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The Impact of Microfinance Services: Increasing Income or Reducing Poverty?

Graham A.N. Wright

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Abstract

When examining the income impacts of Microfinance programmes, it is important to recognise that there is a significant difference between "increasing income" and "reducing poverty". Despite the prevalent emphasis on raising incomes as the central objective of development programmes, the two are not synonymous. Clearly, the use to which income is put is as important in determining poverty and welfare as the level of income itself - increased income can be (and often is) gambled away. It is also important to recognise that poverty is neither linear nor static, and that today's not-so-poor may well be tomorrow's poorest - and vice versa. It is for this reason that the poor place so much emphasis on diversifying their sources of income - it reduces their exposure to catastrophic income loss. Finally, in the context of the drive to create businesses that provide jobs, the differences between the quality of formal and informal sector employment must be noted. These differences also explain why, for many, having diversified sources of home-based income is preferable to depending on exploitative employment. It is clear that, given the right economic conditions, (reasonable levels of inflation, access to markets etc.), well designed Microfinance services can reduce poverty[2].

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Examining The Impact of Microfinance Services: Increasing Income or Reducing Poverty?

Graham A.N. Wright

Introduction

In the last five years, Microfinance, the provision of savings and credit services to the poor, has grown to become a much favoured intervention amongst international development agencies. There is scarcely a multi-lateral, bilateral or private development donor organisation not involved in the promotion (in one form or other) of a Microfinance programme.

Rogaly (1996) noted the "hard selling of a new anti-poverty formula" by the "micro-finance evangelists". In the same year, Preparatory Committee Meetings for the "MicroCredit Summit" clearly showed the tensions between the RESULTS PR machine committed to publicising and promoting the "MicroCredit Revolution", and the angst-ridden practitioners so keen to discuss both its success and short-comings in order to learn how programmes might be further improved.

Many claims are made about the impact of Microfinance programmes, and an outside observer cannot but wonder at the range and diversity of the benefits claimed. This paper will try to examine some of the claims and counter-claims in the light of a practitioner's experience of Bangladesh, the cradle of MicroCredit (if not Microfinance), with passing reference to published research on programmes elsewhere across the globe. It is important to try to understand what Microfinance programmes can and cannot achieve, not least of all to optimise resource allocation and targeting.

The paper examines whether we should be worried about "Increasing Income or Reducing Poverty ?". It contains sub-sections on how and what we should measure ("How Do We Know, and Is Income What We Should Be Looking At Anyway ?"); the importance of diversified sources of income ("Security in Diversity"); whether microenterprise development assistance or employment helps ("But What About Business Development Services and Employment ?"); if minimalist Microfinance services have made a substantive difference ("So Has There Been Any Increase in Incomes With All This Minimalism ?"); and finally, what about "Serving the "Poorest of the Poor"".

<u>MicroCredit v. MicroFinance</u>
(A Definitional Digression)

Grameen Bank began lending operations in 1976, but has since then paid scant attention to savings (except as a source of capital and loan guarantee [Wright, Hossain and Rutherford, 1997]), an approach that has dominated thinking and practice throughout Bangladesh. The Grameen, credit-driven model is the inspiration for the "first wave" of MicroCredit programmes. The model is based on the premise that the poor need loans and that "credit is a human right".

The original slogan of MicroCredit Summit Campaign was "Working to ensure that 100 million of the world's poorest families, especially the women of those families, are receiving credit by the year 2005." This prompted many to suggest that it could be more simply re-stated as "Driving 100 million women into debt by 2005" ! A typically inelegant committee-compromise was reached and the slogan was amended to read: "Working to ensure that 100 million of the world's poorest families, especially the women of those families, are receiving credit for self-employment and other financial and business services by the year 2005."

Increasing numbers of practitioners (Robinson, 1994 and 1995; Otero and Rhyne (eds.); 1994, Rutherford, 1995; and Wright, Hossain and Rutherford, 1997) are stressing the importance of offering a range of quality, flexible financial services in response to the wide variety of needs of the poor - this approach is known as Microfinance.

Increasing Income or Reducing Poverty ?

How Do We Know, and Is Income What We Should Be Looking At Anyway?

Rogaly notes that "Mansell-Carstens argues that direct investigation of impact is suspect, for several reasons:

- respondents may be interested in giving false information if the loans have been used for a purpose other than the stipulated one[3];
- establishing a causal relationship to the actual loan in question involves knowledge of all the beneficiary's sources and uses of funds; and
- it is difficult to establish what could have happened if the loan had not been made (Mansell-Carstens, 1995: 103)."

Kobb (1997) also examines the problems (practical and theoretical) arising from trying to measure impact through changes in income. He notes that incomes are heavily skewed - several high-income earners distorted averages, that respondents are influenced by the way and by whom questions are asked ("Interviewees are likely to provide strategic rather than truthful answers."), and that disentangling project impact from "exogenous factors" is impossible. Kobb offers alternative measures - they revolve around PRA, case studies and qualitative techniques. "One advantage of this methodology is verifiable, observable indicators (p.46)."

Despite these objections, the declared aim of Microfinance programmes generally includes a reference to "increasing the income of the target group" or some similar income-denominated objective. Implicit in this is that increased income results in a reduction in poverty. This assumption requires careful examination. On a simple, money-determined level, if increased income is simply spent in the cinema or at the tea-stall or on alcohol, there is no increase in wealth and no reduction in poverty. In addition, in the words of Sharif (1997: 69), "Poverty, ... is not only about having inadequate income or income below the "poverty line", but is also about the inability to sustain a specified level of well-being".

A focus on "income poverty" is usually associated with seeing poverty-reduction as a process of moving households from a stable "below poverty line" situation to a stable "above poverty line" situation. This leads to strategies aimed at "raising persistently low incomes" (Dreze and Sen, 1989). In the context of financial services, these strategies, emphasise (often exclusively) the provision of credit for income-generation through self-employment. A broader, less linear, view of poverty sees income levels as fluctuating below and above the poverty line. Strategies to address poverty seen in this way seek to reduce dramatic decreases in income as a means for poverty alleviation and introduce a quite different way of viewing the role of financial services. "Protectional strategies ((Dreze and Sen, 1989:60-61) become significant: in terms of financial services this fosters a focus on voluntary savings mechanisms, emergency consumption loans and relatively low-risk income generation activities that are unlikely to create indebtedness" (Hulme and Mosley, 1997:100).

Here is a clear statement of the case for Microfinance programmes to provide a variety of financial services tailored to the specific needs of the clients (be they extreme, moderate or not-so-poor). The financial services should allow clients to manage their household income and expenditures more effectively. To do this, the financial services should provide options both to minimise "shocks" (arising from illness or death in the household, crop failure, theft of key assets, dramatic price fluctuations, the payment of dowry etc.), and to invest in income generation activities with risk levels appropriate to the household's basic needs security. In short they should offer a range of both savings and credit facilities.

[3] A practice found by many practitioners and authors to be extremely common - see Helen Todd's discussion of this phenomenon amongst Grameen Bank borrowers where 94% reported the use of their loans incorrectly (Todd, 1996).

Security in Diversity

We should pay careful attention to Hulme and Mosley's (1997: 107) conclusion that "A significant minority of investments fail (leading to decreases in income), while many investments that increase income soon reach a plateau (for example, operating a rickshaw, manually hulling rice, adopting HYVs and inputs on a small farm). For the latter, credit schemes give borrowers an important "one step up" in income, however, "survival skills" rarely provide the technological or entrepreneurial basis for poor borrowers to move on to the escalator of sustained growth of income."

Ironically, this commentary overlooks (or at best fails to highlight) two of the authors' own conclusions: firstly that the significant minority of investments that fail are closely associated with the poorest borrowers (see below) and secondly that the poor are generally seeking to <u>diversify</u> income sources - no single income source is expected to provide an "escalator of sustained growth of income". Todd's (1996) case studies provide interesting insights into how her "women at the centre" manage their diversified sources of income to maximise (first food and material, and then social) security for their families and themselves. For the poor it is "Less of a matter of achieving a low step on the escalator of growth than of continually inventing income strategies that ensure a modest economic lot" (Walton, 1985:472).

Contrary to the model implicit in traditional agricultural credit, households do not have one source of income or livelihood. Rather, as Hulme and Mosley (1997:100-101) note, "depending on season, prices, health and other contingencies, they pursue a mix of activities that may include growing their own food, labouring for others, running small production or trading businesses, hunting and gathering, and accessing loans or subsidies (from the state, friends or NGOs). In terms of economic behaviour, they are closer to the manager of a complex portfolio than the manager of a single-product firm."

<u>Kamala Rani's Diversified Portfolio</u>

"Kamala Rani is an experienced borrower. She had taken loans three times. The first loan was small (one thousand) and was invested in her husband's business who trades in bamboo (used as construction material). Bamboo product is also sold in his shop. Kamala provides labour input to make bamboo mats. When she obtained the second loan," (Tk. 2,000) " she invested it in bamboo product making. She makes large storage containers (used for storing crops) and other products and sells them from home, to both wholesalers and to village users. Next she borrowed another 4,000 taka, most of which she spent on buying a cow. She can repay her loan from the sale proceed of milk and profit from husband's business.

She still makes mats and other bamboo products. The mats are in greater demand after December. She therefore plans to sell at that time when the price per piece will be 20 taka. The current price is between 12-15 taka. She can utilize the price advantage because she has other sources of income to make payment of weekly instalments. Thus the choice of a diversified portfolio enables one to maximise the returns from investment" (Rahman, 1996:30).

As Dawson (1997:16) notes in his review of the Sebstad and Chen (1996) and Hulme and Mosley (1996) studies, "In both of these overview studies, technical innovation among borrowers was found to be limited to a minority among those who had taken multiple loans. Much more commonly, loans were used either to increase the scale of existing activities or to diversify into related fields. Few cases of further specialisation and technological deepening were identified." Given MicroCredit institutions' careful targeting, quite why this should be either a surprise or a disappointment remains a mystery. The poor are too smart and too risk-averse to put "all their eggs in one basket" and invest exclusively and heavily in one enterprise. They are managing their portfolio of income generation activities and looking to minimise risk, so that if activity or "enterprise" fails, it only has a limited, manageable impact on total household income.

This is amplified by Hulme and Mosley's (1996) exhaustive study of 13 Microfinance institutions (including Grameen Bank, BRAC, TRDEP, BancoSol, BRI, BKK, K-REP and SANASA) which concluded that “There is clear evidence that the impact of a loan on a borrower's income is related to the level of income ... This finding should not be unexpected given that those with higher incomes have a greater range of investment opportunities, more information about market conditions and can take more risk than the poorest households without threatening their minimum needs for survival (Hulme and Mosley, 1997:102).”

Todd (1996:65) provides a grass-roots view of this when she notes “19 out of the 27 households which have risen out of the poverty group (70%) are partnerships or are run by a dominant woman. One would expect a relationship between economic contribution of active female loanees and the success of their households. Two or three incomes are better than the one traditionally earned by the male household head. Several incomes make a family less vulnerable to disaster in any one line of business.”

Spreading The Risks

“ ... women rarely use all their loans for one activity - even if they husk four *maunds* of paddy between one *haat* and another, the capital they need to roll over comes to less than 1,000 Taka. They spread the risks between activities which generate cash for repayment and longer-term assets. In the first loan cycles these are small assets: poultry, ducks, perhaps a calf or goats to fatten” (Todd, 1996:214).

“It is the income from land cultivation which has pushed most of the successful GB families out of the poverty group. Land is also strongly invested with other emotions. It means food security; "eating our paddy." It is the asset which confers the most status within the village, and turns the husband from a labourer at the mercy of the landlord, into an independent farmer. It is the crucial nature of land and the critical function of the woman's capital in getting access to it that I think underlies the very strong position that two-thirds of our sample have been able to attain with their families” (Todd, 1996:211). This “income from land cultivation” it should be noted, is largely income from decreasing the rental costs of using land. Grameen (and other Microfinance organisations’) members use their loans to lease land in preference to share-cropping - the savings on rental costs increase the net income substantially.

It is for this reason that “frontier” Microfinance programmes do not seek to put restrictions on the use of the loans they issue: the poor will generally put credit (and all elements of financial services) to the most rational (and usually economically sound) use available. And they usually have a better understanding of the issues and socio-economic circumstances facing them than the staff of the Microfinance institution providing the financial services.

But What About Business Development Services and Employment ?

BRAC, the largest development NGO in Bangladesh, believes that “The greatest potential of micro credit to improve the lives of the poor on a sustainable basis has been offset by a lack of concomitant promotion of technology. Much of such credit has been used for traditional activities, and not enough has been done to include technology along with it” (Chowdhury and Alam, 1997:179). BRAC has tried to address this issue by providing training to its Village Organisations and attempting to create backward and forward linkages for most of the technology-based activities, which now comprise 30% of its portfolio.

But as we have seen in the previous section, the specialisation necessary to develop a larger-scale microenterprise is not necessarily what the poor are looking for. However, profitable such a mono-focused microenterprise may be this year, its very nature increases the owner’s exposure to risk in the years to come. Furthermore, from a development programmer’s perspective, it is difficult to escape the conclusion that technology-based approaches are relatively expensive.

Dawson (1997); Gibson (1997) and other proponents of the "Business Development Services" school would argue that their primary goal is to create sustainable microenterprises and thus employment, and that such services can be offered on a reasonably cost-effective basis. But Harper (1997:3) is forced to conclude, "it is still difficult to find examples of business development services where the benefits exceed the costs". Wood (1997) in his "Breaking Out of the Ghetto: Employment Generation and Credit for the Poor" asserts that many of the poor are not natural entrepreneurs, and would like to be employed in preference to self-exploitative self-employment generating marginal returns. This is indeed true, if the employment is what Bangladeshis would call "chakri" - respectable, regular and reasonably paid (ideally in a Government office). But these formal sector opportunities are few and far between. Most informal sector employment opportunities are insecure, irregular and verging on exploitative at best. In the words of Yunus (1994:47), "Unless designed properly, wage employment may mean being condemned to a life in squalid city slums or working for two meals a day for one's life. Wage employment is not a happy road to the reduction of poverty. Removal or reduction of poverty must be a continuous process of creation of assets, so that the asset-base of poor person becomes stronger at each economic cycle, enabling him or her to earn more and more." This perception is shared by many of the rural poor, Rahman (1996:20) citing (Hirashima and Muqtada, 1986) notes that, "In the rural areas among female workers in particular and among all workers in general, self-employment is considered to be more prestigious compared to wage employment".

Yunus and many Microfinance proponents would assert that providing financial services to the poor gives them the tools to better shape their own socio-economic destiny. In the words of Bornstein (1997:
215), "Above all, a staff member had to know when to keep silent. Grameen's collateral was largely based on it borrowers' sense of personal accountability, so it was essential that villagers come up with their own business ideas. If an idea came from their bank worker, a borrower would not enjoy the same sense of accomplishment; and if the business failed, the villager would blame the staff member who advised her. … When villagers requested investment advice, Yunus told his staff to reply, "The Grameen Bank has lots of money, but it has no ideas"".

So Has There Been Any Increase In Incomes and Wealth With All This Minimalism ?

The first detailed research into the economic impact of a MicroCredit programme was Mahabub Hossain's work on Grameen Bank in 1983/4. Hossain (1988:10) noted, "The most direct effect of the Grameen Bank has been on the accumulation of capital by the poor. The amount of working capital employed by members' enterprises increased by an average of three times within a period of 27 months. The investment in fixed assets is about 2.5 times higher for borrowers with more than three years' membership than for those who joined during the year of the survey." He also noted in the same study that "About a third of the members reported that they were unemployed before joining the bank - almost 7 percent of the men and 50 percent of the women. With these loans, these members generated self-employment in activities of their choice (p.10)." The resulting effects on income were also impressive, "... Grameen Bank members had incomes about 43 percent higher than the target group in the control villages, and about 28 percent higher than the target group non-participants in the project villages (p.10)." And Hossain's analysis indicated that " ... the positive income effect has been highest for the absolutely landless, followed by the marginal landowners ..." A more recent study, conducted by the World Bank in collaboration with the Bangladesh Institute of Development Studies, and cited by Hashemi and Morshed (1997:223), showed that the Grameen Bank not only "reduced poverty and improved welfare of participating households, but also enhanced the household's capacity to sustain their gains over time."

Kamal (1996) noted higher rates of per capita income among MicroCredit programme borrowers compared to those who did not borrow. In 1991 Chowdhury et al. asserted that women (and men) participating in BRAC sponsored activities have more income (both in terms of amount and source), own more assets and are more often gainfully-employed than non-participants. A more recent detailed study by Mustafa (1996) confirmed this and noted that the BRAC members have better coping capacities in lean seasons and that these increased with length of membership and amount of credit received from BRAC. The same study report growth in household assets from an average of Tk. 10,959 (for members who had been members for 1-11 months) to Tk. 23,230 (for members who had been members for 48 or more months), and increase of 112%. Similarly, household expenditure increased from an average of Tk. 419 per week (for members who had been members for 1-11 months) to Tk. 528 (for members who had been members for 48 or more months), and increase of 28%.

In their study of the impact of the Grameen Bank, Khandker and Chowdhury (1995) noted that the increase in self-employment among the poor with access to credit has resulted in an increase in rural wages, a finding confirmed by Todd's work in Tangail (Todd, 1996). This effect on local wage rates is disputed by Hulme and Mosley (1996), but Todd's conclusions may reflect the longer term impact of lending (Grameen has been operating in Tangail for more than a decade) or the widespread access of the poor to credit in Tangail where not only Grameen but also BRAC, ASA, Proshika, SSS and BURO, Tangail are all competing for clients.

Tangail is in many ways saturated with NGOs and MicroCredit/Microfinance programmes. This is because of its proximity to Dhaka: which both makes it a pleasant day trip for donor representatives (and thus a favoured site for demonstration projects or groups), and gives farmers and producers relatively easy access to the major market in Bangladesh. As Greeley (1997:95) points out, we should not forget that “There is strong evidence that robust non-agricultural rural growth is closely linked to local agricultural growth, principally through consumption linkages but also through backward and forward linkages in production. Many of the activities that micro credit programmes support are dependent on this rural purchasing power, from farmers especially. If this purchasing power becomes more concentrated then there will be marked regional differences in the effectiveness of micro credit services for poverty reduction.” As Grameen Bank and others have found out in remote areas like Rangpur and Pathuakali, MicroCredit is more difficult to recover when the local economy offers few income generation opportunities.

As Hulme and Mosley (1997:112) point out, “there is no evidence that structurally based constraints on demand for the products and services of the poor are likely to be removed by credit-induced activity: rather, they are dependent on changes in the wider economy.” However, this overlooks the "Multiplier Effect" (however slight and slow), and the simple fact that it is the access to financial services that helps the poor to manage their way through "shocks" and crises so that they are ready and able (with loans if necessary) to take advantage of whatever opportunities arise. In Stuart Rutherford's terms “Rural financial services for the poor thus act as platforms rather than sky-hooks. Access to financial services enables poor rural households to secure and improve their existing situation (their current set of income sources and their capacity to exploit them), giving them a foundation on which to build. Financial services do not ‘reach down’ with packages of pre-digested assistance that somehow grab poor households and ‘lift’ them out of poverty” (Rutherford, 1997:28).

In his address to the concluding session of the “Poverty and Credit Workshop”, Dhaka, August, 1996 Professor Rehman Sobhan expressed scepticism as to whether all the micro-level impact had had any macro-level impact on the village, union or thana level economy. This concern is in part at least answered by Bornstein’s (1997:148) observation that: “Aleya (rich), who fits near the top of the poorest third of the population, and Aleya (poor) who belongs, perhaps to the bottom eighth, are, to the high flyers, indistinguishable. To policy makers, they are interchangeable. On the ground, however, the differences in their daily experiences are enormous. Which is why the most vital work of Grameen Bank - which has helped millions of villagers to move from one level of poverty to a less oppressive level - is invisible at the national level.”

Serving the “Poorest of the Poor”

Several authors, including Hulme and Mosley (1997:110) have noted that “Worryingly, both BRAC-RDP and Grameen Bank recently appear to be moving away from working with significant proportions of the hard core poor and focusing their activities on the middle income and upper poor, rather than the most desperate.” This is generally attributed to the increasing emphasis on institutional sustainability which Hulme and Mosley (1996, 1997) and Rogaly (1996) see as incompatible with reaching the poorer of the poor.

But the exclusion of the poorest is recognised by both Grameen Bank and BRAC. “It seems that Grameen Bank and similar credit programs have failed to target this group [the hard core poor] effectively, resulting in most of them remaining outside the micro-credit net" (Hashemi, 1997a:253). "In spite of all good intentions and efforts, BRAC's success in reaching the poorest ten to fifteen percent of the rural population has been modest" (Chowdhury and Alam, 1997:182). And both BRAC and Grameen Bank are experimenting with other strategies to reach the poorest. In Rangpur, Grameen is experimenting with goat loans, and in what is generally viewed as the most successful approach, BRAC runs the Income Generation for the Vulnerable Group Development (IGVGD) programme explicitly to bring the poorer households into its Rural Development Programme. By 1995, IGVGD was already operating in 74 Thanas and had reached 166,918 of the poorest (Chowdhury and Alam, 1997).

In view of the accusations that MFIs are increasingly forsaking the poor for the better off as the drive for sustainability gathers momentum, several studies have been conducted to try to differentiate between "self" and "programme" exclusion. In fact, the difference is limited: not only do programmes exclude clients, potential clients also "self exclude" on the basis of programme design. Thus, as Rutherford (1995) and Wright et al (1997) would argue, the exclusion of the poorest is often primarily driven by the emphasis on credit delivery by many organisations.

For the poorest households the opportunities for productive use of loans are limited, and the risk of taking loans that are repayable on a weekly basis are unacceptably high. In preference to "targeting the poorest" and trying to persuade them to join organisations that are offering inappropriate financial services, it is the services themselves that require revision and tailoring to meet the needs of the poorest, and thus to attract them into Microfinance programmes. As donors and practitioners place increasing emphasis on Microfinance as opposed to MicroCredit, the poor are likely to join the Microfinance programmes in order to save. Over time the poor may also enjoy the benefits of scale that Microfinance Institutions' more affluent clients allow - in terms of interest on savings, a broader range of financial services and possibly even lower cost loans. For further discussion of this important issue, see Wright, (forthcoming).

Conclusions

Rahman and Hossain (1995) suggest that we best understand the vulnerability of the poor as function of "downward mobility pressures" arising from: 1. Structural factors in the economy (demand for the products and services of poor people (including labour) and seasonality of these); 2. Crisis factors (household "shocks" - illness, theft of assets, natural disaster etc.); and 3. Life-cycle factors (in particular the proportion of economically active to dependent household members, but also in the context of marriages etc.).

This paper tries to demonstrate that Microfinance services (particularly quality financial services that have been developed to address the differing needs of clients) empower the poor to cope with and overcome many of these shocks, in particular through diversifying their income sources. Furthermore, it argues that it is time to move away from the preoccupation with "raising income" to focusing on "improving net wealth and income security". When examining the income impacts of Microfinance programmes, it is important to recognise that there is a significant difference between "increasing income" and "reducing poverty". Despite the prevalent emphasis on raising incomes as the central objective of development programmes, the two are not synonymous. Clearly, the use to which income is put is as important in determining poverty and welfare as the level of income itself - increased income can be (and often is) gambled away. It is also important to recognise that poverty is neither linear nor static, and that today's not-so-poor may well be tomorrow's poorest - and vice versa. It is for this reason that the poor place so much emphasis on diversifying their sources of income - it reduces their exposure to catastrophic income loss. In the context of the drive to create businesses that provide jobs, the differences between the quality of formal and informal sector employment must be noted. These differences also explain why, for many, having diversified sources of home-based income is preferable to depending on exploitative employment. It is clear that, given the right economic conditions, (reasonable levels of inflation, access to markets etc.), well designed Microfinance services can reduce poverty.

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