Microfinance and Financial Inclusion

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(Forthcoming Chapter 37 in Brady, David and Linda Burton (eds.): *The Oxford Handbook on the Social Science of Poverty*. Oxford: Oxford University Press.)[†]

Abstract

Microfinance is currently considered one of the most important tools for international development and poverty alleviation. Despite numerous empirical inquiries, however, the actual effects of microfinance on economic and gender variables relative to poverty remain unclear, and a number of critiques have challenged the efficacy of microfinance at promoting women's empowerment and alleviating poverty. Moreover, since the 1970s, microfinance has grown and transformed into a largely commercial financial sector that connects capital investors with poor borrowers at a significant scale. Nonetheless, through its business success, microfinance has also engendered a series of overindebtedness crises, most notably the one in India in 2010. These crises, as well as the strong critiques levied against microfinance, have prompted the sector to search for new methods and a new mission as well as new markets to conquer.

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Introduction

> [E]ven though she worked hard to grow her tiny businesses, Rukia was never able to put aside any savings and her dreams remained out of reach. Then, Rukia applied for and received a microloan. . . . Gradually her profits have increased and she has since been able to move her business to a permanent stall on the busy main street outside the market where she attracts even more customers. Thanks to her perseverance and [the microfinance organisation's] loans, Rukia's goal of constructing a house is finally within grasp. "We've already made the foundation and purchased some of the bricks," Rukia states proudly.[1]

Countless success stories like this one are told about microfinance. Summarily, they form a globally recognized narrative about the power of financial services to transform lives in positive ways. Microfinance refers to the provision of financial services to poor and low-income populations, usually in the global South. Microfinance appears as a financial market solution to the social problem of poverty, promising poverty alleviation in a market-friendly and cost-efficient way, and is regarded by many today as a key tool in the portfolio of international development policies. Proponents hope that the financial inclusion of poor and low-income population segments will help them cope better with multifaceted problems of poverty, in particular their uncertain and low incomes.

The activities of the global microfinance sector today directly impact nearly 200 million clients worldwide. Total loans in 2012 amounted to $100.7 billion, equal to roughly two-thirds of global aid, a part of which went to funding microfinance projects.[2] However, for a poverty-alleviation tool of its extraordinary scope and reputation, there is remarkably little consensus about its practical impacts. As a systematic review assessing the entire domain of microfinance-impact studies concluded, until today "it remains unclear under what circumstances, and for whom, microfinance has been and could be of real, rather than imagined, benefit to poor people" (Duvendack et al. 2011:75). This chapter therefore offers a concise examination of the microfinance sector and its practices, explaining its historical origins and rise, discussing and interpreting the results of impact studies, relating the critical debates waged over microfinance, and taking stock of three sets of recent developments: a spate of crises, a new mission, and a growing scope of activity.

Overview of Microfinance

Under the heading "What Is Microfinance?" the World Bank's in-house microfinance agency Consultative Group to Assist the Poor (CGAP) explains:

> "Microfinance" is often defined as financial services for poor and low-income clients offered by different types of service providers. In practice, the term is often used more narrowly to refer to loans and other services from providers that identify themselves as "microfinance institutions" (MFIs). . . . More broadly, microfinance refers to a movement that envisions a world in which low-income households have permanent access to a range of high quality and affordable financial services offered by a range of retail providers to finance income-producing activities, build assets, stabilize consumption, and protect against risks. These services include savings, credit, insurance, remittances, and payments, and others. (CGAP 2012; emphasis added)

While merely one possible description, it comes from a key organization linked to the World Bank, which aspires to represent the "consensus" in the microfinance field and reveals several things. First, microfinance can be understood as services for certain populations and services from certain providers. Second, it is neither so clear-cut who the clients are—poor or "low income"—nor exactly who the providers are.[3] Third, the focus is on lending, although other services also matter. Fourth, the vision behind microfinance has been adopted by a broader social movement dedicated to promoting it.

The microfinance sector is an amorphous field, constituted by a diverse set of actors at the intersection of the state with the market and civic society. They include the following:

- Microfinance institutions (MFIs), directly working with the clients; some are NGOs or cooperatives, others are strictly for-profit banks, many are in-between.
- International financial institutions (such as the World Bank or Asian Development Bank); they are funders, standardizers, and political promoters of MFIs.
- Governmental development agencies and multilateral development bodies (like USAID or the International Fund for Agricultural Development) that fund and promote MFIs;
- Foundations and philanthropic organizations (such the Gates Foundation or Oxfam) that fund and operate MFIs.

- Specialized for-profit microfinance investment vehicles (MIVs) and investment funds, which are often linked to major banks.
- Transnational private funding and advocacy organizations (such as Accion, Oikocredit, or Kiva).
- Private, wealthy individuals funding and publicly promoting microfinance.
- A broader social movement, including small-scale middle-class investors and active enthusiasts.

The sector rose to global recognition with small loans for entrepreneurship—microcredit—but since at least the mid-2000s the term microfinance has dominated. This rephrasing denotes more than a mere semantic change since microfinance also encompasses savings, insurance, and money transfers. At the same time, the justification for offering microfinancial services has shifted: the core mission previously was exclusively to help small enterprises with credit, but today financial services more generally are expected to alleviate poverty through popular participation in the financial sector. The new mission of "financial inclusion" emphasizes savings, sending money, and insurance services but also suggests that poor people's ubiquitous financial needs (such as housing, water, or consumption) should be served with credit. (Mader and Sabrow 2015)

Credit still stands out as the core activity of the microfinance sector. For example, although the global scope of microinsurance remains very small (Kiviat 2009; Binswanger-Mkhize 2012) a major, if not predominant, part of it is credit default or life insurance which is often obligatorily sold with loans, not a loan-independent service like health or crop insurance (Wipf, Kelly, and McChord 2012). Microsavings, meanwhile, are also far less important than often made out to be. Although in total they came to $86.5 billion globally (compared to outstanding loan balances of $100.7 billion), of these savings nearly half were held at two large institutions, Harbin Bank (China) and Bank Rakyat Indonesia—hardly typical microfinance institutions.[4] Practically all MFIs worldwide—even those ostensibly focusing on savings like SafeSave in Bangladesh and MicroSave in India—make loans. Out of 1,263 MFIs reporting to the database MIX, 579 MFIs reported no client savings at all (another 255 had less than $1 million), while 1,255 reported issuing loans (and 978 had lent more than $1 million). Only at 172 MFIs worldwide did clients hold greater savings than the loans they owed.[5]

The focus in microfinance is clearly on credit. Although poor people evidently have fairly little to save (and many of the savings held at MFIs are not from very poor people), MFIs focus on loans for an even simpler reason: lending is more profitable than their other activities. When MFIs do take savings, this service is often tied to credit, such that clients are only allowed to save if they take a loan—worse yet, some parts of what appears as savings are actually forced savings (cf. CGAP 2003; Sinclair 2012).[6] Furthermore, the commercialization of microfinance dissuades MFIs from taking savings because it eases MFIs' access to other capital sources; among those MFIs in which commercial MIVs have invested, the share of savings has decreased (Symbiotics 2013).[7] The effort and cost of administering small savings accounts is high, so MFIs often prefer to borrow their capital from larger banks or seek investors; many can even borrow capital without interest from "p2p" funders, like Kiva, or obtain grants from donors.

Economic and Gender Impacts of Microfinance

From the outset, MFIs and other key organizations have argued that poverty alleviation and women's empowerment are the main objectives of microfinance. For instance CGAP (1995:2) explains: "Finance and enterprise systems that serve the majority can be the pivotal links and the levers, enabling the poor to share in economic growth and giving poor people the means to use social services." The idea behind microfinance is that poor people above all lack the financial tools with which to help themselves out of poverty; with hard work and some borrowed capital as their substrate, they should be able to grow. Muhammad Yunus likened microcredit clients to "bonsai people" in his 2006 Nobel lecture:

> To me poor people are like bonsai trees. . . . There is nothing wrong in their seeds. Simply, society never gave them the base to grow on. All it needs to get the poor people out of poverty [is] for us to create an enabling environment for them. Once the poor can unleash their energy and creativity, poverty will disappear very quickly.[8]

The notion of microfinance as a poverty-alleviating instrument was (and still often is) underpinned by stories of poor individuals investing in their small businesses and gaining material wealth—as with Rukia's story, above. By the 1990s, however, many donors and academics sought more systematic evidence of impact. The most supportive evidence came from studies conducted with World Bank support in Bangladesh, studying "the impact of participation, by gender, in . . . three group-based credit programs on women's and men's labor supply, boys' and girls' schooling, expenditure, and assets" (Pitt and Khandker 1998:960). Pitt and Khandker concluded that "participation in these credit programs, as measured by quantity of cumulative borrowing, is a significant determinant of many of these outcomes. Furthermore, credit provided to women was more likely to influence these behaviors than credit provided to men." They estimated that for every 100 Taka lent to a woman, her household's consumption expenditure—the main poverty indicator used—increased by 18 Taka (11 Taka for men) relative to households who did not borrow. Practitioners broadly welcomed these results as proof of microfinance's success; but the results in fact were far less clear than they first appeared. For instance, when Morduch (1998) and later Roodman and Morduch (2009) adjusted certain parameters, ensuring among other things that the characteristics of borrower households matched those of comparison households, or accounting for women generally receiving much smaller loans, their analysis suggested a slightly negative overall impact from microcredit. Mosley and Hulme's (1998) research found that the poorer the client, the more likely they were to fall deeper into poverty, and only comparatively better-off households stood to benefit from borrowing. Anthropologists in particular meanwhile questioned whether women really gained empowerment through loans, especially because men often appropriated their wives' loans and rising levels of domestic tension and violence were found (Rahman 1999:74).[9]

Pitt and Khandker's contested studies triggered a still-ongoing academic debate over appropriate statistical methods for measuring poverty impact (cf. Duvendack and Palmer Jones 2012), fuelling an enterprise of further studies aiming to resolve the shortcomings of earlier ones. The earlier phase of impact research may be distinguished from a later phase since the mid-2000s which has been dominated by studies using increasingly sophisticated, randomized sampling methodologies (cf. Banerjee and Duflo 2011). The recent spell of randomized controlled trials (RCTs) has drawn upon methods adopted from medical testing in order to eliminate the sources of upward bias, which critics and skeptics asserted accounted for alleged improvements in poverty indicators, for instance self-selection bias (more success-prone households likelier to apply for loans) and program-placement bias (MFIs lending in settings more conducive to success). By randomizing membership in "treatment" and "control" groups, akin to clinical trials, it was to be ensured that any differences in poverty outcome were actually caused by the intervention itself. RCTs in the social sciences, however, only incompletely reproduce the clinical situation; for instance, since "patients" and "doctors" are not double-blinded (both know who received a loan), no "placebo" is administered (to the control group), and therapeutic equivalence is not tested (no comparison of the tested "treatment", microfinance, against another established one) (Mader 2013b).

Instead of clearly demonstrating impact, however, the microfinance RCTs so far have shown very few significant positive differences between the "treatment" and "control" groups; the results of the first two studies were released in 2009. The Indian RCT, conducted in Hyderabad, had partnered with an MFI, agreeing to randomly open branches only in half of certain slum districts where it planned to open new offices (Banerjee et al. 2009). The researchers found no net change in the expenditures of households living in these "treatment" slums relative to "control" slums, indicating that loan availability did not make the areas less poor on aggregate. Also, no impacts on women's empowerment and other "social" outcomes were found. The researchers, however, noted that MFI lending made people living here marginally more likely to start a business and increase their overall spending on business purposes, although this did not raise their incomes or assets. They also found that spending on so-called temptation goods (Banerjee et al. 2009:28) decreased, which they interpreted as a successful outcome.[10] In the Philippines RCT, an MFI in Manila randomly gave loans to some marginally creditworthy applicants and denied loans to others (Karlan and Zinman 2009). This research turned up puzzling results: for instance, "treated" businesses shrank and laid off workers. Borrowers' children were more likely to attend school, but only if the borrower was a man. Microcredit did not measurably change households' incomes or consumption levels, yet "self-reported wellbeing, based on responses to standard batteries of questions on optimism, calmness, (lack of) worry, life satisfaction, work satisfaction, job stress, decision making power, and socioeconomic status" worsened significantly (Karlan and Zinman 2009:17).[11] More recent RCTs (such as Augsburg et al. 2012; Crépon et al. 2014) have painted similarly unclear pictures, finding a mixed bag of correlations between certain variables and access to credit but never demonstrating clear-cut poverty-alleviating effects.

In 2011, the British Department for International Development (DFID) published a systematic review summarizing the findings of all available studies on microfinance impact. After considering a total of 2,643 publications, the reviewers short-listed a sample of 58 studies of sufficient quality (in terms of research design and method of analysis) to be reviewed in depth. These studies covered all types of microfinance programs and a variety of different tested outcomes, including gender and economic empowerment. The DFID reviewers concluded that all the studies commonly cited in favor of microfinance were too flimsy to credibly demonstrate positive impact, since,

> . . . almost all impact evaluations of microfinance suffer from weak methodologies and inadequate data, thus adversely affecting the reliability of impact estimates. Nevertheless authors often draw strong policy conclusions generally supportive of microfinance. This may have lead [sic] to misconceptions about the actual effects of programmes, thereby diverting attention from the search for perhaps more pro-poor interventions and more robust evaluations. (Duvendack et al. 2011a:2)

The DFID team argued it had to "come down on the side of 'there is no good evidence for' rather than 'there is no good evidence against the beneficent impact of microfinance'" (Duvendack et al. 2011b:72). Others, like mathematician and microfinance expert David Roodman (2012), have also clarified that "today the best estimate of the impact of microcredit on poverty is zero."

It is worth asking then, given these findings (or lack thereof), exactly why the positive impacts expected by CGAP and Yunus are not materializing, or why microcredit for microenterprise (the key activity of microfinance) may perhaps even generate negative impacts. The problems noted in the literature lie in the micro-, meso- and macrolevels.[12] The issues at the microlevel can be summarized as three interrelated problems: displacement, saturation, and fallacy of composition. Displacement (or spillover) refers to how a borrower's microenterprise impinges on other people's microenterprises: a borrower using her loan, for instance, to sell vegetables on a local street usually enters a market with few or no barriers to entry in which others already compete. If this borrower financially succeeds, she likely does so by displacing a (nonborrowing) competitor, and thus the microloan leaves the net local economic situation unchanged. Or, one enterprise does not displace another, but instead both collectively saturate the local market, producing a new distribution, but no growth, that is, saturation occurs.[13] Given displacement and saturation effects, the impact of microfinance may appear exaggeratedly positive when the out-competed nonborrowers are the comparison group. Fallacy of composition occurs when an observer (MFI employees, researchers, policymakers) falsely take their individual observations of positive impact among the clients as representative of the entire local economy, which may be stagnant or in decline; a handful of prosperous MFI-financed microenterprises does not equate local economic development.

These issues connect with larger meso-level problems: demand and returns to scale. Microfinance increases the supply of goods and services locally offered by microenterprises, but demand generally only rises if overall wealth in the area increases; an issue which microfinance does not address.[14] To make matters worse, microenterprises typically offer products and services whose demand is income inelastic, such that even rising local incomes would create relatively few opportunities for microenterprise expansion. The demand for local farm produce, rickshaw rides, hand-sewn clothes, or haircuts is most likely to remain static while demand for processed foods, motorcycles, urban fashion, or high-tech products (produced by large industry elsewhere) rises. The converse, supply-side issue is that informal microenterprises show low returns to scale; that is, they are inherently hard to grow since there are few feasible means for raising their productivity. For instance, a $100 loan can make the difference between doing nothing and setting up a roadside vegetable stand or buying a sewing machine. The next $100, however, makes comparatively less difference; the vegetable seller could buy at bulk rates or advertise, the tailor could buy a newer machine, but their business remains essentially unchanged, unlike larger industrial enterprises, where additional investments (for instance in machinery) can increase output by a significant factor.

Resting on these issues, finally, are larger problems of economic transformation: industrial policy and entrepreneurship. Viewed macroeconomically, microfinance spreads credit broadly among many users. However, as scholars like Ha-Joon Chang (2002) argue, successful national economic development hinges on industrial policy—deliberately targeting key industries and channeling finance to them (as for instance, historically, happened in South Korea and Taiwan). Milford Bateman (2011) argues that microfinance even actively undermines sustainable development by directing scarce capital to tiny uninnovative, low-productivity undertakings that cannot generate growth. Moreover, microfinance idolizes and misunderstands entrepreneurship by supporting practically any autonomous income-generating activity. The ideology behind microfinance suggests everyone is—or should be—an entrepreneur.[15] But, following Schumpeter (1962), it is only select individuals with vision and creativity who create the capitalist dynamic of "creative destruction" that drives economies forward, and while some microfinance clients may be such characters, most probably are not. Most borrowers would likely prefer a decent job, given the choice (Karnani 2007). Worse yet, the tiny loan sizes doled out by MFIs force even the most gifted entrepreneurs into pursuing minimalistic, emulative, noncreative microenterprise activities.

The positive impact which microfinance is supposed to have on women specifically also turns out to be far less clear than commonly assumed. Proponents often cite as evidence for women empowerment the high percentage of female borrowers (over three-quarters are female) and highlight the sheer fact that microloans place significant amounts of cash in many women's hands for the first time. But feminist and anthropological scholars doubt that such borrowing brings empowerment. Microfinance may have a disempowering effect on women since "[w]hen women are constructed as responsible clients," as Katharine Rankin (2001:29) argues, "the onus for development falls squarely on their shoulders." Critics like Nancy Fraser (2013) argue that microfinance politically replaces welfare state paternalism with new, neoliberal forms of oppression. Empowering the female entrepreneur as a new a catalyst for development may appear progressive, but "in traditional patriarchal fashion, women, idealized for their responsibility, are rewarded by being made responsible for more and more labor activities" (Isserles 2003:48).

In practice, instead of MFIs focusing on women as more promising entrepreneurs or better stewards of family money (the "public transcript of microfinance"), Rahman (1999) found it is often the case that MFIs target women because they are weaker. Women's "positional vulnerability" in Bangladesh's rural social hierarchy makes them more pliant borrowers for majority-male MFI staff to manage, and MFIs actively draw on and reinforce these local gendered inequalities through their lending practices. As Karim (2011:84) argues, far from being anathema to microfinance, existing patriarchal structures that suppress women are actually useful ingredients in MFIs' business model:

> Loan recovery technologies deployed by NGOs used public shaming as a form of social control. . . . Women who were unable to pay their loans on time were often publicly humiliated, or the fear of a public humiliation hung over their heads, acting as a form of discipline in their lives. Moreover, women were treated effectively as a tool, in that NGOs shamed rural men by shaming their wives. (Karim 2011:86)

Moreover, Kabeer (2000:64) found that in Bangladesh a majority of borrowing women practically "exercised little or no control over their loan," and husbands or other male relatives often decided how they should use it. Some women simply had to hand over the loaned money while still bearing the burden of repayment.

History and Prehistory

The roots of microfinance are often traced back to the lending experiment begun in 1976 in Bangladesh by Muhammad Yunus, who founded the Grameen (Village) Bank in 1983.[16] Yunus and the Grameen Bank won the Nobel Prize for Peace in 2006 and became the public face of microfinance globally. However, Yunus's story is hardly as unique, and microfinance not quite as new, as the commonplace story suggests. Very similar lending experiments were going on in different parts of the world around the same time, particularly in South Asia, where credit as a form of social policy had an institutional lineage dating back to the British colonial administration.[17]

Cooperative credit societies were brought to South Asia by the colonial administration in the late nineteenth and early twentieth centuries as a "transplant of a German idea, with

English characteristics, slightly modified to suit conditions in British India" (Turnell 2005:16). Aided with state money, while simultaneously avowing free-market principles and insisting on freedom from state interference,[18] the cooperatives grew to 4 million members by 1930. At the beginning of the twentieth century, prominent cooperatives promoter Henry W. Wolff (1910:520–21) conducted a global survey of cooperatives and specifically lauded the British Indian credit societies for their independence and firmly capitalist ethos, which apparently made them vastly superior to their European counterparts. But ironically, unlike the more solidarity-oriented European cooperatives (many of which survive until today), the British Indian system went into decline around 1925 and wholly collapsed in parts of the subcontinent. The reasons included social imbalances, poor governance, and various departures from the original German model (Turnell 2005). The South Asian co-ops particularly failed in their mission of ousting the moneylender, and instead were often run by landlords, moneylenders, and other elites who used them as sources of patronage and influence (Shah, Rao, and Shankar 2007). After independence, despite these shortcomings, the new South Asian nations drew on the colonial lineage of credit as a social policy and continued to encourage cooperative credit particularly for farmers and artisans. India, especially, operated large, state-driven rural-lending programs. The effect was that the total share of informal credit from moneylenders, traders, and landlords fell by more than half during the 1970s, while households' debt share to formal lenders doubled (Shah et al. 2007).

The Bangladeshi war of independence in 1971, from which a weak and autocratic state emerged, proved a crucial event in the development of modern microfinance. After the war, a catastrophic famine followed in 1973–1974, and throughout the young country newly founded civil society organizations sought to fill the void left by the incapable state, particularly in supporting marginal and recently displaced communities (Zohir 2004). But most of these nascent NGOs lacked funding for large transformative projects, and some discovered short-term loans were one cost-effective way of working with the poor. Thus, a number of nongovernmental relief organizations, such as the Bangladesh Rural Advancement Committee (BRAC), started in 1972, pioneered microfinance before Grameen Bank. It was in this environment that Muhammad Yunus, the son of a jeweler from Chittagong and professor of economics educated at Vanderbilt University, returned from the United States and began experimenting with small rural loans. After initial success, through personal connections, Yunus was able to secure funding from the national Bangladesh Bank and commercial banks. In 1983 the project officially became a government-regulated bank, thanks to a unique ordinance passed by the government of dictator Hussain Muhammad Ershad (Hulme 2009:165).

This new approach to poverty alleviation, with private organizations disbursing small loans for rural entrepreneurship, was also championed by organizations such as Accion and FINCA in Latin America around the same time. It coincided with a series of paradigm shifts in the field of global development. In the 1970s and 1980s, state-driven policies of import-substituting industrial development fell out of favor, while the importance of the informal sector and women's role in development were noted and emphasized; poor women in particular were "discovered" as productive members of society. Also, the "basic needs approach" advocated by the International Labor Organization (targeting the poorest and their most urgent needs first) and the budding NGO sector were recognized as being closer to the lives of poor people than the state and its massive industrial development policies. The new, exciting idea of microcredit matched these new imperatives as a nonstate, women-oriented, grassroots-level intervention that promised to release the productive energies of poor people. It was also a response to the critique of subsidized credit launched by a group of economists who became known as the "Ohio School,"[19] which strongly influenced World Bank policy in the 1980s. Subsidized credit discouraged savings, they argued, actually leading to "redistribution in reverse" (Gonzalez-Vega 1982); therefore, to benefit the poor, credit markets needed to be made competitive and follow market forces (Adams, Douglas, and von Pischke 1984).

Microcredit began to garner serious recognition from the international policy community and economic observers in the 1980s when it began to be used in implementing structural adjustment programs (SAPs). In the context of SAPs orchestrated by multilateral organizations, microcredit played a strategic role in facilitating economic and financial liberalization as a financially steered poverty-alleviation program. The World Bank and the IMF (directly as well as through subsidiaries such as CGAP) employed microcredit to impose an "enabling environment" for financial services, integrated with their development agendas (Weber 2002). In the course of Bolivia's New Economic Program, for instance, from 1986 onward, microloans were deployed in order to assuage resistance to the worst effects of austerity and facilitate the transition of formerly government- or formal-sector employed workers into informal self-employment. Political mainstreaming coincided with the commercial mainstreaming of microfinance. Following the first MFI transformations in the 1980s, in the 1990s a growing number of economically successful microfinance NGOs transformed into for-profit companies. The private for-profit approach to microlending was picked up by the World Bank as a model for the sector, which founded a suborganization, CGAP, to promote and standardize the template for commercial microfinance (Bateman 2010:16–17).

CGAP, over time, also proposed a broader range of financial activities for MFIs, beyond their traditional focus on entrepreneurship lending. MFIs should aim for a general "provision of credit, savings, and financial services to very poor people" since providing "these services to very poor households creates opportunities for the poor to create, own, and accumulate assets and to smooth consumption" (CGAP 1998:1). The focus of policy actors increasingly shifted in the 1990s from directly supporting MFIs to promoting an appropriate financial system for the growth of microfinance providers, primarily through enticing private investors to enter the market. This effort at commercializing microfinance fell onto politically and economically fertile ground in an era of general enthusiasm about financial development paired with an abundance of investment capital. A number of high-profile events finally anchored microfinance in the public imaginary, adding widespread social credence to the increasingly clear business case for microfinance. The Microcredit Summit in 1997 (organized by NGOs, MFIs, and lobby groups), the United Nations' Year of Microcredit in 2005, and particularly the Nobel Prize for Peace awarded to Muhammad Yunus and Grameen Bank in 2006 all raised microfinance's profile among alternative policies in the global development and poverty alleviation toolkit.

	1995	2005	2011/12
No. of MFIs	ca. 735*	1,228^	1,263^
No. of loans or borrowers (million)	12.2*	48.8^	195†
Size of loan portfolio (US$ billion)	5.0*	18.2^	100.7^

Sources: *World Bank (2001), †Maes/Reed (2011); ^MIX (2013)

Table 1: Growth of the microfinance industry

Under the new approach that encouraged the entry of private capital (often via subsidies designed specifically to entice commercial investments) the global microfinance sector has grown rapidly since the 1990s (see Table 1). While public sector funding for microfinance has continued, and has even grown, major institutional investors have also taken a growing interest particularly since the turn of the millennium (MicroRate 2013). The commercialization of the microfinance sector is ongoing, but today already in many countries the leading MFIs are private companies primarily funded by private capital. The enthusiasm of private, profit-seeking financial investors was further encouraged by a number of stock market share issues by MFIs since the mid-2000s and the emergence of more sophisticated investment tools such as debt collateralization, which improve the liquidity of microfinance investments (Lieberman et al. 2009). Although still fairly small compared to other parts of global finance, with $100.7 billion in loans (in 2012) the microfinance sector is no longer wholly negligible. The Microcredit Summit Campaign, an advocacy organization, counted 195 million clients served by 3,652 MFIs as of December 2011, and more than three-quarters of the clients were women (Maes and Reed 2012:3). However, the vast majority of MFIs are small or very small, and the industry is highly concentrated: of the 1,262 MFIs reporting their 2012 loans to the Microfinance Information Exchange (MIX, a CGAP brainchild), only 50 large MFIs accounted for more than two-thirds of lending worldwide.

Recent Developments

Three recent developments in microfinance are worth interpreting in light of the ongoing commercialization and concentration of the microfinance sector. First, a number of crises and collapses have shaken the microfinance field, exposing the tendency of commercial microfinance to push clients into overindebtedness traps; the transformation of some national MFI sectors has come with all the trappings of financial markets. Second, the uncertainty about the impacts of microfinance has fostered the search for a new mission and meaning, such that microfinance is now justified as an integral element of a global push for "financial inclusion," instead of the older, simpler idea of lending for microenterprise. Third, because of its recent expansion beyond its traditional spheres of activity, microfinance is increasingly proposed as useful for addressing a whole range of social problems and is also making headway in the Global North.

Overindebtedness and Collapse

The ongoing transformation and maturation of microfinance into a financial market has brought a series of collapses; the widely reported crisis in India 2010 was only the most recent and severe case.[20] Each collapse appears to have taken the sector by surprise, and industry spokespeople have generally placed the blame on political actors. But the commonalities of the crises suggest they are caused by more fundamental factors inherent to the microfinance business itself. In spite of their geographic dispersion—from Bolivia in 2000 via the crises in Bosnia-Herzegovina, Morocco and Nicaragua in 2007 and 2008, to the huge collapse in the south Indian state of Andhra Pradesh in 2010—the microfinance collapses have shown four common factors: commercialization and growth; competition and overindebtedness; an unsound political economy; and a triggering event.

A first notable feature of the countries that experienced microfinance collapses is that these were fast-growing markets where commercial MFIs dominated. They were leading, exemplary microfinance markets, not backwaters. During the 1980s and 1990s, Bolivia was the global paragon of commercial microfinance, India was the same in the late 2000s, and Morocco was home to several globally renowned MFIs.[21] The underlying problem is that commercialization requires MFIs to seek growth and efficiency (which are supposed to benefit clients via higher outreach and lower cost), but this striving for growth and efficiency often leads MFIs to cut corners and overreach. For instance, among India's leading MFIs before the collapse it was not uncommon for one loan officer to supervise more than 400 clients. Rapid growth also, incidentally, can hide the consequences of bad lending, giving MFIs a false semblance of health, since older, nonperforming loans are numerically eclipsed by new loans that are being repaid on time.

A second feature of these markets was the high level of competition, which amplified the pressure on MFIs to grow and exacerbated the side-effects of growth. The Ohio School economists had suggested competitive credit markets to enhance efficiency and ensure optimal capital allocation, but in practice competition often leads to very poor lending decisions. Since commercial MFIs depend on securing finance from capital markets, they compete in signaling to investors a high likelihood of generating exceptional returns. The most effective means for signaling this is to expand their market share by growing the client base and making larger loans. Competition thereby encourages (or even requires) MFIs to act in ways that in the short term and for each MFI make sense but in the long term and collectively can be disastrous. To illustrate: in a market with several MFIs targeting the same client, each MFI knows that if it does not lend, another will gain the fees and interest payments. Given strong enough competition, even if the client's creditworthiness is doubtful, at least one MFI (and perhaps all) will lend. Perversely, however, if the borrower ever finds herself in repayment trouble—even just temporary trouble—all MFIs will competitively squeeze her for repayments. Competition also extends beyond the other MFIs. In Bolivia and Bosnia-Herzegovina, MFIs and commercial consumer lenders competed for the same clientele. In Nicaragua, MFIs competed against a large state program, and in India they competed against the state-supported "self-help group" model of linking poor borrower groups to commercial banks. Furthermore, ubiquitously there remains the traditional moneylender as a competitor.

Third, the political economies of these locales were conducive to both the growth and subsequent collapse of the microfinance system. In different but comparable ways, desperation rather than opportunity drove many borrowers to take loans. In all locales, a reduction of economic security for low-income populations drove people into debt, generating the high demand for microcredit that attracted MFIs and their investors. In the

1990s, Bolivia's economic reforms thrust multitudes of previously formally employed or transfer-dependent people into the labor market, leaving many with no other option than to self-employ through microenterprise to survive in the country's stagnant economy. For Nicaragua, the 2000s were a period of slow growth and historically relatively low coffee prices. Bosnia-Herzegovina faced not only postwar rebuilding after 1999 but also the construction of a capitalist economy, which European and international donors sought to achieve through microfinance; but their strategy succeeded only in creating a deindustrialized and "infantilized" market economy (Bateman 2007). In India, post-1994 liberalization saw the discontinuation or reduction of various social programs, farmer subsidies, and state lending, which squeezed the livelihoods of the rural poor. Given the lack of economic security and opportunity, it was only a matter of time until many clients became caught in debt traps, which were deepened by the competitive supply of credit.

Fourth, the collapses were all to some extent triggered or accompanied by an external (political or economic) event on which microfinance industry representatives placed the blame. In Bolivia, in 2000, debtor protests arose in the context of successful nationwide campaigning against neoliberal reforms (Marconi and Mosley 2005). In part, they were organized by well-known political activists, and some protestors resorted to desperate means including hunger strikes and building occupations; MFIs mostly blamed the political activists for the crisis (Rhyne 2001). In Nicaragua, in 2008, after six borrowers in a small town were arrested for not repaying; protests ensued and rapidly spread throughout the north of the country, turning violent. This protest movement "No Pago" ("I'm Not Paying") was publicly endorsed by President Daniel Ortega, who accused the MFIs of committing "usury". Again, politics (only the proximate trigger) was blamed for the crisis. The collapses of Bosnia-Herzegovina and Morocco in 2008, meanwhile, were blamed on the global economic downturn (Chen et al. 2010). An explanation that makes the most sense when considering how that credit crunch deprived MFIs of the funds necessary to continue raising the loan balances of their already-overindebted clients.

To understand the interplay of these four factors, it is worth examining the Indian crisis, the deepest and most dramatic one to date. In India, microfinance began expanding in the late 1990s, building on the legacies of colonial cooperative credit and state-lending programs. Indian MFIs were generally founded as NGOs using state and donor money, but within under 10 years many had transformed into private "nonbank financial companies" successfully chasing commercial funding and aiming for share listing on the stock market. Focusing solely on the business of credit, India's hyperefficient MFIs achieved unheard-of growth rates and were well-capitalized by Indian banks and investors from abroad. Showing default rates as low as 0.14 percent in 2008 (nationwide) and posting extraordinary profits, Indian MFIs exemplified the commercial microfinance model's success at generating efficiency, outreach and profitability.[22] Behind the scenes, however, extreme forms of social coercion and multiple borrowing upheld the microfinance miracle; debtors were often driven to take extra loans (including from moneylenders) to survive each successive loan cycle. The boom centered on Andhra Pradesh, a leading neoliberal reform state, where MFIs found many people well-experienced in the management of debt and handily preorganized into borrower groups thanks to the Self-Help Group (SHG) system (the MFIs "poached" these groups) who often also faced extreme and worsening hardships. An ecological crisis (including depleting common resources, unsustainable agricultural change, and climate change) intertwined with the retrenchment of social spending and farmer subsidies to push rural populations to use credit for handling income losses and insecurity or for migrating to cities. By the end of the boom, 84 percent of households in Andhra Pradesh held two or more loans (from different sources) and 58 percent had four or more; the median household had three. In late 2010, after two years of droughts and floods afflicted parts of the state, a wave of violence and suicides swept through the ranks of Andhra borrowers, exposing widespread overindebtedness and unleashing a media storm that induced the government of Andhra Pradesh to temporarily halt all microlending and loan collection.23 Although the halting effect of the emergency ordinance lasted only five days, widespread repayment defiance took hold, and the MFIs lost an estimated fifth of their nationwide loan portfolio (over $1 billion), for which they blamed the Andhra government.

New Methods and Mission

Rather than retreating from microfinance, or critically reconsidering the suitability of finance-driven approaches to poverty alleviation altogether, since the 2000s the microfinance industry and its funders have reacted to the collapses and deepening questions about impact broadly in three ways. The first is the construction of a new market infrastructure in many countries, particularly those which already experienced collapses. Debt counseling is now supposed to help clients manage and reduce their debts, but its effectiveness is doubtful. For instance, in Bosnia, widespread debt counseling began in 2009, but a 2013 survey still found 69 percent of borrowers "vulnerable" to, "exposed" to, or "concerned" about overindebtedness (Goronja 2014). Credit registries, on the other side, aim to prevent clients from becoming indebted to more than one MFI (cf. McIntosh, Sadoulet, and de Janvry 2006). However, under conditions of intense competition (as described earlier) they may not succeed and might even help one MFI poach another's client. Finally, financial education programs—often supported by large, corporate donors (e.g.cf. MasterCard Foundation 2011)—aim to educate (prospective) clients about the benefits and risks of different financial products, but it is unclear to what extent they actually succeed at improving clients' ability to calculate and plan ahead in practice. Furthermore, there is a risk of "education" merging with marketing and promotion.

A second reaction has been the launching of initiatives for "socially responsible" microfinance—coming together in a "Global Appeal for Responsible Microfinance"[24]—by investor groups and thought leadership organizations. The "Smart Campaign" (initiated by global investor network Accion), "Social Performance Task Force" (spearheaded by CGAP), and "Truelift" (a multistakeholder initiative which, for a fee, assigns a "Pro-Poor Seal of Excellence") are the most prominent in a flurry of new global standards and action plans for responsible, transparent and client-centered microfinance. What unites the initiatives is their emphasis on voluntary participation, an absence of restrictive rules (such as interest rate limits above which lending is considered irresponsible), no measurement of client poverty alleviation, and a lack of mechanisms for sanctioning or exposing transgressors. Citing the example of the Mexican MFI CompartamosBanco, infamous for charging up to 195 percent interest, gaining the Smart Campaign's "Client Protection Certification," critics have argued that the initiatives lack substance and merely serve to deflect criticism from the sector (Sinclair 2014).

Third, and most fundamentally: microfinance has progressively gained a new mission.[25] Earlier, the mission of microfinance was to provide finance for microenterprise (with an explicit focus on credit), but lately the goals have broadened and become more diffuse under the mission of "financial inclusion." The new mission asserts access to financial services as a fundamental, ubiquitous need. An early and important marker in this mission shift was CGAP's 2002 annual report, which explained why financial services should be seen as universally applicable and universally necessary tools:

> Like everyone else, poor people need and use financial services all the time. They need financial services to take advantage of business opportunities, invest in home repairs and improvements, and meet seasonal expenses like school fees and holiday celebrations. They need financial services to prepare for life-cycle events like the wedding of a daughter or the death of a grandmother. They need financial services to cope with emergencies like the sudden death of a wage-earner or a monsoon that wreaks havoc on their village. (CGAP 2001:5, emphasis added)

Unlike microenterprise finance, the financial inclusion mission explicitly endorses credit for survival and consumption, proposing "consumption smoothing" as an important goal in itself: poor people's problem is less that their incomes are low, and more that they are uncertain and volatile, and here microfinance can help. Using finance for income generation is therefore but one financial need the poor have, and MFIs should help them manage their money in whichever way they themselves deem suitable to handle their uncertain lives. Financial inclusion thereby officially inscribes and legitimates practices that were already widespread yet unacknowledged, such as credit for nonproductive purposes. In contrast to the earlier microenterprise mission, it is no longer assumed that poor people need to generate the money for loan repayment via entrepreneurial ventures. Here, they already have it, as past or future incomes: "Financial services allow people to reallocate expenditure across time . . . if you don't have the ability to pay for things now, out of current income, you can pay for them out of past income or future income, or some combination of both" (CGAP 2000b:2). Taking this logic to the extreme, proponents of the new mission argue, "Not having enough money is bad enough. Not being able to manage whatever money you have is worse" (Collins et al. 2009:184). In this way, with financial inclusion, the goal posts for microfinance have shifted from raising incomes and assets to the more attainable goals of consumption smoothing and financial access for all, such that the troubling issue of (measurable) poverty alleviation disappears from discussion.

Expansion of Scope

In part thanks to the new mission, the hype about microfinance has continued and the sector's scope of activities is still growing. Microlending has gelled with other market-based poverty-alleviation initiatives from the hubristic idea of "social business" serving "humanity's most urgent needs," promoted by Muhammad Yunus (2011), to the idea of a "fortune" for corporations to earn at the "bottom of the pyramid" (Prahalad 2004). In many places, microlending increasingly is directly linked to the sale of products and services from multinational corporations that are marketed and sold on credit, such as chemically enriched foods, home solar systems, mobile phones, or seeds and farming services.[26] Among the most consequential outgrowths is the expansion of microfinance into goods and services traditionally governed politically as public goods, such as electricity, education, water, and sanitation. Microfinance proponents suggest that poor people should use credit to privately buy access to these goods, rendering public, redistributive solutions obsolete. However, models using microfinance for such goods in practice often go against social values, precipitate local political conflicts, enhance existing inequities, and do not succeed in circumventing the underlying problems related to public sector incapacity (Mader 2011).

Geographically, the scope of microfinance has expanded to the Global North. Grameen America, based in New York and launched with a media buzz in 2008, is only one of numerous microfinance programs now operating in the United States. Muhammad Yunus's new brainchild involves applying to North American poverty the Bangladeshi microfinance model of targeting women (primarily among minority groups) who engage in small, simple, often home-based, income-earning activities. In practice—much as in the Global South—the activities supported in the United States often involve poor people selling goods and services to other poor people.[27] The European Union, meanwhile, funds a growing number of microfinance programs, complementing a plethora of national and subnational schemes, which aim to get the unemployed—particularly youths and ethnic minorities—into self-employment. According to former Italian Minister of Foreign Affairs

Giulio Terzi di Sant'Agata (in an uncommonly candid endorsement analysis) microfinance is useful as an instrument for keeping volatile populations occupied, "safeguarding the quality of democracies" by preventing "material distress from encouraging populist deviation and citizen regression" (Foreign Ministry of Italy 2013). Through helping uphold consumption and facilitating self-employment while saddling the poor themselves with social risk, microfinance in Europe serves as a device for austerity facilitation. In Terzi's words: microfinance could "help contain public spending by contributing to the reduction of social buffers, the cost of which rises in times of recession." A 2012 European Investment Fund report, meanwhile, argued that more European public funding should be used to catalyze "the entry of private capital in order to create a self-sustainable market in the long run" (Bruhn-Leon, Eriksson, and Kraemer-Eis 2012:14). Just as previously in the Global South, under conditions of fiscal austerity, taxpayer money may be redirected into microfinance to build and prepare the market for private investors.

Conclusion

Microfinance still enjoys popular appeal and growing success as a business and is recently expanding in scope. These factors may obscure the state of crisis which microfinance is in—a crisis that has less to do with symbolic events like Muhammad Yunus's ousting from office as head of Grameen Bank in 2011 (after a spat with the Bangladeshi government), and more with the doubtfulness of it achieving positive social aims. The lack of demonstrable impact (beyond the individual success stories, which are true albeit misleading exceptions), the diverse critiques which highlight its economic and gender-political flaws, and the collapses of major markets all draw into question the idea of microfinance serving as a just and cost-effective poverty-alleviation policy. Certainly, even if public and philanthropic backers were to withdraw, for instance in the wake of even larger and more dramatic collapses than the prior cases, parts of the microfinance sector (which in 2012 earned more than $21 billion in surplus payments from the borrowers[28]) may be able to survive thanks to private, speculative funders seeking high returns. However, in an era increasingly skeptical of financial market solutions to social problems, it is unclear how much longer the sector can retain the public legitimacy on which it has banked so far.

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Footnotes

1 A typical client success story, taken from Accion (2004:8).

2 Public funders accounted for US$21 billion of cross-border funding for microfinance in 2012 (CGAP and MIX 2013. What share of this was declared as aid is unknown. Global aid (Official Development Assistance was US$150.9 billion in 2012 (OECD 2014).

3 In most understandings, "microfinance" providers are formal lenders; as opposed to informal, private moneylenders. Most are at least as formalized as NGOs; at most formal end of the scale, some are registered banks.

4 A standard commercial bank and a part-privatized state development bank.

5 All data here is from 2012; source MIX (2013).

6 Forced savings are parts of loans not fully paid out by the MFI and withheld as collateral but registered as "client savings." These are one of the industry's "dirty little secrets," raising loan interest rates considerably while appearing client-friendly (Sinclair 2012:35–36, 101–102). For instance, when Nigeria's largest MFI, LAPO, was criticized for its 114 percent interest loan rate, management responded by publicly announcing a decrease. At the same time, it silently raised "compulsory" savings from 10 to 20 percent. Clients still had to pay interest on the full loan amount, and the annual effective interest rate for some clients rose to nearly 126 percent (MacFarquhar 2010).

7 From 83 percent voluntary savers as a percentage of active borrowers in 2009 to 57 percent in 2012.

8 Nobel lecture, Oslo, December 10, 2006. Retrieved December 12, 2014, http://www.nobelprize.org/nobel_prizes/peace/ laureates/2006/yunus-lecture-en.html.

9 Practitioners and development agencies gave little attention to anthropological findings, while economic studies were hotly discussed and new research programs created for economic impact measurement.

10 "Temptation goods" included alcohol, tobacco, betel leaves, gambling, also tea and food consumed outside the home. The economists never wondered whether such declining consumption could adversely affect clients' life satisfaction or the businesses of local microenterprises selling tea or food on the street.

11 The authors, mystifyingly, neglected to interpret this aggregate “reduced happiness” finding in their paper but discussed at length why shrinking businesses may be more efficient.

12 They are only briefly sketched here, drawing on Dichter and Harper (2007), Bateman (2010) and Bateman (2011), where a deeper engagement can be found.

13 Microfinance practitioner and whistle-blower Hugh Sinclair (2012:239–49) suggests that displacement and saturation effects therefore could combine to generate artificial demand for debt, as competitor enterprises are forced to also borrow to remain competitive.

14 MFIs can (and do) lend for consumption, which may raise demand in the short term, but only at the price of interest payments that depress demand even further at a later point in time.

15 Muhammad Yunus (2003:205) for instance says: “I believe that all human beings are potential entrepreneurs. Some of us get the opportunity to express this talent, but many of us never get the chance because we were made to imagine that an entrepreneur is someone enormously gifted and different from ourselves.”

16 On the roots of microfinance see, for instance, Counts (2008).

17 For a more detailed version of this historical overview, see Chapter 2 of Mader (2015).

18 Much as the microfinance movement, decades later, has also avowed market principles while using government funds.

19 Many of the economists were based at Ohio State University.

20 This part systematizes the accounts given in Mader (2013a), and Chapters 2 and 5 of Mader (2015).

21 Compare, for instance, the global MFI ranking in MIX (2008).

22 This means that less than 1 in 700 dollars was reported as not repaid; a utopian figure.

23 According to different sources, between 54 and 88 suicides in the space of one month, plus many more attempts.

24 http://www.theglobalappeal.org; retrieved December 12, 2014.

25 As analyzed in depth (in German) in Sabrow and Mader (2014).

26 Cf. Hartmann (2014), in German.

27 The New York Times for instance reports borrowers engaged in home cooking, tailoring, street hawking, or direct selling of cosmetics and products distributed through dubious multilevel marketing schemes (Dewan 2013).

28 For calculations, see Chapter 3 of Mader (2015).