Microcredit & its Significance in Sustainable Development and Poverty Alleviation: Evidence from Asia, Africa, Latin America and Europe

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Abstract

The paper examines the role of microfinance in poverty alleviation by focusing on various microfinance programmes in several countries in Asia, Africa, Latin America and Europe. In doing so, it also explores the constraints faced by poor people who want to avail the scheme. Various constraints faced by both the lender (financial institutions) and the borrower (rural people) have been appraised including transaction costs, time, collateral, insufficient or fewer programs, government intervention or political patronage and social, political and occupational segmentation of society. Specifically, the study focuses on the Grameen Bank and Bangladesh Rural Advancement Committee (BRAC) and how these contribute in reducing the incidence of poverty in Bangladesh. Innovations like collateral-free group-based lending of the Grameen Bank have been widely replicated in other countries. These initiatives have not only reduced poverty but have also contributed in improvement in nutrition, better health, and education and employment opportunities.

Keywords: Microfinance, Microcredit, Grameen Bank, Bangladesh Rural Advancement Committee (BRAC), Sustainable Development, Poverty Alleviation

Introduction:

Evidence shows that microfinance plays a pivotal role in poverty alleviation.[1] It fulfills the broad range of population needs by reducing

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the poverty, improving health and education and also helps in establishing small businesses.[2] The role of microfinance is instrumental because it not only gives resources to the poor but also provide them economic empowerment.[3]

This paper is an attempt to explore the role of microfinance and microcredit concept and its significance in poverty alleviation and sustainable development. It also appraises various efforts made by Micro-finance institutions (MFIs) and microcredit enterprises for the reduction of extreme of poverty through rural credit. It highlights various issues associated with microcredit from the lender as well the borrower perspectives. Some strategies and innovations adopted by MFIs have been enormously successful in the alleviation of poverty and empowerment of rural women. According to Sophie, Posarac, and Vick effective strategies of microfinance helped in improving socio economic status of the masses as these are opportunities for the poor to earn better livelihood and helps them to live with self-esteem.[4] This research paper also throws light on the features of successful programs and on the drawbacks of failed interventions. By reviewing relevant literature on various microfinance interventions in different countries, recommendations and suggestions are given in the end.

Microcredit and Microfinance:

Majority of the population in the Third World countries live in rural areas and is often not in good condition due to myriad of factors. Most landless and marginal groups are in the vicious cycle of poverty for decades. As for as grants and loans from the state and other commercial banks are concerned, in most cases, they do not have access to the facilities provided.[5] Majority of these rural poor depends and relies on traditional informal money lenders.[6,7] The conventional banks and other financial institutions are not ready in most of the cases to take the risk of bad debts.[8] Due to this in developing countries majority of peoples do not have their access to avail loans. This is one of the main reasons for increasing the level of poverty in developing countries.[9]

Microcredit and microfinance initiatives have played significant role in the alleviation of rural poverty in different developing countries. Microfinance programs provide poor people with small loans given to jointly liable self-selected groups.[10] Microcredit provides financial capital for poor entrepreneurs who toil in the informal, poverty sectors in developing country economies.[11] According to the United Nations Children's Fund, microcredit is the extension of small loans to groups of poor people, especially women, for the purpose of investing in self-employment programs.[12] According to Armendáriz, "The principal objective of the programs is to raise incomes and broaden financial markets by providing financial services, principally credit, to small-scale entrepreneurs who otherwise lack access to capital markets."[13] Various academics, researchers and practitioners involved in microcredit enterprises claim that the impacts of microfinance are substantial in rural livelihoods. By quoting widely from a number of writers whose experience range from Asia to Africa and from Latin America to Europe, Goldberg[14] in his comprehensive and detailed analysis of the impacts of microfinance on the reduction of poverty is of the view that microfinance has been quite successful in its objective−the alleviation of poverty. By evaluating the findings of different researchers, the same author asserts that microfinance has been and can be more effective tool in bringing self-sufficiency and prosperity in rural livelihoods. The success of microfinance and its international recognition have created a growing social demand and expectations that it can be used as a tool for promoting microenterprises as well.[15] It is argued that microfinance provider can also provide trainings on business opportunities and challenges. This is possible by supporting borrowers with informal training and education.[16] Tsai[17] claims that microfinance programs have emerged as a potential solution for bridging the gape between the supply and demand for rural finance. Various microcredit initiatives have not only taken the poor out of the vicious cycle of poverty but have also been helpful in reducing or eradicating other social ills which contribute to poverty (Grameen Bank Sixteen Decisions).[18] Once these rural poor begin their journey of self-sufficiency and stand on their own feet, slowly and gradually they make their way out of chronic poverty. Access to microfinance initiatives enables rural household children to have better nutrition and increase school enrolment rate.[19] The same author further adds that microfinance programs have wider impacts including empowerment of women and other marginal groups, use of contraceptives, increase in wages and employment opportunities, better nutrition, and health and education opportunities besides the alleviation of poverty.

Key constraints faced by the Lender (financial institutions) and the Borrower (rural poor):

The role and significance of microfinance and microcredit can not be denied in the alleviation of poverty. As discussed earlier, some programs (e.g. Grameen Bank in Bangladesh) have been quite successful in their objective of eradication of poverty through microenterprises and microcredit. But as a whole, it is not a smooth process as there are various factors and issues which create hindrances and become constraints for both parties (lender and borrower) involved.

Among various constraints, one of the key issues faced by banks and other financial institutions is the transaction.[20] Rogaly[21] has rightly pointed out that lending money runs the risk of losing it. The same author goes on to say that to assess who should be given credit, potential borrowers are screened. It may be a long and slightly complicated process which involves gathering information about different individuals and their belongings which may not be easily available and which may take quite some time. The transaction costs also include time, travel and a lot of paper work. "Then enforcement costs are incurred to ensure repayment, and risks (though reduced) still remain. If a loan is disbursed on condition that it is used for a certain purpose, supervision costs also arise".[22] For microfinance to be more effective, transaction costs including supervision etc should be less than the interest earned through loans.

Besides transaction costs, it also takes enough time to finalise the first disbursement of loan to respective borrowers. It is another issue that most borrowers do not like these official formalities and unnecessary delays. That is why they prefer traditional informal moneylenders which often take less time than formal banking system. In most cases (in case of disease, dowry, funeral or some other emergency situation etc) borrowers are in need of quick capital and it compels them to go to the traditional moneylenders despite their high interest rate and other conditions. "Interest rates are usually high and transaction costs are low and disbursement is normally quick."[23] By giving the example of traditional moneylender from Africa, the same author further adds that the average time taken between first approaching the lender and getting the cash was 2.28 days. So the issue of time is another important constraint faced by both, the lender and the borrower. Even the quick response of formal financial institution like that of the Grameen Bank which takes one to two weeks in disbursement of loan cannot be compared to the traditional moneylenders in this regard.[24]

One of the key constraints faced by rural communities in dealing and utilising microfinance opportunities is the issue of collateral. The conditions of credit access such as collateral, third party guarantees and savings requirements are among the key constraints faced by rural poor.[25] In most cases, it is imperative for the borrower to have some assets or entitlements etc which may either be mortgaged or presented as a guarantee to microcredit institutions. Most rural people who do not have land, home or property etc are unable to access microcredit enterprises. In the words of Morduch[26] "many low-income households lack assets to put up as collateral."[27] By giving the example of microcredit opportunities in India and the issue of collateral, Basu[28] claims that the criteria for obtaining these loans, for example, loans for the installation of pump sets and tube wells, is that farmers should be able to offer 10-15 acres of land as a mortgage. If the farmers are very poor and are landless, it means that they would never be able to access these facilities.

It is because of this constraint that rural poor depend on traditional moneylenders for loans who sometimes do not ask for tangible collateral. In such circumstances either character of the borrowers or their social assets or links can enable them to seek loans from informal money market. The absence of suitable assets which can serve as collateral for loans necessitates a close lender-customer connection wherein information about the capability and character of the individual borrower becomes a substitute for collateral.[29]

In some cases, even if the rural communities possess collateral in the form of property, like land or home, they may not be able to offer it as collateral because of rules and regulations forbidding them from doing so. Also it is often not possible to use land etc as collateral because of ambiguous or unrecorded traditional title.[30] Sometimes in documents such property belongs to more than one owner while the actual possession is held by one person. In such cases, it is also not possible to mortgage it or present it as collateral. Such absence of property rights makes the transfers or inheritance of property difficult and hence creates obstruction for the owners to utilise it properly, particularly dealing with financial institutions.[31]

In most cases, subsidized loans or microfinance initiatives are affected and influenced by political patronage. "Loans often ended up subsidizing well-off, politically-connected entrepreneurs rather than poor households".[32] Referring to the same problem in microfinance interventions in Thailand, Coleman[33] claimed that the wealthiest often become program committee members and borrow substantially more than rank-and-file members. Political interventions and linkages prove negative both for the borrowers as well the lenders. In such circumstances the real objective of microcredit, the alleviation of poverty is difficult to achieve.[34]

Another constraint faced by rural poor to microfinance programs is simply their inability to reach or make access to financial institutions.

In most cases, these institutions operate mainly in urban areas and do not outreach to the rural poor.[35]

As stated earlier, majority of the Third world poor population is concentrated in rural areas which make it difficult for microcredit institutions to reach to them. Tsai[36] has also highlighted this point by asserting that the supply of formal finance is limited and insufficient to meet the demand of the rural poor for credit. Due to long distances from different branches of the banks, the rural poor often can not access these facilities. Even if in some cases the banks are accessible, illiteracy, ill-health and other factors (Table 1) make hindrances for them. In the words of Evans "Singly or in combination, these factors work to prevent the eligible poor from taking advantage of microcredit opportunities". [37]

These authors further claim that the poorest 20% of the population are excluded from microcredit programs. They also enumerate other factors for their exclusion like the limited number of microcredit programs and membership barriers etc. Program participation and membership may require payment of registration fees, attendance at weekly meetings and the accumulation of weekly savings. It may also require filling different forms and it is this documentation process that sometimes discourages the rural illiterate poor. In the words of Tsai (2004) "Government-sanctioned microfinance programs are often structured in a manner that fails to serve its intended clientele".[38]

Table 1. *Conceptual framework of barriers to participation in microcredit programs*

Program-related barriers	Client-related barriers
— Insufficient supply of microcredit	— Insufficient resources
— Membership requirements	— Ill-health or vulnerability to crisis
— Peer group expectations	— Female head of household
— Institutional incentives	— Lack of education
	— Individual and household preferences

Source: Evans et al. 1999.

Another constraint which limits access of the rural communities to microfinance is social and political segmentation of communities and societies. By giving the examples of India and China, Tsai asserts that "market segmentation also occurs along political and social lines, which further distorts the way local credit markets function in practice".[39] The same author further adds that besides social and political factors, tribal, caste, gender and occupational segmentation also plays its role in local credit market. In various cases in India and China, these factors limit access of borrowers to microfinance initiatives.

Evaluation of various Microfinance programs in different countries:
Microfinance is emerging as an integral part of the new development paradigm and the idea has become quite popular among donor agencies, development practitioners, and academicians.[40,41] In most of the Third world countries, it is perceived as an efficient tool for the eradication of poverty and different initiatives have been carried out with encouraging results and impacts. Goldberg has given a comprehensive assessment of various programs and their impacts on the eradication of poverty. These initiatives have been implemented in diverse settings and in many cases the impacts are healthy. As a whole, the scenario is optimistic for microcredit enterprises.[42]

One of the outstanding programs has been that of the Grameen Bank in Bangladesh. By quoting Khandker, Goldberg claims that between 1991/92 and 1998/1999 moderate poverty in all villages in Bangladesh declined by 17%.[43] The Grameen Bank not only reduced incidence of poverty but also contributed in the empowerment of women and eradicating social ills. Along with the Grameen Bank, Bangladesh Rural Advancement Committee (BRAC) has also played significant role in the provision of health, education and food etc services.[44] The organizational structure and mode of operation of the Bank, and its innovation of group formation of the like-minded borrowers makes it easy for the borrowers to access it without collateral.[45] The Bank also stresses on participation in training sessions and workshops and keeps a vigilant eye on the borrowers to invest loans in productive ventures immediately. The impacts of these microfinance initiatives in Bangladesh could be summed up in the words of Khandker "microfinance can account for some 40 percent of the overall reductions in poverty in rural Bangladesh".[46]

Coleman[47] has thrown light on two microfinance interventions in Northeast Thailand. Both these programs were not very successful in targetting the intended customers. Mostly well-off people benefited and got huge loans from MFIs because the village bank members were already rich. That is why the objecitves of these schemes were not achieved. There were minimal or no impacts on physical assets, savings, health, education or nutrition etc.

By citing reports from Honduras and Mali, Goldberg[48] claims that the effects of microfinance initiatives were quite successful in these places. There was clear difference and increase in inocomes of the program participants than those of non-clients. Particularly those clients who stuck to these schemes for longer time showed improvements in various aspects.

Table 02. Clients vs. Non-clients.

	Clients	**Non-Clients**
Monthly Profit (lempiras)*	7,214	4,125
Savings Increased (percent)	47	23
Income Increasesd (percent)	57	40

Source: Goldberg (2005).

*The exchange rate was approximately US$1=13 lempiras at the time of survey

Makina and Malobola[49] evaluated the impacts of Khula Enterprise Finance, a South African wholesale finance institution that does not provide loans directly to clients but facilitates access to finance by small, medium and microenterprises (SMMEs). The authors claim that the impacts are greater on higher income people than on lower income or poorer clients. The reason is that "there is a strong tendency among poor people to use credit for consumption rather than for investment".[50] By quoting Mosley & Hulme,[51] authors are of the view that impact also depends on the nature and design of the intervention. If MFIs are well-designed and the staff is committed then their impacts are also significant and targets of reaching to the poorest and attaining financial self-sufficiency could be achieved.

Pretes[52] has assessed the mode of operation and performance of the Village Enterprise Fund (VEF), a microfinance non-governmental organisation (NGO) that offers small grants to poor entrepreneurs for business or any productive activity. The VEF also emlpoys group formation mechanism for offering grants. To be eligible to get grants, the applicants first describe their future intensions of new business, its requirements, expected costs and expected sales and profits. Besides grants, clients are also imparted relevant training to enable them to carry out their ventures successfully. At present, the VEF is active in Kenya, Uganda and Tanzania. Pretes[53] claims that besides other advantages, "grant-based programs also have the best chance of reaching the very poor".[54]

Buckley[55] has questioned the significance of microfinance initiatives in Malawi, Kenya and Ghana. He is doubtful that despite enormous expansion of microcredit schemes in almost all Africa, there is little to be optimistic about their positive impacts on the intended beneficiaries. In the absence of basic rights like education, nutrition, health services and employment opportunities; microcredit enterprises can offer little to eradicate poverty, asserts the above writer.

Conclusion:

By studying and analysing various microfinance and microcredit schemes after reviewing relevant literature, it can be said that depending on the program and design of the institution, and on socio-economic and political settings, eradication of poverty is possible to a large extent. Efforts should be made to expand the scope of these interventions and reach to the poorest lot, particularly to those socially and geographically distanced.[56] These initiatives have indeed produced significant results, but a lot more to be done to reduce social injustice and maximise the impacts. Mere reproduction and replication of the existing successful schemes may not work in a different environment and setting. Nothing is ideal and perfect, academics and practitioners should research and try innovations like group-based loans and something new.

MFIs should make efforts to simplify their criteria of registration or access to loans. They should find ways to develop and maintain simple operational, management and accounting structure and system so that rural poor may find them easy to access and swift to act. The more they simplify their mode of operation, the more the clients will be attracted. There should also be some emphasis on the entrepreneurial skills of the borrowers. Relevant training and short local courses will prove very fruitful in this regard. Appropriate stake-holders analysis focusing on the needs, priorities, abilities and skills of the intended beneficiaries may create suitable environment for microcredit enterprise and yield better results. [57] Consideration should also be given to as what degree of importance is necessary to be given to microcredit against services like education, health, and infrastructure or awareness creation.

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