients.
- Application and enrollment services are kept simple.
- The services are provided to underserved and underbanked communities.
- The loans are administered with market-rate interest rates.

While not all necessary, the above are generally accepted as the basis for microfinance, specifically microloans.

For a basic summary of the issues and controversies surrounding microfinance, this PBS NOW Documentary from 2007 provides a helpful overview.

The History of Modern Microfinance



Percentage of Population living on less than $1 a day (http://wikipedia.org)

While the goals and objectives of microfinance have changed over the years, the initial movement is most popularly characterized by the early efforts of Muhammad Yunus and the Grameen Bank of Bangladesh. As Pitt and Khandker explain, "the Grameen Bank of Bangladesh is perhaps the best known example of these small-scale production credit programs for the poor. The Grameen Bank, founded in 1976 by Muhammad Yunus, an economics professor, provides financing for nonagricultural self-employment activities. By the end of 1994, it had served over 2 million borrowers, of whom 94 percent were women. With loan recovery rates of over 90 percent, the Grameen Bank has been touted as among the most successful credit programs for the poor, and its model for group lending has been used for delivering credit in over 40 countries."(Pitt and Khandker 1998, pg.959)

Yunus' goal was not of profit making, but to provide relief to the desperately poor. Grameen focused on the poorest rural households of those owning less than half an acre of land and invited them to form groups that would share the responsibility of receiving and repaying a small loan meant for entrepreneurial investment. The groups, primarily women, were responsible for policing payment themselves and met weekly with representatives from the bank and would also contribute to a small savings account that went towards the repayment of the loan. Upon repayment another larger loan would be made available.(Collins, Morduch, Rutherford and Ruthven, Portfolios of the Poor chapter 6)

However Grameen and the greater microfinance industry ran in to trouble in the late 1990s. As explained by Collins, Morduch, Rutherford and Ruthven, "Loans were no longer being repaid at the on-time rate of 98 percent that the bank had long advertised: in some areas it had fallen below 75 percent. In 1998 a devastating flood, one of the worst in the country's history, damaged many millions of households and exacerbated Grameen's problems by a further dramatic erosion of loan repayment." (Collins, Morduch, Rutherford and Ruthven Pg 154) As Yunus said, "The system consisted of a set of well-defined standardized rules. No departure from these rules was allowed. Once a borrower fell off the track, she found it very difficult to move back on." (Collins, Morduch, Rutherford and Ruthven Pg 157) Yunus' short-lived political aspirations and alleged mismanagement also damaged the credibility of the industry.

Furthermore, the explosion in popularity of microfinance actually damaged its effectiveness and credibility, and bad press followed. As described in an article by Elisabeth Rhyne in the Huffington Post, the large growth in microfinance in Bangladesh created a situation where borrowers would accept loans from multiple MFIs at the same time and loan officers would sell loans to those indebted to other organizations. The oversaturation of microfinance organizations and the overlending that followed led to the crisis. At the same time, many MFIs brought in private investors and began to mix the goals of social service delivery and corporate profit - usually to their detriment.

Similarly, a New York Times article from 2011 quoted the Prime Minister of Bangladesh, Sheik Hasina Wazed, as saying microlenders were "sucking blood from the poor in the name of poverty alleviation." The Times article also reported that the microfinance industry was growing too quickly, saying "Most borrowers do not appear to be climbing out of poverty, and a sizable minority is getting trapped in a spiral of debt, according to studies and analysts."

However the bank was able to reconfigure, and there are now approximately 20 million microfinance customers in Bangladesh. (Collins, Morduch, Rutherford and Ruthven, pg. 155) To do so it made two major changes. First, it relaxed the repayment requirements and allowed borrowers more flexibility in paying down their loans. They could now prepay or pay larger amounts and were allowed to "top-up" to the original amount when faced with lucrative investment possibilities. This repayment flexibility better matches income flows, it is argued, and the "top-up" feature allowed borrowers to maintain loan access without needing to continually borrow. Grameen also moved away from group lending in response to criticism that it was pitting neighbors against each other. In its second change, the bank made more traditional financial services, such as savings available to their customers.

Though only one MFI, the history of Grameen tracks the general trajectory of many in the microfinance industry from heady, seemingly-endless, opportunity through conflict and back to the more moderated balancing act of being both a provider of social services and a bank.

II. Microfinance Providers
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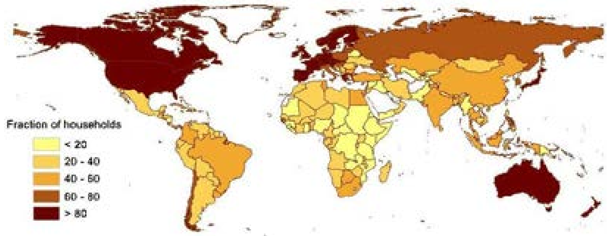
Microfinance Institutions

A microfinance institution (MFI) is an organization that provides microfinance services. MFIs range from small non-profit organizations to large commercial banks.

A list of large and notable MFIs include:

- Grameen
- Accion
- BRAC
- ASA
- SKS
- Compartamos
- Whole Planet Foundation
- Kiva

Why don't banks serve poor people?



World population with access to Finance (http://worldbank.org)

There are several reasons that banks do not service the poor. It is generally assumed that banks cannot profit from providing financial services to the very poor, as the denominations of the transactions would be too low and the associated risk too high. This leads to a paradox described by Alfredo Cuecuecha from El Colegio de Tlaxcala in a June 7 presentation at Fordham University where banks do not open branches in rural areas because they have small economies, and rural areas have small economies because there are no banks.

There have been efforts by credit unions and others to address these underbanked populations and the very high rate of remittance transfers in some regions could create further demand for financial services. According to Cuecuecha, worldwide remittances reached $191 billion in 2008, 50 percent larger than the total foreign aid for developing countries.

However as Cuecuecha explains, credit as a percentage of GDP in Mexico is only 17 percent with 67 percent of all municipalities in Mexico lacking a bank and nearly a third of all adults living in areas with access to a bank. In the rural areas, only 4 percent of municipalities have access to the financial sector.

III. Costs, Interest Rates, and Sustainability
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Interest Rates (They're High)


Sikiratou Salami is from Togo, she took a loan out to purchase supplies for her cosmetics business and plans to use part of her profits to finance the schooling of her three children.

As Armendáriz and Morduch explain in The Economics of Microfinance, the costs to lenders "may not be small, particularly when potential borrowers do not offer seizable collateral, and when legal enforcement mechanisms are weak." (pg. 33) In fact, interest rates must often be quite high - sometimes up to, and even over, 100 percent of the loan value. The recipients of microloans are often the very poor and do not own or have titles to their homes and land that can otherwise be used to secure financing. This lack of collateral would seem to make defaults quite likely and MFIs employ a variety of strategies to help guarantee against the two major problems associated with the lack of borrower collateral: moral hazard and adverse selection. Moral hazard refers to the theory that because the costs are not borne by the borrower (as they have no collateral at stake) they will take undue risks with the money that they would not otherwise accept if their own funds were involved. Adverse selection refers to the theory that people who use a microloan are doing so only because they cannot secure better, more traditional bank financing and are therefore more risky.

Often, these concerns are translated into higher interest rates. To cover the administration costs incurred servicing microloans and to account for the significant risk of default, the interest rates must either be very high, as embodied by the group Compartamos as seen in the PBS NOW Documentary linked above, or the organization must be subsidized in other ways such as NGO or government funding.

Critics such as Muhammad Yunus argue that these high interest rates have created what are effectively development community-sanctioned money-lenders, but others maintain that the market sets the appropriate rates (Armendáriz and Morduch, pg. 32) and the market will accept the high interest rates as these borrowers have few alternative options. Several strategies have attempted to mitigate this inherent risk while simultaneously providing market-level interest rates.

Profitability and Sustainability of MFIs

The strategies for sustainability of microfinance institutions fall into three main categories: group lending, self-financed lending, and subsidized lending. Generally, MFIs must either charge very high interest rates, to the point where the commitment to desirable social goals can become questionable, or they can accept outside subsidy and lend at more reasonable rates.

Group Lending

The group lending strategy, typified by Grameen I, attempts to spread the risk around a pool of borrowers, thereby both lowering the probability of default and softening the financial blow to the firm should an individual fail to repay. It is also expected that the groups will self-police and will keep individuals from becoming delinquent on their loans. The operational costs of administering a larger loan to a group that is then divided is also expected to be lower than writing several individual loans.

Individual, Self-Financed Lending

Some private MFIs, such as Compartamos examined above, forgo the group lending strategies and make loans directly to their customers. This is a more traditional banking model whereby the borrower and financial institution interact directly with each other, just on a smaller scale. While this model avoids the unintended and sometimes vicious consequences of group lending such as intimidation and violence by those in a group against an insolvent peer, the direct lending model has its own drawbacks. Again, the people served by these companies are without assets or equity that can be provided as collateral. In addition to the high default risk, these companies argue that servicing these individual loans among this population is expensive - as do Armendáriz and Morduch, who quote another study, Braverman and Guasch (1989), which estimates that "the administrative costs of handling small loans range from 15 to 40 percent of loan size." (pg. 33) To cover these costs, companies like Compartamos utilize extremely high interest rates that can reach 100 percent of the loan value, according to the PBS documentary. They assure that each borrower is given a structured repayment plan, but the rates are seen by many as excessively high. Some of these organizations, such as Compartamos, are also publicly traded companies - a fact that opens them up to further criticism. These excessively high interest rates seem even more questionable when the company's priority is that of providing shareholders profit rather than social welfare. Critics question whether their loyalty lies with their customers or their shareholders. That large multinational banks have recently showed increased interest in the microcredit industry has only made these critics, such as Muhammad Yunus, more suspicious.

Subsidized

Finally, the providers of subsidized microfinance address the questions of administrative costs and default risk through more traditional aid mechanisms whereby government or NGOs provide credit at low interest rates and use other traditional development funding to cover losses.

While the question of sustainability (and even profitability) of MFIs was once an intense argument, the acceptance of the paradox between profitability and social-responsibility has actually allowed the field to mature. Instead of worrying about whether MFIs can eradicate poverty through entrepreneurialism while simultaneously enriching shareholders, the organizations can focus on the best ways to provide financial services and relief to the extremely poor and underbanked.

In examining the Grameen Bank, Ananya Roy argues in Poverty Capital, Microfinance and the Making of Development that the organization is caught between competing narratives, or the "Bangladesh paradox" (pg. 109) of the "public" and "hidden transcripts". The public transcript of the organization is that access to credit is a human right, and that the extension of microcredit to the very poor is an economically and financially sound strategy that empowers the mostly-female borrowers, while at the same time opening up markets among the "bottom billion" to international, liberalized, trade. Conversely, the "hidden agenda," as Roy says on page 116, is that the organization is less focused on developing free market financial services for the poor than it is on alleviating poverty and providing opportunity for social welfare advances - strategies that put the bank more in line with traditional development policies:

"The "public transcript" of microfinance in Bangladesh, especially that advanced by the Grameen Bank has exalted credit, insisting that credit is a human right. It has also exalted the entrepreneurial talents and capacities of the poor, especially poor women. However, a closer look at the Grameen Bank, as well as at BRAC and ASA, suggests a logic of development to which neither credit nor entrepreneurship are key. It is my contention that the poverty truths of the Bangladesh consensus fit much more comfortably in the "social protection" family of programs and policies than in the "micro-enterprises" family. Such forms of social protection are greatly enhanced and deepened by the human development infrastructure and value chains created by these institutions."

Roy argues, as do others, that while the microloans are not always used in the entrepreneurial spirit in which they are publicly intended, the alternate use of the loans to "smooth dips in consumption and manage vulnerability," (pg. 120) are equally valid and may help families maintain a higher level of consumption and standard of living than otherwise possible.

Whereas Grameen and its imitators follow this model that places ultimate emphasis on the social good the borrowers receive, the Compartamos model more closely follows the structure and goals of a traditional financial services firm - which is to ultimately make money. That their interest rates are significantly higher than that of Grameen (up to 100 percent compared to 15 percent, according to the PBS documentary) is a sign of their fiscal objectives. As a publicly traded company, their ultimate goal is to create profit for their shareholders. This goal then shifts the focus off of those receiving the loans, and moves it onto the more established lenders and providers of aid.

IV. Microfinance Impact and Outcomes
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To Lend, or not to Lend

"Gun Keshari has become a regular borrower of [an MFI] and over time, with the support of small, low-interest loans, Gun Keshari has seen a dramatic improvement in the living standards of her family."
- Polly Banks Kiva Fellow, Nepal

Having taken a look at the history of microfinance and the methods these institutions employ, it is finally necessary to assess whether or not the strategies are effective. This is important not merely as an academic exercise. As has been illustrated, many MFIs enjoy outside subsidizing as a way to continue their lending practices while also focusing on promoting social gains. If microfinance is proven to be an unsuccessful development strategy, then the sector would require serious reassessment as development dollars might be spent better elsewhere.

To help in evaluating the effectiveness of microfinance, four famous studies will be examined. First, an early and influential paper The Impact of Group-Based Credit Programs on Poor Households in Bangladesh: Does the Gender of Participants Matter? by Mark M. Pitt and Shahidur R. Khandker (1998). Second, a rebuttal from Jonathan Morduch titled The Microfinance Promise (1999). Third, a response from Khandker in 2005 Microfinance and Poverty: Evidence Using Panel Data from Bangladesh. And last, another overall criticism by David Roodman and Jonathan Morduch (2009), The Impact of Microcredit on the Poor in Bangladesh: Revisitng the Evidence.

Pitt and Khandker

The most famous and influential aspect of this study was that they found annual household consumption increased by 18 taka for every 100 additional taka borrowed by women credit programs, compared with 11 taka for men. (pg. 958) The paper estimates the impact of microlending on poor men and women, and the impact these loans have on household expenditure, household assets, the labor supply, and levels of schooling.

In addition, the study examines the greater results of participation in microcredit programs and finds significant impact on social and economic measures such as women's and men's labor supply, household education levels, household expenditure, and household assets. These results are seen in their Table 5 (pg. 987), where it is worth noting that the effects are greater in instances where women were the borrowers.

TABLE 5
WALD TEST (χ^2) STATISTICS

	Joint Significance of*			
Outcome Variable	Credit Variables $\chi^2(6)$	Female Credit Variables $\chi^2(3)$	Male Credit Variables $\chi^2(3)$	Equality of Gender-Specific Credit Variables $\chi^2(3)$
Girls' schooling†	10.04	9.28	2.66	.92
Boys' schooling†	26.92	22.21	9.49	2.68
Women's labor supply†	16.23	14.15	.85	8.67
Men's labor supply‡	98.66	53.11	7.65	2.26
Per capita total expenditure‡	22.69	19.03	4.11	3.39
Women's nonland assets†	15.95	8.39	5.12	14.27

* Critical values are $\chi^2(3)_{.10} = 6.25$, $\chi^2(3)_{.05} = 7.82$, $\chi^2(3)_{.01} = 11.34$, $\chi^2(6)_{.10} = 1.64$, $\chi^2(6)_{.05} = 12.59$, and $\chi^2(6)_{.01} = 16.81$.
† Based on WESML-FE estimates.
‡ Based on WESML-LIML-FE estimates.

However they also make allowances for selection bias in their sample saying, "it seems possible that households that are more egalitarian in their treatment of the sexes are more likely to provide additional resources to females, such as providing additional schooling to girls, and also more likely to have female household members participate in credit programs than otherwise identical but less egalitarian households." (pg. 965) So that the groups that accept microloans may already be predisposed towards these increases in personal wealth and education.

Morduch
In The Microfinance Promise (1999) Morduch examines some aspects of microfinance with a more critical eye than others had attempted, arguing that the "'win-win' rhetoric promising poverty alleviation with profits has moved far ahead of the evidence, and even the most fundamental claims remain unsubstantiated." (pg. 1609)

Morduch then explains the reliance of MFIs on subsidies, estimating that as many as 95 percent of institutions would be forced to close without outside funding. To arrive at this conclusion he evaluates the different steps attempted to mitigate the costs of lending and the issues of moral hazard and adverse selection through strategies such as group lending, peer monitoring, dynamic incentives, the decision to focus on women, regular repayment schedules and collateral substitutes.

Finally, he concludes saying, "Some experts estimate that no more than 1 percent of NGO programs worldwide are currently financially sustainable - and perhaps another 5 percent of NGO programs will ever cross the hurdle. The other 95 percent of programs in operation will either fold or continue requiring subsidies, either because their costs are high or because they choose to cap interest rates rather than to pass costs on to their clients. Although subsidies remain integral, donors and practitioners have been reluctant to discuss optimal subsidies to alleviate poverty…instead, rhetoric privileges financial sustainability." (1587) The following (somewhat dated) tables indicate his concern:

TABLE 2
PERFORMANCE INDICATORS OF MICROFINANCE PROGRAMS

	Observations	Average loan balance ($)	Avg. loan as % of GNP per capita	Average operational sustainability	Average financial sustainability
Sustainability					
All microfinance institutions	72	415	34	105	83
Fully sustainable	34	428	39	139	113
Lending method					
Individual lending	30	842	76	120	92
Solidarity groups	20	451	35	103	89
Village bank	22	94	11	91	69
Target Group					
Low end	37	133	13	88	72
Broad	28	564	48	122	100
High end	7	2971	359	121	76
Age					
3 to 6 years	15	301	44	98	84
7 or more years	40	374	27	123	98

Source: Statistical appendix to *MicroBanking Bulletin* (1998). Village banks have a "B" data quality; all others are graded "A". Portfolio at risk is the amount in arrears for 90 days or more as a percentage of the loan portfolio. Averages exclude data for the top and bottom deciles.

TABLE 2 (*Cont.*)

	Avg. return on equity	Avg. percent of portfolio at risk	Avg. percent female clients	Avg. number of active borrowers
Sustainability				
All microfinance institutions	–8.5	3.3	65	9,035
Fully sustainable	9.3	2.6	61	12,926
Lending method				
Individual lending	–5.0	3.1	53	15,226
Solidarity groups	–3.0	4.1	49	7,252
Village bank	–17.4	2.8	92	7,833
Target Group				
Low end	–16.2	3.8	74	7,953
Broad	1.2	3.0	60	12,282
High end	–6.2	1.9	34	1,891
Age				
3 to 6 years	–6.8	2.2	71	9,921
7 or more years	–2.4	4.1	63	16,557

The real concern, he says, is that there had not been suitable experiments to test the effectiveness of the new microfinance strategies. If the organizations had been profitable, then their overall utility for reducing poverty would have been less important, as investors would be happy to receive their returns. However if the industry needs to be subsidized, the development community should be sure that the programs work, and that limited development funds could not be better spent elsewhere.

To this end he retests the Pitt and Khandker (1998) data and finds that his results differ considerably, saying that after limiting the samples to a more accurate and comparable group of households, he finds "no increase in consumption or education (and a slight increase in labor supply) when using the data to measure the impact of program access. However he does corroborate their findings of evidence of consumption smoothing. (pg. 1605)

Khandker

The next reply in the conversation over the effectiveness of microfinance came from Khandker in 2005, who agrees that as MFIs may not be profitable or self-sustaining, it is important to assess their success rates. Ultimately he argues that microfinance does have the capability to reduce poverty through consumption smoothing, marginal returns and consumption, and also has further spillover effects that can even benefit households that do not participate directly. He notes that "total household annual per capita expenditure grew by 30.5 percent over the seven-year period for all households compared with 34.6 percent for program participants," and highlights even more significant gains by women. (pg. 273)

TABLE 5. Marginal Returns to Microfinance Loan Based on Household Fixed-Effects Estimates (taka per 100 taka in borrowing)

Gender and Period	Household Yearly Total Expenditure	Household Yearly Food Expenditure	Household Yearly Nonfood Expenditure
Women's borrowing			
Returns in 1991/92	14.7**	7.1**	8.0**
Returns in 1998/99	20.5**	11.3**	9.2**
Men's borrowing			
Returns in 1991/92	−6.5	−11.8	7.1
Returns in 1998/99	−16.6	−12.9	0.6

**t-statistic is significant at the 5 percent level or better.

Note: Because the estimation equations are in log-log (elasticity) form, marginal returns are calculated using the formula, $dY/dX = \beta(\overline{Y}/\overline{X}$, where $\overline{Y}$ and $\overline{X}$ are sample means of Y (household expenditure) and X (women's credit, for example). Household expenditure figures are obtained by multiplying household per capita expenditure by household size (5.8 for the sample). The return in 1991/92 includes that from current credit only (because in 1991/92 past credit is zero), and the return in 1998/99 includes that from both current (4.2 percent in 1998/99) and past (16.3 percent in 1991/92) credit.

Source: Author's computations based on 1991/92 and 1998/99 household surveys in Bangladesh.

Next he evaluates data on consumption and the poverty line to show that moderate poverty in sample villages declined 17 percent and extreme poverty declined 13 percent, with overall poverty rates falling 20 percentage points between 1991/92 and 1998/99.

TABLE 7. Poverty Status (Headcount) by Program Participation Status and Survey Period

	Moderate Poverty		Extreme Poverty	
Program Participation Status[a]	1991/92	1998/99	1991/92	1998/99
Program villages				
Program participants (targeted)	93.0**	75.5**	57.3**	36.8**
Program participants (mistargeted)	82.3**	57.2**	37.8**	22.9**
All program participants	90.3**	70.1**	52.5**	32.7**
Target nonparticipants	91.1**	72.0**	58.9**	44.0**
Nontarget, nonparticipants	69.8**	50.8**	23.6	19.3
Total	83.7**	65.5**	45.0**	31.4**
Nonprogram villages				
Program participants (targeted)[b]	(89.3)*	79.0*	(60.2)	51.6
Program participants (mistargeted)[b]	(93.0)**	61.2**	(51.4)	32.8
All program participants[b]	(90.8)**	71.6**	(56.6)*	43.8*
Target nonparticipants	87.4	82.9	57.0	51.2
Nontarget, nonparticipants	72.7	53.2	35.5	26.0
Total	80.3**	67.7**	46.6*	38.3*
All villages				
Program participants (targeted)	93.0**	75.8**	57.3**	38.5**
Program participants (mistargeted)	82.3**	57.9**	37.8**	24.7**
All program participants	90.3**	70.3**	52.5**	34.2**
Target nonparticipants	90.2**	75.1**	58.4**	45.5**
Nontarget, nonparticipants	70.5**	50.5**	26.3	20.0
Total	83.1**	65.8**	45.3**	32.6**

*Change in poverty from 1991/92 to 1998/99 is significant at the 10 percent level or better.
**Change in poverty from 1991/92 to 1998/99 is significant at the 5 percent level or better.
[a]Program participation status is based on program placement in 1991/92. By 1998/99 all sample villages that had not had programs in 1991/92 had programs.
[b]There were no program participants in nonprogram villages in 1991/92. Figures in parentheses show headcount in 1991/92 for households in those villages that became program participants in 1998/99 (whose headcount in 1998/99 is shown in next right cell).
Source: Author's computations based on 1991/92 and 1998/99 household surveys in Bangladesh.

Roodman and Morduch

Finally, Roodman and Morduch attempt to replicate the findings of earlier evaluations and respond with criticism towards the Pitt and Khandker 1998, and Khandker 2005 studies. As they say, "After going through a replication exercise - applying the same methods to the same data as in Pitt and Khandker, Morduch, and Khandker… we come to doubt the positive results in all three. With regard to the headline Pitt and Khandker finding, our replication generates results opposite in sign. But we do not conclude that microcredit harms; rather, specification tests suggest that the instrumentation strategy is failing." (pg. 3)

In their critique of Pitt and Khandker, they mount several attacks on both the findings and the methodology. For example in one case they show that the poorest are excluded (or self-excluded) from microcredit programs, they graph the probability of borrowing compared to household property owned. In both cases, participation increases along with land ownership, showing that the very poor and landless are unlikely to participate in microfinance programs.

Figure 1. Probability of borrowing vs. *area* of household land before borrowing (Lowess) , households with access to credit for given gender

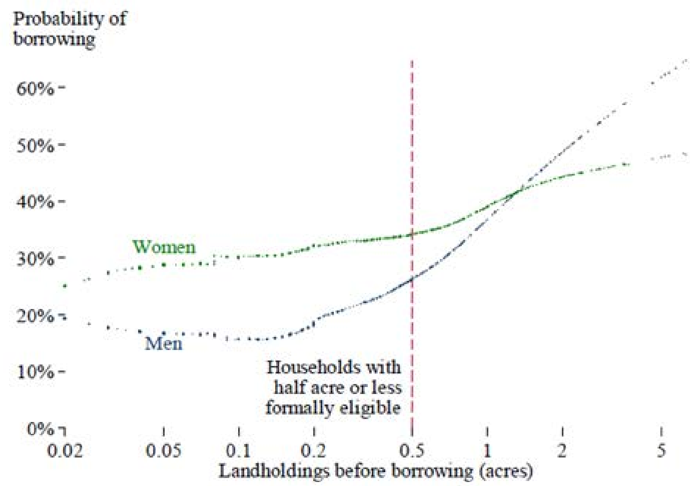
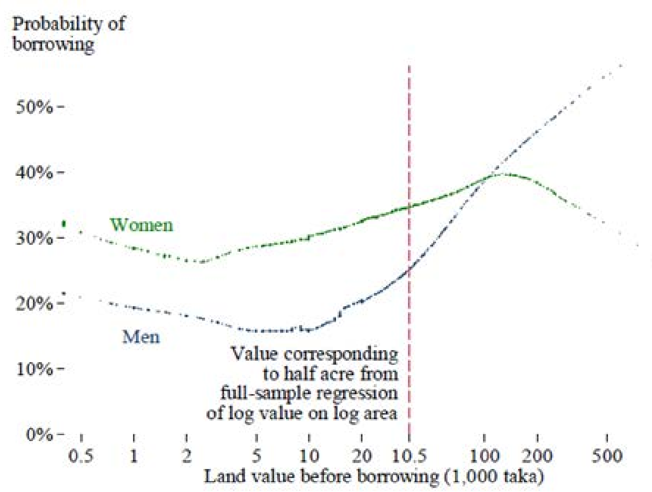


Figure 2. Probability of borrowing vs. *value* of household land before borrowing (Lowess), households with access to credit for given gender



They also cast doubt on the methodology of Khander's work in 2005, wondering whether the effects of the extension of microcredit represent suitable exogenous variation and saying "Overall, these findings reduce our confidence that Khandker's results reflect causality from credit to household consumption. Since we doubt the OLS foundation of the Khandker paper, we also doubt that which is built upon it, in particular the claim that microcredit has disproportionately helped extremely poor people." (pg. 39)

Consensus

Clearly, the jury is still out on the quantifiable effects of microfinance. Historical economic disagreements aside, there do seem to be some advantages to the provision of microcredit to the very poor. For instance there does seem to be evidence that the poor have been able to use these small loans in place of savings or insurance to smooth consumption shocks such as a poor growing season, a death in the family, or other sudden and unexpected loss of income.

As discussed in an article by CGAP, poverty is not just a matter of having small incomes, but also of dealing with irregular income flows. As they say, "whether or not financial services lift people out of poverty, they are vital tools in helping them to cope with poverty. The poor use credit and savings not only to smooth consumption, but also to deal with emergencies like health problems and to accumulate the larger sums they need to seize opportunities (occasionally including business opportunities) and pay for big-ticket expenses like education, weddings, or funerals."

In addition, it is difficult to deny that the situation in areas saturated with MFIs has been promising, as illustrated in these lecture slides from Darryl McLeod and Norma Fuentes of Fordham University:

Figure 1: Bangladesh growth accelerated after 1990

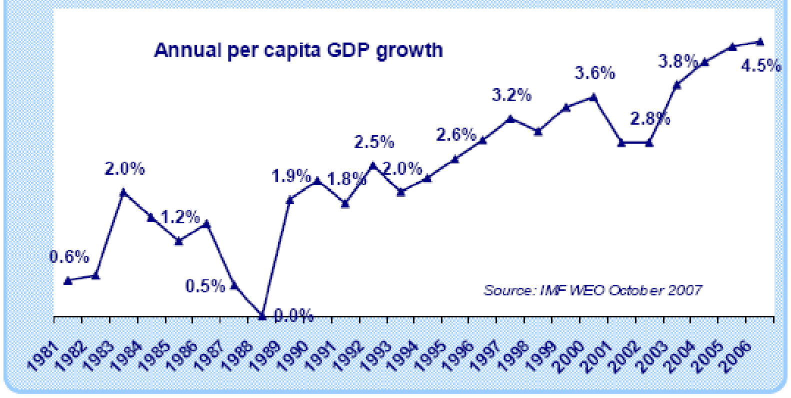


Figure 2: Bangladesh Poverty Trends

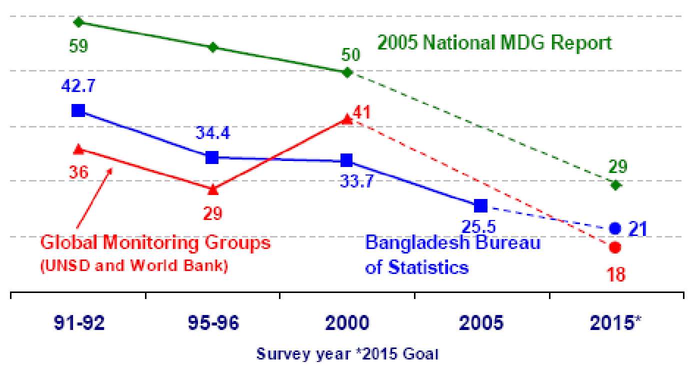
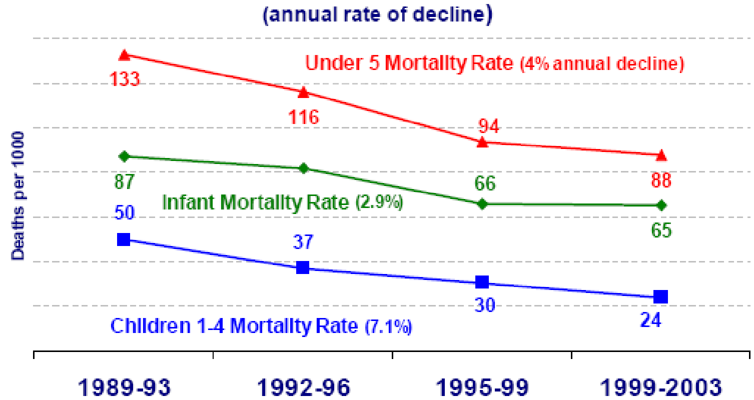


Figure 5: Bangladesh DHS Child Mortality Trends
(annual rate of decline)



Microfinance Can Be a Good Tool For Empowering Women

Microfinance has a long history of using women as the primary borrowers. To return to the early study of Pitt and Khandker from 1998: "Many of these programs specifically target women on the basis of the view that they are more likely to be credit constrained than men, have restricted access to the wage labor market, and have an inequitable share of power in household decision making." (pg.959)

From a statistical and economic perspective, the benefits to women are also significant. In their 2009 critique of earlier studies of microfinance, one thing that Roodman and Morduch found that remained true, despite their replications that questioned many of the previous studies' findings, was that the extension of microfinance demonstrably increased the assets of the female recipients compared to women that had not participated. As seen in the table below:

Table 2. Weighted means and standard deviations of PK endogenous variables, new data set

	Program villages				
	Participants	Non-participants	Total	Nonprogram villages	All
Cumulative female borrowing (1992 taka)	5,619.540		2,661.615		2,661.615
	(7,608.565)		(5,940.411)		(5,940.411)
	N = 779	N = 326	N = 1,105		N = 1,105
Cumulative male borrowing (1992 taka)	3,854.775		1,771.669		1,771.669
	(7,482.515)		(5,423.560)		(5,423.560)
	N = 631	N = 263	N = 894		N = 894
Current school enrollment of girls aged 5–18 years (yes = 1)[1]	0.535	0.528	0.531	0.552	0.534
	(0.499)	(0.500)	(0.499)	(0.498)	(0.499)
	N = 802	N = 434	N = 1,236	N = 225	N = 1,461
Current school enrollment of boys aged 5–18 years (yes = 1)[1]	0.566	0.555	0.558	0.553	0.557
	(0.496)	(0.498)	(0.497)	(0.498)	(0.497)
	N = 856	N = 468	N = 1,324	N = 267	N = 1,591
Women's labor supply (hours/month, aged 16–59 years)	40.390	32.438	35.068	31.238	34.446
	(70.532)	(64.283)	(66.512)	(60.202)	(65.540)
	N = 3,420	N = 2,108	N = 5,528	N = 1,074	N = 6,602
Men's labor supply (hours/month, aged 16–59 years)	202.747	185.779	191.252	180.604	189.371
	(100.817)	(104.870)	(103.872)	(99.400)	(103.168)
	N = 3,534	N = 2,254	N = 5,788	N = 1,126	N = 6,914
Per capita household total expenditure (taka/week)	76.537	85.250	82.376	88.993	83.475
	(44.862)	(64.986)	(59.241)	(66.212)	(60.498)
	N = 2,696	N = 1,650	N = 4,346	N = 872	N = 5,218
Female nonland assets (taka)	2,365.546	1,736.295	1,945.805	838.152	1,759.426
	(6,695.634)	(5,048.828)	(5,656.181)	(2,212.449)	(5,253.494)
	N = 899	N = 542	N = 1,441	N = 292	N = 1,733
Female assets (taka)	7,503.448	4,831.695	5,721.258	1,997.424	5,094.669
	(31,557.500)	(19,994.800)	(24,482.600)	(6,480.442)	(22,527.100)
	N = 899	N = 542	N = 1,441	N = 292	N = 1,733

Based on round 1 data. [1]PK report using school enrollment for ages 5–17, but 5–18 produces a near-perfect match with the enrollment variable aggregates in their Table A2.

More generally, institutions ultimately settled on lending to women as they proved to be more likely to use the funds to better the whole family, either through greater household consumption expenditure, or the original goal of the expansion of home business. They were also found to have higher repayment rates, whether because they were 'smarter' with the funds and less likely to use the loans impulsively, or because they are more sedentary, anchored to the household as they often are in poor societies, and easier for servicers to track down.

In addition to helping the loan servicers, the extension of financing to women has the potential to increase empowerment. From a sociological perspective, controlling a significant source of household income has the potential to immediately raise the profile of women in the family.


"Today I'm a very respected woman in the community. I have come out of the crowd of women who are looked down upon. Due to the loan that I received... you have made me to be a champion out of nobody."
- Rose Athieno, Produce Reseller, Uganda

Examples of Some Alternative Strategies

In his early criticism of microfinance studies, Morduch writes that savings may be a suitable alternative to microloans, "First, it can provide a relatively inexpensive source of capital for re-lending. Second, today's depositors may be tomorrow's borrowers, so a savings program creates a natural client pool. Third, building up savings may offer important advantages to low-income households directly: households can build up assets to use as collateral, they can build up a reserve to reduce consumption volatility over time, and they may be able to self-finance investments rather than always turning to creditors. On the other hand, handling lots of small deposit accounts can be prohibitively expensive." (pg. 1606)

Remittances are a huge source of income for many of the world's poor and harnessing this flow could be of great development use. To turn to the remittance figure quoted by Cuecuecha in his Fordham University presentation, worldwide remittances reached $191 billion in 2008, 50 percent larger than the total foreign aid for developing countries. In Mexico alone in 2011 remittances were $23 billion, down from a $26 billion peak in 2007. Creating new ways of transmitting and storing this massive cash flow, whether through technological advances in online and mobile banking, or the expansion of traditional financial networks, has the potential to provide significant change to the poor who depend on these remittances. Savings accounts, for example, or remittance accounts accessible from both countries are new strategies that can relax credit constraints and give the poor greater access to investment and financial stability.

V. How Can I Learn More?
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Additional Resources

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