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BOWLING GREEN

# The Impact of Microfinance in the Developing World

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A greatly contested topic of discussion among the  
global development community

**Kaitlin Bur**

**4/28/2013**

**Definition**

Microfinance is “the provision of small loans (microcredit) to poor people to help them engage in productive activities or grow very small businesses. The term may also include a broader range of services, including credit, savings and insurance” (PBS).

**Intention for Writing**

Beginning my research, I had a limited understanding of and knowledge regarding the subject of microfinance. Having only encountered the concept a handful of times in various literature for international studies courses, I conceptualized and idealized a revolutionary development practice that I thought perhaps could be the answer to ending extreme poverty, creating more egalitarian societies and/or promoting more extensive economic development. I knew Muhammad Yunus was famed for winning a Nobel Peace Prize in 2006, for establishing the Grameen Bank in his home country of Bangladesh. I had also heard mention of the successes of such organizations as Opportunity International at the Millennium Campus Conference, which I attended for two consecutive years in Boston. My enthusiasm was “based on the success of a few famous financial institutions in mobilizing savings and distributing large amounts of credit with high repayment rates and good outreach on a rather sustainable basis” (Food 1). Given this foundation for understanding, I was justifiably optimistic and not all of my beliefs were unfounded.

It was not until I decided to pursue the topic further that my high expectations were challenged by countless skeptical arguments. From here, my initial intention to write about the blossoming growth of this perceivably successful industry shifted to a focus on the heated debate over microfinance that has produced a great deal of literature and discussion within the international development community. Given my more mature

understanding, I will discuss both sides of the debate, attempting to set aside my optimism and view the criticism as a jumping-off point for honing and improving best practices. I will address how microfinance has impacted the developing world, more specifically in its relationships with women's empowerment and the eradication of poverty.

The paper will take shape in the form of a primarily qualitative framework analysis. This approach allows me to simultaneously explore data sets in research while maintaining a transparent and compelling audit route. I will be focusing on microfinance on the macro level, rather than the micro. In doing so, I will discuss the fundamental design of the industry, its relative progress, its perception within the international development community and the overall impact it has made on the developing world. Beyond this, I will draw connections between my chosen theoretical frame and the practice of microfinance in our continually globalizing and interconnected world. Rather than focusing my attention on specific case studies, I will attempt to analyze the microfinance industry more generally as a whole. While I realize this is potentially problematic, in that I would be creating broad generalizations, I believe there are a number of success stories to account for the more beneficial and fruitful components of the practice and some wide-ranging drawbacks that have proved themselves problematic to nearly all realms of the microfinance world. In considering these overarching practices, I will be able to come to clearer conclusions about the global industry.

### **Historical Context**

What we perceive of as modern-day microfinance emerged in the 1970s, in Bangladesh, during a period of famine. Mohammed Yunus began lending money to members of his community who were struggling during this period of instability. Less than

a decade later, in 1983, he founded the Grameen Bank “and Bangladesh became a textbook example of microfinance” (Becker 46). Other similar such programs were established around the same time period in Brazil (ACCION) and in Indonesia (Bank Rakyat). The rise of these and other microfinance institutions (MFIs) was primarily a product of failed international subsidy programs that operated by means of local governments, setting up rural development programs that were financed by development institutions such as the World Bank. Three factors aided in the downfall of such programs. Firstly, local banks did not make a sufficient profit to cover high operating costs, too many debtors failed to pay back interest rates and lastly, corrupt lending was cultivated by rationing of credit programs. Given such scenarios, “locally originated microfinance has proved to be the better solution. It has become one of the rare financial and sustainable success stories of today’s emerging and developing market’s financial system” (Becker 47).

### **Theoretical Frame**

Leslie Sklair, a renowned Sociology professor at The London School of Economics, has published multiple works about his research and findings regarding sociology and its relationship with globalization, capitalism and development. From his publications, I have directed my attention to his book, *Globalization Capitalism and Its Alternatives*, more specifically the chapter entitled “Transnational Practices: Corporations, Class and Consumerism,” in which he elaborates on his Theory of the Global System and the transnational capitalist class. This theory draws on the interdisciplinary relationship of the global economic, political and culture-ideology spheres and how it helps to explain our increasingly capitalist and consumer-driven world.

For the purposes of my paper, I felt addressing all three realms of our global society would be appropriate. Society is inextricably interconnected, due in large part to the processes of globalization. The political, cultural, social and economic realms have no choice but to interact in order to maintain a functioning society. Transposing Sklair's theory onto the concept of microfinance requires a bit of abstraction, however, I believe there is an undeniable relationship between the two. As for microfinance, the three sectors set the stage for success within a given community, and I believe some balance between the three is a necessary precondition for successful implementation of these practices. Each domain has its respective role in this fundamental relationship and is "typically characterized by a representative institution, cohesive structures of practice, organized and patterned, which can only be properly understood in terms of their transnational effects" (Sklair 84).

Economic transnational practices are most commonly viewed as the foundational "building blocks" of the capitalist global system and are frequently derived from transnational corporations (TNCs). In the world of microfinance, economics is most obviously fundamentally significant to the industry. Microfinance institutions are the benefactors; they are the source of capital for all related opportunities such as micro credit and insurance, they dictate the amounts given, to whom it is allocated and at what interest rate. Funding for MFIs is provided by public and private institutions alike that see financing these endeavors as profitable and in their own best interest and that of the clients. Other components of the economic piece of microfinance are the interest rates placed on microloans to cover operation costs and the economic situation in the community and/or state of the client. Interest rates are very widely discussed within

microfinance literature and many different explanations are provided for their justification as well as their ability to exploit borrowers and make repayment more difficult. Broader economic situations are also very telling. They can dictate whether or not MFIs are successful in serving the poor and whether the poor clients are able to repay loans and thrive in the marketplace with their new microenterprises.

The next order of business to be addressed is the political system. In this arena, we must consider the role of the government in the success of microfinance programs, viewing it as the organizer or administrator that systematizes and gives structure to the industry within a certain community or state.

The role of the state encompasses insuring minimum banking structure in the rural areas, subsidizing microfinance start-up capital and innovations, and investing in complementary services such as infrastructure, health and education. The state must also develop a clear and flexible regulatory framework for MFIs with the means to enforce rules for the supervisory bodies (Food iv).

As in Sklair's theory, the government has the power to manipulate the system based on its involvement with microfinance efforts. Given this, the state must be figured into the equation when a microfinance transaction is being considered.

Lastly, there is a cultural connection that can be made between microfinance and the Theory of The Global System. This connection is perhaps the most obscure, in that it could be perceived in two different ways. First, I could argue that substituting sustainability for the culture of consumerism would adequately explain the culture-ideology relationship with microfinance. And secondly, I could delve deeper, considering arguments that deem microfinance unsuccessful and say that the microfinance industry falsely pushes for sustainability and development, when really that is just a mask for the capitalist motives of the lenders and donors. This arena must also consider what is being

promoted, who is receiving the loans, traditional values and practices along with a whole other host of factors that impact the “glue” of the system.

### **The Debate**

For those of us ill-informed idealists, the concept of microfinance signifies a way out of poverty, a promise of a brighter future and the answer to all of the developing world’s most grave problems. It is famed by the distinguished Nobel Peace Prize winner, Mohammed Yunus who established the first modern-day form of a microfinance institution (MFI). The Grameen Bank, based out of his home country, Bangladesh, was founded on microcredit; small-scale loans extended most commonly to clients in the developing world that are intended to encourage entrepreneurship and alleviate poverty. This new industry soon became vastly popular among development communities all across the globe.

In time, the word microfinance was coined to convey that other financial services, such as savings and insurance, could also be delivered economically and in bulk to the poor. In this respect, the success of the microfinance movement is indisputable and goes far beyond the estimated 150 million people who use it (Roodman ix).

It has been considered successful in areas such as the empowerment of women, lifting people out of poverty and providing opportunities for microenterprise. However, measuring the tangible effects of these supposed successes I believe has proven to be more difficult than many people, myself included, would have imagined. The outcome of implementing loans from MFIs is irrefutably based on situational influences, most notably, unstable economies, underdeveloped infrastructure and corrupt governments. Having made these inconsistent declarations, I attempt will present the numerous contrasting debates regarding this provocative development practice to help clarify the positive and negative aspects which are not necessarily mutually exclusive.

### **Contested Components**



## Provision of Credit

As I mentioned previously, microfinance is regarded by many in the global development community as a positive and compelling practice. At the most obvious and fundamental level, it provides its recipients with access to capital. Often times, residents living in developing communities lack immediate access to capital. Poor infrastructure, absence of a strong formal financial sector and lack of confidence in borrowers could all be potential causes of this deficiency. ATMs and banks are not as common as we may readily perceive them to be in the developed world, and often times only have branches in large cities where there is a greater degree of economic activity. Thus, accessing capital can prove difficult for the rural poor, who live an isolated life due to lack of transportation (vehicles and underdeveloped or non-existent roads). Also, lending to poor clients potentially provides a sense of insecurity for lenders because most clients of such socio-economic standing do not have sufficient collateral to confirm their reliability.

In considering these conditions, it is clear that microfinance could provide a better alternative to credit acquisition. Microloans do not necessitate collateral, and instead, often put in place forced savings accounts to ensure client responsibility or within the framework of group lending, loans are collateralized by confidence in the group rather than by tangible assets (Rankin 2). Microfinance institutions have the capability to reach rural clients and provide them with immediate capital, allowing for faster turnaround time when establishing the foundation of their microenterprise. This access to capital also helps to diversify and increase the source of recipients' incomes. Also, according to Ashley Hubka and Rida Zaidi,

Access to financial services also translates into broader social benefits, including improved health (better nutrition, better living conditions and preventative health

practices, higher immunization rates); increased educational participation (children of microfinance clients are more likely to go to school, and drop-out rates of those students are lower than average); and greater gender equality (increased confidence and assertiveness, increased participation in household and community decision-making) (4).

Also in emergency situations, microfinance is an easy and accessible option. I am not just speaking of micro credit, but referencing the other services most commonly offered by microfinance institutions that take a more holistic approach on microcredit: insurance, savings and healthcare. Many organizations offer these services as a package deal to clients as a means of covering them in times of familial or business strife. I believe by providing these services, MFIs are helping to better serve the basic needs of their clients as well as providing the basis for and ideally more sustainable transaction. Being guaranteed this security will make a MFI more likely to give out a loan and the recipient more confident about the prospect of opening his/her own business.

#### Vulnerability to External Influence

A great deal of my support for this section comes from Patrick Meagher's "Enabling Environment for Microfinance: A concept Note" which was financed by the Bill and Melinda Gates Foundation. He makes an analogy between microfinance and farming, stating that crops start with the seed provided by a farmer, but the growth and prosperity of the plant is contingent on the environment and external factors such a fertile soil, adequate sunlight and proper access to nutrients and water. In the microfinance world, a grant is supplied by a MFI, but the probability of it flourishing is subject to other factors such as access to proper resources, a stable economy, a supportive government and favorable legislation.

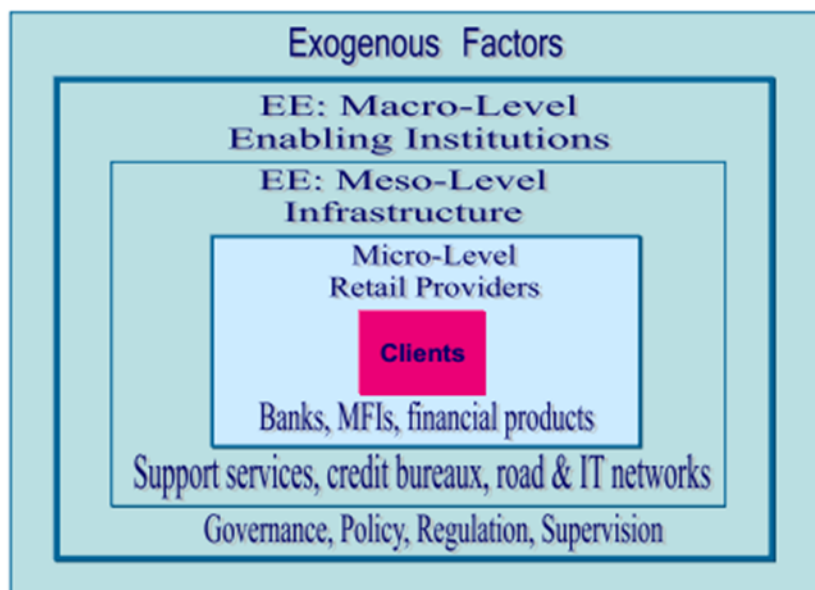
Meagher focuses on an approach to dealing with the complex issues and uncertainties of microfinance which he terms the enabling environment (EE). The actors

responsible for creating this supportive environment are most notably government and financial organizations which create reforms that “create mechanisms that reduce costs, risks and uncertainties” (2).

The components of the enabling environment arise in response to exogenous factors. It includes two categories of independent variables situated between the micro level and the exogenous factors. These are the macro- (consist largely of public goods) and meso-level factors. Together, these elements- briefly, institutions and infrastructure- enable access to microfinance services to a particular extent. These factors make it possible for consumers and providers of microfinance services to cope with exogenous uncertainties, to manage the risks and costs arising within microfinance transactions, and thus to take steps at the micro level to ensure that the supply of services meets demand (4-5).

The following chart provides a supportive visual representation of the above mentioned concept.

**Figure 1: Environment for Microfinance**



Adapted from CGAP Direct Donor Guidelines ([http://www.cgap.org/direct/resources/donor\\_guidelines.php](http://www.cgap.org/direct/resources/donor_guidelines.php)).

Table 2 below provides a listing of factors within the enabling environment.

**Table 2. Microfinance Access: Enabling Factors**

<b>MACRO LEVEL FACTORS</b>	
<i>Quality of governance</i>	<ul style="list-style-type: none"> <li>o Rule of law, transparency &amp; accountability in government</li> <li>o Security, public order, crime</li> <li>o Capable and accessible courts/tribunals</li> <li>o Quality of legislature, executive, bureaucracy</li> <li>o Civil and political rights</li> <li>o Corruption, political interference</li> <li>o Enforcement of civil, criminal, commercial laws</li> </ul>
<i>Property rights and enforcement</i>	<ul style="list-style-type: none"> <li>o Property laws: real estate, movables, intangibles</li> <li>o Property registration, protection, conveyance</li> <li>o Family law: marital property, inheritance, divorce, legal autonomy of spouses &amp; children, customary/religious law on personal status</li> </ul>
<i>Local governance and informal organization</i>	<ul style="list-style-type: none"> <li>o Local government: quality of administration &amp; taxation</li> <li>o Local government: treatment of property rights</li> <li>o Informal norms, authority structures, dispute-resolution</li> <li>o Social capital, networks, associations, resource-pooling.</li> </ul>
<i>Economic and commercial laws and policies</i>	<ul style="list-style-type: none"> <li>o Monetary policy, interest rates, exchange rates</li> <li>o Investment (domestic &amp; foreign) law and regulation</li> <li>o Taxes: incidence, levels, stability, application</li> <li>o Rules on company formation &amp; registration (including non-profits)</li> <li>o Regulations affecting operations: labor, health &amp; safety, competition, consumer protection</li> <li>o Commercial laws: contract, corporations, securities, bankruptcy</li> <li>o Secured finance law</li> </ul>
<i>Financial law and regulation</i>	<ul style="list-style-type: none"> <li>o Banking, financial services, and insurance laws</li> <li>o Financial services regulation, including licensing &amp; prudential standards</li> <li>o Specific provisions for microfinance</li> <li>o Supervision: quality, burden, cost</li> <li>o Deposit protection/insurance</li> <li>o Financial products accessible by law to the poor, e.g. inexpensive, low minimum-balance savings accounts</li> <li>o Operating rules including branching and agents</li> <li>o Provision for transformation to regulated status (e.g. by NGOs, coops)</li> <li>o Usury and money lending laws, interest rate caps</li> <li>o Treatment of small/informal microfinance groups &amp; providers</li> </ul>
<b>MESO LEVEL FACTORS</b>	
<i>General infrastructure and services</i>	<ul style="list-style-type: none"> <li>o Road and transport networks</li> <li>o Electricity, water, sanitation services</li> <li>o Telecommunications and information technology accessibility</li> <li>o Healthcare and education</li> <li>o Social safety nets, welfare &amp; relief programs</li> <li>o Availability of qualified personnel</li> <li>o Systems for identity documentation and record-keeping</li> </ul>
<i>Support systems for business and finance</i>	<ul style="list-style-type: none"> <li>o Clearing, transfer systems</li> <li>o Credit information system/credit bureau</li> <li>o Enterprise development support &amp; promotion</li> <li>o Infrastructure: marketplaces, information access (e.g. on relative prices)</li> <li>o Associations/apexes for microfinance, microenterprise</li> </ul>
<i>Financial sector conditions</i>	<ul style="list-style-type: none"> <li>o Banking infrastructure – quality and extent</li> <li>o Competition in banking and small-scale finance</li> <li>o 'Credit culture,' market (or non-market) basis of development finance (including aid donor programs)</li> </ul>

The EE can serve to meet the needs of both MFIs and potential clients. Macro- and meso-level factors can both be potentially beneficial or harmful. This distinction is largely

contingent on the stability and reliability of related government and financial institutions as I mentioned previously. Because the relationship between MFIs and borrowers is so client-centered, enabling factors “can exert major influence on the ability of MFIs to achieve scale and effectively expand access to poor households and informal entrepreneurs” (Meagher 8).

### High Interest Rates?

“Microcredit interest rates are high because microlending remains a high-cost operation” (13 Fernando). Among microfinance literature, the issue of high interest rates remains a continual point of contention and speculation. Many critics view interest rates as being exorbitantly high, hindering potential clients from obtaining a loan and being able to feasibly repay in a timely manner, or ever for that matter. In many of the arguments I have come across in my research, a popular proposition to impede these high rates is the implementation of rate ceilings, however, I agree with Nimal A. Fernando in his paper, “Understanding and Dealing with High Interest Rates on Microcredit”, that this is not the answer.

As with any business enterprise, “charging prices high enough to cover costs is an essential practice” (Fernando 1) if it intends to continue operating. Interest rates range from MFI to MFI and region to region vary, but the average global interest rates stands at about 37 percent (MacFarquhar). In order to meet the objective of providing financial services to poor clients, MFIs must be able to acquire enough income to continue lending and providing corresponding services. The interest incurred on these loans makes up a majority of that necessary income. The following four factors are the primary determinants of these rates according to the Fernando paper:

1. The cost of funds
2. The MFI's operating expenses
  - Personnel and administrative
3. Loan losses
4. Profits needed to expand their capital base and fund expected future growth
  - Hope for future innovation, funding larger client networks

In reading this, I wondered why it was that microfinance institutions were so reliant on interest when most of them receive funds from external sources to finance operations.

With further reading, I realized that many of these concessional funds received from donors are given for specific reasons and have particular time frames in which they must be spent, thus why the provision of interest rates is so pertinent (Fernando 2).

All too often, critics compare the rate of interest on microloans with that of commercial banks and other lending institutions that receive a great deal of subsidization. This comparison is unfair and inaccurate because MFIs operate in a different playing field.

Commercial banks most often deal with large loans, and their transaction costs are lower than those of MFIs on a per unit basis. Thus, commercial banks are able to charge lower interest rates than MFIs. A financial institution receiving large subsidies may charge much lower interest rates than other MFIs (Fernando 3-4).

The Grameen Bank in Bangladesh is an example of a microfinance institution that receives a great deal of government subsidies, thus it is able to charge interest rates as low as 20%, however, this is not the case for many smaller institutions that receive fewer subsidies (Fernando 4).

As I mentioned briefly earlier in this section, imposing rate ceilings is not a viable answer to decreasing interest rates. Appropriate interest rates are set to cover the necessary cost recovery, and by commanding a drop in these rates, MFIs will be unable to continue lending at an optimal level and unwilling to innovate and expand operations because of the mere fact that they will not be able to financially afford such an endeavor.

This has the potential to create a downward cycle, discouraging supporters from investing, inhibiting MFIs' ability to finance their operations based on current market prices and changing focus on larger, less risky, short-term loans that require fewer operation costs. This would undermine the goals of microfinance, detracting from poorer clients and ignoring the goal of sustainability. "Empirical evidence from the Asia/Pacific region strongly supports the view that liberal interest rate policies fuel the growth of the microfinance industry. More than 50 million poor people now have access to microcredit from formal and semi-formal institutions in the region" (Fernando 5). Rather than implementing rate ceilings, I believe policy makers should take other measures to improve the industry. This mirrors Patrick Meagher's idea of creating an enabling environment. Governments have the power and potential to create an environment conducive for more effective lending by improving infrastructure, implementing supportive legislature, encouraging innovation, providing the foundation for more competitive markets, etc.

While the rationale for high interest rates is reasonable, the other side of the token must be considered: high interest rates exclude clients who may fall at the very bottom of the socio-economic pyramid. This group of people could likely reap the most benefits from the provision of microfinance; however, it is a sad reality that most of them are never even offered the option. MFIs view investing in the poorest of the poor an unsafe investment because the likelihood of them having the proper whereabouts to pay back loans is slim to none. With the government intervention suggested above, microfinance institutions, given the proper resources and conditions, could cut back on operating costs and reduces interest rates. This decline in interest rates presents a "win-win" situation. "It is beneficial for both lenders and borrowers, will reinforce rather than undermine the development of



microcredit service, and will help policy makers achieve their objectives of ensuring access to credit for the poor at affordable prices” (Fernando 11).

### The Impact on Women’s Empowerment

A great deal of microfinance efforts today are directed at the female population. Women are considered fundamentally necessary components to escaping the confines of extreme poverty. According to United Nations Deputy Secretary-General Asha Rose Migiros, “Increasing gender equality and women’s empowerment, as a means of accelerating growth and development, is an end in itself”. In many developing countries that uphold traditional gender roles, women are responsible for maintaining a positive and productive home environment while their husbands are most commonly responsible for earning an income in support of the family’s well-being.

Many microfinance institutions, such as Opportunity International, believe lending to women will produce the most positive return on investment. As articulated by Linda Mayoux in her article, “Microfinance and Women’s Empowerment: Rethinking ‘Best Practice’”,

Microfinance programs have significant potential for contributing to women’s economic, social and political empowerment. Access to savings and credit can initiate or strengthen a series of interlinked and mutually reinforcing ‘virtuous spirals’ of empowerment. These virtuous spirals are potentially mutually reinforcing in that both improved wellbeing and change in women’s position may further increase their ability to increase incomes and so on (27).

This so-called “spiral of empowerment” could result in women’s increased contribution to economic decision making within the family. Her increased role may produce improved well-being for the household and for the social position of the woman within her family and society at large. Having said this, it is hard to group women into one category and assume microfinance will help all female clients climb the social ladder.

Living in traditional fundamentalist societies often offsets women and denies them enjoyment of the same rights and opportunities as their male counterparts. They frequently are oppressed as a result of the patriarchal hegemonic structure of society, which assumes women are subservient to men at all costs and this norm should not be questioned or assumed otherwise. According to the research of Sabrina Regmi, a writer for New York University's journal, *Perspectives on Global Issues*, women receiving microfinance services sometimes feel overburdened by their numerous responsibilities, having to serve roles at home, in the field and in the work place. Also, if women become responsible for the family's finances, husbands may assume they are absolved of their responsibilities within the family, placing an even greater workload on the women. Another possible result of lending to female clients is the possibility of men assuming ownership of the loan, spending it as they please, but not taking responsibility for repayment. In these patriarchal societies, because men are assumed to be the predominant bread winners and heads of the household, women often have no control over the finances. Because of this, men could quite easily take the capital for themselves and spend it on the advancement of the male family members, rather than females and/or for personal means. Both of these outcomes, rather than serving to empower women, could quite easily result in just the opposite.

In having said this, the position of microfinance arises as potentially problematic because what is most immediately being promoted through the provision of the microloan is economic empowerment, and other aspects are considered of secondary importance. Feminist analysis advises, "the development community to take socio-cultural realities into account while implementing development initiatives so as to ensure that microfinance

initiatives do more than just generate income but work to transform societal relations and empower women” (Regmi). Empowerment suggests progress in more areas than one, thus, I believe addressing social and political needs is also necessary to the advancement of women.

Perhaps “what is required is a careful analysis of needs and priorities and then consideration of a range of possible ways in which they can be met” (Mayoux 30) on behalf of the MFIs. Being deliberate and transparent about what needs are most pertinent, consulting women about these objectives for empowerment and sustainability, considering the reality of obtaining these based on given resources and societal conditions, realizing the importance of the male-female alliance, and collaborating with other local institutions to provide complimentary services are all considerations that should be made. I believe these components of the lending process are within the realistic reach of microfinance institutions and would likely make the process smoother and more beneficial to the female clients receiving the services.

### Contrasting Paradigms

We perceive the end goal of microfinance to be an end to extreme poverty. While ideally this is what I would like to believe, it is difficult for me to ignore the fact that many MFIs are undeniably out to make a profit. And while I realize that this is the end goal of all businesses enterprises, perhaps microfinance institutions need to reevaluate their services and consider adjusting their approach to truly strive to reach the end goal. Having said this, I have been considering ways in which to make this possible. How can MFIs stray away from the influence of our global culture of consumerism that Sklair discusses in his theory and realize their goals through more sustainable and socially responsible means?

Srikant M Datar et. al., who writes for *Stanford Social Innovation*, argues that there needs to be a shift in focus from an “institution-centered approach” to a “client-centered approach” on microfinance. In doing so, the loan recipients will be recentralized as the MFI’s primary area of focus and concentration.

The theory of institution-centered MFIs revolves around the idea that,

Building financial institutions for poor clients will eventually help lift these clients out of poverty. In keeping with this theory of change, institution centered MFIs aim to serve as many clients as possible by offering a few basic, high-quality, low-cost services. They assume that their clients will be able to use these services to improve their businesses and, in turn, their socioeconomic standing. And like banks, they track financial outcomes such as loan repayment rates, loan sizes, and number of clients (Datar).

Client-centered institutions on the other hand focus more on the clients’ socioeconomic well-being. They realize that alleviating poverty does not just entail provision of credit and financial services, but must consider a more holistic approach as I mentioned earlier, that offers training and education in personal finances, management and social services. There should be a specific system that tracks progress in poverty alleviation, concentrating on the clients as a whole person rather than just a businessperson.

“Indeed, MFIs routinely report repayment rates of over 95 percent” (Datar), but this does not translate as all of their social and economic needs are being met. Just because these clients are repaying their loans, does not mean they are necessarily successful in their business endeavors, thus, allowing them to climb the socioeconomic ladder. A true understanding of finances would better allow clients to meet their business as well as personal needs. Unfortunately, many MFIs do not focus their efforts on this necessity, disadvantaging many of their clients who are financially illiterate and unknowingly make poor choices with the newfound *freedom* they feel they have. There are however,

exceptions. “In Peru, the Foundation for International Community Assistance (FINCA), teaches its clients how to identify their customers, market their products and perform basic accounting” (Datar). The article sites other organizations that offer enterprise-specific training, focus efforts on health and happiness of clients and provision of value chain support, however, this is sadly a practice that is far and few in between.

Another area where institution-centered MFIs are lacking is in considering clients’ individual needs before a loan is provided. Realizing personal economic situations is of primary importance for determining a repayment timeframe, assessing what additional services need to be provided along with the loan to achieve the best, most profitable outcome for the client and making note of the bottom line to track progress and measure whether the loan is actually helping to raise clients out of poverty.

In this section, I am not necessarily suggesting that large MFIs reduce to non-profits, but rather consider a reevaluation of priorities and mission. Microfinance clients have the same basic needs as the rest of the world, so “if MFIs are serious about alleviating poverty, they must provide more training, support and products tailored to poor clients” (Datar).

### **Measuring Impact**

Going off of my last section, I would like to touch on the idea of measuring MFI impact on clients. At present, there is little agreement about a system capable of accurately measuring impact and change. This lack of common understanding makes determining the success of microfinance institutions in the developing world quite difficult. In Chapter 6 of his book, *Due Diligence*, David Roodman discusses development as an escape from poverty and delves into the different ways the industry has attempted to study impacts. He says, making accurate generalization about the microfinance industry is so hard because there

are many drastically different stories out there. To make sense of this complexity, he believes,

“Measuring *average* effects of microfinance must take three difficult analytical steps.

1. The details of people’s lives must be observed.
2. Researchers must estimate the counterfactual, what the lives of microfinance users would have been like without the microfinance.
3. Since the complexity of the effects- different for each person- would exceed the grasp of the human mind, they must be distilled to a more manageable, yet ideally representative, set of stories and statistics” (143).

However, this has proven more easily said than done. I understand situational variability to be extremely difficult to measure and my reading of Roodman proved me to be absolutely correct as it turns out.

The ambiguity about average impact arises in part from an opaque mixture of four factors:

- Different people use microfinance different ways.
- Even people who use it in the same way can experience different outcomes.
- Families, villages, and neighborhoods are complex webs of casual relationships, which are hard to disentangle.
- Average effects depend as much on the ability of microfinance institutions to *select* those most likely to use finance well as it does on the potential effects of each user.
- 

From this chapter, I believe that detecting strong averages through randomized analysis is perhaps the strongest way MFIs have to measure overall impact. But perhaps, hearing firsthand from microfinance clients is the more honest and insightful way of drawing conclusions? Regardless of the answer, I believe coming to a common understanding of measuring benefits among the global microfinance industry would be entirely beneficial in revealing the average harm or benefit the provision of microfinance has/is having on the developing world.

## **Final Thoughts**

### Conclusions

From my extensive research, my confidence in the microfinance industry has been put through the wringer numerous times. Living in our globalizing world, it is easy to understand that an industry with such a wide reach and mission would have flaws, but not quite as easy to realize modifications that could be made to override this inconsistency. I believe, first and foremost, that acknowledging the importance of the clients and poverty alleviation is central to reexamining the industry. Taking a more holistic, client-centered approach could possibly improve the success of the industry as a whole. However, this cannot be done without the help of other actors. Creating an enabling environment is an objective government and financial organizations should realize as beneficial not only to the clients, but for the well-being of a region or state as a whole. As it stands, microfinance has undeniably had a positive influence on the lives of many individuals, but because of the many external factors that impose their influence, whole regions or communities have not received quite the same benefits.

In saying this, I question myself because there is an obvious absence of a proven system to measure impact. So perhaps, larger groups of people have benefited from microfinance, but as it stands we have no way of knowing for sure. Agreement of the economic, political and cultural realms is vital to the success of microfinance in the developing world. I believe the industry holds great potential, given that we can create this ideal balance and support network.

### Limitations

It is no secret I am not an expert in microfinance. My background in economics is severely lacking, making understanding the subject matter a bit more difficult than I initially perceived. Also, because it is such a popular topic of discussion and contention in

development literature, addressing all aspects of the industry was beyond my capabilities. However, given my timeframe and resources, I believe I did an adequate job at capturing the essence of the microfinance industry.

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