MICROFINANCE MISSION OF POVERTY ALLEVIATION EMPIRICAL EVIDENCE FROM SOUTH ASIA

Wajid Khan[*] & Sun Shaorong[**]

[*]PhD Scholar, Business School, University of Shanghai for Science & Technology, China. Email: wajiduom@yahoo.com

[**]Professor, Business School, University of Shanghai for Science & Technology, China

Abstract. *This article provides new insight to depth of outreach (a measure of mission drift) in the South Asian microfinance markets. For the purpose data of 62 rated MFIs for the period of seven years from (2007-2014) were analyzed. Data were collected from four South Asian countries, Pakistan, India, Bangladesh and Nepal. The objectives of the study was to investigate does microfinance helps in poverty alleviation or MFIs drifting from their original mission of serving the poor to making profits?. We have used fixed effect method to measures mission drift. The results reveal that the MFIs are align with their original mission of poverty alleviation but the negative relationship of women empowerment show that south Asia women's were least served by MFIs in the subject area.*

Key words: Microfinance institution, poverty, South Asia

Introduction

Microfinance institution from last couple of decades served the poor communities both in developed and developing world. Microfinance consist of various financial services which includes, deposits, payments, money transfer and provide insurance to low income household and entrepreneurs[1] (Asian Development Bank 2001). Micro-credit and microfinance has been used interchangeably, but there is a difference between micro-credit and microfinance. The former means only the provision of small amount of money to the poor people, while the latter also includes, saving, insurance

1 Asian Development Bank (2002). *Interim Progress Report on the Policy on Gender and Development*. Available online (http://www.adb.org/sites/default/files/institutional-document/32030/in317-02.pdf).

and transactional services. Microfinance institutions (MFIs) exist because poor people are bankable which means that poor people can repay their borrowed money along with interest on time. Besides financial services, MFIs also provides non-financial service which includes counseling, training and education etc. The prime objective of both these services is to enable the poor to increase their access to a desirable life. But individual lending and dependent on grant and subsidies questions their sustainable position in the long run. MFIs primarily target those poor who were excluded by formal financial institutions in the past (Batman, 2010). MFIs operated with two focus objectives, one, to reach out and served the poor people, also called depth of outreach. Second, to remain sustainable during the process, it means that to target the poor clients profitably. Targeting the poor is risky because MFIs incur various costs, like administrative, to reach the depth (the poor) these cost lower down the profits digits of the MFIs. The amounts of loan of MFIs are small compare to commercial banks and the numbers of borrowers are large which also create cautious decision to select the reliable clients. For long sustainability MFIs need to receive the principle amount along with interest rate on time. In the long run MFIs heavily dependent on Government subsidies and donor funding, also like commercial banks MFIs do debt financing to have sufficient financial means to attain the desire outreach level.

Poor people receive little in the past from microfinance institutions, and majority of these MFIs are now working with less poor (Hulme & Mosley, 1996). Thereafter in 90s the financial system advocates accelerate this exclusion process (Batman, 2010). Commercial banks also extend microloans but their focus is on profitability. On the other hand, microfinance institutions focused on poor peoples and do individual lending. Though credit risks are very high in individual lending, this can be reduced through group lending. But lending large number of small loans to greater number of individuals in disperse locations increases administrative costs which cause lesser returns on individual lending's compared to group lending. Poor borrower demands for smaller loan and pay their installments frequently which increases a borrower's ability to repay its outstanding amounts (Conning, 1999). That is why individual loans represent large proportion of microfinance institutions (Christen, 2001) because the aim of MFIs is to reach the poorer while also to increase its breadth. Broadening the base of individual lending may affect the sustainability and financial performance of the MFIs because broadening the base may be costly. Thus, in long run, if these MFIs are not subsidized through government or donor funding, their sustainability will be at risk. Therefore, in order to remain sustainable, these MFIs need subsidized credit. In short run subsidize credit programs benefits entrepreneur, but these programs cannot survive over a long term and fail to reach a significant number (Morduch, 2000). Further, other government involvement is considered bad but here are some evidences in developing countries where governments provided fruitful inputs.

This paper empirically examined two main issues of the business of microfinance, one, the mission of serving the poor, and second, leverage financing. Previous studies provide empirical evidence of mission drift (Mersland & Strom, 2010; Armendariz &

Szafarz, 2011) on the other hand leverage financing is very important to study in microfinance because on one hand MFIs incur high cost on small loans and on the other hand cost of debt may make situation more turbulent for MFIs if they are not profitable. For the purpose, to measure mission drift two widely used measures were used, Average loan size (Merland & Strom, 2010) and women borrower, and for leverage financing debt to equity ratio were used. Average loan size is the very common proxy to measure the depth of outreach (Mersland & Storm, 2010). Also to allocate the depth of outreach women empowerment level is need to analyze, because women are considered have low access to financial services and are excluded in household decisions (Morduch, 2000). We used various other related explanatory variables, Total Assets, Cost per borrower, return on assets ratio and age of institutions to examine the various aspect of outreach. According to Schreiner (2002) define various dimensions of outreach, first, value of the microfinance loan to the client, second, cost of a loan to the client, third, breath of outreach, fourth, scope of outreach and fifth length of outreach. Using average loan size means that MFIs are targeting service and trading business of his greater outreach potential than MFIs targeting manufacturing sector assuming that their average loan balances are big, We put restrictions on data and used larger dataset, average loan size, women borrower measure we come up with. Also these measures were used by various academia in their high impact studies.

Literature Review

The literature largely focuses on organizational issues associated with, microfinance and poverty. Microfinance represent small loan provided to low income individuals. Microfinance programs are in operation to help financially poor people to enable them to live a sustainable life. These programs were initially run by various governments and NGOs to assist the poor in both urban and rural areas. The aim of this study is to determine the contribution microfinance institutions in poverty alleviation of the world emerging south Asian economies. Microfinance is the financial service provide to the poor to alleviate poverty and bring financial development in a country (Sinha, 2008). Micro credit enables poor people to start their own business and start self employed projects to generate revenues and live a sustainable life (Onuamah, 2002). Micro finance institutions face a challenge of collateral, often mission drift occur, as they target the wealthy people and try to generate maximum returns and on their investments. Poverty is a key challenge faced by developing and developed economies to attain economic growth and development. Poverty prevails in various forms, low income, lack of basic resources, education and so on. Rhyne (1998) states that there is no way to determine the accurate loan size, financial report represent average loan lend to the borrower.

Like other Asian counties, Pakistan is rated a low income country by IMF facing serious problems in industrial sectors. These problems prevail in form of, lack of energy, lack of latest technology availability and uncertain law in order situation. The foreign direct investment has been decrease 9.7 % 2011. Like conventional banks in poverty reduction and economic growth, the role of microfinance intuitions is critical to examine in south Asia. Omotola and Murad (2011) examined and suggest that microloan and saving has direct positive impact on Gross domestic product. Akanji (2001) investigates that micro credit is the development process which provides an opportunity to local entrepreneur and poor people of society to avail start a business and contribute to the economy. But, with time when the institution matures, they change their focus from poor to rich people of the society. Christen (2001) empirically examined that changes in loan size explain mission drift. Mission drift can be affected by institution age and nature of loan size i.e. individual lending or group lending not by profitability and regulation. Further, he added individual loan comprise of large proportion compare to group loans, because the goal of MFIs are to reach to the poorer while also at the same time increase the breath.

Cull, et al. (2007) examined that institutions who lend smaller loans are more profitable then firms who do group lending. But, in average loan portfolio poor and women are less in numbers. Added to this, micro lending was provided to the poor to eradicate poverty. And bring development in society at large. But, these institutions have also one prime objective ‘profit’. It is known that nonprofit non government organizations usually lend smaller loan compared to institution operating with profit status institutions. And mainly work for the poor of the society (since it is assumed that poor people are interested in smaller loans). Love and Bruhn (2009) investigate microfinance institution ownership structure and conclude that improvement in ownership bring a positive change in income and employment. Mustafa (1996) identifies that, micro lending receipt earns economic values such as, increase in income, increase in spending, house proprieties, increase expenditure in foods and increase overall expenditure house expenditures. Hossain (1988) reported a significant impact of micro credit and poverty reduction in Bangladesh, indicating that micro credit receiver had high income and get recipient of capital and employments. Trivedi and Cameron (2005) examined that poverty as the result of low income.

To eradicate poverty investments are required in human and physical capital to boost the productivity and provide employment opportunity to poor. For instance, Cull *et al*. (2007) find out by analyzing data of 124 MFIs from 49 countries and concluded that individual lending institutions are more profitable then group lending institutions. More than a hundred of nongovernmental organizations are presently operating in both Rural and Urban areas of south Asia to eradicate poverty by means by financial assistance. Poor borrower demand for smaller loans and pay their instalment frequently which increase poor borrower ability to repay its outstanding amounts (Conning, 1999). Age of the institutions plays a vital role while reaching to the depth. Christen and Drake (2002) examined that mission drift is like a natural evolution for NGOs, when institutions matures their outstanding loan balances increase and they transferred to regulated institutions. Christen and Drake (2002) reported that nongovernmental institution follow natural evolution, when institution matures then transpired to regulated institutions and loan size tend to increase causing mission drift. Further, they argue that to know, whether institution achieve the outreach or not. At this point we can divide the literature discussed into three parts, the first one, the poor are excluded from financial services because they lack collateral requirements and cannot service the debt (Hulme & Mosley, 1996; Fernando, 2004). The wisdom behind this belief was that demand for credit in poor's is very limited because they were unable to bear the price of the financial services. Second, the poor should be reach out on a sustainable manner and the poor need credit not the cheaper one, the idea was that there is exist demand for credit in poor masses and also informal finance has been approached by many poor (Morduch, 2000). Third, the depth of outreach should be expanded by employing the continuous innovative approach because very few MFIs do both individual and group landings.

Date and Methodology

Data

In order to test empirically the theoretical framework we have developed for this study. Data were collected from Mix Market. It is a reliable data source of microfinance institutions. Max Market is a non for profit organization established to exchange information of microfinance institutions. We have collected data of 62 rated MFIs from south Asia region of the world, (Mersland & Strom, 2008) also used rated MFI in their study. The qualified MFIs were those having data available for seven years from 2007-2014 and were rated from 4 to 5 diamonds. The variables are available in the table 1.

Table 1 *Variables of the Study*

Variable	Measure	Source
DTER	Debt to Equity Ratio	Market Mix
PFB	Percent of Female Borrower	Market Mix
ALS	Average Loan Size	Market Mix
AS	Total Assets	Market Mix
CPB	Cost Per Borrower	Market Mix
ROAR	Return on Assets Ratio	Market Mix
AGE	Number of Years	Market Mix

Methodology

In this method, we combine all the cross section and year (62*07) and estimate the regression analysis. The OLS doesn't capture the random effect and fixed effect in penal data.

Equation 01 represents the estimated form of regression used in this study.

$$\text{Ln DTER} = \beta 0+\beta 1AS+\beta 2CPB+\beta 3ROA+\beta 4AGE \quad \ldots\ldots\ldots(01)$$

$$\text{Ln PFB} = \beta 0+\beta 1AS+\beta 2CPB+\beta 3ROA+\beta 4AGE \quad \ldots\ldots\ldots(02)$$

$$\text{Ln ALS} = \beta 0+\beta 1AS+\beta 2CPB+\beta 3ROA+\beta 4AGE \quad \ldots\ldots\ldots(03)$$

Results and Analysis

The results in table 02 shows all the variables used in the study and the dependent variables are debt to equity ratio, percent of female borrowers and average loan size.

Table 2 *Regression Analysis*

Variables	**Dependent variables**		
	DTER	**PFB**	**ALS**
Constant	-1.03*	4.35*	-2571.75*
AS	0.21*	-0.04*	296.23*
CPB	0.32*	-0.09*	272.79*
ROA	0.23*	-0.01	111.41*
AGE	-0.29*	0.01	29.19
Hausman Test	47.93*	26.99*	47.67*
Redundant Fixed Effects LR Test	21.72*	9.43*	6.61*

*Significant at the 0.05 level (2-tailed)

The results show that total assets have a positive relationship with debt to equity ratio and average loan size, and negative with female borrowers. The debt to equity result shows that, when MFIs becomes larger their attitude toward leverage financing was increases. Also the positive sign of average loan size show that larger firm increase its loan balances and their depth of outreach increases with size of the MFIs. The negative significant relation-ship with female borrower suggest that MFIs targeting towards women empowerment decease as the size of MFI increases. The cost aspect of targeting the poor clients show a positive relationship with debt to equity ratio and average loan size and negative with female borrowers, the findings shows that external financing and increase in loan size increases the overall cost of the loan, while targeting women decrease the MFI cost. The profitability which was measured through return on assets ratio show a positive relationship with average loan size and debt to equity ratio and negative with female borrowers, the results indicate that debt financing which is consider costly for MFIs but in our findings the results suggests otherwise. Also the profitability increases the average loan size of the MFIs. The age results show that with increasing the MFIs age their dependence on external financing decrease and their tendency to women empowerment decreased. Moreover, with age the MFIs increase their average loan balances as their age increases.

Conclusion

Microfinance birth took place with two distinguish feature, the first, not for profit (focused on social well being of the poor masses) the second one, financing through donor funding. This study discusses the depth of outreach (a measure of mission drift) and other factors which has notable impact on depth of outreach. The present study was examined to check the impact of external financing and two outreach measures, female borrowers and average loan size. Other explanatory variables were taken to explain the potential impact of these variables on cost and profitability of MFIs. The findings conclude that, MFIs did external financing and their access to poor despite incurs high costs was increased. The women empowerment was taken a measure of mission drift and we found that MFIs attitude towards women are negative, the result show that empowering women were decreased because of its negative impact on profitability of MFIs. The second depth of outreach measure which was taken average loan size shows a positive relationship with cost and profitability of MFIs. It means that MFIs reach out the poor clients and serve them and they remain profitable in the process.

References

Akanji, O. A. (2001). Microfinance as a strategy for poverty reduction. *CBN Economic and Financial Review, 30*(4), 1-20.

Armendariz, B., & Szafarz, A**.** (2009). On mission drift in microfinance institutions. Centre Emile Bernhein. Working Paper No. 09/015.

Bateman, M. (2010): *Why Doesn't Microfinance Work? The Destructive Rise of Local Neo-liberalism*. London: Zed Books Ltd.

Bruhn, M., & Love, I. (2009). The economic impact of banking the unbanked: Evidence from Mexico. World Bank Policy Research Working Paper No. 498.

Cameron, A. C., & Trivedi, P. K. (2005). *Micro-Econometrics: Methods and Applications*. New York: Cambridge University Press.

Christen, R. P., & Drake, D. (2002). Commercialization: The new reality of micro-finance. In D. Drake & E. Rhyne, (Ed.). *The Commercialization of Microfinance*: *Balancing Business and Development.* (pp. 2–22). Kumarian Press, Bloomfield.

Christen, R. P. (2001). Commercialization and mission drift: The transformation of microfinance in Latin America. Occasional Paper, 5. Consultative Group to Assist the Poor (CGAP), The World Bank, Washington D.C.

Conning, J. H. (1999). Outreach, sustainability and leverage in monitored and peer-monitored lending. *Journal of Development Economics*, *60*, 51-77.

Cull, R., Demirguc K. A., & Morduch, J. (2007). Financial performance and outreach: A global analysis of lending micro-banks. *The Economic Journal*, *117*(1), 107-133.

Fernando, N. A. (2004). Microfinance outreach to the poorest: A realistic objective? *Finance for the Poor, 5*(1), 1-5.

Hulme, D., & Mosley, P**.** (1996): *Finance Against Poverty*. London and New York: Routledge.

Hossain, M. (1988). *Credit for Alleviation of Rural Poverty: The Grameen Bank in Bangladesh*.

Mustafa, S. (1996). *Beacon of Hope: An Impact Assessment Study of BRAC's Rural Development Program*. BRAC Research and Evaluation Division. Available at: http://www.bracresearch.org/publications_details.php?scat=29&tid=95&v=

Mersland, R., & Strom, R. O. (2008). Performance and trade-offs in microfinance organizations – Does ownership matter? *Journal of International Development*, *20*, 598–612.

Mersland, R., & Strom, R. O. (2010). Microfinance mission drift? *World Development, 38*(1), 28-36.

Morduch, J. (2000). The microfinance schism. *World Development, 28*(4), 617-629.

Onumah, G. E. (2003). *Improving Access to Rural Finance through Regulated Warehouse Receipt Systems in Africa.* Paper presented at the United States Agency for International Development–World Council of Credit Unions conference on Paving the Way Forward for Rural Finance: An International Conference on Best Practices. Washington, DC, June.

Omotola, A., & Murad, A, B. (2011). *Microfinancing for Poverty Reduction and Economic Development: A Case for Nigeria MPRA Paper No. 33530*. Online at http://mpra.ub.uni muenchen.de/33530/

Rhyne, E. (1998). The Yin and Yang of microfinance: Reaching the poor and sustainability. *Micro Banking Bulletin*, *2*, 6-9.

Sinha, H. (2008). Microcredit: impact, targeting and sustainability. *IDS Bulletin*, *29*, 4. Papers. 1.

Schreiner, M. (2002). Aspects of outreach: A framework for discussion of the social benefits of microfinance. *Journal of International Development, 14*, 591-603.