Is Microfinance an Effective Strategy to Reach the Millennium Development Goals?

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January 2003

Introduction

The United Nations' Millennium Development Goals (MDGs) have galvanized the development community with an urgent challenge to improve the welfare of the world's neediest people. Donor agencies are orienting their programming around the attainment of the MDGs and are mobilizing new resources to reduce hunger and poverty, eliminate HIV/AIDS and infectious diseases, empower women and improve their health, educate all children, and lower child mortality.[1]
The MDGs are framed as concrete outcomes in the areas of nutrition, education, health, gender equity, and environment. Thus work in these specific areas will be a large part of any development strategy driven by the MDGs. But decades of experience has shown that that progress in these areas is powerfully affected by other factors in the broader context, such as a functioning government, physical security, economic growth, security, and basic infrastructure (for example, transportation). This paper reviews the mounting body of evidence showing that the availability of financial services for poor households ("microfinance") is a critical contextual factor with strong impact on the achievement of the MDGs.
Microfinance, and the impact it produces, go beyond just business loans. The poor use financial services not only for business investment in their microenterprises but also to invest in health and education, to manage household emergencies, and to meet the wide variety of other cash needs that they encounter. The range of services includes loans, savings facilities, insurance, transfer payments, and even micro-pensions. Evidence from the millions of microfinance clients around the world demonstrates that access to financial services enables poor people to increase their household incomes, build assets, and reduce their vulnerability to the crises that are so much a part of their daily lives. Access to financial services also translates into better nutrition and improved health outcomes, such as higher immunization rates. It allows poor people to plan for their future and send more of their children to school for longer. It has made women clients more confident and assertive and thus better able to confront gender inequities.
Microfinance clients manage their cash flows and apply them to whatever household priority they judge most important for their own welfare. Thus microfinance is an especially participatory and non-paternalistic development input. Access to flexible, convenient, and affordable financial services empowers and equips the poor to make their own choices and build their way out of poverty in a sustained and self-determined way.
Microfinance is unique among development interventions: it can deliver these social benefits on an ongoing, permanent basis and on a large scale. Many well-managed microfinance institutions throughout the world provide financial services in a sustainable way, free of donor support. Microfinance thus offers the potential for a self-propelling cycle of sustainability and massive growth, while providing a powerful impact on the lives of the poor, even the extremely poor. Evidence shows that this impact intensifies the longer clients stay with a given program, thus deepening the power of this virtuous cycle.
Unfortunately poor people in most countries have virtually no access to formal financial services. Their informal alternatives such as family loans, savings clubs, or moneylenders are usually limited by amount, rigidly administered, or available only at exorbitant interest rates. The challenge ahead is to ensure access to financial services for the poor majority.
This note reviews the evidence on the impact of microfinance as it relates to the attainment of the MDGs.[2] Specifically it assesses impact in the areas of eradicating poverty, promoting children's education, improving health outcomes for women and children, and empowering women. Finally,

the note addresses the feasibility of reaching significant numbers of the absolute poor with financial services on a sustainable basis and on a massive scale.

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Eradicating Poverty

Microfinance allows poor people to protect, diversify, and increase their sources of income, the essential path out of poverty and hunger. The ability to borrow a small amount of money to take advantage of a business opportunity, to pay for school fees, or to bridge a cash-flow gap, can be a first step in breaking the cycle of poverty. Similarly poor households will use a safe, convenient savings account to accumulate enough cash to buy assets such as inventory for a small business enterprise, to fix a leaky roof, to pay for health care, or to send more children to school. Microfinance also helps safeguard poor households against the extreme vulnerability that characterizes their everyday existence. Loans, savings, and insurance help smooth out income fluctuations and maintain consumption levels even during the lean periods. The availability of financial services acts as a buffer for sudden emergencies, business risks, seasonal slumps, or events such as a flood or a death in the family that can push a poor family into destitution. Various studies, both quantitative and qualitative, document increases in income and assets and decreases in vulnerability of microfinance clients.[3] Below are findings from some of the more reliable studies.

- Barbara MkNelly and Chris Dunford report that the incomes of two-thirds of CRECER (Bolivia) clients had increased after joining the program.[4] Moreover clients reported "consumption smoothing" over the year as a result of diversifying income sources and purchasing food in bulk. Eighty-six percent of clients said their savings had increased; 78 percent did not have any savings prior to program participation.[5]
- In another study of Freedom from Hunger clients in Ghana, MkNelly and Dunford found that clients had increased their incomes by $36 compared to $18 for non-clients.[6] Clients had also significantly diversified their income sources. Eighty percent of clients had secondary sources of income versus 50 percent of non-clients.
- In Indonesia borrowers increased their incomes by 12.9 percent compared to increases of 3 percent in control group incomes.[7] Another study on Bank Rakyat Indonesia borrowers on the island of Lombok in Indonesia reports that the average incomes of clients had increased by 112 percent and that 90 percent of households had moved out of poverty.[8]
- A study of SHARE clients in India documented that three-fourths of clients who participated in the program for longer periods saw significant improvements in their economic well-being (based on sources of income, ownership of productive assets, housing conditions, and household dependency ratio) and that half of the clients graduated out of poverty. There was a marked shift in employment patterns of clients-from irregular, low-paid daily labor to diversified sources of earnings, increased employment of family members, and a strong reliance on small business. Over half of SHARE clients indicated that they had used their microenterprise profits to pay for major social events rather than go into debt to meet such obligations.[9]
- In 1997-99, there was a downward trend in food expenditures in Zimbabwe. This was probably a cash-management strategy to cope with the rising cost of living. Participation in the Zambuko Trust, however, led to a positive impact on the consumption of high protein foods (meat, fish, chicken, and milk) for extremely poor client households.[10]
- A detailed impact assessment study of BRAC in Bangladesh suggested that members who stayed in the program for more than four years increased household expenses by 28 percent and assets by 112 percent.[11] Another analysis of household level data demonstrated that access to financial services enabled BRAC clients to reduce their vulnerability through smoothing consumption, building assets, and receiving services during natural disasters.[12]

- A comprehensive study of microfinance conducted by the World Bank in the early 1990s on three of the largest programs in Bangladesh-Grameen Bank, BRAC, and RD-12-found that female clients increased household consumption by 18 takas for every 100 takas borrowed, and that 5 percent of clients graduated out of poverty each year by borrowing and participating in microfinance programs.[13] More importantly households were able to sustain these gains over time. There were also spillover effects in the village economy. Average rural household incomes in program villages increased even for non-program households. One of the programs even influenced village wage rates. Increases in self-employment and subsequent withdrawals from informal labor pools led to a 21 percent increase in wages in the program villages.
- An important, earlier study of the Grameen Bank also found statistical evidence of economic welfare.[14] The incomes of Grameen members were 43 percent higher than incomes of control groups in non-program villages and 28 percent higher than non-members in Grameen villages. Grameen members were also able to rely more on savings and their own funds to cope with crises rather than borrow from moneylenders. Wage rates in program villages increased as well.

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Promoting Children's Education

One of the first things poor people all over the world do with new income from microenterprise is invest in their children's education. Studies show that children of microfinance clients are more likely to go to school and stay in school longer. Student drop-out rates are much lower in microfinance client households.
To support this priority, many microfinance programs are developing new credit and savings products specifically tailored to school expenses.
There have been a few studies on microfinance and its impact on schooling.

- A longitudinal study in a BRAC area in Bangladesh found that basic competency in reading, writing, and arithmetic among children 11-14 years old in member households had increased from 12 percent of children at the start of the program in 1992 to 24 percent in 1995. In non-member households, only 14 percent of children could pass the education competency tests in 1995.[15]
- Helen Todd's 1996 ethnographic study of a Grameen village points to the much higher levels of schooling of Grameen children compared to children of non-members. Almost all of the girls in Grameen households had some schooling compared to 60 percent of girls in the comparison group; 81 percent of Grameen boys went to school compared to 54 percent in non-Grameen households. This is also substantiated in the World Bank study in 1998, which found higher levels of schooling for children of all credit program participants and statistically significant higher rates of schooling for girls in Grameen households.[16]
- A Save the Children study on different microfinance programs report that in Honduras clients indicated that participating in the credit and savings program increased their earnings and the availability of resources.[17] This allowed them to send many of their children to school and reduce student drop-out rates.
- An impact study of a microfinance program in Uganda, conducted for the USAID-AIMS project, showed that client households invest more in education than non-client households. Microenterprise revenues were important in financing the education of their children for over half of the client households. Clients also were significantly more likely than non-clients to pay school charges for a non-household member. This has implications for keeping orphans and the children of households affected by HIV/AIDS in school.[18]
- The AIMS study of Zambuko Trust clients in Zimbabwe found positive impacts on enrollment ratios for boys 6-16 years old from 1997-99. Over the same period, school-

enrollment ratios for girls 6-16 declined, who possibly dropped out of school in response to a need to care for the sick. The data for repeat borrowers suggested that cumulative loans increase the likelihood that clients' children aged 6-21 would stay in school.[19]

- School enrollment among working-class children in Ahmedabad was 55 percent for girls and 65 percent for boys 11-17 years of age in 1997. Over the period 1997-99, borrowing from SEWA Bank had a positive impact on boys' secondary-school enrollment rates, which rose to 70 percent. However, the relationship of SEWA participation to the enrollment of girls at the secondary-school level or of girls and boys at the primary-school level was weak.[20]

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Improving Health Outcomes for Women and Children

Illness is generally the most important crisis for poor families. Deaths in the family, taking time off from work when sick, and health-care related expenses can deplete incomes and savings. They can lead to selling assets and indebtedness. For microfinance clients, illness is often the main reason for failure to repay loans.

Households of microfinance clients appear to have better nutrition, health practices, and health outcomes than comparable non-client households. Larger and more stable incomes generally lead to better nutrition, living conditions, and preventive health care. Increased earnings and financial management options also allow clients to treat health problems promptly rather than waiting for conditions to deteriorate.

Along with financial services, some microfinance institutions also provide health education, usually in the form of short, simple preventive care messages on immunization, safe drinking water, and pre-natal and post-natal care. Some programs provide credit products for water, sanitation, and housing. A growing number of microfinance institutions have forged partnerships with insurance providers to offer health insurance to clients.

The specific evidence on health outcomes for women and children in program households, though sparse, does point to a strong positive impact.

- CRECER in Bolivia provides basic health education along with financial services. An impact study shows that clients had better breast-feeding practices, were more likely to give rehydration therapy to children with diarrhea, and had higher rates of DPT immunization for their children.[21]
- A similar study in Ghana found that Freedom from Hunger clients had better breast-feeding practices, and their one-year-old children were healthier than non-client children in terms of weight-for-age and height-for-age. Clients also showed significant positive changes in a number of health practices-breast-feeding immediately after birth (so newborns get colostrum), introducing liquids and first foods to infants, and giving rehydration therapy to children with diarrhea.[22]
- A study, commissioned by USAID-AIMS, reported that clients in the FOCCAS microfinance program in Uganda, who received health care instructions on breastfeeding, preventive health, and family planning, had much better health care practices than non-clients. Ninety-five percent of clients engaged in some improved health and nutrition practices for their children compared to 72 percent of non-clients. Thirty-two percent of clients had tried at least one AIDS-prevention practice compared to 18 percent for non-clients.[23]
- A comprehensive longitudinal study of BRAC clients found that fewer members suffered from severe malnutrition (relative to the control group), and more importantly the extent of severe malnutrition declined as the length of membership increased.[24]
- In Bangladesh a World Bank study showed that a 10 percent increase in credit to women was associated with a 6.3-percent increase in mid-arm circumference of daughters. Mid-arm circumference of sons also increased, though by a smaller amount. There was also a statistically significant positive effect on height-for-age for both boys and girls.[25]

- Another survey of microfinance clients in Bangladesh indicated that rates of contraceptive use were significantly higher for Grameen clients (59 percent) than for non-clients (43 percent).[26] Similar findings of increased contraceptive use were reported in a later study by Mizanur Rahman and Julie DaVanzo.[27] This is generally due to greater awareness of contraceptive programs gained by attending group meetings and from increased mobility that allows women to seek out such services.

There are no studies that specifically address the link between microfinance and improved access to safe drinking water and sanitation. However, there is good evidence that increased earnings stemming from access to financial services lead to investments to improve housing, water, and sanitation, which in turn improve health outcomes. Many microfinance programs provide loans specifically to finance tube-wells and toilets. Other programs, such as SEWA in India, provide loans to upgrade community infrastructure (including tap water, toilets, drainage, and paved roads). Partnership between microfinance programs and private infrastructure providers is a promising option, given the limited success by governments to provide water and sanitation to large numbers of poor people and the high initial investments that deter private provision of such services to poor people.

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Empowering Women

Microfinance programs have generally targeted women as clients. Women often prove to be more financially responsible with better repayment performance than men. Also it has been shown that women are more likely than men to invest increased income in the household and family well-being. Perhaps most importantly, access to financial services can empower women to become more confident, more assertive, more likely to participate in family and community decisions, and better able to confront systemic gender inequities. But such empowerment is by no means automatic-gender-related issues are complex. Appropriate program design can have a strong, positive effect on women's empowerment, resulting in women owning more assets, having a more active role in family decisions, and increasing investment in family welfare.

- Microfinance programs from different regions report increasing decision-making roles of women clients. The Women's Empowerment Program in Nepal found that 68 percent of its members were making decisions on buying and selling property, sending their daughters to school, negotiating their children's marriages, and planning their family. These decisions traditionally were made by husbands. World Education, which combines education with financial services, found that women were in a stronger position to ensure female children had equal access to food, schooling, and medical care. TSPI in the Philippines reported that program participation increased the percentage of women who were principal household-fund managers from 33 percent to 51 percent. In the control group, only 31 percent of women were principal fund managers.[28]
- Results of the Freedom from Hunger studies in Bolivia and Ghana indicate that program participation led to increased self-confidence in women and improved status within the community. Participants in Ghana played a more active role in community life and community ceremonies, while participants in Bolivia were actively involved in local governments.[29]
- A survey of 1300 clients and non-clients in Bangladesh showed that credit-program participants were significantly more empowered than non-clients on the basis of their physical mobility, ownership and control of productive assets, (including homestead land, involvement in decision making, and political and legal awareness. This empowerment increased with duration of membership, suggesting strong program influence. The study also found, in some cases, that program participation led to an increase in domestic violence. However, over time, men and families became more accepting of women's participation, which eventually led to a decrease in violence.[30]

- In her study, Naila Kabeer finds that in microfinance programs changes occurred at a personal level in the form of increased self-worth. At the level of the household, she finds that women's increased contribution of resources led, in a great majority of cases, to declining levels of tension and violence. Women often reported feeling an increase in affection and consideration within the household with longer program membership.[31]
- Political empowerment of microfinance clients, in terms of participation in political mobilization or running for political office, is not well documented. However, there are many instances of such occurrences. Women clients of Opportunity Microfinance Bank in the Philippines have been elected to the local government. CRECER in Bolivia, CSD in Nepal, Grameen and BRAC in Bangladesh, and World Education, all report clients running for local government office and being elected. FORA in Russia organized a campaign for democracy in the Russian elections. Members of both SEWA and the Working Women's Forum in India have organized to get better wages and better rights for informal women workers, to resolve neighborhood issues, and to advocate for legal changes.

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Reaching Those in Extreme Poverty

The Millennium Development Goals include halving the number of those living in absolute poverty-the estimated 1.2 billion people subsisting on less than one dollar per day. Does microfinance reach such people? Can it do so on a massive scale?

The first question is whether it is financially feasible to reach those in absolute poverty. In credit-based microfinance institutions, poorer clients tend to take out smaller loans, and as average loan size gets smaller, costs seem to be harder to cover. However, innovative program design has been able to counteract this cost pressure, enabling a growing number of microfinance institutions to reach the extremely poor and still cover their costs through simplified, cost-effective banking approaches. ASA in Bangladesh is a pioneer in developing such systems. Banco do Nordeste in Brazil channels many of its transactions through post office networks, dramatically reducing its costs and borrowers' transaction costs.

A growing number of microfinance institutions reach clients living on less than one dollar per day and are financially sustainable.[32] In Bangladesh 65 percent of BRAC's clients live on less than one dollar per day and own no agricultural land, yet BRAC's return on assets in 2000 was 4.3 percent. Over 70 percent of the clients of SHARE (in India) and CARD (in the Philippines) own no agricultural land, so that most of them can be inferred to live on less than one dollar per day. In 2001 SHARE's return on assets was 1.1 percent and CARD's was 3.3 percent. In Cambodia EMT earned 2.3 percent on assets in 2001, even though half of its clients appear to be living in absolute poverty. In Nepal two-thirds of Nirdhan's clients live on less than one dollar per day. Nirdhan's adjusted return on assets for 2001-02 was 0.4 percent.

More generally, new evidence from the MicroBanking Bulletin shows little correlation between the profitability of successful microfinance institutions and their average loan size, a rough proxy for poverty levels.[33] Of the 62 institutions reporting data that have reached full financial self-sufficiency, the 18 that target the poorest clients (loan size at 20 percent GDP per capita) average better profitability than the rest. Programs that target very poor clients perform better than others in terms of cost per borrower, an efficiency indicator that neutralizes the effect of smaller loan sizes. Their efficiency comes from higher productivity: they average almost 200 borrowers per staff member compared to

140 for institutions that serve a broad range of clients and 70 for institutions that serve relatively better-off clients.

A number of microfinance institutions have also shown that, with strong management and efficient operations, the massive scale required to reach the billion people targeted by the MDGs is possible. With its streamlined and formulaic procedures, ASA in Bangladesh is rolling out new branches for every 1,800 clients. (They added nearly 78,000 new members each month in 2002.) As of January 2003, ASA had over 2.1 million clients. BRAC, with over 3.6 million members, recently set up in Afghanistan and after only 6 months in operation already has almost 5,000 clients. Acleda and EMT both have more clients than any other financial institution in Cambodia, with over 80,000 clients served by each. In Latin America, Banco do Nordeste, operating in one of the poorest regions of Brazil with very little donor support, became the second largest microfinance operation in Latin America. In just a few years, they have reached 110,000 clients. Compartamos, a non-bank financial institution in Mexico, has nearly doubled the number of its clients in the past year to become the largest Latin American program with over 150,000 clients.

Thus both individual program results and database averages justify the optimism that innovative products and methodologies can enable microfinance institutions to lower their costs and reach the very poor profitably. Once sustainable, institutions can become a permanent feature of the financial landscape, growing rapidly to reach significant scale without reliance on donor funding.

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Conclusion®The Role of Microfinance in Meeting the MDGs

No single intervention can defeat poverty. Poor people need employment, schooling, and health care. Some of the poorest require immediate income transfers or relief to survive. Access to financial services forms a fundamental basis on which many of the other essential interventions depend. Moreover, improvements in health care, nutritional advice, and education can be sustained only when households have increased earnings and greater control over financial resources. Financial services thus reduce poverty and its effects in multiple, concrete ways. And the beauty of microfinance is that, as programs approach financial sustainability, they can reach far beyond the limits of scarce donor resources.

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Footnotes

1 The Millennium Development Goals are: (1) eradicate extreme poverty and hunger; (2) achieve universal primary educations; (3) promote gender equality and empower women; (4) reduce child mortality; (5) improve maternal health; (6) combat HIV/AIDS, malaria, and other disease; (7) ensure environmental sustainability; and (8) develop a global partnership for development.

2 Credible measurement of the impact of financial services is challenging. Correlation does not prove causality. For example, merely showing that clients in one village are better off than those in another village does not prove that the financial services caused them to be better off: it is possible, after all, that the financial services only attracted or selected clients who were likely to be better off in the first place, even if they had not received the service. Studies that do not deal with biases have little power to prove causality. Few studies include fully rigorous control for selection biases, but all of the studies cited in this paper have addressed this issue by trying to select control groups whose observed characteristics were comparable except for their participation in microfinance. The authors believe that the general pattern of results sheds valid light on the question of impact-that is, does availability of financial services for the poor actually cause improvements in the achievements of MDGs?

3 A few studies have failed to find positive impacts from microfinance and in rare cases have identified a negative impact. However, the frequency of such outcomes has been too low to cast much doubt on the generally favorable conclusion indicated by the bulk of the evidence.

4 Barbara MkNelly and Christopher Dunford, Impact of Credit with Education on Mothers and Their Young Children's Nutrition: CRECER Credit with Education Program in Bolivia, Freedom from Hunger Research Paper No. 5 (Davis, Calif.: Freedom from Hunger, 1999).

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32 Financial sustainability measures whether an institution would be profitable in a fully commercial environment, adjusting operating revenues down for factors such as inflation, subsidized loan funds, and in-kind donations.

33 The MicroBanking Bulletin is part of the new Microfinance Information Exchange (the MIX), an information service reporting on almost 200 MFIs, networks, and investment funds, that CGAP incubated over the past few years and has now spun off.