From Microcredit to Microfinance: Towards a More Sustainable Way of Poverty Alleviation.

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Abstract: *This paper explores the principles that could, and perhaps should be followed by the Microfinance Institutions (MFIs) when considering why and when microfinance works-and when and why it fails to achieve its promise of poverty alleviation. Taking the Grameen Bank (GB) of Bangladesh as a case study, this paper specifically examines microcredit's poverty-alleviating ability and argues that microcredit has insurmountable limitations as a model of sustainable poverty alleviation. Developing client-responsive, flexible, and quality financial and skill-enhancing, non-financial services is imperative now. Thus, the more appropriate and higher the quality of services on offer, the better will be the impact on poverty alleviation.*

Keywords: Micro Credit, Grameen Bank, Poverty

1. INTRODUCTION

With the Nobel Peace Prize for Grameen and its founder Muhammad Younus, there is an enhanced interest in the role of microfinance in poverty alleviation. It has now become an icon in targeting of financial services to the poor drawing attention of development practitioners, policymakers, and the larger development community.

While much has been written about Grameen by scholars, this paper takes a creative, critical view on the role of Grameen microfinance in alleviating poverty in Bangladesh. The paper argues that the Grameen microfinance program, though satisfactory so far, could have been even more impressive, if the Grameen had introduced client-responsive, flexible financial services including open access savings and flexible loan products.

Money begets money. "Money makes money. When you have got a little, it is often easy to get more. The great difficulty is to get that little (Smith 1937: 93)". It is very difficult for the poor, especially the poor women, to get small working capital from formal banking system for various reasons. A collateral free working capital loan is the requirement at the doorsteps of

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the poor at the right time to help start feasible income generating activities. It is with this background that microcredit is seen as one of the significant strategies for poverty alleviation.

Microcredit, or in its wider dimension microfinance, is the extension of small amounts of collateral-free institutional loans to jointly liable poor group members for their self-employment and income generation. In recent years, microcredit has become a much favored intervention for poverty alleviation in the developing and least developed countries. It is argued that the poor themselves can positively contribute to economic growth rather than rely on *trickle down* from others.

Despite the success of some of the microfinance institutions (MFIs), including the Grameen Bank (GB), the cradle and flagship of microcredit movement, in delivering loans to the poor and bringing socioeconomic changes to some of these borrowers, there are still many borrowers who are unable to improve their poverty situation, but instead become more vulnerable and trapped in the rigid, supply-driven, credit-alone system.

Studies of microcredit programs (Islam 2007; Khandker 1998; Sobhan 1997; Hulme and Mosley 1996; Todd 1996) show that these have been successful in improving the economic condition of the members. Macro studies, however, demonstrate that there has not been any significant decline in the overall levels of poverty. This trend in overall poverty alleviation is comparable with the studies that indicate that a decade of one's membership with the MFIs has done little more than keep one's head above water (Sobhan 1997: 132-4). Perhaps microcredit, especially in the form that is currently in practice, is not the answer to the hardcore poor.

In Bangladesh there is significant differentiation within the ranks of the poor. Roughly about half of the poor constitute what is referred to as the *hardcore poor*, who are forced to subsist on a daily calorie intake of less than 1740 and a per capita income that is less than three-fifths than that of the poverty line (Rahman 1995). While the poverty situation seems to have improved a little over the last seven years, a little less than a quarter of the rural population still seem to rank among the hardcore poor (Hashemi 1997: 253). Microcredit programs have not been very successful in including these hardcore poor effectively, resulting in most of them remaining outside the microfinance net.

The paper has four sections. After this brief introduction, Section 2 explores the limitations of microcredit in alleviating poverty; taking the GB as a case study. Section 3 highlights the potential of quality financial services in alleviating poverty and achieving financial sustainability and finally Section 4 concludes.

2. THE IMPACT OF GB ON POVERTY

2.1 Methodology

This study employs cross sectional household data from two study periods, i.e., 1998 and 2008. The survey has used three methods: semi-structured interview (SSI); direct observation; and document analysis. There are four different aspects under SSI, i.e., individual interview, key informants\` interview, participatory group discussions, and case study. Besides using individual interview as the main method of collecting data, the survey also took into consideration the participatory group discussion and key informants\` interviews as well. In individual interviews, the open-ended method was preferred over other methods (e.g. discrete choice method) because of its inherent advantages such as this method would give a crystal picture of the day to day harsh realities of poor people\`s lives.

Keeping in view of the different stages in the GB\`s development, the zones selected for survey were Tangail, Comilla, and Bogra. In the base year survey in 1998, the 300 households, 25 each from 12 different projects, to be surveyed were randomly selected. In 2008, due to time and financial constraints, only 60 households, 5 each from 12 different projects, amongst those surveyed in 1998 were randomly selected to examine the impact of client-responsive financial services including voluntary savings.

Several studies on rural poverty in Bangladesh used a consumption bundle providing an intake of 2,112 calories and 58 grams of protein as the norm, which by and large conforms to the minimum diet recommended by the Food and Agricultural Organisation of the United Nations. This is the standard practice in the Bangladesh development literature (Khandker and Chowdhury 1996: 12), which has also been accepted by the Planning Commission of the Government of Bangladesh. This study used this norm to identify the extent of poverty across different groups of population in the sample areas. Given average village-level prices, the level of consumption that qualified as *moderate poverty* was fixed at Tk. 6,350 per person per year, while the level of consumption that determined *extreme poverty* was Tk. 5,547 per person per year, which would satisfy 85 per cent of the required calorie and protein needs. The figures include a 30 per cent provision of the cost of non-food items.

In the absence of comparable benchmark data, the impact of the GB's operation on poverty had to be estimated using a *with* and *without* approach. This conventional approach relies on quantitative data and structured interview and is favored by economists and project analysts. The alternative approach usually favored by sociologists and anthropologists is to adopt a *Participatory Rapid Appraisal* (PRA) techniques to evaluate a project. Both these approaches have their advantages and disadvantages. While the former may be time consuming and requires more resources in terms of time and budget, it relies on solid quantitative data, whereas the latter though less time consuming and resources relies largely on qualitative data and impressionistic accounts. The present study relied more on the former approach in assessing the GB impact on rural poverty.

2.2 Findings

Despite the GB members on the average appeared to be benefiting notably from credit, a closer look at the self-perception of the GB members in 1998 depicts a rather trivial picture of the role of microcredit in poverty alleviation. The members were experiencing increases in income, equity capital, employment, productivity, and access to institutional credits. Due to differences amongst the poor in terms of economic and social endowments, however, all members of the poor did not experience identical improvements in terms of alleviation of poverty.

Figure 1 shows that 23 per cent of all members had *reasonably improved* their positions, while 50 per cent members had experienced a *marginal improvement* only. Nearly 17 per cent members experienced *no change*, and 10 per cent of members experienced *further deterioration* in their positions. This means that nearly 77 per cent of the members did not experience any significant improvement in their positions as a result of their membership with the GB.

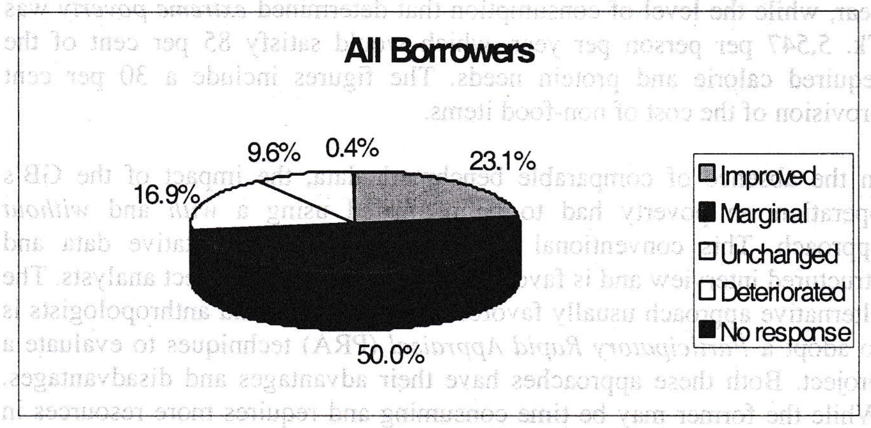

Figure 1- GB members` perception of poverty situation after joining GB, 1998. (Figures in percentage)

Source: Grameen Bank Survey in 1998

It is clear that most of the GB members, especially the *extreme poor*, could not be free from poverty. In some instances, instead of an improvement in their situations, they actually experienced a further deterioration. Those members experiencing further deterioration probably had some inherent weaknesses beside the low level of productivity and income in the GB-financed microenterprises. These frustrated, hesitant borrowers were either trapped in previous debts with the informal lenders and as such could not use the loan money for productive purposes, or had faced any natural calamity or illness or some unexpected incidents like the theft or death of the livestock, purchased with the loan money.

These factors, in single, or in combination, have resulted in further deterioration of their position. This tendency, drawn essentially, but not conclusively, from the empirical findings, suggests important conclusion about the limitations of credit as a poverty alleviation strategy in Bangladesh as well as other countries following a similar strategy.

The limited impact that microcredit services of the GB have insignificantly alleviated poverty of its clients demonstrates the need for a wider range of financial services for the poor. Poor people need sustained access to an evolving set of financial products and services. These can only be provided by financially sustainable institutions, dealing with client-responsive, diverse financial product, each in the position to increase outreach and grow with their clients.

After nearly thirty years of research and experimentation, it is now widely perceived that *monotheistic microcredit formula* promoted as a panacea (Wright 2000; Wood and Sharif eds. 1997) is not only inadequate to meet the needs of the poorest, but also a tool to monopolize resources that could, and perhaps should be used for other more pressing or important interventions. Microcredit for the poor is unlikely to be a win-all solution to a wide range of development problems, as much of the microcredit evangelists' rhetoric would imply. It does not and perhaps cannot support the extreme poor in their efforts to climb out of poverty.

In order to have a significant impact on poverty alleviation, this paper argues for a shift from a worldview that considers microcredit as an input into enterprise development to one that thinks about a microfinance industry providing client-responsive, and flexible financial services to poor people. The success of policy efforts to address the problems of the rural poor is to provide quality financial services taking into consideration their different needs.

3. QUALITY FINANCIAL SERVICES

Increasing numbers of practitioners (e.g., Matin et al., 2001, Wright 2000, and Rutherford 2000) are stressing the importance of offering a range of quality, flexible financial services including voluntary savings, insurance products, and money transfers in response to the wide variety of needs of the poor. But savings services for the poor remain forgotten in rural areas of most developing countries, including Bangladesh. In 1984, savings were called *the forgotten half of rural finance* (Vogel 1984: 248). For more than 20 years later, savings services still remain forgotten.

From the point of view of the lender, savings deposits mobilisation, makes an MFI viable. Experience across different MFIs (for example, Buro-Tangail, a private MFI in Bangladesh, and Bank Rakayat, a government-owned bank in Indonesia, and Bank Shinta Daya, a private MFI also in Indonesia) shows that the viability of institutions and outreach to the poor can be achieved by emphasizing savings rather than credit. Savings-driven MFIs have generally achieved both these apparently contradictory goals of outreach and sustainability. Institutions that resist innovation in different savings products and continue to stick to their preferential compulsory savings and rigid floor size loans, find their growth impeded. A savings facility is an extremely valuable service in its own right, which often attracts many more clients than a credit program, particularly from amongst the poorest. The mobilization of voluntary savings, if properly and rigorously implemented, helps reduce the dependence for concessionary donor funds, ultimately paving the way for the lender to achieve financial sustainability, a cherished goal desired by many, but achieved by very few, if any.

Again a closer look at the self-perception of the GB members (Figure 2) draws a comparative picture of the limitations of *credit alone approach* in 1998 and potential of client-responsive micro financial services in 2008 in significantly alleviating poverty of the GB members.

Only 23 percent of the GB members could *significantly improve* their poverty situation under the *credit alone approach* in 1998 whereas the percentage of such members was as high as 44 under the *credit plus approach* in 2008. Fifty percent members under the credit alone approach in 1998 could *marginally improve* their poverty situation; the figure for such members was 36 percent in 2008. This indicates the percentage of members experiencing *Improved* in their poverty situation had increased, reducing the percentage of *Improved marginally* members from 50 percent to 36 percent. Likewise, 14 percent members in 2008 and 18 percent in 1998 experienced *Unchanged* in their poverty situation. This also shows an improvement in the poverty situation of some of the members experiencing *Unchanged* situation earlier. In 1998, 9 percent members' experienced *further deterioration* in their poverty situation, the corresponding figure was 6 percent in 2008. All this indicates that most of the members had a positive change in their poverty situation in 2008.

The introduction of voluntary savings and other client-friendly financial products in recent years has enabled the GB to finance 100 per cent of its outstanding loan from its own fund and the savings of its depositors. Deposits alone are 99 per cent of the outstanding loans. If deposits of the members and the GB`s own resources are combined, it becomes 129 per cent of loans outstanding. The GB is now self-sufficient and does not take any donor money or even take loans from local or external sources.

This self-sufficiency of the GB has been achieved without incurring any additional costs. It is to the GB's interest to provide voluntary savings services for its poor clients. With the enabling environment that the GB has created for its clients through the *borrowing circle* and the mandatory weekly meetings, it makes it all the more easier for the GB to deliver voluntary savings services to its poor clients.

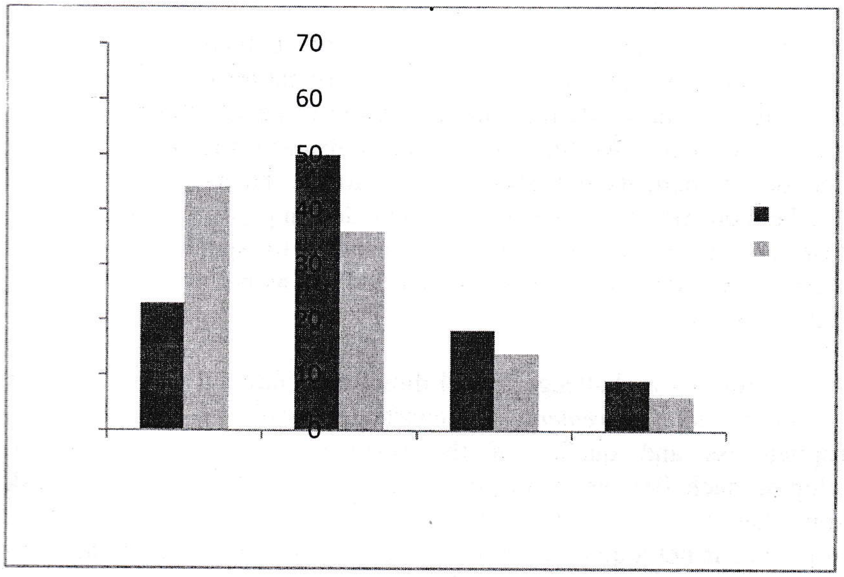

Figure 2: GB Members' Perception of Change in Poverty Situation in 1998 and 2008

Source: Grameen Bank Surveys in 1998 and 2008.

What is clear about the importance of flexible, quality financial services is that such services will respond to the different needs of the rural poor. It seems important to have a more disaggregated understanding of the poor, and to recognize the diversity of their capacities/efficiencies, social position, family circumstances, and livelihood options. The poor are not a homogeneous, undifferentiated mass, to be offered an undifferentiated, single, universal package of financial services.

Even once such a client-friendly microfinance system has been implemented, there is a need for an on-going programme of *product development* to seek to improve the quality of services being made available to clients. This is the challenge for the future. The eventual impact of microfinance on poverty alleviation and the sustainability of MFIs will ultimately depend on organizations' systems and products. The more appropriate and the higher the quality of services on offer, the better the impact on poverty alleviation and financial sustainability.

4. CONCLUSIONS

This paper has explored the limitations and potentials inherent in microcredit in alleviating poverty that will be critical for the success of the microcredit movement. Microcredit has proven to be an effective tool for poverty alleviation. As the microcredit movement matures, we get a clearer idea of both its strengths and limitations. To move forward, we need to be more effective, increase outreach, design products to include the poorest, and take any other measure needed to spread the poverty alleviation net wider, so that a significant as well as noticeable decline in poverty takes place.

The *Conclusion* is a challenge for all directly or indirectly involved with the *microfinance movement* to constantly seek to improve the appropriateness and quality of the financial services to the poor. Developing such flexible financial services is, however, a complex task and one that takes time-not the donors' prescribed time of 3 to 5 years. Microfinance is not a quick fix but the kind of slow, often frustrating step-by-step process that is usually the hallmark of real change.

The real taste of microfinance depends mainly on two big *ifs. If* microfinance is meant to include only microcredit, it usually tastes sour. *If*, on the other hand, microfinance services include broad range of client-responsive, quality financial services, it does really taste sweet. The time has come to re-think the purpose and potential of microfinance, going far beyond microcredit for enterprise development to encompass the provision of demand-responsive flexible financial services to poor people, regardless of whether they own enterprises or not.

The 1990s have been the "Decade of Microcredit Complacency". It is time to stocktaking, to stop recycling myths and to stop copying the initial breakthrough products, and to focus on the real task by providing client-responsive services, both financial and non-financial, that will help to achieve the apparently contradictory twin goals of poverty alleviation for the poor and financial sustainability of MFIs.

Microcredit that originated in Bangladesh has spread all over the globe. Today within the global coverage of microcredit Bangladesh's achievement stands out prominently. Whatever happens, the world will not forget that it was in Bangladesh where it was first proved that an institution lending exclusively to the poor could become a large, successful and near-self-sufficient financial organization.

Recognizing the importance of microcredit in poverty alleviation, the UN has declared 2005 as the UN International Year of Microcredit. With combined efforts of the governments, MFIs, donor agencies and above all the peoples of the nations through multipronged approach poverty can be alleviated significantly, if not removed completely, from the face of the earth and thus peace in its true sense will be restored around the world.

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