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### RESEARCH PROGRAM MISSION

The research program titled Rural Financial Policies for Food Security of the Poor seeks to identify policies and institutional arrangements that help the poor integrate themselves into sustainable savings and credit systems in order to increase capacity to invest, bear risk, and preserve livelihoods.

### FOCUS COUNTRIES

- Bangladesh
- Cameroon
- China
- Egypt
- Ghana
- Madagascar
- Malawi
- Nepal
- Pakistan

### ABOUT THE AUTHOR

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# RURAL FINANCIAL POLICIES for FOOD SECURITY of the POOR

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## Impact of Microfinance on Poverty Alleviation: What Does Emerging Evidence Indicate?

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The spectacular growth of the microfinance industry has been fueled not by market forces but by conscious actions of national governments, nongovernmental organizations (NGOs), and donors who view microfinance as an effective tool for alleviating poverty. Since much of the impetus behind this large and increasing support for microfinance hinges on the assumption that its economic and social impacts are significant, it needs to be examined more closely.

### Why Measure Benefits

Some question the value of assessing impact in the first place, arguing that when institutions that serve the poor attain financial viability, a level of impact that justifies investment is automatically assured. After all, profitability—the extent to which revenues exceed costs of providing services—is a reflection of the extent to which returns to clients from whatever they finance are high enough to pay for the financial services they received. This approach, however, is not of much help when it comes to evaluating institutions that are not yet financially sustainable but that are assumed to make significant contributions to poverty alleviation and depend on continuing public support to remain operational. When confronted with this type of situation, policymakers, who have to allocate *public* resources between competing ends, ask how credit programs affect broader social goals such as adoption of agricultural technology, income generation, and attainment of food security. Sometimes even broader goals are considered such as women's empowerment or environmental quality. Assessing these benefits helps policymakers evaluate the relative weight to attach to credit programs vis-à-vis

other poverty alleviation programs and helps them answer the question of whether shifting resources away from other poverty programs toward credit-based programs is good social policy.

### The Format of Impact Studies

Two types of impact studies have been conducted. First are those that may be termed “investment-led,” since they attempt to measure returns on credit as an input that facilitates investment. They attempt to answer the question of whether greater access to credit leads to greater levels of income, wealth, and consumption. The second type of studies may be termed “insurance-led,” as they measure the extent to which access to credit assists households in upholding essential expenditures in the aftermath of unexpected income shocks (e.g., bad harvests) or expenditure shocks (e.g., health emergencies). A common methodological problem in conducting impact research is the difficulty of finding a satisfactory control group that can be used to isolate the effects of improved access to microfinance services. For example, the level of entrepreneurial skill is likely to affect an individual's decision to join a microfinance program. But because entrepreneurial skill is hard to observe and quantify, finding a control group that actually controls for this unobserved trait would be difficult. This, in turn, makes it difficult to obtain a clean estimate of the effects of improved access. In recent years several studies have attempted to address this problem by using quasi-random experimental methods, qualitative surveys, special instruments that measure access to credit, and panel data techniques. However, two additional caveats are noted. First, investments yield a flow of returns over time, so the time profile of

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yields and the timing of the impact study have an important bearing on the magnitude of benefits reported. Second, many microfinance institutions bundle credit with other services (training, health, etc.) and the reported impact is likely to include the effect of such services.

### Results of Investment-Led Studies

Overall, the investment-led studies present mixed results of the impact of credit on various indicators affecting household welfare. Apart from methodological differences, country- and program-specific conditions drive results of these studies. For example, the extent to which households have access to other complementary production inputs may affect the returns to credit. Studies in Bangladesh, Malawi, and Madagascar reiterate that access to credit carries good returns to poor households only when complementary inputs such as seeds or irrigation water, or market access are present.

The impact of credit on household food security via increases in household productivity and income also falls under the same caveat as above. However, it is found again and again that most loans taken by the poor, especially in the informal sector, are for financing consumption-related expenditure, especially during low-income seasons. Despite this fact, the effect of credit on the nutritional status of children has generally remained unclear—mainly because nutritional outcomes are strongly conditioned by many other factors on which credit, by itself, has little effect.

Many microfinance services in Asia and Africa target women on the assumption that empowering women and targeting services to them leads to better allocation and use of household resources. Several studies in Bangladesh support this assumption, indicating that services directed to women significantly increase assets, incomes, and educational attainment of children, especially girls. But positive gender effects cannot always be taken for granted, as other studies, also in Bangladesh, highlight cases where only a few of the targeted women were able to exercise effective control over loan use. Some point out that sometimes the very lack of women's empowerment makes it easier for program managers to enforce loan conditions, thus making them preferable borrowers.

### Results of Insurance-Led Studies

A number of studies in Asia suggest that poor households generally use a combination of savings, credit, and increased wage employment to cope with income volatility and unexpected expenditure requirements. Access to credit and saving services makes it feasible for households to borrow during, or save for, adverse times; thus access to financial services has an important impact on the welfare of

the poor. The importance of access to financial services increases with the severity of income downturns. When households confront severe events such as floods or drought that depress their incomes temporarily, access to financial services, especially in the informal sector, enables them to buy enough food to maintain the nutritional status of their children and finance other important activities such as education.

The insurance cover provided by access to credit and savings also has an impact on the efficiency with which household resources are managed. For example, with the insurance cover, poor households may be emboldened to undertake more efficient, albeit riskier, projects to increase household income, such as adoption of new agricultural technology or off-farm microenterprise. Insurance benefit studies show evidence of consistent positive impact, perhaps because insurance benefits, unlike investment benefits, are conditioned less by access to or ownership of other complementary inputs.

### Remaining Gaps

Impact-benefit studies are still somewhat clouded by methodological issues, i.e., the difficulty of obtaining a comparable control group. There are also several other considerations. First, most credit programs studied are actually hybrids that bundle credit with other services such as health and education. Disentangling credit impact from overall impact and accounting for the full range of benefits produced by a program is a challenging task. Second, many microfinance programs also induce empowerment at the community level by enabling collective action as well as by setting the foundation for sustainable community-based organizations. A more complete evaluation needs to account for these types of benefits. Third, many impact studies fail to reveal the exact processes by which poverty is affected. To improve the impact of microfinance, more explicit discussion of the actual process of impact is needed. Finally, impact has been evaluated only for the most successful programs, and generalization can be dangerous.

Whatever the current size of impact, further increases in benefits per dollar of investment critically depend on cost-saving innovations that microfinance institutions make. Public support to fuel this process is critical, especially since private market-based initiatives are hardly forthcoming. Returns on such efforts will be substantial, but strongly conditioned on access to other complementary inputs. Our review also indicates that impact studies themselves must be improved to make more accurate assessments of benefits. This is important, for only through cycles of innovation, experimentation, and evaluation can we hope to establish lasting institutions that alleviate the financial constraints faced by the poor. ■

#### ABOUT IFPRI

IFPRI's mission is to identify and analyze strategies for meeting food needs of the developing world, with particular emphasis on low-income countries and the poor.

IFPRI is a member of the Consultative Group on International Agricultural Research (CGIAR).

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