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The Role of Micro-financing in Rural Poverty Reduction in Developing Countries

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Preface

2005 has been declared the international year of microcredit and microfinance. Therefore, it is not surprising that microfinance is currently discussed as one of the possible paths towards poverty reduction in developing countries.

This research paper by Momoh Juanah, which has been submitted in the fall of 2004 at SPRING Centre, University of Dortmund, takes a closer look at its contribution towards this aim. Momoh Juanah not only evaluates the concept as presented in today's scientific discussion, but also outlines a research programme on how to measure the real effects of microfinance.

The topics and problems that are addressed in this paper are numerous as well as complex. Each individual aspect deserves a detailed discussion, a task which is not lessened by the high degree of inter-linkage among them. Such a study-in-depth, however, is not provided by this paper. Instead, it aims at providing an outline for further and additional research. Therefore, it is more of a management brief on the chosen topic than a detailed study on all relevant aspects.

Due to this character, it names areas for future research and, it is hoped, will also provide an incentive for increased interest in microfinance and its effects on poverty reduction, especially in rural areas of developing countries.

It was a pleasure for me to read Momoh Juanah's paper and therefore I am glad to make his thoughts available to a greater public with the help of the Wismar Discussion Papers. Hopefully, it will prove to be another step forward within this year of microcredit and microfinance.

Wismar, September 2005

Jost W. Kramer

Dedication

This work is dedicated to the memory of my mother, late Madam Lucia Maamu. May her soul Rest in Perfect Peace. I also dedicate this work to all those poor rural men, women and children, who on most occasions may not even know from where the next meal will come.

Acknowledgement

I would like to acknowledge the assistance I received from different people in producing this work and during my studies here in Germany. I am greatly indebted to Professor Dr. Günter Kröse for his guidance. I am also thankful to all the staff of the SPRING Centre, Faculty of Spatial Planning at the University of Dortmund, Germany.

In a special way, I am highly grateful to the Evangelischer Enwicklungsdienst (EED) for sponsoring my studies here in Germany and in Kumasi, Ghana. I would like to thank on a special note the staff of the EED Scholarship Desk in Bonn, Germany for their great cares and concerns for my well-being while in Germany.

I am also grateful to my wife, Mrs. Khadiatu Juanah, who traveled all the way from Sierra Leone to Germany to comfort me on my course, providing me most needed companionship and food. I also extend sincere thanks to my friends in Germany, including Momoh Kobba, Foday Nyandewa, Roland Allieu, Late Mrs. Janet Bunduka, Pastor Golden, Sister Natascha and her mother, Angelica, who contributed in various ways to making life in Germany more interesting for me. I am very much grateful to the Echoes Evangelical Mission (CEEM) members in Bochum for their spiritual and moral support to me and my wife.

Over and above all, I thank God almighty, whose grace and abundant blessings upheld me through high and low periods during my stay in Germany.

Abstract

Throughout the developing world, there is a desperate quest for a way out of the financial predicament confronting the rural poor. In most countries of the developing regions, especially South Asia and Sub-Saharan Africa, the rural population forms the larger proportion of the entire population and poverty is prevalent among them. According to the International Fund for Agricultural Development (IFAD 2001), in an assessment of poverty in West and Central Africa, poverty in West and Central Africa is essentially a rural phenomenon with three quarters of the population being located in rural areas.

Following the theoretical methodology, this study has examined the role of microfinance in developing countries and has described some measures which

can enhance the effectiveness and efficiency of microfinance as an instrument for reducing rural poverty in developing countries. The thesis of this study is that with a well planned and coordinated institutionalized microfinance system operating within the appropriate legal and policy framework, the rural poor may be able to get out of the chronic poverty trap that plagues their lives.

By means of a review of relevant literature and a conceptual framework on poverty in general, rural poverty in particular and microfinance services and institutions in the developing countries (using the cases of selected countries), the increase in popularity of microfinance as an instrument for addressing the problem of rural poverty in most developing countries was discovered.

Although there is empirical evidence that microfinance can contribute immensely to improving the lives of the rural poor, much evidence points to the fact that the impact of microfinance on the lives of the poorest of the poor is yet to be up to the expectations of developers. Existing evidence also indicate that microfinance services, such as savings, insurance, money transfers, entrepreneurial training and so on, which are more attractive to this class of clients, are yet to be provided. Regulation and supervision is deemed to inhibit the operation of the market but in the case of rural microfinance provision a reasonable amount of regulation and supervision is discovered to be necessary, particularly to protect the mostly illiterate rural poor, from usury interest rates, for example.

In all the selected countries and most other developing countries, government regulation and supervision of microfinance operations are present, either directly or indirectly.

This paper is sub-divided into five chapters. In Chapter one, the problem, objectives, study area and the research questions of the study are presented. In Chapter two, the research is operationalized through the formulation of a framework of the research methodology. The case study approach which is the major analysis approach for this study is discussed in-depth in this section. Existing literature and studies on rural poverty and microfinance are reviewed in Chapter three. Also in this chapter, microfinance practices in four countries in the developing regions, Bolivia, Ethiopia, Ghana and the Philippines, selected at random are discussed. Chapter Four examines the contribution of microfinance to rural poverty reduction under the various categories of services which include credit, savings, insurance and money transfers. In Chapter five, recommendations are advanced for improving on the provision of microfinance in order for its full impact on rural poverty to be realized.

1. General Introduction

1.1. Introduction

Impoverished people, carrying out very small businesses, can improve their standard of living through the proper use of financial services designed specifically for them. Savings mechanisms allow them to conveniently and safely accumulate surplus funds to create financial stability, while credit services allow them to expand their enterprises and improve earnings. The provision of these crucial, specialized services to “small-scale rural farmers and business people” and how to ensure the effectiveness and sustainability of the services is what this study is all about.

This research paper presents a general theoretical framework for the actual research to be undertaken for the final thesis in Ghana. My intention is to make a comprehensive assessment of the role of microfinance services in the reduction of rural poverty, using selected rural area situations in Ghana. Focusing on the rural poor, I am not by any means suggesting that poverty does not exist in the urban areas of developing countries. Indeed there are a considerable number of the urban poor in all developing countries. I have concentrated on the rural poor because, according to Todaro (1992: 249); if ‘development’ is to take place and become self-sustaining, it will have to start in the rural areas in general and the agricultural sector in particular. There can be no national development without rural development.

Although the idea of micro-credit had long existed among the rural people and more so urban communities in Developing Countries (for instance in West Africa), there has been no organized form of a microfinance system that embraces ‘best practices’ until recently. A most common form of microfinance practice which had existed among small business operators in most developing countries like Ghana, Uganda, Bangladesh, and many more is the Rotating Savings and Credit Associations (commonly called RoSCA). The main objective here is to make a lump sum available to members to be able to make bulk purchase of the goods they trade in and durable household goods. The emphasis of this study, however, is on institutionalized microfinance systems.

1.2. Statement of the Problem

Microfinance could be a powerful strategy or instrument, among several others, for alleviating poverty in general and rural poverty in particular in developing countries. Although many developing countries, such as Bangladesh in Asia (the Grameen Bank) and Ghana, to name but two, have scored relative successes in using microfinance as an instrument for alleviating poverty in general, and rural poverty in particular, it has not been so for many other developing countries, especially in Africa and some South Asian Countries.

Rather than improve the conditions of the poor, most of the microfinance programs operated in these countries have left the so-called beneficiaries in debts. In a similar vein, most organizations involved in providing microfinance services, including government institutions, cooperatives and Non-governmental organizations (NGOs) have in most cases performed very poorly. High rates of non-repayment of loans by clients have on several occasions led to the collapse of microfinance institutions. Not withstanding this, microfinance has continued to gain popularity among rural developers as a viable tool for improving rural agricultural practices and the diversification of economic activities of small-holder farming households. Lack of adequate loan funds, inadequate institutional capacities, poor coordination, little or no participation of the beneficiaries in the planning of microfinance programs, lack of effective training programs for both beneficiaries and operators of the programs are some of the reasons behind the ineffectiveness of microfinance as a strategy for alleviating rural poverty in developing countries. Another very serious problem militating against microfinance is the attempt by governments to use it as a tool to gain political favor and stability rather than for the primary purpose of enhancing economic activities among the poor, so as to improve their overall standard of living.

The entire situation outlined above, has contributed to the lack of access to sufficient capital by the rural poor and thus inhibited them from venturing into other economic activities like small-scale industries and businesses, and adopting appropriate modern farming technologies, in order to increase their yield and earnings.

1.3. The Hypothesis

Finance is described by many business scholars and practitioners as the lubricant which keeps the business machinery smoothly and successfully running. I think this is equally true for all types of groups, be they commercial, religious, political or a rural farming household. It must be noted that most poor rural households depend mostly on agriculture, yields from which never guarantees a substantial standard of living for them. A diversification of the economic activities of the rural people and enabling them to access appropriate modern farming technologies can be a very effective and sustainable way of ensuring an improved standard of living for them.

My assertion here therefore is that with an effective and efficient microfinance system operating in the rural areas of developing countries, coupled with other enabling factors such as legal and policy framework, good governance and adequate physical infrastructure, the poor rural people will undertake diversified business activities, and also be able to adopt more appropriate modern farming technologies. This, it is assumed, will lead to the reduction of rural poverty and an increased overall standard of living of the rural poor in developing countries in general, and the least developed countries (LDCs) like those in Sub-Saharan Africa and South Asia, in particular.

1.4. Justification of the Study

The core problems of widespread poverty, growing inequality, rapid population growth and rising unemployment all find their origins in the stagnation and often retrogression of economic life in rural areas (Todaro 1992: 249). Todaro (1992: 249) further asserts that "a greater importance than sheer number is the fact that the vast majority (almost 70%) of the world's poorest people are located in rural area." The International Fund for Agricultural Development (IFAD) estimated in 2001 that three quarters of the world's extremely 1.2 billion poor people live in rural areas (http://www.ifad.org/poverty).

This is why I consider it most justifiable to undertake an in-depth investigation into the operations and impact of micro-financing, as an instrument for reducing rural poverty, which enhances the diversification of economic activities and improve on agricultural practices in rural areas. Many African countries like Sierra Leone, Uganda, Congo, Liberia, Sudan, to name a few, have experienced devastating civil wars that have disrupted almost all economic structures and left a vast majority of the people impoverished. In Asia and the Middle East, countries like Bangladesh, Iran, Palestine and Iraq have experienced either natural disasters or wars. In all of this, the rural poor are mostly affected because they are already disadvantaged with low income, high illiteracy, and inadequate physical and social infrastructure and so on. I am strongly convinced that well coordinated and efficiently operated microfinance services can contribute immensely to the reduction of rural poverty in developing countries.

1.5. Objectives of the Study

The main objective of this study is to critically examine how micro-financing can be used as an effective instrument or strategy to reduce the high level of poverty in rural areas of respective developing countries, especially in Africa and South Asia. The paper is the theoretical and conceptual framework for the thesis on *the Assessment of the Role of Microfinance in the Reduction of Rural Poverty in Ghana*. My intention was to do an assessment of the same for post-war Sierra Leone but because of the economy of time, institutional constraints and logistical problems, I will have to look at the Ghana situation. Other pertinent objectives of the paper are listed below:

- To examine how microfinance institutions operate in selected rural settings in the country.
- To analyze the strengths, weaknesses, opportunities and threats (SWOT Analysis) of microfinance institutions in the selected region.

- To investigate into and analyze the types and nature of microfinance services provided in selected rural settlements in the country.
- To assess the problems encountered by microfinance services consumers in rural areas.
- To evaluate how microfinance has impacted on the lives of household and its contribution to the reduction of poverty in the selected rural setting.
- To suggest ways in which efficient and effective microfinance service provision in rural areas can be enhanced.
- To produce a document that could be useful to other scholars intending to undertake a similar study and to people providing or intending to go into microfinance provision.

1.6. Research Questions

In a bid to make this piece of work operational and logical, relevant questions have been developed from the problem statement, hypothesis and objectives of the study. These questions relate to rural poverty, poverty reduction strategy and microfinance. The main purpose of the questions is to establish a relationship between rural economic activities and poverty on one hand, and between microfinance and poverty on the other hand.

The first set of questions will examine the relationship between rural economic activities and rural poverty. What are the main economic activities that the rural poor are engaged in? Are they poor because of the type and nature of economic activities they are involved in? What are the nature, depth and incidence of poverty in the selected areas? What are the existing systems and methods of addressing the issue of poverty in the areas under investigation? How do the poor rural households perceive poverty? How can they reduce or escape the chronic and excruciating poverty they live in?

The second group of questions addresses the role of microfinance in rural poverty reduction. Can microfinance be an effective tool for reducing rural poverty? What are the shortcomings of microfinance institutions operating in the selected rural areas? Who are benefiting from microfinance services? What gender issues are involved in microfinance operations in the regions under review? What are the viable measures for improving on the provision of microfinance services in rural areas? How do rural people perceive the concept of microfinance?

Essentially, the above questions will facilitate the critical analysis of the operational link between micro financing and rural poverty reduction. They also enlighten decision making regarding the provision of effective and efficient services appropriate for, and attractive to the rural poor, especially the poorest of the poor.

1.7. Description of the Study Area

The purpose of this section is to give a brief description of the area on which this paper, which is essentially general and theoretical, is based. The words "developing Countries," have different meanings to different people and at different times. To the economists, Developing Countries may mean: Countries in which the average annual income is low, most of the population is usually engaged in agriculture and the majority live near the subsistence level (World Trade Organization – WTO). Most African states, many of the states in South America and the Caribbean, and most of Asia except Japan and the East Asian Tiger countries are considered developing counties. The United Nations Human Development Index (HDI 2003) list classifies countries of the world into highly developed, medium and low developed. 54 countries are listed as highly developed with a human development index of at least 0.80, 85 are medium with an index between 0.50 and 0.80. The rest 34 are least developed with HDI under 0.50.

According to Hope Olson at the University of Alberta's School of Library and Information Studies (Angiel 2000): "The increased level of global awareness has shifted the terminology that has been assigned to certain countries when discussing their status on the world stage. For example, there has been a visible shift in replacing the term *Third World Countries* with *Developing Countries*. I use the term *developing countries* when I refer to countries that have such characteristics as widespread poverty, debt, and illiteracy. There are obvious problems with the using of the term "developing countries". Some now refer to these countries as simply the "the South". This term as well has its problems. It is therefore too simplistic to refer to countries as either developed or developing, or as the North or the South, as this dichotomous relationship can not adequately define the grey area that lies in between these two polar concepts."

For the purpose of this paper, developing countries refer to most of the countries in the middle level of the United Nations human development index and all of those in the least developed category in general. The study is specifically focused on countries in South Asia, South America and Africa. These are countries which are characterized by high dependence on agriculture, high unemployment rate, inadequate social and physical infrastructure, high level of adult illiteracy, low life expectancy, low percentage of primary school enrolment, and high population growth rates, with a large proportion of the population living in the rural areas. (See appendix 1 for map of the world showing developing regions).

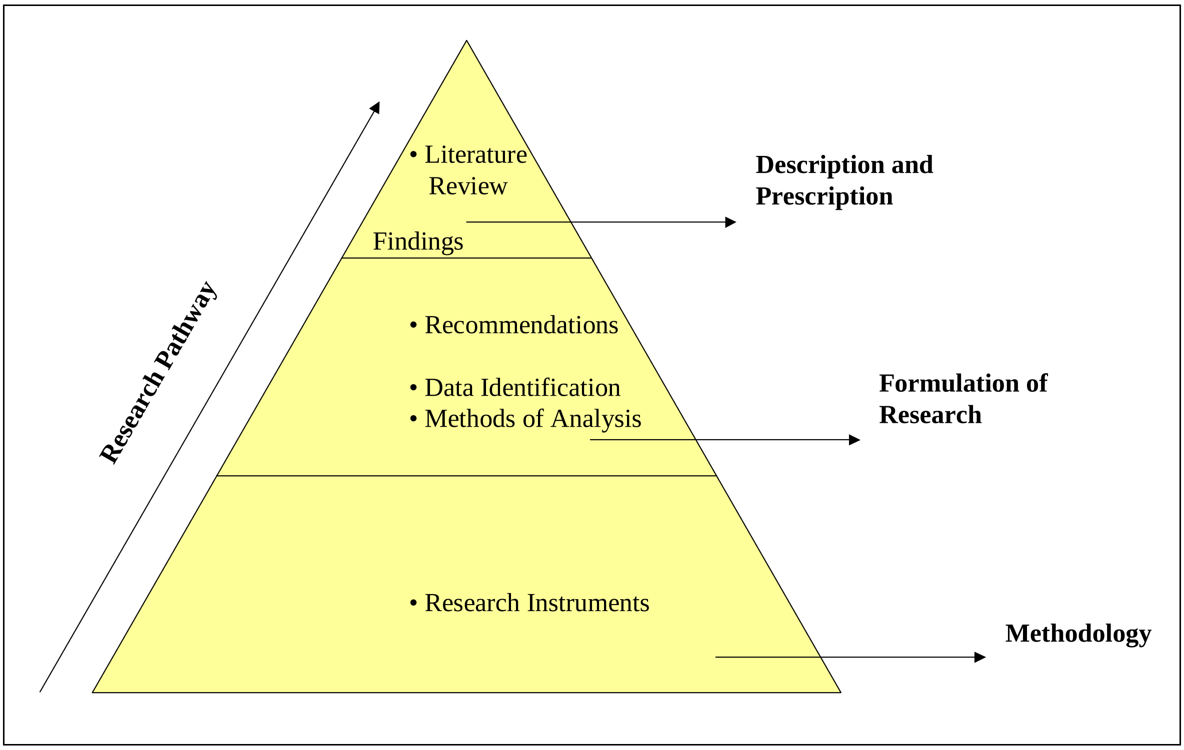
1.8. Limitation of the Study

The major limitation of this study is data gap. Because of the absence of a field survey, secondary data and experience have been mostly relied on. Limited time is another very serious constraint of this work. Much time was not available for an intensive research into the subject matter.

1.9. Organization of the Study

The organization of the process of this work is presented in the diagram below:

Figure 1: Framework of the research process



Source: Original.

2. Research Methodology

2.1. Introduction

The successful outcome of the report of any scientific study largely depends on, and is a direct function of, the quality and accuracy of data collected and used during the research. This chapter is concerned with the development of the logical framework of the research method. The development of the framework of the research methodology is based on the problem statement, hypothesis and objectives of the research, and the research questions. In fact it embraces the entire research up to the analysis and deduced conclusions. Although this paper is mainly general and theoretical in nature, it lays the basis for a further and more empirical study of the subject matter – *the role of micro-financing in rural poverty reduction.* This section discusses the approach adopted for data collection and analysis (the case study method), data classification and sources and the major instruments of data collection.

2.2. The Case Study Method

As I have earlier stated, this work is not strictly situational although the spatial aspect is addressed by reference to the developing countries in general and rural areas in particular. For the purpose of this paper, I have selected a number of developing countries and briefly analyzed the operation of microfinance in the individual countries. I must make it clear here that there is danger in making any generalization on the basis of what has been discussed on the four countries, although to a very large extent, there are more commonalities than differences, and generalizations are made out of the extensive literature that has been reviewed and personal experience.

For the actual research in Ghana, I will have to adopt the case study method for *the assessment of the impact of microfinance on the lives of the rural poor* in selected rural settings in the country. The case study method is a research method for empirical inquiry that investigates a contemporary phenomenon within the real-life context; it addresses a situation in which the boundaries between phenomena and context are not clearly evident, and uses multiple sources of evidence (Yin 1993) quoted by Richard Conteh (2001: 32). The issue of poverty reduction is a phenomenal one, which has to do with "why" and "how" questions and it involves a wide range of variables which the researcher has no control over. Outlining the way of live, interactions and attempts of the rural poor to escape poverty is a complex social phenomenon that can not easily be done by using quantitative or statistical analysis. It is because of this fact that the case study approach is deemed appropriate for this study, so that the descriptive element of the case study approach can explain those issues which mere statistical mean or standard deviation, for example, can not do. According to Conteh (2001: 32), case studies enable researchers to study in-dept peculiarities and idiosyncrasies that may shed light on the prominence of certain, hitherto uncovered, complex events and processes-most of which may escape statistical manipulations.

Although a real-life situation will be examined by the selection of villages and households for analysis, quantitative methods will have to be used alongside descriptive and explanatory analyses, where appropriate. To some extent, quantitative elements like percentages, ratios and graphs will be used to give more meaning to data analysis and interpretation. From the discussions above, it can be deduced that this researcher seeks to explore two contemporary phenomena of poverty and microfinance, and their relationship within the context of rural settings. The research deals with issues like norms, values, perceptions of the poor and non-poor with regards to poverty and microfinance, and interactions between individuals and groups; factors which the researcher has little or no control over. A relevant issue that must be highlighted here is that this research is a people-centered one because it commences from the rural household, the people directly affected. The people are made to identify their problems and explain ways in which microfinance as a poverty reduction instrument can be made effective and sustainable.

2.3. Classification and Sources of Data

The traditional classification of data for an empirical study like this will be followed in this section. Both secondary and primary data sources will be used for data collection. The most important limitation to this paper is the data gap. It is in fact the reason why a general theoretical approach has been developed for this study. The fact that a field research can not be conducted reduces the whole exercise to developing a thesis proposal for the actual research phase in Ghana. This section therefore discusses formulation of the research framework, that is, how data collection and analysis for the actual thesis writing on this subject will be conducted.

2.3.1. Secondary Data Sources

Secondary data sources are the foundation on which the theoretical and conceptual framework of the research is built. Relevant literature from existing empirical studies and reports, district or regional records on microfinance and poverty reduction and records of organizations and institutions related to the microfinance sector and rural poverty reduction programs, are to be carefully reviewed.

2.3.2. Primary Data Sources

First hand data, in simple terms, will form the bedrock of explanations, generalizations, conclusions and recommendations for this research. Much emphasis will be placed on the collection of accurate and reliable data so as to be able to come up with objective evaluations and to make informed conclusions and judgments. In the light of the above, the following research instruments will be used.

Interviewing Key Informants

Key informants such as coordinators of microfinance institutions, regional or district development departments, members of civil society or community based organizations and non-governmental organizations will be interviewed. These interviews will be in-depth and open ended so as to be able to solicit as much independent and objective information as possible. In the case of the community people sample households and individuals in the society will be selected at random and interviewed, using appropriate approaches to ensure a balance.

Personal participative observation

The researcher's involvement in community activities where possible and touring of the research area will largely buttress data collected from interviews and by other means. Microfinance intervention projects will be the target of such observations.

Administration of Questionnaires

Although this research is based on the case study approach involving selected microfinance institutions (MFIs) and households, some quantitative analysis will be required. For this purpose, sets of questionnaires will be administered to coordinators of MFIs, NGOs and CBOs who are involved in microfinance provisions and rural poverty reduction programs in the area of study. A set of questionnaires will also be used for a sample group of microfinance clients in the selected areas.

3. Review of Relevant Literature

3.1. Introduction

This chapter of the study reviews empirical evidence on two crucial and contemporary phenomena. The first issue is poverty in general and specifically rural poverty in developing countries. The second issue is the concept of microfinance and microfinance services in countries of the developing world as instrument for rural poverty reduction or alleviation.

3.2. The Concept of Poverty in Developing Countries

In this section the concepts of poverty in general and rural poverty in particular, on the one hand, and poverty reduction strategy on the other hand, which form the bedrock and focal point of this study, will be discussed in some detail.

3.2.1. Historical Perspective of Poverty

Poverty and efforts and the strategies to escape it are not new issues as is evident in a good number of studies that have been undertaken at different stages in economic development history. According to Peter Townsend (1970: ix), in the mid-1950s a number of studies appearing in Britain showed that despite post-war social reforms, high taxation and low levels of unemployment, there was poverty among old people, fatherless families, the unemployed and the sick. Up to that stage few people in any advanced industrial societies believed that, following the 1939 war, substantial poverty remained.

By 1960 public assumptions were transformed. Michael Harrington's *The Other America* was published in 1959 and official studies in the United States showed that, according to new definitions which became widely accepted, more than a fifth of the population was living in conditions of poverty (Townsend 1970: ix). On the issue of poverty reduction, Townsend further states that in 1964 the American war on poverty was launched, and throughout the early 1960s, in many parts of Europe, problems of squalor, deprivation and want were gradually acknowledged. In Britain two government studies of pensioners and families with children, found substantial numbers living below subsistence standard which society had approved.

Unfortunately, well planned and calculated efforts to address the issues of poverty reduction are relatively new in so-called developing countries, especially in most part of Africa and south Asia, where the poorest of the poor are found. Serious efforts to combat poverty in so-called developing countries date back to the later part of the last century.

3.2.2. Nature and Incidence of Poverty in Developing Countries

Poverty has no precise definition. It is a multi-dimensional phenomenon related to the inadequacy or lack of social, economic, cultural, and political entitlements. Poverty is hunger. Poverty is lack of shelter. Poverty is being sick and not being able to see a doctor. Poverty is not being able to go to school and not knowing how to read. Poverty is not having a job, is fear for the future and living one day at a time. Poverty is losing a child to illness brought about by unclean water. Poverty is powerlessness, lack of representation and freedom (World Bank 2000).

Poverty has many faces, changing from place to place and across time, and has been described in many ways. Most often, poverty is a situation people want to escape. So poverty is a call to action – for the poor and the wealthy alike – a call to change the world so that many more may have enough to eat, adequate shelter, access to education and health, protection from violence, and a voice in what happens in their communities (World Bank 2000).

Globally, 1.2 billion people are living in extreme poverty. Nearly two thirds of them live in Asia; South Asia accounts for half of them. About one fourth of the extremely poor people live in Sub-Saharan Africa (IFAD 2001: 11). Table 1 below shows that Sub-Saharan Africa is one of the poorest regions in the world. When measured in terms of the US One Dollar per day poverty line, poverty seems to be on the increase in the region. The table also shows that the incidence of poverty in the rest of the developing regions slightly declined between 1987 and 1999, when compared to Sub-Saharan Africa. Most disheartening is the fact that, while poverty gap in the entire developing regions put together dropped to 7.2 %, the situation in Sub-Saharan Africa remained at a constant 20% (IFAD 2001: 14).

Table 1: Poverty Incidence and Poverty Gap-in Sub-Saharan Africa and the Rest of the Developing Regions

Region	**Number of poor (millions)**			**Poverty incidence (% of total population)**			**Poverty Gap ratio (%)***		
	1987	**1990**	**1999**	**1987**	**1990**	**1999**	**1987**	**1990**	**1999**
Sub-Saharan Africa	217.2	242.3	301.6	46.6	47.7	48.1	20.0	20.0	20.1
All Developing Countries	1,227.1	1,276.4	1,174.9	28.3	29.0	23.4	8.6	5.0	7.2

Source: World Bank (2000).

Poverty is not just an issue of low income. Social factors must also be considered in addressing the issue of poverty, although an improvement over time does not necessarily mean that the conditions of all the poor have improved. Social factors are usually measured through outcome indicators in health and education. Infant mortality, life expectancy, adult literacy and primary school enrolments are most often considered. Table 2 compares social indicators of West and Central Africa with those of the whole of Sub-Saharan Africa. It shows that social indicators for West and Central Africa have slightly improved but at an uneven rate. Female illiteracy in particular is shown to reduce over the period. The drop in life expectancy has been attributed by development experts to the impact of HIV/AIDS epidemic in the region over the period.

* Poverty gap ratio (%) is the mean distance below the $1 (1993 PPP US$) a day poverty line, expressed as a percentage of the poverty line. The mean is taken over the entire population, counting the non-poor as having zero pov-erty gap. The measure reflects the depth of poverty as well as its incidence.

Table 2: Selected Social Indicators: A Comparison of West and Central Africa and Sub-Saharan Africa

Indicators	**1970**	**1980**	**1990**	**1999**
West and Central Africa				
Female Illiteracy Rate (% of total population)	90	81	71	54
Infant Mortality (no. of deaths per 1000 live births)	150	126	108	88
Life Expectancy (years)	42	46	49	48
Primary School Enrolment (% of school-going age children)	53	78	68	Not available
Sub-Saharan Africa				
Female Illiteracy (% of total population)	82	72	60	Not available
Infant Mortality (no. of death/1000 live births)	137	115	101	92
Life Expectancy (years)	44	48	50	47
Primary School Enrolment (% of school-going-age children)	51	81	76	Not available

Source: World Bank (2000).

To know what helps to alleviate poverty, what works and what does not, what changes over time, poverty has to be defined, measured, and studied, and even lived. As poverty has many dimensions, it has to be looked at through a variety of indicators – levels of income and consumption, social indicators and now, increasingly, indicators of vulnerability to risks and of socio-political access. So far, much more work has been done using consumption or income-based measures of poverty, but some work has also been done on non-income dimensions of poverty.

According to Karen Brock and Rosemary McGee (2002: 45), the dynamics of poverty are complex and mostly not easy to explain only by using economic models such as price equilibrium, perfect competition, and surplus extraction and so on. However, there are many variables that may explain why people enter into, escape from, or remain in poverty over the short, medium and long terms. These variables interact in ways that are hard to understand and predict. Using the parameters of social change has become a very popular approach for analyzing poverty and its implications among people in societies. However, 'the inherent complexity of processes of poverty-related social change would seem to call for detailed empirical studies of actual processes of change with a view to a better understanding of their underlying dynamics. Typically this is not how the analysis of poverty proceeds in economics.' From the above, it can be inferred that the two approaches, economic analysis and social change analysis could be used to analyze poverty and its dynamics. Brock/McGee also postulate that a major limitation of economic analysis of the poverty processes is its highly stereotype account of poverty processes which inform them.

The authors recommend the social change approach and express preference for the use of the Participatory Rural Appraisal (PRA) method. They argue that ‘in this context, PRA-type or the participatory analyses of poverty processes have a central role to play in examining actual processes of social change and the forces that constrain or impel them. There are a number of special problems that arise, however, when attempting to draw policy conclusions from PRA-type analyses of poverty dynamics’ (Brock/McGee 2002: 45).

In participatory rural appraisal, a range of techniques borrowed from anthropology and sociology are used to understand why people become poor and how their livelihoods change. Methods such as group discussions, semi-structured interviews and timelines and so on are used in this approach.

The great strength of participatory analyses of poverty is to focus attention squarely on actual, empirically informed processes of social change and the mechanism that generate them, as articulated by people experiencing them’ (Brock/McGee 2002: 46). A disadvantage of this process, however, is that the small-scale and local nature of the data generated by most of such analyses raises immediate questions about its applicability for drawing policy conclusions over a broader area. Questions may relate to comparability, reliability, generalizability, and casual weighting.

Contrarily, economic analyses of poverty, as stated earlier, relies on models which depict the flow of income and expenditure within an economy between production activities, factors of production (land, labor capital), institutions (households, firms and governments), capital accounts (investments and savings) and external transactions. Additionally, indicators such as household welfare, per capita income and consumption, to name a few are used in economic analysis. Most critiques say development can not only be measured or seen from economic perspectives. The issue of inequality in the distribution of wealth within regions and countries, and even between countries has always been crucial.

On the issue of measurement of poverty, Tridiv Borah (2001: 16), states that, to address the human problems of poverty we need analysis, policies and programs. He further states that in order to conceptualize poverty, two things are required: a method of identifying a group of people as poor (identification) and a method of aggregating the characteristics of the set of poor people into an over-all image of poverty. Borah further asserts (2001: 17), that the identification method involves the simple process of counting the number of the poor and then expressing poverty as the ratio of the number of the poor to the total number of people in the community in question. This ratio he refers to as the Head Count Ratio (HCR). Limitations are the failure of the method to take account of the extent and depth of poverty and its insensitivity to the distribution of income among the poor.

'Poverty Line' is the second method elaborated by Tridiv Borah. He describes it as the cut-off point between the poor and the non-poor based on income or consumption on a per capita basis. A person is considered as poor when his measured standard of living is below the minimum accepted level, known as the "poverty line". This line is said to be set in relative and absolute terms. Presently the US One Dollar per day per person is the international poverty line

According to Peter Townsend (1970: 6), whether development is defined restrictedly in terms of economic variables alone or broadly to cover economic, social and political variables, there is a problem not only of selecting the variables, but of relating variables of different weights, many of which may not be quantifiable. If a broad definition is adopted, how would the indicator for higher education be weighted with that of the number of inhabitants per physician? Table 3 below is a summary of a broad definition established on behalf of the United Nations Research Institute for Social Development (UNRISD) by Drewnowsk/Scott (1966). In the table, the index represents an attempt to produce an operational definition of social development. Level of Living is defined as, 'the level of satisfaction of the needs of the population assured by the flow of goods and services enjoyed in a unit of time' (Townsend 1970: 6). The authors give equal weight to the entire variables and declare that any weighting applied to them will be arbitrary.

Table 3: Level of Living Index

<table>
<tr><th colspan="3">Components</th><th>Types of indicators</th></tr>
<tr><td>I</td><td>Basic Physical Needs</td><td>1. Nutrition
2. Shelter
3. Health</td><td>1. Intake of calories and protein per head
2. Degree of overcrowding; structural facilities
3. Proportion of death at young age, proportion of pop; with access to adequate medical care</td></tr>
<tr><td>II</td><td>Basic Cultural Needs</td><td>4. Education
5. Leisure and recreation
6. Security</td><td>4. Proportion of children enrolled at school; pupil teacher ratio
5. Number of hours free from work per head per year; daily newspapers per 1000 population; radio and TV sets per 1000 population
6. Violent death per million population per year; proportion of population covered by unemployment and sickness insurance and old age pension</td></tr>
<tr><td>III</td><td>Higher Needs</td><td>7. Surplus income</td><td>7. Income in excess of cost of meeting basic needs</td></tr>
</table>

Source: Drewnowski/Scott (1966: 44-45).

3.2.3. Types of Poverty

There are different types of poverty. Lack of money or limited income (**income poverty**) is common to any definition of poverty. When we think of poverty we may think of starving people, living without proper housing, clothing or medical care – people who struggle to stay alive (Sen 1984). This is known as **absolute poverty**. Most people in the developing nations, especially Sub-Saharan Africa and South Asia, experience this type of poverty.

Unlike developing countries, the type of poverty experienced in developed countries, is more usually called **relative poverty**. In this case, people are considered to be living in poverty if their standard of living is substantially less than the general standard of living in society. The national anti-poverty strategies of governments must reflect this: that people are living in poverty if their income and resources (material, cultural and social) are inadequate to preclude them from having a standard of living that is regarded as acceptable by the society generally. As a result of inadequate income and resources, people may be excluded and marginalized from participating in activities that are considered the norm for other people (Sen 1984: 335).

Relative poverty is made up of two key elements: income poverty and deprivation. The combination of these two elements is called **consistent poverty**.

The focus of this paper is on both income poverty and absolute poverty explained above. These two types of poverty remain to be the main type of poverty in most developing countries, especially South Asia and Sub-Saharan Africa.

3.2.4. The Concept of Rural Poverty and Poverty Reduction Strategy

3.2.4.1. Meaning of "Rural"

In order to put rural poverty into a theoretical concept, it is first pertinent to establish what is meant by rural. The problem of defining "rural" is not new. In most cases authorities have to make difficult decisions on how to allocate resources on some quantifiable basis. However, it must be noted that numbers are not adequate to define rural because they miss the essence of what it means to be rural, and seldom satisfy those on the receiving end of the definition (Rios 1988: 1).

There is no concise and generally accepted definition of rural and I will make no attempt here to provide one. My intention is to show the complexity of the problem of defining rural and to provide some examples of definitions used by other people and agencies in order to make this exercise operational.

Developing a definition for rural has been a problem for some time. For example, in an analysis of 178 rural mental health workers and sociology sources published from 1971 through 1980, 43% did not define the "rural" they discussed, 48% used local or “homemade quantitative” definitions, and 23% used “external quantitative” definitions, such as census data (Bosak/Perlman 1982) quoted by Rios (1982: 1).

Quantitative definition of rural restricts the meaning to the number of people in a geographical area. According to Whitaker (1982), “rural” was first used by the United States Bureau of Census in 1874 when it was defined as indicating the population of a country exclusive of any to cities or towns with 8,000 or more inhabitants. This specific definition was dropped over the years by the 1980 Census. In this piece of work, emphasis is placed on the qualitative definitions of rural which considers major features such as simple life, agriculture, smallness, homogenity, and dullness.

3.2.4.2. Rural Poverty in Developing Countries

Rural poverty is a complex problem that has several characteristics: low incomes, low consumption resulting from low productivity, inequality in ownership and access to productive assets, poor health and education, degradation of natural resources, vulnerability to risk, and weak political power. Despite their importance, rural areas tend to be neglected and problems have been dealt with on an ad hoc basis. Rural poverty is heterogeneous, resulting variously as it does from lack of opportunity, of empowerment, and of security.

In its Rural Poverty Report 2001 – *The Challenge of Ending Rural Poverty* – the International Fund for Agricultural Development (IFAD), states that three quarters of the world’s 1.2 billion extremely poor people live and work in rural areas (2001: 1). Tridiv Borah (2002: 26), quoting Chambers et al, states: “The challenge is the scale and awfulness of rural poverty in India. There are other countries where poverty and suffering is immense and prospects grim, but India has one sixth of humankind, and nowhere outside India is there such a concentration of so many rural people who are so poor. In 1988, perhaps more than 200 million rural people were below the ‘poverty line.’”

In Volume 37, December 2000 edition of “The FINANCE,” a quarterly magazine of the International Monetary Fund (IMF), Mahmood Hassan Khan writes under the topic – *Rural Poverty in Developing Countries* – that rural poverty accounts for nearly 63 percent of poverty world wide, reaching 90 percent in China and Bangladesh, and between 65 and 90 percent in Sub-Saharan Africa. Khan maintains that in all countries, conditions – in terms of personal consumption and access to education, health care, portable water and sanitation, housing, transport, and communications – faced by the rural poor are far worse than those faced by the urban poor. The article, *Rural Poverty in Developing Countries*, goes further to postulate that persistently high levels of rural poverty, with or without overall economic growth, have contributed to rapid population and migration to urban areas; and that, in fact, much urban poverty is created by the rural poor’s effort to get out of poverty by moving to the cities

The IFAD report (2001: 25), mentioned earlier in this section, states that the rural poor are disadvantaged by remoteness, lack of education and health care, insecure and unproductive jobs, high fertility and (often) discrimination as women or ethnic minority.

IFAD argues that the rural poor, especially women, normally have higher age-specific mortality rates than the non-poor. It also states that the population of malnourished children in the bottom quintile is typically twice in the top (see table 4 below).

Table 4: Poor/Non-poor Mortality Ratios (Selected West and Central African Countries)

West and Central Africa	**Adults (15-59) (% of total population)**		**Children (0-5) (% of total population)**	
	Male	Female	Male	Female
Cote d'voire	1.5	1.5	2.4	3.3
Guinea	2.1	3.5	3.7	5.6
Guinea Bissau	1.7	2.1	2.2	3.0
Mauritania	1.9	3.4	3.0	3.7
Niger	1.9	3.5	3.4	4.8
Nigeria	1.8	3.1	3.1	3.7
Senegal	2.2	3.8	4.0	4.9

Source: IFAD 2001.

In economic terms, the rural poor depend largely on agriculture, fishing and forestry, and related small-scale industries and services. Some authors have classified the rural poor into two economic-related groups namely, cultivators and non-cultivators. Cultivators are described as those who have access to land as small landowners and tenants, and non-cultivators as landless, unskilled workers. Several authors (including Jaizary et al 1992; Ghaiha/Deolalikar 1993) have come up with factors both internal and external which influence, create and perpetuate rural poverty. Among these factors are;

- Grossly inadequate physical infrastructure such as roads, electricity and water supply systems;
- Political instability and civil strife;
- Systematic discrimination on the basis of gender, race, ethnicity, religion, or caste;
- Ill-defined property rights or unfair enforcement of rights to agricultural land and the natural resources;
- Corrupt politicians and rent-seeking public bureaucracies;
- Economic policies that discriminate against or exclude the rural poor from the development process;

- Large and rapidly growing families with high dependency ratios;
- Market imperfection owing to the high concentration of land and other assets and the distortion public policies;
- External shocks stemming from natural causes (for example, climatic changes) and changes in the international economy.

This discussion has basically focused on the incidence of rural poverty in developing countries, principally because the developed countries have almost, if not completely overcome the type of chronic and excruciating poverty rural people in developing countries are now experiencing. The experiences are quite different. For instance, according to Niles M. Hansen (1970: 31), in March 1967, about 57 million persons lived in rural America. Of this total, 47 million were in the non-farm population. Since World War II the average number of persons engaged in agricultural production has dropped from 10 million to about 5.2 million. Of these, about three-fourths are farm operators and members of their families; the rest are hired workers. This is just an indicator that the characteristics of the rural settings in the developed countries are at great variance with those of the developing countries in general, and much more greater for those of the least developed countries (LDCs) in particular.

3.2.5. Rural Poverty Reduction Strategies in Developing Countries

After comprehensively dilating on poverty in general and rural poverty in particular, the next most important question is: how do households escape from poverty and enjoy all the other benefits of development? IFAD (2001: 15), asserts that the majority of the world’s poor are rural and will remain so for several decades. Poverty reduction programs must therefore be refocused on rural people if they are to succeed. Poverty is not gender neutral: women enjoy less access to, and control over, land, credit, education, technology, health care, and skilled work. Therefore, a meaningful and sustainable rural poverty development program must aim at promoting knowledge and learning for increased rural well-being and broad-based rural development that takes into account all dimensions of poverty in rural areas. The multidimensional nature of poverty and its specific characteristics in a rural context require a comprehensive approach to rural poverty reduction that accounts for changes in today’s development context: the new situation created by the forces of globalization, the challenges of decentralization, institutional development, inadequate governance, the increased role of the private sector and civil society, as well as the rising number of conflicts.

In the 2001 *Assessment of Rural Poverty - West and Central African regions* by the International Fund for Agricultural Development (IFAD), it is observed that during the 1990s, in Africa and elsewhere, “getting prices right” became the overarching theme for advocates of structural adjustment. In the late 1980s and early 1990s, as adjustment efforts stalled in many countries – sometimes exacerbating social tensions – and researchers began to detect differential impacts of adjustments on social groups, poverty problems became more visible and calls for social safety nets became more pronounced (IFAD 2001: iii). Worst still, governments and the international community regarded safety nets as charities and instruments for buying political stability. They failed to recognize the essence of making poverty reduction the central theme of economic and social development efforts.

The good news is that, from the mid 1990s to date, the development community has recognized the dire need for poverty reduction. This became evident when the United Nations General Assembly adopted *Resolution 47/196* in 1992 recognizing that an increase in public awareness was necessary in order to eradicate poverty around the world and declared *17th October* the International Day for the Eradication of Poverty (IDEP). In a similar vein, in 1995, the World Social Summit placed poverty reduction on the global development agenda, resulting in the decision to halve global poverty by 2015. This position was re-enforced by the Millennium Summit in 2000, where it was emphasized by governments and international donors that development can only be sustainable – socially, economically and politically – when poverty reduction is explicitly taken into account.

These affirmations have been followed by actions by both international and bilateral donor organizations. In module one of the series *An overview of Poverty Reduction Strategy*, published by the Asian Development Bank Institute, Sheila Marnie (2004: 1) explains that the World Bank and the International Monetary Fund have made the preparation of national Poverty Reduction Strategy Papers (PRSPs), a prerequisite for concessional lending. United Nations organizations are working on setting country targets and indicators for the Millennium Development Goals; income and non-income targets that should be fulfilled by 2015. The African Development Bank (ADB) has declared poverty reduction as its prime objective, and like other international donor organizations, has adopted the Millennium Development Goals as principal target for poverty alleviation.

The three major ways in which policies affect the rural poor are: through markets, infrastructure (including public services), and transfers. The markets, in which the rural poor participate are those for products, inputs (labor and non-labor), and finance (formal and informal sources). The infrastructure that directly affects the rural sector's productivity and the rural poor's quality of life include the economic (transport, communications, extension services, and irrigation) and social services (education, health care, sanitation and water). Quality of service: access of the rural poor to public services and infrastructure has important impacts on human capital and productivity in rural areas. Public transfers can take the form of redistribution of assets, like land, employment on public works and projects, and targeted subsidies for inputs and some consumer products (Khan 2000: 5).

Although in early years, several different approaches were taken by different countries as measures for poverty reduction, national Poverty Reduction Strategy Papers (PRSPs) have become prevalent in recent years because of the position taken by the World Bank and International Monetary Find (IMF) on poverty reduction in poor countries. PRSPs are a requirement for countries in order to receive concessional assistance from the World Bank (through the International Development Association) and the IMF (through the Poverty Reduction and Growth Facility). They are also a basis for the provision of debt relief under the enhanced Highly Indebted Poor Countries (HIPC) Initiatives. Seventy low income countries around the world have PRSPs on their agenda (World Bank Group-Poverty Net, http://www.worldbank.org/poverty). In order not to delay their access to concessional assistance, very poor countries that have not developed a full Poverty Reduction Strategy Paper are allowed to prepare Interim Poverty Reduction Strategy Papers (I-PRSP).

According to the World Bank Group-Poverty Net, the core principles underlying the preparation and implementation of PRSP should include the following:

- A description of the **participatory process** that was used: A PRSP will describe the format, frequency, and location of consultations; a summary of the main issues raised and the views of participants; an account of the impact of the consultations on the design of the strategy; and a discussion of the role of civil society in future monitoring and implementation.
- **Comprehensive poverty diagnostics:** A good understanding of the poor and where they live allows the PRSP to analyze the macroeconomic, social, structural and institutional constraints to faster growth and poverty reduction.
- **Clearly presented and costed priorities for macroeconomic, structural and social policies:** In light of a deeper understanding of poverty and its causes, the PRSP sets out the macroeconomic, structural and social policies that together comprise a comprehensive strategy for achieving poverty reducing outcomes. It is important that policies are costed and prioritized as far as possible so that they do not become a "wish list."

For the most part, I-PRSPs and PRSPs, to date have focused on economic and structural policies to achieve higher growth rates and on social sector investments (World Bank). A Joint Staff Assessment (JSA) team, comprising national staff and staff of the World Bank and the IMF evaluates the soundness of each PRSP, and accompanies the PRSP to the Boards of Executive Directors of the World Bank and IMF. This document is an assessment of whether or not the strategy presented in the Poverty Reduction Strategy Paper constitutes a sound basis for concessional assistance and debt relief. It should be noted that a positive Joint Staff Assessment does not signify agreement with all the analysis, targets, or public actions included in the PRSP or that the PRSP represents the best possible strategy for the country. Rather, it indicates that the PRSP is a credible framework which the World Bank and IMF will support.

Besides the World Bank and the IMF, almost all external development partners have expressed their strong support for the objectives and principles of the PRSP approach, their eagerness to work with governments in preparing strategies, and their intention to adjust their own programs to support these strategies. For example, the European Union decided to base its five-year assistance programs in African, Caribbean, and Pacific countries on PRSPs. Key bi-lateral donors, including the Netherlands and the United Kingdom, see PRSPs as playing a leading role in shaping their development assistance. Many governments have begun to use the PRSP process as a means to improve aid coordination. To this end, certain countries have presented their strategies to donors (Burkina Faso and Uganda). The PRSP approach has its own challenges. These include tensions that were recognized from the beginning as inherent. The most important of these are the tension between quality and speed in preparing country strategies; and between country ownership on the one hand and the World Bank and IMF assessment of country strategies on the other. The World Bank Group-Poverty Net (WBG-PN 2000) explains the aforementioned challenges of PRSPs as follows;

The **"quality versus speed"** tension is related to two competing needs – the need to ensure that country-owned strategies are based on broad-based participation and effective analysis, versus the goal of moving forward quickly with strategy preparation so as to enable access to concessional assistance and debt relief. This tension is alleviated by the use of Interim-PRSPs, which do not require the participatory processes or the degree of analysis expected for full PRSPs. However, both countries and development partners have become increasingly concerned about the time required to move from I-PRSPs to full PRSPs. To give countries more time where needed, the World Bank and IMF have recently modified the original expectation that a full strategy be completed within a year of I-PRSP preparation. The government will need to submit a short progress report to the World Bank and IMF, providing a revised submission date and outlining the progress made to date since the I-PRSP.

The **"ownership versus assessment"** tension reflects two competing principles – that strategies genuinely reflect country priorities, but that the Bank and Fund ensure, on behalf of their shareholders, that concessional assistance and debt relief will be wisely used in a policy environment and for purposes that promote poverty reduction. This tension can be reduced by a constructive policy dialogue with countries, openness on the part of the Bank and IMF to countries' **"home-grown"** approaches, and the exercise of good judgment in light of specific country conditions and international experience (World Bank Group-Poverty Net 2004).

The essence and appropriateness of the Poverty Reduction Strategy Papers to developing countries in their quest to reduce/alleviate national and rural poverty is that PRSPs are all inclusive and places emphasis on full participation of all stakeholders including the rural communities.

3.3. The Concept of Microfinance in Developing Countries

A conceptual and theoretical framework of microfinance in developing countries is the subject of this section. Existing literature and available empirical data relevant to the purpose of this study will be reviewed with the aim of creating a meaningful link between the problem statements, hypothesis and objectives of the study and the research questions. I will examine microfinance issues in four countries selected arbitrarily in Asia, South America and Africa.

3.3.1. Nature and Scope of Microfinance in Developing Countries

In a strict sense, micro-credit and microfinance do not mean the same thing. While micro-credit may have a narrower meaning (the provision of small loans), microfinance extends beyond just providing loans. To most people, microfinance means providing very poor families with very small loans (micro-credit) to help them engage in productive activities or grow their tiny businesses. Over time, microfinance has come to include a broader range of services such as savings, credits, insurance, and remittances from abroad and other related products. "We have come to realize that, the poor and the very poor, who lack access to traditional and formal financial institutions, require a variety of financial products" (Microfinance Gateway; www.microfinancegateway.org). In this piece of work much attention will not be paid to the strict technical difference between the two terms, and so I will use them interchangeably. For ease of presentation and for the purpose of this paper, the working definition of microfinance or micro-credit will be the lending out of small amounts of money for short periods with frequent repayment, rural savings scheme, insurance services, and other related services such as money transfers and payments.

In one way or the other, almost every country in the world has seen the need to adapt its structure of financial services to improve outreach to the many as yet "unbanked" people and enterprises. This was the genesis of thrift institutions, local savings associations and cooperatives across the world over the rest of the century and more. The same need motivated the rise of formal Microfinance institutions in developing countries since the Grameen Bank came into being in the 1970s. Patrick Meagher (2002: 1) asserts that microfinance across the world began variously as the activities of informal savings and credit groups, money lenders, donors, and NGOs. However, according to Microfinance Gateway Institute, micro-credit came to prominence in the developing countries in the 1980s, although early experiments date back 30 years in Bangladesh, Brazil and a few other countries.

Traditionally, microfinance was focused on providing very standardized credit products. The poor, just like anyone else, need a diverse range of financial instruments to be able to build assets, stabilize consumption and protect themselves against risks. Thus, we see a broadening of the concept of microfinance. Our current challenge is to find efficient and reliable ways of providing a richer menu of microfinance products. The typical microfinance clients are low-income persons that do not have access to formal financial institutions. They are typically self-employed, often household-based entrepreneurs. In rural areas, they are usually small farmers and others who are engaged in small income-generating activities such as food processing and petty trade. In urban areas, microfinance activities are more diverse and include shopkeepers, service providers, artisans, street vendors, and so on (Microfinance Gateway; http://www.microfinancegateway.org).

3.3.2. Microfinance Institutions and Services in Selected Developing Countries

As we broaden the notion of the types of services microfinance encompasses, the potential market of microfinance clients also expands. For instance, micro-credit might have a far more limited market scope than, say a more diversified range of financial services which includes various types of savings products, payment and remittance services, and various insurance products. For example, many very poor farmers in developing countries may not really wish to borrow, but rather, would like a safer place to save the proceeds from their harvest as these are consumed over several months by the requirements of daily living. In many if not most developing countries, microfinance has grown to the point where financial regulators see the need to frame a policy, and eventually integrate some portions of the microfinance spectrum into the framework of the regulated financial services units (Meagher 2002: 1).

In this section I will concentrate on selected countries from the three major regions with developing economies (South America, Asia and Africa). In South America, I have selected Bolivia, Ghana and Ethiopia in Africa and the Philippines in Asia. Selection of these countries was basically arbitrary and not based on any scientific approach.

Microfinance institution operating in the four selected countries may be divided, for ease of presentation, into two categories. In the first category are those directly regulated or supervised by the government through designated government agencies.

The second category contains those that are not directly regulated. In

Ghana, Ethiopia and Bolivia, Microfinance institutions are regulated. The Philippines operates a mixture of the two, direct regulation and indirect (self-) regulation. The microfinance services can also be provided by formal and informal sectors. A detailed description of the economic, social, and geographic profile of the countries selected is beyond the scope of this paper.

3.3.2.1. The Formal Sector

The formal-sector microfinance institutions include government agencies such as rural banks, public-private partnerships or solely private ownerships, civil society or community based organizations or non-governmental organizations.

I. **Bolivia:** Bolivia's 1993 Law of Banking and Financial Institutions introduced multiple-service banking or "multi-banca," which allowed banks to offer several types of services, from universal banking to microfinance. The law's liberal nature, freed interest rates to be determined by the markets and placed few directions on financial institutions' placing of resources and investments. According to Meagher (2002: 14), it lead to the lower end of demand not being met. However, in 1995 the authorities created a Private Financial Fund (PFF) for Non-Banking Institutions (NBFIs) to channel resources to small and micro-entrepreneurs and individuals for durable goods purchase. These PPFs can lend money, engage in finance leasing and factoring. Out of six PPFs in 1996, two were microfinance institutions; four NGOS were converted into regulated MFIs and had about 104,000 clients with a portfolio of $105 million (FONDESIG/GTZ 2001). Microfinance institutions in Bolivia are required to be incorporated and have a paid-up capital of one million dollars. They are regulated by the Bolivia Central Bank and the Superitendency of Banks and Financial Institutions. Superitendency fees and license fees are paid by MFIs. See table 5 below for a cross country comparison and microfinance sector analysis.

II. **Ethiopia:** The Ethiopian Financial Regulatory Structure enacted in 1996 demands that MFIs are 100% Ethiopian owned. In order to accept savings demand and time deposits draw and accept drafts within Ethiopia, they must secure a license from the National Bank of Ethiopia. Only licensed MFIs are allowed to accept concessional assistance or credits from foreign organizations. License fees, no recognition and non-tolerance of informals, and lack of self-regulation in the microfinance sector constrains innovation and puts new entrants in too much of legal formality. Ceilings on loan size and terms are apparently maladapted to many farmers' needs (Shiferaw/Amha 2001). Patrick Meagher (2002: 19) reports that 16 major Microfinance Institutions operate in Ethiopia presently with a mixture of regional governments, NGOs and individual ownership, with an estimated half a million active clients. At the time of writing there was about $34 million in credit and $16 million held in savings. Repayment rate is almost 100 %. Table 5 gives additional details on the country.

III. Ghana: A Financial Institutions Law offered potential microfinance providers a non-banking license option. In this category are thrifts and a variety of licensed companies. Non-banking financial institutions must be incorporated and licensed by the Bank of Ghana. The three types of non-banking financial institution licenses are: (1) institutions taking retail, wholesale and no deposits, (2) depository and credit only institutions which are regulated with more strict prudential standards and (3) credit only institutions which apply to the bank of Ghana to accept deposits from the public (Meagher 2002: 19). See table 5 below for additional information on the sector.

IV. The Philippines: Both regulated and self-regulated microfinance systems operate in the Philippines. The rural banks operate under the legal framework for rural banks. They are fully owned by Filipino individuals and entities. According to Gomez et al (2000), by end of 1997, 800 rural banks, 51 of them cooperative rural banks were operating in the Philippines. There are also NGOs providing microfinance services outside the legal framework for regulated rural banks. They are not allowed to take deposits from the public. Because they are not regulated by the state, self-regulation systems have emerged among them in the form an NGO-MFI association, the Peoples Credit and Finance Association (PCFA), the Association of Private Partners for Enterprise Development (APPEND) and PHILNET- a group of MFIs replicating the Grameen bank system. Other services such as training, funding, coordination among others are undertaking by these groups. See table 5 for other important information on the Philippines

V. Summary: Examining the information on the four countries in the above discussion and table 5 below, a number of important issues common to all four countries arise. First, it is clear that in all four countries the operation of microfinance institutions is regulated by the various governments. According to Gomez et al (2000), as a result of the constraints imposed by the regulatory regime, there had been (at the time of writing) only one NGO transforming into a Microfinance institution in the Philippines. These supervisory or regulatory practices are also reported to have increased operational cost for MFIs and, therefore, inhibit the expansion of the sector. It is also obvious from the data given that all the countries have very low per capita income based on the Purchasing Power Parity (PPP) – Bolivia \$2,380; Philippines \$4,220; Ghana \$1,940 and Ethiopia \$660. This is also a very common incidence among almost all developing countries especially Sub-Saharan Africa and South Asia. Demand for microfinance in most developing countries is mostly under-supplied as is evident in data presented in table 5. For instance in Ethiopia, 64 million people (76.4% of the population), are in the poverty bracket, living on less than \$2 a day. The table shows that only 500,000 people are benefiting from microfinance services. In Ghana 74.6 % of the population (19 million) are poor. In the Philippines 76 million are poor.

Table 5: Cross Country Comparison of Economic indicators and Microfinance - Sectors in Four Selected Developing Countries

Countries	**PPP National Income per Capita (2000)**	**Population with Income under $2 per day (1990s)**	**Domestic Credit from Banks share GDP(2000)**	**Definition of Microcredit**	**Minimum Capital for MFIs**	**Microfinance Clientel**	**Total Microfinance Portfolio**
Bolivia	$2,380	8 Million 51.4%	63.2 %	Loans under $500	$1 Million	40,000 (PPFs)	$105 million (PPFs)
Philippines	$4,220	76 million	62.9%	Services to farmers, fishermen, merchants with small cash requirement	$50,000 to $500,000 (rural banks)	500,000 (rural banks)	$1.04 billion (rural banks)
Ghana	$1,940	19 million 74%	38.7 %	Loans up to $140, $1400 with group guarantee	Old: $140,000 $70,000 non depository New: $2.1 million $1.4 million non depository	No answer	$8.9 million (rural banks)
Ethiopia	$660	19 million 74 %	63.3 %	Loans $625 or less, especially marginal farmers	$25,000	500,000	$34 million

Source: World Bank (2002); Meagher (2002: 19).

In the market system, supervision or regulation may lead to suppression of the system. The challenge for policy makers is to design non prudential standards and controls in ways that accommodate the realities of microfinance and help stabilize the market, rather than suppress it (Meagher 2002: 14). The main rules on regulation relate to entry requirements and operating practices. Entry requirements for starting MFIs or conversion into regulated entities cover minimum capital requirement, institutional form and governance requirements, and ownership restrictions.

However, according to Meagher (2002: 14), high minimum capital requirements pose obstacles to entry or conversion into MFIs, although requirements set too low create the supervisor’s nightmare of too many entrants, with resulting painful exit and consolidation. One suggestion is to assess the economies of scale that are available in the market and to encourage MFIs to move in that direction.

Operating regulations place a limit on several aspects of day-to-day operations. These include usury laws and interest rates, loan documentation requirements, operational restrictions affecting, for example, business hours and branch openings. Rules for fair treatment and information disclosure to borrowers are also part of the operational regulations.

In recent years international financial organizations have focused much attention on enhancing the operation of microfinance services in various countries as the following information outlines; In July 1996, the World Bank published a study on over 200 micro-credit institutions around the world. At the time of the World Bank's survey, about seven billion dollars in loans to more than 13 million individuals and groups were outstanding. In 1994 alone, 33 million new loans were issued to clients of the sampled institutions. Micro-credit institutions include banks, savings banks, credit unions and non-governmental organizations (NGOs). Many NGOs rely on donor funding or concessional funds for the majority of their lending while banks and credit unions utilize customer and member deposits and commercial loans for funding. A growing number of NGOs are progressing quickly towards self-reliance, however. Nevertheless, it is clear that NGOs offer the smallest loan sizes and relatively more social services than banks, savings banks, or credit unions. Credit unions and banks appear as leaders in serving large numbers of clients with small deposit accounts (World Bank 1996)

Many micro-credit institutions focus on lending to the extremely poor. Fifty-three percent of the clients live in rural areas. Many organizations also focus on loans for women. NGOs have actively sought female clients, based on traditionally high female loan repayment rates coupled with the finding that women tend to spend a greater percentage of their share of household income on items such as food and children's clothes, education, and health. Grameen Trust had 105 partner projects in 34 countries around the world by the end of 2000. Approximately 600,000 poor families - more than two million people in all - are benefiting (World Bank 1996).

3.3.2.2. The Informal Sector

Even though a family may have a significant income for extended periods, it may also face months of no income, thereby reducing its ability to enter into the type of commitment demanded today by most microfinance institutions. Some people are just too poor, or have incomes that are too undependable to enter into today's loan products. These extremely poor people at the bottom percentiles of those living below the poverty line need safety net programs that can help them with basic needs – some of these are working to incorporate plans to help ‘graduate' recipients to microfinance programs (Tiwari/Fahad 2001).

For the type of people referred to above, the informal microfinance sector remains still important and relevant to them. For this class of people micro-saving should be the emphasis rather than micro-credit. Rebecca Vonderlack and Mark Schreiner (2001: 3) observe that microfinance practitioner have come to understand that small credits are not always appropriate for poor women. After all, a loan becomes debt and the poor are exposed to crisis if an expected source of funds for repayment evaporates. Thus, borrowing is often riskier than saving. For example, a woman can save to buy a sewing machine. If a child falls ill, saving could be tapped to pay for medicines, but debt precludes medical treatment. Vonderlack/Schreiner argue further that although not all people are credit worthy, all people are deposit-worthy and want assets. Below are some of the informal micro-savings facilities that exist in most developing countries:

I. Door-to-Door Deposit Collection

This involves people paying others to collect and keep their savings, at their door steps or market stalls, on a daily basis. Small fixed amounts are involved. For example in Ghana, men and women make 30 small daily deposits a month and at the end of the month they receive 28. The deposits are kept on the bank and the collector lends the monies out informally. Transaction costs are eliminated.

II. Rotating Savings and Credit Associations (ROSCA)

This type of savings facility involves a small group meeting or regularly to make fixed contributions at intervals. For instance 12 people can meet each month for 12 months to contribute $50 each. At end of every month each member gets the pool. Those who have received from the pool are debtors while those yet to receive are depositors**.** According to Andener/Burman (1995), Rotating Savings and Credit Associations are common among poor women because of low transaction costs and the pressure to save regularly.

III. Annual Savings Clubs

These resemble large scale rotating savings and credit associations or small scale credit unions. They are run by religious organizations, social clubs trade associations etc, and members make smaller deposits in regular meetings they attend for non-financial reasons. These are more flexible because each saver decides on what to deposit regularly and balances earn interests. Annual cycles of the clubs end around major events like Christmas.

IV. In-kind Savings

This is one of the most common forms of informal savings among poor people in rural areas. It involves keeping high value items that can be sold for cash in time of emergency. Examples include cattle, jewelries, alcohol, to name a few. These types of microfinance services, although they may sound simplistic to some people may have remarkable impact on the poorest of the poor who, because of their circumstances do still not qualify to receive benefits from the rapidly growing formal microfinance programs in the various developing countries.

V. Summary

Often, governments and aid agencies may wish to use microfinance as a tool to compensate for some other social problems such as flooding, relocation of refugees from civil strife, recent graduates from vocational training, and redundant workers who have been laid off. Since micro-credit has been sold as a poverty reduction tool, it is often expected to respond to these situations where whole classes of individuals have been ‘made poor'. Micro-credit programs directed at these types of situations rarely work. Credit requires a 98% ‘hit' rate to be successful (Microfinance Gateway). This means that 98% of recent vocational school graduates or returning refugees would need to be successful in establishing a micro-enterprise for repayment rates to be high enough to allow for a program's overall sustainability. Running a programme with substantial default rates undermines the very notion of credit and destroys credit discipline among those who could repay promptly but who look foolish given that many do not.

Micro-credit serves best those who have identified an economic opportunity and who are in a position to capitalize on that opportunity if they are provided with a small amount of ready cash. Thus, those poor who work in stable or growing economies, who have demonstrated an ability to undertake the proposed activities in an entrepreneurial manner, and who have demonstrated a commitment to repay their debts (instead of feeling that the credit represents some form of social re-vindication), are the best candidates for micro-credit. The universe of potential clients expands exponentially however, once we take into account the broader concept of ‘microfinance'.

It is also important to design background interventions that build the market for microfinance clients. Such interventions can range from building infrastructure to opening up new markets for the produce of the poor to providing business development services. Often these interventions will create conditions and opportunities for microfinance and not the other way round. What needs to be avoided is directional use of microfinance to sort out developmental challenges in situations where the basis of peoples' livelihood is destroyed. Grameen-style banking in the Philippines for rural poor people – especially women – can be highly successful for both the borrower and the lender. Increasingly, rural banks are adopting group lending techniques (peer group method), increasing the guarantee of repayment and their outreach

4. Contribution of Microfinance to Rural Poverty Reduction

4.1. Introduction

The thesis of this study is that a well coordinated, effective and efficient microfinance system in developing countries can contribute positively to the reduction of poverty among poor rural households. My assertion here is that, with easy access to finance, farmers will be able to acquire appropriate modern farming inputs such as high-yield variety seeds, fertilizers, insecticides, irrigation systems and extension services, which will subsequently lead to increased agricultural productivity. In a similar vein, it is postulated that with access to capital more poor people in rural settings will invest in small-scale and microenterprises and industries, and that those who are already entrepreneurs operating small-scale and micro enterprises and industries will expand their ventures. These assumptions, however, are against the background that other enabling environmental factors such as proper business enterprise and economic policies, and an appropriate legal framework exist. Available physical infrastructure like roads, electricity, and markets are necessary. The ultimate outcome of the above is increased income for rural households, which is a prerequisite for an increase in the overall standard of living.

In his speech at a Microfinance Summit in 2002, in New York, Hugh Grant, the Operating Officer “Monsanto-Imagine,” an organization working with partners in developing countries to provide small-holder farmers with beneficial agricultural technologies and economic help through credit, had this to say: “micro-credit is an important tool to fight poverty, particularly in rural communities. These small loans are enabling impoverished people, especially women, to provide goods and services that where not available or not affordable before” (http://www.monsanto.com).

However, Linda Mayoux (2002: 6), observes that an increasing body of evidence on microfinance in Africa and elsewhere, suggests that its contribution to poverty reduction and women’s empowerment is generally less than expected. In this section I will discuss the contributions of microfinance to reduction/alleviation of poverty in general and rural poverty in particular.

4.2. Impacts of Microfinance Services on Rural Poverty

In this section, the contributions of microfinance to rural poverty reduction in developing countries will be examined under the various categories of services that are provided by both formal and informal microfinance institutions. The main focus however, is on institutionalized microfinance providers. The services provided by microfinance institutions have been classified into four categories namely, savings facilities, credit facilities, insurance services and money payments or transfer services. The reasons for such clarification are for sustainability, monitoring and evaluation of programs. The rationale for the choice of this approach of analysis is to make the presentation logical and more explanatory, and to eventually come out with impacts of existing services on rural poverty.

4.2.1. Savings Facilities

With more financial savings, capital is accumulated and greater capacity for self-investment is enhanced. In addition, the need to borrow at high interest rates from private money lenders is reduced and the ability to purchase more productive assets improved. Most of the other advantages and impacts of Savings facilities, mentioned under credit facilities (below) in terms of investment opportunities apply to savings facilities. Vonderlack/Shreiner (2001: 1) state that the recent shift in terms from micro-credit to microfinance reflects that savings services – and not just loans – may help to improve the well-being of the poor in general and women in particular and that (2001: 3) borrowing is riskier than saving.

4.2.2. Credit Facilities

This is the micro-credit component of microfinance services. It involves giving small loans to poor rural people for relatively short periods and regular and frequent repayment. “Small amounts” of loan is however a relative term and varies from institution to institution and from time to time. According to Oxfam, micro credit consists of "very small scale financial services, including savings, loans for emergencies, day-to-day living, and investment in productive activities" Credit is usually provided to groups of individuals or village organizations that use joint-liability (a. k. a. peer pressure!) to enforce loan repayment. “If we can come up with a system which allows everybody access to credit while ensuring excellent repayment – I can give us a guarantee that poverty will not last long” – Muhammad Yunus (1994). These are the words of Muhammad Yunus, the founder and executive director of the Grameen Bank in Bangladesh.

As a result of better credit facilities, technologies can be adopted by farmers and small- and micro-industry entrepreneurs. This will invariably lead to the diversification of economic activities and economic growth at local, regional and even national levels. At household level, access to credit facilities enables rural households to smoothen their consumption over the year, especially for low income seasons. In addition, micro credit reduces reliance on expensive personal and informal exploitative sources. It enhances the ability of the poor to face external shocks and reduce the distress selling of their assets. Ultimately, the impact on the household will include higher income, more diversified sources of income, increased household consumption and better education for the children. Furthermore, by reducing the severity of poverty, the rural poor are empowered and their social exclusion is reduced. It must be noted that the overall impact of credit facilities on the regional and national economy will depend on other factors like good roads, market facilities and so on, as earlier mentioned in this study.

4.2.3. Insurance Services

This encourages more saving in financial assets and reduces the risk and potential losses in times of unforeseen circumstance. Particularly insurance services reduce the impact of external shocks. As a result of the above, it leads to an increased desire among the rural poor to invest. The ultimate impacts are greater income, less volatility in consumption and greater security.

4.2.4. Payments and Money Transfer Services.

This service facilities the free flow of money and subsequently trade and investments. The easy transfer of money from one place to another and from person to person is a very effective instrument in facilitating business between people and places near and far. Thus with banking services that enhance investors and even individual to easily access money, greater income is available among people in the rural area and their consumption level increases.

4.2.5. Concluding Observations

Following are evidences presented by the Asian Development Bank on contributions of microfinance to poverty reduction in the Asian region. About 21 percent of the Grameen Bank borrowers and 11 percent of the Bangladesh Rural advancement Committee, a micro finance NGO, managed to lift their families out of poverty, within about four yeas of participation. According to ADB extreme poverty declined from 33 percent to 10 percent among Grameen Bank participants and from 34 percent to 14 percent among Bangladesh Advancement Committee participants. In Indonesia sample survey in 1988 of unit Desa estimated that household income of borrowers increased by about 76 percent and employment increased by 84 percent with three years of programme participation.

On the issue of women, ADB asserts that microfinance institutions have also brought, particularly poor women into the formal financial system and enabled them to access credit and accumulate small savings in financial assets, reducing their household poverty. Finally, it must be observed that there is general agreement among researchers and practitioners that the poorest of the poor are yet to benefit from microfinance programs in most developing countries partly because most microfinance institutions do not offer products and services that are attractive to this category (www.adb.org 2000). African countries, especially South Saharan-Africa, are yet to provide more planned and coordinated microfinance services for the very poor in the rural areas.

5. Conclusion and Recommendations

5.1. Conclusion

As stated earlier, this theory-based study lays the foundation for the final thesis on the role of microfinance in rural poverty reduction. Through the chapters of this paper, several empirical research literatures have been reviewed. The study covers, in a broad frame, developing countries. However, there are areas where reference is made to situations in particular countries in the regions of the so-called developing world.

The contribution of microfinance to rural poverty reduction through the provision of credit and savings facilities, insurance and money transfer services may be a very viable way forward for the socio-economic development of rural societies in developing countries. Poverty and chronic deprivation have long been a tragic aspect of human society. In the past this was often accepted with a sense of resignation, a sense of fatality that the poor will always be with us. Helping the poor by then was always an issue of compassion and charity, and a thing for religious organizations. According to IFAD (2001: i), compassion drove some to offer charity to the poor, particularly through religious institutions. However, today, with 1.2 billion human beings, a vast majority of them in the developing countries, condemned to short lives, stunted by malnutrition, ill-health and illiteracy, the perspective on poverty has transformed. This was manifested by the world leaders in the Millennium Summit when for the first time in history human society committed itself to reducing substantially – by half – the number of people in absolute poverty within a short period of time by 2015. Practical evidence points to the fact that poverty poses a growing threat to social stability and civil order, acts as a reservoir for communicable diseases and a trigger for crimes and strife (IFAD 2001: i), This is a fact now as manifested in most developing countries, especially South Asia and Sub-Saharan Africa.

Present studies show that poverty, especially in developing countries in general and Africa in particular, has not considerably declined, irrespective of several poverty reduction strategies adopted by these countries (UNDP Human Development Report 2003). Microfinance can be a stimulant to several other economic development activities, with a very serious multiplier effect on rural and overall national economies. This underscores the importance of enhancing the effectiveness and efficiency of microfinance services in the various countries of the developing world so as to enable the rapidly growing population of the rural poor to escape from the trap of absolute poverty. The lack of proper organization, coordination, best practices and attractive services which target the poorest of the poor, account for the ineffectiveness of microfinance as a strategy for reducing rural poverty in the developing countries. Many poverty reduction strategies including microfinance operations in the developing countries fail to ensure the full participation of the rural poor, especially the women. These programmes have had very little significance. The poor have demonstrated in several studies their willingness to pay for facilities as long as they are convinced that the services will yield benefit to them.

5.2. Recommendations

This researcher is of the strong opinion that the adoption of the financial system development approach is the key to achieving sustainable results and maximizing social and economic development impacts. This approach emphasizes an enabling policy environment, financial infrastructure, and the development of financial intermediaries that are committed to achieving financial viability and sustainability within a reasonable period. My strongest conviction is that a thorough and careful implementation of the suggestions forwarded below, by the relevant organizations and authorities will lead to the successful and sustainable achievement of the desired impact micro-financing should have on rural poverty in developing countries.

5.2.1. Policy and Legal Framework

Although governments are usually not good at lending, they play an important role in setting appropriate policies and legal framework for the smooth operation of microfinance institutions. The key things that a government can do for microfinance are to maintain macroeconomic stability and to avoid interest-rate caps that prevent microfinance institutions from covering their costs and operating sustainable. Beyond this, it is doubtful that the development of microfinance, at least in its earlier stages, requires a national policy framework. It is advisable that institutions are given the freedom to develop there own system. In fact, political attention to microfinance has sometimes done more harm than good. However, although regulation inhibits the operation of the market system, some legislation that will guide the mostly illiterate gullible rural poor must be put in place. Issues like prudential standards and usury interest rates must be addressed through appropriate regulatory legislature.

5.2.2. Institutional Capacity Building

Strong retail institutions committed to outreach and sustainability are essential for extending the permanent reach of financial services and to have a significant impact on poverty reduction. Thus, building the capacity of institutions with a commitment to reach the poor is vital. Financial institutions committed to providing microfinance services in most Developing Countries require considerable technical assistance for capacity building. This is particularly true for institutions that target potential clients in resource-poor areas and the poorest of the poor.

5.2.3. Community Participation Mobilization

Because microfinance is primarily targeted to the poor who are disadvantaged, social mobilization is necessary to introduce them to a formal or semiformal, market-oriented institutional environment. This is particularly true for poor women and the poorest of the poor. It is important, however, to distinguish between financial intermediation and social intermediation in designing support program. With their full participation in planning and developing programs meant for their development, full acceptance and sustainability of the program is enhanced.

5.2.4. Donor Support

Donors who support financial services for the poor are advised to search out microfinance institutions (MFIs) that are committed to financial self-sufficiency. Sustainability – the ability of a microfinance institution to cover all of its costs through interest paid by its clients and other income – is a cornerstone of sound micro-financing. Financially sustainable MFIs can become a permanent part of the financial system because they can stay in business when grants or soft loans are no longer available.

5.2.5. Gender Issues

Since women are the most disadvantaged in most rural communities, in terms of low education, access to job, household chores, microfinance services must be designed in such a way that can enable a good number of women to participate. This will go a long way to empower them in the society and to integrate them into the economic main stream

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