

Kick-Off Seminar
Master's Degree in Local Development (UNIPD)
Online Lecture

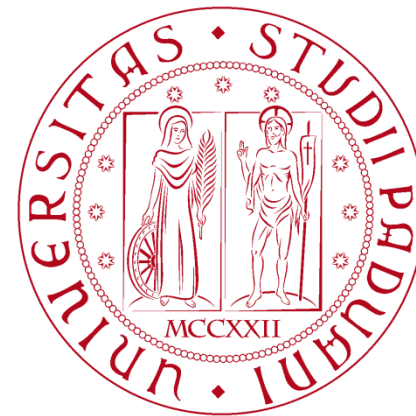
Microfinance and Development: Myths and Reality



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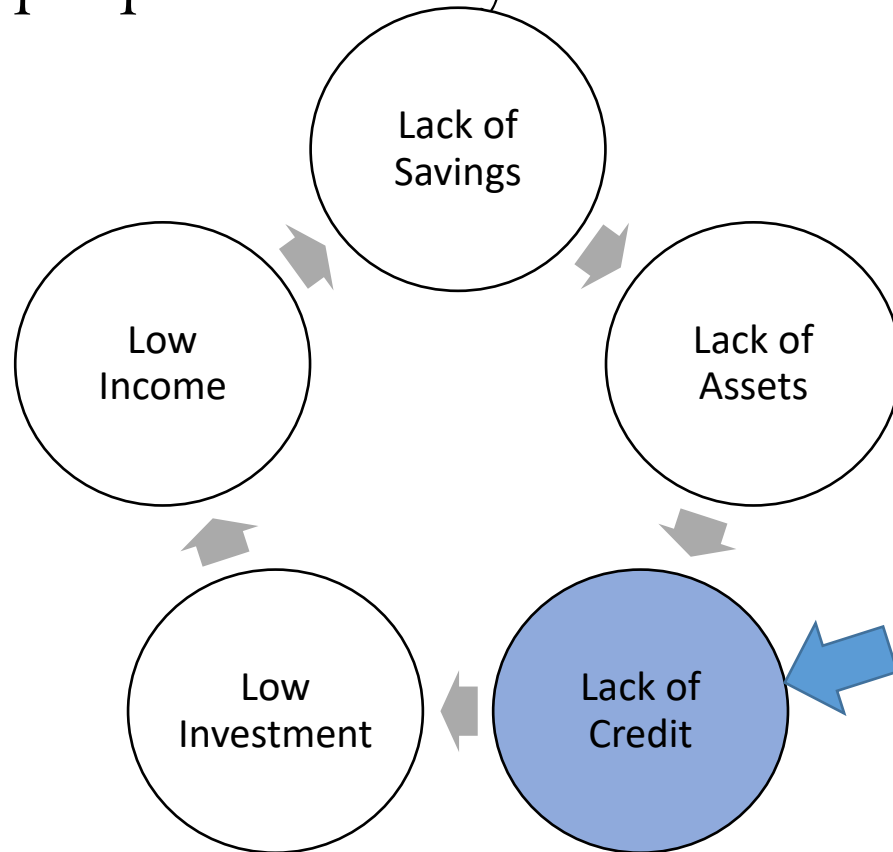
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Outline

- Understanding microfinance
- Evolution of microfinance concept
- Theory of change for microfinance
- Microfinance service providers
- Microfinance and development
- Myths and realities
- Way forward
 - Potential of microfinance for SDG
 - Creating enabling ecosystem

Basic idea of Microfinance

- Poor people are always in **Vicious Cycle** of poverty!



“Poor people are bonsai people. There is **nothing wrong with their seeds**. Only **society** never gave them a base to grow on.”

➤ **Muhammad Yunus**

Microfinance innovations ensured collateral free loans and helped the poor household break the vicious cycle.

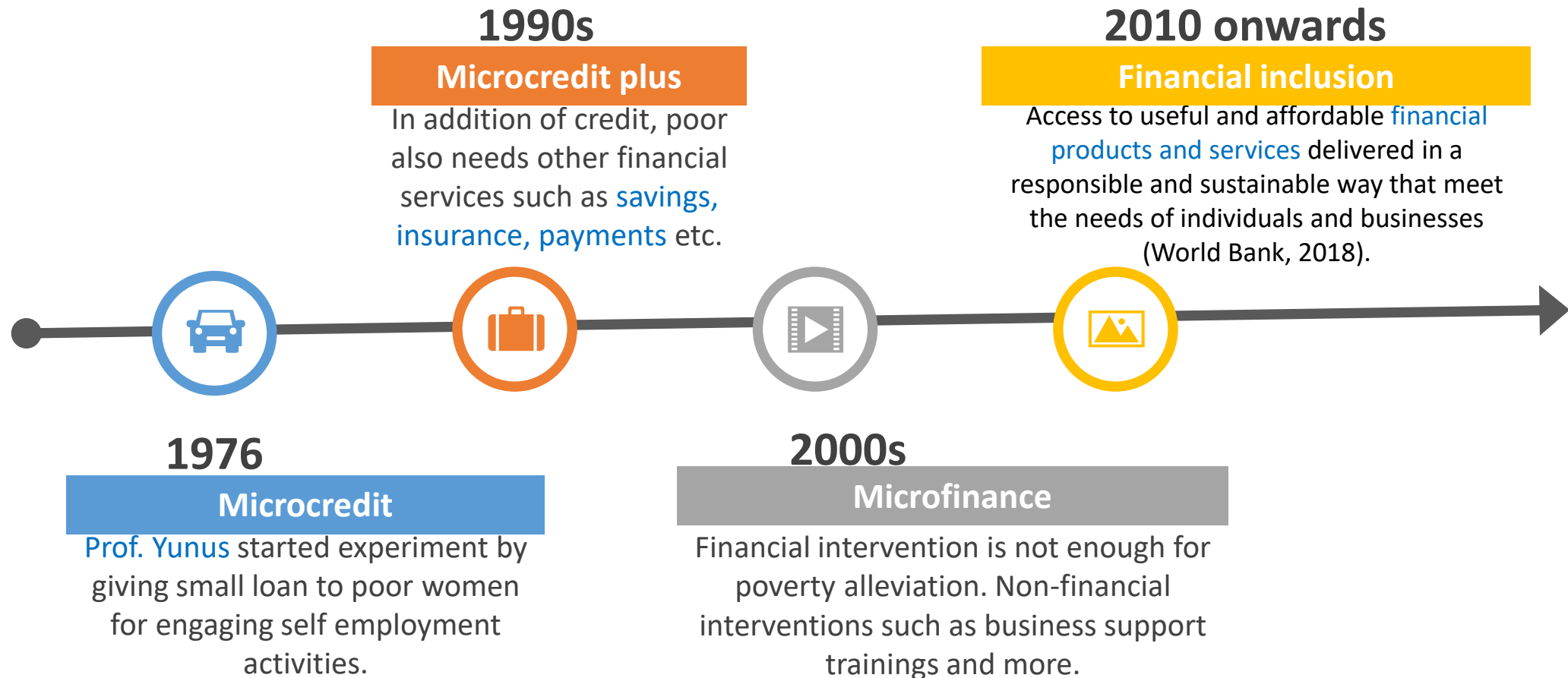
Opens the blocked opportunity for poor.

Microfinance is supposed to replace expensive informal sources of credit.

Targets of Microfinance



Evolution of Microfinance Concept



Theory of Change for Microfinance

Source: Loiseau and Walsh (2015). *Povert Action Lab (J-PAL)*

Inputs

- Microfinance products
 - Credits
 - Savings
 - Insurance
 - Payment and remittance
- + services (Trainings)

Outputs

- Enterprise development
 - Start new business
 - Improve current business

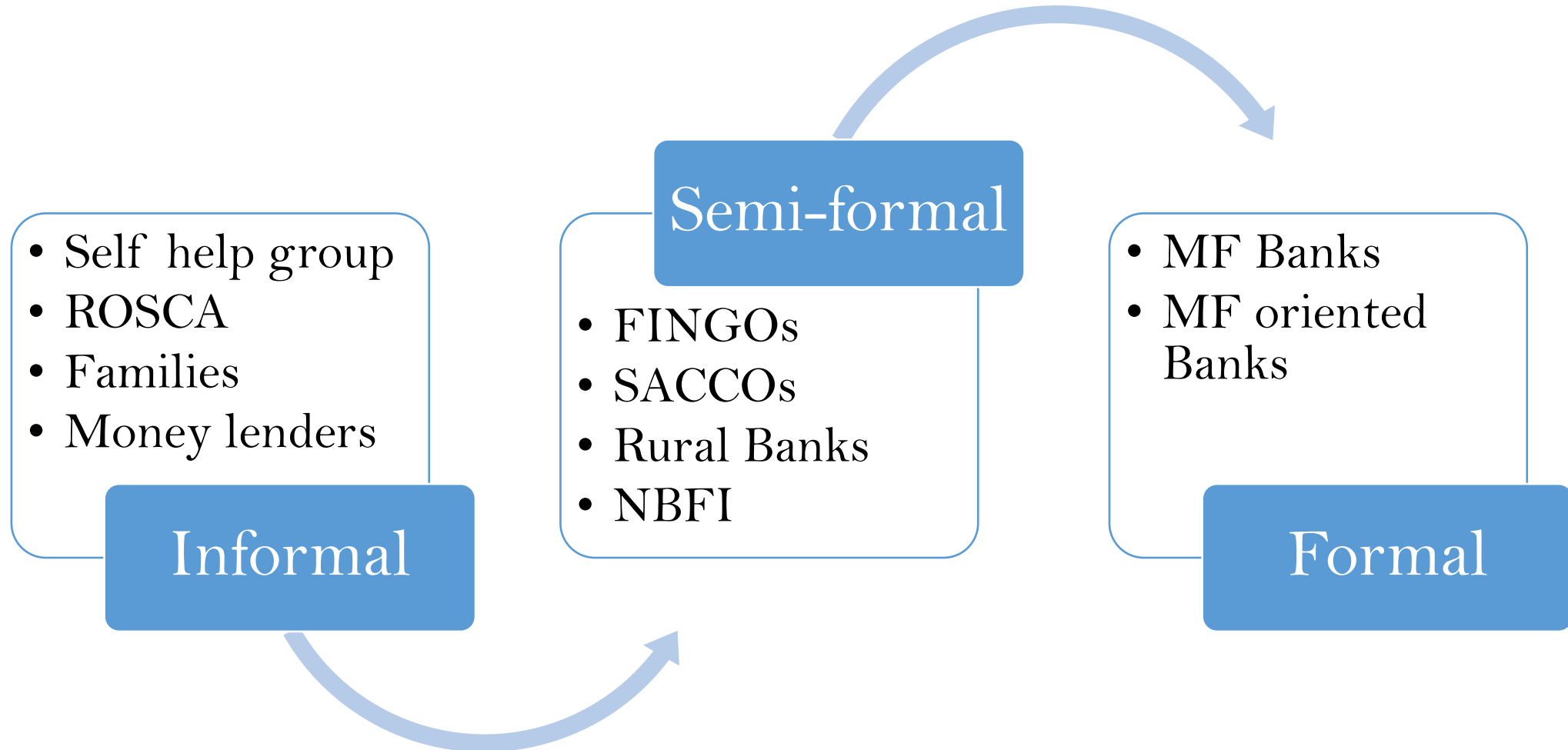
Outcomes

- Business Activities
 - Increase sales
 - Increase profits

Impacts

- Increase household income, savings and consumptions
- Improved social capital
- Improved human capital

Microfinance Service Providers



Regional client numbers as percentage of global totals (As per 31 Dec., 2013)

	Total	Women	Poorest	Poorest Women
Sub-Saharan Africa	7.6%	5.4%	7.6%	6.2%
Asia and Pacific	79.1%	85.8%	88.7%	90.6%
Latin America and Caribbean	8.2%	6.8%	2.4%	2.1%
Middle East and N. Africa	2.5%	1.8%	1.1%	1.0%
<u>"Developing World"</u>	97.4%	99.8%	99.9%	99.9%

Source: Microcredit Summit Campaign, State of the Summit Report 2015

Microfinance and Development

- Microcredit had paved the way, creating an unprecedented business model promising to combine **social progress and financial profitability**.
- Double bottom line
 - **Social progress:** Poverty alleviation, women's empowerment and rural development
 - **Financial profitability:** Return on investment
- However, MFIs have **kept promises of financial profitability** but that they **hardly combine** it with the achievement of **social progress**.

Myth 1: Microfinance alone can solve poverty

- Poverty is multi-dimensional and complex. It comprises of:
 - Education
 - Health
 - Infrastructure and
 - Economic opportunity
- Yunus and international development partners over-promised.
- Microfinance can be part of overall development strategy rather only tool (Banerjee et al., 2015; Karlan and Zinman, 2009).

Myth 2: All microfinance programs are successful in economic development

- Success of microfinance programs varies widely.
- Some programs are highly successful while others have moderate success and some other programs are failed to bring the impact (Bateman 2010a, 2011a).
- It depends on:
 - Program design
 - Borrowers characteristics
 - Local context

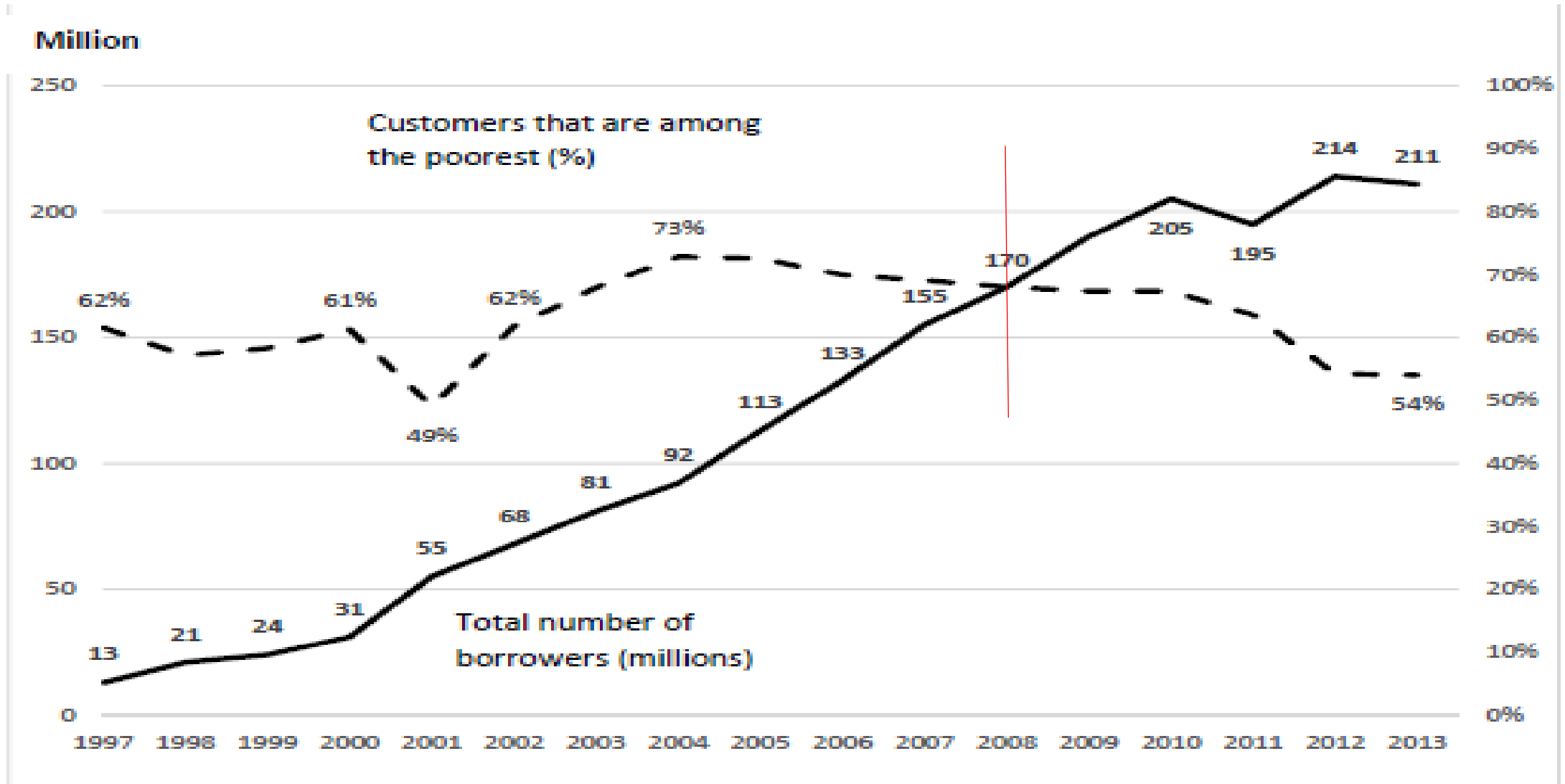
Myth 3: Microfinance leads to women empowerment

- Initially, all MFIs targeted to women only.
- Why?
 - They use loan for family and community
 - They are more trustworthy
 - They have less or no ownership in household assets
 - They should be part of economic activities
- Microfinance loans can help to empower women by giving them access to financial resources and control over their own incomes.
- A deeper analysis revealed that the lending to women was often leading to female [indebtedness associated with male control over debt use](#) (Armendariz & Szafarz, 2011; Mersland & Strom, 2010).
- In extreme cases, [women clients are microfinance are misused by money lenders](#). This leads to disaster in the time of Covid 19 pandemic, economic downturn and other crisis.
- This may increase the burden of work on women. [Ongoing case of Nepal](#).

Myth 4: MFIs always look after poor's need

- MFIs should transform society by taking care of poor's need.
- However, MFIs are criticized for:
 - Charging high interest rate and service charges/fees
 - Coercive loan recovery process is highly criticized (Andhra Crisis 2010, India)
 - Over-indebtedness among clients (excessive focus on the lending/loan distribution)
 - Quick repayment of loan might put poor at risk
- Thus, impact of microfinance depends on terms and condition of loans (**Customization**).

Targets are also shifting from ultra-poor to less poor



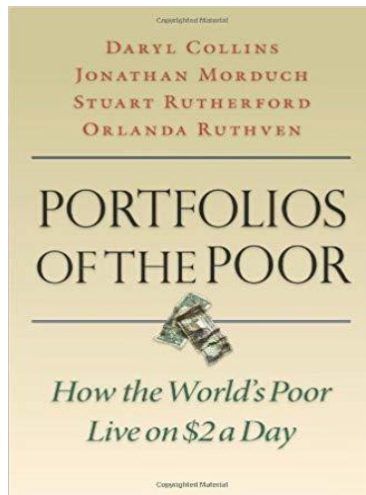
Source: Microcredit Summit Campaign

Microfinance is not a charity

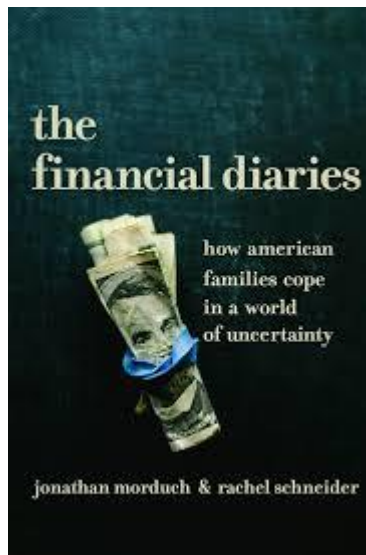
- Microfinance paradigm has been shifted from **non-profit NGOs** (social mission only upto late 1990s) to **commercial MFIs** (for profit business).
- **Breakthrough:** IPO of Banco Compartamos (Mexico, 2007) and SKS Microfinance (India, 2010)
- **Neoliberal policy and globalization** trend pressurized the structural change in MFIs towards the commercial form (Yunus strongly opposed it and advocated for social banking/social enterprise)
- The essence of the microfinance lies in balancing **Double bottom line**, now **Triple bottom line** (*Economic, Social and Environmental*)

Myth 5: Microfinance is entrepreneurial finance

- Every one can be an entrepreneur if he/she has given sufficient capital fund (Yunus)
- Predominant Say's Law – “supply creates its own demand”
- World Bank economists proved it empirically (Pitt & Khandker, 1998)
- New and expanded microfinance-induced microenterprises do not raise the total volume of business so much as [redistribute or subdivide amongst market participants](#) the prevailing volume of business (Galbraith 2008; Amsden, 2010; [Bateman](#), [Blankenburg](#) & [Wright](#), 2018)
- Many borrowers use the fund for [consumption smoothing and other household purposes than for entrepreneurship](#) (Bateman, 2010; Cull and Morduch, 2017).



Collins et al (2009) studied financial lives of the very poor in India, Bangladesh and South Africa. They found that Poor need money for *consumption smoothing* and *easing the unpredictability* of daily life.



Morduch and Schneider (2017) made descriptive assessment of 235 US household representing 5 states in a year long financial diaries.

High volatility in income of poor household was observed due to unpredictable pay and irregular hours. This problem can be fixed with the help of *microfinance*.

Conclusion and Way Forward

- Microfinance is **not a silver bullet** to solve all development issues. It is not a **one-size-fits-all solution**.
- It is just one piece of the puzzle, and a **holistic approach to sustainable development** that addresses the diverse needs of low-income populations.
- A **balanced approach** that considers both the **potential benefits and risks of microfinance** is essential for achieving sustainable development outcomes.
- Effectiveness of microfinance depends on: **program design, local economy, level of infrastructure, culture, and social norms of clients**
- Microfinance has tremendous potential to contribute in achieving the **SDG 2030**.

1 NO
POVERTY



Enhance the entrepreneurial capacity of those living below the poverty line (e.g. MSME finance)

2 ZERO
HUNGER



Financing modern agriculture (e.g. special credit to buy modern machinery)

3 GOOD HEALTH
AND WELL-BEING



Affordable insurance for better healthcare (e.g. universal health insurance scheme)

4 QUALITY
EDUCATION



Access to higher education for low income households (e.g. education loan for skill based professional education)

5 GENDER
EQUALITY



Empowering women through financing women entrepreneurship (e.g. low interest loan for women MSMEs)

7 AFFORDABLE AND
CLEAN ENERGY



Promoting renewable energy solutions at household and in production processes (e.g. financing solar, micro hydro etc.)

8 DECENT WORK AND
ECONOMIC GROWTH



Financing sectors which create more jobs results in higher economic growth (more people getting paid means more customers buying goods/services)

9 INDUSTRY, INNOVATION
AND INFRASTRUCTURE



Industry, innovation and infrastructure related endeavors financed on a priority basis (e.g. financing green enterprises at grassroots level)

10 REDUCED
INEQUALITIES



Enhanced access to finance for communities lagging due to socio-economic factors (ethnicity, geographic backwardness etc.)

Future of Microfinance

MSME Financing

(Employment creation)

Women Empowerment

(Promoting Women Entrepreneurship)

**Linking MFIs,
NGOs, Banks and
Local Government**

Enhancing Rural Outreach

(focus on agro-finance)

**Sustainable Finance & Other
Innovations**



Grazie and Welcome to Nepal

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