Microfinance and Development: A development strategy at the service of the global neoliberal agenda?

A case study of three Microfinance Institutions in Kenya, Peru and Bangladesh

Master’s Thesis

submitted in partial fulfillment of the requirements for the degree of

Masters of Arts (M.A)

awarded by

the Philosophical Faculty of Albert-Ludwigs-Universität Freiburg i. Br. (Germany)

and the

University of KwaZulu-Natal, Durban (South Africa)

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Wintersemester 2010/2011

Social Sciences
ACRONYMS

BRAC  Bangladesh Rural Advancement Committee
CGAP  Consultative Group to Assist the Poor
DFI   Development Financial Institution
GDP   Gross Domestic Product
IFC   International Financial Corporation
IMF   International Monetary Fund
KfW   Kreditanstalt für Wiederaufbau
MDGs  Millennium Development Goals
MFI   Microfinance Institution
MFIF  Microfinance Investment Fund
MIX   Microfinance Information Exchange
NGO   Non Governmental Organization
PPP   Purchasing Power Parity
RED   Research and Evaluation Division
UNCDF United Nations Capital Development Fund
USAID United States Agency for International Development
VO    Village Organizations
WB    World Bank
WTO   World Trade Organization
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Introduction

The role of microfinance as a strategy focused on poverty reduction has gained momentum, placing it as one of the most attractive socio-economic development policies worldwide. It has become an increasingly attractive recipient of donor funds, as well as private capital, as a result of it becoming one of the latest trends in development discourse. Its popularity reached a peak in 2005 when the UN created the ‘International Year of Microcredit’, and one year later, one of the fathers of the ‘banking for the poor’, Bangladeshi Muhammad Yunus, was awarded the Nobel Peace Prize.

The idea, originally developed in Bangladesh, began as a project of mainly NGOs providing credit and human development services. Their delivery systems proved that the poor were bankable and despite the lack of serious assessments, the poverty reduction outcomes were celebrated all over the world. Since the late 1980s, but mainly during the 1990s, a new wave of microfinance took over: ‘a commercial revolution’ was encouraged by powerful international institutions and the private sector as the only solution to reach all the unmet demand for banking services (Otero, 1999; Robinson, 2001; Drake & Rhyne, 2002). Based on an absolute faith in the market and embedded in financial system theory, this new strategy replaced its predecessor and has been sold as a developmental ‘magic bullet’ against poverty. It is argued that it is an approach that can reduce poverty and generate profits at the same time (Robinson, 2001; Tulchin, 2003).

The development of this anti-poverty strategy triggered an intellectual debate between advocates of microfinance as a win-win solution and an increasing group of intellectuals criticizing its connection with neoliberalism, the lack of serious analysis of its impact on poverty, and the failure of this approach to generate development. Whereas for the former position microfinance is the best way to solve poverty through the empowerment of poor people through a reconfiguration of their role as financial consumers (Robinson, 2001), the latter put in evidence the lack of challenge to the system and the vagueness of the assumptions incarnated in the microfinance project (Rogaly, 1996; Bateman, 2010). The supremacy of the market as the most efficient mechanism to guarantee equality of opportunity hold by the proponents of commercial microfinance (Otero, 1999; Robinson, 2001) is counterattacked by the important role assigned to the state by those critiques that highlight the importance of collective organizations (Fernando, 2006, Weber 2006, Bateman 2010). At the end, one of the most significant controversies is the dispute between seeing poverty simply as lack of capital (Smith & Thurman, 2007; Robinson,
or if it is more about a multidimensional phenomenon (Rogaly, 1996; Harper & Dichter, 2007), like the critiques suggest, and how to evaluate the impact on it.

The main aim of this research is to assess, using both a theoretical analysis and a practical case study, the impact of microfinance on developmental, and specifically, on poverty reduction outcomes. To achieve this, an in-depth review of both positions will be conducted, focused on the ideological components of microfinance, as well as a detailed analysis of its claims about poverty reduction outcomes. This study will explore two main hypotheses:

I. The connection and serviceability of microfinance to a neoliberal globalized world rhetoric, that links local markets with global ones through the inclusion of the poor, has led to financial performance dominating social outcomes, undermining both development and poverty reduction goals.

II. A narrow poverty approach is encouraged by microfinance proponents because it results in an assessment of poverty reduction outcomes that is positive.

This study therefore focuses on the question of whether microfinance can be considered a development policy in itself, or if it is just a pro-poor policy providing financial services to the unattended poor, with limited impact on poverty reduction. To answer this question and to explore the two hypotheses proposed above, the following secondary research questions have been developed: Considering the multidimensional aspects of poverty, to what extent do the proponents of Microfinance adopt an approach that grasps poverty’s complexity and have an impact on it? What is the role of the state and the market in terms of poverty reduction for both positions developed for microfinance? Lastly, to what extent does the sustainability of the Microfinance Institutions (MFIs) prevail over the sustainability of the social change they are meant to achieve?

The methodological approach of this study will be focused on a case study with three MFIs from Kenya, Peru and Bangladesh, which partially represent the heterogeneous global microfinance scenario. Through interviews with their staff, content analysis of key documents of each of the institutions, an ideological examination of their institutional approach to poverty and a thoroughly review of their financial and social reports, a comparative approach that will provide clear examples of how microfinance works is intended.
This thesis is divided in six chapters. The first chapter provides the introduction and research questions. The second chapter focuses on the theory and ideological system underpinning the proponents of microfinance. An in-depth review of Yunus’s intellectual system provides the point of departure for this chapter. This is followed by a discussion on the remaking of microfinance under the commercial revolution paradigm. The last section of Chapter 2 focuses on the characteristics of microfinance as a global development strategy. The third chapter presents a thorough analysis of all the critiques of microfinance. It is divided in to three main approaches that are relevant to this study: the ideological and governance critique; the poverty approach critique; and the developmental critique. The fourth chapter presents the background to the case study and the methodology adopted in this dissertation. It includes the methodological approach and limitations of the study. The main findings of this study, which reveal the practical state of affairs in the global microfinance industry, through the lenses of the three MFI{s} selected for this research, are presented in Chapter 5. A comparative analysis of the three institutions is undertaken in this chapter. Finally, Chapter 6 presents the conclusions of this research. Here the key findings of the case study will be assessed against the theoretical framework to reflect on the main research questions and hypotheses of this thesis.
Chapter 2

Microfinance: Markets and Poverty

Muhammad Yunus acclaims the label of the visionary who encouraged the microcredit idea to turn into a global movement sold as a ‘magic bullet’ against poverty\(^1\) (Bateman, 2010). His involvement in the microcredit world in 1976 with a simple university research project evolved into the creation of a microcredit specialized bank in 1983, the Grameen Bank. Widely known because of its outreach capacity, this bank stands as a clear example of a successful model, at a large scale, in providing small credit to the poor.

An in-depth review of Yunus’s book “Banker to the Poor” (1999) is the starting point of this chapter. The review will provide insight into the ideological system of the man whose ideas were used and reshaped to convert the successful approach of giving microloans to poor Bangladeshi people into the most favoured and acclaimed poverty reduction strategy in the world.

2.1 Yunus’s solution to Global Poverty

Yunus believes that the cause of poverty is simple. Referring to the poverty he saw on an everyday basis in Bangladesh, he states that “they were poor because the financial institutions in the country did not help them widen their economic base” (Yunus, 1999:50). Taken over by informal local moneylenders, poverty was deepened because of the high interest rates charged by ‘loan sharks’. According to Yunus (1999), the answer to poverty must rely on solutions that can set free the potential, energy and creativity of every human being. Yunus (1999:261) states that “a world without poverty means a world in which every person can take care of his or her basic life needs”. The provision of credit to encourage income generating activities is framed as a definite and important step to escape from poverty. As Yunus (1999:150) suggests: “if economists would only recognize the powerful socioeconomic implications of credit, they might recognize the need to promote credit as a human right”. In a solution that sees every human being as an entrepreneur, economic growth arises as a result of expanded demand and the poor’s capacity for innovation and creativity.

By setting up his institution, which provided cheap credit and used a group methodology, he was sure he was providing the poor with the solution they were waiting for. Yunus (1999:59) believes that “the poor know this credit is their only opportunity to break out of poverty”.

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\(^1\) The strategy of providing small credits to the poor has been used for decades in poor countries, but this historical analysis is beyond the scope of this paper. The position hold here is that because of Yunus and his media exposure, the concept of microcredit became very well known and reached the stage of a global phenomenon.
Targeted mainly at rural women who did not own any land or very limited amounts, the idea was to encourage self-employment solutions in a country suffering from strikingly high unemployment rates. Yunus (1999) explains that the group methodology used had two main advantages: first, the creation of a social collateral system, where the group was responsible for the payments of those women who could not pay their installments. Second, it fostered the development of social capital among the women, through weekly meetings, which led to their empowerment. The approach was minimalist as it was just about credit and the Grameen Bank held the view that there was no need of formal training schemes because poor people already had enough skills. The high repayment rates worked as clear evidence of a double success: the institutional and the poverty reduction one.

This solution proposed by Yunus saw poverty as a problem of lack of opportunities, rather than a distributional problem. Yunus argued that the time had arrived for market forces to prevail over state forces, because “whatever governmental programs have achieved, they certainly have not created equality of opportunity” (Yunus, 1999:250). The profit motivation of government officials and the inefficient bureaucracy made him pronounce a blunt statement about the role of the state: “government, as we know it, should pull out of most things except from law enforcement, the justice system, national defense, and foreign policy, and let the private sector, a ‘Grameenized private sector’, a social-consciousness-driven private sector, take over its other functions” (Yunus, 1999:204). If this point is reached, the forces of the market will rule, and people would be able to have access to education and health because they would have a price, and they would be able to pay for it. As a consequence of this, Yunus (1999:261) believes that “all state organizations that provide free or subsidize services for the poor could be done away with. There would be no need for welfare agencies, handouts, soup kitchens, food stamps, free schools, free hospital care”.

The demise of the public sector is therefore one of the aims of Yunus (1999) in his microfinance argument and it would result in a system ruled by a personal, gain-based private sector. However, this is not of serious concern from a social justice perspective, as the Grameen Bank shows that through market mechanisms, where greed is replaced by social goals, a poverty free world can become a reality. Yunus (1999:230) states that “social goals can replace greed as a powerful motivational force”. The main difference between the private sector and a corrupt bureaucratic public sector is that “the private sector, unlike the government, is open to everyone, even those not interested in making a profit” (Yunus, 1999:206). A big, free, open market is the best solution for the poor, because “the poor have a better chance in a bigger open market than in a small protected market. Everyone would
benefit from the free flow of commodities, finances and people” (Yunus, 1999: 244). Yunus believes this private sector would encourage social investors to address poverty issues, and they will become important players in building a more fair and equal society.

Yunus´s (1999) solution to poverty became increasingly popular within the international community. His simple idea was backed up by a powerful intellectual system whose aim it was to humanize capitalism and provide the poor with an opportunity to be part of it. Starting in the 1980s but mainly during the 1990s, these ideas, using the same ideological framework, were repackaged and reframed into a commercial wave that took over microfinance. Originally, the concept was just ‘microcredit’. Alongside with its commercialization revolution, the term microfinance started to replace it. Microfinance refers to the provision of not only credit, but also a diverse set of other financial products like micro-insurance and savings schemes. It also encourages the view of seeing the industry as part of the formal financial systems of a country. Microfinance became an increasingly attractive recipient of donor funds as well as private capital. Its popularity reached a peak in 2005 when the UN created the ‘International Year of Microcredit’, and one year later Yunus and the Grameen Bank were jointly awarded the Nobel Peace Prize. However, despite his recognition as a pioneer in microfinance, the commercial revolution resulted in several changes and a diversion from his original ideas. This shift is presented in the following section.

2.2 The reshaping of an Idea: Microfinance and Financial Systems

Rooted in the idea that microfinance is not only the source of major social transformation, but also a seed in the shift towards a wider provision of banking access, Yunus´s ideas were adapted into a commercial revolution that microfinance ‘needed’ in order to reach all those desperately needing a loan (Robinson, 2001). As Bateman (2010) notes, this microfinance revolution, by the end of the 1990s, reached a position of unparalleled influence and power within the international development community. The commercialized approach to microfinance was portrayed as the only way to provide financial services to low income clients, marginalizing the nonprofit organizations, the public initiatives and the subsidized programs present in different parts of the world.

2.2.1 The Commercial Revolution: A New Approach to Microfinance

Yunus´s most important legacy is that his Grameen Bank proved that poor households, ‘the bottom billion’ living with less that $2 a day, can save, borrow and repay loans promptly and

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2 Dichter (2006) highlights that despite being named ‘International Year of Microcredit’, United Nations was referring to what is commonly known as microfinance.
with interests. According to Collins et al (2009:157) “the key messages came to be recognized around the world: success, measured by the economic and social progress of borrowers, depended on women, on group solidarity, on microenterprises and on loans”. Therefore, a solution for poverty, based on the capabilities and entrepreneurship of the poor, was demonstrated. As a result of this powerful idea with its successful record, a new singular approach began to be shaped in the international development community, with a strong support from the private sector. However, it had many different premises. According to Drake and Rhyne (2002), among the most important ones, was the emphasis on the importance of providing credits in a commercial and sustainable way, which implied a shift to focus more on the clients than on the microenterprises using an individual lending methodology. This fact produced the development of a variety of products addressing not only credit demands, but also savings and insurance schemes. The main new premise was that the real cost of money should be charged, which implied a view where subsidies were considered a bad practice. Overall, microfinance became a highly professionalized sector ruled by financial experts.

As Robinson (2001) explains, the 1990s were marked by a major debate between the two leading views, namely the old poverty lending approach and the new financial system approach, about how to provide all the financial services that were required by the poor, but as yet not offered. The first approach focuses on poverty reduction, with considerable effort being made to reach the poorest of the poor. This was the paradigm created in Bangladesh by the Grameen Bank, its main exponent. The focus here was more on microcredit rather than on microfinance. Robinson (2001) claims that the cost of the provision of institutions using the poverty lending approach was low, since most of them received subsidies. They were therefore not self-sustainable, despite strong efforts to achieve longer term sustainability. This paradigm was dominated by nonprofit organizations, which were the most suitable type of institution to implement this approach.

As an alternate idea, the new ‘financial system approach’, focused on commercial financial intervention, where a stronger emphasis is made on the self-sufficiency of the institutions. With appropriate designed financial products and services, financial institutions knowledgeable about microfinance can become profitable and self-sustainable while still achieving wide client outreach. Therefore, as Armendariz de Aghion and Morduch (2010:241) explain, “expanding access to reliable financial services could improve prospects for a

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3 There have been many academic discussions about the sustainability of the Grameen Bank. The institution has claimed to reach that stage soon after its inception, but several documents have shown that many hidden subsidies were not reported and that suspicious write-off policies took place to inflate the high repayment rates. See Hulme (2008).
substantial portion of the world’s poor and unbanked”. One of the biggest advantages of the commercialized model, its advocates argue, is that because of the strong emphasis on profitability and self-sustainability of the MFIs, governments and donors do not need to provide subsidies or funds for the microfinance industry to make it work properly. Actually, because of the size of the ‘absurd gap’ between demand and services on offer, “government and donor funds cannot possible finance microcredit on a global scale” (Robinson, 2001:8). Only financially sustainable⁴, commercial microfinance institutions have the capacity to reach the unmet demand in a strategy that “integrates the poor as a market segment” (Otero, 1999:6). The Conference Group for Assisting the Poor (CGAP)⁵, a consortium of thirty three development organizations created by the World Bank, supports this view in its Microfinance Consensus Guidelines⁶. In its guideline number three it states that “microfinance means building financial systems that serve the poor… In order to achieve its full potential of reaching a large number of the poor, microfinance should become an integral part of the financial sector” (CGAP, 2003:1).

One of the most important characteristics of the financial system approach is the focus not only on credits, but also on other specific needs of the clients. As Collins et al (2009:25) note, “when Yunus started Grameen, his focus was not on microfinance but on microcredit. Moving to microfinance from the narrower goal of microcredit begins with the recognition that poor households want to save and insure as well as borrow”. Despite both the approaches basing their rhetoric on the importance of supporting income generating activities of microenterprises, the new approach emphasizes that poor households seek loans for a multitude of uses, besides business investment. This includes emergencies, acquiring assets, school and health fees and others products “that are convenient, flexible, and reasonably priced” (CGAP, 2003:1). On a methodological note, this implies a slow shift away from group-based methodology towards an individual approach, without the heavy burden for clients of weekly meetings in social groups. Regarding the use of collateral, the credits could now be “disbursed against smaller land parcels, deposits or liquid assets, or even against strong credit record” (Collins et al, 2009:26).

⁴ A lot of literature focuses on the different measures of sustainability, being economic sustainability and financial sustainability the two main measures. The first one refers to the ratio between income from programme activities and the costs (excluding financial one). The second one refers to the ratio between income and operation costs, financial costs and loan loss provision. The MFIs approaching microfinance in a purely commercial way are striving for this second concept of sustainability. See Morduch (1999).

⁵ Originally, CGAP referred to Conference Group to Assist the Poorest. However, after some years and when some criticism arose regarding the power of microfinance to reach the poorest, the name changed for the current one, replacing the word ‘poorest’ for ‘poor’.

⁶ CGAP elaborated in 2003 a list of guidelines with eleven Key Principles of Microfinance. These statements are a sort of basic guidelines for following best practices in commercial microfinance. See CGAP (2003).
Another important shift that the commercial microfinance revolution made is linked with the institutional forms that the MFIs can take. The literature available\(^7\) suggests that there are three broad types of MFIs: for profit institutions (Type I), NGOs (Type II) and cooperatives (Type III). As Von Pischke (2007:139) explains: “the boundaries between Is and IIs are strongly determined by their approaches to subsidy, while Type III is defined most strongly by solidarity”. For Type I institutions, subsidies are dangerous and foolish, and are only used in starts-up of the projects or network expansion. They are advocates of the minimalist approach, “concentrating on financial services only, rather than on social services” (J.D. Von Pischke, 2007:142). Type II has commonly been associated with the Bangladeshi paradigm, with a stronger poverty focus and the use of subsidies. These institutions usually have a political focus on the poor and adopt a maximalist approach. Type IIIs can vary from commercial to non-commercial, subject to cooperative law in each country. Subsidies may be helpful in meeting objectives. The microfinance industry leaves room for these three types of institutions but the commercial revolution has implied a gradual shift towards Type I institutions. Apart from a strong support already for commercial ‘for profit’ institutions, the new paradigm also encourages traditional commercial banks to ‘downscale’ their business and develop financial products targeted to low income clients. Moreover, this process also pushed for the conversion of many Type II NGOs to Type I. As Armendariz de Aghion and Morduch (2010:242) state: “the most important shift for a commercialized institution is the ability to distribute profits to shareholders … Profit earned by an NGO cannot be distributed to shareholders”. The aims of this transformation, according to Lauter (2008), are varied: to offer financial services beyond lending\(^8\), to access capital, to gain legitimacy and to enable employees, clients, and other stakeholders to become owners. Many NGOs, without intention of converting into a for profit organization, also started adopting the main guidelines of the commercial revolution: charging market interest rates, stopping the use of subsidies and trying to achieve full financial sustainability. The rationale behind this was the lack of funds from donors or any type of support from the international community resulted if the commercial model was not followed. Armendariz de Aghion and Morduch (2010:239) highlight that “one of the most unexpected and encouraging turns in the brief history of

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\(^7\)See Hulme and Mosley (1996) and Robinson (2001).

\(^8\)It is important to note that in many countries only regulated financial institutions can take deposits from clients. Therefore, if NGOs want to capture savings and offer related financial products to their clients, they need to be registered as a commercial company.
microfinance is the degree to which leaders who were first driven by social impulses to create NGOs have seized the logic and imperative of engaging with capital markets.

The ‘financial system approach’ reliance on market mechanisms encourages a minimal role left for the state: one more as an enabler rather than a direct provider of financial services. As CGAP (2003:2) suggests, “the key things that a government can do for microfinance are to maintain macroeconomic stability, avoid interest-rate caps, and refrain from distorting the market with unsustainable subsidized, high-delinquency loan programs”. The state is given the role of helping to create the appropriate market mechanisms to make poor people escape from poverty. It is through markets relations that poor people can achieve economic freedom and opportunities, given the right incentives and framework for commercial microfinance to operate. The true revolution in the new microfinance approach is to make the markets accessible for those that have been historically neglected of that opportunity. This type of solution should be celebrated by the government, the advocates of microfinance claim, because it enables a win-win situation: at zero cost for the government a solution to poverty is found. Pro poor markets encourage “the creativity of poor entrepreneurs, and the success of local institutions in enabling such entrepreneurship” (Roy, 2010: 63). This is creative capitalism, as Roy calls it, a model with new inventive forms that can achieve the double bottom line: maximizing profit while creating social value.

Following her argument, it is through the democratization of capital using the pro-poor markets, that the bottom billion can gain access to the main instrument of capitalism, capital. Finally, Robinson (2001) justifies the reliance on the market instead of the government because through the history of development it can be seen that state-led development is usually captured by local elites, whereas development led by the market forces is more egalitarian. On the same line of thinking, Easterly has argued that historically the rich had access to and control over the markets, and the poor had access to bureaucrats. Therefore, “microfinance is a solution to this problem – it rids the poor of bureaucrats and solves the problem of credit by creating markets for the poor” (Easterly, 2006:59).

According to Prahalad (2004), there is a ‘fortune at the base of the bottom of the pyramid’ and it is possible to eradicate poverty through profits. This implies a re-conceptualization of the poor as financial consumers and the need to create markets around their needs. Armendariz de Aghion and Morduch (2000) highlight that despite the fact that seeking profit and serving the

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9 In this regard, the most striking example is the conversion in the 1990s of Grameen Bank into Grameen Bank II. Despite this did not imply a change in the institutional form (it was already a Bank), the commercialization revolution implied a transition in the way the bank operates in terms of products diversification and stronger financial focus in their overall operations. See Hulme (2008).

10 This concept is further elaborated by Tulchin (2003) and Chu (2007)
poor can be achieved simultaneously there is also the possibility of some tension between these twin objectives. However, the advocates strongly affirm that truly commercial MFIs should seek and support both objectives at the same time, while recognizing that under the new paradigm profitability may receive the highest rank in the agenda. To support this view, Robison (2001) and Otero (1999) believe that by agreeing that the measure of success is set in terms of efficiency and outreach, there are incentives to look for both profitability and outreach at the same time, otherwise microfinance “begins to disintegrate as a compelling development approach” (Otero, 1999: 7).

The section above has presented the main principles and approaches of the commercial microfinance approach. The next section focuses on the financial management of MFIs, an issue that became highly relevant under the new paradigm.

2.2.2 The Main Concern: Financial Management

There is one mandatory strategy in order to be considered a commercial MFI: the cost of the money lent to the poor should reflect the real value of it. Charging market interest rates has an implicit supporting argument: “households require access to credit, not cheap credit” (Morduch, 2000: 622). MFIs should contemplate in the price of the money the operating costs (much higher than traditional banking), the cost of funds, loan loss expenses and profits. These four components added will sum the total cost of the interest to the poor. CGAP states that

“interest rate ceilings can damage poor people’s access to financial services .... Unless microlenders can charge interest rates that are well above average bank loan rates, they cannot cover their costs, and their growth and sustainability will be limited by the scarce and uncertain supply of subsidized funding. When governments regulate interest rates, they usually set them at levels too low to permit sustainable microcredit” (CGAP, 2003: 2).

According to Robison (2001) despite the higher interest rates compared with traditional NGOs, MFIs through commercial microfinance offer two main advantages: they are cheaper than the informal moneylenders poor people are used to relying on and they offer a much more reliable source of credit.

Drake and Rhyne (2002) argue that one of the main reasons for an MFI to adopt the commercial strategy is related to the increased access to different sources of funding in comparison with subsidized NGOs. The main new sources are savings from depositors,
commercial debt and investment from many institutional investors that see microfinance as a profitable industry. The explicit non negotiable pre-condition to access these sources is that MFIs need to be sustainable. In this regard, the Microfinance Information eXchange (MIX)\textsuperscript{11} has emerged as the most important entity collecting and presenting all the information of MFIs across the globe regarding financial performance, and lately, social performance as well.

One of the new players entering the industry are the Microfinance Investment Funds (MFIFs), which have been increasingly channeling funds to MFIs. As Goodman (2005) explains, its presence encouraged a greater financial discipline by fostering competition between MFIs. As a result of this, those MFIs that have the best financial performance are more prone to receive capitals from these funds. As Matthaus-Maier and Von Pischke (2007:4) highlight, “the arrival of MFIFs extends the funding chain that provides wealth creation opportunities among the poor”. In this regard, despite the existence of strictly commercial and only profit seeking investors, Armendariz and Morduch (2010) claim that typically they cater to socially responsible investors that operate with the double bottom line of financial and social returns, just like Yunus (1999) predicted and argued for.

The increasing sources of commercial funding boost the ability of the institutions to augment their leverage\textsuperscript{12}, by using the interest revenues and mobilization of savings deposits. Cull et al (2009) explain how this financial strategy of borrowing against the loan portfolios is very much dependent on the corporate structure and organization, and therefore there are striking advantages for banks, compared to NGOs.

To put this information under a quantitative lens, it is worth mentioning that each year the CGAP conducts the \textit{Global Results for Funder Survey} that puts together the data from donors (bilateral and multilaterals agencies, foundations and international NGOs) and investors (Development Financial Institutions (DFIs), individual investors and institutional investors), involving the 61 most important funders of the globe. According to last survey (CGAP, 2009), the total amount of money committed to microfinance in 2008 was $14.8 billion, what represents an increase of 24% compared with the previous year. For the first time in history, the amount committed by investors (52%) of the total was bigger by those of donors (48%). The biggest 5 players were: KfW (German DFI), Asian Development Bank (multilateral

\textsuperscript{11} The MIX Market presents itself as “the leading business information provider dedicated to strengthening the microfinance sector” (The MIX, 2010 b).

\textsuperscript{12} Leverage refers to the ability to use an institution’s existing assets to gain access to a larger amount of capitals.
agency), World Bank (multilateral agency), European Bank for Reconstruction and Development (DFI) and International Finance Corporation (DFI from the World Bank), which provided 46% of the total funding. When it comes to the analyses on where the money was invested, the figures show that retail dominates by far (61%), followed by wholesale finance (33%). The analysis of the instruments used for this investments, debt was the main instrument (63%) followed by grant (17%) and equity (11%).

The main issues regarding the financial management of the MFIs have been explained above. It is now important to move forward and analyze within this framework, if and how microfinance can defined as a development strategy, and to explore its main characteristics.

2.3 Microfinance as a Global Development Strategy

Otero (1999) summarizes the difficult task of microfinance integrating the paradigms of development and finance, which have not co-existed before. The linkage between finance and development will only be possible if they combine both major principles together. If not, Otero (1999:9) believes that “one will fail because it will gradually forget its target market as it seeks quick profit: another will fail because it ignores the basic principles of finance”. In this scenario, “the world is paying attention to the connections between poverty and finance like never before” (Collins et al, 2009:23). This section of the chapter explores the developmental arguments proposed by the advocates of commercial microfinance, with the main focus being on microfinance’s anti-poverty face. As Otero (1999:2) states, “all development approaches, regardless of their shortcomings, have attempted to address poverty, to alleviate it, to eradicate it”.

2.3.1 Poverty Reduction Strategy

The possible impact on poverty reduction is microfinance’s most acknowledged and celebrated outcome. However, in order to assess the microfinance impact on poverty, it is necessary to specify which definition of poverty is being used to be able to quantify the outcomes, in terms of people moving out of poverty. The way poverty is measured, as well questions about who constitute the poor, are highly contested issues. Hulme and Mosley (1997) believe that at the heart of the debate stands the question of whether poverty is largely about material needs or whether it is about a much broader set of needs that permit well-

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13 Due to space reasons, the arguments regarding this discussion will be narrowed to a practical approach and will not use any specific theoretical framework. Many authors have done celebrated works in analyzing the major constraints for poor people to move out of poverty. To mention two of the most important ones with striking differences in their approach, De Soto (2001) focuses on the lack of capital and the importance of property rights to ensure that poor people can escape poverty. Sen (1999) goes much further than De Soto’s narrow arguments, and believes that to understand poverty the analysis should focus on individual entitlements, capabilities, freedoms and rights. It is in the importance of empowerment of the poor people where both arguments meet.
being. Similarly, Johnson and Rogaly (1997) claim that if poverty is understood just as low levels of income, then reducing poverty is about raising average income level. However, if poverty is framed as the powerlessness suffered by the poor in a variety of situations, that means that for microfinance programs to be able to assess their impacts, the focus should be “on their influence on social relations and the circumstances which reproduce them” (Johnson & Rogaly, 1997:11).

An analysis of several authors who support microfinance (Otero 1999, Yunus 1999, Robinson 2001, Rhyne & Otero 2006) shows that the most practical way of defining poverty is to measure it by its connection with lack of capital, which reflects De Soto (2001) views. As Otero (1999:3) confirms, “conceptually, microfinance addresses one constraint faced by the poor: their shortage of material capital, the input necessary to generate income”. Smith and Thurman (2007:9) accordingly state that “poverty is about money. Many things cause poverty, but one common thread is that there is absolutely no access to capital in poor countries, and without capital the people and their societies have no chance to grow their business”. Roy (2010) connects this view with Yunus ideology, by saying that his approach “puts forward the argument that the cause of poverty is the lack of capital and that by addressing this deficit, microfinance can allow the poor to fully participate in a more humanized capitalism” (Roy, 2010:66). Therefore, microfinance encourages income generating activities and a better planning of financial needs for the poor. The increase in income can have positive effects in other areas that are deeply embedded in poverty: health, nutrition, education, empowerment and vulnerability. As the CGAP Consensus Guidelines state

“Microfinance is a powerful instrument against poverty. Access to sustainable financial services enables the poor to increase incomes, build assets, and reduce their vulnerability to external shocks. Microfinance allows poor households to move from everyday survival to planning for the future, investing in better nutrition, improved living conditions, and children’s health and education” (CGAP, 2003:1).

The impact of microfinance is also assessed in terms of its ability to achieve the Millennium Development Goals (MDGs), as the work made for CGAP by Littlefield, Morduch and Hashemi (2003) suggests. Parallel to this capital-income-consumption triangle, microfinance is seen as the best strategy because at the same time of addressing these needs, it strengthens a sense of dignity, by empowering the poor to find their own way out of poverty.
An important topic of discussion in microfinance is around the situation of the poorest of the poor. Robinson (2001) makes a clear distinction between the economically active poor and the extremely poor, emphasizing that not all the poor are the same, and those extremely deprived are not the focus of microfinance products. In that sense, Hulme and Mosley (1996) explain that the target of microfinance are those poor who have reliable income, freedom from pressing debt, sufficient health to avoid incapacitating illness, freedom from imminent contingencies and sufficient resources (savings, non-essential convertible assets and social entitlements) to cope with problems when they arise. This implies that the extremely poor are not catered for in a system that was initially designed to alleviate poverty at all levels (Yunus, 1999). The question therefore needs to be about what systems then are responsible for addressing the needs of the extreme poor, who are perhaps made even more vulnerable by the fact that the state withdraws from poverty reduction strategies from a finance perspective as microfinance becomes more dominant. Therefore, despite the public rhetoric of placing microfinance as the strategy for poverty reduction, some advocates started to recognize that microfinance cannot do it alone. Sam Daley-Harris, Director of the Microcredit Summit Campaign, claims that “there is no one single solution to global poverty. The solution must include a broad array of empowering interventions and microfinance, when targeted to the very poor and effectively run, is one powerful tool.” (Daley-Harris, 2007:1). Even Yunus argues on the same line,

“Microcredit is not a miracle cure that can eliminate poverty in one fell swoop. But it can end poverty for many and reduce its severity for others. Combined with other innovative programs that unleash people’s potential, micro-credit is an essential tool in our search for a poverty-free world” (Yunus, 1999:171).

The next step in this study, now that the poverty approach from the advocates of microfinance has been explored, is to analyze the way MFIs assess their impact.

2.3.2 Evaluating the Impact

The reliability and need of impact assessments has been a focus of more recent debates between academics and practitioners. These social performance assessments were completely neglected in the development of microfinance systems until the last years. The need for them was triggered by media attention and some internal critics who claimed the need of including social performance data together with financial reports. The need to justify microfinance as an ‘anti-poverty strategy’ was one of the main reasons for this change.
The original lack of concern with impact studies is shown by the lack of attention that has been paid to it by the main scholars pushing for the most aggressive commercial revolution. Robinson (2001) writes in the preface of her book that “most impact studies on microfinance have deep methodological flaws, although breakthroughs are beginning and better knowledge of the impact of financial services on the lives of the poor can be expected in the coming decades” (Robinson, 2001:xxxv, emphasis added by the author). Even more, in the introduction Robinson states that the content “does not focus on the impact of microfinance on clients’ households or enterprises. Money is fungible, and the use of small loans and savings is difficult to track accurately” (Robinson, 2001: xxxv). However, many authors strongly support the need for these studies. For example, Johnson and Rogaly (1997:2) believe that “the impact on poverty reduction should be continually assessed rather than taken for granted, which tends to happen if a microfinance intervention is covering its costs and has many low-income users”. Moreover, and despite the recognition of the many difficulties of accessing reliable and significant data, as well as how expensive it might be, authors like Ledgerwood (1999), from the World Bank, emphasizes the need to conduct impact assessments. Since the interventions are aimed at poverty reduction without assessments “it becomes difficult to justify microfinance as a tool for poverty alleviation” (Ledgerwood, 1999:46).

As common practice, MFIs often show particular cases of successful micro entrepreneurs, that escaped from poverty thanks to the loans received, as a strategy to publicize microfinance’s anti-poverty face, rather than a serious assessment of its real impacts. Armendariz de Aghion and Morduch (2010:199) clearly state that these anecdotes “are not a substitute for careful statistical evidence on impacts from large samples”. Despite the fact that there are not many rigorous impact assessments, they believe the number is growing. From a theoretical perspective, rather than a practical one, it is clear that impact assessments should not only include income variables, but increasingly also internal household dynamics that cover a broad set of issues (empowerment, children schooling rates, nutrition, fertility, risk, asset holdings, among others). Armendariz de Aghion and Morduch (2010:222) state that “the microfinance movement was born on the ideal to create new banks with social and economic missions. Completing impact evaluations is an important way to determine if those missions are being achieved”. However, as the authors claim, there is no single study yet that has achieved wide consensus as to its reliability.

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14 Bennet & Cuevas (1996), Hossain (1988) and Khandker (1998) are the most celebrated impact studies until today. Morduch & Haley (2002) is probably the best summary of all the impact assessments conducted until that year, highlighting both the positive and negative results regarding the impacts of microfinance on poverty reduction.
In practical terms, the most common assessment methodology is to compare households or individuals of the same target group, with or without access to microfinance. Using this approach, Khandker (1998) conducted one of the biggest impact studies ever, analyzing a massive amount of data of Bangladeshi MFIs. In accordance with the theoretical framework explained earlier in this study, his definition of poverty was in terms of income and consumption. Khandker’s (1998) conclusion was that through an increment in per capita consumption among program participants, microfinance effectively reduces poverty. The other main finding is that microfinance was useful in helping the poor in terms of smooth consumption. This refers to the availability of funds that allowed families to organize better the consumption needs of the households, spreading the cost of health and education expenses over a longer period of time. In 2005, a large project conducted by the Institute of Development Studies at Sussex, named Imp-Act, assessed 50 MFIs in 40 countries. For Aghion and Morduch (2010), this study tracked many indicators, focused on borrowers that can lead to program refinements. However they suggest that it cannot claim to be an impact study because it did not answer the question: What would have happened to the participant had the program not existed? However, because of the magnitude of the study and the relevance of the MFIs selected, this dissertation will use its results for the case study.

To sum up, there is an increasing recognition by the advocates of microfinance of the need to conduct serious and rigorous impact assessments to justify microfinance as a poverty alleviation tool. However, there is still no single ‘best practice’ to be followed.

Another important rhetoric used by proponents of microfinance as a development tool focuses on its link with social capital. This link is explored in the next section of this chapter.

### 2.3.3 Fostering Social Capital

It is probably through the justification of the group methodology developed by Yunus (1999) that microfinance as a concept was linked to social capital. According to Putnam (1993), if people engage in networks and different forms of association, a moral resource is being built by the creation of a framework of common values and beliefs. They have the power to “improve the efficiency of society by coordinated actions” (Putnam, 1993:91), creating a sort of ‘social glue’. The World Bank webpage seems to agree with this view of social capital, by stating that “a growing body of evidence indicates that the size and density of social networks and institutions, and the nature of interpersonal interactions, significantly affect the efficiency and sustainability of development programs” (World Bank, 2010). As Roy (2010) also points out, the World Bank highlights the role of social capital in improving income, exceeding in
importance the role of investments in human capital such as education. This conceptualization of social capital “rests fundamentally on liberal rational choice theory, which interprets the development process to be driven foremost by the decisions of equally endowed, self-maximizing individuals subscribing to principles of economic rationality” (Rankin, 2006: 91-92). Along this line, Johnson and Sharma (2007:64) explain that this beneficial role of social capital has “been analyzed from the perspective of transaction cost economics to emphasize the role of local knowledge in lowering the costs of screening, monitoring and enforcement in lending”. Therefore, social capital is functional to the way microfinance operates, and this is its main contribution. Ledgerwood (1999) provides evidence of how much easier it is to establish sustainable financial intermediation systems with the poor in societies that have high levels of social capital15. Also Stiglitz (2000), former chief economist of the World Bank, sees social capital as a non-economic means to alleviate market failure and improve market efficiency.

Lastly, Morduch (2000) develops the argument that this could be seen as a win-win approach to development: the financial viability of MFIs working with poor women is expanded through the mobilization of bonding social capital, while the clients can access not only financial capital but also social capital, which enables them to help themselves through markets mechanisms.

The next part of this Chapter focuses on the governance of this global strategy by asking the question: Who controls microfinance?

2.3.4 Microfinance Global Governance

The global scenario of microfinance involves local institutions working in developing countries deeply connected with financial capital in the developed world. ‘Knowledge’ is being produced by powerful institutions, which increasingly have been shaping the policy through dissemination of ‘best practices’ in those countries where microfinance is being applied. A complex network of local and global players is increasingly connected. The democratization of capital for the poor involves an increasing connection (and tension) with the financialization of development. The agenda of this development strategy can be linked to a ‘creative capitalism’16, that through the creation of principles, norms and knowledge make

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15 Karlan (2003) researched the value of social capital in loan repayments rates. Armendariz de Aghion and Morduch (2010:106) comment that “the findings suggest the possibility of beneficial risk sharing: namely, that clients who are forced to default due to circumstance beyond their control are less likely to be forced to leave the program when the clients have strong social ties to the rest of the group”.

16 For Roy (2010), this term, coined by Bill Gates, stands in contrast to Yunus’s people’s capitalism populated by poor entrepreneurs. For Gates it is not about poor entrepreneurs or social business, it is about technology, innovation and big corporations reaching the poor.
financial markets central players to the practice of development. The governance of this new industry involves the coordination of a structure that has many different players, missions, values and motivations, but with apparently a common wish and ideology: to alleviate world poverty through profits.

The inclusion of private capital into the business of development shifts microfinance from being the sole domain of NGOs towards including commercial banks, investment vehicles and money markets. Through the democratization of capital to reach the poor, Roy (2010:5) believes that “microfinance is one of those rare development ideas that originated in the global South and was taken by powerful development institutions in the global North”. The World Bank plays an important role through CGAP, which tries to promote a different model from the one originated in Bangladesh. Therefore, CGAP does not speak about human development, but about advancing financial access for the world’s poor, as the slogan in their webpage claims and in accordance to the commercial revolution of microfinance. In the end, CGAP’s intention is related to the creation of a global financial industry under the framework of poverty reduction. CGAP states in its Webpage that it “provides market intelligence, promotes standards, develops innovative solutions and offers advisory services to governments, microfinance providers, donors, and investors” (CGAP, 2010). But CGAP is not alone. The broad set of actors included in this market friendly version of development includes other agencies of the World Bank, Multilateral Agencies (mainly regional development banks), Bilateral Agencies (like the United States Agency for International Development (USAID), UN Agencies (UNCDF, United Nations Capital Development Fund), Foundations (like Grameen Foundation, Bill & Melinda Gates Foundation), Development Finance Institutions (International Finance Corporation from the World Bank and KfW, from the German government), Institutional Investors (Microfinance Investment Funds) and private individual investors. The Microcredit Summit Campaign can also be included in this shortlist, as an organization bringing together microcredit practitioners, advocates, donor agencies, international institutions, non-governmental organizations and others, advocating for self-sustainable financial systems focused on the double bottom line.

The intellectual and ideological system behind the proponents of the microfinance industry has been unveiled. Starting by Yunus´s ideas, this chapter explained how the microcredit idea created in Bangladesh was transformed into a ‘financial system approach’ by those proponents of commercial microfinance. This new approach has a stronger focus on the sustainability of the MFIs and their financial management and it encourages for profit companies rather than NGOs. The conceptualization of poverty of this approach is rooted in
the lack of capital by the poor. In this process, the market is proposed as the best mechanism through which it is possible to address the demand for banking services by the poor, sidelining the role of the state. Last, the conceptualization of social capital as a mean to alleviate market failure and the support from the international community were presented as a key elements for the imposition of this global poverty reduction policy that it is being sold as a win-win solution to poverty. The next chapter of this dissertation focuses on the increasing critique of this form of development, highlighting the intellectual confrontation and debates between both positions.
Chapter 3

Microfinance under Revision

In this third chapter, a thorough analysis of the increasing literature criticizing microfinance will be developed. After some years of strong international community support without major negative perceptions, the critique to microfinance has become progressively more frequent. Hulme and Mosley (1996) were the first to put into perspective the lack of reliability of the data presented by MFIs to prove their impact, and Rogaly (1996) produced the first academic attempt to enumerate a number of reasons highlighting why the idea of microfinance could be problematic. As time passed by, there was an increasing perception of the “widening gap between reality and propaganda” (Dichter, 2006:1), that became more visible through the academic work of Weber (2002), Fernando (2006), Dichter and Harper (2007) and two very recent books, Bateman (2010) and Roy (2010). This chapter presents three main approaches that this study argues accurately represent the three different dimensions of the critique: the ideological and governance component, the poverty approach critique and an assessment in terms of the developmental outcomes of microfinance.

3.1 The Ideological and Governance critique

Questioning the idea that microfinance is just about "helping the poor", several scholars developed a critique that examines its ideological roots. Three broad topics of concern can be found under this approach: the link with neoliberalism, the structures of its global governance and the connection with social capital.

3.1.1 Neoliberalism at Work

Weber (2002), Fernando (2006), Bateman and Chang (2008), Bateman (2010) and Roy (2010), among others, have a common starting point for their academic work criticizing microfinance, namely, that its central role and popularity in development policy is deeply connected from its supreme serviceability to the neoliberal global agenda. Microfinance is in line with the basic ideas of neoliberalism, “the unquestioned application of market forces and private individual entrepreneurship” (Bateman & Chang, 2008: 2) and “the methodological individualism of neoclassical economics” (Fernando: 2006:19). It is framed as a development strategy that can go hand in hand with those premises, without challenging the pillars of the neoliberal economic world order.

As Roy (2010:24) emphasizes, Yunus´s ideas “are in fact concerned with entrepreneurialism rather that redistribution, with opportunity rather than equality. His fierce emphasis on self-
reliance creates a model of poverty alleviation that is simultaneously poor-centric and anti-welfare”. Therefore there is an implicit assumption in this strategy that the poor “do not need the state to intervene on their behalf … All they need, in fact, is individual entrepreneurship, self-help and a microcredit” (Bateman, 2010:156). Selling credit to the poor is consciously positioned as the longer run substitute for social welfare spending. Therefore, Bateman and Chang (2008:26) state that “once the poor accept that they are now in control of their individual and family destiny using microfinance, it becomes much easier for the government to fully absolve itself of continued responsibility towards them”. This glorification of the market mechanisms comes at a serious price: the loss of the state as a major structure to achieve beneficial outputs for the poor. Bateman (2010) believes that if microfinance ‘wins’, the poor “will have lost control of the very institutional vehicle that in recent history has been most responsible for helping them escape poverty” (Bateman, 2010:159). Social movements, trade unions and redistribution initiatives would also be silenced behind the victory of microfinance. Interestingly, Fernando (2006) uses a metaphor to explain the shift in the role of the government, by highlighting that “now the state, similar to the poor, is expected to be an entrepreneur and function according to the logic of market rationality as coordinated by global centers of capitalism” (Fernando, 2006:19).

Microfinance is seen as the perfect answer because it “seems to contain the magic key to unlock the mystery of capital and enable the transformation of the bottom billion into a new frontier of capital accumulation” (Roy, 2010: 26). This process involves not only the guarantee to the capitalist system to remain safe as the organizing principle of the society but also a deep re-conceptualization of poverty. Under this paradigm, institutions are designed to respond more to what they consider effective demand than an answer to a genuine human need. The microfinance model pictures the poor as clients that can be served by markets and empowered through the purchase of services and goods. As a result of this, one of the main beneficiaries of this re-conceptualization is the global financial market. Roy (2010) explains that if microfinance is about giving loans to the poor, it is also about the conversion of the microcapital of the poor into new global financial flows. Roy (2010:30) argues that microfinance “is a subprime frontier where development capital and finance capital merge and collaborate such that new subjects of development are identified and new territories of investment are opened up and consolidated”. In that sense, microcredit can be seen as a “financially steered targeted poverty reduction strategy that via its implications for policy facilitates financial sector liberalization” (Weber, 2002: 541).
Roy (2010) enriches this ideological characterization of microfinance with the famous thesis of ‘double movement’ of capitalism developed by Karl Polanyi (1944). Briefly, his argument is that in the capitalist system there is a tension between the ‘market society’ and the ‘society with markets’, between a system dominated by market exchange and one where reciprocity and redistribution is possible. To judge by the analysis of the arguments of those proponents of microfinance, in a certain way it can be claimed that microfinance “is designed to primarily reassert the supremacy of Polanyi’s first movement” (Weber, 2002: 551). As Roy (2010) puts it, borrowing a phrase from David Harvey, microfinance celebrates the people’s economy but it also entails “an effort to bring all human action into the domain of the market … to value market exchanges as an ethic in and of itself” (Harvey 2006:3 cited in Roy, 2010: 32). In this dynamic supranationalisation of local social policy, increasingly defined at the level of global institutions, Weber (2002:545) believes that “Polanyi’s insights provide a backdrop for locating and understanding the historical continuity of the poverty reduction agenda of the post-Washington Consensus”. This serves as an introduction for the next section of this chapter that will look at the global governance of this industry.

3.1.2 Knowledge and Global Governance

Building on Foucault’s approach to the ‘spaces of knowledge’, Roy (2010:5) states that “it is the World Bank that controls the portals of knowledge, establishing the norms, metrics, rankings and best practices of microfinance”. Through CGAP, the World Bank controls what microfinance is about and how it is understood. This creation of knowledge has a double task: the portrait of their view as the unique truth, and the need to adapt financial markets principles and norms to become central to the practice of development. Interestingly, many years ago Yunus refused to work with the World Bank in Bangladesh, arguing that the Grameen Bank “have never wanted or accepted World Bank funding because we do not like the way the bank conducts businesses … They do not rest until they have molded things their way” (Yunus, 1999:143). Not surprisingly, this new face of microfinance has definitely involved a shift from its Bangladeshi predecessor, placing that model as a marginalized one. Weber (2002) highlights that this process it is not just about the World Bank but a broad set of actors like the World Trade Organization (WTO), International Monetary Fund (IMF), Regional Development Banks and Multilateral organizations that are part of this global policy harmonization that has come to occupy the role of an hegemonic discourse, creating a ‘Washington Consensus on Poverty’, as Roy (2010) calls it.

This ‘Washington Consensus on Poverty’ seems to have little consensus and much of an own agenda. As Roy (2010:46) asks, “can there be a consensus on development if it is not
generated by Washington D.C.?” Moreover, she asks in which terms is the Global South included in the ‘Consensus’? Would they choose microfinance as a tool away from poverty? Roy (2010) shows evidence that the production of knowledge created by institutions like CGAP are presented as a ‘unique public good’. Picturing it as ‘neoliberal populism’, their speech looks like a blend of free-market ideology and an interest in the bottom billion. The global governance encouraged by this development strategy means not only the management of development, but also the management of the business around development. According to Weber (2002), it is not only the governance of global development but also part of a World Bank strategy to find new ways to do business in the field of finance.

This dual objective in the governance of microfinance implies a shift towards a new way of making development. Microfinance governance appears to be a science of best practices, much more concerned about institutional performances in financial terms than real outcomes in poverty reduction. Despite the fact that traditional banking has largely failed to meet the demands of poor people, today all across the microfinance spectrum the standards of the commercial banking industry are being promoted as the best practice for every MFI in the world. As an example, Roy (2010) shows how the MIX elaborates the Global 100 Ranking, which “ranks microfinance institutions on the basis of outreach, scale, profitability, efficiency, productivity and portfolio quality. Strikingly absent, of course, are criteria that are explicitly concerned with impacts on poverty” (Roy, 2010: 51). The global financial flows move following these principles, and MFIs are evaluated through the lens and parameters established by the World Bank. The conditions in which MFIs engage with these global financial flows are on terms controlled much more by powerful institutions like CGAP than by the MFIs themselves, blurring the concept of development democratization. Resembling Wall Street strategies, Roy (2010:217) asks “how can a dishonest, incompetent, and negligent Wall Street serve as the institutional model for the democratization of capital?”

This globally organized and regulated political system involves microfinance schemes that are embedded within a system of global financial circulation. As Weber (2002:553) states, “the microcredit minimalism and poverty reduction agenda can be seen to make a significant contribution to the removal of barriers to capital mobility in terms of both direct policy implications as well as legitimating it in terms of increasing access to credit for the poor; creating pro-poor enabling policy environments”.

### 3.1.3 Illusionary Social Capital
In the previous chapter, it has been shown how microfinance relies on social capital theories based on rational choice arguments and utility maximizing individuals as the locus of progressive change. According to Rankin (2006), the World Bank’s position assumes that social capital is inherently positive and also restricts the level of analysis to individual tastes, preferences and behaviors. Consequently, development is just about crafting “more associative subjects by creating opportunities for membership in various forms of associational life” (Rankin, 2006:93). That specific way of interpreting social capital implies ignoring several other conceptualizations that could be more relevant for social change analysis but in which microfinance might not achieve positive results.

Bourdieu (1977) is the main author overlooked in the international community’s approach to social capital. His approach to ‘symbolic capital’ is much more complex that Putnam’s one. His unit of analysis is not the individual but the social structure, where different positioned individual experience associational life in a different way. Therefore, associational life is more about conflicts and contradictions rather than a panacea for benign and harmonious socialization. This expanded understanding of social capital allows him to analyze the exploitative dimensions of culture and social practice, where apart from individual self-interest, it is possible to get into the logic of class interest. Bourdieu also warns about the way in which forms of social bonding and associational life generate common values that can operate as forms of power within culture. As Rankin (2006:96) suggests, “social change thus requires the awakening of ‘political consciousness’ through which subordinate groups recognize the established order as an arbitrary human construction and fashion alternative futures”. In these terms, real development would not be just about fostering associational life, but to create forms of associational life among the oppressed that have the power to be collective forms of consciousness and resistance, transforming the individual recognition of oppression. This important omission about challenging power structures and questioning the roots of the disadvantageous position of the poor “enables the architects of neoliberal economic policy to cast the reconfiguration of state-society relations in progressive terms – local capacity building, local self-reliance, net social benefits from reduced transaction costs, and increased returns to human capital” (Rankin, 2006:97). Social capital, as used by the World Bank, therefore offers a ‘governmental strategy’, one that by focusing on the poor as the agents of their own survival, obscures the structural sources of inequality produced by the present political-economic conjuncture, and at the same time, offers an economic and moral justification for reducing the state’s role in the provision of basic social protections.
As a result, the power and social relations of capitalism remain unchallenged through the microfinance project. As Bateman (2010:108) explains, “by recasting individual survival as a function of individual entrepreneurial success, the bonds of solidarity, shared experience and trust that exist within poor communities are undermined”. What microfinance does is to ensure that the poor will not use the democratic process, popular pressure or any form of collective organization as means to achieve social change. Bateman and Chang (2008:24) argue that microfinance “delegitimizes and helps dismantle all possible ‘bottom-up’ attempts to propose alternative development policies that might be of direct benefit to the majority, but which would circumscribe the power and freedom of established elites”. As Rankin (2006:100) puts it, this view “responds more to lenders´ concerns with financial sustainability and profit than to established traditions of fostering radical collective action”. Microfinance seems to be containment of the poor. Through its disciplinary potential, it dampens or contains resistance to the implementation of neoliberal policies at the local level. According to Bateman (2010:108) “it is increasingly being recognized that social capital and local solidarity are more often destroyed by microfinance than encouraged”.

Lastly, the political factor needs some consideration. Roy (2010) presents the thesis that the ‘capital’ in social capital is not innocent, and that the World Bank´s interest in social capital can be seen as a ‘depoliticization of development’. Roy (2010:68) suggests that “the conversion of social capital into economic capital and ultimately into global finance capital is thus underpinned by practices of disciplines and punishment” (Roy, 2010: 68). As Harriss (2002:13) summarizes, “those who sincerely want to help the poor but who are unwilling to contemplate political challenge to existing structures of power end up on the wrong side”.

3.2 A view of poverty from within Microfinance

A growing number of scholars and insiders of microfinance started questioning the given assumption that more microfinance automatically leads to less poverty. By questioning which poverty view is held by advocates of microfinance as well as the tools used to measure its ‘success’, suspicions about the real accomplishment of poverty reduction began.

This chapter is structured in two main sections: the first one, the critiques of the poverty view held by microfinance and the link with impact studies. Second, a critical assessment of the most renowned advantages of microfinance which are part of every ‘best practice’ to reduce poverty.

3.2.1 A complex approach to Poverty
It was Rogaly (1996) who first schematized why microfinance, touted as the solution to global poverty, was faulty on a number of counts. Following his structure, the first reason found is that it encourages a single sector approach, despite the acknowledgement that it cannot fight poverty alone. The argument is that it cannot be claimed that it is an appropriate poverty reduction strategy for every given situation because the mechanisms that are most effective depend on the nature of poverty in a particular context. David Hulme (2007) also expresses his concerns about the general impression that microfinance is a cure for poverty. He regards this marketing strategy used by the international community and the MFIs as a dangerous line of argument because “it distracts attention from the fact that poverty reduction requires action on many fronts: social safety nets for the poorest and most vulnerable, an effective education system, low-cost and reliable health services, governments that can provide social inclusion and sound macroeconomic policies” (Hulme, 2007: 21).

This brings to the discussion Rogaly’s second issue, namely, the empirical evidence that suggests that microcredits are irrelevant for the poorest people, who are sidelined by this poverty reduction strategy. Rhyne and Otero (2006) and Morduch (1999; 2000), once strong advocates of the microfinance industry, started to question harshly who is being served by MFIs, an issue that is absent from the ‘best practice’ case studies in microfinance. As Johnson and Rogaly (1997:12) suggest: “whether income promotion is based on loans for individual micro-enterprises or on group-based income generation projects, its appropriateness as a strategy for poverty reduction in the case of the poorest people is questionable”. Interestingly, one of the most important methodologies used by MFIs, the group-based one, has increasingly been criticized because it exacerbates the bias against the poorest, as a result of self-selection processes commanded by the wealthy of the group, who prefer relatively less poor people. Nevertheless, microfinance continues to be sold as a magic bullet for poverty alleviation even if those more disadvantaged do not benefit at all from it. Rogaly (1996) supports the view that the poorest might need grants and social security nets in order to be bankable.

The third argument pointed out by Rogaly (1996:109-110) is that “an over simplistic notion of poverty is used, based on average annual income at a household level. Seasonal vulnerability, sudden shocks and the social and power relations within and between households are omitted”. Rankin (2006) believes that the narrow view on poverty is strictly connected to the macro-regulatory imperatives of market-driven development that “pares down microfinance to the strictly financial dimensions of poverty alleviation (credit, savings, and increasingly insurance and other financial instruments)” (Rankin, 2006:100). This extremely narrow view
on poverty is functional for an industry that claims to be providing exactly what the poor need: capital. Harper and Dichter (2007) ask to stop seeing poverty just in mere economic terms, but to include all the social dimensions that are part of its complexity, and that should be taken into account if the real impacts on socio-economic outputs ought to be highlighted. The poor, apart from material disadvantages, are highly affected by different dimensions of disadvantages: powerlessness, access to education and health and even symbolic dimensions of poverty, which make them extremely vulnerable. Their work supports a move away from the ‘individual entrepreneur’ image that microfinance tries to impose, to one that can evaluate possible results in the relationship between the individual and the society as whole. The microfinance solution to poverty naturally leaves in evidence the lack of serious analysis of its causes. There is no intellectual work in trying to connect the evidence of poverty with the structural conditions that cause it. Thus, microfinance does not seem to be a strategy against poverty but a tool within poverty: as Dichter and Harper (2007:cover) bluntly ask: “Is it a short term palliative, keeping poor people poor?” There is an absence of a serious analysis of the multidimensional characteristics of poverty and the lack of proper assessments on how microfinance could be having a positive impact in these different levels. From a Marxian systemic view, Weber (2002) explains that the notion of poverty involved in microfinance does not involve a causal relation with the relations of power and domination prevalent in the capitalist system. Even more, poverty is not seen at all as product of the system of accumulation fostered by neoliberalism. Weber (2006:51) states that “rather, the advocates of microfinance as an approach to poverty reduction view conditions of poverty (material insecurity and livelihood strategies) as the consequences of unfulfilled market potentials. The response from this latter perspective then becomes one of creating the appropriate market conditions”. This situation, according to Rogaly (1996) and Kabeer (2005), triggers a focus more on the sustainability of the institutions than on social change, warning that the trade-off between financial and social performance of an MFI becomes sharper if the focus considers economic and social goals in context of extreme deprivation. They believe this pushes MFIs to adopt a narrow view on poverty.

The lack of concern on poverty outcomes becomes even more evident in the analysis of the impact studies. Their design is much more functional to the ongoing support for microfinance schemes than being a real, serious and rigorous assessment of the impact on the poor. The official argument is that “assuming that the win-win position is correct, financial viability should be sufficient to show social impact” (Morduch, 1999:1571).
Bateman (2010) and Ellerman (2007) make a thorough assessment of the impact studies controversies. Ellerman (2007) starts by looking at the funding structure of the impact studies, claiming that usually the evaluators are rarely the bearers of bad news. Ellerman (2007:155) states that “impact studies have become a fad in their own right and are now entwined with microfinance as a means to help sustain programs that have little if any developmental effectiveness”. Both authors believe that one of the biggest flaws of the impact studies is that they focus much more on outreach and institutional sustainability rather than in sustainable economic and social development impact\(^\text{17}\). As a rule, by showing how many poor clients are being ‘benefitted’ by self-sustainable and profitable MFIs, the positive impact becomes ‘evident’\(^\text{18}\).

Apart from these overall facts, impact studies have several methodological flaws. The main problem is the absence in the analysis of a basic economic concept: opportunity cost. As Ellerman (2007:155) suggests: “the counterfactual is not the best alternative use of the resources in the current circumstances but what would have happened if no resources had been expended in the current circumstances”. Therefore, by comparing a community that received loans with a community, with similar characteristics, that did not receive loans, if the former one has any positive income (increased income, higher access to health or education) microfinance is seen as having a ‘positive impact’. However, it is hard to imagine that in very poor communities any injection of cash will not improve things, no matter the way it is provided, to whom and under which circumstances. Bateman (2010) distinguishes two other major methodological flaws on microfinance impact studies. The first one refers to the displacement effects, which is related to “the jobs and incomes lost in non-client microenterprises as a result of the entry or expansion of client microenterprises” (Bateman, 2010: 64). For MFIs, clients and non clients are separated; there is no consideration of what happens in those non-clients as a result of an expanded provision of microfinance products to clients. The microfinance industry made “a fatal assumption that the typical local economy in any developing country could elastically stretch to painlessly accommodate any increase in the microfinance-induced local output of non-tradable items; ergo there can be no displacement effects” (Bateman, 2010: 73). The second major critique is the lack of

\(^{17}\) Rogaly (1996) warned many years ago that if microfinance focuses too much on scale, there is a disincentive to the analysis of local specific conditions (like existing savings or credit facilities) and that this increases the risk of the emergence of a ‘blueprint’ approach to anti-poverty action.

\(^{18}\) For more details of the dubious methodology of the main impact studies supporting microfinance, see Bateman (2010) who shows for many impact studies how originally positive results turned out to be misleading when the same input information was analyzed by different researchers. The main work on revising originally positive impact was done by Roodman and Morduch (2009) on the famous Khandker (1998) impact study in Bangladesh.
awareness of client failure or exit, which is a common face of every microfinance programme in the world. When impact assessments are conducted they focus on the actual clients, completely losing out of sight those that by several reasons decided to abandon the institutions. Since the poor will use many fallback strategies to repay their loans, many might end worse-off and pushed into deeper poverty once they leave the MFIs. However, this situation is not captured by impact studies.

To summarize the absence of best practices in this regard, Morduch (1999) elaborates a possible explanation, by stating that “part of the problem is that the programs themselves also have little incentive to complete impact studies. Data collection efforts can be costly and distracting, and results threaten to undermine the rhetorical strength of anecdotal evidence” (Morduch, 1999: 1572).

Interestingly, for many scholars it appears that MFIs are trying to hide some of the real facts behind microfinance. Therefore, the next section will critically look at four of the main pillars of the commercial revolution in microfinance to try to assess how solid they are in terms of poverty reduction outcomes.

3.2.2 The Critique to the four Pillars

The need for credit to support income generating activities, the sustainability of the MFIs, the high repayment rates and women empowerment will be critically reviewed under the lens of the main critiques to challenge the supposed benefits of microfinance.

i. The bulk of credits are used and demanded for income generating activities

Microfinance’s positive impact is rooted in one main assumption: the money lent to the poor is used to support income-generating activities that through their entrepreneurial skills will lead to an incipient microenterprise, producing higher income and a way out of poverty. However, the bulk of microfinance “has been used instead simply to facilitate consumption spending that cannot be financed out of current income” (Bateman, 2010: 29). As this became more evident, the advocates of microfinance began to admit this fact about MFIs and its products. However, Weber (2002:541) explains that these critical findings “have not translated into policy rectification, rather policymakers have reacted by changing the terms of reference”. Therefore, instead of recognizing the complications for microfinance to fight against poverty if the loans are used just for consumption needs, policymakers now refer to this as ‘consumption smoothing’ and it is being promoted as a positive outcome of microfinance. Critics of microfinance agree that the point is not that this consumption goal is
unworthy but that it bears no relationship to the development-oriented storyline of funding entrepreneurship by the poor. Because money is fungible, it can be used for any purpose. However, as Dichter (2007:180) states “poor people using credit for things and services (even if some are necessary such as medicine or education) is not really what microcredit started out to do”.

The shift into a commercialized microfinance has triggered the creation of MFIs heavily involved in low-risk and high-profit consumer loans in order to ensure their financial self-sustainability. Bateman (2010:36) states that “it is quite wrong to extrapolate from the widespread use of microfinance by the poor to conclude that they actually want and need microfinance, and so fully agree with microfinance as the main or only way out of poverty predicament”. The use of microfinance products might be a desperate impulse of the poor to avoid complete destitution. This involves that a very significant proportion of effective demand could be artificially stimulated by the increasing availability of microfinance. The risk of a microcredit bubble, with poor people over-indebted is much more probable when credit is used for a consumption destiny rather than for income generating activities.

ii. It is about sustainability

Once an important issue for the original microcredit project but now converted into a premise for any commercialized MFI, the sustainability of the institution became the main priority of the bulk of MFIs in the globe. But if originally MFIs were highly subsidized, at which cost comes this solution? According to Weber (2005) and Bateman (2010), the very same poor are paying for their supposed way out of poverty through high interest rates. For Bateman (2010) this has two implications: first, the high interest rates are not only a way to attain financial sustainability, but also to generate a significant profit through the repayments of the poor. Second, it is asking the poor to facilitate not just their own way out of poverty but also to finance that of other poor. Khandker (1998) adds another dimension: he believes that high interest rate reduce the impact on poverty alleviation, because it impedes the use of the benefits of the microenterprise by the poor. However, this need for high interest rates allowing sustainability and profitability remains unchallenged, since it is common “to interpret financial viability as indicative of the social, political and economic success of microfinance programmes” (Weber, 2006: 53).

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19 The explanation is as follows: in a start-up phase, the MFI charges much higher interest rates until it reaches economies of scale. Therefore, the first clients are charged a higher interest rate than future clients.
As Kabeer (2005:93) states “it is the concept of sustainability that will have to be broadened to go beyond the focus on organizations sustainability and to address the question of sustainable social change”. The current focus on financial objectives means fewer of those most in need of microfinance services are being targeted, and the very poor remain ignored by MFIs. For Allen (2007) this is a clear sign that reaching the very poor requires subsidies because “there will always be a large number of people who live in hard-to-reach places, or whose needs are so small-scale that they cannot be served profitably” (Allen, 2007: 51). But subsidies are not an option for those advocates of commercial sustainable MFIs.

Opposed to those arguments by Robinson (2001) and Otero (1999), many authors doubt whether it is possible to achieve financial and social return at the same time. Their standpoint is that there is a mission drift\textsuperscript{20} when microfinance becomes commercialized and for profit. Bateman (2010:55) explains that “the new wave commercialization model has added enormous impetus on the ongoing abandonment of the social mission aspect to microfinance”, and even its own practitioners agree that the average commercialized MFI has begun to veer significantly off course.

Finally, on a statistical note, Bateman (2010) also argues that reaching financial self-sustainability is only possible for a very small number of MFIs, and that the bulk of MFIs are unlikely to reach it. Only the largest and most commercialized MFIs, targeting the less poor, will be able to achieve it.

iii. High repayment rates: A measure of success?

Many authors have unveiled this rhetoric to discover what is behind the high repayment rates. Originally a proof that the poor pay despite not having collaterals, the high repayment rates became also “the manner in which microfinance loans may serve as an arena for the negotiation of power and hierarchy – both within the household and beyond” (Roy, 2010: 109). They can mean women empowered to make choices but also women obliged to transfer loans to their husbands and excluding themselves from the public sphere, while keeping the obligation of repayment. It can be the expression of a hidden transcript of a patriarchal discipline enacted in order to ensure loan collection. The dark side of high repayment rates is that it can also imply a trap of over-expanding debt. Bateman (2010) demonstrates how the poor will use many strategies to fulfill the requirements of payments, from borrowing from friends to asking credit from more than one institution, which can lead to over-indebtedness or

\textsuperscript{20} Mission drift states for a situation where an institution that one served the poor moves up-market, abandoning them.
loss of family assets. This set of fallback strategies are linked more with microenterprise failure than with it success and with credits used more for purposes linked with consumption than for increasing income. As Dichter (2006:3) asks, “if borrowers repay microloans does this automatically mean that microcredit is a useful intervention in poverty reduction?” Bateman (2010:58) answers that “they very often mean that, for reasons of shame, fear and future microloan availability, the poor are simply drawing down other financial, physical, social and reputational assets in order to repay their microloan, and thus getting poorer overall”.

However, despite the evidence of negative connotations of what high repayment rates can involve, MFIs have used it as one of the most attractive tools for investors and private capital. The repayment rates work much more as an undisputable indicator of a highly safe business than a measure of poverty alleviation. That is why they became one of the main instruments assessed in risk scoring when it comes to evaluate MFIs. As Roy (2010:213) states, “the risk scoring in microfinance is thus less a valuation of the labor of the poor or the assets of the poor and much more an assessment of the capacity to enact repayment”. The connection between microfinance and microenterprise is blurry and can be an ‘exotic fiction’, “a huge divide that separates microenterprise success and high repayment rates” (Bateman, 2010: 57).

iv. Women and Empowerment

Women´s empowerment claims have been based on the combined access to material resources with tools and strategies in order to build solidarity and expanding women´s agency in the development process.

However, some important critiques started to appear in this field as well. Fernando (2006), from a Marxian systemic perspective, identifies the use of empowerment´s rhetoric as a way to justify the governmental strategy of writing out the state and its welfare spending, and lead to a market-led approach to development. According to him, any theory or programme with real objectives of empowerment must be grounded in a theory of social change that questions the ideologies and institutions that are framing the meanings of empowerment. Rankin (2006) supports his view by stating what real empowerment should be focused on: “solidarity among women can serve as a powerful tool for progressive social change, as long as it fosters critiques of dominant cultural ideologies” (Rankin, 2006:105). A minimalist approach to microfinance by no means can achieve this, since it reinforces a system that avoids the ideological dimension of social change.
Fernando (2006) and Kabeer (2001) believe that microfinance may entrench rather than challenge existing social hierarchies, disciplining poor women to manage their own welfare through active participation in the liberal economy by increasing the burden on poor women. The reliance of microfinance on peer group pressure and local culture and traditions has the problem of reproducing the internal institutions and power relations that historically have oppressed women.

Therefore, if real empowerment is far from being a reality for those critiques of microfinance, are there hidden reasons of why women are targeted? Rutherford (1995) has an answer to this complex question. The real reasons for targeting women are based on financial and economic terms that are beneficial for the MFIs. Women are much more accessible than men because they spend more time at the house, they are more likely to repay on time, more pliable and patient than men, and cheaper to service. Therefore, by lending to women, MFIs offset major costs by using intrahousehold gender relations of obligation or persuasion to recover weekly loan payments. The use of intimidation techniques is also more effective with women than with men.

From a historical perspective, Bateman (2010:31) shows how “self-employment and microenterprises have most often been promoted as part of the programmed disempowerment of the poor”. The informal markets overcrowded with petty traders together with the expansion of petty survivalist activities had traditionally worked as a way of moving the poor away from more transformational activities, to discourage their participation in popular movements or political uplifts.

The empowerment effects appear to be one more of a long list of self-created myths by microfinance, when real disempowering effects might be taking place. The real empowerment claimed by Ellerman (2007), one where “the idea is to foster and catalyze agency of poor people to change their own circumstances, not to simply have better services delivered to them as passive customers and clients” (Ellerman, 2007:153) is missing. At the end, microfinance’s empowerment could be portrayed as a different one, more concerned with empowering the market at the expense of the poor in general, and the women in particular.

### 3.3 The Developmental Critique

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21 Goetz and Sengupta (1996) showed in figures for rural Bangladesh how women most often lost managerial control of their credit, by giving the money to their partners, but still remaining as the main responsible of its repayment.
Microfinance has a strong focus on poverty reduction, but has been sold as a development strategy that is a ladder for economic and social development in a broader sense. These claims have lately been subject of an increasing critique.

Ellerman (2007), Bateman and Chang (2008) and Bateman (2010) highlight the fact that poor East Asian countries experienced a very successful development with a negligible microfinance presence. These successful development cases were achieved “by using a range of state coordinated policies, financial institutions and investment strategies that there are not only the complete opposite of today’s new wave microfinance model but also very likely to be undermined by the proliferation of microfinance” (Bateman and Chang: 2008:12). The flip side of the coin is the situation of Bangladesh or Bolivia, countries that have a very high penetration index of microfinance but still remain as some of the least developed countries in the world.

Ellerman (2007) asks about microfinance: “is the purpose assistance to economic development, or is it more a tool for the relief of poverty?” (Ellerman, 2007: 151). Despite the framing under developmental terms, he believes that microfinance’s most legitimate activity is to put money in the hands of the poor, moving the money quickly but without clear impact on neither poverty nor development. Therefore, microfinance is publicly touted as an instrument of development but is privately defended by many practitioners as a form of poverty relief that can hardly be demonstrated. One of the most problematic feature is the assumption that the poor people have the necessary entrepreneurial knowledge, skills and opportunities to start businesses once they have access to finance. Reality shows that the loans have little of developmental value and often support unsustainable consumption. Ellerman (2007:153) states that “genuine development assistance, where the helpers do not crowd out and undercut the agency of the doers, is a slow, subtle and painstaking process” and in general it is not compatible with for profit actors. Even in those cases where some commercial activity is encouraged, the little or no barriers of entry will end up with overcrowded markets.

Bateman (2010) develops a detailed analysis of how microfinance fails every developmental trigger that in the last years have proven to underpin sustainable local economic and social development. The first one is related to economies of scale. By providing short terms loans, with strict repayment periods and high interest rates, MFIs offer a product that have little concern with sustainable local development and the advantages of units of production that reach economies of scale. It is in the agricultural sector where this is more striking by offering
a bad product to the wrong customer. Ellerman (2007:154) states in the same line that the problem of microfinance is that “it is often small and medium sized business that have the real development potential to engage the market, but their financing needs seem to be crowded out by the quick fix to alleviate the symptoms of poverty by financing individual micro business”. These arguments give relevance to Thomas Ditcher’s statement about the ‘microfinance paradox’, which refers to a situation where “the poorest people can do little productive with the credit, and the ones who can do the most with it are those who do not really need microcredit, but larger amounts with different (often longer) credits terms” (Dichter, 2006:4).

The second developmental issue for Bateman is the concern of a microfinance industry that fosters the encouragement of an informal sector rather than of formal business. Bateman assures that the development of the informal sector “is manifestly not causally associated with sustainable economic and social development anywhere” (Bateman, 2010: 91). Rather, the opposite might be true, with large informal sector being the expression and the safety valve of collapsed formal labour markets. In the same line, Dichter (2006:4) states that “informal markets are not the way out of poverty; they are driven by it”. Also a ‘bazarization’ of the economy is promoted through the import dependency generated through the promotion of petty traders. The problems once again have to do with the products microfinance offer: it is much easier and profitable to provide a credit for an informal trader that buys and sells imported goods than to make a medium-term investment in a productive company.

The third developmental trigger that microfinance fails to address, concerns industrial policy. If the main source of finance nowadays is for profit and based on short term loans on very expensive terms, the suitability of those products for projects that are focused more on the longer term manufacturing industry are quite inaccurate. Microfinance does not have the role to finance long and expensive projects, but its popularity produces a diversion of funds that otherwise could be channeled to more labour intensive and development oriented industries. This scenario is even worse if it is taken into account that many MFIs are taking deposits. Shortly, this means that the private savings of the country are derived into very low-productive activities instead of being used in long term developmental projects. The collapse of local manufacturing firms, especially important in job creation, are the main victims of this process, which also crowds out innovative and technology based microenterprise, that are key for any development strategy. As Morduch (1999:1610) confesses, “the best evidence to date suggests that making a real dent in poverty rates will require increasing overall levels of

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22 The argument is that microfinance tends to finance small subsistence farms and not small family farming units that have reached minimum efficient scale that have much more tools to contribute to long-term growth and development.
economic growth and employment generation. Microfinance may be able to help some households take advantage of those processes, but nothing so far suggests that it will ever drive them”.

The sum of all these factors makes Bateman (2010) conclude that the temporary uplift often provided by microfinance is being paid for into the longer term by the progressive deindustrialization and stagnation of the country concerned. Therefore, microfinance is not only an anti-development strategy but also a poverty trap. As Dichter (2006:1) claims, “the development of the advanced industrial countries did not depend on the average middle class or poor person having access to credit”. So, “why do we make the assumption that in the developing countries, the poor are all budding entrepreneurs; that they will use credit wisely for investment in income production and are ready for all manner of financial services?” (Dichter, 2006:3). The answers may be found in the profitability of microfinance as a business for a few, despite the lack of positive results for the majority.
Chapter 4

Methodology

4.1 Some background on the case study

This practical case study of the research is based on three MFIs: K-Rep Kenya Development Agency, a private company; Pro-Mujer Peru, an International NGO; and Bangladesh Rural Advancement Committee (BRAC), a nonprofit organization. This study includes an analysis of the institutional characteristics of the three MFIs, of their financial and social performance and an in depth review of their ideological systems. A comparative analysis of these three different MFIs is intended.

The aim of this study is to critically analyze, in relation to the different positions presented in the theoretical framework, three examples of MFIs who provide financial products to the poor. The main objective is to reflect on the research questions of this dissertation using the most reliable information available for each MFI studied: Can microfinance be considered a development policy in itself or is it just a pro-poor policy providing financial services to the unattended poor with limited impact on poverty reduction? Secondly, do explore the extent to which these MFIs consider poverty as a multidimensional phenomenon and how their programmes attack its causes and different expressions. Drawing on this poverty reduction strategy, the role of the state and the market in each MFI strategy will be explored. Finally, the question of sustainability of the institution versus sustainability of social change will be addressed.

The rationale behind the selection of these three institutions is manifold. Their geographical location is the first one: with microfinance framed as a global phenomenon it is important to develop a case study that takes into account some different localities to be able to draw more representative conclusions. Second, the three MFIs are well-known and well established MFIs. As a proof of this, is their historical involvement with the provision of financial services to the poor and their presence in the Imp Act research Programme mentioned in Chapter 3. Third, the three MFIs are part of the selected group that reports on a regular basis all their financial performance to the MIX. In the year 2009, the MIX also encouraged the institutions to report their social performance data through the launching of the Social Performance Task Force. This initiative, triggered by the lack of data regarding impacts of MFIs, consisted of the submission of a broad set of social performance indicators in order to assess the social impact of MFIs programmes. Despite the financial factors which drove this
initiative\textsuperscript{23}, for the first time MFIs were encouraged to report their impact in a schematized way. In the case of Pro Mujer and BRAC this information will be analyzed in Chapter 5. Unfortunately, K-Rep has not reported this information yet and therefore the comparison between the three institutions in this regard will not be possible. Lastly, they represent a broad range of institutions in size, scale, context, mission and vision, sought for exploring in detail the heterogeneity of the microfinance sector.

\subsection*{4.2 Methodology of this study}

As a result of the serious limitations of information regarding the microfinance industry, this study has been designed purposively using an unorthodox methodology that intends to combine inductively the most reliable sources of information for each MFI selected to be able to test the hypotheses of this research, answer the research questions and analyze them against the theoretical framework.

The inputs to be used for this analysis include: institutional information provided in their WebPages and promotional material, reports of financial and social performance of each institution to the MIX, key documents produced by each of the institutions (impact studies, annual reports and any research activity relevant to the topic), the results of the Imp-Act study and the information gathered of each institution through in-depth structured interviews held with their staff. All the information was analyzed in a systematic and inductive way in order to develop a reliable analysis of each of the three institutions. This study included a qualitative examination on the findings as well as some basic quantitative analysis of the information available, especially for the analysis of financial and social performance.

Regarding the structure, each MFI in this thesis is analyzed individually in Chapter 5. The categories of this analysis include: 1. An introduction to each country and microfinance industry; 2. Official documents to explore the institutional characteristics of each MFI and main characteristics of the microfinance programmes; 3. Financial and Social Performance using the data reported to the MIX in 2009 together with the results from the Imp-act study and other key researches when available; 4. Critical assessment and interpretation of the data using the previous information together with the information gathered through the interviews. At the end of that chapter, a comparative conclusion is provided, with the focus on the key research questions of this thesis. All the results that arise from the practical case study have

\textsuperscript{23} In the key document the MIX circulated among the MFIs for encouraging the report of social performance there is a list of the benefits to MFIs that includes: attracting investors, attracting donors, building personal reputation and gaining publicity. See The MIX (2009)
been assessed and tested against the theoretical framework adopted for the study and are presented in the last chapter of this dissertation.

4.3 Limitations of this study

Due to different reasons, there were many limitations in conducting the case study. The main limitation was the lack of first hand fieldwork in the three MFIs. Undoubtedly, the impressions that the researcher could gather in the field through the direct contact with the loan takers of microfinance would have given to this case study a much more reliable source of information in order to analyze and compare the different institutions. Financial and time constraints are the causes of this deficiency that implies the reliance on other sources of information.

Second, the structured interviews conducted were either by phone (Pro Mujer Peru) or by email (K-Rep Kenya and BRAC Bangladesh). The limitations in comparison to a face to face interview are several. The limited time of the interviewees to reply, the impossibility of making follow up questions and the possible misinterpretation of some questions and answers can be highlighted as the main ones. Another important methodological limitation regarding the interviews was the impossibility to randomize the respondent of each MFI. The institutions were contacted and encouraged to provide respondents that could represent the management and operational teams. At the end, each institution, arguing time constraints, only proposed one respondent and the purposive sampling method was not effectively used. Therefore, the lack of more than one respondent from each MFI might result in some inaccurate information or personal views that do not represent adequately the standpoint of the institution. When noted, this will be highlighted in the case study.

Third, many of the very recent instruments created by the microfinance industry to show the social performance of MFIs, like the Progress out of Poverty Index\textsuperscript{24} used for the Social Performance Report by the MIX, are calculated in a closed way. There is no detailed information about its construction or the sources of information used. Therefore, doubts about the reliability of this information are one of the main limitations for any research concerned with poverty outreach or developmental outcomes rather than just with financial performance.

Overall, the lack of homogenous information from the same sources for the three MFIs is definitely not the best scenario for the case study. However, this unavoidable drawback works

\textsuperscript{24} The Progress out of Poverty Index is a tool created by the Grameen Foundation that measures the likelihood of microfinance clients’ poverty. It is built on a universal methodology, but each country has its specific PPI using the most representative income and expenditure surveys. For more information, see Grameen Foundation (2008)
also as an expression of the lack of norms and guidelines that MFIs deal with, in an industry that it is on the make. Therefore, the intent of developing a comparative case study might not be based in the most scientific baseline. However, despite the heterogeneity of the data and the complications that these facts produce for its comparison, the author believes important information has been gathered for validating the case study as an empirical assessment of the theoretical framework.
Chapter 5

Microfinance Institutions, Development and Poverty Reduction: the results of three institutions

5.1 The Three Microfinance Institutions

5.1.1 Pro Mujer Peru

i. An Introduction

According the National Institute of Statistics and Informatics, the Peruvian population in 2009 was about 30 million inhabitants, of which 25% live in rural areas. According to the same source, the population below the poverty line is 34.8%, calculated as the amount of people that have a level of expenditure below that which is needed to buy a defined basic basket of goods. The GDP per capita in PPP terms is $8647, which places Peru in the 72th position in the world. These indicators picture Peru as a middle income developing country. In this context, an incipient Microfinance Industry takes place. According to the MIX (The MIX, 2010), the Peruvian financial system has gone through extensive development which is evidenced by the entrance of new participants, transformation of the types of institutions and mergers. This has led to a rise in the geographical expansion of the microfinancial system, contributing to the decentralization of financial services in the country. According to the Copeme Report (2010), the microfinance sector in Peru is composed by 70 MFIs (including commercial banks, NGOs and cooperatives). However, there are hundreds of small organizations providing microcredits as part of their activities. The total number of borrowers is slightly over 3 million. In this context, Pro Mujer is a medium-sized MFI. It is placed in the thirteenth position in the country in terms of outreach, reaching a total of 64 844 clients.

ii. The Official Documents

Pro Mujer describes itself as an international women’s development and microfinance organization whose mission is to provide Latin America’s poor women with the means to build livelihoods for themselves and futures for their families through microfinance, business training and healthcare support. Pro Mujer states that “it fights poverty by establishing

25 This is an estimation by the Instituto Nacional de Estadística e Informática. The last Census (in 2007) reported a total population of 28,220,764. For more information, see Instituto Nacional de Estadística e Informática (2008).

26 Gross domestic product (GDP) at purchasing power parity (PPP) per capita refers to the value of all final goods and services produced within a nation in a given year divided by the average population for the same year. Using a PPP basis is arguably more useful when comparing generalized differences in living standards on the whole between nations because PPP takes into account the relative cost of living and the inflation rates of the countries, rather than using just exchange rates which may distort the real differences in income.
sustainable microfinance organizations that provide an integrated package of financial and human development services that women require to build and improve their small business” (Pro Mujer, 2010), focusing on the most economically and socially disadvantaged women. Pro Mujer believes the best way to fight poverty in Latin America is through the empowerment of women, resembling Collins et al (2009) ideas of a message rooted in women entrepreneurial success. The organization “has confidence in women, in their values, abilities and experience” (Pro Mujer, 2010). Pro Mujer’s strategy involves not only the provision of financial resources, but also training schemes and access to health service. The organization believes it is important to achieve greater equity in homes, workplaces and communities.

Pro Mujer methodology consists of providing the financial and human development services to associated groups of women. There is only one product offered by the institution: the microenterprise group loan, undoubtedly rooted in Yunus (1999) original idea. The only difference between groups can be the amounts of the loans, as it follows a progressive scheme. The village banking methodology employed by Pro Mujer requires that its clients gather in Communal Associations of 15 to 30 members. Each Communal Association is composed of Solidarity Groups of 4 to 7 women, who mutually guarantee the loans of the other members, borrowing and saving together. Communal associations meet at a Focal Center weekly or bi-weekly according to a fixed schedule. The Focal Centers are a unique feature of Pro Mujer that allows clients a ‘one stop’ access to financial, education and health services. This methodology is aimed to foster and enhance solidarity network and mutual trust, in accordance with Putnam’s (1993) vision of social capital.

The health services in Pro Mujer Peru links clients with other health organizations through partnerships developed by the institution. Velasco, one of the founder members of Pro Mujer International and its current Executive Director, states that “the emphasis that Pro Mujer gives to health education and services is linked to the multiple roles played by women in the society: as income earner, wife, mother and caregivers” (Velasco and Chiba, n.d: 15). Apart from primary health care, this scheme allows other services, like primary dental consultations. It covers the needs of the client, but not her family. Because “health is a social priority and a universal human right, Pro Mujer has been mainstreaming health into the services offered to the clients” (Velasco and Chiba, n.d: 15). The educational services are carried out by the staff of the organization. It includes both health and personal development areas, like family care, sexual and reproductive health, hygiene, self-esteem and civil and human rights. The rationale if that “education becomes a crucial instrument to empower women because it complements and enhances the advantages of the improved access to economic resources given by the
loans” (Velasco and Chiba, n.d.: 16). Pro Mujer also states that it offers women empowerment services, including business training to enhance women’s market opportunities, women leadership training and women’s rights education and gender issues.

Because of Pro Mujer not being able to capture deposits as a commercial bank, there are no specific products designed in this regard for non-credit takers. However, through a compulsory saving mechanism, clients are obliged to keep in the MFI part of each loan, and that money works as savings as well as a fund they can use in case of not being able to repay their loan. The clients can only recover all their savings when they leave the institution.

iii. Financial and Social Performance

Table 1 at the end of this chapter summarizes the key findings for each MFI. Pro Mujer has a special focus in the lower end of the microfinance market of Peru. The level of the average loan balance (USD 207) works as a sign of this. The lack of need of collateral and the solidarity group and village banking methodology are also aimed to target the poorest clients, following Yunus’s (1999) methodology. Pro Mujer’s prioritization of women is confirmed by the facts: in the year 2009, more than 93% of their loans were received by women, most of them in urban areas. Every loan given by Pro Mujer was officially declared for microenterprise development.

The analysis of the financial performance and productivity levels shows a highly sustainable MFI. Pro Mujer shows a high operational self-sufficiency (140%). The profits earned are reinvested into the organization. The rates of return of both equity (23.76%) and assets (12.44%) are very high in international standards, and good enough to attract social investors to the organization, driven by a high revenue profit margin (28.74%). Due to the group methodology, Pro Mujer exhibits high efficiency rates of borrowers per staff member (232) and loan officer (453), in accordance with the best performances of the industry. The portfolio at risk of 3.5% is low in a comparative perspective, and makes the whole performance of the institution a very good one. This low level of credits at risk is even below of those of formal banks requiring collateral (Copeme, 2010).

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27 It is registered as a non-profit organization and this implies a legal restriction on developing savings products.

28 All the data in this section is from the Financial Report 2009 (Pro Mujer, 2010c) and Social Performance Report 2009 (Pro Mujer, 2009) submitted to the MIX, otherwise stated.

29 However, the size of the loan is not necessarily a proof to be used as a proxy of poverty levels because it implies the assumption that only poorer households will be willing to take the smallest loan.

30 It is curious that despite the focus of financial sustainability, no data was available on this regard.
Pro Mujer does not conduct regular and continuous impact assessment. In the webpage, under the label ‘Measuring our Progress’ (Pro Mujer, 2010 b) no information is found about poverty impact, income of clients or any other piece of information regarding the poverty reduction outreach that the credit programmes might have had on the clients. Instead, it is possible to find four variables: number of clients, number of communal banks, gross loan portfolio and clients savings. The similarities with Roy’s (2010) description of an industry without concern with poverty impacts are striking.

In the Imp-Act study, Pro Mujer did not hold a protagonist role like other MFIs because its internal research capabilities were weak, and therefore, it was only subject of some basic studies carried out by the research project. One of the main aims was to build capabilities to conduct further research. However, as part of the findings highlighted, Imp-Act found that Pro Mujer effectively targets the poor, but without using any specific targeting tool. This means that the institution uses inclusionary strategies, which “include many poor women and their household, but does not actively exclude anybody who does not meet these criteria” (Greeley, 2005:25). As the study suggests, this targeting method has the risk of shifting away from its mission unless poverty outreach is monitored. Pro Mujer focuses on neighborhoods with high density of female vendors working in the informal sector as a strategy to target the poor clients.

The only comprehensive source of information regarding social performance is in the Social Performance Report (2009) reported to the MIX. The developmental outcomes indicated in this report are poverty reduction, employment generation, adult educational improvement, health improvement, gender equality and women empowerment, despite it is only possible to find disaggregated information for the first one.

In respect to the poverty measurements regarding the clients, Pro Mujer reports the measurement of their poverty level (for both new and old clients) at a certain moment of time, in a randomized way. To conduct this assessment, Pro Mujer used ‘The Progress Out of Poverty Index (PPI)’ using a sample of 766 cases. In the last measurement, the use of this index showed that 35% of the new clients of Pro Mujer in the last working year were below the poverty line. And 14% of them were in the bottom 50% of those below the poverty line. Interestingly there is a specific segment regarding the clients who have been in the institution for three years. The PPI measurement showed that still 27% of those clients are below the poverty line. And 73% are above that line. However, the information provided is very incomplete since there is no data provided for the original poverty status three years ago.
regarding these clients\textsuperscript{31}. Therefore, the analytical value of this information remains limited. In an institutional report presented in 2010 because of the twentieth anniversary of Pro Mujer NGO (Pro Mujer, 2009b), the only statement focusing in Peru highlighted the increase in income (19\%) of long lasting clients in comparison with recent ones\textsuperscript{32}.

They also state the institution aims to reach poor and very poor clients and they specify which benchmark they use to estimate the poverty level of their clients. For the very poor clients, they use the reference of persons in the bottom 50\% of those living below the poverty line established by the national government, whereas for the poor clients it is the persons living with less than USD 2 a day. However, as it has been stated before, the Imp-Act study holds the view that these targeting tools were not effectively used.

The last important information regarding the Social Performance Report is that Pro Mujer states that they conduct market research for development of new products, client satisfaction assessments and interviews with salient clients. In this regard, the institution experienced an extremely high dropout rate for the year 2009: 48\% percent, putting into perspective Bateman’s (2010) concern about salient clients. Since the total amount of credits given slightly increased compared with the previous year, about half of those credits were given to new clients. In the section corresponding to social responsibility to the clients, the most striking fact is the statement that Pro Mujer does not evaluate borrower’s repayment capacity including over-indebtedness before giving out the loans.

iv. Analysis

The official documents show an organization holds a view where poverty seems to be rooted in lack of resources to build livelihoods and therefore the institutional approach is the provision of financial and human services in a microfinance plus scheme. Naldi Delgado, Pro Mujer’s Peru National Director, states that the institutional recognition of poverty not being just a matter of lack of income translates into a program that offers microcredit and health service as one integral service. Interestingly, there is an internal cross-subsidization that implies that the price of the financial service is paying for the cost of the health provision\textsuperscript{33}.

\textsuperscript{31} As an example, if 3 years ago the percentage of clients below the poverty line when joining the institution was 27\%, the result exposed by Pro Mujer would show no change in the poverty situation of the clients.

\textsuperscript{32} Morduch (1999) explains that these simple measures can be deceiving, because they could also imply a difference in targeting. In this case, it could imply that Pro Mujer first targeted women with a higher propensity of growing their business in comparison to the newer clients. Thus, the result might not be linked at all with the supposed positive benefits of the microfinance programme.

\textsuperscript{33} Cross subsidy refers to the strategy of using the benefits of a sustainable and profitable programme into the development of one that is more costly and not sustainable. Velasco and Chiba (n.d) show in their study that the small payment the client make when accessing health services not included in the basic provision only covers 0.6\% of the total costs of the health scheme.
Using this combined approach, she believes Pro Mujer is helping “at least a little the fight against poverty” (Delgado, interview, 23.11.2010, translation by GP). Despite poverty being recognized as a phenomena that is not just about income, the institution only offers one single product for all its clients. “What can change is the channel of commercialization depending on the location of the group, but there is only one product for all our clients” (Delgado, interview, 23.11.2010, translation by GP). She believes that one of the most important features characterizing Pro Mujer fight against poverty is the high provision in rural areas, where other MFIs do not go because of the higher costs. For its Director, that is a clear sign that Pro Mujer is really concerned about poverty. However, figures show that only 18% of the total credits were given in the rural areas for 2009.

The focus on the very poor is evident through many figures. Delgado gives as reasons “the average size of the loan, the percentage of credit in rural areas and the fact that our strongest focus is in the south of Peru, the poorest area of the country” (Delgado, interview, 23.11.2010, translation by GP). The other main concern of Pro Mujer expressed in their mission is the empowerment one. In this regard, Delgado confirms that Pro Mujer believes, like Yunus (1999), that the answer to poverty relies on freeing the potential, energy and creativity of every human being. Through their communal bank “women are encouraged to develop their personal strengths, to be more secure about themselves, through the building of leadership while strengthening their economic activities” (Delgado, interview, 23.11.2010, translation by GP). However, no specific way of measuring this has been attempted by the organization and it looks that the MFI makes an assumption that participation in group based methodology leads automatically to empowerment.

Delgado resembles Robinson’s (2001) idea that microfinance is not suitable for those extremely deprived, when states that “reaching the poorest of the poor is not possible through microfinance. They need another type of help, one that involves the state. The lack of roads to reach a small community in the middle of the mountain works as an example of this” (Delgado, interview, 23.11.2010, translation by GP). This leads to implications of the role of the state and the market. In this regard, Pro Mujer is very clear. “Pro Mujer all the time tries to present itself as a non-governmental programme. If you are linked to the government, they believe what you offer is for free or a gift” (Delgado, interview, 23.11.2010, translation by GP). However, there is role assigned for the state when she states that “to solve poverty in Peru you need the state. The market can help to provide services, but the responsibility of the state is to build the roads and the communications channels needed for that” (Delgado,
interview, 23.11.2010, translation by GP). This brings back the arguments of CGAP (2003), of a state helping to create the appropriate market mechanisms to make microfinance work.

It has been shown in the development of this case study that Pro Mujer is not particularly recognized for conducting thorough impact assessments. The only Social Performance Report available is the one submitted to the MIX and it has several methodological flaws. When asked about this, Delgado states that Pro Mujer only conducted two or three impact studies but they reached the conclusion that “they are much more useful for the consultant that charge for them than for the institution” (Delgado, interview, 23.11.2010, translation by GP). She also mentioned that they have done the PPI of Grameen to comply with the MIX Report Social Performance Report but “this has not reported any advantage to the institution” (Delgado, interview, 23.11.2010, translation by GP). So after these experiences Pro Mujer reached the conclusion of trying to develop a series of indicators that are useful for the organization, not to the researchers. “Now, after eleven years of Pro Mujer, we are starting to construct and develop this” (Delgado, interview, 23.11.2010, translation by GP). This lack of concern about the impact of the credit is quite astonishing that even one decade after its inception, it is still not institutionalized. And it perfectly reflects the views of Morduch (1999) regarding the lack of incentives to conduct impact studies that can challenge the assumed positive impacts of microfinance programs.

Regarding the use of credit, Pro Mujer reports that all the credits given are used for microenterprise activities. Therefore, it was asked to Delgado how they control the credits that are not taken up by consumption. She stated that clients specify that are used for production, service or commerce but “I cannot assure you that the entire amount is used for investment, because at the end money is fungible so clients can use it for whatever they want” (Delgado, interview, 23.11.2010, translation by GP), using the same arguments as Robinson (2001) when it comes to describe money as a fungible resource and the difficulties to assess where it is spend. This fact leaves in evidence that there is an assumption on the use of the loan; however no real study is made on its actual use. As it has been shown before, Pro Mujer experienced an extremely high dropout rate of nearly half of its clients in 2009. This issue, the Imp Act study suggests, is a bad sign in terms of provision of a demanded service. The lack of adjustment into what clients really need did not occupy much of the attention by the institution since Delgado accepted the existence of those cases, “but we do not carry out any type of analysis on that situation” (Delgado, interview, 23.11.2010, translation by GP), as Bateman (2010) highlighted as one of the main problems of impact studies.
All these facts can be used as a proof of a lack of analysis on the sustainability of the social change the institution claims to have. On the other hand, the issue of financial sustainability “is very important, because if not we would not exist” (Delgado, interview, 23.11.2010, translation by GP). The good performance of the institution in terms of sustainability, backed up by high efficiency rates, allow the institution to have high return rates that are attractive for investors, which increasingly became a major source of funding. In this regard, the benefit of having a systematic report of financial data seems to provide an immediate benefit to the institution. This reflects Armendariz de Aghion and Morduch’s (2010) views of NGOs that change the way they work in order to be attractive for capital markets.

5.1.2 BRAC Bangladesh

i. An Introduction

According to the World Bank (2009), the total population of the country is 162,220,762 inhabitants and only 25% live in urban areas. The small area of land of the country makes Bangladesh the highest populated country in the world. The poverty rate estimation expressed as the percentage of the population below the poverty line is 40%. The GDP per capita in PPP terms is $1420, which makes Bangladesh hold the position 140th in the world and picturing it as one of its poorest country.

The microfinance industry in Bangladesh is huge, and keeps growing. According to the World Bank (2009), it has grown in the last five years at a yearly rate of 23% in gross portfolio terms. According to the MIX (2009), the formal microfinance sector in Bangladesh has 73 MFIs34; with three of them having massive outreach: between ASA, BRAC and Grameen Bank, 14.6 millions clients are being serviced, of a total of 20.6 million borrowers. The number of depositors climbs to 27.8 million. In this context, BRAC is the second biggest MFI in Bangladesh, just below Grameen Bank, in terms of outreach, servicing more than 6.2 million clients, making it one of the biggest MFIs in the world.

ii. The Official Documents

In their website (BRAC, 2010), BRAC states it is a nonprofit development organization dedicated to alleviate poverty by empowering the poor to bring about change in their own life. BRAC was founded in the year 1972 as a relief agency, and through a constant process of

34 There are also many other organizations providing credit, which the World Bank (2009) estimates roughly in 5000.
evolution, became a pioneer in recognizing and tackling the many different realities of poverty.

BRAC’s mission to empower people comprises vulnerable groups in situation of poverty, illiteracy, disease and social injustice. As its Webpage states, “our interventions aim to achieve large scale, positive changes through economic and social programmes that enable men and women to realize their potential” (BRAC, 2010 b), based on values of innovation, integrity, inclusiveness and effectiveness, resembling Yunus’s (1999) original ideas.

BRAC has a broad and extensive area of work and the microfinance component of their approach is under the economic development department. It is BRAC’s largest programme. In its webpage they claim that “we provide access to financial services to the poor, who are unable to obtain credit from mainstream banks due to lack of necessary assets and referrals. Our borrowers, most of whom are women, use these loans to engage in various income generating activities to improve their socio-economic status” (BRAC, 2010 b). When it comes to the description of their approach, they highlight that they aim to reach the landless poor, the marginal farmers and vulnerable small entrepreneurs. A main difference with many other MFIs is that they “recognize the heterogeneity among the poor and focus on careful targeting and development of customized financial products and services that best meet their varying needs” (BRAC, 2010 b). They focus on a microfinance credit plus programme: apart from the credit and training, they provide an integrated set of services, such as basic nutritional/health services, children and youth education, and a broad set of medical services and empowerment activities.

BRAC has three different microfinance programs. In the DABI program, the target is moderate poor women from households owning no more than 50 decimals of land. The women are organized in Village Organizations (VOs) that are a platform of 30-40 women where they get together, access services, exchange information and raise awareness on social, legal and other issues concerning their daily lives. These loans (between 50 and 700 USD) are given exclusively on an individual basis. The VOs acts as an informal guarantor by creating peer pressure for timely repayment. The loans are repaid through weekly meetings. Microloans are generally used for small operations in poultry, livestock, fruit and vegetable cultivation, handicrafts or rural trade. The second microfinance programme is the PROGOTI. It implies much higher amounts (700-7000 USD), and they are for both men and women entrepreneurs to support and expand their existing enterprises. The repayment is on a monthly basis and is targeted at those microenterprises that are too small to access formal banking schemes. The third programme is BRAC’s evidence of its particular approach to
microfinance. Originally introduced as a pilot project called the Income Generation for Vulnerable Group Development (IGVGD), it was then formally converted into the Challenging the Frontiers of Poverty Reduction – Targeting the Ultra Poor Programme (CFPR-TUP). As the leading researcher in BRAC suggests, it was originated in the challenge of “developing mechanisms through which the extreme poor too could be included within its microfinance programmes” (Matin, 2005: 5). It is a recognition through research that the poorest were sidelined by their mainstream programs. It has two objectives: to assist the ultra poor population to graduate from ultra poverty level and to support the same population to get access to the mainstream development programs. Conceived as a development ladder, the programs involve a “careful combination of protection, prevention, and promotional approaches to address the agenda of ultra poverty reduction in Bangladesh” (BRAC, 2010 c). It entails two phases: first, a grant for food aid with skills development. In the second phase a microcredit component is introduced, starting with small amounts, being 30 USD the average first loan. This product inevitably challenges Robinson’s (2001) idea of microfinance being only for the economic active poor. In a certain way, it also reflects some elements of what Robinson (2001) considers it is the old paradigm, focused on a poverty lending approach.

Another distinctive characteristic of BRAC is that it counts with its own Research and Evaluation Division (RE), a multi-disciplinary independent research unit within the framework of BRAC. Its activities are very important in designing interventions, monitoring progress, documenting achievements and also conducting impact assessments, reflecting the idea of Dichter and Harper (2007) regarding the need of impact studies.

iii. Financial and Social Performance

BRAC has a broad target market with its three different types of products aimed at the ultra poor, poor and microenterprises. The average loan in 2009 was USD 102, a very low amount that gives a glimpse of the focus on the poor. BRAC does not provide the disaggregated information of how many loans corresponds to each programme for 2009, but to judge by the average loan size, most of the credits are the ones focused on the poor and very poor and not in the PROGOTI scheme. More than 96.6% of the total loans are given in the rural areas and it is also very high the percentage of women borrowers (94.88% of the total). When it comes

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35 All the data in this section is from the Financial Report 2009 (BRAC, 2010d) and Social Performance Report 2009 (BRAC, 2009) submitted to the MIX, otherwise stated.

36 To confirm this statement, Matin (2005), confirms for figures of 2003 that more than 70% corresponds to the DABI programme focused on the poor, 15% to the CFPR focused on the very poor, and the rest for the PROGOTI programme and a temporary rural one.
to the use of the loans, all of them are reported as microenterprise loans by the information BRAC provided to the MIX\textsuperscript{37}.

When it comes to the analysis of savings, BRAC’s figures in terms of outreach are even more massive than for credit. In the year 2009, 8,359,593 persons saved using BRAC’s products. However, the average amount of those savings is very low (USD 32) when compared with the amount of the loans.

BRAC’s massive outreach, together with very efficient delivery mechanisms, makes this MFI highly sustainable, reaching in 2009 a 123.64\% rate of operational self sufficiency. However, because of the existence of products targeting the ultra poor that combine grants with very small loans, the use of cross-subsidies became a common practice, reflecting Allen’s (2007) view of the need to reach the poorest using subsidies. The total profit margin on revenues is 19.12\%, which is a very good figure in international benchmarks standards. The 14.62\% return on equity is an attractive one for social investors. The funding strategy of BRAC involves grants, loans and savings. Regarding efficiency, the rate of borrowers per staff member (331) and per loan officer (406) are strikingly high and reflect an organization that works at very high international standards. Lastly, the portfolio at risk of 8.01\% is just above the international standards. However, because of the size of BRAC, this also means that around half a million clients do not repay their loans on time.

Moving into the social impacts, BRAC has been globally recognized as one the MFIs that assigns more importance to its impact studies. Their RED has been very active since its inception, carrying out different studies in order to improve the products and assessing the real impact of their programmes on the poor. As an Imp Act researcher suggests, the most important thing about BRAC and the synergy with RED is “how BRAC has used knowledge of poverty conditions to identify new programming needs” (Greeley, 2005:35). This section will focus mainly on the Social Performance Report that BRAC submitted to the MIX (BRAC, 2009) and some of the most important findings of the Imp-Act study. Regarding the latter, many aspects of its social performance where analyzed because of the strong internal research capabilities of the institution.

The development objectives that BRAC pursues are very broad. They include: poverty reduction, employment generation, development of start-up enterprises, growth of existing

\textsuperscript{37} It seems that there are some inconsistencies with this. In the Social Performance Report presented by BRAC to the MIX (BRAC, 2009), they state that the provision of microenterprise loans, SME loans, loans for agriculture and housing loans. However, in the financial report there are apparently no clients in any of these products but just on microenterprise loans.
businesses, youth opportunities, children schooling, health improvement, gender equality and women’s empowerment.

The focus on very poor, poor and low income clients involves a hard process of identification. According to the information provided to the MIX (BRAC, 2009), for the very poor, there are basically two: first, a broad international measure: the persons in the bottom 50% of those living below the poverty line established by the national government. The second one is based on the specific characteristics of Bangladesh, and comprise four different measures: the identification of those people having less than 10 decimals of land with no adult active male member in the household; when the household is dependent upon female domestic work or begging; when children of school going age have to take paid work and lastly, when there are no productive assets in the household. For the poor, the indicator used is the ownership of less than one acre of land or if the source of income is the selling of manual labor. This leads to the analysis of the targeting methods used by BRAC. According the Imp-Act Research (Copestake, Greeley, Johnson, Kabeer, & Simanowitz, 2005), BRAC uses a hard targeting method, common in South Asia targeting only poor people, where this method is straightforward since there are large numbers of readily identifiable poor household living close to each other. BRAC’s specifics methods are: geographical targeting, Rapid Rural Appraisal and Participatory Wealth Rating.

BRAC reports (BRAC, 2009) that they measure the clients’ poverty level at a certain point in time, every one or two years. In this regard, they use the international standard of people living below the USD 1 international poverty line. They estimate that for 2009, 80.2% of the new clients are below this line. Regarding the ones in bottom 50% of the poverty line, BRAC portrays a very high figure: 61.5%. A poverty analysis is made for those clients that have been 3 or 5 years in the institution. The figures speak for themselves: 67.5 % of the clients who have been in the institution for 3 years are still below the poverty line whereas 49.2% of the ones that have been clients for at least 5 years remain poor. The situation of the clients out of poverty, the picture is the complementary one: 32.5 % of those who have been at least three years are above the poverty line, and for those that stayed with the institution more than 5 years, the figure climbs to 50.8%. The last figure provided is also interesting: 19.4% of those clients now out of poverty were below the poverty line before.

Interestingly, BRAC has developed an incentive structure connected with social indicators performance. Some of the indicators involved are the ability to attract new clients on target markets, women and rural communities outreach, and the quality of the portfolio. Regarding the market research on clients, BRAC states that they conduct market research for
development of new products, client satisfaction assessments and interviews with salient clients. However, when it comes to the social responsibility to the client, there is a very interesting fact that BRAC does not enquire about: no analysis is conducted to assess if clients are borrowing from other institutions.

Regarding the Imp-Act study findings, it is worth highlighting that BRAC was selected among the participant MFIs to conduct a pilot study regarding the wider social impacts with variables linked with citizenship and exclusion. Kabeer (2005b) highlights that an expanded social network could be found in those clients with more years in the institution. Interestingly, it was also found that older members reported the acknowledgment of cases of women wanting to join a group, but systematically being refused to it. This reflects on the possible exacerbation of inequality that can take place in the community through the exclusion of the poorest, resembling Rogaly’s (1996) and Bateman’s (2010) concerns. Regarding notions of citizenship, it was found that the length of involvement with BRAC had a positive correlation with the participation in the village tribunals and levels of trust. However, it was also found that the land ownership variable was important in levels of trust as well: people with more land were usually more likely to be consulted by other villagers. As Kabeer (2005b:111) states, “this suggests that the findings on trust may tell us more about the social hierarchy in Bangladesh than they do about public confidence in the integrity of the actors and institutions concerned”. On a positive note for the poor, group membership did act as a form of social capital, in Putnam’s (1993) terms, achieving some of the effects associated with wealth (more political knowledge, higher levels of trust, more participation in the community), partially compensating their material deficits.

iv. Analysis

Through the information provided above, it is straightforward to notice BRAC’s concerns regarding poverty reduction in Bangladesh. A Research Fellow at BRAC’s Research and Evaluation Division, who preferred to remain anonymous for this study, confirms this view in the interview held with him. For him it is important to put into perspective the mission of BRAC that “clearly identifies the need to build a platform for the poor which will enable them to realize their strengths and utilize them efficiently to combat the hardships of life. There is definitely a need to make the poor identify their potentials and assist them to strengthen it further, which will ultimately make them come out of the poverty circle” (Research Fellow, interview, 2.12.2010). However, his answers do not address the specific questions of how the institution addresses the causes of poverty. Nevertheless, it is possible to identify which is for BRAC one of the main issues causing poverty when the interviewee states that one of the key
objectives of microfinance is to remove the financial market imperfections to be able to engage the women in self-employment. Further, the interviewee states that “without empowering them, economic development of this country is difficult to achieve” (Research Fellow, interview, 2.12.2010). Regarding the actors to be included in that process, the interviewee believes that economic development should not be faced without the government since “BRAC believes that development can only be achieved through maintaining partnerships and effective communication with the appropriate authorities and other related bodies” (Research Fellow, interview, 2.12.2010). This can be link with the view of Daley-Harris (2007) of the need to combine microfinance with other policies in order to end poverty.

Regarding the view of poverty as a complex phenomenon, “BRAC microfinance addresses many of the complexities of poverty in Bangladesh, particularly with regard to heterogeneity” (Research Fellow, interview, 2.12.2010). As a proof of this he cites several programmes that BRAC develops. One of these programs, the CFRP-TIP aimed at the ultra poor, is especially mentioned because “there is strong empirical evidence that microfinance often bypass the extreme poor or poorest of the poor because they cannot utilize the loan for productive purposes” (Research Fellow, interview, 2.12.2010), therefore agreeing with Rogaly´s (1996) concerns about traditional microfinance not reaching those more in need.

The way BRAC uses its knowledge and targets the different groups of the poor reflects that the research they conduct is used to develop better products. In the information reported to the MIX (BRAC, 2009), despite some methodological flaws, it is possible to assess the progress out of poverty of the clients. However, the numbers reported show that a big percentage of the clients that have been accessing services from the institution still remain below the poverty line. Only one out five clients of BRAC that are now above the poverty line was poor before. This allows two readings: first, many of the clients that are not poor were not poor when they joined the institution. The other one is that for those below the poverty line, it is still extremely difficult to raise their level of income to be above that line, despite the provision of microfinance. An in depth review also shows that this index out of poverty is just based on income variables, despite the apparent commitment of the organization to recognize several variables affecting the condition of poverty. The other main finding in this regard is how the length of time linked to the organization has allowed certain groups to gain further trust and political participation. However, as the Imp Act study suggests, “MFI group membership may be more effective in promoting participation in the political process than in transforming the informal social hierarchies of the community” (Kabeer, 2005b: 123), resembling the critical
ideas of Rankin (2006) regarding the connection between a shallow social capital conceptualization and microfinance.

Another important issue to consider is the impact of the particular programme aimed at the ultra poor. Internal research, like Das and Misha (2010), prove rigorously that the programme impacts on income, employment, food security and asset holding are sustainable and positive in the long run. However, a review of this study suggests that many of the impacts might be much more related to the safety nets provided to the clients rather than on the microcredit part of the program because of the striking bigger impact achieved in the first phase of the programme. The cross-subsidization strategy used by BRAC allows the possibility of designing products that are not profitable, targeting the ultra poor without undermining the overall financial sustainability of the institution. The interviewee confirms that “Self-sustainability is the prime aspect of any organization, whether in a NGO or a private company … The microfinance program of BRAC is self-sufficient and hence enjoys the benefits of deploying all their efficiencies and strengths in combating poverty and developing the livelihood of the poor people” (Research Fellow, interview, 2.12.2010). The magnitude of its operation and high standards in efficiency allows the institution to enjoy also very good return on assets and equity. Despite the fact that BRAC does not use microfinance investors as part of their funding, they do use commercial loans and recently have accomplished a securitization of their debt that allowed them to receive a massive injection of capital into the institution. This reflects the importance that MFIs give to the access to funds, as Cull et all (2009) and Armendariz de Aghion and Morduch (2010) highlighted. The interviewee assures that new ideas and suggestions from the different stakeholders are taken into account, but that BRAC would “not go out of our way or take such action that will hamper our organizational value” (Research Fellow, interview, 2.12.2010).

5.1.3 K-Rep Kenya

i. An introduction

The last Census carried out in 2009 by the Kenya National Bureau of Statistics stated that the official population of Kenya is 38,610,097 inhabitants (Kenya National Bureau of Statistics, 2010). The majority of this population, 67.7%, lives in rural areas. The high incidence of poverty is striking: 46.6% of the total population lives below the poverty line, according to the World Bank (2009b). Kenya’s GDP per capita in PPP terms is $1572, a very low figure in international standards, which places the country in the 136th position in the world.
The MIX (2010c) states that the microfinance industry takes place in one of the broadest and most developed financial sectors in sub-Saharan Africa. In what is probably a reverse process of the most common tendency in other countries, it is the microfinance sector that has played a very important role in the evolution of the formal financial sector, with four important commercial banks having started originally as microfinance institutions, one of them being K-Rep. One important characteristic of the Kenyan microfinance sector is a relatively strong alliance with the government, which in the last years has pushed hard for financial inclusion and eased monetary policies as well as providing funds for some of the institutions. There are 36 formal registered MFIs and many commercial banks offering microfinance products. The industry total outreach is 1.5 million. In this context, the information from the MIX (2009) indicates that K-Rep reaches 56,534 clients, which makes it the sixth institution in terms of outreach and the third biggest one in the country in terms of size of portfolio (USD 71,128,108).

ii. The Official Documents

K-Rep Bank is one of the constituent parts of K-Rep group, which also includes K-Rep development agency, focused on research and development work, and K-Rep Advisory Services, specialized in consulting services. In 1997, K-Rep Bank Limited was created as a subsidiary of K-Rep Group and in 1999 it became the first commercial bank in Kenya to directly target low-income clients. The official statement for the conversion into a bank states that “after considering the limitations of operating as an NGO that it was sustained by donor funding, K-Rep opted to establish microfinance bank” (K-Rep, 2010). This reflects the ongoing tendency of NGOs converting into for profit organizations, as signaled by Lauter (2008) and Armendariz de Aghion and Morduch (2010). In the year 2009, the social enterprise Juhudi Kilimo was created by K-Rep in order to provide asset financing and technical assistance to smallholder farmers and small to medium agro-businesses throughout Kenya. Today it operates as a completely differentiated structure from K-Rep.

K-Rep Bank’s mission is to provide banking and microfinance services to low-income people on a commercially viable basis. According to its Webpage, “what distinguishes K-Rep Bank from other commercial banks is its social objective of serving the poor. It aims at

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38 The Microfinance Act in 2006 contains the main policies in this regard. For more information, see Central Bank Of Kenya (2007)

39 Apart from these official institutions, the Central Bank of Kenya conducted an assessment in 2006 and the total number of organizations providing credit ascended to 5350. See Central Bank Of Kenya, (2007)

40 For this reason, it will not be included in this case study.
demonstrating that the poor are bankable” (K-Rep, 2010 b). The philosophy behind the institution is to bring microfinance to the center of the financial markets arena, as opposed to the peripheral financial activity it has hitherto been perceived to be. The bank seeks to demonstrate that lending and providing banking services to low-income or poor people, is both commercially viable and an important development intervention for poverty eradication. All these facts show a clear correlation between the ‘financial system approach’ explained by Robinson (2001) and Otero (1999) and K-Rep’s institutional strategy. The official documents from the bank show that the core business is to serve low-income customers, especially those operating in small and micro enterprises, as a means of facilitating their participation in the economic development of Kenya. In this regard, “K-Rep believes that an institutionalized access to financial services enables poor people to better organize their financial lives and enhance their chances to propel themselves from the poverty cycle” (K-Rep, 2010 b), in a clear common line with CGAP’s (2003) guidelines. The rationale behind this tool to fight against poverty is rooted in a conception where “poor people are not sedentary and do not need handouts. What they need is access to appropriately delivered financial services” (K-Rep, 2010 b). Moreover, K-Rep delivers financial products to the poor because it believes that “this is a basic human right that every Kenyan, especially the low-income, small and micro entrepreneurs must have access to” (K-Rep, 2010 b), bringing into the picture the clear connection with Yunus’s (1999) conceptualization of microcredit. Lastly, the bank “believes that the access to this service is an essential ingredient for eradicating poverty and developing this country” (K-Rep, 2010 b). K-Rep Bank claims to be also committed to the principles of sustainability reporting (triple ‘P’ bottom line reporting -on profits, planet and people)

Regarding the approach to microfinance and the products they offer, K-Rep is characterized for offering both individual and group loans. The group methodology products are called Juhudi and Chikola, where the individual product is called Katikati. For both Juhudi and Chikola, the products are designed for people that do not have collateral; they are small in size and have a short tenor. The lack of collateral is compensated by a cash security payment and group guarantees. Juhudi offers the smallest initial amounts (370 USD), it entails a mandatory weekly saving of 2.5USD, is open for new clients and involves weekly meetings. Chikola also involves weekly meetings, but has higher initial amounts (618USD), an increased saving requirement (6.18USD) and it is open only for clients with at least one year history in the institution. As well as for Juhudi, before disbursement of the loan, eight weekly meetings, where the clients pay their obligatory savings schemes, are required. The main

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41 K-Rep executes this guarantees in case that the debtor does not fulfills the payment requirements.
difference with the product aimed at the lowest strata of the market is that Chikola requires a guarantee at a personal level and a minimum of 20% of the credit cash as collateral, despite it being considered by K-Rep as a group loan because of the methodology involved. The third product, the individual loans Katikati, is especially designed for those individuals, which through group mechanisms, cannot access the amount of money they need to grow their business. It has three main products: the retail loan, the consumer loan and an overdraft facility for old clients. As expected, the individual loans are targeted to the higher segment of the market. The minimum amount that clients can ask is 1236 USD and despite not having a mandatory weekly savings, it asks for a guarantee at a personal level as well as the 20% of the credit in cash. Katikati scheme involves two meetings per month, the groups are formed by K-Rep and are much smaller (maximum of 11 clients in comparison to the maximum of 35 of the group products). It is only available for clients with more than one year in the institution with an enterprise that should be already functioning and generating benefits to be eligible (K-Rep, 2010 b).

Two other special products have been created in the last year by the organization. First, the Youth Fund and Enterprise Program, which use both the group methodology and the individual one. It targets young clients at a cheaper interest rate than the traditional products, since it uses subsidized government funds supporting the development of products for this target market. Second, the GOWE (Growth Oriented Women Entrepreneurs) is a program to finance women microenterprises, “to empower them economically through increasing access to business credit” (K-Rep, 2009). It includes training on business management, and requires a collateral and growth potential of the microenterprise demonstrated through a business plan.

iii. Financial and Social Performance

K-Rep has given credit to 56 534 clients in the year 2009, which implies a slight reduction with the previous year and a massive one compared with 2007 with 153 961 credits. This was triggered by the unstable socio-political situation in the country in 2007 that led to violence, several deaths and a financial crisis with massive drop out of clients from microfinance institutions.

K-Rep does not target the very poor, since all their credits are aimed at people who already have a business and can provide some sort of collateral, at least in cash. In this regard, the institution is in line with Robinson’s (2001) view of microfinance not being a suitable

42 All the data is from Financial Performance Report 2009 (K-Rep, 2010c) submitted to the MIX, otherwise stated.
instrument for every poor. The size of its average loan (USD 1258) works as a clear sign of the target they are trying to reach, because of its high value in absolute and relative terms. Mostly given in urban areas (60%), K-Rep does not focus particularly on women, since only 46% of their total borrowers were women in 2009. Regarding the use of the credit, the official report to the MIX (K-Rep, 2010c) shows this figure: Microenterprise (76%), Consumption (22%) and others (2%). When it comes to an analysis of the methodology, it is observed that slightly more than half of the credits were given through solidarity groups (52.38%) and the rest through individual loans (47.62%).

Triggered by the formality of being a bank institution, 298 924 clients decided to trust their savings to K-Rep. Despite the fact the figure shows a small average deposit balance (USD 196) in comparison to the loans, it is still a very important funding source for the institution. This funding is matched with commercial loans and shareholder capitals. The shareholders listed in the report include some of the major global microfinance players: the International Financial Corporation (IFC) of the World Bank, the African Development Bank, the Netherland Development Company, Stichting Triodos Doen and the Shorebank Corporation.

Also affected by the crisis, the performance for 2009 in terms of profitability and efficiency shows very bad indicators. Therefore, it is worth mentioning that since its inception until the year 2007, according to K-Rep (2010c), K-Rep increasingly performed at very good rates, reaching self sustainability in the year 2001 and positive returns. The picture for 2009 is not positive, but showing an improvement in comparison with the previous year. In 2009, K-Rep could not reach operational sustainability in its operation, and reported a negative profit margin of 17.67%. This is mainly explained by the sharp decrease in the number of clients the bank experienced, which also affected the efficiency indicators which performed at very low standards in comparison with the international benchmarks: 99 borrowers per staff member and 222 per loan officer. The last explanation that becomes clear from the financial report is an impressively big portfolio at risk: 26.74%, meaning that more than one out of four loans is not being repaid on time, or not being repaid at all.

43 There is a very interesting figure in comparison with years before. According to K-Rep(2010c), the average loan size in 2007 was USD 529, less than half of the one for 2009. As a general trend in the Kenyan microfinance industry, the complicated socio-political situation triggered a strategy that implied increasing the loan size for those clients that remained in the institutions as a way of avoid a decrease of the total portfolio size.

44 The Global Credit Rating made a study in K-Rep for the year 2003 that was strikingly positive about its financial performance despite its immaturity as a bank (MicroRate, 2004). As a result of this good performance, the bank final rating was a good one for short term debt, and also a positive one, but with warnings about economic cycles, for the long term one.
Being a serious drawback for the comparative purpose of this research, but also interesting in the possible interpretations, K-Rep openly accepts the lack of standardized impact assessments on their behalf to evaluate the impact of their products in the clients. Not only there are no internal reports about this, but also they did not comply with the MIX in submitting their Social Performance Report of 2009. Curiously, all the studies or references in academic works found about the institution were focused on its financial performance (Johnson 2005, Morduch 1999, MicroRate 2004, Rosengard et al 2000).

Regarding the Imp-Act study, the results were not so revealing. Because of the lack of internal research capabilities, the approach with K-Rep was a very narrow one since the research project did not contemplate the building of internal research systems. Among the key findings for K-Rep it was the lack of any screening or targeting method. As for its poverty outreach, it highlights that there were no specific measurements for this, but that the organization tended to focus on various groups excluded from formal financial services access. The specific aim of K-Rep for the future when joining this research programme was to evaluate the impact that K-Rep had in the building of farmer service associations in some of the rural villages they work. Interestingly the only specific information about this is that “donor support was critical in encouraging K-Rep in Kenya to experiment with the ‘farmer service association’ approach to providing financial services in relatively sparsely populated areas” (Copestake, 2005: 185). However, there is no quantitative information that could encourage a proper analysis for this case study.

iv. Analysis

K-Rep has many characteristics that suit the most advanced commercial model of MFIs. Originally an NGO, this Bank claims to have a special focus on the poor, where credit is portrayed by the bank as a human right. An in depth structured interview was held with Susan Wangwe, Microfinance Business Development Manager of K-Rep Bank. She states in the interview that K-Rep encourages through its credits the innovation and creativity needed to eradicate poverty in Kenya. When asked about the provision of credit as a way to attack the causes of poverty in the country, Wangwe links the reply to the different products the bank has by answering that “K-rep bank attacks causes of poverty by encouraging self employment to the youth, young entrepreneurs below the age of 30 years access fund to the bank with low interest rate and without security” (Wangwe, interview, 4.11.2010). She also holds that the lack of knowledge in business management has been a cause of poverty, therefore “K-rep bank has enabled weekly meetings with all microfinance groups, where by bank officers train and monitor loan repayments and also facilitate contractual savings. Micro-finance products
and services have greatly reduced poverty in Kenya” (Wangwe, interview, 4.11.2010). However, this self confidence in the strategy followed by the bank is not backed by any kind of reliable quantitative evidence, fitting into the critique that Bateman (2010) and Rogaly (1996) have made about the assumptions of impact that are not corroborated in reality. On the same line of arguments, she believes K-Rep is a major contributor to the development of the country because “K-Rep Bank has helped many developments in Kenya, through easy funding” (Wangwe, interview, 4.11.2010). The vagueness of her assumptions is striking.

Another area of enquiring was the recognition of poverty as a multidimensional phenomena and not just a matter of income. In this regard, Wangwe, assuming that credit provision helps to eradicate poverty, believes that “the heterogeneity among the poor translates in different kind of products and services … those products are meant to boost the business and also improve social status of an individual” (Wangwe, interview, 4.11.2010). Once again, her answers reflect that provision of credit per se is the right recipe. In a certain way, it also confirms the views of Easterly (2006) referring to the fact that what the poor need is access to market. Related to this is the situation of the very poor, she believes “it is possible to reach the poorest since we operate in very poor areas (in Nairobi we operate in Kibera slum, Mathare slum etc). Our clientele is found mostly in slum areas where the poor reside” (Wangwe, interview, 4.11.2010). This confirms the lack of specific targeting methods by the institution.

As it has been stated above there is a relationship with the government where funding is provided. This situation is confirmed by the interviewee when she states that “K-Rep bank works closely with the Kenya government to fight poverty, the government has channeled funds through K-Rep to low income earners targeting women and youth. Those loans are given at a very low rate compared to normal loans in the bank” (Wangwe, interview, 4.11.2010). This answer puts into perspective the synergy created by the government and the MFIs to provide with financial products to historically neglected populations. However, it can also imply, in Bateman´s (2010) terms, the justification for the withdrawal of the state from its responsibility with the poor.

The lack of impact assessments was not interpreted as a major drawback since for Wangwe “K-rep bank conducts socio-economic assessments regularly; a bank officer is able to meet microfinance clients in a group set up every week. Business and homestead visits are made at the time of in taking clients and also on every loan application. With such visits the bank will be able to know the impact of a loan to an individual. Assessments are continuous” (Wangwe, interview, 4.11.2010). This answer backed by the lack of availability of data on the social performance of the institution shows a clear denial of rigorous socio-economic impacts of
their products, following Robinson’s (2001) ideas and Armendariz de Aghion and Morduch’s (2010) concerns on anecdotal evidence as a justification of mission achievement. Related to this, the interview also focused on the use of credits and the ways the institution has to assess how the credit has been used. The interviewee states that “we have a tool that clients fill at the time of loan application; the loan appraisal form indicates the purpose of loan and also the loan application form. The officer revisits the business after disbursements and gives the report to the bank. However this is a challenge since some clients give false information at the time of loan application, this leads to diversion of funds and eventually default” (Wangwe, interview, 4.11.2010). The case of drop outs is analyzed on a monthly basis through reports of the loan officers but there is not overarching reports putting these cases together, as Bateman (2010) warned.

Lastly, Wangwe states that “self sustainability is very important and key in K-Rep Bank when designing micro-finance programmes” (Wangwe, interview, 4.11.2010). Interestingly, it is the financial performance of the institution the only area where information can be easily found, through the reports to the MIX and credit scoring documents, cited above. To end up with, in a bluntly answer, Wangwe also confesses that the private investors that finance the institution are very important stakeholders when it comes to design the products.

5.2 A Comparative Conclusion

The purpose of this case study is to show in practical terms how three fundamentally different MFIs work on the ground and through its analysis, provide an answer to the research questions of this research. In that regard, first it is important to highlight the main findings in each institution.

Pro Mujer combines the provision of a microcredit plus scheme with a very good financial performance in terms of outreach, repayment rates and efficiency. However, the impacts regarding social change and progress out of poverty remain considerably under researched. Despite claiming itself as a developmental organization with several outcomes apart from poverty reduction, like empowerment or improvement of health and education, there are no serious assessments pointing out the results of their activities. In that sense, it can be said that development outcomes are claimed but not researched. Strikingly, even when it comes to the assessment of poverty reduction outcomes, there seems to be an implicit assumption that access to credit with human development services automatically brings people out of poverty and improves their situation. However, the figures analyzed cannot probe a positive correlation between the access of microfinance and poverty reduction. The statements by its
National Director about the institution helping “a little” the fight against poverty or that the state is needed to solve poverty leave some doubts about the institution belief in the efficiency of their own poverty reduction strategy. There are two important facts presented in the case study that can work as explanations of a limited impact on poverty: first, the lack of control on where the money given by the credit is spent, and second, clients that are not satisfied with the products they are receiving, since the dropout rate in 2009 showed that one out of two clients left the institution. The broader lecture should highlight that the different causes of poverty are not fully examined and that a single product might not be the appropriate way to address all the different shortages that Pro Mujer clients might be experiencing. The progress out of poverty is only focused on income levels, working as a contradictory fact of recognizing poverty as a multidimensional phenomenon. Despite the achievement of goals in the financial performance, after eleven years working for the poor, its real social impact remains unknown with clear signs of not performing well.

BRAC has an unorthodox approach to microfinance, with a strong focus on social services and away from the premises of commercial microfinance. The broad array of human development services offered alongside with their microfinance schemes but especially the program targeting the ultra poor, using a cross-subsidy strategy, are a proof of this. The fact of having an in-house research department works as a clear sign of a serious concern of assessing the impacts of their products and as the Imp-Act study highlights, the institution has also an interest in the wider social impacts that their products might be triggering. However, the analysis of the results shows some interesting facts. First, the programme aimed at the ultra poor has definitely some positive results, but that could be much more related to the social safety nets provided than with the credit component itself. Second, the way of assessing the poverty level of the clients based on the USD 1.00 international poverty line appears to be ignoring all the other dimensions of poverty that the institution seems to recognize as part of the problem. Third, after several years of involvement with the institution, the bulk of clients continue being poor, despite some improvements in their life. Last, the results regarding the wider social impacts reveal that social hierarchies are not being challenged and that a process of intensification of exclusion of the poorest could be taking place among the borrowers. Regarding the financial performance, it is a model institution in terms of efficiency and outreach. Overall, within the limitations of microfinance as a poverty reduction strategy and the possible importance of the use of subsidies, BRAC shows some moderate positive results and institutional strategies to be highlighted because they allow a deeper analysis of the effect microfinance has on the livelihoods of its clients.
K-Rep represents the commercial agenda of microfinance at its best expression, despite the fact that the data for 2009 pictured a very bad performance in terms of profitability, sustainability and efficiency. Definitely, the organization is much more concerned with profits than with social impact. The lack of any type of social performance assessment works as an indicator of this. The bank fails to demonstrate that providing banking services is an important intervention for poverty eradication and development. The variety of products according to the needs of the customers also fit into the agenda of fostering microfinance as part of the financial system of the country more than a human development service. Despite the public rhetoric of the MFI, the fact of having many different products does not imply an understanding of poverty as a multidimensional problem, as the literature has shown. Interestingly, the analysis should also mention that the interviewee seems to assume many of the supposed benefits of the credits, and therefore feels confident to express the successful outcomes in terms of empowerment and poverty reduction and development of the country. There are two basic facts that work in the opposite direction: the lack of any kind of educational, health or empowerment schemes in their programmes and an absolute lack of evidence gathered because no single statistics has been produced to show an improvement in the living conditions of their clients.

The analysis of these key findings encourages assessing the key research questions that run through this entire research through the lenses of these 3 MFIs: Is microfinance a developmental policy in itself or is it just a pro-poor policy providing financial services to the unattended poor with limited impact on poverty reduction? Which is the poverty view held by those proponents of microfinance? Which is the role assigned for the state and for the market? To what extent these institutions are more concerned with their financial sustainability than with the sustainability of the social change they are meant to achieve?

Through the evidence gathered in the case study, it is difficult to claim that microfinance is about development. The findings in the three MFIs are hardly an evidence of medium or long term strategies in terms of job creation, enhancing of labour markets or permanent asset building that could make the poor climb the ladder of development. Instead, the case study reflects a situation where microfinance can be described as an influx of microcapital that in certain specific situations and contexts might have a positive result in improving some key variables of the life of the poor. Even more, the poverty reduction outcome is far from being guaranteed by the mere provision of credit since it depends on a number of factors. First, the assessment on poverty reduction is deeply connected with which poverty definition is being used and the capacity of the MFIs to evaluate levels of poverty. In that sense, it is BRAC
through its research department and commitment to reach the very poor, the institution that is more equipped to assess poverty levels in a rigorous ways. However, the only information available shows that when it comes to assess the level of poverty of old clients, not only the indicator is just based on monetary measures (which is a contradiction with their standpoint of seeing poverty as a multidimensional phenomena), but also that its progress is really slow, and the bulk of clients who were poor before joining BRAC continue being poor even after five years with the institution. In the case of Pro Mujer, despite publicly recognizing that poverty is not just about income, it provides very limited and unreliable information on this regard. The limited assessments conducted by the institution are focused on the income of the clients, contradicting their public statement. Even worse, the figures provided show that the level of poverty of those clients that have been in the institution for three years is similar to those that join the organization as new clients, rising doubts on the effects of the credits in terms of poverty reduction. This makes the institution claims about poverty reduction uncertain, with the added concern that if poverty outreach continues not being monitored, there could be a mission drift. For K-Rep, poverty is just seen as lack of capital and this triggers the fact that the MFI assumes the positive effect on poverty reduction of their loans because they believe that main constraint in the poverty status of their clients is being addressed. There is absolutely no impact assessment conducted by the institution apart from the regular visits to the clients businesses, which can hardly work as a rigorous evidence of the institutional impact on poverty reduction.

The consumption destiny of many of the credits, uncontrollable for Pro Mujer and K-Rep, but also a fact for BRAC, not only jeopardizes the poverty reduction outcomes and development intentions of the industry but also puts into question the main premise of the microfinance industry: the poor just need capital to release their entrepreneurial power. This fact highlights not only that the poverty view of microfinance proponents is very limited, but also that even with that poverty view results in terms of poverty reduction cannot be guaranteed. The provision of resources for the poor can imply a diversion of funds for activities that have little or no connection with the entrepreneurial power of the poor. In this regard, one of the most striking results is how the three institutions use the empowerment rhetoric to justify their way to address poverty. The provision of credit (K-Rep) or the provision with credit and human development services (Pro Mujer and BRAC) are institutionally linked with the idea of releasing the power inside each poor to find their way out of poverty. Strikingly, none of the three institutions tries to measure this, perhaps explained because of the even more limited results on poverty reduction that this could imply.
Regarding the role of the market and the state, some different standpoints were found. The most interesting fact is that the role of the state was not denied or ignored by any of the institutions. For K-Rep, the state represented a partner that provides funds to the organization. In the case of Pro Mujer, it represented an enabler of the infrastructure needed to make Pro Mujer reach the clients more effectively. In the case of BRAC, an important partner to work with. However, none of the MFIs considers that it is the state who should address directly the problem of poverty. A possible explanation could suggest that when poverty is understood as lack of capital, the provision of credit becomes the natural answer to fight against it, and these MFIs claim to be an efficient vehicle to reach the poor. Therefore, the state can perform a supervising role, assist with building the infrastructure needed or provide funds, but as an institution is absolved from addressing directly the problem of poverty. In this sense, poverty is seen much more as an opportunity for these institutions to provide a service than a responsibility the state should take care of.

Last, this study intends to assess if the sustainability of the MFIs prevails over the sustainability of the social change the MFIs are meant to achieve. It is probably in the answer to this question where the three MFIs fully coincide: the financial sustainability of the institution is the biggest concern for each of these institutions. The fact of being for profit (K-Rep) or nonprofit (BRAC and Pro Mujer) can be regarded as a secondary issue in this regard, because to access credits and funds from donors or investors, financial sustainability is the foremost conditionality. This assertion has its basis not only in the fact that the availability of financial performance information is much more available than the social one, but also in the way each of the MFIs emphasizes the fact of being sustainable, in official documents and in the interviews held with them. The case of Pro Mujer becomes very clear when looking at their official documents and finding that the ‘measure of their progress’ does not include any social variable. In the case of K-Rep, a clear focus on the financial performance has taken over social objectives as a consequence of its conversion into a commercial bank. Interestingly, among the three MFIs studied, it is K-Rep the one with strongest support from the international community to judge by some of its stakeholders like the World Bank or the African Development Bank. On a different note, BRAC has a concern in both financial and social performance at the same time, probed by the importance given to social assessments and impact studies. This situation gives relevance to the transformation that this truly developmental tool originated in Bangladesh has experienced through the commercial revolution that took over microfinance. The apparent ‘win-win’ proposition it is only being analyzed in terms of financial performance of MFIs. The fact of experiencing sharper trade-offs between the financial and social performance when extreme deprivation is considered.
works as a clear explanation of the narrow poverty view explained above, with the obvious consequences that this implies in both development and poverty reduction outcomes.

As the last step of this study, the final chapter will reassess all these results against the theoretical framework used for this dissertation and serve as a final conclusion.

| Table 1. Key Quantitative Findings from Financial and Social Performance Report 2009 to the MIX |
|-----------------------------------------------------|-------------------------|-------------------------|-------------------------|
| Pro Mujer Peru | BRAC Bangladesh | K-Rep Kenya |
| **Credit Programme** |
| Number of Active borrowers | 6484 | 6241328 | 56534 |
| Microenterprise loans | 6484 | 6241328 | 42732 |
| Consumption | 0 | 0 | 12819 |
| Others | 0 | 0 | 983 |
| Urban | 79.39% | 5.12% | 60.00% |
| Rural | 18.24% | 96.65% | 40.00% |
| **Main characteristics of the credit programme** |
| Target clients for lending | POOR AND VERY POOR | POOR AND VERY POOR | POOR & NOT POOR |
| Average Loan Balance (in USD) | $207 | $102 | $1258 |
| Average loan balance per borrower / GNI per capita | 4.72% | 18.23% | 49.43% |
| Total Assets (in USD) | $16,643,505 | $990,587,788 | $94,083,733 |
| Percentage female members | 93.01% | 94.88% | 46% |
| Mostly rural/urban? | URBAN | RURAL | URBAN |
| **Methodology** |
| Group-lending contracts? | YES | YES | YES |
| Collateral required? | NO | NO | YES |
| Voluntary savings emphasized? | NO | YES | YES |
| Progressive lending? | YES | YES | YES |
| Regular repayment Schedules | WEEKLY | WEEKLY/MONTHLY | WEEKLY/MONTHLY |
| **Savings** |
| Deposit Taker? | NO | YES | YES |
| Number of Depositors | $0 | 8,359,593 | 268,924 |
| Average Deposit Balance (in USD) | $0 | $32 | $196 |
| Deposits (in USD) | $0 | $266,840,002 | $58,480,092 |
| **Financial Performance & Productivity** |
| Operational self-sufficiency | 140.33% | 123.64% | 84.99% |
| Return on assets | 12.44% | 3.74% | -2.72% |
| Return on equity | 23.76% | 14.62% | -18.61% |
| Revenue profit margin | 28.74% | 19.12% | -17.67% |
| Borrowers per staff member | 232 | 331 | 99 |
| Borrowers per loan officer | 453 | 406 | 222 |
| Portfolio at risk more than 30 days | 3.75% | 8.01% | 26.74% |
| **Social Performance** |
| Method of Targetting the Poor | Inclusionary | Specific (Area of Land/RRA/PWR) | Inclusionary |
| Method to Assess Poverty Level | PPF Gramene | USD 1 PPP International Poverty Line | n/a |
| Drop Out Rate | 48% | 9% | n/a |
| % of New Clients below Poverty Line/In the bottom 50% | 35%/14% | 80.2%/61.5% | n/a |
| Clients with 3 year history in the institution below poverty line | 27% | 67.5% | n/a |
| Level of Poverty when joining the organization | n/a | 19.4% | n/a |
| Clients with 5 year history in the institution below poverty line | n/a | 49.2% | n/a |
| Level of Poverty when joining the organization | n/a | 19.4% | n/a |

Sources: BRAC (2009, 2010d); K-Rep (2010c); Pro Mujer (2009, 2010c)
Chapter 6

Conclusion

An analysis of the literature of both the advocates of the microfinance industry and the critics of it, reveals a dominant characteristic of micro-finance, namely that it is about the inclusion of the poor into the capitalist system through the availability of especially designed products targeting them. However, the ways in which MFIs support or condemn this tool as a strategy for development and poverty reduction is markedly different.

In the second chapter, the position of the supporters of microfinance as a development strategy was developed. For them, the historical failure of financial markets to reach the poor could be conceived as a brilliant opportunity to address a twofold objective: an expanded financial market and a solution to global poverty, through a remaking of Yunus’s original idea. The repackaging of markets as pro-poor, with the poor being empowered by being financial consumers encourages a solution that conceptualizes poverty as the lack of capital needed to generate income. The support from the international community, partner of a financial capital eager to be part of this new subprime market, worked as a major force to impose a global poverty reduction strategy which was formerly shaped in poor, rural villages of Bangladesh. The creation of knowledge fostered by powerful players, like the World Bank through CGAP, induced a situation where the previous Bangladeshi model was judged as inefficient because of its dependence on subsidies, and a shift towards a much more commercial microfinance was encouraged. The new rules of the games implied a solution built around the idea of microfinance as part of the broader financial system, with the incorporation of the microcapital of the poor, into global financial flows, being its main feature. This led to an industry governed by sophisticated financial ratings, rankings and benchmarks, provoking doubts regarding a bias towards the financial performance of the MFIs rather than on the social impact of their credits. As Fernando (2006) explains, the language of self reliance, sufficiency and empowerment through microfinance appeared to be extremely productive since they simultaneously provide legitimacy for the withdrawal of the state from development and created the conditions for capitalist expansion. Through the financial system approach, a solution to poverty compatible with the search for profits was encouraged. The impact on poverty was assumed through massive outreach and impressive repayment rates. The supremacy of the markets and minimal role for the state was justified under the apparent fairness of markets, which implied that it addressed equality of opportunities.
In Chapter Three, the other side of the intellectual debate was presented, focusing on the critique to this ‘magic bullet’ against poverty. The arguments were divided into three main categories, the first being the ideological and governance critique. This line of thought highlighted the narrow economic approach methodologically rooted in self-maximizing individuals. This implied a negation of the importance of tools like collective organizations and politics as a strategy that could be used for the poor to improve their disadvantaged situation. The limited view on social capital encouraged by this view and the role of the ‘spaces of knowledge’ created and imposed by Washington DC were fostered by the global governance of an industry that combined development with businesses. The critique also raised the lack of recognition of an expanded dimension of societal change and the permanent unequal position of the poor that is reinforced by the partnership between microfinance and neoliberalism. The second critique, focusing on the narrow poverty view by those advocates of microfinance, encouraged a need to see poverty as a multidimensional phenomenon and to look at its real causes. The arguments provide evidence of the lack of benefits for the very poor, but also put into question the income generation outcomes of credit and the prevalence of financial sustainability as an end in itself, over goals for social change. They unveil the lack of connection between high repayment rates and micro businesses success. Another major focus was the concern about the dubious empowerment effects of microfinance. In general, they are not meant to deny the importance of credit in capitalist development but to challenge the assumed impact in terms of poverty reduction. The third critique looks at the bigger picture: the overall development outcomes of microfinance were distrusted since a lack of a long term perspective was recognized, and made evident with the minimal role given to the state. The lack of funds for ‘real’ development activities was highlighted in the final claim that microfinance is an anti-development strategy and a poverty trap.

The results from the case study in three different MFIs, presented in Chapter Four, suggests that microfinance is publicly touted as a development strategy with a strong focus on poverty reduction but at its very best the evidence suggests that it is about putting some fungible resources in the hands of the poor. The study of these MFIs involved an analysis of three very different institutions found in the microfinance world but with some striking similarities. Pro Mujer seems to fit the description by Roy (2010) of a typical NGO emulating an industry that has largely failed to reach the poor, using a microcredit plus scheme. Despite being nonprofit, it has very good performance in terms of financial sustainability but its social impact remains highly under researched and hard to prove. The main figure that came out was that nearly half of the clients abandoned the institution in 2009, making the institutional claims of achieving empowerment and poverty reduction dubious. BRAC Bangladesh represents an organization
that has not agreed with the main premises of the commercial revolution and resembles the old Bangladeshi model, more focused on human development. Its internal research capabilities shows an institutional concern with its social performance but three results jeopardize microfinance as a poverty reduction strategy: first, its most successful impacts on a multidimensional conception of poverty have much more to do with the social security nets provided through the programme aimed at the ultra poor and not with the credit. Second, the impact on poverty reduction (analyzed only as income of clients) is painfully slow despite many years of engagement with the institution and most of the clients that are not poor now, were not poor before. Third, the use of subsidies has been central to reach the poor. Last, K-Rep Kenya represents the commercial agenda at its best. Despite the fact that the data for 2009 has not shown good performance, largely due to local socio-political reasons, the institution follows every principle of the commercial revolution. The aim of seeing microfinance as part of the financial system sidelines any type of research on the social impact of the MFI and implies strong assumptions regarding its outcomes in terms of poverty reduction and developmental results that are not proved at all. The shift in mission or vision that the institution might have experienced after its conversion into a formal bank gives relevance to the idea of a commercial model that produces an abandonment of the social mission and the creation of MFIs involved in short term and high profit loans.

In general it can be said that microfinance, in some particular settings, can have a poverty reduction outcome (though not for the very poor), but the inference of making it a global poverty reduction strategy involves many assumptions that can hardly be corroborated. The strongest one, held by the Bangladeshi model and reinforced by the commercial revolution, is that the poor are by nature entrepreneurs and that capital is their main constraint to escape from poverty. The critiques of microfinance have pointed out how inaccurate and deceiving this definition can be when contrasted with and applied to a multidimensional approach to poverty and when a serious assessment on the use of loans is made. As it has been shown, microfinance intentionally uses this narrow definition of poverty to justify the provision of capital as a magic strategy against poverty. In this sense, one of the hypotheses of this study gets confirmed: this narrow poverty view encouraged by microfinance has been purposively pushed in order to try to demonstrate the effects on poverty reduction that cannot be confirmed if a more complex approach towards poverty is adopted. A second strong assumption is that microfinance automatically leads to empowerment and fosters social capital. However, the theory suggests that access to credit can reinforce unequal structures of power at the community and household level. This has been confirmed through the systematic bias against the poorest clients mentioned in the BRAC example. To make matters worse, not
a single empowerment assessment is encouraged by MFIs. The poor analysis of wider social impacts of microfinance and the lack of relevance given to the importance of associational life among the poor, reflect the lack of commitment to empowerment. The last assumption, encouraged only by the advocates of commercial microfinance, is that microfinance fosters a ‘win-win’ situation. However, these benefits are only seriously assessed in terms of financial performance for the MFIs, but hardly done in the other dimensions of poverty alleviation, probing in a very limited way, the sustainability of the social change the MFIs are meant to achieve. In that sense, the case study works as a reflection of the general scenario regarding assessments of the social performance: today the microfinance industry is much more concerned about its financial performance than its social performance, with the exception of BRAC. The commercial agenda and the link with for profit capital play a very important role in this regard: they impose a way of doing microfinance where the sharp socio economic deprivations are omitted to avoid a bigger trade-off between financial sustainability and social performance, undermining serious developmental and poverty reduction outcomes and confirming the other main hypothesis of this study. The gap between theory and empirical evidence, or between reality and propaganda in Dichter (2006) terms, becomes as absurd as the supposed gap between supply and demand of microfinancial services.

Overall, the limited availability of social impact information together with the lack of reliability on those limited assessments carried out makes it hard to probe microfinance as a tool that makes poor people climb the ladders of development and achieve a way out of poverty. Even when approaching poverty with a very narrow view, the claimed positive results are hardly visible and definitely reflect a sidelining of the very poor. The increasing critique towards the lack of reliable data probing microfinance’s impact and the recognition that the use of anecdotal evidence cannot replace rigorous social impact assessments implied a re-appropriation of the social performance assessment in the last years by powerful institutions like CGAP. However, as it has been shown in this study, the Social Performance Report of the MIX, tends to be more of a legitimizing tool or safety valve for ‘social conscious’ investors, rather than a real assessment tool concerned about both performance and impact. As the critiques suggest and the case study highlights, the problem is that microfinance is being assessed through shallow and customized indexes to draw attention to the results they are meant to probe.

Both the case study and the theoretical debate are clear about which is the role given to the state and to the market in this industry. The key to unlock the poverty crisis is based on market mechanisms and the supposed equality of opportunity that they guarantee. The
creation of pro-poor markets is portrayed as one of the best ideas encouraged by the microfinance industry. The state is just given the role of helping to create the appropriate market mechanisms to make poor people escape from poverty.

The possibility of shifting the performance of the MFIs towards a different conceptualization on how to attack poverty and eliminate its causes, appears as a very improbable scenario given the results of this thesis. There are three main reasons for this. First, it would imply a re-conceptualization of the complexities entrenched in the poverty status of the poor. The way microfinance portrays poverty and its solution, which is weakly applied in the Bangladeshi model and very strongly applied in the new commercial one, implies a standpoint that disables any type of critique that might challenge some basic premises of the system. The role of the state in this regard is probably the most sensitive issue. Secondly, the commercial revolution advanced an industry highly dependent on for profit financial capital. It seems unlikely that investors that are already profiting from this safe sub-prime market will accept a change in the rules, which will result in the erosion of their profits. They are even less likely to participate in an industry that at the end should be temporary, as Harper (2007) claims. Third, the microfinance world does not give enough space to work hand in hand with other poverty reduction strategies, despite the public recognition that microfinance can hardly do the job by itself. Taking all of this into account, the worrisome state of affairs implies that if microfinance continues performing the way it has been doing it, it can hardly bring a solution to the bulk of the poor in terms of poverty reduction, despite its public rhetoric.

As a final conclusion, this study challenges and puts into perspective the false expectations of global microfinance project to solve poverty through profits. The analysis entailed in this study shows that to a certain extent microfinance seems to be much more about ideology and politics that about the real impact on the poor and development. In the end, it is framed as a global poverty solution that does not address the causes of poverty. This can be triggered by two causes: a false assumption of the positive effects that credit can have in the life of the poor or, more probable, a hidden transcript of selling a pro-poor formula that does not work for the poor but it does for financial capital. Either way, the neoliberal agenda supported a strategy that sees the crisis of global poverty as an independent fact of the way the capitalist system works. The solution proposed in terms of including the poor into the system through access to financial products is controlled by financial markets. The title of this thesis therefore needs to be questioned and re-ordered. Microfinance started as a subsidized project, rooted both in credit and in human development services, which seemed to have some positive impact in rural Bangladesh, even though it was based on dubious grounds and unchallenged.
deeper inequalities. These moderately good results were magnified, repackaged, decontextualized and reproduced as a global anti-poverty strategy and were sold as a win-win situation for the poor and the market. Therefore, the neoliberal governance put microfinance at its service, finding new markets to expand into, drawing in eager financial capital with a clear lack of concern about the real social impacts. This thesis argues that the time has arrived where poverty should be recognized as a structural problem of our economic system. To claim that the poor need to pay their own way out of poverty and also facilitate the development of the next generation appears to be more like the redistribution of poverty, rather than of wealth. A proper solution for poverty can be achieved within the capitalist structure but it has to imply a very different conceptualization to the one microfinance proposes, and should definitely involve a strong state which is able to craft redistributive policies. Apart from addressing poverty through strategies seeking long term development goals, it ought to be seen as a responsibility and as a debt society has with the poor rather than a market opportunity that uses debt as its main commodity.
Bibliography and Resources


Appendix

Interview 1: Naldi Delgado, Pro Mujer Peru National Director

Conducted via phone on 23.10.2010. In Spanish.

1. ¿En qué sentido considera usted que a través de los programas de microfinanzas, Pro Mujer contribuye al desarrollo de Perú? En este sentido, ¿considera que las diferentes actividades llevadas a cabo por Pro Mujer son una herramienta en pos del desarrollo?

Como Pro Mujer tiene un servicio integrado, la parte de salud y microfinanzas definitivamente enfocamos la pobreza desde otro ángulo. Por eso nuestra respuesta y nuestra oferta es integral. La pobreza no está vinculada solo a la escasez de recursos económicos sino a otros elementos como la salud la educación y otros aspectos mucho más amplios. Entonces nosotros desde este enfoque tratamos de combatir en algo la pobreza al integrar estos 2 servicios.

También tenemos una penetración cada vez más grande en el área rural, donde no llegan otras entidades. O donde llegan con cierta dificultad. Tenemos un canal de comunicación bastante más cercano que otras entidades en el ámbito rural y evidentemente mucho más costoso. Yo creo que esos aspectos fundamentan nuestro sentido para poder atender a la gente más pobre.

2. ¿De qué forma los programas de microfinanzas de su institución abordan la complejidad de la pobreza en Perú? ¿La heterogeneidad entre los pobres se traduce en diferentes tipos de programas y/o servicios? En este sentido, ¿Cómo describiría la forma en que Pro Mujer ataca las causas de la pobreza?

Lo básico y lo único es salud con microfinanzas. El programa es siempre el mismo. El canal de comercialización comercialización o estrategia de llegada puede variar de acuerdo a la localidad.

3. ¿Diría usted que la institución está de acuerdo con la idea de Muhammad Yunus que “la respuesta a la pobreza debe basarse en liberar el potencial, energía y creatividad de cada ser humano”?

De hecho, porque la metodología que utilizamos que es la asociación comunal, banca comunal permite que las mujeres vayan desarrollando esas fortalezas internas, que vayan ganando seguridad, construyendo su liderazgo y fortaleciendo sus iniciativas económicas. De hecho acá nada es gratis y eso también contribuye a que indirectamente comienzas a aprender a desarrollar sus negocios PARA pagar sus créditos, comienzas a desarrollar más inversiones, generando más compromisos financieros y eso hace que contribuyamos porque sino…. La parte capacitación está incluida ahí también, y eso ayuda mucho al autoestima de las personas y también tener un negocio cada vez más grande y se puedan fortalecer.

4. ¿Considera que es posible llegar a los más pobres a través de sus programas de microfinanzas?
Mira, atender a los más pobres pobres no se puede con microfinanzas. Esa población definitivamente necesita otra ayuda y apoyo del estado. Por ejemplo, llegar al más pobre más pobre en la zona rural más alta de Perú no se puede llegar porque no hay camino. Entonces evidentemente hay circunstancias y situaciones donde el estado tiene que jugar otro rol.

El más pobre en la punta del cerro no tiene acceso a un mercado. Esa persona solo se dedica a la auto subsistencia, para que pueda salir de eso, tendría que mudarse y migrar a una ciudad más grande.

Entonces no creo que nosotros tengamos que llegar a los más pobres porque eso necesita otros elementos de la economía, del mercado, de la sociedad para poder per se salir adelante.

Pero si es cierto que dentro el mercado de las microfinanzas en Perú, nosotros llegamos a los más bajos. Prueba de ellos es el tamaño promedio del crédito, el porcentaje de participación de población en área rural de nuestro portafolio, prueba de ello es que estamos en el sur de Perú. Prueba es que nacimos en Puno que fue una ciudad pero es uno de los 5 departamentos más pobres del Perú, donde la realidad es muy distinta a una metrópoli, a una capital. Hay muchos problemas de comunicación. Tengo zonas donde no hay líneas de comunicación, no hay internet. Y usamos un chasis que trae la información para consolidarla. Entonces nosotros si llegamos a los más bajos de todo el mercado del Perú, pero no del todo el Perú en general. Porque esos condicionantes ya nos corresponden directamente a nosotros.

Esta es una diferencia con nuestros competidores, porque de hecho tenemos el préstamo más bajo promedio. Creo que está entre 160 y 190 dólares.

5. ¿Qué lugar o rol le asigna su institución al gobierno en términos de reducción de pobreza? ¿Tiene Pro Mujer un contacto fluido con autoridades gubernamentales? ¿Cuán importante es el mercado como institución para resolver los problemas relacionados a la pobreza?

Ehhh, tenemos vínculo habitual de cualquier organización para poder trabajar. Mas bien, nosotros siempre nos presentamos más bien como un programa NO de GOBIERNO porque en el Perú, pero me imagino en otros países de América latina también, si a ti te asocian con el gobierno, te asocian que es una donación, que es gratis y que es lo que el estado te da a causa de cobrarte tantos impuestos. Entonces, la presencia del estado está muy digamos limitado o presentada como el que hace las obras publicas, o el que regala los alimentos. No queremos tener esa confusión con el estado.

Tenemos otro tipo de alianzas con el ministerio de salud por ejemplo, como para llegar a las zonas más rurales. Para ofrecer el servicio de salud cuando hay campañas de información o de vacunación, ese tipo de posibilidades.

Para resolver la pobreza, más que el mercado para resolver los problemas de pobreza en Perú se necesita el Estado. El mercado puede ayudar, pero yo creo que es más el estado que tiene que brindar los accesos, las vías de comunicación. Hay lugares donde no hay presencia del estado, donde nosotros tenemos la única banderita en el pueblo. Entonces si no hay presencia del estado como se identifica a la población, como se encuentra al poblador más lejano, que es peruano también.
Económicamente, desde el lado de los indicadores, Perú está muy bien todos quieren venir a invertir acá, estar en la bolsa. Niveles de crecimiento de más del 8 por ciento, en esa faceta Perú estamos muy bien. El problema que yo veo es que García se ha enfrentado, a diferencia del gobierno anterior, a muchos problemas regionales. Y las regiones tienen un poder social un poco más fuerte. Los problemas han venido por desacuerdo entre la población y las mineras a causa de leyes. Por ejemplo, no han consultado sobre por ejemplo el río de la mina que viene contaminado y que se yo, entonces ha habido problemas regionales, fundamentalmente en el sur, esta es una zona conflictiva por eso. Y es conflictiva porque por años de historia nunca han sido escuchadas. Entonces este es el problema social que enfrenta García.

6. ¿Cuán importante es para Pro Mujer el objetivo de la propia sostenibilidad de la institución a la hora de diseñar los programas de microfinanzas? ¿Cuán relevante es la forma institucional (ONG, con o sin fines de lucro, compañía privada) en este sentido?


7. ¿Pro Mujer conduce impactos socio-económicos regularmente? En caso afirmativo, ¿son estudios puntuales o en forma continua con la misma muestra?

Nosotros hemos hecho uno o 2 estudio de impacto pero hemos llegado a la conclusión que los estudio de impacto son para satisfacer al investigador. No tanto para una cuestión de utilidad de la organización. Eso sale de nuestra experiencia

Por esa razón, hemos comenzado a hacer análisis de las ventajas y desventajas, que nos ofrece. Nos ayuda, no nos ayuda, hemos hecho algunos estudios con universidades, hemos aplicado el PPI de Grameen Foundation. Hemos hecho varias experiencias y también tenemos ranking de calificación de evaluación sociales de y a la conclusión que hemos llegado es que pro mujer va a levantar una serie de indicadores que de alguna manera le permita medir o tener alguna referencia de su trabajo desde la perspectiva del impacto social en lugar de estar alimentando el conocimiento de los investigadores. Estamos en un proceso interno de construcción y aplicación. Lo estamos armando.

8. En referencia a la pregunta anterior, ¿cuentan con herramientas para conocer si los préstamos son utilizados para actividades generadoras de ingresos o consume? ¿Analiza la institución los casos de clientes que abandonan la institución?

Mira del total de la cartera, todos indican el destino del crédito. Casi todos, de acuerdo a lo que dice el cliente, es para comercio, producción o servicio. Definitivamente nosotros cuando informamos al cliente le decimos que NO ES para consumo pero no te puedo asegurar que todo lo que se de se invierta en lo mismo, porque siempre al final el dinero es un bien fungible entonces la gente lo usa en lo que prefiere. Hay clientes que abandonan pero no hacemos análisis.
9. ¿Los capitales que financian a su institución, bajo forma de inversión o donación, son una parte importante a la hora de decidir el diseño de los productos, el segmento de mercado y los objetivos de los programas de microfinanzas?

Tenemos crédito de banca local e inversionistas extranjeros. En los contratos que firmamos nos fijamos muy bien que no tengan injerencia o derecho a modificar nuestro programa. Ellos solo nos están prestando dinero.
Interview 2: Research Fellow, BRAC. (The interviewee preferred to stay anonymous).

Conducted via mail. Received the answers on 16.01.2011

1. In which sense would you consider that through the microfinance programme the institution helps to develop your country? In this sense, would you consider your activities a “developmental” tool?

Key objectives of the microfinance is to remove the financial market imperfections that do exists in Bangladesh and help client women engage in self-employment and empower them. Since about half of the population of Bangladesh is women, keeping aside them from mainstream development and without empowering them, economic development of the country is difficult to achieve.

2. How does the microfinance programme tackle the specific complexities of poverty in your country? Does the heterogeneity among the poor translate in different kind of products and services? In that sense, how would you consider that the institution attacks the causes of poverty?

BRAC microfinance addresses many of the complexities of poverty in Bangladesh, particularly with regard to heterogeneity. Besides the conventional microfinance designed for the adult women in Bangladesh, BRAC is implementing a credit programme coupled with training activities for the adolescent poor girls in Bangladesh. Furthermore, BRAC has experience of working with the retrenched workers of state owned enterprises. BRAC combined microfinance with series (such as stipend for the children and training to the adult person of the households) to address the needs of the retrenched workers from the state owned enterprises.

3. Would you claim that the institution is in line with Yunus idea that “the answer to poverty relies on freeing the potential, energy and creativity of every human being”?

Our vision says – “A world free from all forms of exploitation and discrimination where everyone has the opportunity to realise their potential”. This statement clearly identifies the need to build a platform for the poor which will enable them to realise their strengths and utilize them efficiently to combat the hardships of life. There is definitely a need to make the poor identify their potentials and assist them to strengthen it further, which will ultimately make them come out of the poverty circle.

4. Is it possible to reach the poorest through your microfinance programme?

There is strong empirical evidence that microfinance often bypass the extreme poor or poorest of the poor because they cannot utilize the loan for productive purposes. Based on this understanding BRAC is implementing a grant based-approach for the extreme poor. The programme is known as challenging the frontiers of poverty reduction.

5. Which role your institution gives to the state in terms of poverty reduction? Do you have a fluent contact with the local government? How important is the market to solve the problems of poverty?

BRAC is engaged in a number of development activities in coordination with the government. Most of these campaigns are directly related to the sustainable development in the living standards of the poor people. In addition to that, BRAC maintains a cordial relationship with the local government for most of their activities, as BRAC believes that development can only
be achieved through maintaining partnerships and effective communication with the appropriate authorities and other related bodies.

6. How important is the objective of self-sustainability of your institution when designing the microfinance programmes? Is the institutional form (NGO, for a non for profit, private company) a key aspect in this respect?

Self-sustainability is the prime aspect of any organization, whether be a NGO or a private company. Dependency on donor funds for the microfinance program affects the overall planning and smooth operation of the organization. The microfinance program of BRAC is self-sufficient and hence enjoys the benefits of deploying all their efficiencies and strengths in combating poverty and developing the livelihood of the poor people.

7. Do you conduct socio-economic impact assessments regularly? Are they a once off assessment or a continuous one?

BRAC’s independent research unit (Research and Evaluation Division) conducted some impact assessments; all are available at www.bracresearch.org.

8. Regarding the question above, do you have tools to know if the loans are used for income generating activities or consumption smoothing? Do you analyse the case of drop out clients?

Our loan issuing mechanism gives us the scope of assessing where the loan funds will be utilized. Our loan assessment takes place in different levels. From the start of the process the PO makes a detailed assessment of the Business or Particular Purpose. Accordingly it is again assessed by a higher level Staff (Branch In charge/ Area Manager/ Regional Manager/ SRM/ Program Head/ Program Coordinator/ Director). For different selling of loan the authorization needs to go through different levels. Also there are different independent bodies who usually conduct Review and Monitoring both randomly and special case Basis about the Client and branch’s Capability to asses them.

9. Are the donors/private capitals that finance your institution an important stakeholder when it comes to design the products, market target and objectives of your microfinance programmes?

Fulfilling the core objective Microfinance has always been a priority of BRAC. We have always advanced with a motto of “Poverty alleviation by realizing Potential”, our long-standing in this industry continuous to help us to understand the market and its requirement. Also being an innovation driven organization we would always keep in our consideration new ideas and suggestions from our different stake holders. But this also needs to be kept in mind, we would not go out of our way or take such action that will hamper our organizational values.

Conducted via mail. Received the answers on 1.12.2010

1. In which sense would you consider that through the microfinance programme the institution helps to develop your country? In this sense, would you consider your activities a “developmental” tool?

Yes k-rep bank has helped many developments in Kenya, through easy funding.

2. How does the microfinance programme tackle the specific complexities of poverty in your country? Does the heterogeneity among the poor translate in different kind of products and services? In that sense, how would you consider that the institution attacks the causes of poverty?

K-rep bank aims at eradicating poverty through ensuring easy accessibility of funds by training on co-guarantee mechanism in groups.

Yes the heterogeneity among the poor translates in different kind of products and services; we have different unique products that only suites micro clients, i.e school fees loans, water tank loans, bio gas loans, business loans that can be accessed without security but guaranteed by members in the group. Those products are meant to boost the business and also improve social status of an individual.

K-rep bank attacks causes of poverty by encouraging self employment to the youth, young entrepreneurs below the age of 30 years access fund to the bank with low interest rate and without security. The bank ensures that continuous trainings on business management are done to all microfinance clients; this is done by micro-finance officers who attend to group meetings daily according to a planned schedule.

3. Would you claim that the institution is in line with Yunus idea that “the answer to poverty relies on freeing the potential, energy and creativity of every human being”?

Yes, absolutely. K-rep bank encourages innovation, creativity for the purpose or eradicating poverty in Kenya.

4. Is it possible to reach the poorest through your microfinance programme?

Yes it is possible to reach the poorest since we operates in very poor areas (in Nairobi we operates in kibera slum, mathare slum etc) our clientele is found mostly in slam areas where the poor reside.

5. Which role your institution gives to the state in terms of poverty reduction? Do you have a fluent contact with the local government? How important is the market to solve the problems of poverty?

K-rep bank works closely with the Kenya government to fight poverty, the government has channelled funds through k-rep to low income earners targeting women and youth. Those loans are given at a very low rate compared to normal loans in the bank. Lack of knowledge in business management has been a cause of poverty, k-rep bank has enabled weekly meetings with all microfinance groups, where by bank officers train and monitor loan repayments and also facilitate contractual savings. Micro-finance products and services have greatly reduced poverty in Kenya.
6. How important is the objective of self-sustainability of your institution when designing the microfinance programmes? Is the institutional form (NGO, for non profit, private company) a key aspect in this respect?

Self sustainability is very important and key in K-rep bank when designing micro-finance programmes. K-rep is a private company.

7. Do you conduct socio-economic impact assessments regularly? Are they a once off assessment or a continuous one?

Yes K-rep bank conducts socio-economic assessments regularly; a bank officer is able to meet microfinance clients in a group set up every week. Business and homestead visits are made at the time of in taking clients and also on every loan application. With such visits the bank will be able to know the impact of a loan to an individual. Assessments are continuous.

8. Regarding the question above, do you have tools to know if the loans are used for income generating activities or consumption smoothing? Do you analyze the case of drop out clients?

Yes we have a tool that clients fill at the time of loan application; the loan appraisal form indicates the purpose of loan and also the loan application form. The officer revisits the business after disbursements and gives the report to the bank. However this is a challenge since some clients give false information at the time of loan application, this leads to diversion of funds and eventually default. Yes the bank analyses cases of clients drop outs through monthly reports.

9. Are the donors/private capitals that finance your institution an important stakeholder when it comes to design the products, market target and objectives of your microfinance programmes?

Private investors who finance our institution are very important stake holders when it comes to designing products.
Declaration of Authenticity

“I hereby certify that:

1. this master thesis titled ‘Microfinance and Development: A development strategy at the service of the global neoliberal agenda? A case study of three Microfinance Institutions in Kenya, Peru and Bangladesh’ being submitted for examination is my own account of my own research;

2. where I have drawn on the work, ideas and results of others this has appropriately been acknowledged in the thesis;

3. this work has not been submitted to any other examining body in the same or a similar form.

I am aware of the fact that a false declaration will result in a legal aftermath.”

_______________________  ______________________
Place                              Date

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Signature