Everything revolves around money

Understanding the role of microfinance in Poverty reduction: a study of ASA Bangladesh

Significance of Topic selection:

In the present world we live in, practically everything revolves around money. With the growth of world economies different types of financial services have emerged to help people deal with the management of their money and other resources. In every country in the world both developing and developed countries, rich and poor economies, high-income or low-income countries, there exists some sort of financial institutions that serve people. The only difference and which is the main topic of discussion is that a large number of people in these different countries have little or no access to the financial services . The risks involved in giving loans without collaterals and also the high transaction costs involved with little loans, including the inability of financial institutions to operate in the very remote rural villages where low-income households live makes it difficult for the formal financial institutions. According to latest estimation by Financial access Initiative there are about " 2. 5 Billion adults in the world who do not use formal financial services to borrow or save" with about 80% of the total adult population of sub-Saharan Africa " unbanked".[1]

This gap between demand and supply of financial services is being filled up by Microfinance which is the provision of financial services to the poor. There has been a global movement in favor of microfinance in these past two decades from the slums of Dakar in Bangladesh and Belen in Peru to the dark corners of the squalors of Ajengunle in Lagos, Nigeria. Due to the fact that access to financial services can go a long way to help the poor in managing risks and loss better and also gives them the opportunity to make decisions that affect their own lives on what to do with their money for example how to send money from the city to a poor family member who lives in a very remote area in the village, how to save for future investment like the school fees of their children, for emergencies like sickness or death, take opportunities that help them increase their income or start business. Governments, International institutions, development NGOs around the world have all in one way or the other being instruments to the spread of Microfinance. As the potential Market for Microfinance is huge, it is only but expedient that we get more understanding of Microfinance and its role in poverty reduction. Due to the nature of MFIs most of them depend on donor contributions to cover some administrative costs like salaries, rents depreciation of assets, loan loss and so on. In a situation where by there are moves by some MFIs to become financially self-sufficient[2], there is every possibility that those MFIs may have the tendencies to loan to borrowers who are on the poverty line or just slightly below or above the poverty lines of the country in question. In Serving the " poor" my main objective is to understand how these MFIs independent of donor funds cover their cost without comprising the goal of Microfinance which is providing quality services to the poor.

Literature Review

Microfinance is simply defined as the financial services for the poor (Helms 2004). It is involves providing small loans without collateral(micro-credit), collecting deposits, selling insurance, money remittances to poor customers " who had been initially written off by commercial banks as being unprofitable"(De Aghion and Morduch 2005) . The institutions that provide these services for the “ Poor” are called Microfinance Institutions (MFIs). Some literatures indicate that the ideas and inspirations behind Microfinance are not that new, that the supply of loans to low-income households have been in existence for long time before the experiment on microcredit (Helms 2004) . Some other literatures have connected the foundation of Microfinance to the micro lending that started in Bangladesh in the 1970’s to poor local villages (De Aghion and Morduch 2005).

Most literatures refer to Mohammed Yunus as the Pioneer of microcredit because of his experiment project of lending small loans to the poor households of Jobra for use in running small business. Mohammed Yunus “ an economist trained at Vanderbilt University lecturer at Chittagong University”[3] in the early 1970’s. As a country that just gained independence from Pakistan after a civil war, with 80% of the population living in poverty due to the widespread flooding in Bangladesh(De Aghion and Morduch 2005), there was a lot to be done. So Mohammed launched an experiment to explore a way to help the poor enter a proper financial credit network (Du Xiaoshan, Sun Ruomei1997) lending small loans to the poor households to do small business , this proved productive and profitable and this experiment gave birth to the present Grameen Bank(De Aghion and Morduch 2005). The goal of Microfinance is to “ provide millions of poor people with the continued access to credit and saving services that helps them better respond to income raising opportunities, better manage risks and loss and most essentially helps avoid future sliding into poverty or becoming further impoverished”.(UNCDF Microfinance Distance Learning)

Due to the present boom of the Microfinance Industry around the world, there are now so many literatures available for issues concerning microfinance. The one major argument in the literatures of Microfinance is the argument of self-sufficiency and sustainability of MFIs. This argument is based on the lending approach of the Microfinance institutions. Robinson (2001 p. 7) describes the two main approaches as the “ Poverty lending” approach and the “ financial systems” approach. The Microfinance Programs (MFPs) with “ poverty-lending” approach has the main goal of “ reaching the poor or the poorest of the poor”. These MFPs focus mainly on poverty reduction through credits and other services funded by donor and government subsidies and other concessional funds therefore majoring on only “ microcredit”. The “ financial system” approach on the other hand according to Robinson (2001 p. 8) refers to the “ commercial financial intermediation” among borrowers and savers emphasizing more on “ institutional self-sufficiency” with the view point that there is no possibility that the government funds and donor funds can finance the huge need for microcredit on a global scale. Institutional self sufficiency This argument is seen in the light as two parties, one is the party that advocates that the MFIs should be able to cover it’s operational costs and financial costs with revenues generated from, the programs and not depend on donor or government funds to cover it’s cost thus making it a more “ commercial financial system” for the poor.

Arguments in favor of the “ commercial financial system” for the poor against that of “ Poverty lending approach” is that the policy of poverty reduction through banking services is not a new innovation because “ from the early 50’s through 80’s some countries poverty alleviation strategy was the allocation of subsidized credits to the low income households (Morduch 1999 pg. 2) . The result of this strategy was nothing to write home about as it brought about adverse effects with low repayment rates, the money being siphoned by the political elites far away from the poor it was originally designed for. (Adams Dale and J. D Von Pischke 1992). This debate between the “ poverty-lending” system and the “ financial lending” system is discussed in what Morduch (2000) titled the microfinance Schism. The “ Poverty-lending” MFPs emphasizes more on poverty reduction so they place more emphasis on the depth of outreach and the quality of outreach and not necessarily the breadth of outreach. The breadth of outreach means the number of people served not withstanding whether they are “ core-poor” or “ non-poor” (that is whether they are under the poverty line or slightly above the poverty line), the depth of outreach meaning servicing the very poor clients. In emphasizing the need for financial viability of MFIs, (Du and Sun 1997) states that for development programs in the MFIs to be sustainable, the MFIs need to achieve some sort of financial viability otherwise the MFIs will only rely of donor funds which may not be always accessible thus leading to the “ premature end” of the program or MFI.

In favor of the “ financial system” approach it is argued that not all poor people are eligible for loans. This is because those that are economically inactive or mentally retarded for example will not benefit much from borrowing but can benefit from other products and services in the Microfinance. Since the early 90’s there have been innovations in the Microfinance sector to serve the Poor better. The Move from “ Microcredit” (which had a focus on lending to the poor) to the present “ Microfinance” (which includes a broader range of services for the poor like savings, micro insurance) indicates the relentless efforts of microfinance practitioners in finding better ways to serve the poor.

The innovations in the Microfinance industry are very necessary as they bring to life best management techniques and services to clients. Best management techniques in search for what suits each particular client in the aspect of the best loan size, the best interest-rate to charge the clients, the way to lend to the clients that is whether group-lending or individual lending best suits the clients is a great determining factor of the future success of Microfinance (Bhatt, Nitin and Shui-Yan Tang 2001). This is very specific about the importance of research to understand the client’s needs and the best way to follow up services to achieve profits for both the service providers and the service receivers. Best management techniques also brings into consideration “ who” the target audience is, in respect to gender and their poverty status. Studies have shown that loans to poor women were more efficient than those lent to men (Pitt and Khander 1998). It is also no surprise that many MFIs in the world have more women clients than men clients. Who is the target client is also decided as the MFIs would have to choose it’s model of approach in order to reach it’s goals which are good outreach financial viability

Research objective:

This is an attempt to understand the role of microfinance in poverty reduction . This project will study the ASA (Association for Social Advancement an NGO-MFI in Bangladesh) to understand the features and operational principles of ASA that led to her become financially self-sufficient. Understand the implications for being financially Self-Sufficient as an MFI on the depth of outreach.

Methodology:

Definition of terms:

Microfinance is the provision of financial services like credits, savings, insurance, remittances and so on for the poor. Poverty on the other hand is a multidimensional word that doesn't have a sentence definition. For the basis of this research, I will choose to define poverty as the lack of material needs as this concentrates on the measurement of income (Hulme, Mosley 1996). The reason for choosing the income-poverty approach is because most governments and organizations use the income-poverty approach to analyze their policies. Secondly microfinance has direct effect on the income-poverty because it creates loans that enable the poor to participate in profit-making economic activities thus increasing their income. Financial self-sufficiency is the is the ability of MFIs to operate at some level of profitability that enables them to still provide quality services to their clients and still have the financial ability to cover all expenses with revenues generated from interests and service fees, therefore becoming independent of donor funds. Depth of outreach is means reaching the servicing the " very poor" clients.

This study will employ a case oriented qualitative research strategy. This is going to be mainly to explore ASA (Association for Social Advancement an NGO-MFI in Bangladesh) to understand their role in poverty-reduction. Due to the fact that Microfinance is a new concept to me, it increases my interest to understand how it works more, I will undertake an 8 week internship course in ASA Bangladesh starting January 2010 to give me an ample opportunity to do some field research and get a first-hand experience on the area of Microfinance. The other way of data Collection for this study is mainly the secondary data from sources like CGAP, World Bank, UNDRC, ASA data base and other relevant data from organizations that are into microfinance. I would also use relevant reports and records, including academic articles relevant to my study. Depending on the availability of Data NGO-MFIs (Preferably ASA International) in other countries preferably Nigeria and china, I will look into their performances in these countries to test the possibility of ASA model replications outside of Bangladesh.

The main questions that I will be looking forward to answering are the following. Can MFIs really to financially Self-sufficient without compromising with the depth and breadth of outreach? What is the operation Model of ASA and can this model be replicated.

Analysis

There will be a structural analysis of ASA to understand the operating principle of organization. I will be doing secondary analysis of data especially of years before and after becoming financially self-sufficient to see if I there are any new trends in outreach.

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1. Financial Access initiative 2009 Half the world is unbanked Financial Access Initiative Framing note accessed from http://financialaccess. org/sites/default/files/110109%20HalfUnbanked_0. pdf on 16th November, 2009
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3. Being financially self sufficient is the ability of MFIs to operate at some level of profitability that enables them to still provide quality services to their clients and still have the financial ability to cover all expenses with revenues generated from interests and fees. Being financially self sufficient allows the MFIs to cover the all expenses varying from administrative costs to depreciation expenses by using revenues generated from interests and services fees ultimately allowing the MFIs to maintain it’s services to the poor for a long time without being influenced by the unpredictable fluctuations in donor funding. (from UNDCF Microfinance Distance Learning course. http://www. uncdf. org/mfdl/index. php? _mode= students. home)
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