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Microcredit in Developing Countries: Evaluating Programs for Poverty Alleviation

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MICROCREDIT IN DEVELOPING COUNTRIES:

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Purpose

There is no question that poverty is a devastating problem in our world today; the UN estimates 34,000 children and 16,000 adults die each day from hunger or preventable diseases with poverty-related causes, totaling more than 18 million a year (Riddell, 2007). One way that poverty is exacerbated is through the inaccessibility of credit to the poor (Todaro, 2006). Microcredit/microfinance has become a popular way of addressing this problem, and this affects a great percentage of the world population that is impoverished. Therefore, a true evaluation of the benefits and downfalls of this economic tool should be addressed. The purpose of this thesis is to determine if microcredit/microfinance programs in developing countries are truly helping those living in poverty, and how these programs can achieve the main goal behind the concept. A specific case of microcredit programs in Nicaragua will serve as an illustration of the focus of this thesis. Finally, the implications of the findings will be discussed and suggestions for future projects will be offered.

"Poverty" in this paper will be viewed in terms of the concepts of the "poverty line" and "absolute poverty." Absolute poverty is defined as, "A situation where a population or section of a population is, at most, able to meet only its bare subsistence essentials of food, clothing, and shelter to maintain minimum levels of living" (Todaro, 2006, p. 805). The poverty line is defined as any person with a daily income at or below $1 purchasing power parity (PPP). PPP means that the figure has been adjusted to be comparable across different countries and currencies; for example, what can be bought for $1 in the United States can also be bought for the same amount in China. People living with incomes below this level of $1 PPP are considered to be living in absolute poverty. These measures will illustrate the pure economic view of poverty, but a broader concept of poverty including diminished capabilities will be discussed.

Literature Review

Overview

The Microcredit Summit Campaign of Washington, D.C., defines microcredit organizations as "programmes that extend small loans to very poor people for self-employment projects that generate income, allowing them to care for themselves and their families" (Norwood, 2005, p. 2). The basic objective is to give people in poverty a grassroots opportunity to help themselves. Support of microfinance has increased greatly as many developmental organizations have embraced it as useful poverty reduction tool. In September 2000, the Millennium Goals were set for improving human welfare, the first listed objective being to halve the amount of people living under the international poverty line. This objective includes a provision of funding for microfinance to alleviate poverty. The Millennium Goals have come from a consensus between many world leaders and international developmental organizations.

Microfinance institutions require a different framework than the commercial-lending counterparts because of the staggering differences of the consumer-base, and this is a large consumer base to cover. Even though thousands of microfinance institutions are serving millions of clients, Robinson (2001) states that about 90% of the people in developing countries still have no access to financial services from an institution.

Many institutions have learned from one of the first and most well known micro-creditors, Mohammad Yunus. Yunus started by lending only $27 to 42 women in his village in Bangladesh, and later established the Grameen Bank in 1983. The Grameen framework has since been extensively studied, in part because it has boasted success with repayment rates that have "never dropped below 90%" (Develtere & Huybrechts, 2005, p. 168). The success and repayment rates of Grameen are impressive, but will be evaluated further in later sections.

In 2006, Yunus and his bank were awarded the Nobel Peace Prize for the efforts to create economic and social development. The Grameen Bank set an example showing that the poor can be credible in the financial sector and has since spurred many microcredit institutions to be started around the world. There are now an estimated 10,000 microfinance institutions serving over 113 million clients (Ming-Yee, 2007).

Microfinance organizations are not are not all like Grameen, and are not all based on solely one model of operation. Microfinance initiatives have been set up in many different types of organizations such as non-profits, corporations, governmental, and non-governmental organizations (NGOs). Microfinance institutions have a multitude of differing frameworks, but some commonalities will now be discussed.

Microfinance institutions typically issue the loans to women because this practice has shown to be successful in many cases around the world. A study by Reinke has shown women to be more conscientious in their payments (Reinke, 1998). One example is an Indonesian case study which shows that making credit available to women increases repayment rates, reduces the costs of delivery, and improves the well-being of poor families (Panjaitan-Drioadisuryo & Cloud, 1999). It is believed that women are better at making repayments because they will be more motivated to ensure the well-being of their family by continuing to receive the loan funds. Also, male alcohol abuse is a problem in many countries. It was discussed in Nicaragua that male alcoholism is problematic, and giving the loans to women helps with the proper use of the loan instead of it going towards alcohol consumption. The loans are also typically given to women because females and children are more likely to be in poverty than adult males (Todaro, 2006).

Another common characteristic of many institutions is that the loans are issued to a group of people. This serves several purposes, an important one being that the group is a source of collateral. The peer selection of members and peer accountability of repayment serves as a form of social collateral where there is no material or monetary collateral. Also, working with groups allows access to help in time of need. The groups in the Grameen Bank have been known to help cover loan payments for their peers when needed, which reduces default on payments (Yunus, 2003). Forming groups also brings down the cost of issuing loans individually (Mwenda & Muuka, 2004). There is reason to believe for these combined reasons, group lending is a beneficial way to issue loans to the poor. A study in Bolivia found that group lenders reached the poorest better than the individual lenders (Navajas, Schreiner, Meyer & Gonzalez-Vega, 2000).

Microfinance organizations also tend to require smaller, more frequent payments from its clients. This is usually true of business loans in the urban areas. If it is an agricultural loan, it is more likely that the loan amount will be due at the time of harvest because the client would more likely be able to pay at that time.

One last commonality to be discussed is that microcredit loans will have higher interest rates than commercial loans. The interest rates will range according to the type of organization, how it is set up, the makeup of its clients, the location, etc. The main justification for the higher rates is that making many small loans is more costly than to issue a smaller amount of larger loans. This is especially true when there is a lot of training and administrative support involved for each client.

To serve as an example of an organization, the Grameen Bank issues most of its loans to poor, landless women that form groups of five. They go through seven days of training and have an individual oral test at the end. The loans are usually for one year at 20% interest, with 2% weekly installments paid for 50 weeks (Yunus, 2003).

Methodology

This analysis of microcredit was conducted through an extensive literature review of microcredit programs. As well as gaining information from literary research, the United Nations Capital Development Fund (UNCDF) Microfinance Distance Learning Course was taken. This includes eleven interactive modules which cover microfinance programs from the perspective of the United Nations.

Additionally, a trip to Nicaragua in May expanded my research in microcredit. I had the opportunity to visit Prestanic, a microfinance organization located in Managua (with branches throughout Nicaragua). I also spoke with a former employee of the Local Development Fund, and received information from him about this organization as well as many other microfinance organizations located in Nicaragua. The experience of traveling to the country has provided me with first-hand observations of the benefits and problems associated with the microcredit programs, as well as other developmental efforts in Nicaragua.

Anticipated Results

It was expected that research would show that the implementation of microcredit institutions has helped the majority of people involved come out of poverty because they now have access to credit. It was also anticipated that the poor will gain the most from combined efforts in economic development and human issues, such health and education, in addition to having access to credit.

Microcredit Debate

Although many cases show how microfinance has helped people involved in micro-loan programs, there have also been many examples of how it has had detrimental effects. This has created a debate over the claims of microfinance's ability to help the poor, and how the programs should be carried out. For this reason, the debated issues of program characteristics as well as the results will be discussed. The topics relating to the results of programs are poverty alleviation, health, education, women's empowerment, repayment rates, child labor, and transitional poverty. The topics to be discussed relating to aspects of the microcredit programs include subsidization, group or individual lending, reaching the poorest, and non-credit program aspects.

Before proceeding, it should be stated that throughout much of the research, it has been established that microcredit programs are not the absolute solution to eradicating poverty (Lucarelli, 2005; Gibbons, 2002; Navajas, Schreiner, Meyer, Gonzalez-Vega, & Rodriguez-Meza, 1998; Yee, 2007; Lashley, 2008; Matin, Hulme, Rutherford, 2002). This is but one tool that can be used with the goal of helping to alleviate poverty. With so much money being allocated to microfinance programs, there must be evidence found for its redeeming value.

Results of Microcredit – Poverty Alleviation

The first debated topic is the ability of microcredit to bring people out of poverty by giving them access to credit. Impoverished people are unable to access credit in commercial markets because they lack monetary forms of collateral, and the cost of issuing microloans is typically higher because by nature the loans are smaller, but still require about the same amount of work as issuing a large loan. Pretes (2002) also states major reasons the poor cannot access credit, including a lack of investment capital in developing countries, living too far away from a bank, and the inability to take the risk of repaying the loan if the microenterprise fails.

Impoverished people have been known to rely on other sources for funds due to their inability to receive credit in the commercial markets. This would include receiving money from family and friends, or going to moneylenders for access to credit. However, money from family and friends is not always accessible because they may be in the same impoverished state, or simply unwilling to loan their money. Another option is going to moneylenders who typically charge a very high interest rate for funds, sometimes charging 20% *per day* (Pretes, 2002; Yunus, 2003). In contrast, institutions like Grameen charge around that rate of interest *per year*. Microfinance institutions have helped fill the demand for credit among low income individuals while reducing the impact of informal moneylenders' ability to capitalize on their economic situation.

Results of Microcredit – Health

Studies have shown a correlation between higher incomes and the level of health (Ecob & Smith, 1999; Fiscella & Franks, 2000). This is no different for many women who participate in microcredit programs and increase the level of their incomes. A study by Wagstaff, Bustreo, Bryce, and Claeson (2004) states that the increase in children's' health is not only effected by the household's total income, but also by the level of control that a woman has over the use of the money. If many of the women that are involved in microcredit programs are empowered, and maintain control of the loan funds they possess, this would therefore show an increase in the level of their families' health, as well as their own.

Chris Schrage, a professor at the University of Northern Iowa, conducted a case study on a women's microcredit project in Ghana which found improvements in health as well as other increases in the participant's standard of living (Schrage, 2004). The participants were able to improve their diet with the increase in income and higher production levels possible because of the micro-loans.

Some programs include health provisions within the microfinance program because, after all, a person will be less productive if they are not healthy. It is in the microfinance institution's interest to keep the participants in good health in order for them to pay back their loans. For example, the Women's World Bank in Argentina has a deal with health-care companies and pays US $1.70 for each client, which means that the members of the bank pay a third of what it would otherwise cost to visit the doctor (Lashley, 2008).

Whether the program includes health insurance or not, there is evidence that people's health can be improved with microcredit. Although, microcredit programs are not seen as the solution to health issues in themselves, but rather are complimentary to health programs (Mohindra & Haddad, 2005; Mohindra, Haddad, Narayana, 2008).

Results of Microcredit – Education

Microcredit has also been correlated with increased participation in education (Besley & Burgess, 2003). Investing in human capital is an important aspect of economic development. Families that once could not afford to send their children to school are now able to do so because people in poverty have access to credit. A study in Cairo showed a relationship between access to credit and the increase of schooling of both boys and girls (Nader, 2007). The fact that the study shows increases in both boys *and* girls is substantial, and it is possible that the increase in education could serve as an additional source of women's empowerment for the next generations. Women's empowerment related to microcredit will be more fully discussed in the subsequent section. The increase in education among the poor is especially beneficial to developing nations because studies have shown that each additional year in schooling is associated with a 6-10% increase in earnings (Besley & Burgess, 2003). Much like the study of microfinance, the expansion of education must also be and implemented evaluated appropriately to achieve the objective.

Results of Microcredit – Women's Empowerment

The topic of women's empowerment has become important because many microfinance organizations focus on women, and claim that women's empowerment is one of the main benefits of being involved in the programs. It is important to note that many microfinance organizations are funded by developed western nations which have had women's movements and live with an expanded set of rights for women. Evan Selinger brings up the question if "empowerment" is a Western ideal being chauvinistically applied to other cultures (2008). The importance of empowerment as a result of microcredit may be more highly valued by those from developed nations.

Some research shows that microcredit has had a positive effect on the empowerment of women (Mwenda & Muuka, 2004; Sims, 2006; Koenig et al., 2003). Women's access to loans gives them the opportunity to gain social relationships in the community, especially when working in groups. Their interaction in the community has been seen to have a positive effect on the empowerment of women (Schuler, Hashemi, & Badal, 1998).

The women's gained relationships also relate to reduction in violence to women (Kabeer, 2000). Research has shown that violence against women decreased when they were either involved in a microcredit program or simply living in a community where credit is available to women working in groups (Schuler, Hashemi, Riley & Akhter, 1996).

Some programs require participants to be educated or trained in certain areas, be able to sign their name, and of course, carry out the business venture to pay the loan back. These activities also help empower women participating in microcredit programs. Some women have never had the opportunity to be educated in writing their own name. This is illustrated in a video about the Grameen Bank when an aging woman is shown how to write her name for the first time and she continues to practice writing with a small stick in the dirt on the ground. Once she can write her name on her own, one can see that she is proud of her accomplishment (Aardenburg, 1997). It is instances like these that give rise to women's empowerment being commonly noted as a positive externality of such micro-lending programs.

In some cases, involvement in microcredit programs actually increased the level of domestic violence. A study by Rahman (1999) shows that 70% of women in savings and credit groups reported an increase in violence from the time they became members. The increase in violence could be due to a variety of reasons such as being unable to get new loans, being unable to make payments, the woman's reluctance to give up control of the loan to her husband, or the disruption of domestic responsibilities. The fact that men can take control of loans women acquire shows that the empowering aspect of microcredit programs can be taken away quite easily depending on relationships in the household.

Therefore, in reality the women involved in microcredit programs have both empowering and disempowering experiences (Selinger, 2008). The idea of empowerment is not easily defined or quantified, and the use of this idea to support the proliferation of microcredit programs may be overstating the true effect on women.

Results of Microcredit - High Repayment Rates

High repayment rates are often cited as a success factor in many microfinance organizations. This does for the most part show that the poor are credible applicants for credit, but a closer look at repayment rates shows they are not a definite indicator of success. Repayment rates have nothing to do with the notion that the poor are becoming more well off, or if they are graduating to higher levels of commercial credit. They only show that people are finding some way to get the money paid back on time, regardless of their well-being or investments for the future. As stated before, in some cases peer pressure in group lending schemes have forced clients to take out other loans to pay the original loan, so the repayment rate might not even reflect the client's ability to pay.

Morduch (1999) demonstrated how Grameen's reported repayment rates were not reflecting the true rates. Grameen stated repayment rates around 98% until 1995, but after his recalculation he found the actual rates were around 92-95% between 1985 and 1994, with a slight downward trend. These are still high rates, but the small difference in default rates can make a big difference in the financial sustainability of the organization. It is not only a problem with repayment rates; studies have argued that some organizations have stretched their accounting data to make it seem to be doing better than what reality would truly suggest. (Morduch, 1999; Morduch 2000). The microfinance organizations that are now spread around the world are not required to report with the same accounting practices, so the differences in reporting structures will make a difference in the appearance of their business success.

Results of Microcredit – Child Labor

A study that came out this year shows evidence that, "in the season of peak labor demand, household access to microcredit, measured as self-assessed credit limits at microcredit organizations, raises the probability of child work in households with average landholdings and retail sales enterprises" (Hazarika & Sarangi, 2008, p. 843). In short, microcredit is correlated in some circumstances with an increase in child labor.

However, some developmental organizations such as the World Bank believe that child labor is caused by poverty, so alleviating poverty also has effects on reducing child labor (Todaro, 2006). In this sense, microcredit can decrease the levels of child labor when the incomes of the parent participants in the microfinance programs are increased.

Income shocks are significantly related to increases in child labor, and access to credit helps mitigate these shocks (Beegle, Dehejia, & Gatti, 2003). Income shocks can arise from natural disasters, health issues with family members, etc. Microcredit can help smooth income and give parents the ability to continually pay for their children's needs, such as their education. This is further evidence that child labor can be decreased with participation in microcredit programs.

Results of Microcredit – Transitional Poverty

When people are living in poverty for extended periods of time, it is likely that they will pass on the poverty burden to any children they might have. Microcredit can help break this cycle. Microcredit can help those that are in poverty today as well as decrease the prevalence of poverty in the future.

Cultural attitudes and parenting have been shown to have an effect on the next generational economic outcomes. Behaviors of parents will likely produce similar behaviors in their children (Beinhocker, 2006). If more families have access to credit, one can see how the opportunity of parents to participate in productive economic activities will have a positive effect on the small entrepreneur's children. The children can learn a trade or some kind of economic activity instead of learning how to live at subsistence or beg.

Results of Microcredit – Continued Subsistence

An argument against microfinance is the fact that some borrowers continue to live at subsistence levels, using loans for consumption purposes instead of growing their microenterprises (Halder & Mosley, 2004). Growing a business requires taking some risk, and given the alternatives, the poor will be somewhat risk averse as to not worsen their situation. Also, it may be difficult to get out of the state of microcredit dependency to the point that clients no longer have to use the loans for consumption purposes. The continuance of using loan funds for consumption leaves the client in a state of cyclical dependence on the loan money if they do not have other sources of income.

Program Aspects - Subsidization

There are certain benefits as well as drawbacks associated with subsidization. Although microcredit institutions like Grameen have seen success, there have also been downfalls or possible overstatements of their success. The fact that Grameen has been continually subsidized, and has reports that mask true repayment rates and problem loans, obscures the true value of Grameen's success (Morduch, 1999). Grameen is by no means the only micro-lending institution to be subsidized; it is well recognized that many microfinance organizations today rely on subsidies or donations (Abbink, Irlenbusch, Renner, 2006). In fact, Robinson (2001) states that 80-90% of all microcredit institutions that exist today will not be able to become self-sufficient. Mourduch (2000) cites this figure to be more around 95%. This is no doubt a large percentage, and with so many microfinance institutions in existence today, that percentage represents a large absolute number. Another factor is that there are continually more microfinance institutions entering the market, which creates more competition for the same donations and subsidies (assuming the starting organizations are competing for start-up capital, which is very likely).

The United Nations Capital Development Fund (UNCDF) course on microfinance sheds light on how it (as well as many other developmental institutions) believes microfinance organizations should be set up in order to maintain the best offering of services. It is preferred an institution covers its own operating costs without being subsidized so it does not have to be reliant on grants and other sources of external financial support in order to continue doing business. Subsidization is justified with the argument that the continued services are preferred over an unstable future of the company and its services. People need the continued access to credit, and are willing to pay slightly more for that security. Although, there is the argument that subsidized organizations may be able to provide their customers with lower interest rates on their loans, and when you are dealing with people already in poverty, every penny counts. As of right now, Grameen has stated that it will not request donor funds and will not take loans from external sources because it is able to operate with its increasing deposits (*Grameen,* 2008). Morduch stated in 1999 that a switch to full cost-recovery at Grameen could gain an even greater social benefit, so this change could prove to be beneficial to both Grameen and its clients.

Self-sufficiency seems to have a general consensus in research and in some developmental organizations such as the UN, World Bank, and CGAP, but it is of course not a complete consensus, and the subject continues to be debated. Some find that a while a large amount of subsidization is not preferred for an institution, partial subsidization can be justified (Todaro, 2006; Morduch, 2000; Dunford, 2000). This is to ensure the social benefits of programs without putting too much emphasis of success on the profitability of the organization.

In recent years the World Bank alone has funded over a billion dollars to NGO microfinance programs while USAID, the UN, and other institutions have also given much toward micro-loan fund (Hiat & Woodworth, 2006). The level of funding might change due to criticisms of microfinance NGOs. The American Enterprise Institute (AEI) has partnered with the Federalist Society to create "NGO Watch," a new institution to monitor international NGOs (Hiat & Woodworth, 2006). Many leaders in NGOs are critical of larger governmental development organizations because of inefficiencies and overhead costs among other reasons. This was apparent in Mohammad Yunus' book, *Banker to the Poor,* and this serves as just one example of one NGO (Yunus, 2003).

There are several reasons why self-sustained institutions may have more impact than subsidized institutions. Mosely and Hulme (1998) make three points, first being that self sustained organizations charge higher interest rates which screens out borrowers with projects that have low returns. Second, they tend to have savings elements included in the program that give some security in repayments. This is an important factor because savings facilities are often more highly demanded by the poor than credit services (Robinson, 2001). Third, they usually collect loan installments frequently, and close to the home of the borrower. This is also important because of the fact that many of the poorest live in rural areas where it would be difficult to travel to make payments.

Program Aspects – Group/Individual Lending

Group lending schemes have been used as a source of collateral in peer selection and accountability. If a person in the group cannot make the payment, others will usually cover for the payment if possible. For these and other reasons, there have been studies that show group lending performs better than individual lending (Abbink, et al., 2006). For example, the study states that a group model is a way to minimize risk. As long as the members' risks are not perfectly correlated, the risk taken on by the individuals will be lowered. To illustrate this, think about a group of people that have different enterprises in the same loan group. If one project fails and the person is unable to pay, another may be able to cover the payment.

While the group model can be beneficial, it can also have downsides for the client. What is called peer accountability in regular payments can turn to a bad case of peer pressure if clients are forced to take out expensive loans from moneylenders in order to pay their part of the group loan (Selinger, 2008). This will only make it more difficult for the client to pay future payments now that they are taking on another loan with much higher interest. This can become even more difficult for women that obtain loans but do not maintain control over them. The women would be taking the burden and pressures of repayment without having control over how it is repaid. It can also be problematic if the group tends to be more forgiving of loan payments. They will pay the defaulter's part of the loan, which creates an incentive to free ride (Abbink et. al., 2006).

Some organizations prefer larger groups, and some prefer smaller groups. Grameen has done tests on the group size at its organization, and found the most productive to be a group of five people (Yunus, 2003). Grameen has smaller groups to reduce the likelihood of free-riding and to help with coordination within the group (Abbink, et. al. 2006).

A certain case near Cape Town, Africa has shown that micro-loans to individuals can be just as profitable as group lending schemes. This case was done by using a bank as an intermediary for payments and disbursements, having access to information systems resources, and relying on self selection of its clients (Reinke, 1998). The argument of the case was that lending that is uncollateralized, impersonal, and without enforcement is financially sustainable (Reinke, 1998). The problem with this study is that many places that need access to credit are in rural areas and would also not have access to sources of information systems and banks close enough to use and an intermediary. The case in Cape Town would work well for the situation it was in, but it is not entirely practical for many frameworks.

Program Aspects - Reaching the Poorest

Helping people work their way out of poverty is a goal of microcredit, but this does not always include the "poorest of the poor." Mosley and Hulme (1998) speak of a tradeoff that microfinance organizations have to address. Lenders can either focus on the poorest and have less of an impact on household income, or instead focus on those relatively less poor to have more impact. Ghosh (2006) states that microcredit may only redistribute incomes of the relatively poor, instead of actually increasing the incomes of the poor (as cited in Selinger, 2008).

It is true that some institutions do in fact target the poorest of the poor, such as BRAC and Grameen (Evans, Adams, & Muhammad, 1999). However, some studies show that microcredit does not always reach the poorest (Legavini, 2003; Lucarelli, 2005; Pretes, 2002; Ming-Yee, 2007; Hulme & Mosley, 1996). There are institutions that intend to be this way and target those just below or above the poverty line. Robinson (2001) suggests that microfinance organizations target this group of people because people living below the poverty line need programs for food, water, sanitation, medicine, and employment more than access to credit. Money that would be spent on microcredit programs could be better used for the basic needs of the poorest of the poor. The CGAP and many other development organizations also suggest targeting the "active poor" instead of the extreme poor for the same reasons. Additional research has shown that microcredit is not the best option for the poorest (sometimes worsening their situation) and other options would be more beneficial, such as microequity, education, infrastructural measures, and basic needs like access to clean water and food (Pretes, 2002; Navajas et al., 2000; Buckley, 1997; Mosley, 2001). Access to clean water is especially important because of the amount of people that actually die because of the lack of this essential human need. UNICEF cites that about 4,500 children die *each day* from unsafe water and lack of basic sanitation facilities (*Water,* 2008). Our host in Nicaragua, Angela Kuang, was lucky to have (intermittent) access to water at her farm in the rural community of Siares, even though the water was not clean. A test was done on a water sample that would stay clear if there were low amounts of bacteria, and it would turn dark if the level was high. The sample turned black. There is something to be said for the amount of tolerance the local people have built up in their immune systems for this level of bacteria, but certainly there should be measures taken for more clean water sources.

Non-credit Program Aspects

Non-credit program aspects include but are not limited to education, vocational training, information on health, civil responsibilities, and rights, and sharing and monitoring information among members (McKernan, 2002). While non-credit aspects are difficult to measure and value, it was concluded in a study by Signe-Mary McKernan (2002) that non-credit aspects make a difference in the microcredit programs' success.

Many institutions have educational or training requirements before a client can receive a loan. The amount of requirements important, as too little or too much becomes inefficient to both the client and the microfinance business. Too little could cause a default on the loan because of the client's needed knowledge to complete their economic task. On the other hand, too much would cause an inefficiency of resources and would not add value to the client. Also, too many requirements can deter some people from trying to obtain a loan (Yunus, 2003). They may have low self efficacy in being able to complete the training, or they may be unsure they can invest time or money into the training.

Health care and insurance packages have been introduced with some microcredit programs in order to benefit both the client and the organization. The microcredit organizations that include health provisions believe that this will help with repayments because clients will be more able to repay if they are well and able to be productive. A microfinance institution in Kenya stated that many of its clients were falling behind on their payments and found that a great majority of them were using the money to pay health cost of a family member rather than repaying the loan. The Kenyan organization now provides health care to its clients (Lashley, 2008). This case in Kenya follows with other research showing that ill-health leads to further impoverishment, and decreases the chances of people to improve their economic situation (as cited in Mohindra & Haddad, 2005).

In contrast to this thought, a study done in Uganda found that insuring against health expenditure risk had no effect on repayment rates. This is somewhat surprising due to the prevalence of disease in Uganda, and the author cites this as a reason to believe that health shocks can therefore not be a large determinant of microfinance delinquency (McIntosh, 2008). There may be other factors involved, such as how the clients are covered and if the health care provisions can help them with whatever illnesses they might have. They also may not have access to health care services close enough because as stated before, many of the poor live in rural areas.

Another example of a non-credit program aspect is the Grameen Bank's "16 decisions," which are 16 simple statements for the participants to improve their lifestyle. These include boiling water before drinking it, planting and eating plenty of vegetables, keeping children and the environment clean, as well as not giving or collecting a dowry (Yunus, 2003). The dowry decision may seem peculiar at first. However, studies from India indicate that the level of dowry plays a large part in both leading to and protecting from domestic violence (as cited in Koenig, Ahmed, Hossain, & Mozumder, 2003). Eliminating the dowry could remove it from being an issue in relation to violence.

Nicaragua: A Case Study

Nicaragua will serve as a specific case in this paper to illustrate the effects of microcredit on the poor. Nicaragua is one of the poorest nations in the world, with almost half of the population living on less than $1 PPP a day, and about 80 percent living on less than $2 PPP a day, according to the United Nation's 2007/2008 Human Development Report (*Nicaragua: Human Development*, 2008). With such a great portion of the population living in conditions of poverty, it is no question that this is an important issue to be dealt with in the country. Even though statistics show the economic conditions of this country, it is all the more apparent when you are actually in the environment. Muhammad Yunus, the founder of the Grameen Bank, said in best in that, "When you hold the world in your palm and inspect it only from a bird's eye view, you tend to become arrogant – you do not realize that things get blurred when seen from an enormous distance" (Yunus, 2003, p. ix).

Nicaragua included many provisions of microfinance in its National Development Plan This included plans to "expand access [of financial services] to small, medium, and low-income groups," with the sources of financing coming from the World Bank and the Netherlands (National, 2005, p.101). See Figure 1 for a full list of Nicaragua's financial plan highlights. The fact that the government has implemented microcredit into its national development plan is significant and shows how important the economic tool is becoming.

Microfinance is used broadly in Nicaragua. Microcredit was previously defined as small loans to very poor people, but microfinance is generally used as a term referring to loans that are issued to people in an amount anywhere below the level of commercial loans. Because microfinance is offered to more than the very poor, sometimes borrowers do have sources of collateral, and the organizations will sometimes require it. After doing a semester of research on microfinance, I was taken aback by this simple fact because uncollateralized loans seem to be one of the main characteristics of microfinance.

Using land as collateral can become tricky in Nicaragua. During the Sandinista movement, there was a widespread land reform that redistributed large amounts of land from the few rich landowners. Since then, the land has gone back to the rich. This all makes the reporting of ownership of land a complicated issue, and it is difficult to use as collateral even if a client technically owns the land. Our group visited a sewing cooperative that was fully established in a fair trade zone, and had documentation for the land the building is on. Even so, they are currently in a lawsuit over the land because someone else appeared with their own documentation for the land, each title seemingly legitimate as the next. The issue with land collateral is in keeping with a study by Pretes (2002) which states that using land as collateral does not always work in developing countries because of "ambiguous or unrecorded" titles (p. 1342).

Amarta Sen, known for his work in the field of economic development, recognized the need to see poverty as a "deprivation of basic capabilities" rather than only measuring it by the level of income (qtd. in Robinson, 2001). The UN's Human Poverty Index (HPI) includes developmental aspects that go beyond the measure of pure income. The measurement compiles four different aspects: the probability of not surviving past age 40, the adult literacy rate, people without access to an improved water source, and children underweight for their age, ranging from 0-5. The 2004 HPI measurement for Nicaragua is rated at 17.9 as of 2004, and this is about the middle-range compared to other countries (*Nicaragua: Human Development*, 2008).

Efforts are being made in the human poverty elements in Nicaragua. For example, CEPAD has been improving water sources in the communities the organization works in, and the organization trains in water purification processes at its Cepana farm. Self-Help International, a non-profit organization located in Waverly, Iowa, is currently working on a two-year feeding project to reduce malnutrition in children ranging from 6 months to 5 years old. Self-Help International also has micro-credit programs set up in Nicaragua. The enterprises include poultry and pig-raising, bread baking, and Quality Protein Maize (QPM) production. QPM is the main product in the porridge made for the feeding project, so the organization is creating the demand for the QPM producers. This seems like a noble cause to help in two different areas, but there is the question of when the feeding project ends and if there will be less demand for the QPM production in the future.

Efforts have also been made in education in Nicaragua; one example that had a big impact in the country was the literacy campaign by the Sandinista movement in 1979. A professor at CEPAD stated that in five to six months, the percentage of illiteracy was greatly reduced, from 62% to 12% (personal communication, May 14, 2008). Even so, illiteracy remains a challenge for both the people and microfinance organizations in Nicaragua, with one institution citing that 44% of its clients are illiterate, and only 7% make it to the high school education level (personal communication, May 22, 2008). The fact that microcredit programs are linked to increased participation in education is beneficial to Nicaragua. Increased participation in microcredit programs could possibly have an effect on the educational efforts and literacy rates in Nicaragua.

A study by Arianna Legovini (2003) found that while microcredit is good for the economy as a whole in Nicaragua, it is not the most beneficial for the "poorest of the poor." In addition, Hulme (2000) stated that microdebt may not be beneficial for poor people doing activities with low-returns in saturated markets, and where there are many environmental and economic shocks. One can see that many people in Nicaragua are in this kind of situation because of the high unemployment and underemployment rates. Many people have to work in the informal sector, and seeing the products that are available in the various markets shed light on some of the micro-entrepreneurs. Many produce and sell homogenous products which make for saturated markets and a difficult environment to compete in. To serve as an example, there were an infinite number of hammocks and suppliers of hammocks. The interesting thing was that many had the same kind of designs and colors that made them seem all the more similar. I looked at one vendor in the market and the salesperson lowered their price as other vendors tried to entice me to look at their own supply of hammocks. It was surprising to me that many did not take the opportunity to differentiate their products in order to separate themselves from the competition.

As was mentioned earlier, women's empowerment has been shown to be a positive outcome of some microcredit programs. Empowerment would be beneficial to Nicaragua's women, as you can especially see through another measurement compiled by the United Nations. This measurement is called the Gender-Development Index (GDI), and shows the degree of gender imbalance on the achievements in the country, relating to the Human Development Index (HDI). The HDI is much like the HPI in that it makes assessments on development relating to more than just pure income of the country. It is important to recognize the expanded views of development and poverty because one will see ratings in pure income measures will be different in many cases. For an illustration of this, see Figure 2, which is a graph from the UN's 2007/2008 Human Development Report.

Nicaragua's 2004 GDI value is 98.0% of its HDI value. Out of the 156 countries with both HDI and GDI values, 123 countries have a better ratio than Nicaragua's. (*Nicaragua: Human Development*, 2008). This shows that there is a high inequality between men and women's contribution to the country's development. Nicaragua would have much to benefit from the inclusion of women in the accomplishments of development in the country. It could be similar to the stimulation of the economy in the United States with the inclusion of women in the workforce. Many microcredit programs focus on women, and the creation of many enterprises owned by women could help with the inequality shown in the GDI figure for Nicaragua.

Many households are headed by women in Nicaragua because so many men have to move in order to find a job, sometimes to different countries. Underemployment is a problem in Nicaragua, with 5.6% unemployment plus 46.5% underemployment (*Nicaragua,* 2008, May 15). This does not include the informal sector, which is typically a large sector in LDCs, and this includes many of the microenterprises that are started with access to microcredit. Most enterprises started with microcredit are microenterprises in the informal sector, which gives people a grassroots solution to the problem of underemployment. They might not be able to find a job, but they can create one. And if that microenterprise is successful and grows, there may be the opportunity to create employment for others as well. An example of this was shown on a local news program from a reporter's trip to Nicaragua. Kimberly Hunt traveled with Opportunity International, a non-profit microfinance organization based in Illinois, to meet some of its clients. Zacharias Antonio Solis owned a small business that made tools out of metal, and was able to employ four other people in the community (*ABC News,* 2008).

While in Managua, I visited Prestanic, a Christian microfinance organization that originated in 1991 as a part of CEPAD (the Nicaraguan Council of Protestant Churches). It later branched off into an independent organization in 1997. The slogan of Prestanic is, "En el campo y la ciudad, Prestanic es la oportunidad." Translated in English this means, "In the village and the city, Prestanic is the opportunity." This follows with the notion that giving people access to credit gives them economic opportunities.

Prestanic has a double mission, consisting of a financial and a social mission. The organization wants to achieve its mission in an ethical and sustainable way. The company has checks for its social performance by creating social management indicators and the company is rated by third party organizations. The company is proving to be self-sustainable because it has been in business since 1991, and operates with basically no subsidies or donations. There is one exception in that it accepts one donation of US $6,000 every year from a Baptist church in the US, which is used for capital. Part of the reason that donations are not used is because Prestanic branched off of CEPAD, which does require the use of donated money. Prestanic does not want to compete for donated funds from CEPAD especially when it is fully capable of being self-sustainable. Also, as discussed before, self-sustainability is seen as a worthy goal of microfinance organizations.

At this time, Prestanic issues individual loans that are an average of US $1,100 for rural/agricultural loans, and an average of about US $500 for urban loans. On loans for the improvement of housing, the average is around US $800-1000. These averages are higher than some other organizations, and this is the level that the organization currently specializes in.

According to Armando Gutiérrez Navarro, the CEO of Prestanic, there are plans to implement group lending in the future (personal communication, May 22, 2008). This is different from its complete structure of individual loans that has remained that way since its inception in 1991. Navarro explained that group lending helps develop technical assistance, and it helps reach the poorest because people can access smaller individual loans. The interest rate will likely be the same or higher on these loans because of the higher cost than the larger individual loans that the company typically gives out. The higher cost will arise from the overhead to manage the larger amount of smaller loans, and also because Prestanic will require more training for rural group loans than the individual business loans (personal communication, May 22, 2008).

Prestanic is also flexible with the timing of payments and the amount of loans associating with the economic activity the borrower engages in to pay the loan. This is an efficient way of carrying out the business because while not everything is standardized, the loans will be more likely to be paid on time. For example, it does not make sense to give a loan to a coffee farmer and require a payment before the crop is harvested. The farmer would not be able to pay and would default on the loan.

Prestanic charges about 30% interest (yearly rate), which is similar to rates at other institutions. The 30% interest rate is the same as BRAC (Bangledesh Rural Advancement Committee), who targets the poorest (Mourduch, 1999). This figure was cited in 1999, so it is likely the interest rate has increased since then. The interest rate is also partly explained by the fact that it is a self-sufficient institution. Navarro went over the justification of the interest rate which included an explanation of higher costs of servicing more people than with commercial loans, as well as the need to cover the costs of sources of other funds that they need in order to give out more loans (personal communication, May 22, 2008). In other words, they need to charge a higher interest rate than they are being charged from other banks for funds.

I also had the opportunity to speak with Harold Blandon, an employee at CEPAD and a former employee of a local microfinance organization called Fondo de Desarrollo Local (Local Development Fund), which is also known by many of the locals as "banquito".

When questioned about the effectiveness of microfinance organizations in Nicaragua relating to poverty alleviation, Blandon stated that it is difficult to measure for several reasons. First, there are many institutions present in the country, especially located in cities, and the presence of multiple credit providers allows people to sometimes take more than one loan from more than one organization. Some people pay for one loan with another, much like some people's use of credit cards here in the US. For this reason, it is hard for an organization to track the progress of its clients. This observation follows with other research citing the difficulty of showing exactly how poverty is reduced with microcredit (as cited in Pretes, 2002). Also in that many poor people will use every service they can, and will use the different types of financial services for different things, such as school fees and business costs (Matin, Hulme, Rutherford, 2002).

On the topic of transitional poverty, it was stated before the behaviors of parents will likely produce similar behaviors in their children and will have an effect on the next generational economic outcomes (Beinhocker, 2006). In Nicaragua, some of the children had learned how to beg, especially in the city where there were more people. We were told by the CEPAD staff to not give money to beggars because they do not want to encourage begging and want to instead empower the people of Nicaragua to earn income in more productive ways. Some children learned how to make little figures out of leaves to try to sell to the tourists. I paid one of the children to teach me how to make a flower figure out of the leaf.

Another example of a parent's influence on their children could be seen in a family that our group stayed with in Siares. Maria is a mother, raising her children on her own, like many women in Nicaragua. She is a very loving and hard-working woman, and she has instilled the same qualities in her children. She is the director of the local school, and you can see that her children have acquired her teaching skills. I worked with her son, Gerald, in teaching him English, and at the end of the day I felt like I had learned more about Spanish from Gerald than I had taught him in English. Gerald voiced a lot of his dreams for the future, and I can see that he fully intends to accomplish them.

Implications

As one can see from the literature review, there are many issues that continue to be debated on the topic of microcredit/microfinance. The anticipated results of this project were to find that microfinance is in fact beneficial to the poor and that the benefits are increased by other developmental efforts in the community/country. In the case of health and education, studies have shown correlations with increases in both areas with participation in microcredit. Although in many other topics discussed, the benefits and downfalls of microfinance have turned out to be multifaceted and dependent on circumstantial factors, which has made it difficult to assess to what degree the programs have helped or hindered those in poverty. Instead of becoming disconcerted with the whole debate and conflicting studies, we can learn lessons from the different sides of the issues. Most importantly, microfinance institutions should leverage the discussed benefits while minimizing the downfalls of microfinance's ability to help the poor.

One of the widely debated issues is women's empowerment. If a goal is to actually help with empowerment, the loans could continue to be issued to women, but also have structures in place to ensure the control of the loan stays with the woman who received it. If violence is a problem, there could be avenues to report abuse and protect the women from further violence.

The topic of child labor also had conflicting studies showing that it increased in some cases and decreased in others. Microcredit programs could include provisions against child labor in the contract, and possibly include education requirements for children when a certain level of income is approached.

Continued subsistence was a problem for some microcredit clients. The poor will tend to be risk averse, so safety nets and other ways of hedging risk should be implemented. An example of decreasing risk in a group model is to have diverse activities within the group so that the risks are not correlated. Hedging risk will give incentives to take risks and grow their business instead of continuing to live at subsistence levels. This will also help with the poor's vulnerability to shocks (economic as well as natural disasters).

Some institutions will continue to be subsidized while others remain fully self-sufficient. When microfinance organizations start, they should look for sources of grants and other low cost financing. But the organizations should also have a clear plan for financial self-sustainability in the coming years. In the meantime, it seems that a good option for a majority of the organizations is to have a good balance between affordable interest rates for clients while receiving attainable subsidies and affordable funding from other commercial banks.

When dealing with group schemes in the organizations, there should be some kind of rules or protection against free-riding. A possible restriction could be that only a certain number of loan payments can be paid by others and the amount would have to be paid back by a certain time. There also should be provisions against extreme peer pressure so that people would not have to try to obtain other loans to pay the original loan. The microloan provider should be in contact with their clients when there is a default in order to find out why the default occurred, and how it can be fixed.

Another question raised was if microfinance organizations were reaching the poorest, and if they should be targeting that group in the first place. Different organizations will continue to specialize in different target groups and be involved in different markets (especially with increased competition). The organizations focusing on the poorest of the poor need to be especially sensitive to the needs of their clients and realize the situation they are in. This may require more safety nets or other services that will increase the well-being of their clients.

Outcomes from other projects can give significant insight to what can be done in the future. Many things can be learned from a study of several failed cases of microfinance, for example, "where credibility is unattainable, where given practices (such as using large groups) are at cross-purposes with local conditions (e.g., where there are marked class, status, and ethnic divisions), or where impartial individuals cannot be found to audit financial records, it is unlikely that a program will succeed (Woolcock, 1999, p. 11).

Especially in microcredit programs with work groups, relationships are crucial to the success of the program (Woolcock, 1999). Creating and maintaining the relationships between group members, as well as borrowers, staff, and others involved are important because the strength of these relationships "can influence whether appropriate borrowers are identified, whether loans are likely to be repaid, and in the event of impending default, whether a resolution can be negotiated" (Woolcock, 1999, p. 12).

It is important to address the lessons of the past while leaving room for creativity in creating better programs for the future. Hulme and Mosley (1996, p. 135) state, "Ironically, it is the success of the "first wave" finance-for-the-poor schemes, and particularly the Grameen Bank, that is the greatest obstacle to future experimentation. Most designers and sponsors of new initiatives have abandoned innovation, and "replication" is leading to a growing uniformity in financial interventions." For example, the Malawi Mudzi Fund failed to implement a successful program in a labor-rich and land-scarce environment in Africa.

It should also be noted that some feel there are a lack of studies that provide clear data that reflect the true situation for microcredit programs. Many articles on the subject of microfinance point out that certain studies lack structures that would lead to a true assessment (Morduch, 2000; Morduch 1999; Legovini, 2003; Lucarelli, 2005). This is in part due to the fact that primary motivations for studies were from specific institutions, and there would be a bias to demonstrate success. Other studies are characterized as having methodological problems, such as non-random and small sample sizes (Legovini, 2003). Because of this, studies must be investigated more than merely taking the information for face-value.

Other Options - Social Businesses

Mohammad Yunus has brought up another way for businesses to have a social impact. He discusses what he calls "social businesses" in his newest book, *Creating a World Without Poverty*. He believes that social businesses should require investors to take no dividends from the projects they invest in. Instead, the benefits go towards social benefit and toward the organization to invest for future social benefit. Investors can withdrawl from the investment, but leave the benefits for the project (Yunus, 2008).

This model relates to the framework of Kiva, an internet-based company to facilitate microcredit loans, because Kiva does not collect interest from lenders. Although, this could not be considered a pure "social business" because people who are taking loans still have to pay interest because the loan goes through the intermediary "partners" of Kiva – the microfinance institutions themselves. In the case of Kiva, the lending process is set up in a format that is reminiscent of child-sponsoring programs in that individual lenders can see pictures and information about the people they are lending to on the Kiva website, as well as periodic updates on status of the borrower. The money is taken from the individual "lenders", which are really donations. Money is then forwarded to Kiva's microfinance partners that actually lend and maintain the payback of the loan (*About,* 2008). The owners of Kiva originally had the objective of having interest paid to the lender, but because of legal regulations dealing with the international exchange, this was not possible. Although, there is still a future objective of charging interest (Flannery, 2007). As of right now, the company is set up as a 501(c)(3) non-profit organization, and people can give tax-deductable donations. Although the money received is interest-free, the borrowers still pay interest to the microfinance institutions for the loan they receive. The funds gained at Kiva give micro-lending institutions a source of more inexpensive capital.

Conclusion

The purpose of this thesis has been to determine if microcredit/microfinance programs in developing countries are truly helping those living in poverty, and how these programs can achieve the main goal behind the concept. Research in microcredit offers a multitude of sometimes conflicting answers to the dilemma. Even though the debate continues, we can see how microcredit has been both beneficial and detrimental, and we can learn how to develop programs that will live up to the goal of alleviating poverty. A specific case of Nicaragua was offered and served as an illustration for many of the concepts reviewed in this paper.

A commercial banker once told Mohammad Yunus, "You are an idealist, Professor. You live with books and theories." Half of the world's population, and 80% of Nicaragua's population, live on less than $2 a day and need idealists like Yunus to provide real solutions in alleviating poverty. Although some people see eradicating poverty a lofty and unattainable goal, it is my belief that it can be achieved with the help of the proper use of microcredit.

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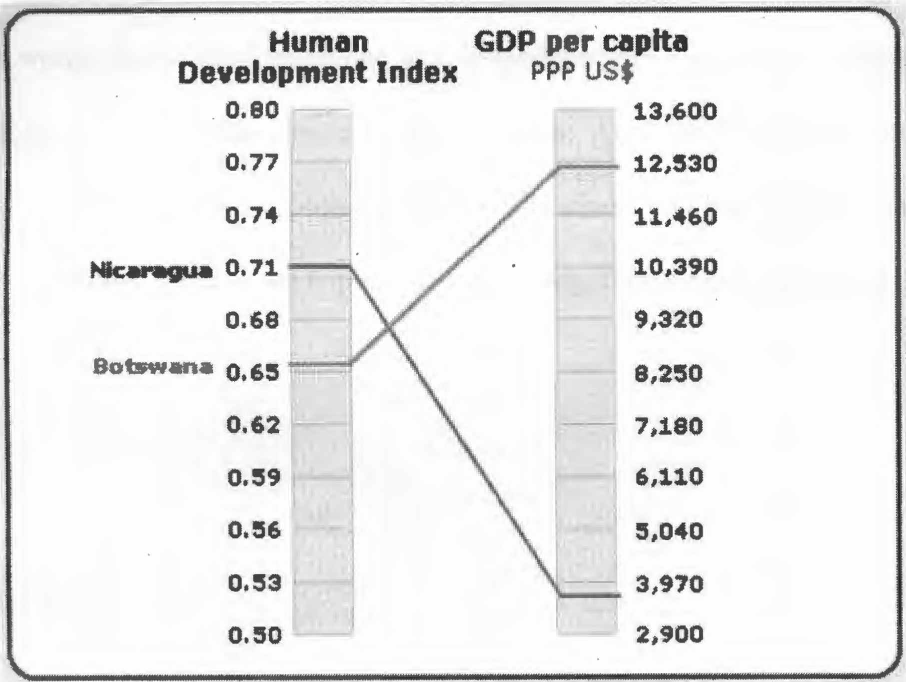
Figure 1

ECONOMIC GROWTH
PRIORITIZED CORE AREA
Objectives/Actions
FINANCIAL SERVICES
Expand access to small, medium firms and low-income groups
Approve Law for Microfinances / JFA-PAM
Prepare prudential norms for microcredit /JFA-PAM
Strengthen and give training to the SIBOIF in microfinance activities
Strengthen the risk central of the SIBOIF
Establish legal and normative framework for the competition of the credit information markets
Improve normative framework for the protection of users of financial services
Strengthen microfinance institutions
Strengthen providers of services to the microfinance institutions
Establish system for monitoring and evaluation of microfinance activities
Establish legal framework and norms for supervision of finance cooperatives
Improve institutional framework for State credit entities USAID, WB
Restructure and reform the FCR
Reposition the IDR in a new role
Strengthen the FNI in techniques for microfinance evaluations
Study the feasibility of having an institution with a multisector character and mixed capital
Reduce risk and expand capacity for collateral IDB, FOMIN, USAID
Modernize the public registries for Moveable Guarantees
Propose and approve a new Law for Real Moveable Guarantees
Approve Law for Trusteeship
Establish legal and normative framework for incentives to leverage the growth of small and medium investments
Develop and implement programs of technical assistance and training
Develop networks of producers, commercial and service providers
Establish legal and normative framework for a risk/venture capital fund

Figure 2



HDI and GDP data refers to 2005 as reported in the 2007/2008 Report.

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