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# Using Microcredit to Serve the Poorest: Problems and Possibilities

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**Abstract:** Microcredit program is thought to be a 'silver bullet' for poverty alleviation, which on the one hand gives opportunity to the poor people to become involved in income-generating activities and thereby reduce poverty on the other hand. Proponents of microcredit assume that such activities empower women when it targets women to give loan. These ideas have been heavily criticized in recent times. Researchers have shown that microcredit fails to reach to the poorest of the poor, wherever it reaches, hardly changes anything in terms of poverty alleviation. Taking these critiques into consideration, this paper specifies two main problems of credit program. Firstly, there is a targeting bias. Group lending system and the organizational structure of credit program systematically leave the poorest of the poor outside the target of microcredit program. Secondly, there is a trade-off between sustainability and outreach of the micro credit program. When a microcredit program tries to reach to the poorest section of the community, the cost of overall program increases, which makes a microfinance institution unsustainable. Using six research works from six different contexts, this paper tries to give some suggestions like, flexibility in repayments incorporation of the program with other development activities, giving loan in emergency time and understanding socio-cultural context etc., to get out from those problems and fulfilling some needs for the poorest section of the society.

## 1. Introduction

Microcredit program, pioneered by a Bangladeshi economist, Muhammad Yunus, claimed that it gives necessary means to the poor, which is required to become a successful entrepreneur. It is an innovative idea by Muhammad Yunus which goes beyond the traditional banking system and aimed to give loan to the poor people without collateral. The assumption is, poor people like others have idea is to involve in business, need a little bit help from the bank to start their informal business and later expand it to the formal system. Many microfinance institutions (MFIs) give loan to the women hoping it will give them financial security which will lead to empowerment. Some MFIs also use the group-lending system as an alternative to collateral. The idea behind this approach is that it will help MFIs to outreach the poor who lacks any material asset. These ideas, however, are criticized by various scholars (e.g. Hermes and Lensink 2011; Copestake et al. 2001; Navajas et al. 2000; Goetz and Gupta

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1996; Mayoux 2001 etc.) who argue that MFIs have some biasness of targeting core poor people and there is a trade-off between outreach to the core poor and sustainability of MFIs. For this reason, microcredit program hardly reaches to the poorest of the poor[1] Its nature of regular repayment and peer pressure create an obstacle for the poorest to use that loan for a long-term investment. Therefore, microcredit program, is not the answer when talking about poverty alleviation. In terms of women empowerment, those researchers also showed that microcredit influences very little to the women empowerment as socioeconomic condition of a region creates obstacle for them to involve in productive activities.

Based on the above criticism, this paper will argue that microcredit program as its traditional form, will do very little to fulfil the needs of the poorest. However, if we tailored it a little bit like more flexibility in return payment and incorporate it with other development activities, microcredit can reach to the poorest and fulfil some of their needs. For this purpose, I will discuss these issues in three more sections. Next section, I will deal with the targeting bias of microcredit program and suggest that microcredit program needs more subsidies to reach to the core poor. In the subsequent section, I will discuss the failure of the microcredit program to fulfil the need of the poorest and give some policy recommendations for getting out from those problems. In the penultimate section, I will review and conclude my overall discussion and give some suggestions for microcredit program to do better to fulfil the need of the poorest.

## 2. Targeting Bias and Outreaching Problem in Microcredit Program:

In microcredit program, there is a debate whether it should target the poorest section of a community or not. As Leikem (2012:9-10) showed, there are two schools of thought about this issue. One argued that microcredit program should only target the poor as poor people involve more in economic activities than the poorest. Economic activities of the poor thought to be trickle down to the poorest which will help them indirectly. Other schools disagreed with this trickle down approach and argued that microcredit should reach to the poorest directly. This distinction between poor and poorest is based on the

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[1] The distinction between 'poor' and the 'poorest' has different meaning for different discourses. In dominant development discourse, the distinction between poor and poorest based on the national statistical data on the poverty line. Poor indicates, are those who stand below the poverty line and poorest are those who stay bottom fifty percent of that national poverty line (Leikem 2012:9). In this paper, I have used the poorest to mean those people whose situation is worst in a given community. They can be single mother or disable or elderly people who do not have younger earning member or people whose economic situation is extremely bad. The word core poor also used in this paper as a synonym for the word poorest.

national statistical data on the poverty line. Poor, as Leikem (2012:9) indicates, are those who stand below the poverty line and poorest are those who stay bottom fifty percent of that national poverty line. Research, however, has shown that very few MFIs were actually trying to reach to the poorest of the poor. Hermes and Lensink (2011:876) discussed this issue and have shown four reasons behind MFIs failure to reach to the poorest. First of all, there is a self-targeted bias. Poorest feel less confidence about repayment, therefore they themselves may not join the program. Secondly, group lending bias. In traditional microcredit program, it is necessary to form a group that acts as a substitute for collateral. This group uses social pressure to ensure repayment. Whether a person getsthe next loan or not depend on that group's performance. Hence, poorest people are less likely to select by other members of the community because it may create problem for the whole group. Thirdly, there is an organizational bias. Because of the above reason, microfinance institution often excludespoorest section in a community. Finally, there is a program structure bias. Loan recipients, in some cases, required to save some money in order to get grants or in other cases, they have to registrar for a business. These biasnesses create problem for the poorest to incorporate in the microcredit program.

In relation to above biasness, as Hermes and Lensink (2011) explained, there seems to be another obstacle – the trade-off between sustainability of microfinance institutions on the one hand and outreach to the poorest people on the other, which create problem for microfinance institution for reaching the poorest section of the community. There are several reasons behind this trade-off. First, deciding who are the poorest is itself expensive process. National survey data may give one solution but these are often incomplete and do not take count social and cultural aspect of vulnerability in developing countries. Therefore, workers of microfinance organizations need local knowledge to understand vulnerability, which by no means is easy. Secondly, doing research on the poorest also needs lots of money, which can increase the cost for microcredit program. Various research have shown that organizations which prefer to reach poorest people turn to be least sustainable than those who only target moderate poor. Hermes et al showed in their research, using 435 MFIs data, that there is a trade-off between sustainability of MFIs and outreach as MFIs that try to outreach more women are less efficient (as cited Hermes and Lensink 2011:878). Similarly, Cull et al showed that MFIs that mainly offer individual loans are more profitable as they prefer more on wealthier clients than group lending institutions who target less wealthy clients (as cited in Hermes and Lensink 2011:879). This creates a standpoint that there is, in fact, a trade-off between efficiency and outreach in MFIs.

Another important factor for MFIs is that they heavily relied on subsidy provided by the governments or donor organizations, which they use to reduce the transaction and other cost. The fact that the more MFI try to outreach the poorest the more their transaction cost increases, and the more they rely on subsidy. Hence, sustainability of MFIs is a big question. Cutting the subsidy, on the other hand, will increase the interest rate, which will take the program further away from the poorest. Therefore, subsidy is necessary for the MFIs to outreach to the poorest. However, MFIs can decrease the transaction cost by using the subsidy in an innovative way. Hudon and Traca (2011) explained about 'smart subsidy' which can be used for opening new branch in untouched areas or training field workers (as cited in Hermes and Lensink 2011:880). Another way can be using existing social network to lower the cost for outreaching. Wydick, Karp, and Hilliker did research on the impact of the social network to influence individual decision-making process. They found that individuals are actually influenced by a lot from their friends and relative by imitating them or following them in the belief that it may turn good result for them (as cited in Hermes and Lensink 2011:879). Therefore, MFIs can use these networks to outreach their activity and lower their costs. However, they need to be cautious about contextual differences. They should search variety of social networks to find the appropriate one. Nevertheless, these changes in microcredit program may give some options for MFIs to lower the trade-off and reach to the core poor of a community.

## 3. Getting Closer to Fulfil the Need of the Poorest:

The crisis of microcredit program to fulfil the need of the poorest seems to be even more than its outreaching crisis. Literature is actually divided about this issue. Defender of the microcredit program(e.g. Pitt and Khandker 1998; Leikem 2012; Copestake et al. 2001 etc.) argued that the access to finance give opportunity to the poor to invest in their self- employed business, diverse their income source and smooth their consumption to some level. It also thought to gives them protection in the bad period. They even argued that microcredit program works well when it targets women as it gives financial security to the women by involving them in income-generating activities. This process is also thought to lead women empowerment. These claims, however, are criticized by other scholars who argued that microcredit fails to reach to poorest of the poor, wherever its reach, it hardly changes anything in terms of poverty alleviation. In the case of women empowerment, research has shown that the influence of microcredit is very small. Women who take loan often give or are forced to give to the male member of the family who uses it for his/their own purpose (Goetz and Gupta 1996:45). Hence, it is very difficult to generalize about the impact of microcredit program. The story of success and failure came from a specific context which may provide different result if we try to apply in different context.

To understand the impact of microcredit, at first, we need to deal with the claim that microcredit helps the poorest to start an informal self-employed business which can later expand to a big formal business. The important fact here is that, very few people, even in elite class, want to become an entrepreneur. In the case of poor, it is far more unrealistic. For poor people, as Berner et al (2012) explained, survival is the most important aspect. In their article, they showed that poor people do not invest all their money in one sector. They diversify their investment so that if one fails, other could help them. They share their resource in order to survive collectively. These facts help them to cope with vulnerability, insecurity and one-off shocks in badperiod. However, these are also the very reason that creates obstacle for them to become a 'Schumpeterian growth oriented' entrepreneur (Berner et.al 2012:383-384). Likewise, Banerjee et al (2015:49) also showed that the amount MFIs offer to the poor people is very small which is not helpful to make big profitable business. Hence, microcredit intervention changes very little for this group of people. They may use it for consumption smoothness or may start a little business that may never grow because of above reason. Therefore, the impact of microcredit to graduating a small informal business to a larger scale is very limited.

Poorest people, however, have other needs like income generation, protection in bad time, asset creation etc. Various research have shown mix results about the impact of microcredit program to fulfil these needs of the poorest. The work of Pitt and Khandker (1998) on the issue of the impact of microfinance in Bangladesh is influential and refers many places to know about the 'success story' of Bangladesh. They use nonrandomized approach to claim that microcredit indeed increased consumption spending for poor families and it works better when the loan is taken by women. Khandker later argued in her works that microcredit helps the poorest better than the moderate poor (as cited in Hermes and Lensink 2011:876). This conclusion, however, had been drawn from national survey data, which may not be reliable all the time. In addition, using non-randomized data is problematic in the sense that it may have a bias in selecting relatively wealthy areas (ibid). Contrary to Khandker, Pellegrina argued that microcredit in Bangladesh was less effective in relation with the investment in fixed asset like agricultural land. The reason behind this, as she argued, is the nature of microcredit program- short time repayment, group-lending system etc. (as cited in Hermes and Lensink 2011:877). Although various literature argue that microcredit does little or no impact on the poorest, some literature, in fact, have shown the success of microcredit program. In order to understand those successes, we need to scrutinize the specific context and reality. For that purpose, I will now discuss six literature which claim that microcredit was successful in six different contexts:

Copestake et al (2001) use both qualitative and quantitative method to understand the impact of microcredit program, called Peri-Urban Lusaka Small Enterprise Project (PULSE), which aimed to give loan to the self-employed young men and women in Lusaka, Zambia. This project targeted only to those people whorun a business at least for six months. They use official survey data as well as qualitative methods like FGD, key informant interview to understand direct and indirect consequences of microcredit program. Their findings showed that people who are able to continue in credit program and graduate to the second or third loan were able to increase their profit from their business. Their situation was much better than the people of similar kind but did not take loan. However, for those who left the credit program after the first loan, microcredit seem to effect very little to them, in some case,it even worsen their situation. This research is important for us as it shows how microcredit could be useful if it targeted only to the group that already involve in productive activity. This, however, creates problem as poorest are less involved in self-employed business. Copestake et al. (2001:95,) however, argued that one third of the participant of that credit program was under the poverty line in Zambia.

Navajas et al (2000) analysed the impact of microfinance on the question of outreach to the poorest of the poor in La Paz, Bolivia. They took five MFIs of Bolivia to analyse their impact to the poorest. Their findings showed that those five MFIs, most of the time, serve only to the moderate poor rather than the core poor (Navajas et al. 2000:333). However, they also found strong evidence that the group lending system is more helpful for outreaching to the poorest as it substitutes collateral system and it also gives confidence to poorest people to join when they see their friends and relatives joining there (ibid:345). They also found that microcredit program is more chance to reach to the core poor when it is implemented in rural areas. Navajas et al. concluded that microcredit program rarely reaches to the core poor and when it reaches, it only smoothes their consumptions. Discussion of Navajas et al. is important for us as it shows the importance of group lending system to outreach the core poor. Like Navajas et al (2000), Banerjee et al (2015) also showed that microcredit program fails to outreach to the poorest. They evaluated the impact of a famous Indian MFI - 'Spandana' run microcredit program in Hyderabad, India. On that evaluation, they illustrated that the impact of that program is very disappointing as very few poor people take loan. Moreover, this loan did not influence much in the life of the people who took loan. However, it worked well for those people who have been able to take loan on the third time. Because of the organizational biasness, these third-time loaners were relatively less poor people. For the poorest, microcredit only helps to smooth their consumption expenditure.

Hermes and Lensink (2011:877) indicated two literature that showed positive impact of microcredit program when it applies in a special situation or in relation to other development activities. One, is the research of Becchetti and Castriota, which tried to understand the effectiveness of microcredit program as a recovery tool in a disaster situation. Using randomized method, this research argued that microcredit helped people who were affected by the tsunami in 2004, which led them to recover faster than the other people who did not take loan. Not only it helped them to recover fast but also it reduced the gap between the person who was hit by the tsunami and who was not. This research is very significant for the MFIs as it shows how microcredit can be useful in a post disaster period. Rai and Ravi conducted the other work that Hermes and Lensink (2011) indicated. They discussed about the impact of microcredit program in India where borrowers have to buy health insurance after getting the loan. In their findings, they showed that recipients of the microcredit loan used their health insurance more than the non-borrower. The partnership between health and microcredit seems to work well in the context of India.

Hashemi and Rosenberg (2005) reviewed microcredit program of four different MFIs in various parts of the world and argued that microcredit program can help the poorest if it is incorporated with training and safety net program. Among those MFIs, two Bangladeshi MFIs were CARE-Bangladesh and BRAC. These two MFIs targeted female-headed household to give loan. They provide skill training, saving training and business idea (raising cattle, chicken, opening a small shop etc.) to those women. They also link their program with the government safety net program. These extra features, according to Hashemi and Rosenberg (2005), change the life of the poorest people. However, authors failed to mention what was the specific change that happened. Did it increase their consumption or raise the business they involve? They mention another case from Malawi where DFID-CARE run microcredit program failed to replicate the so-called success of CARE-Bangladesh. For authors, it was unsuccessful because it failed to understand the need of the poorest, which has changed after they receive skill training. For me, skill training is helpful but cannot guarantee the success of a credit program as many features like socio-cultural aspect, economic situation of that area, available resource etc. involved with the process. Nevertheless, Hashemi and Rosenberg (2005) seem to advocate training and safety net program in addition to microcredit program to help the poorest.

From the above discussion, it could be argued that microcredit can help the core poor if tailored with other development activities like, use it a recovery tool in disaster or target only those poor people who want credit for business purposes. Nonetheless, these arguments need to be tested in different context, as success from one place may not give assurance in other. However, in development discourse, microcredit seems to come as a solution that solves many problems. Beside poverty reduction, it also assumes that it could empower women by giving financial security. Women, in here, seen as a good borrower who are more discipline in loan repayment and use the loan for their household activity which in turn help the whole household. Research, however, showed a different picture of this. Scholars argued that access to financial sector does not ensure women's control over loan. These researches urge for taking socio-economic context in to account. I will now discuss three of these works and explain why context is important.

Goetz and Gupta (1996) try to assess the impact of microcredit in terms of women empowerment in Bangladesh. They mainly use data from two MFIs in Bangladesh - BRAC's Rural Development Programme (RDP), and the CIDA-funded component of the government's Rural Poor Programme (RD- 12). For Comparison, they also use data from the Grameen Bank, *Thengamara Mohila Sabuj Sangha* (TMSS), and *Shaptagram Nari Swanivar Parishad* (SNPS). Their findings showed that only 37% of their women participants have some control over their loan, the rest 63% either have no or very limited control in the productive use of that loan (Goetz and Gupta1996:49). They rely or forced to rely on a male member of the family to use that loan in productive purpose. The main reason behind this, as authors explained, is the patriarchal norms in Bangladesh, which limit women's access to the market (Goetz and Gupta 1996:55). However, they also found that women from female-headed household control loan much higher than the male-headed household (ibid:50). In both cases, however, women tended to have more control on productive activities that are not directly related tomarket, like poultry rearing, embroidery etc. Yet, at some point, they have to rely on the male member for marketing those products. Overall, authors stand negatively on the discussion that microcredit can lead to women empowerment. Women may get the money but how and where they use it, is more often decided by a male member of the family. Patriarchal norms play a significant role in here in which women are not seen as a person who should carry or invest money. For that reason, women themselves sometimes give money to their male relative which they assume do well for them (ibid:58).

In a similar way but in different context, Mayoux (2001) tried to analyse the relation between microcredit, social capital and women empowerment. She used focus group and qualitative method to examine six microcredit programs in Cameroon. Her findings showed that microcredit program at its present form has very little effect on empowering women agenda. It gives some financial access and fund for their consumption expenditure, but it changes very little to their overall unequal position of gender. She argued that group-lending system has great potentiality as it creates social bonding and social capital. However, its potentiality can be restricted by the local power structure. She argued that almost for all the ethnic communities in Cameroon, women's control and use of loan to productive purpose was limited because of customary rights (Mayoux 2001:451). This creates a barrier for women to compete in market, which is dominated by men. She also discussed the system of group lending in those six MFIs where they only give credit to one member of a family and assume that other members of the family will benefit from that. Mayoux disagreed with this and showed that polygyny nature in Cameroonian society creates obstacle for this process as young bride often discriminated by other members of the family. Therefore, she asked to revise that group lending approach and suggested to incorporate training of gender issue with credit program, which for her, can improve the ultimate aim of women empowerment (Mayoux 2001:461). Similarly, Kabeer (2005) also argued that microcredit does not automatically empower women, it need other development interventions. She reviewed various research works and concluded that poor women will fight for change only when it relates to their daily struggles. The problem they face in their daily life because of patriarchal discourse needs to be addressed first. Therefore, credit program needs to link with other empowerment interventions like, education, political quotas, access to waged work etc.

All these discussions show that microcredit is less effective in terms of women empowerment. However, all three research urge for considering local context and incorporate other development interventions. Understanding local power dynamics can give MFIs a sense that loan itself cannot change the condition of women. Additional measures like training on gender issues for both men and women, as Mayoux (2001) showed, can help the overall aim of women empowerment.

## 4. Some suggestions to improve microcredit program in order to outreach and fulfil the need of the poorest

From the above discussion, it could be argued that microcredit as a development intervention does very little in terms of poverty alleviation and helping poorest people out from the poverty. It helps moderate poor in some context to involve in productive and income generating activities. However, because of the small size of the loan and regular payment scheme, it fails to inspire people to use loan in long-term investment. It hardly reaches to the core poor and wherever it reaches it only act to smooth their consumption expenditure. This effect is also important in a sense that it gives an option for the poorest people when no other means are available. This is in my view, the most important success of microcredit program as it gives poor, in some cases poorest people, an option for consumption smoothness. This process is more useful when traditional banking system did not work for the poor people and access to those is difficult to them. However, microcredit program did not arise only to give consumption smoothness to the poor. Its claims of reaching poorest people remain questionable and its overall effect on poverty reduction remains limited too. However, above discussion showed that microcredit program could be successful if it is incorporated with other development activities. In terms of women empowerment, above discussion showed that micro credit program needs to deal with the gender inequality and market power dynamics that limit women's opportunity to involve in productive activities. Those discussions also showed that group lending system, though having some biasness, have more possibility to reach to the poorest than the individualistic one. I will now suggest some ideas from my previous discussion, which can be used to tailored microcredit program for the betterment of the poorest.

### *4.1. Reaching to the poorest*

Discussion of targeting bias shows that there is a trade-off between outreaching to the poorest and sustainability of the MFIs. However, that discussion also shows that subsidy was necessary to reach to the poorest. The interest rate microcredit scheme, in general, is already too high, and if the subsidies taken out; interest rate may increase even higher which will take poorest people further away from the credit program. Nevertheless, use of that subsidy can be more innovative. For example, Hudon and Traca (2011) explained about 'smart subsidy' that can be used for opening a new branch in untouched areas or training field workers (As cited in Hermes and Lensink 2011). This can help to lower the transaction cost as well as improve the knowledge of field workers about the local community and power dynamics, which in a way can smooth the process of overall credit program. Another way can be, as Wydick et al. show, using of social networks (as cited in Hermes and Lensink 2011). Still, MFIs haveto careful about socio-economic condition of the specific region. For example, Wydick et al show how church community play an important role to inspire its member to apply for microcredit in Guatemala (ibid). This idea may not applicable in a country like Bangladesh where religious institutions are relatively weak. Other networks like agricultural labourer or community base NGOs who working on poverty issue may be helpful in this context. These innovative ideas can help MFIs to lower their cost and lessen the trade-off between outreach and sustainability.

### *4.2 Group lending*

From the discussion of Navajas et al. (2000), it is clear that group lending works better than individual loan to reach to the poorest in Bolivia. This result, however,needs to be tested in other regions to see whether it works well in other context. Using group pressure, on the one hand, helpful for the poorest as it gives opportunity to take loan without collateral. On the other hand, as section two of this paper shows, it excludes poorest because of the assumption that they create a problem for the whole group. This problem needs to be tackled. MFIs can create a separate scheme for the poorest where they incorporate only the poorest people. This may be difficult to implement but it can give solution to incorporate poorest people. Mayoux (2001) discussion about group lending where she argued that group lending work as a social bonding can be useful here. MFIs have to find more innovative ideas to involve the group not only in lending process but also in social mixing where they share their problems and learn from the others.

### *4.3. Fulfill the need of the poorest*

Previous discussion of this paper showed that microcredit alone cannot fulfil the needs of the poorest. In order to do better, microcredit program needs to incorporate other development programs. Rather than letting its participant alone in the market, MFIs can train its participants about productive activity and help them to involve in the market. Bangladesh Rural Advancement Committee (BRAC) is actually doing this by buying milk or handicrafts from their lending clients. These approaches can give confidence to the poorest to invest money in the productive purpose and raising their business. In terms of women empowerment, financial accessibility is just one part of empowerment. Research of Goetz and Gupta (1996) showed that women hardly control the use of their loan because of patriarchal norms. Therefore, MFIs need to incorporate gender training program for their workers as well as their clients. This can change the whole process. As Mayoux (2001) showed in her research, this type of training can change the attitude, behaviour and prejudice of male member of the community. She gave an example of a Cameroonian MFI called, BERDSCO who train male partner of their female clients, as a result, those men become lot more supportive to their women's income generative activities (Mayoux 2001:461). Hence, it is very important for MFIs to incorporate male in their programs when they target only women for loan. Patriarchal norms create lot of obstacles for women to involve in the market. Therefore, support of men is necessary. Furthermore, MFIs also can make a linkage between their clients and market, as BRAC did.

Researches also showed that regular tight repayment method createsobstacle for the poorest to use loan for long-term investment. Therefore, microcredit program needs to be more flexible in case of loan repayment. The amount of loan also needs to be increased. MFIs have to understand that credit can be most effective in disaster time, as Rai and Ravi showed. Although this idea needs to be tested in other places, nonetheless, it gives the opportunity to show worthiness of microcredit program. Beside this, MFIs need to revisit its core idea. Not all the poor people need credit and not all the poor people want loan. Loan, as Copestake et al (2001) showed, work well when it targets that group of poor people who involve in business for at least six months. Thus, microcredit program needs to include those people who wantloan. Subsidy is necessary to lower the interest rate. Social network can be used to lower the cost. Above all, socioeconomic context needs to understand, where necessary training about a social issue need to incorporate. Finally, yet importantly, MFIs need to make the linkage between poorest and the market. All of this can help microcredit program to serve better to the poorest of the poor.

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