Microfinance as a strategy to fight global poverty

Critically discuss the following statement: “ Microfinance stands as one of the most promising and cost-effective tools in the fight against global poverty.”, Jonathan Morduch, UN Expert Group on Poverty Statistics.

Microfinance, as a special arrangement form of financial system, a provision of financial services to poor and low-income groups, has made important contribution poverty alleviation in many developing countries. Scholars have different view on microfinance which can relieve and eliminate poverty. Most scholars believe that microfinance has a positive impact on poverty reduction by providing basic financial services such as providing financial credit to the poor. However, some scholars believe that microfinance is not enough to cover all the poor people living in extreme poverty and directly make benefit. Moreover, the commitment of microfinance relates to too many social functions which lead to economically unsustainable.

Theoretical Studies on Reducing Poverty in Microfinance

The Microfinance Annual Conference (2005) noted that many qualitative and quantitative studies have shown that microfinance has a positive impact on the well-being of the poor and contributes positively to anti-poverty efforts. But there are many uncertainties that affect their assessment of the extent to which microfinance is reducing poverty. Nazrul Islam (2009) argues that microfinance must have an impact on poverty reduction, and that microfinance not only indirectly affects finance, but also reduces poverty through indirect means. Gulli (1998) analyzes the impact of microfinance on poverty reduction. In her view, the main contribution of microfinance to poverty reduction is to help the poor overcome financial credit constraints and manage their money. Microfinance services can be divided into two categories: 1) consumption and household's risk management and 2) production and investment. These financial services can play a dual role to the poor, that is, poor families in the face of income fluctuations in the Consumption smoothing, but also to enhance its economic activities.

Bakhtiari (2006) summed up the anti-poverty practices of micro-finance institutions of Grameen Bank in Bangladesh, Rakyat Bank in Indonesia, BAAC in Thailand, SHARE in India and CARD in the Philippines. He claimed that the micro-finance mainly through the smooth consumption of the poor, better management of risk, and gradually build the poor's assets to help the poor development of micro-enterprises and other direct ways to improve the poor's ability to generate income and improve the quality of life of the poor. Moreover, it reduces poverty by improving the allocation of resources, cultivating the market environment and accelerating the use of new technologies to promote economic growth. De Aghion & Morduch (2006) summarizes the direct income effects of microfinance on poor households, indirect income impacts through non-financial benefits such as additional training and education, and enhanced family social relations and self-esteem. Bail Swain and Floro (2007) found that microfinance's risk response mechanism can improve the participant's ability to control risk, thereby reducing their vulnerability, good for poverty reduction.

A study of the poverty reduction effects of three types of microfinance institutions in Central America in Guatemala found that all participation in microfinance 1 Year-old customers will have a significant increase in their incomes and a lower level of poverty than those who have just joined microfinance, and those who remain in microfinance institutions have a significantly higher standard of living than their customers. The case of Uganda’s microfinance institutions. The study also shows that all women’s clients have reported income growth and have significantly improved their current standard of living. The studies in three regions of Nigeria have also shown that farmers who participate in microfinance programs have increased their average income by nearly three times Far higher than those who are not involved in micro-finance projects; they also found that if the increase in the number of loans and extend the repayment time, its role will be more significant (Hiatt & Woodworth, 2006; Matovu 2006; Kudil, 2009).

Debate on microfinance to reduce poverty

Microfinance has a positive impact on reducing poverty, both directly and indirectly. However, there are still some debates about the impact of microfinance on poverty reduction, focusing on microfinance coverage and Sustainability.

1) Microfinance coverage

Marcus, Porter & Harper (1999) argues that the exclusion of extreme poverty from microfinance does not mean that extreme poor cannot benefit from microfinance. On the contrary, it illustrates the failure of microfinance in project design to meet the needs of extremely poor families. The key to solving the problem lies in the design of financial services for the needs of extremely poor families. Simanowitz & Walter (2002) more sharply pointed out that microfinance tends to exclude those who are extremely poor, whose services tend to meet the needs of specific populations in the customer’s market rather than providing services that meet all needs in a variety of specifications. They also criticized the weekly financial system of microfinance. The income cycle of the poor varies greatly from individual to firm. Some poor families earn income in one week, while others earn income in two weeks, or even one month. Requiring each client to comply with the weekly reimbursement system will make microfinance lost to many poor people. Micro-financial institutions that lack diversified services will lose customers and reduce efficiency.

Dewan & So-manathan (2007) Empirical research on India also shows that the microfinance participation of the poorest households in the survey area is lower than those of the slightly affluent families. Kondo et al. (2008) A case study of the Philippines also shows that although microfinance has a significant positive impact on per capita income and per capita expenditure on poor groups, this positive impact is mainly reflected in the more affluent poor households For those extremely poor families, the role of micro-finance is not significant.

2) Microfinance sustainability

The main reason for the difficult economic sustainability of microfinance is that microfinance has undertaken too many social service functions, such as providing basic survival needs to extreme poor people, providing basic education and business training to poor families. Microfinance is not possible to provide training to the poor, but also to ensure economic sustainability in the case of financial constraints. The choice between microfinance institutions between these two goals leads to two completely opposite directions: The Integrated Approach and the Minimalist Approach (Bhatt & Tang, 2001).

The proponents of Integrated Approach agree that microfinance institutions should reduce poverty as their primary goal, even if it means that microfinance institutions cannot survive without subsidies. Poverty is not just a simple lack of funds, but a combination of vulnerability, lack of rights and attributes. As a result, microfinance institutions should provide comprehensive training, basic education, health and nutrition programs and microcredit equivalents to the poor (Bhatt & Tang, 2001). The ability of microfinance institutions to attract extreme poverty depends on the financial services they provide and whether they meet the needs of the poorer members of the community. While the cost of providing training and education services is high and is likely to undermine the sustainability of microfinance institutions, this is the only way to reduce extreme poverty. As a result, the integration approach has a stronger impact on poverty reduction.

The proponents Minimalist Approach argues that if microfinance is economically unsustainable, it will not grow, which will remove thousands of potential customers who would have been able to access microfinance services(Bhatt & Tang, 2001). Microfinance institutions must first achieve economic sustainability, and it is possible for microfinance institutions to provide training and education services only if sufficient profits are accumulated. The integration of financial services and training, education, or other components confuses the relationship between business and welfare, which undoubtedly undermines the commercialization of microfinance; and if microfinance is forced to rely on In the subsidy, then the sudden breakage of the capital chain will lead to the collapse of institutions.

Despite the dilemma between microfinance institutions in reducing poverty and economic sustainability, some scholars still believe that microfinance institutions can successfully achieve both goals at the same time. First, microfinance institutions can resolve this conflict by working with non-financial institutions that provide training (Simanowitz & Walter, 2002). The provision of commercial training and microcredit for the poor is complementary. By working with charitable organizations, microfinance institutions can focus on economic sustainability and hand over customer training to other organizations. Successful microfinance institutions and effective social programs work together to have a greater impact on poverty reduction. Second, microfinance institutions can also use new technologies such as computers to better access funding and manage funds, reduce transaction costs and better targeting poverty (Herani, 2010). The adoption of new technologies can effectively reduce labor costs, intermediate link costs and the cost of disorderly management, which can better reduce poverty and improve the welfare of the poor.

To sum up, the theoretical circles on micro-finance to reduce the impact of poverty mechanism and its impact were discussed in depth, in some respects reached a consensus, but there is some controversy. The focus of the debate is mainly on whether microfinance is the first place to provide social services such as training to the poor, or to ensure that its economic sustainability is at the top, and thus split into welfarism and institutionalism, microfinance institutions. The direction of development is also divided into an integrated approach and a Minimalist approach. (1496 words)

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