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To cite this article: JOHN WEISS & HEATHER MONTGOMERY (2005) Great Expectations: Microfinance and Poverty Reduction in Asia and Latin America, Oxford Development Studies, 33:3-4, 391-416, DOI: [10.1080/13600810500199210](https://doi.org/10.1080/13600810500199210)

To link to this article: <https://doi.org/10.1080/13600810500199210>



Published online: 23 Jan 2007.



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# Great Expectations: Microfinance and Poverty Reduction in Asia and Latin America

JOHN WEISS\* & HEATHER MONTGOMERY

**ABSTRACT** *Microfinance institutions (MFIs) are often seen by aid practitioners as a manifestly effective means of improving the position of the poor. Despite this widely held view, detailed research studies have been much more guarded about the impact of MFIs. In particular, several studies have raised doubts about the effectiveness of MFIs in reaching the “core poor”. This paper surveys the evidence from Asia and Latin America and contrasts experiences in the two regions. Studies on the former have been carried out more “rigorously”, but in both regions the evidence that microfinance is reaching the core poor is very limited.*

## 1. Introduction

The microfinance revolution has changed attitudes towards helping the poor in Asia and Latin America, and in some countries it has provided substantial flows of credit, often to very low-income groups or households, who would normally be excluded by conventional financial institutions. Much has been written on the institutional arrangements pursued in different organizations and countries, and a vast number of studies have attempted to assess the outreach and poverty impact of such schemes. However, amongst the academic development community there is a recognition that we know much less about the impact of these programmes than might be expected, given the enthusiasm for these activities in donor and policy-making circles. To quote a recent authoritative volume on microfinance:

MFI field operations have far surpassed the research capacity to analyze them, so excitement about the use of microfinance for poverty alleviation is not backed up with sound facts derived from rigorous research. Given the current state of knowledge, it is difficult to allocate confidently public resources to microfinance development.

(Zeller & Meyer, 2002)

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This is a very strong statement. In part it reflects the lack of accurate data, but it also reflects methodological difficulties in assessing what proportion of income and other effects of micro credit can actually be attributed to the programmes themselves. Here we compare poverty impact studies from Asia and Latin America. In particular, we examine the evidence on three issues:

- the success of microfinance programmes in reaching the core poor;
- the effectiveness of microfinance initiatives in pulling households out of poverty;
- the cost-effectiveness of microfinance as a poverty targeting tool.

These are very basic questions and the fact that they can still be posed reflects the extent of uncertainty in the literature. Since a number of other surveys are available, we focus on evidence produced in the last 3 or 4 years<sup>1</sup> and highlight similarities and differences in microfinance as it has developed in Asia and Latin America.

The paper is organized as follows. Section 2 provides a brief overview of some of the distinguishing characteristics of the microfinance industry in Asia and Latin America. In Section 3, the potential for microfinance to combat poverty and methodological issues relating to assessing its success in doing so are discussed, and in Section 4 the evidence from selected research studies is surveyed. Section 5 addresses the question of cost-effectiveness. Finally, we draw some brief conclusions.

## **2. Characteristics of Microfinance in Asia and Latin America**

Microfinance developed in Asia and Latin America under very different ideological, political and economic conditions, leading to distinct differences in their microfinance industries. A brief look at the history of two of the most famous microfinance institutions (MFIs), the Grameen Bank in Bangladesh and Banco Sol in Bolivia, illustrates how the industry in the two regions differs.

Modern microfinance was born in Bangladesh in the 1970s, in the aftermath of the country's war of independence, when Muhammad Yunus, an economics professor at the University of Chittagong, began an experimental project providing credit to the rural poor of Bangladesh. That experiment, driven by a strong sense of developmental idealism, developed into what is now the world's most famous MFI, the Grameen Bank, and institutions that replicate its pioneering methodology world-wide.

Microfinance in Latin America developed under quite different conditions. In Bolivia, a collapsing populist regime led to widespread unemployment. Banco Sol, a pioneering MFI in the region, developed to address the problem of urban unemployment and provide credit to the cash-strapped informal sector. The notion of commercial profitability was embraced relatively early in this approach.

As a result of the different conditions under which the first MFIs were founded, the industry in the two regions developed distinctive characteristics. In the beginning, "by comparison with Bangladesh, the Bolivian intervention was typically urban rather than rural, less concerned with poverty and more focused on micro-enterprise. It targeted the 'economically active poor'—people with established businesses that needed capital to grow . . . from the start, Bolivian microcredit was itself seen as a business, potentially as a branch of commercial banking" (Rutherford, 2003, p. 5). Many of these differences still characterize the industry in the two regions today.

For example, data from various sources suggest that Asian MFIs lead the world in terms of both breadth (number of clients) and depth (relative poverty of clients) of outreach.

In their analysis of over 1500 MFIs from 85 developing countries, Lapeneu & Zeller (2001) found Asia accounted for the majority of MFIs, retained the highest volume of savings and credit, and served more members than any other continent. The most recent data from the *Microbanking Bulletin*<sup>2</sup> reinforce these findings (Table 1). Average size of loans and deposits is often taken as a simple proxy of depth of outreach. By this criterion, Asian MFIs have among the lowest loan and savings balance per borrower, even after adjusting for GNP per capita, suggesting that they are effectively reaching the poor.

The same data indicate that Latin American MFIs are ahead of Asian MFIs in terms of financial viability. On average, Latin American MFIs registered with the *Microbanking Bulletin* show a higher return in Asia. Latin America MFIs are also further advanced in the process of drawing in external funding through savings deposits with registered MFIs on average having a deposit-loan ratio of 29%, roughly double the comparable figure for Asia (Ramirez, 2004).

Regional data conceal some wide disparities within each region. Microfinance is highly concentrated and the giants of the industry—Bank Rakyat Indonesia (BRI), BRAC (originally known as the Bangladesh Rural Advancement Committee) and the Association for Social Advancement (ASA)—account for more than 50% of the total number of borrowers from the more than 300 MFIs world-wide, who report to the MIX Market. BRI alone accounts for nearly 40% of their gross loans. Within Asia, Bangladesh, Indonesia, Thailand and Vietnam have the largest number of members served and the largest distribution of loans and mobilization of savings as a share of GNP in the world. In contrast, the two most populated countries in Asia, India and the People's Republic of China, have very low outreach, despite a high concentration of the region's poor. In Latin America, there is very strong skew, with MFIs playing a major role as financial providers to micro-enterprise in Bolivia and Central America, but being largely insignificant in the larger countries of Brazil, Mexico and Argentina. There is also wide disparity in terms of financial viability. Within Latin America there is a wide range financial viability, with the larger MFIs showing a return on assets in 2001–02 well above the average for the commercial banking sector in their countries and that of the smaller MFIs in the region, which on average operate at a substantial loss when capital costs are calculated at commercial rates.

The strong financial performance of larger MFIs in Latin America is linked with a trend towards commercialization of microfinance in the region. In 1992, Banco Sol became the first case of a non-governmental organization (NGO) transformation to a commercial bank and thus became the first regulated microfinance bank. Banco Sol surpassed other Bolivian

**Table 1.** Outreach indicators by region

	Average loan balance per borrower (US\$)	Average saving balance per saver (US\$)
Africa	228	105
Asia	195	39
Eastern Europe/Central Asia	590	N/A
Latin America	581	741
Middle East/North Africa	286	N/A

N/A, not available.

Source: *Microbanking Bulletin*, issue 9, July 2003.

banks in profitability and became the first MFI to access international capital markets. Following this successful example, at least 39 other important NGOs world-wide transformed into commercial banks over the period 1992–2003 (Fernando, 2003). Given that the failure of commercial financial institutions to reach the poor provided the initial impetus for MFIs, this new trend is paradoxical and raises the question of whether the initial poverty reduction objectives of the transformed NGOs will be subjugated to commercial criteria (so-called “mission drift”). This potential disadvantage is still unexplored empirically, but the advantages of transformation are clear: increased access to funding and regulatory authority, freeing the institutions from dependence on donor funds and capital constraints on growth and allowing them to offer a wider range of financial services.

There is also a recent trend in the opposite direction—traditional banks becoming involved in microfinance in a variety of ways. In both regions there are examples of large state banks that have moved into microfinance, e.g. Banco Nacional de Costa Rica and BRI’s Micro Business Division.<sup>3</sup> Recently, there has been a similar trend in the private banking sector as well. Until it was closed in April 2004 for non-compliance with prudential regulation, Bank Dagang Bali (BDB) was an early example of commercial banking involvement in microfinance in Indonesia. Rural banks in the Philippines are the dominant providers of microfinance and the USAID-funded Microenterprise Access to Banking Services (MABS) programme aims to assist participating rural banks in expanding the services they provide to the micro-enterprise sector. Pakistan has established a number of private commercial banks that provide retail microfinancial services. Malaysia, Nepal and Thailand also have programmes in effect to encourage commercial bank involvement in microfinance.<sup>4</sup> In Latin America, Banco Agrícola Comercial (El Salvador), Banco del Desarrollo (Chile) and Banco Wiese (Peru) and Banco Empresarial (Guatemala) are examples of private commercial banks that are involved in varying degrees with microfinance. Falling in between state involvement and private commercial initiatives is a programme in India started by the National Bank of Agriculture and Rural Development (NABARD), under which a number of private banks in India have become involved in microfinance. ICICI Bank in particular has experimented with some innovative approaches to microfinance involvement under the NABARD programme. These trends place microfinance squarely within the conventional financial sector and raise important issues of governance and regulation in connection with the new institutions.

In both regions, therefore, we see similar trends towards a provision of a wider range of financial services, a move away from traditional group lending to individual loans, and a greater shift towards commercialization of the sector, with Latin America more advanced in this process. However, in both regions NGOs remain important providers and in Asia they are still the dominant mode of delivery. The NGO sector is still, with exceptions, not financially sustainable and continues to rely on subsidies of various sorts. In these circumstances, there is a need for studies that shed light on the poverty consequences of different modalities. If NGOs are to continue to draw on subsidized finance there is a need to demonstrate that they can reach the poor and do so in a cost-effective manner, as compared with other forms of poverty targeting interventions. If public policy is to encourage the transformation of NGOs to regulated financial institutions or if the delivery of small loans is to be left to the commercial banking sector, the concern that the client base will change so that poor clients are excluded by application of tighter commercial criteria must be addressed. In such instances there is a need to learn more about the poverty consequences of the ongoing changes in the MFI sector in many countries.

### **3. Poverty and Microfinance**

Here we define poverty as an income (or more broadly welfare) level below a socially acceptable minimum and microfinance as one of a range of innovative financial arrangements designed to attract the poor as borrowers or savers. In terms of understanding poverty, a simple distinction can be drawn within the group “the poor”, between the long-term or “chronic poor”, and those who temporarily fall into poverty as a result of adverse shocks, the “transitory poor”. Within the chronic poor one can distinguish further between those who are either so physically or socially disadvantaged that without welfare support they will always remain in poverty (the “destitute”), and the larger group who are poor because they lack assets and opportunities. Furthermore, within the non-destitute category one may distinguish by the depth of poverty (that is how far households are below the poverty line), with those significantly below it representing the “core poor”, sometimes categorized by the irregularity of their income. In some Latin American cases, for example, the core poor or destitute are taken to be those below 50% of the poverty line (although Latin American poverty lines are generally higher than in Asia).

In principle, microfinance can relate to the chronic (non-destitute) poor and to the transitory poor in different ways. The condition of poverty has been interpreted conventionally as one of lack of access by poor households to the assets necessary for a higher standard of income or welfare, whether assets are thought of as human (access to education), natural (access to land), physical (access to infrastructure), social (access to networks of obligations), or financial (access to credit) (World Bank, 2000, p. 34). Lack of access to credit is readily understandable because of the absence of collateral that the poor can offer conventional financial institutions, in addition to the various complexities and high costs involved for the institutions in dealing with large numbers of small, often illiterate, borrowers. The poor have thus to rely on loans from money-lenders at high interest rates or from friends and family, whose supply of funds is limited. MFIs attempt to overcome these barriers through measures such as group lending and regular savings schemes, as well as the establishment of close links between poor clients and staff of the institutions concerned. The range of possible relationships and mechanisms employed is very wide.

The case for microfinance as a mechanism for poverty reduction is simple. If access to credit can be improved, the poor can finance productive activities that will allow income growth, provided there are no other binding constraints. This is a route out of poverty for the non-destitute chronic poor. For the transitory poor, who are vulnerable to fluctuations in income that bring them close to or below the poverty line, microfinance can provide credit at times of need and, in some schemes, the opportunity of regular savings that a household can draw on. The avoidance of sharp declines in family expenditures by drawing on such credit or savings allows for “consumption smoothing”. In practice, this distinction between the needs of the chronic and transitory poor for credit for “promotional” (that is, income creating) and “protectional” (consumption smoothing) purposes is over-simplified, since the chronic poor also have short-term needs to be met, due to income shortfalls or unexpected expenditures such as medical bills or social events like weddings or funerals. An interesting generalization to emerge from the microfinance and poverty literature is that the poorest of the chronic poor (the core poor) borrow essentially for protection, given both the low and irregular nature of their income. This group, it is suggested, is too risk-averse to borrow for promotion (that is, for investment in the future) and is therefore only a very limited beneficiary of microfinance schemes (Hulme & Mosley, 1996, p. 132).

The view that it is the less badly-off poor who benefit principally from microfinance has become highly influential and was repeated in the *World Development Report* on poverty (World Bank, 2000, p. 75). Apart from the risk-aversion argument noted above, other explanations for this outcome have been put forward. A related issue refers to the interest rates charged to poor borrowers. Most microfinance schemes charge close to market-clearing interest rates (although these are often not enough to ensure full cost-recovery given the high cost per loan of small-scale lending). It may be that, even setting aside the risk-aversion argument, such high rates are unaffordable to the core poor given their lack of complementary inputs; in other words, despite having a smaller amount of capital, marginal returns to the core poor may be lower than for the better-off poor. If the core poor cannot afford high interest rates they will either not take up the service or take it up and get into financial difficulties. Also, where group lending is used, the very poor may be excluded by other members of the group, because they are seen as a bad credit risk, jeopardizing the position of the group as a whole. Alternatively, where professional staff operate as loan officers, they may exclude the very poor from borrowing, again on grounds of repayment risk. In combination, these factors may explain the weakness of microfinance in reaching the core poor.<sup>5</sup> The sector has responded in a number of cases by establishing special programmes for the core or “ultra-poor”. The best known of these are in Bangladesh and involve the well-established institutions of BRAC and ASA. The programmes essentially aim to provide a range of services, covering training, health provision and more general social development for the disadvantaged, as well as grants of assets or credits. The ultra-poor are encouraged to build up a savings fund and to graduate to conventional microfinance programmes. Other variants of this approach involve greater flexibility in repayment terms for the poorest (Fernando, 2004).

Given the new trends in the sector and their possible effects in diluting the original poverty focus of MFIs, the question of their impact on the poor (particularly the core poor) is of great policy interest. It might be thought that if such institutions are designed to serve only poor clients and if repayment rates are high, no further detailed analysis is needed. Such a view is misleading for a number of reasons. First, there is no guarantee that only the poor will be served unless strong eligibility criteria (such as land ownership) are enforced. Often, the aim is to dissuade the non-poor with the inconvenience of frequent meetings or the stigma of being a member of a credit group of the poor. Such disincentives may not work and eligibility criteria, where they exist, may not be enforced. Second, high repayment rates may be due to social pressure within a group or family and may not reflect the capacity to repay (if, for example, loans from money-lenders have to be taken out to repay the micro credit). Third, even if the poor are genuinely served by MFIs, as long as public funds are required to finance the MFI there is the issue of how cost-effective this means of reaching the poor is compared with alternatives. This requires a comparison of the cost of transferring the funds through a micro credit institution per unit of benefit received by the target group with the benefit-cost ratio for alternative schemes for reaching the core poor, such as food subsidies, workfare and integrated regional development initiatives. Such comparisons must take account not just of the administrative costs involved, but also of the leakage rate (the benefits to the non-poor).

Hence, there is a strong case for attempting to assess both the depth of outreach of microfinance programmes, the impact of access to microfinance services on the welfare of clients and the costs of achieving this impact.



On the first point, assessing the depth of outreach or access of the poor to microfinance programmes, it is important to note from the outset that most MFIs probably do not consider their institutional mission to be serving the poorest of the poor. Particularly in Latin America, most MFIs report a broader agenda to provide financial services to poor communities or specific groups such as female entrepreneurs who would not otherwise have access. Among MFIs that report to the MIX Market, slightly less than half of those in Asia identified “specifically targeting very poor clients” as their institutional mission. In Latin America, the share is even smaller: only around 10%. Of the Latin American MFIs that claim to target very poor clients, only two use some sort of targeting tool to identify clients. In Asia, most of the MFIs that specifically target the very poor use some sort of targeting tool, such as a means test, participatory wealth ranking or a housing index to identify the target group.

For those MFIs that explicitly aim to serve the poorest within their community, recent work on poverty outreach of MFIs has focused on constructing a poverty index that can be used to establish whether the target group is being reached. The Consultative Group to Assist the Poorest (CGAP) has developed a poverty assessment tool (PAT) that can be used to compare clients and non-clients of MFIs in the same community. This is based on the construction of a weighted index of poverty based on a range of indicators covering the human resources of households, characteristics of their dwellings, measures of food security and their assets. The different indicators are weighted by principal components analysis, which allows weights to differ between cases (Zeller *et al.*, 2001). The approach here is to sort a non-client sample into three equal groups (high, intermediate and low) on the basis of their poverty score. The poverty index scores at the cut-off points between the three groups then become a reference point for the client or participant sample and their distribution between the three categories can be compared with that of the non-clients. As the non-client groups are divided equally, any deviation from equal proportions amongst the clients signals a skew either for or against greater poverty outreach.<sup>6</sup>

The PAT is an outreach, as compared with an impact, assessment and therefore does not directly address the question of what impact the programmes have on their clients. Conducting a rigorous impact assessment is challenging. It is not simply a case of looking at a group of borrowers, observing their income change after they have taken out micro loans and establishing who has risen above the poverty line. Accurate assessment requires a rigorous test of the counter-factual—that is, how income (or whatever measure is used) with a micro credit compares with what it would be without it, with the only difference in both cases being the availability of credit. This requires a control group, identical in characteristics to the recipients of credit and engaged in the same productive activities, that has not received credit, and whose income (or other measure) can be traced through time to compare with that of the credit recipients.

A practitioner-friendly impact assessment toolkit is also available from the Assessing the Impact of Microenterprise Services (AIMS) Project. This assessment tool has been used in longitudinal studies of the impact of programmes in Peru (Mibanco), India (SEWA) and Zimbabwe (Zambuko Trust). This procedure looks at change over time and matches pairs of observations between borrowers and members of a control group, where each pair has similar starting values for the impact variable (like income or sales revenue) and other characteristics, such as age, gender or sector of activity. Simplifying, this approach identifies impact as:

$$\text{Impact} = 1/n \sum (Y_{t+1} - Y_t)p,$$



where  $Y_t$  and  $Y_{t+1}$  are an impact variable (such as income) in periods  $t$  and  $t + 1$ , respectively, and  $p$  refers to matched pairs of borrowers and non-borrowers, where there are  $n$  pairs. Thus, impact can be rationalized as the average difference between matched pairs of programme participants and control group.<sup>7</sup> Where impact is greater than zero (and statistically significant), microfinance will have made a difference and initially poor and non-poor borrowers can be distinguished in the analysis. The weakness in the applications of the approach to date is that researchers have been able to control only for observable characteristics.

Failure to account for unobservable characteristics may lead to biased measures of impact. Two key sources of bias can arise in empirical work that attempts to assess the impact of micro credit on poor households—selection bias and placement bias. The former arises where there are key differences between borrowers and non-borrowers that cannot be observed, measured and allowed for, with self-selection bias (that is, where those with particular characteristics choose to participate in a programme) a key problem. Hence, whilst differences in education, age or gender can be controlled for statistically, there can also be differences in attitude to risk or “entrepreneurship”, which will be basically unobservable. A bias will arise if there is an association between a decision to take a micro loan and these unobserved characteristics. If the more entrepreneurial individuals are those who take out loans, growth in their income relative to income of those who have not taken out a loan may be due in part to the effect of the loan itself, but in part also to their entrepreneurial ability. Attribution of all of the change to the loan will then overstate its impact. Placement bias arises where loans go to locations or activities that are in some way favoured, such as villages with better infrastructure or sectors with strong demand growth. Comparing income change for households in a superior location (or sector) who have a loan, with income change for similar households in another location (or sector) who have not taken out a loan, and attributing all of this to the loan will create an upward bias.

Best-practice approaches to resolving these problems employ a form of “difference-in-difference” (two-stage least-squares instrumental variables) analysis that compares participants and a similar control group and compares between locations or sectors with and without access to the programme.<sup>8</sup> One approach (as used, for example, by Pitt & Khandker (1998) on Bangladesh) is to use exogenous eligibility criteria for participation in a microfinance programme (e.g. lack of land ownership) as a means of avoiding a self-selection bias. Placement bias is allowed for by comparing those who are eligible with those who are ineligible, in both villages that are covered by programmes and those that are not. Hence, the analysis based on a double difference can be simplified as follows:

$$\text{Impact} = (Y_{ep} - Y_{ip}) - (Y_{en} - Y_{in}),$$

where  $Y$  is change in an outcome measure (such as income) over the study period, e and i stand for eligible and ineligible households, respectively, and p and n stand for programme and non-programme villages, respectively. For microfinance to produce positive results, impact must be greater than zero. If poor and non-poor borrowers can be identified, there will be a quantification of poverty impact.

The chief problem with this approach is that many microfinance schemes do not use formal eligibility criteria and those that do may not always enforce them, creating a further source of error. An alternative, where no formal criteria are set out but approvals for borrowing are known, is to use as a control group those approved for loans who have not yet taken them up (e.g. as used by Hulme & Mosley (1996) in their country studies).

This addresses the self-selection issue, unless not taking up a loan reveals an aversion to risk and is correlated with subsequent outcomes.

A variant of this approach (as applied by Coleman (1999, 2004) for Thailand) draws on the fact that most microfinance activities start in a narrowly defined area and then expand their coverage to similar villages elsewhere or within urban centres. In the rural case, if the villages are similar and if the borrowers can choose to participate, then self-selecting participants in villages that have been identified for later inclusion in a programme should provide an accurate control group for current borrowers in villages with a programme. Here, again simplifying, this is equivalent to estimating impact as

$$\text{Impact} = (Y_{Pt+1} - Y_{Nt+1}) - (Y_{Pt} - Y_{Nt}),$$

where  $Y$  is as before, P and N stand for (self-selecting) participants and non-participants, respectively, and  $t$  stands for time a programme has been operative in a particular village, so  $t + 1$  covers the early and  $t$  the late entrant villages.

Here we examine some of the recent “rigorous” studies on the impact of MFIs based on survey data that employ versions of these methodologies. We do not report the results of work based on more qualitative or participatory approaches.<sup>9</sup> Table 2 summarizes the results of the studies surveyed here for Asia and Table 3 does the same for Latin America. In general, it is perhaps not surprising that studies based on a rigorous counter-factual find much smaller gains from microfinance than simple unadjusted before and after type comparisons, which erroneously attribute all gains to micro credit. Also, although the results are far from consistent, studies on Asia tend to report a stronger poverty impact from microfinance than does comparable work from Latin America.

### 3.1 Poverty Impact Studies: Asia

One of the early and most widely cited of the poverty impact studies is that by Hulme & Mosley (1996). They employed a control group approach, looking at the changes in income for households in villages with microfinance programmes and changes for similar households (e.g. in terms of initial income, gender, education and location) in non-programme areas. As far as possible, the control groups were drawn from households eligible for loans, and who had been approved for loans by the institutions concerned, who had not yet received a loan. Programmes in a number of countries were considered, including the Grameen Bank in Bangladesh and the BRI. In general, a positive impact was found on borrower incomes of the poor (1988–92) with, on average, an increase over the control groups ranging from 10–12% in Indonesia to around 30% in Bangladesh and India (Hulme & Mosley, 1996, table 8.1). Gains were larger for non-poor borrowers, however, and within the group the poor gains were negatively correlated with income. However, despite the breadth of the study and its use of control group techniques, it has been criticized for possible placement bias, whereby microfinance programmes may have been drawn to better placed villages, so that part of the advantage relative to the control group may have been due to this more favourable location. The quality and accuracy of some of the data, particularly in relation to the representative nature of the control groups, have been questioned (Morduch, 1999, p. 1600). There also appears to be a basic problem with the data used in the case studies, since they were not based on a comparison between baseline data and those for a later survey year. Rather, there was at least partial recourse to a recall approach for the earlier years of the period covered, as respondents were asked to estimate

**Table 2.** Microfinance impact studies: Asia

Study	Coverage	Methodology	Results
Hulme & Mosley (1996)	Indonesia (BKK, KURK, BRI), India (Regional Rural Banks), Bangladesh (Grameen, BRAC, TRDEP), Sri Lanka (PTCCS)	Borrowers and control samples, before and after	Growth of incomes of borrowers always exceeds that of control group. Increase in borrowers' income larger for better-off borrowers Positive benefits, but no statistical tests for differences reported
MkNelly <i>et al.</i> , (1996)	Thailand (village banks—credit with education)	Non-participants in non-programme villages used as controls	
Khandker (1998)	Bangladesh (Grameen, BRAC)	Double-difference comparison between eligible and ineligible households and between programme and non-programme villages	Five per cent of participant households removed from poverty annually. Additional consumption of 18 taka for every 100 taka of loan taken out by women.
Pitt & Khandker (1998)	Bangladesh (BRAC, BRDB, Grameen Bank)	Double-difference estimation between eligible and non-eligible households and programmes with and without microfinance programmes. Estimations are conducted separately for male and female borrowing	Positive impact of programme participation on total weekly expenditure per capita, women's non-land assets and women's labour supply. Strong effect of female participation in Grameen Bank on schooling of girls Credit programmes can change village attitudes and other village characteristics
Coleman (1999)	Thailand (village banks)	Double-difference comparison between participant and non-participant households and between villages in which the programme has been introduced and villages where it has not yet been introduced Control group from same geographic area	No evidence of programme impact. Village bank membership has no impact on asset or income variables
Chen & Snodgrass (2001)	India (SEWA bank)		Average income increase rose for bank's clients in comparison with control group. Little overall change in incidence of poverty, but substantial movement above and below poverty line Programmes are not reaching the poor as much as they reach relatively wealthy people. Impact is larger on richer committee members rather than on rank-and-file members
Coleman (2004)	Thailand (village banks)	Double-difference estimation between participants and non-participants and villages with and without a microfinance programme	

Table 2. Continued

Study	Coverage	Methodology	Results
Park & Ren (2001)	China (NGOs, government programmes, mixed NGO-government programmes)	(i) Probit estimation of participation and eligibility for each type of programme; (ii) ordinary least squares (OLS) and IV <sup>1</sup> estimation of impact of micro credit on household income	In NGO and mixed programmes the very rich, even if eligible (for mixed programmes), are excluded from participation. In the government programme, the rich are both eligible and more likely to participate. Impact estimation finds evidence of positive impact of micro credit on income
Duong & Izumida (2002)	Vietnam (VBA* 84% of total lending), (VBP**), PCFs***, commercial banks, public funds)	Tobit estimation of: (i) participation in rural credit market; (ii) behaviour of lender toward credit-constrained household; and (iii) weighted least-square estimation for impact on output supply	Poor have difficulties in accessing credit facilities: livestock and farming land are determinants of household participation; reputation and amount of credit applied for to MFI are determinants of credit rationing by lenders. Impact estimation showed positive correlation between credit and output
Kaboski & Townsend (2002)	Thailand (production credit groups, rice banks, women groups, buffalo banks)	Two-staged least-squares and maximum likelihood estimation test of microfinance impact on asset growth, probability of reduction in consumption in bad years, probability of becoming money-lender, probability of starting business and probability of changing job. Separate estimation according to type of MFI and policies of MFI	Production credit groups and women groups combined with training and savings have positive impact on asset growth, although rice banks and buffalo banks have negative impacts. Emergency services, training and savings help to smooth responses to income shock. Women groups help to reduce reliance on money-lenders
Amin <i>et al.</i> (2003)	Bangladesh (Grameen Bank, BRAC, ASA)	(1) Non-parametric test of stochastic dominance of average monthly consumption of members and non-members (2) Maximum likelihood test of micro credit membership on vulnerability, consumption and household characteristics	Members are poorer than non-members. Programmes are more successful at reaching poor, but less successful at reaching vulnerable. Poor vulnerable are effectively excluded from membership
Gertler <i>et al.</i> (2003)	Indonesia (Bank Rakyat Indonesia, Bank Kredit Desa, commercial banks)	(1) Basic consumption-smoothing test on household's ability to perform daily living activities (ADL index)	Significantly positive correlation between household's consumption and measure of health.

Table 2. Continued

Study	Coverage	Methodology	Results
Khandker (2003)	Bangladesh (Grameen Bank, BRAC, BRDB)	(2) State dependence tests of basic regression (relative man-woman earning, physical job, savings) (3) Test of geographical proximity to financial institutions on consumption smoothing  (1) Fixed effect Tobit estimation of borrowing dependent on land, education endowments of households (2) Panel data fixed effects IV estimation to define long-term impact of microfinance borrowing on expenditure, non-land assets and poverty (moderate and extreme)	Wealthier households are better insured against illness.  Households that live far from financial institutions suffer more from sudden reduction in consumption Households who are poor in landholding and formal education tend to participate more.  Microfinance helps to reduce extreme poverty much more than moderate poverty (18 percentage points as compared with 8.5 percentage points over 7 years). Welfare impact is also positive for all households, including non-participants, as there are spillover effects Significantly positive effect of female credit on height-for-age and arm circumference of both boys and girls. Borrowing by men has either negative or non-significant impact on health of children
Pitt <i>et al.</i> (2003)	Bangladesh (BRAC, BRDB, Grameen Bank)	Maximum likelihood estimation controlling for endogeneity of individual participation and of the placement of microfinance programmes. Impact variables are health of boys and girls (arm circumference, body mass index and height-for-age)	

\*Vietnam Bank for Agriculture and Rural Development.

\*\*Vietnam Bank for the Poor.

\*\*\*People's Credit Funds.

<sup>†</sup>Instrumental variable (IV).

Table 3. Microfinance impact studies: Latin America

Study	Coverage	Methodology	Results
Hulme & Mosley (1996)	Bolivia, BancoSol	Borrowers and control samples, before and after. Retrospective assessment of incomes	Growth of incomes of borrowers always exceeds that of control group. Absolute increase in borrowers' income larger for better-off borrowers
Mosley (2001)	Bolivia, BancoSol, ProMujer, Fundacion para la Promocion y Desarrollo de la Microempresa (PRODEM) and Sartawi	Borrowers and control samples, before and after. Time series data for BancoSol only; for others retrospective assessment of incomes	Growth of incomes and assets of borrowers always exceeds that of control group. Increase in borrowers' income larger for better-off borrowers. No evidence of impact on "extreme poverty"
Banegas <i>et al.</i> (2002)	Ecuador, Banco Solidario and Bolivia, Caja de los Andes	Logit model. Control group selected from households working in the same sector but with no loans from other institutions.	Being a client of a programme is associated with rising incomes
Dunn & Arbuckle (2001a, b)	Peru, Mibanco	Logitudinal study using "analysis of covariance" methodology; control group based on non-participants with similar observable characteristics to participants. Focus on micro-enterprises.	Micro-enterprises of participants found to have substantial increases in net income, assets and employments relative to those of non-participants. Positive impact on poverty reduction with incomes in participating households rising relative to control group. Poor participants more likely to sell assets in face of a shock than control households.
MkNelly & Dunford (1999)	Bolivia, credit with education programme	Longitudinal study of comparison with baseline for nutritional data. Control group of communities who would be offered same programme 2 years later	No evidence of improvements in household food security or nutritional status of client's children relative to the control group.

their income retrospectively. Finally, the major conclusion of the study, that there is a positive correlation of gains from microfinance with income so that poorer borrowers gain proportionately less, has also been challenged on the grounds that their comparison of income changes for different categories of borrowers biased their results in favour of the conclusion. This follows, since gains for different income groups were compared with the average for a control group, not with the change for comparable income categories within the control group; in other words, gains to very poor borrowers were compared with average gains in the control group, not with the gains to the very poor controls (Morduch, 2003).

Other early initiatives that have provided some of the firmest empirical work were the surveys conducted in the 1990s by the Bangladesh Institute of Development Studies (BIDS) and the World Bank. These provided the data for several major analyses, such as that by Pitt & Khandker (1998). Khandker (1998) summarized a number of different studies conducted in Bangladesh using the 1991/92 survey and focusing on three major microfinance programmes, including the Grameen Bank and the BRAC. As discussed earlier, impact is assessed using a double-difference approach between eligible and ineligible households (with holdings of land of more than half an acre making households ineligible) and between programme and non-programme villages. After controlling for other factors, such as various household characteristics, any remaining difference is attributed to the microfinance programmes. The study draws a number of conclusions, but the main one is that the programme had a positive effect on household consumption, which was significantly greater for female borrowers. On average, a loan of 100 taka to a female borrower, after it is repaid, allows a net consumption increase of 18 taka. In terms of poverty impact, it is estimated that 5% of participant households are pulled above the poverty line annually.

Khandker (2003) followed up this earlier work by employing panel data. He used the BIDS-World Bank survey conducted in 1998–99 that traced the same households from the 1991–92 survey. He found apparently strong and positive results. Whilst borrowing by males appeared to have no significant impact on consumption, that by females, who are the dominant client group, did have a positive impact. From this analysis, a 100 taka loan to a female client leads to a 10.5 taka increase in consumption (compared with 18 taka in the earlier analysis). Allowing for the impact of higher consumption on poverty gives estimates of poverty impact. It is estimated that, due to participation in microfinance programmes, moderate poverty among programme participants decreased 8.5 percentage points over the period of 7 years and extreme poverty dropped about 18 points over the same period.<sup>10</sup> He also found evidence of positive spillovers on non-programme participants in the villages, with the impact greater for those in extreme poverty. Over the study period of 7 years, poverty for non-participants was found to decline by 1 percentage point due to the programmes, whilst extreme poverty declined by nearly 5 percentage points. This impact was due solely to female borrowing.

The same data set has also been used to identify health impacts as opposed to income changes. Pitt *et al.*, (2003) found that credit going to females has a large and significant impact in two out of three health measures for children. Male borrowing has no such effect. For example, a 10% increase in credit to females increases the arm circumference of daughters by 6.3%. A 10% increase in female credit on average increases the height of girls by 0.36 cm annually and of boys by 0.50 cm. The relations are stronger for daughters than sons. Hence, in Bangladesh micro credit and improved family health appear to be related.



These are strong and positive results and are probably the clearest evidence there is that microfinance is working in the way intended to bring sustained relief from poverty. However, a couple of caveats are in order. First, the accuracy of the original results as presented in Pitt & Khandker (1998) has been disputed on the grounds that the eligibility criteria of low landholdings was not enforced strictly in practice. In a reworking of the results, focusing on what are claimed to be more directly comparable households, no impact on consumption from participation in a programme was found (Morduch, 1999, p. 1605).<sup>11</sup> Second, in the BIDS-World Bank survey data the “ultra-poor” (defined as those with less than 0.2 acres of land) formed nearly 60% of participants and the likelihood of participation was strongly and negatively associated with level of landholding. None the less, how much was borrowed depended principally on the entrepreneurship of households, so that the charge that the risk-averse very poor would benefit proportionately less has not been totally dispelled. Furthermore, the panel data reveal a relatively high drop-out rate of around 30%, indicating that there may have been problems of repayment for many households.

For Asia, there are other studies that are either inconclusive or provide less convincing results. Coleman (1999) and MkNelly *et al.* (1996) focused on experiences with village banking in Thailand. Coleman (1999) utilized data on villages that had participated in village bank microfinance schemes and those control villages that were designated as participants, but had not yet participated. This allowed a double-difference approach that compared the difference between income for participants and non-participants in programme villages with the same difference in the control villages, where the programmes were introduced later. From the results here, the poverty impact of the schemes appeared dubious. Months of village bank membership had no impact on any asset or income variables and there was no evidence that village bank loans were directed to productive purposes. The small size of loans meant that they were used largely for consumption, but one of the reasons there was a weak poverty impact was that there was a tendency for wealthier households to self-select into village banks.

Coleman (2004) used the same survey data but reconsidered the estimation strategy to control for self-selection. He argued that the village bank methodology, which relies on self-selection by loan size and monitoring by frequent meetings, may not reach the poorest. As many better-off households tend to be on village bank committees, the failure to control for this leads to systematic biases. The regression results of Coleman (2004) indicate that there is a substantial difference between ordinary members and committee members of village banks. The impact of micro credit on ordinary members’ well-being is either insignificantly different from zero or negative. On the contrary, the impact of microfinance programmes on committee members’ measures of wealth, such as income, savings, productive expenses and labour time, is positive, implying a form of programme capture by the better-off in the village, even though this group may not be well-off by national standards. A similar result in terms of rationing micro credit in favour of better-off groups or members was found by Duong & Izumida (2002) in a study of six villages in Vietnam. There, whilst credit availability is linked with production and income, household economic position and prestige in a village plus the amount of credit applied for are the main determinants of how credit is allocated.

MkNelly *et al.* (1996) evaluated the Freedom from Hunger credit with education programme in Thailand operated through village banks. The results show positive benefits, however, although non-participants in non-programme villages were used as controls, there are problems in accepting the results. No statistical tests were reported, so one cannot

judge whether differences between participants and non-participants are significant. There is also a potential measurement bias since the staff responsible for the programme also did the interviewing.

Chen & Snodgrass (2001) examined the operations of the Self Employed Women's Association (SEWA) bank in India, providing low-income female clients in the informal sector with both saving and loan services. The study tested for the impact of these services by comparing the bank's clients against a randomly selected control group in a similar geographic area. Two surveys were conducted 2 years apart. Average incomes rose over time for all groups—borrowers, savers and the control—although the increase was less for the latter. In terms of poverty incidence, there was little overall change, although there was substantial “churning”, in that there was quite a lot of movement among the clients of SEWA above or below the poverty line. In interpreting these results, Meyer (2002) argued that the evidence on the counter-factual—that is, what would have happened to the clients in the absence of the services of SEWA—is not sufficiently strongly established to draw any firm conclusions on poverty impact.

The smoothing of consumption over time to protect the poor against adverse shocks is one of the principal objectives of micro credit. Using data again for Bangladesh, Amin *et al.*, (2003) computed several measures of vulnerability.<sup>12</sup> They found that the micro credit participants in the two villages covered were more likely to be below the poverty line than if they had been selected at random, so the programmes had reached the poor. However, the vulnerable were more likely to join a micro credit programme in only one of the two villages. Further, for the vulnerable below the poverty line in one village, there was no evidence that they were more likely to be members of a programme, and in the other village there was evidence that they had either chosen not to join or were actively excluded, presumably on the grounds that they were a poor credit risk. Hence, the very poor and vulnerable did not appear to have been reached.

More positive conclusions in terms of the ability of microfinance to reduce vulnerability were found for Indonesia by Gertler *et al.* (2003), who found that access to microfinance helps households smooth consumption in the face of a decline in the health of adult family members. Having established an empirical relationship between health condition and consumption, the authors tested for a relation between access to a financial institution and consumption shortfalls associated with ill health. Using geographic distance as a measure of access they found that for households in an area with a BRI branch, health shocks have no effect on consumption. This study does not differentiate within the group of the poor.

### *3.2 Poverty Impact Studies: Latin America*

In Latin America, in general the impact of microfinance on poverty has been less well documented, both in a methodological sense and in terms of coverage in individual studies, which tend to be concentrated in a small number of countries, principally Bolivia and Peru. The overall impression, however, is that compared with Asia, microfinance has reached less far down the income scale and that a significant proportion of borrowers is not in fact below the poverty line, although they may well have below average incomes. This is likely to be due at least in part to a greater commercial orientation with a focus on credit for urban micro-enterprises, with lower rural outreach in Latin America as compared with other regions. A typical requirement for access to credit from an MFI has been that the borrower should be the owner of a micro-enterprise, holding a national identification card

and having at least 6–12 months' experience in the economic activity for which the loan is to be used (Gulli & Berger, 1999, p. 26). It is perhaps not surprising that many of the poor do not meet these criteria.

For example, detailed evidence on the outreach of MFIs in Bolivia is provided by the survey reported by Navajas *et al.*, (2000), who used an index of basic needs fulfilment to classify borrowers into poor and non-poor groups. For the urban area of La Paz, they found that of three MFIs, two tended to lend disproportionately to those above the poverty line. For two of the three, the share of “moderately poor” borrowers (at 29%) was lower than their share of the population (at 38%), although this was not the case for the third MFI, BancoSol (at 47%). However, of the very poorest group, the share of borrowers in all three institutions (at 2–5%) was well below their share in the population, reinforcing the view that MFIs have difficulty in reaching the very poor. When rural lending activities are also included, there is a tendency for a skew in lending towards the “threshold” group, defined as those just above the poverty line and the “moderately” poor. Table 4 gives the ratio of the share of groups of borrowers by poverty class in the portfolio of the different MFIs to their share in total population. A figure above unity thus indicates a positive skew towards a particular poverty class and a figure below unity indicates the opposite.

In terms of institutional mix, FIE, PRODEM and Sartawi are NGOs, whilst BancoSol and Caja Los Andes are regulated financial institutions. Table 4 shows that being an NGO (like FIE) is no guarantee of strong allocation of loans to the poor and that both regulated institutions had a superior distribution to FIE. However, in turn, the rural-based NGOs, PRODEM and Sartawi, outperform BancoSol by this criterion.

This type of evidence on poverty outreach does not address the issue of how far incomes of poor borrowers have been affected. In the limited number of detailed poverty impact studies on Latin America, BancoSol of Bolivia remains by far the most studied institution. Hulme & Mosley (1996, table 4.1) looked at a small sample of BancoSol borrowers. Using those approved borrowers who had not yet taken out a loan as a control, they found an average annual increase in income of 28% for borrowers compared with an average of 14.5% for the control group. An estimated 8% of borrowers crossed the poverty line in 1992 alone. However, in comparison with the MFIs from other countries in their study, BancoSol had only a relatively small proportion of borrowers in the sample below the poverty line (29%) and average borrower household income from the sample was nearly five times the national poverty line, which was far higher than for any institution studied in other countries. BancoSol also showed the largest average absolute income increase for borrowers, and the proportionate

**Table 4.** Distribution of MFI lending by poverty classification relative to population share in la Paz, Bolivia

	Fulfilled non-poor	Threshold non-poor	Non-poor subtotal	Moderate poor	Poorest poor	Poor subtotal
Urban						
FIE	1.2	2.1	1.6	0.7	0.1	0.5
Caja Los Andes	0.7	2.9	1.5	0.8	0.2	0.6
BancoSol	0.6	2.0	1.1	1.2	0.3	0.9
Rural						
PRODEM	0.0	4.8	3.2	2.4	0.5	0.9
Sartawi	1.6	4.4	3.5	2.2	0.5	0.9

Source: Navajas *et al.* (2000), table 4.

increases were greater for the poor. Although the Hulme and Mosley study had a reasonable control group criterion (those approved borrowers who had not yet taken out a loan, but who might be expected to share the self-selection characteristics of current borrowers), it suffered from several problems. There was only a small sample of 36 borrowers. It is not clear that the control group matched borrowers exactly in terms of characteristics such as education, gender or sector of activity. The sample was surveyed at a point in time, so that retrospective income estimates are required to derive rates of change.

The last of these problems is addressed for BancoSol, but not the other Bolivian MFIs covered, in Mosley (2001), who resurveyed the households to obtain income data at two points in time. Mosley (2001) found that for the BancoSol borrowers re-surveyed, on average income growth was a little more than twice (214%) that of the control group; for the other three institutions, the excess income growth for borrowers over the control group was between 132 and 158%. For poor borrowers (who were a minority of those surveyed), gains relative to the average for the control group were lower than for all borrowers, e.g. 151% in the case of BancoSol. Regression analysis relating income increase per household relative to the control group average to initial income shows a positive relationship, so that proportionate gains from borrowing rise with household income, although at a declining rate. There is a positive poverty impact, although given the fact that only a minority of borrowers (around one-third) were poor at the starting point of the analysis in 1993, this is modest. Between 10 and 20% of poor borrowers, varying between institutions, crossed the poverty line over the period studied as a result of microfinance.<sup>13</sup> However, when the core poor (those in “extreme poverty” defined in Bolivia as those living on half the poverty line) are considered, it is clear that none of the MFIs studied are reaching them. From a sample of 200 borrowers over 6 years for four institutions, there is only one case of the removal of extreme poverty, hence this segment of the poor was not reached.

Dunn & Arbuckle (2001a, b) used an analysis of covariance to examine loans to micro-enterprises for 305 households in Lima, Peru, by Mibanco. The study draws on data at two points in time, 1997 and 1999, and looks at changes in the borrowers relative to a control group of households who had not received a micro-enterprise loan. On average, the borrower group appears to be around or slightly above the national poverty line, with approximately 30% below the national poverty line. The procedure used matched observations in the borrower and control groups that had the same starting values for performance variables, like net revenue, assets or employment, as well as the same values for “moderating” variables, like gender of entrepreneur, sector of activity and location. Changes in the performance variables for the matched observations over 1997–99 were compared to establish if there were significant differences between the borrowers and the control group. The results suggest on average a significant difference in terms of enterprise revenue (roughly US\$1000 annually), fixed assets and employment creation (as much as nine extra days per month). These results are very substantial. However, the study recognizes that it may be difficult to attribute all of these changes to the micro credit programme of Mibanco, as the matching system used does not address adequately self-selection bias, and the moderating variables used seem crude (e.g. sector variables reported are “commercial, service and industrial” rather than anything more precise, such as industrial subsectors).

The poverty dimension of the study as reported by Dunn & Arbuckle (2001b) shows a positive poverty reduction effect. For households starting with the same poverty level, number of income sources and economically active members in 1997, after net effects are allowed for, by 1999 borrowers were 6% more likely to be above the poverty line than non-borrowers.

There is the contrary result, however, that in the smaller group of new borrowers who took out a loan during 1997–99, but not initially in 1997, new borrowers were 15% less likely to have moved out of poverty than the control group.<sup>14</sup> The poor and non-poor appear to benefit almost equally in absolute terms, although there is evidence that the poorer borrowers were 20% more likely to liquidate assets in response to a financial shock.

Banegas *et al.* (2002) looked at the operations of two MFIs in Ecuador (Banco Solidario) and Bolivia (Caja los Andes) utilizing the CGAP poverty index noted above to establish outreach and a logit regression model (where being a client and taking a loan gives a dependent variable of 1.0 and being a non-client a dependent variable of zero) that links participation in a programme with income changes and poverty scores. It is found that, for both institutions, taking a loan is associated with increases in income. However, income change is measured not by the size of monetary values, but by a simple scoring system (one for income decrease, two for unchanged income and three for income increase). The relation with poverty varies since, in the case of Banco Solidario, greater poverty is associated with a greater probability of taking a loan and, in the case of Caja los Andes, with a lower probability. On the other hand, Banco Solidario has a greater depth of outreach, as 75% of its clients belong to the lower and intermediate groups as defined by the CGAP poverty score, as compared with 48% for Caja los Andes. Again, it seems that it is the better-off amongst the poor who are benefiting. Limitations of this analysis are the crudity of some of the indicators, for example for income change, and the way in which a control group of non-clients is selected; that is, from households in the same locality that have micro-enterprises in the same sector as the borrowers and that have not had a loan from a formal sector institution. This simply ignores the issue of self-selection bias and does not control for factors such as education and skills.

From a nutritional perspective MKNelly & Dunford (1999), looked at the impact of credit with education loans to women in rural Bolivia. A relatively rigorous approach was applied by collecting data 2 years apart from a participant group and a control group, who would be offered the credit at the end of the study period. In addition, amongst the participants a sub-group of those who joined during the course of the study, rather than immediately, was examined separately. Small loans were available in combination for

**Table 5.** Cost-effectiveness ratios:<sup>a</sup> Bangladesh early 1990s

Intervention	Female	Male	All borrowers
Grameen Bank	0.91	1.48	
BRAC	3.53	2.59	
Agricultural Development bank (BKB) <sup>b</sup>			4.88
Agricultural Development bank (RAKUB) <sup>c</sup>			3.26
Vulnerable Group Development			1.54
Food for work (CARE) <sup>d</sup>			2.62
Food for work (World Food programme)			1.71
Food for education <sup>e</sup>			0.94 (1.79)

<sup>a</sup>Ratio of costs to income gains to the poor.

<sup>b</sup>Bangladesh Krishi Bank.

<sup>c</sup>Rajshahi Krishi Unnayan Bank.

<sup>d</sup>Run by CARE on behalf of USAID.

<sup>e</sup>Source: Wodon (1998); figure in parentheses is the cost-effectiveness ratio for the very poor.

Source: Khandker (1998), tables 7.2 and 7.3, and Wodon (1998).

training in health and nutrition, as well as micro-enterprise management topics. Roughly two-thirds of participants reported an increase in income over the study period and their net incomes in 1997 appeared to be far higher than the control group (perhaps casting some doubt on the representativeness of the latter). However, on the key concern of the study, nutritional status (e.g. child height-for-age or weight-for-height measures), there was little evidence of any impact as a result of the programme. The most positive result was that for households suffering “food stress”, participants were less likely to sell off animals and more likely to take out loans as a coping strategy, than were non-participants.

In general, for Latin America the available studies suggest that MFIs, whilst they may be flourishing in commercial terms and providing a valuable service to micro-enterprises often run by poor entrepreneurs, have a relatively weak impact on those at the very bottom of the income distribution.

#### **4. Forms of Micro Credit Interventions and Cost-effectiveness**

Experimentation and local variation are likely to be important aspects of successful MFIs. A few studies (more in Asia than in Latin America) have looked in detail at the impact and cost-effectiveness of different forms of intervention. The Hulme & Mosley (1996) cross-country study of 13 institutions in seven countries (including Bolivia in Latin America and Bangladesh, India, Sri Lanka and Indonesia in Asia) found that loan impact, in terms of change in borrower income (which is not necessary the same as poverty impact), was greater in the more financially viable institutions (such as BRI and BancoSol). They explained this in terms of the screening efficiency of higher interest rates and tighter repayment conditions, which deter less financially sound borrowers. The institutions involved used a range of delivery mechanisms and the analysis does not allow clear distinctions between these. Within-country comparisons by ownership are made explicitly in Park & Ren (2001), who looked at the Chinese experience, drawing on household survey data for 1997. They were able to compare three types of programme based on ownership characteristics—NGO-based, mixed programmes and government ownership. Whether in terms of conventional financial criteria like repayment rates, or measures of initial impact like targeting effectiveness, the NGO programmes appear to function best, with the government-run programmes the least successful.

Detailed mechanisms for micro lending were examined for Thailand by Kaboski & Townsend (2002), who looked at different institutional variants such as production credit groups, women’s groups, rice banks and buffalo banks, as well as a variety of services including training and various savings facilities. Of the forms of institution, allowing for a range of other factors, women’s groups appear to have the largest positive impact on their members. Of the services offered, training in conjunction with credit appears to work well and the availability of savings facilities appears to be associated with asset growth amongst households. Of the savings services, regular “pledged savings” have the largest positive impact. Explanations offered for this include the use of savings as collateral for further loans, either from the institution itself or from other sources, and a reduction in the cost and risk of infrequent deposits and withdrawals. However, since the poorest may not be in a position to make regular savings, this also provides an explanation for why they may benefit relatively less from MFIs.<sup>15</sup>

Most studies of the impact of different forms of microfinance do not conduct a full cost-effectiveness analysis to judge the effectiveness of different alternatives and how



microfinance interventions compare in efficiency terms with other ways of reaching the poor. However, there is often a general expectation that MFIs are an effective and efficient means of reaching the poor. For example, Wright (2000) argued that "... microfinance has a particular advantage over almost (and probably) all other interventions" in providing cost-effective and sustainable services to the poor. In fact, the evidence to support such a strong claim is not yet available. Bangladesh and Bolivia, the most widely studied countries for microfinance, provide most of the evidence on its cost-effectiveness.

The early work by Khandker (1998) attempted to assess the cost-effectiveness of micro credit in Bangladesh (i.e. costs per taka of consumption for the poor) as compared with more formal financial institutions and other poverty-targeted interventions. His data are summarized in Table 5. They appear to be based on the assumption of a zero leakage rate to the non-poor. The interesting result that emerges is that the Grameen Bank is considerably more cost-effective than BRAC and that, as expected, loans to female borrowers are considerably more cost-effective than loans to males. Further, subsidies to Grameen (but not to BRAC) appear to be a more cost-effective means of reaching the poor than various food-for-work programmes. However, a food-for-education scheme appears very cost-effective relative to the food-for-work programmes and to BRAC.<sup>16</sup> Formal financial institutions are less cost-effective than Grameen for both female and male borrowers and less cost-effective than BRAC in some, but not all, cases examined (Khandker, 1998, p. 134–139). The high figure for BRAC is in part due to the range of services, such as training, offered in addition to micro credit, but none the less, if such services are essential to the success of micro credit, including their cost in a cost-benefit assessment of micro credit is legitimate.

The above data provide ambiguous support for the idea that microfinance is a cost-effective means of generating income for the poor. The figures for Grameen support this view, whilst those for BRAC do not. More recently, a couple of other estimates have become available. Burgess & Pande (2003) examined whether the pattern of commercial bank expansion in India into rural areas, previously not served by banks (so-called "social banking"), has impacted on rural poverty, and their work allows a simple comparison with microfinance. Their estimates suggest that it costs Rs2.72 to generate an additional rupee of income for the poor via the social banking programme. Compared with the data in Table 5, this ratio is higher than the cost-effectiveness ratio for Grameen, but lower than that for BRAC.<sup>17</sup>

A further look at the effectiveness of Grameen is provided by Schreiner (2003), who calculated the subsidy-lending ratio at 0.22 over the period 1983–97. This is not directly equivalent to the ratios in Table 5, but assuming the same return on borrowing as in Khandker (1998), these figures can be converted into a broadly equivalent ratio of cost-to-gains to borrowers of 1.15. This is consistent with the figures in Table 5, which would need to be averaged to give an overall return to male and female borrowing combined. The result confirms Grameen as a relatively cost-effective form of poverty intervention, although it says nothing about how the benefits from its activities are distributed between the poor, the very poor and those above the poverty line.

For Latin America, Mosley (2001) provided a rare, if approximate, estimate of cost-effectiveness of MFIs relative to other poverty interventions in Bolivia. He compared the estimated numbers in a particular area brought over the poverty line by four different MFIs, as a result of micro credit, with the organizations' expenditure that can be allocated to activities in that area. This gives a cost per person brought out of poverty for four MFIs that use different approaches. BancoSol and PRODEM are more commercial, with greater



use of individual loans, whilst ProMujer lends largely to women in urban co-operative groups and Sartawi offers both group and individual loans, but also provides a range of training and education services in addition to credit. Cost-effectiveness in the MFIs, defined as the cost per person brought out of poverty, is US\$603 for BancoSol, US\$467 for ProMujer, US\$373 for PRODEM and US\$589 for Sartawi. These figures are not directly comparable with those for Bangladesh reported in Table 5, as the latter are the ratio of MFI costs to benefit in income (or consumption) received by the poor. Although the range is relatively wide, perhaps due to the approximate nature of the calculations, the author suggests that they show that there is little difference between the institutions and that no one model dominates micro credit delivery in Bolivia (or indeed elsewhere). There are also some approximate comparisons with the cost of poverty reduction from Social Fund investment in health, education and rural roads, which show microfinance from all of the institutions to be lower cost than the Social Fund programmes.<sup>18</sup> However, the cost-effectiveness figures found for MFIs in Bolivia in dollars per person brought out of poverty are much higher than some of the anecdotal figures used for Bangladesh. The fact that these estimates, approximate as they are, provide one of the few indications of the cost-effectiveness of MFIs in Latin America is an indication of the undeveloped nature of research on this issue in the region.

In general, there is limited support for the view that MFIs can be cost-effective ways of reaching the poor, although the range of figures within both Bangladesh and Bolivia suggests that this is far from inevitable for all types of MFI. BRAC, in particular, appears relatively high cost. However, even if it could be shown that microfinance uniformly outperformed other targeting measures in cost-effectiveness terms, one could still not conclude that other measures should be abandoned and their funds diverted to microfinance. As Khandker (1998) pointed out, participants to microfinance borrowing self-select (that is, they judge that micro credit suits their particular needs, often for self-employed work), whilst microfinance may not be suitable for others amongst the poor. For this latter group, perhaps more risk-averse or more disadvantaged, other forms of targeting will still be required.

## **5. Conclusions**

Despite the current enthusiasm in the donor community for microfinance programmes, rigorous research on the outreach, impact and cost-effectiveness of such programmes is rare. Design of aid programmes would ideally incorporate evidence on all three points, but the research that does exist generally focuses on only one of these criteria: either outreach, impact *or* cost-effectiveness. In part this reflects the difficulty of establishing an appropriate statistical methodology and implementing those standards in practice, and in part no doubt reflects the variation found in practice in the way in which microfinance operates. Critical to establishing impact accurately is the need for an appropriate control group. The evidence surveyed here suggests that the conclusion from the early literature, that whilst microfinance clearly may have had positive impacts on poverty it is unlikely to be a simple panacea for reaching the core poor, remains broadly valid. Reaching the core poor is difficult and some of the reasons that made them difficult to reach with conventional financial instruments mean that they may also be high-risk and therefore unattractive microfinance clients. None the less, reaching the “better-off” poor or potential micro-entrepreneurs with microfinance services remains an important element in a poverty

reduction strategy. The implication is rather that, for the core poor, it will not be credit alone that will be required, but credit plus a range of support services.

Asia has much to learn from Latin America in terms of developing a vibrant commercially oriented MFI sector. However, MFIs in Latin America have often been seen as a vehicle for the development of the micro-enterprise sector rather than as a tool for the removal of core poverty, which was its initial focus in much of Asia. Work on Bolivia has demonstrated this, at least for that country. There has been an extensive debate that we do not touch on here, on the financial sustainability of MFIs. We would simply make the point that just because an institution needs a subsidy to cover its costs is not in itself a reason for not supporting the institution. The issue would be what benefits, in terms of income gains for the poor, can be achieved with the subsidy and how the ratio of subsidy-to-benefits compares with that for other interventions. Detailed cost-effectiveness studies are rare and those that are available show both high and low scores for MFIs in the same country. Hence, there is a need continually to improve design and outreach and to see MFIs as part of the package for targeting the poor, rather than the whole solution.

Our view is that, despite the difficulties, there is a need for more careful research on the outreach, impact and cost-effectiveness of microfinance programmes—studies that rigorously address the critical issues of selection and placement bias. Such studies can inform the debate on the way forward for microfinance by sharpening the donor community's understanding of the role of microfinance in reaching the poor, its impact in different environments, and its cost-effectiveness as a poverty intervention.

## Notes

- <sup>1</sup> An earlier helpful survey published by ADBI is that by Meyer (2002). This draws out some of the methodological problems in assessing impact and surveys a number of important studies available at the time of writing (around 2001). Morduch (1999) is an extremely authoritative earlier survey focusing on both conceptual and empirical questions.
- <sup>2</sup> *Microbanking Bulletin* reports only data on a limited number of MFIs who chose to participate. Those reporting to the *Bulletin* are thought to be amongst the best and are therefore unlikely to be representative of the industry as a whole (Meyer, 2002, p. 14).
- <sup>3</sup> Patten *et al.* (2001) found evidence that the microfinance side of the Indonesian banking system performed much more robustly during the macro crises of the late 1990s than did the commercial banking sector.
- <sup>4</sup> In Sri Lanka, the microfinance sector is highly subsidized, discouraging entry by private commercial banks, but Hatton National Banks (HNB), Seylan Bank and Sampath Bank have become involved in the sector. However, Charitonenko *et al.* (2004) reported that, combined, their micro loans accounted for 1.2% of the industry total at the end of 2000 and that none of the microfinance programmes were profitable, so the future involvement of private commercial banks in microfinance in Sri Lanka is questionable.
- <sup>5</sup> An important attempt to address this problem is the Income Generation for Vulnerable Group Development (IGVGD) programme, run by BRAC in Bangladesh, which combines measures of livelihood protection (food aid) with measures of livelihood promotion (skills training and micro credit). Hence, micro credit is provided as part of a package approach. Matin & Hulme (2003) surveyed the evidence on how far the benefits of this programme actually reach the core poor and concluded that, although the programme was more successful than more conventional micro credit schemes, none the less many target households were still missed.
- <sup>6</sup> CGAP reports that the CGAP-PAT has been used to assess the relative poverty level of clients of seven MFIs—two of these are in Asia and two in Latin America. Three of these MFIs, which explicitly identify serving the poorest of the poor as an institutional mission, appear to be succeeding in that goal.

Institutions with broader goals tend to serve a clientele that is more representative of the communities in which they operate, which may or may not be poorer than the national average.

- <sup>7</sup> The analysis of covariance (ANCOVA) essentially allows separate parallel regression lines to be fitted through the data for the treatment (borrower) and control groups. The regression lines measure the outcome variable for a given year ( $t + n$ ) relative to an earlier year ( $t$ ). In so far as a programme like micro credit has a tangible effect, this will be picked up by the distance between the two lines, that is, by the difference in intercept terms. The statistical significance of this distance gives a test for the impact of the programme.
- <sup>8</sup> This discussion draws extensively on Coleman (2001).
- <sup>9</sup> See Hulme (1999) for a discussion of different approaches to impact.
- <sup>10</sup> Poverty is based on a calorie intake of 2112 and extreme poverty on one of 1739.
- <sup>11</sup> This debate, which in part centres around details of econometric estimation, has not been resolved. An unpublished paper by Pitt reworks the original analysis to address the concerns of Morduch and is said to confirm the original results (Khandker, 2003, note 1).
- <sup>12</sup> Unlike the Khandker studies, these data pick up households before they joined a micro credit scheme. Their vulnerability measure is broader than simply fluctuations in consumption.
- <sup>13</sup> There is some ambiguity in the interpretation of poverty impact, since the definition of the head-count poverty index in the notes to table 5 in Mosley (2001) does not seem to match the explanation in the text. This refers to between 10 and 20% “of borrowers” crossing the poverty line as a consequence of microfinance. We take this to mean “of poor borrowers” given the low poverty outreach reported in table 5.
- <sup>14</sup> To explain this worrying result, the authors suggest that, as the poverty measure is expenditure based, new borrowers may curtail their consumption in the short term to invest in their micro-enterprise at the same time as they take out a new loan and that this lower consumption may show up as higher poverty in the short term.
- <sup>15</sup> Fujita (2000) made this point in the context of Bangladesh.
- <sup>16</sup> The study on this scheme by Wodon (1998) appears to be considerably more sophisticated than the other studies and compares costs with the future stream of estimated benefits to the poor in terms of gains from education. The ratio for this activity may not be directly comparable with the other figures in the table.
- <sup>17</sup> It should be noted that the benefits from Grameen lending found in Khandker (2003), which are almost half of those found in his earlier study, imply considerably higher cost-effectiveness ratios than those reported in Table 5, unless there has been a corresponding rise in the efficiency of operations.
- <sup>18</sup> As defined in Mosley (2001, table 5), the indicators for the MFIs and the Social Fund programmes are not directly comparable as the former are cost per person brought out of poverty and the latter are cost per income benefit received by the poor. Additional assumptions would have to be used to convert the ratios for the Social Fund programmes to cost per person brought out of poverty, but these are not referred to.

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