MICROFINANCE,
POVERTY REDUCTION AND THE MILLENNIUM DEVELOPMENT GOALS

UN-HABITAT
FOR A BETTER URBAN FUTURE

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POVERTY REDUCTION AND MILLENNIUM DEVELOPMENT GOALS

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FOREWORD

Urbanization is one of the most powerful, irreversible forces in the world. It is estimated that 93 percent of the future urban population growth will occur in the cities of Asia and Africa, and to a lesser extent, Latin America and the Caribbean.

We live in a new urban era with most of humanity now living in towns and cities.
Global poverty is moving into cities, mostly in developing countries, in a process we call the *urbanisation of poverty*.

The world's slums are growing and growing as are the global urban populations. Indeed, this is one of the greatest challenges we face in the new millennium.

The persistent problems of poverty and slums are in large part due to weak urban economies. Urban economic development is fundamental to UN-HABITAT's mandate. Cities act as engines of national economic development. Strong urban economies are essential for poverty reduction and the provision of adequate housing, infrastructure, education, health, safety, and basic services.

The *Global Urban Economic Dialogue* series presented here is a platform for all sectors of the society to address urban economic development and particularly its contribution to addressing housing issues. This work carries many new ideas, solutions and innovative best practices from some of the world's leading urban thinkers and practitioners from international organisations, national governments, local authorities, the private sector, and civil society.

This series also gives us an interesting insight and deeper understanding of the wide range of urban economic development and human settlements development issues. It will serve UN member States well in their quest for better policies and strategies to address increasing global challenges in these areas

Joan Clos
Under-Secretary-General, United Nations
Executive Director, UN-HABITAT

CONTENTS

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
ADRA	Adventist Development and Relief Agency
ASA	Association for Social Advancement, Bangladesh
BRAC	Bangladesh Rural Action Committee
CGD	Centre for Global Development
CoDASED	Committee of Donor Agencies for Small Enterprise Development
CGAP	Consultative Group to Assist the Poorest
DFID	Department for International Development
GEESHIM	Groups dedicated to Gender, Enabling Environment, Savings, Skills, Health, Institutional Development and Microfinance)
HIV/AIDS	Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome
HUDCO	Housing and Urban Development Corporation Ltd
IBLF	International Business Leaders Forum
MDG	Millennium Development Goals
MED	Microenterprise Development
MFI	Microfinance Institution
NGO	Non-Government Organisation
ODA	Official Development Assistance
OUP	Oxford University Press
PKSF	Palli Karma Sahayak Foundation, Bangladesh
PPP	Public Private Partnerships
SME	Small and Medium Enterprise
UK	United Kingdom
UN	United Nations
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organisation
WEP	Women’s Empowerment Programme

FOREWORD

The links between microfinance and the Millennium Development Goals must be emphasised because both spheres overlap in the crucial domain of worldwide poverty reduction. The overlap is such that one could argue that progress on Goals is conditioned on the opportunities microfinance can open up for the poor. Likewise, closer attention to microfinance outreach to the poorest of the poor would accelerate progress.

The deadline for the achievement of the United Nations Millennium Development Goals, 2015, is fast approaching[1]. If microfinance has anything of significance to contribute, now is not too soon to ensure that this potential is realised. This report highlights those areas of microfinance that can be geared to the Millennium Goals.

The current debate among academics and microfinance professionals on whether or not microfinance has made a difference to the lives of poor people[2] is active, and even heated, with some wondering whether microfinance is good for the poor. This would come as a surprise to the millions of poor people in virtually every developing country who benefit from microfinance. This report sheds light on why this is so.

If microfinance is to accelerate Millennium Goal achievement, the degree and nature of donor and public sector support for microfinance must change. Where adequately resourced, properly designed and carefully targeted, microfinance can add a significant amount of amount on its own. However, reforms are needed if microfinance is to meet the needs of the extreme poor, too. In particular, public-private partnerships (PPPs) would ensure adequate resourcing and targeting. Donors have a special role to play, and a comparative advantage, in the gearing of microfinance to Millennium Goals, including: taking care of any Goal-specific product and service design expenses, as well as of client and microfinance professional training. Together with client welfare services that are a prerequisite to active involvement in credit-based transactions, addressing those microfinance programme expenses that should not fall onto the shoulders of the poor, especially not the poorest of the poor.

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1 United Nations 2000, General Assembly, Resolution (RES/55/2). See also http://www.un.org/milleniumgoals and UN 2009.

2 Bali 2006; Chowdhury & Bhuiya 2001; Hashemi, Schuler & Riley 1996; Hossain 1988; Jalilian & Kirkpatrick 2002; Kabeer 1998; Khandker 1998, 2005; Morduch & Haley 2001; Remenyi 1991; Rutherford 2000; Roodman & Morduch 2009; Yunus 2003b; and Zaman 2000

RECOMMENDATIONS

The main recommendations of this report concentrate on:

i. learning from the success of those microfinance practitioners already focusing on the chronically poor, especially as these successes relate to specific Millennium Goals;

ii. development of a toolkit enabling microfinance providers to design Goal-oriented products and services;

iii. capacity-building among microfinance professionals and staff to enhance outreach skills with regard to the chronically poor and the Millennium Goals;

iv. establish donor-supported Microfinance Strategic Outreach Funds for each Goal to support the client training, capacity-building and overhead expenditures that can help the chronically poor to take advantage of *Microfinance for Millennium Development Goals* to the extent of their needs; and

v. undertake roundtables on *Microfinance for Millennium Development Goals* for information exchange and action plans.

The detailed recommendations made in the body of this report, especially in Chapter 1, will not be repeated here. Suffice it to stress that much is to be learnt and gained from any replication of successful microfinance outreach, design and delivery. Trying to identify what is replicable would be ineffectual, though, if information is not disseminated and acted upon by those in a position to make a difference. To this end, the report calls for dialogue between microfinance practitioners, governments and donors. To be sure, Millennium Goals are not the preserve of microfinance providers. They are the primary responsibility of governments and donor agencies, and it is for these to launch a dialogue on Goal-oriented policies with microfinance providers.

The dialogue between government and microfinance providers should not, however, be a one-way street, as there is so much to discuss. Examples include competition policies, which must not interfere with pro-poor development strategies, including competition within the microfinance sector or with mainstream financial institutions. Similarly, another objective of any dialogue with government is to make sure that financial regulation does not hinder microfinance growth in a direct or indirect (e.g., perverse effects) sort of way.

The microfinance sector today tends to ignore the relevance of social protection or development goals in microfinance. Minimalist microfinance is the preferred strategy, and received wisdom is that those providers embracing social goals above institutional profit have no long-term future in microfinance. The evidence suggests that this received wisdom is to be challenged.

Microfinance providers do need to recoup operational costs, but this does not prevent them from using subsidies for the more vulnerable poor or where market imperfections justify government or donor assistance/intervention. This highlights the strong need for research on the role of subsidies in microfinance, especially with regard to any pursuit of Millennium Goals for the benefit of the poorest among the poor.

Because of donor and government pressure in favour of financial sustainability, microfinance providers have taken to target the least risky, cheapest and relatively 'easy-profit' segments of the market. As a result, the poorest of the poor have not been the primary targets of microfinance providers, and more readily serviceable customers (households and entrepreneurs operating at the higher levels of the poverty pyramid) have been favoured instead.

Likewise, microfinance providers have been encouraged to embrace repeat business, even with clients who are either no longer poor or are 'near-poor', or even higher in the economic hierarchy of savers and borrowers. Ways must be found to encourage microfinance providers to focus on the lower levels of the poverty pyramid.

Public spending is a significant factor of development. Capital spending on infrastructure achieves long-term goals but delivers immediate gains to people at large. Similarly, government spending on health, education, information services and public administration provides the opportunity to discriminate in favour of the segments of the population that are targeted by the Millennium Goals. Governments can fine-tune public spending priorities and processes in ways that will make it easier for microfinance to provide for the lowest levels of the poverty pyramid. Short of proper dialogue and cooperation between governments, microfinance providers and donors, this will not happen.

CHAPTER 1 MILLENNIUM DEVELOPMENT GOALS AND POVERTY REDUCTION

1.1 INTRODUCTION

The Millennium Development Goals present a practical, policy-oriented means of measuring poverty, and one that has enabled the United Nations to claim a central role in international and country-specific approaches to poverty reduction. As a measure of poverty, the Millennium Goals are a compromise, but they serve to highlight the many dimensions that poverty can take. One can argue that the Goals do not do justice to the differences between rural and urban poverty or to the deprivations that beset millions of refugees and homeless people in the world. Such claims have merit, but they do not detract from the fact that the Millennium Goals focus attention on those dimensions of poverty also point to what needs to change if people are to escape from poverty. This appears clearly from a brief review of the eight Millennium Goals[1].

Millennium Development Goal No. 1: Halve extreme poverty and hunger by 2015

Extreme poverty characterizes individuals who are abjectly and chronically income-poor, i.e., people whose income is less than US $1.25 a day. While the ultimate goal is to eradicate all extreme poverty, the immediate target is to halve the number of people in extreme poverty by 2015 compared with 1990.

It could be said that this Millennium Goal is the main one because a necessary condition for sustainable poverty reduction is that both the absolute and relative numbers of extreme poor must fall. However, this is not enough. Social security handouts are one strategy of assistance to the extreme poor, especially children, pregnant and lactating women, the elderly, infirmed and disabled. However, welfare handouts are not a sustainable solution for the chronically poor. Escaping extreme poverty must involve significant productivity gains arising from improved rates of employment and remuneration, increased self-employment, and asset accumulation by poor households. These improvements are where microfinance has a unique role to play and significant unrealised potential.

Hunger and low incomes are both a cause and a consequence of chronic poverty. For example, while the world today produces more than enough to feed everyone. The numbers of individuals who cannot afford the food they need for a hunger-free life and food security continue to grow in absolute terms. Social security has a role here, especially with regard to underweight pre-school and school age children. However, if the number of hungry people in the world is to be cut by half by 2015, this is not enough. Steps must be taken to give people the means either to grow their own food or to earn enough to purchase from those with a surplus to sell. Where the root cause of low agricultural productivity is that farmers cannot afford the items they need to do better, microfinance production loans (complemented where needed with training and appropriate technology transfers) can bring about sustainable, hunger-free livelihoods. Among the landless poor, on the other hand, microfinance has already demonstrated its capacity to pave the way for new and better quality livelihoods.

1 *The Millennium Development Goals represent a global partnership between governments, civil society, UN agencies and donor nations, arising from world summits since the 1990s and which culminated in the UN Millennium Summit in September 2000. The rationale is to promote pro-poor development, universal education, gender equity, child safety and survival, and health. Progress is monitored and reported in the UN's annual Millennium Development Goals Report.*

The challenge of halving extreme poverty and hunger cannot be underestimated, as it bears on the predicament of more than one billion people today. For them, microfinance is not a magic silver bullet, but it can be the crucial step to the next level up in the poverty pyramid. The extreme poor are often perceived as an extra-ordinary 'risk' when it comes to financial assistance. Yet, a core lesson of the experiences of microfinance institutions, such as Grameen Bank, is that the market overstates the risk of lending to low-income clients. This market failure leads to less lending for productive purposes to poor people than their real risk profiles would warrant.

The practicalities of lending to low-income households are complex and not mainstream in commercial financial circles. Some microfinance providers have experimented with outreach programmes to the extreme poor, but the reality is that the success of microfinance has been far greater with clients who operate further up the poverty pyramid[2]. This does not mean that microfinance cannot help the extreme poor, pointing instead to the rational and simple reality that microfinance institutions behave in ways that are consistent with commercial approaches to market penetration. Microfinance institutions reach out to the ripest fruit first, being those households in the upper strata of the poverty pyramid. Outreach to the poorest of the poor requires tailored strategies that are higher-cost and more skill-intensive. Fortunately, more than one generation of experience with microfinance is now available across the globe on which microfinance institutions can call to ensure that microfinance loans are not only pro-poor, but accessible and suited to the needs and constraints of the extreme chronic poor.

It is commonly believed that higher food prices push millions of people deeper into poverty. This is especially so among the urban poor who have few opportunities to grow their own food. However, among the rural poor higher farm-gate prices are a boon. Microfinance has enabled even the poorest agricultural households to reap the benefits of higher farm gate prices, financing the value-chains that connect poor rural households with new markets and enabling them to diversify into higher-valued produce[3]. Much more must and can be done along these lines to assist the extreme poor. This kind of trend is consistent with reduced unemployment, fewer low-paying jobs among poor villagers, and more opportunities for the extreme poor to find better-paid jobs in less risky areas of production.

The literature on chronic and extreme poverty is not as abundant or extensive as that on poverty in general. This may be because received wisdom continues to be that the needs and circumstances of those at the bottom of the poverty pyramid are not materially different from those of the poor in general[4]. In reality, those needs and circumstances are different in important ways, particularly the way the poorest manage money and deal with risk[5]. Microfinance providers will continue to by-pass the chronic and extreme poor so long as they are unable to include these differences in product design.

Recommendations regarding Millennium Development Goal No. 1:

i. Survey a sample of microfinance institutions to determine, based on their experience of outreach to the chronic poor, the products and services that have effectively addressed the causes of chronic poverty.

2 *See p. 38 below.*

3 *See, for example Abed & Matin 2007; Asian Development Bank 2004; Banerjee & Duflo 2007; Biggs a& Shaha 2006; Chen & Snodgrass 2001; Ford Foundation 2005; Hoffman et.al. 2005; Meyer 2002; Prahalad 2004; SEEP Network 2008; UNDP 2008, 2007; Wheeler et.al. 2005; and World Bank 2006a,c, 2007.*

4 *A useful source of information is www.chronicpoverty.org*

5 *See especially Daryl Collins et.al., 2009, Portfolios of the Poor: How the World's Poor Live on $2 a Day, Princeton UP, Princeton; Chronic Poverty Report 2008-9; Hulme & Shepherd 2003; Rutherford 2000; and Remenyi 1991.*

ii. Develop a toolkit enabling microfinance institutions to design products and services that are specific to the needs of the chronically poor.

iii. Design a training programme for microfinance loan officers to enhance their capacity to work productively with the chronically poor.

iv. Establish a microfinance Strategic Outreach Fund to support client training and microfinance product/service delivery exclusively for the benefit of the chronic poor.

v. Conduct country-specific outreach planning roundtables to facilitate information exchange between microfinance institutions on how best to improve outreach to the chronic poor.

Millennium Development Goal No. 2: Universal primary education by 2015

More than 90 per cent of all children in developing countries attend primary school. However, this figure, while welcome, overlooks (i) the numbers of illiterate individuals in the 12-30 age cohort, (ii) the numbers of children whose school attendance at school is so sporadic that upon completion of primary school their literacy and numeracy skills are insufficient to open doors to higher paying jobs, and (iii) gender inequities in education attainment, especially in the poorest countries of Africa and Asia.

Where poverty keeps children out of school and adults out of 'catch-up' adult education programmes, government must step in. Many microfinance providers have also found, however, that providing clients with basic literacy and numeracy programmes can not only improve on-time repayments and productive investment, but also shake off the traditional local factors that stand in the way of advancement for the poor. Where linked to client participation in training programmes on primary health care, sanitation, maternal health and homestead gardens, microfinance has been found to be a major catalyst for gains in education, more constructive gender relations in the home, lower household morbidity, new ideas for homestead-based income generation, and improvements in gender equity.

Despite the strong links between microfinance outreach and household education attainment, the numbers of microfinance initiatives that target this particular Millennium Goal remain thin on the ground. Yet, the use of financial incentives to reward improved school attendance, compensate families for the loss of 'labour-power' arising from attendance by (especially female) children, or pay for school fees or text books, proves that these are obvious, simple and effective ways of promoting Millennium Goals. The challenge is to determine how best to incorporate them into microfinance efforts to reach out to the poorest of the poor. Donor and government intervention may be required to work with microfinance institutions to ensure that incentives of this sort are a more frequent component of outreach to the extreme poor than is typically the case.

Recommendations regarding Millennium Development Goal No. 2:

i. Survey a sample of microfinance institutions to determine, based on their experience in outreach to the chronic poor, the products and services that have proven especially useful in supporting school attendance and participation by household members in literacy and numeracy classes.

ii. Develop a toolkit enabling microfinance to design products and services that will promote participation in primary education by children from chronically poor households.

iii. Design a training programme for microfinance loan officers to enhance their awareness of school attendance issues in the communities where they work and their capacity to support elementary school education by children and adults from chronically poor households.

iv. Establish a microfinance Education Outreach Fund for the Chronically Poor, to subsidise school fees and education materials such as books, and promote school attendance by children from chronically poor households.

v. Conduct country-specific outreach planning roundtables to facilitate information exchange between microfinance institutions on how best to use their services to promote school attendance by children from chronically poor households.

Millennium Development Goal No. 3: Promote gender equality and empower women

Since the modern era of development began in 1950, women and children have long been the hidden face of poverty. Fortunately, the plight of women and the unique pressures they face from systemic discrimination is no longer wholly ignored as it was in the 1950s through much of the 1970s. This Millennium Goal is an example of the sort of change that is needed for women's improved access to education, health services, employment opportunities and roles in governance[6]. The reality across the world remains, however, much remains to be done until female treatment under law, access to schooling and representation in government, roles in senior management or commercial and professional markets is on pa with standards that apply to males. Gender inequities are particularly significant in rural communities, although in urban slums women and children are most vulnerable to trafficking and exploitation.

Microfinance providers have realised that their best clients are often female. Women are less likely to succumb to alcohol or gambling, while their closer association with children, especially in female-headed households that constitute a significant proportion of the extreme and chronically poor, is a strong incentive for responsible financial behaviour. As a result, the dominance of women in the client lists of microfinance providers is not a symptom of gender bias but an indicator of good business practice favouring best clients. Moreover, for all this apparent gender bias, the beneficiary list typically testifies to the contrary, as it includes all males in the client's immediate and extended family. It is not unreasonable to speculate, therefore, that its close association with women creates significant opportunities to use microfinance as a means to promote gender equity and women's empowerment[7].

Microfinance responds to women's need for financial products and services, including savings, insurance, money management and loans. The way microfinance providers manages and deliver these services empowers women: they play a central role in group organisation, mentoring fellow microfinance clients, mobilizing savings, collecting loan repayments and sharing the burden of learning what works and what does not. Nurturing of peer solidarity could turn microfinance into a significant source of the social capital that is so important for women's empowerment.

Recommendations regarding Millennium Development Goal No. 3:

i. Survey a sample of microfinance institutions to determine, based on their experience in outreach to the chronic poor, the products, service processes and client-relations arrangements that have proven especially useful with regard to gender equity and women's

6 *See Janet Hunt's overview of Gender and Development in Kingsbury et al, 2004, chapter 10.*

7 *See Cheston & Kuhn 2002; Helms 2006; Karlan 2007; Karlan et al2006; Mustafa et al. 1999; ; Remenyi 1991; Todd 1996; UNCDF 2006;*

empowerment issues faced by clients from households and communities in chronic poverty.

ii. Develop a toolkit enabling microfinance to design products, services and management arrangements that will promote gender equity and empower women from chronically poor households and communities.

iii. Design a training programme for microfinance loan officers to enhance their capacity to work productively with their female client base and the communities in which they live to promote gender equity and empower women.

iv. Establish a microfinance Gender Equity Fund to reward clients for progress on gender equity, support training of borrowers and family members in gender equity issues, and enable the staff of microfinance institutions to promote gender equity and empower women in chronically poor households and communities.

v. Conduct country-specific outreach planning roundtables to facilitate information exchange between microfinance institutions on how best to promote and support gender equity and women's empowerment in chronically poor households and communities.

Millennium Development Goal No. 4: Reduce child mortality by two-thirds by 2015

A child in a developing country is 13 times more likely to die by the age of five than one in an economically advanced high-income country. Extreme poverty allows infants and young children to die from readily treatable or avoidable causes. The main culprits – diarrhea and other water-linked mortality and morbidity factors – are closely linked to social development. Unsanitary standards and practices often persist because of ignorance of, or lack of financial capacity for, simple remedies, such as lime for latrine pits, pipes for homestead and village drainage or clean water storage pots for daily home use. These basic facilities are rarely unaffordable, yet relative to the income of the poorest households accumulating the lump sum needed to take action is a serious constraint.

It is easy for even the poorest people to see and understand the relationship between health and living conditions. Experience shows that willingness to contribute, financially or in kind, to ways in which this environment can be improved follows quickly. A stronger link between microfinance and social development also makes it possible to reform hygiene and sanitation practices in ways that are often crucial to child survival. Change is always easier if it can be associated with commitments that householders value. Microfinance can be such a commitment, with strong backward and forward linkages that can pave the way for sustainable escape from poverty.

It is to be lamented that so many leading microfinance providers have abandoned or lost any explicit or direct commitment to social development. Pressure from donors and other financiers to enhance the priority that microfinance institutions give to their own institutional viability (typically under the catch-cry 'making microfinance institutions as financially viable as their clients'), has encouraged 'minimalist' approaches to microfinance, stripping outreach and loan portfolio growth programmes of specific social development targets. This change has encouraged established microfinance institutions to concentrate on loan portfolio growth, savings mobilisation and profit, trading off the complementarities that can and do exist between social development and successful, profitable delivery of microfinance[8].

8 Absence of consensus among practitioners and researchers has favoured microfinance outreach strategies that give a high priority to institutional viability over explicit focus on enabling escape paths from poverty for clients. See Cassar et al., 2007; Chen & Snodgrass 2001; Cheston & Kihn 2002; Hashemi et

As a result, progress with social development, such as improved infant mortality rates, child survival beyond five years of age or maternal health, has not lived up to potential while microfinance reached out to the upper levels of the poverty pyramid, especially those in the entrepreneurial and near-poor categories.[9]

With their choice of minimalist approaches, to microfinance, many microfinance institutions have thrown out social development gains with the welfare bath-water. This is as might be expected in a world environment that has become increasingly hostile to welfare approaches to poverty relief. There is a place for welfare in the alleviation of chronic poverty, but welfare handouts are not a sustainable strategy for pro-poor development. However, this does not mean that important social development goals should be ignored or dismissed.

The contribution microfinance can make to achievement of the Development Goals has suffered from the abandonment of grass-roots community engagement and core client empowerment associated with client participation in the delivery and management of microservices, especially with regard to non-minimalist delivery of such financial to the poorest of the poor. If microfinance is effectively to reach down to the bottom of the poverty pyramid to make a difference to child survival, nutrition, community hygiene and morbidity rates, then the industry must eschew the single- minded minimalist approach and reclaim some of the more important social development structures that are essential to community strengthening and client-oriented human resource development. Progress in these areas has long been a function of the effectiveness of non-government organizations operating as change agents at grassroots level. However, it is also the experience of those change agents that their effectiveness is enhanced when social development programmes are complemented by microfinance.

Recommendations regarding Millennium Development Goal No. 4:

i. Survey a sample of microfinance institutions to determine, based on their experience of outreach to the chronic poor, the products, services and client relations processes that have effectively addressed the causes of child and infant mortality, .

ii. Develop a toolkit enabling microfinance institutions to design products, services, management structures and strategic alliances that will promote behavioural, environmental and other changes linked to improvements in the incidence of child and infant mortality among the chronically poor.

iii. Design a training programme for microfinance loan officers to enhance their awareness of child and infant mortality trends in the communities they serve, and their capacity to work with the chronically poor to address the root causes of child and infant mortality.

iv. Establish a microfinance Child Emergency Fund to support client access to the resources they need for medical assistance, upgrade sanitation standards, improve household sanitation and participate in child survival training without compromising the contribution that access to microfinance products and services can have on improved livelihoods.

v. Conduct country-specific outreach planning seminars to facilitate the exchange of information between microfinance institutions and focus on how best to use microfinance to address the root causes of child and infant

al, 1996; Karlan et al, 2006; Lovell 1992; Mustafa et al. 1999; Remenyi & Quinones 2000; Simanowitz & Waters 2002; and Todd 1996.

9 The poverty pyramid is described below p. 38. See also Remenyi, 1991; and Kingsbury et al., 2004.

mortality in chronically poor households and communities.

Millennium Development Goal No. 5: Reduce maternal mortality by three-quarters by 2015

Poor households associate poverty with a range of circumstances, including female morbidity and maternal mortality. Even relatively short periods of illness can sap the resources of a household, while mortality robs it permanently of labour power.

In developing countries, a major cause of maternal mortality (500,000 women per year) is pregnancy and childbirth, with deaths from these causes all-too often linked to social mores or systemic limits on the freedom of women to move and seek help. Delayed marriage and delayed age of first pregnancy are especially effective strategies for reduced maternal mortality, but poverty can lock individual households and even whole societies into the child-bride trap, which is also a major cause of childbirth fistulas (a rupture of the birth canal that can leave a woman incontinent). In other cases, maternal death might well have been avoided if only the family had had the savings or the ability to borrow the amount needed to consult a doctor or midwife or ensure that one or the other is in attendance at birth.

Reproductive health is a complex area at the best of times, but especially so where access to knowledge and/or contraceptive services is limited. This particular Development Goal includes a subsidiary target of universal access to reproductive health assistance, including family planning. Microfinance groups have proven to be a most effective means by which women of child-bearing age can be assisted with their family planning and maternal health problems. In many Chinese provinces, for instance, affordable contributory health insurance has done much to cut the rate of maternal mortality as well as household expenses arising from pregnancy-related health problems. In other countries, the delivery of microfinance products and services through the good offices of women's health organisations or agencies has also improved maternal health.

Recommendations regarding Millennium Development Goal No. 5:

i. Survey a sample of microfinance institutions to determine, based on their experience in outreach to the chronic poor, the products and services that have effectively addressed the causes of maternal mortality and morbidity.

ii. Develop a toolkit enabling microfinance institutions to establish the strategic alliances and skills required to design delivery systems, products and services that will promote the behavioural, environmental, social, cultural and legal changes linked to improvements in the incidence of maternal mortality and morbidity among the chronically poor.

iii. Design a training programme for microfinance loan officers to enhance their awareness of maternal mortality trends in the communities they serve, and their capacity to work with the chronically poor to address the root causes of maternal mortality and morbidity.

iv. Establish a microfinance Maternal Loss and Insurance Fund to help clients' relatives to overcome their trauma, to extend medical assistance to women at risk, and you enable chronically poor households to upgrade sanitation standards, improve hygiene and participate in training to reduce the incidence of maternal mortality and morbidity, without compromising the normal use of microfinance products or services for livelihood activities, self-improvement spending or household asset accumulation.

v. Conduct country-specific outreach planning seminars to facilitate the exchange of information between specialist institutions on how best microfinance can address the root causes of maternal mortality and morbidity in chronically poor households and communities.

Millennium Development Goal No. 6: Reverse the incidence of HIV/AIDS, malaria and other major diseases by 2015

Disease is a core cause of poverty. In developing countries, HIV/AIDS has justifiably received much attention, but this should not detract from our awareness of the destructive effects of malaria, tuberculosis, hepatitis and other widespread water- or soil-borne diseases. In the case of HIV/AIDS, significant progress has been made thanks to antiretroviral drugs, but costs have restricted access to the 30-plus million patients in developing countries. Though also at a cost, science seems to have come to grips with malaria, which kills one million people every year and debilitates at least 500 million others, of which 90 per cent in Africa.

Where the cause or the treatment of the effects of disease is held back by poverty, microfinance has significant potential for cost-effective remedial outreach. For example, the purchase of bed nets can be seen as an investment in family health that will quickly be recouped through reduced incidence of mosquito- and fly-borne disease. Every year, more than 50 per cent of the world's population is exposed to malaria, which causes up to three million deaths worldwide. Africa is heavily affected, with a child dying of the disease every 30 seconds.

Appropriately designed microfinance products can help address the major causes of malaria and other diseases, especially where the solution is within the grasp and technical capability of those households at risk. For example, loans could be granted to encourage the commercial production and processing of *artemisia annua*, an anti-malarial extract from a herb native to China[10] that has proven effective in the fight against even the most virulent strains.

Recommendations regarding Millennium Development Goal No. 6:

i. Survey a select sample of microfinance institutions to determine, based on their experience in outreach to the chronic poor, the products and services that have effectively addressed the causes and means of recovery from disease.

ii. Develop a toolkit enabling microfinance institutions to design products and services that will promote behavioural, environmental and other changes linked to lower incidence of disease among the chronically poor.

iii. Design a training programme for microfinance loan officers to enhance their awareness of disease and morbidity trends in the communities they serve, and their capacity to work with the chronically poor to address the root causes/vectors by which disease persists or is transmitted among individuals.

iv. Establish a microfinance Disease Prevention and Recovery Fund to help clients' relatives through the trauma of disease, to extend medical assistance to affected households, and provide chronically poor households training in preventive methods, without compromising the normal use of

10 Artemisia is mentioned in the Chinese Handbook of Prescriptions for Emergency Treatments (340 AD) for treatment of fevers. In 1971, extraction of aerial parts of A. annua with low-boiling solvents, such as diethylether, produced a compound mixture with antimalarial properties on infected mice and monkeys. The main active principle, artemisinin (formerly referred to as arteannuin and as qinghaosu in Chinese), was isolated and had its structure correctly defined in 1972 in China as a sesquiterpene lactone with an endoperoxide bridge. Artemisinin is now available commercially in China and Vietnam as an antimalarial drug with proven efficiency against drug-resistant strains of Plasmodium, the malarial parasite. Artemisinin also has phytotoxic activity, even on Artemisia annua, and is a candidate as a natural herbicide.

microfinance products or services for livelihood activities, self-improvement spending or asset accumulation.

v. Conduct country-specific outreach planning seminars to facilitate the exchange of information between specialist institutions on how best to use microfinance to address the root causes of disease in chronically poor households and communities.

Millennium Development Goal No. 7: Promote environmental sustainability

Microfinance can advance local environmental sustainability in a many ways. For example, microfinance has driven many slum dwellers to engage in urban agriculture, slum-based microenterprise production using recycled waste products, or housing rehabilitation. In other instances, improved access to healthier sanitation and potable water in rural and urban areas has have resulted from microfinance support, too.

It is not unusual for microfinance providers to follow-up on customer loans with pro-environment and pro-poor technical support. For example, fertilizer production loans, when granted on condition that borrowers participate in in-field application training sessions, can reduce excessive use as well as contaminated run-off into local catchments and waterways. Similarly, tillage and animal husbandry practices that reduce carbon emissions, or threats to riparian vegetation from uncontrolled livestock access to riverbanks, etc., can be encouraged by the provision of microfinance products and services that discourage burning off and deforestation, encourage composting and planting of shelter-belts and wood-lots, and reward minimum tillage. Loan and savings products that address these issues are not commonspread in the mainstreams of microfinance, though, partly because the incentives require partner funding that is best obtained from donors or local government.

Awareness of local environmental assets is typically high among villagers in developing countries. Yet, it is not uncommon among poor communities to witness production or farming practices that are destructive, undermining local environmental assets, (forests, fish stocks, water, wild stocks of medicinal plants and fungi, etc.), at non-sustainable rates. Chronic flood irrigation, exploitation of lightly timbered areas for fuel-wood and over-harvesting of woodlands for the sale of fungi and medicinal plants are some examples that readily come to mind. Such activities persist because the perpetrators feel they have no alternatives. Microfinance can change this, but only if the right sorts of complementary skills training and marketing programmes are also offered, showing people that loss of environmental resources can not only be stopped but also reversed.

Environmental protection is an area of development where strategic alliances and partnerships can play particularly important roles. Water user associations, for example, can bring microfinance institutions to link agricultural loans to water saving practices. Aquaculture cooperatives and microfinance institutions can cooperate to reduce production costs by disseminating information on overfeeding of fish/crustaceans and disease management. In Bangladesh, some of the smaller microfinance institutions have offered clients training in efficient use of inorganic fertilizers, soil testing and more effective storage of harvested products as ways of improving both the environment and profitability of clients' productive investments[11].

Recommendations regarding Millennium Development Goal No. 7:

i. Survey a select sample of microfinance institutions to determine, based on

11 For example, in 2007 SOJAG (Sojag O Jati Ghatan, or 'conscious society and nation building' in Bangla), a small microfinance institution in Dhanrai subdistrict ,some 55 km from Dhaka, received the Best Partner award from the Palli Karma-Sahayak Foundation for its work with farmers.

their experience in outreach to the chronic poor, the products and services that have proven especially useful in the promotion of environmentally responsible behaviour and environmental sustainability.

ii. Develop a toolkit enabling microfinance institutions to design products and services that will promote environmentally responsible behaviour, environmental awareness and environmentally friendly improvements in production and livelihoods in chronically poor households and communities.

iii. Design a training programme for microfinance loan officers to enhance their awareness of environmental issues and trends in the communities they serve, and their capacity to work with the chronically poor to address the root causes of environmentally irresponsible behaviour and production practices.

iv. Establish a microfinance Environment Improvement and Sustainability Fund to support client efforts in favour of environmental awareness and responsibility, including participation in training and group activities focused on land care, water quality protection, recycling and reduced waste.

v. Conduct country-specific outreach planning seminars to facilitate the exchange of information between specialist institutions on how best to use microfinance to address the root causes of environmentally negative practices, promote the adoption of environmentally aware livelihoods and production, and support the engagement of chronically poor households and communities in redressing environmental damage.

Millennium Development Goal No. 8: Form a global partnership for development

The commitment of developed countries to official development assistance is at risk. The financial demands of the global financial crisis and the slack performance of major economies such as the USA, the UK and major countries in the Euro zone notwithstanding; 'aid fatigue' is evident in the behaviour of donor countries. This is something Millennium Goal 8 must address for the benefit of both recipients and donors. Commitment to good governance is a cornerstone of sustainable pro-poor development with more generous official development aid to be delivered to those countries genuinely engaged in poverty reduction. Official aid flows to support microfinance outreach to the poor could be significant new source of funding.

Recommendations regarding Millennium Development Goal No. 8:

i. Survey a sample of microfinance institutions to determine, based on their experience in outreach to the chronic poor, the most effective governance and accountability/transparency practices that willentice clients from the poorest households to become involved in microfinance decisionmaking and policy development.

ii. Develop a toolkit enabling microfinance institutions to identify those among their products that can best use donor support to achieve those social development goals that are overlooked by market forces.

iii. Lobby for donor funding of a professional training programme for microfinance professionals to enhance their awareness of development trends in the communities they serve, and their capacity to work with the chronically poor to address the root causes of chronic poverty in those communities.

iv. Establish a Global Microfinance Outreach Fund to support training and research and build capacity for effective outreach to the poorest of the poor. The fund can also support innovative pilot projects experimenting with new methods for improved outreach and impact of microfinance on poverty reduction.

v. Conduct regular country-specific microfinance outreach planning seminars to facilitate exchange of information between microfinance institutions, donors, non-governmental institutions, socially responsible investors, commercial finance institutions and government officials, in support of improved partnerships for the promotion of development and poverty reduction through microfinance.

1.2 THE MILLENNIUM DEVELOPMENT GOALS: AN URGENT AGENDA

When in the 1990s the Millennium Development Goals were chosen by the United Nations as the main plank in their agenda until 2015, hopes were that donor agencies would gear their projects and programmes to those goals, and especially the very tangible outcomes sought in nutrition, education, health, gender equity, the environment and growth in bilateral and multilateral development assistance. The subsequent record has not, so far, lived up to this expectation. Why this may be so is a question that is beyond the focus and purpose of this report. Suffice it to say that one of the reasons is that the MDGs are not isolated from the context in which international development and donor commitments to poverty reduction spending takes place.

The foregoing review of the eight Development Goals reveals many areas of overlap and intersection with issues that are fundamental to the rationale behind microfinance. So close can these areas of common interest be, that it is tempting to ask, 'can microfinance give a major boost to achievement of the Millennium Goals?' The answer to this question can be positive, but then only so long as major reforms are pursued. In particular, any microfinance outreach must be carefully targeted, risk management procedures must be tailored to the areas addressed by the Goals, complementary government subsidies must strengthen the links between delivery of financial services and social development, and additional efforts are required to strengthen capacity for microfinance product design in order to expand the range of Millennium-related microfinance services/products available to poor households, small groups and poor communities.

However, such reforms cannot remain confined to the margins of microfinance business. If microfinance is to give a significant boost to the Goals, these must be mainstreamed into any products designed for the chronically poor. This can be achieved only if microfinance institutions have the capacity to serve all levels of the poverty pyramid, including the most vulnerable.

Only five years remain until the 2015 deadline to achieve the Millennium Goals. In July 2009, the UN General Assembly took a decision to hold a high-level meeting at the opening of its 65th session in September 2010 to review progress. This meeting was to provide the General Assembly, Heads of State and Government and the UN with an opportunity to galvanise stakeholders to commit the funds that would put microfinance in a position to help achieve the Goals by 2015.

CHAPTER 2 THE CHARACTERISTICS OF MICROFINANCE

2.1 WHAT IS MICROFINANCE?

The history of microfinance can be traced back to the development literature on rural credit and agricultural modernisation. However, as a branch of 'rural finance', microfinance is new and represents a break with tradition that began in the late 1970s. The term 'microfinance' is a much more recent addition to the contemporary vocabulary of poverty reduction and development. When Prof. Mohammad Yunus, founder of Grameen Bank in Bangladesh, experimented with small loans to villagers in the mid-1970s, the term 'microfinance' did not exist. Moreover, the typical mainstream rural finance project of that time would support agricultural modernisation and especially innovation through technology transfers as well as irrigation. At the time the core issue was not farmer needs for higher incomes and living standards, as it is for microfinance today.

Throughout the decades leading to the launch of the first microfinance schemes around 1980, the link between rural credit and poverty reduction was incidental at best. The purpose of rural credit was to increase agricultural production in countries where starvation was commonplace and reduction of nutritional deficits a priority government policy. It was not unusual for rural credit programmes to welcome the declines in staple food prices associated with increased production as they were beneficial to consumers, falls in farmer incomes notwithstanding. In contrast, microfinance providers viewed what they were doing as *liberating the poor,* enabling them to create their own income-generating businesses, free from the burden of debt that the typical rural credit programme imposed on the rural poor.

The pioneers in microfinance began with the poor as their target 'market' and with micro-credit as their primary 'product'; because they found that poor people could save but could not yet borrow. Where mainstream banks and financial institutions turned poor households away because they lacked collateral or any documented sources of cash income, micro-credit pioneers began to target those rejected by the banks. They quickly learned that their best customers were income-poor women, whose appetite for small 'working-capital' loans for income generation was susceptible to tackle core factor of chronic poverty. It was a relatively easy step for these pioneers to see that credit alone was not up to the task of sustainable poverty reduction, though. Money transfer services were added, along with training for more productive money management, client involvement in microfinance scheme management, sponsored community development, and, better late than never, savings products, including insurance, which all together transformed credit-based income generation schemes into microfinance providers.

Like any commercial bank, microfinance receives low-income clients' deposits (savings) which it turns into loans to individuals or entrepreneurs to fund household improvement (e.g., sanitation) or economic projects (e.g., buying a cart to peddle goods on the street). Innovative methods make it possible to grant loans on relatively favourable terms. Some providers also offer other financial services that are similarly tailored to the capacities and needs of the income-poor, such as insurance.

A feature of 'development' in the decades since the Second World War has been the spread of the money economy. No longer is subsistence production in a rural setting the norm. A consequence of this 'global' change has been an increase in the need for banking services, especially credit and savings. When banks provide these services, they bring together the independent decisions of individual savers and borrowers to facilitate one another's goals. Microfinance extends financial services to poor households that are otherwise unable to access the mainstream financial sector: their earnings are too small, as are – relatively speaking – their needs for credit.

2.2 MICROFINANCE: AN INNOVATION IN BANKING TECHNOLOGY AND PRACTICE

2.2.1 A pro-poor approach to banking

The 'technology' of modern banking has proven inappropriate to provide financial services where the absolute size of transactions is small, as they are in the low-income segment of the economy. Central banks and other financial regulators did the poor no favours by imposing on emerging 'licensed' banks regulatory regimes that were designed to protect the interests of depositors and keep the risk of bank failures to a minimum, together with an array of financial, legal and accounting standards that made it impossible for those banks to serve the needs of income-poor households. Microfinance institutions have avoided this trap, embracing market penetration and management methods that:

- accommodate collateral substitutes as an effective basis for client selection;
- mobilise self-interest to manage risk and maintain high on-time repayment rates;
- reduce to a minimum the cash costs of servicing small loans and mobilizing small deposits;
- harness peer pressure and social mores to enforce contractual obligations;
- segment the market to concentrate on the best clients in poor households;
- devise pricing policies that remain consistent with profitability; and
- deliver financial services and products tailored to the needs of low-income clients.

2.2.2 Diversity in pro-poor banking

Microfinance institutions can be found today under a bewildering variety of guises. Some, like the Bangladesh Rural Action Committee and Grameen Bank in Bangladesh, have matured into formal banking enterprises. The greater majority, however, are legal entities governed by rules that have been devised for non-profit, non-government organizations that are registered, grassroots-based self-help groups, or formally established cooperatives, or credit unions, or building societies, or informal, member-operated, savings groups and revolving loan funds. Microfinance can also be part of the social development programmes run by non-governmental organisations as part of poverty-reduction or sustainable community development policies.

2.2.3 Pro-poor banking is unfinished business

Microfinance has evolved very rapidly. In the *Financial Times* dated 7 June 2007, Richard Lapper described microfinance as the 'big business of small loans'. More than 10,000 providers are in operation today. The total volume of microfinance loans outstanding around the world grew from an estimated \$4 billion in 2001 to \$25 billion (to more than 100 million borrowers at the end of 2006). According to 2007 estimates by Deutsche Bank Research[1], if microfinance institutions were to serve all potential borrowers, i.e., 1.1

1 *Microfinance: an emerging investment opportunity, December 2007, Deutsche Bank, http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000219174.pdf*

billion, they would need to lend (and fund) an additional $250 billion.

2.3 THE WAYS AND MEANS OF BANKING WITH THE POOR

2.3.1 Core microfinance services and trends

Core microfinance services include small loans to the working poor and money management assistance, including deposit services, cash-flow management and money transfers. The working poor are a sub-set of the 1.1 billion poor targeted by the Millennium Goals. This does not mean that microfinance is marginal to the Millennium Goals. On the contrary, because the benefits of microfinance also accrue to the extended families of the working poor, microfinance represents an escape route for the chronically poor and those higher up in the poverty pyramid. The potential to enhance the relevance of microfinance to the chronically poor is the challenge.

Reaching out to the lowest levels of the poverty pyramid will take microfinance into the more challenging segments of the potential market. While banking with the near-poor and others in the upper strata of the poverty pyramid has proven to be profitable for established providers, reaching out to the lowest strata in the poverty pyramid is more costly and challenges profitability. However, experience also shows that the more underprivileged will not escape poverty on any kind of sustainable basis without significantly enhanced access to financial services.

Savings deposits from borrowers are a core source of funding for microfinance loans. In Asia average microloan size was around US $150 in 2009, compared with close to US $240 in Africa, almost US $700 in Latin America and just under $1,600 in Eastern Europe and Central Asia. . In Asia, the deposit-to-loan ratio is almost 60 per cent, compared with almost 75 per cent in Africa, 45 per cent in Latin America and close to 10 per cent in Eastern Europe and Central Asia. The differences among regional ratios are consistent with those in average incomes and the numbers of poor by region, although the lower averages in Asia reflect more extensive market penetration, especially in South Asia.

As penetration of the chronic poor market segment improves in Africa, so the average loan size can be expected to decline. Savings mobilization will dominate as a source of loan funds so long as the risk and profitability of individual microfinance schemes are perceived as too high, although the growth of private sector funding for microfinance, especially from socially responsible investors in the USA and Europe, has grown rapidly, from less than $0.7 billion in 1995 to more than $3 billion in 2006. However, as suggested earlier, these sums are dwarfed by the $250 billion needed to bring microfinance to all 1.1.billion poor in the world.

This is not the place to repeat what is readily available in the microfinance literature[2]. What follows is a brief summary and overview of the defining features of microfinance.

2.3.2 Collateral substitutes are critical to risk management in microfinance

Common to all microfinance institutions is the use of substitutes for collateral to guarantee loan repayments, which contrary to conventional banking practice typically involve peer assessments and the creation of locally

2 *See, for example, Sabiha Mahmud Sumi 2010, Beacon of Hope, ASA, Dhaka; Collins et al., 2009, Portfolios of the Poor: How the World's Poor Live on $2 a Day, Princeton UP, Princeton; Armendáriz* et al., *2005, The Economics of Microfinance;* Sam Daley-Harris *2002, Pathways out of Poverty, Kumarian, Bloomfield; Elizabeth Rhyne 2001, Mainstreaming Microfinance, Kumarian, Bloomfield; Stuart Rutherford 2000, The Poor and Their Money, Oxford UP/DFID, New Delhi; Joe Remenyi & Benjamin Quinones 2000, Microfinance and Poverty Alleviation, Pinter, London; Graham Wright 2000, Microfinance Systems, Zed Books, London; Hege Gulli 1998, Microfinance and Poverty, Inter-American Development Bank, Washington DC; Asian Development Bank 1997, Microenterprise Development: Not by Credit Alone, Manila; Helen Todd 1996, Women at the Centre, Westview, Boulder; Catherine Lovell 1992, Breaking the Cycle of Poverty: The BRAC Strategy, Kumarian, West Hartford; Joe Remenyi 1991, Where Credit is Due, ITP, London.*

managed loan delivery and risk management processes. In the earliest years of micro-credit, the process began with the establishment and nurturing of local groups affiliated to the microfinance provider. These groups were relatively homogeneous, in order to facilitate group harmony and the effectiveness of peer group dynamics, solidarity and mutual support, and encourage disciplined, timely loan repayment. As average loan sizes increased, group responsibility for loan repayments became less practical and the risk unacceptable to individual group members. Microfinance institutions responded by shifting away from group-based to individual lending, along more traditional banking lines but now with the benefit of group member loan and repayment track records, which acted as a powerful new source of collateral substitute.

Finding the best way of reducing risk remains a challenge for microfinance institutions. Making transactions 'friendly' is one avenue, with loan repayment and savings collection arrangements made as simple and frequent as borrowers find convenient. In some cases microfinance institutions might make daily working capital loans that are disbursed in the morning and repaid at the end of the same day. This practice is especially relevant in the case of daily market transactions with goods bought wholesale early on and on-sold for a profit on a retail basis during the rest of the day. In many other cases, the preferred repayment interval is weekly, partly because this is the best way to maintain the discipline of regular saving of a small but manageable amount, which is essential for on-time loan repayment. Where production processes require more time, as is typical in livestock rearing, horticulture and complex handicrafts, repayment intervals and methods can be tailored to borrowers' saving capacities and repayment amounts. Therefore, it is not unusual for microfinance institutions to make interest-only loans, where the interest charged is repaid in weekly, monthly or even quarterly installments, with the loan repaid in lump sum at maturity, i.e., by the end of a season or after one year.

Close loan supervision is critical for risk management and varies greatly across microfinance institutions and size or type of loan. Responsibility for group loan supervision typically rests with group members, with the microfinance institution playing supervisory and training roles. Where loans are based on individual contracts, the microfinance loan officer has primary responsibility for monitoring compliance with lending terms. Among the poorest of the poor, a large proportion may suffer from poor health and extended periods of unemployment, to the point where they barely belong to those identified as the 'working poor'; in these circumstances, group support is crucial to enforce the disciplines of regular saving and loan repayments. It is not unusual for microfinance institutions to step in and provide groups or individual borrowers with emergency support when a natural disaster or other misfortune threatens their livelihoods.

Where a loan is linked to micro-enterprise development, the nature of the service offered by a microfinance institution will depend upon individual risk assessment, the complex, specific or otherwise requirements of the micro-entrepreneur (whether the transaction is a first or a repeat exercise), and the skill with which borrower and lender can negotiate terms and conditions. In some cases, the microfinance institution will insist on the borrower undertaking some skills training with direct relevance to their business project, but a loan may also require complementary action such as steps to improve clients' hygiene conditions. Such steps are warranted where the microfinance institution finds that the risk associated with a loan is a function of the entrepreneur's skills or the health and environmental conditions in the market(s) s/he serves. This all comes down to responsible risk management based on effective substitutes for credit collateral, which enable microfinance institutions to expand loan portfolios as they reach out to the poor[3].

2.3.3 Gender matters

Statistics show that women dominate the client lists of microfinance institutions. It is not unusual for 90 per cent or more of all micro-borrowers in a given country to be female. One could admittedly expect this in South and South-East Asia, but less so in other parts of the world, especially Central Asia, Eastern Europe and the Middle East. The worldwide average is around 70 per cent.

3 Significant research is required before it can determine how best to use microenterprise development programmes (MED) to assist the poor. These programmes tend to operate at or near the boundary between the top of the poverty pyramid and the levels of household income above the poverty line. Many such programmes operate within the poverty pyramid, albeit at the upper end. Whether is the benefits of these programmes trickle down to the chronic poor in any significant way is unclear, but deserving of serious investigation.

Female dominance in micro=loan portfolios should not be seen as some unhealthy gender bias in microfinance. Rather, it shows that the industry has early on come to realise that women were not only its best, most reliable clients, but that they were also the best channel through which the benefits of a loan could be shared among a maximum of people. This is because loans to women tend to benefit the whole family, while benefits of loans to men tend to favour the borrower, his circle of friends and business contacts. Indeed, the proceeds of micro-loans to males tend to be associated with higher 'cash leakage' to support gambling, drinking, smoking and other forms of behaviour without any benefit to a family.

TABLE 2.1: **Microfinance market penetration indicators, 2008**

	Asia	Sub-Saharan Africa	L America & Carribean	E Europe & Central Asia	M East & N Africa
Borrowers (millions)	51.9	6.7	12.8	9	2.7
Female borrowers (%)	94	57	80	43	66
Average loan balance (US $)	166	305	1,078	2,177	389
Depositors (millions)	35.4	16.8	13.7	10	0.1
Average deposit balance ($ US)	56	220	207	n.a	765
Loans per lending officer	279	286	233	169	217
Loan portfolio at risk >30 days (%)	1.5	4.7	3.7	2.1	2.4

Source: www.themix.org

The data in Table 2.1 are worth close scrutiny. For market penetration, Asia dominates as microfinance was first introduced in the most populous and poorest nations in the region: Bangladesh, India, Indonesia, the Philippines, Pakistan and Vietnam. It is not a surprise that microfinance penetration should be the most significant in the region that is home to the bulk of the world's poor.

However, this is less true on the savings than on the lending side. In other words, Asian microfinance institutions serve more borrowers than depositors. For many years Asia's original microfinance institution, Grameen Bank would accept savings deposits only from people who needed a loan grant ('loan-linked compulsory savings). It was not until the late 1990s that Grameen changed its approach and took deposits from clients looking for a safe place to keep their savings and possibly benefit from other services.

From the very start, donors have been willing providers of loan funds to microfinance institutions in Asia, while in higher-income developing areas, such as Africa, South America, central Asia and Europe, savings mobilization was the core of microfinance business. Capacity to save has been a much more important collateral substitute for microfinance institutions outside than within Asia. This is also why outside Asia, average loan sizes tend to be larger and clients in the upper levels of the poverty pyramid tend to be favoured since this is where capacities to save are the highest[4].

Africa is the odd man out among the groups of countries in Table 2.1. Since income per head is low across almost the whole of the continent, one might expect that needs for, and market penetration of, microfinance services would mirror those in Asia's poorest economies. But this is not the case. Africa is now home to almost one billion people, at least two-thirds of whom live below the international poverty line of US $2 per day, and yet microfinance reaches out to only well below 0.5 per cent of Africa's poor.

The reason is that in Africa, microfinance typically serves the near-poor, who operate at or close to the poverty line. This goes to show, incidentally, the very high proportion of the 'not-poor' and 'near poor' who have no access to mainstream banking or financial services. This is the market segment microfinance providers have found was easy, least risky to target, rather than potential clients at the chronic poverty end of the economic spectrum. This situation also reflects the constraints under which microfinance has had to operate in Africa. If the flow of donor 'investment' in pro-poor products and services had been at as significant as in Asia or Latin America in the 1980s and 1990s, African microfinance would have been in a much better position to serve the chronically poor.

4 Microfinance performance has varied widely across regions and sub-regions in Asia, Africa, the Middle East and Europe. Performance data is regularly published by the Microfinance Information eXchange (MIX), reported in the MicroBanking Bulletin and discussed in working papers of the Consultative Group to Assist the Poorest (CGAP). The specialist literature includes: Larson 2010; Sinha 2006; Cull et al., 2005; Lafourcade et al., 2005; Marguerite 2001; Remenyi & Quinones 2000.

2.3.4 Microfinance market penetration has further to go

A summary of microfinance market penetration in a number of regions in 2008 is presented in Table 2.1. The data overstate the extent of market penetration since not all borrowers still have outstanding loans, but the differences between regions are instructive. Asia is where market penetration has grown most in both relative and absolute terms, with the number of borrowers more than doubling in the five years up to and including 2008. The main contributor was South Asia, where the number of borrowers in the largest country, India, soared from 2.3 million in 2004 to 16 million in 2008, largely thanks to continuing activism from the self-help-group movement that dominates microfinance in the country. In Southeast Asia, Indonesia and Vietnam are the top performers, with the numbers of borrowers increasing from 3.8 million to 7 million, and from 3.3.million to 4.7 million respectively between 2004 and 2008.

Three features of microfinance as summarized in Table 2.1 are worthy of special note:

First, savings mobilization dominates microfinance in Africa, Eastern Europe and Central Asia. There is reason to believe that this finding is indicative of significant unrealized potential for microfinance providers to work harder,

Second, it would appear that there is a relationship between average loan size and the proportion of loan portfolios that is at risk by more than 30 days. Across the board, these percentages are small and not a reason for serious concern, but the trend is likely linked to the failure of microfinance providers with the highest loan size averages to elicit productive investment among a significant proportion of their smaller depositors. Given that microfinance providers rarely offer depositors interest rates that are positive in real terms, the excess of depositors over borrowers in countries where loan size averages are highest suggests that, unwittingly or otherwise, depositors are subsidizing borrowers. In terms of the goals of microfinance, this is a perverse outcome.

Third, the efficiency of microfinance providers can be measured in several ways, but the industry has arrived at a consensus that one important indicator is the average number of loans administered by a single loan officer. The data show that Asian microfinance providers operated at lower loan management costs than their counterparts elsewhere in the world. Why this is so is a complex matter, but a major reason for the difference is the greater importance of group-based lending in the countries where the number of loans managed by each loan officer is highest. Gearing microfinance to Millennium Goals would likely involve a revitalization of group-based microfinance, which would further enhance the productivity of microfinance providers as measured by this indicator.

2.3.5: Microfinance is a business not a charity, but subsidies still have a role to play

The success of microfinance can be traced, in part, to the fact that it is not a charity business. The consequences of rejecting the 'charity' mindset cannot be under-estimated. The clients of microfinance are not dependants, but partners in business and livelihood pursuits. If it is to succeed, a microfinance provider must be in a position to sustain the services it delivers which, in turn, lifts the importance of 'doing things profitably' to a new level. Microfinance providers have demonstrated that banking with the non-bankable poor can be profitable and sustainable. Even so, the persistence of market imperfections means that profit margins must not always be paid for by microfinance borrowers or depositors. In some cases, it is more than appropriate for donors to subsidise microfinance services, especially where market failures and other constraints impose costs on the poor that entrap them in their predicament.

All major microfinance providers operating in the world today have benefited from subsidies of one sort or another. These subsidies have supported revolving loan funds or staff training and contributed to the costs of projects launched for the purposes of community development. Gradually, as loan portfolios expanded and the benefits of economies of scale could be harnessed, interest rates and service charges could be set at levels that earned the microfinance provider a profit on operations. In almost all cases, these rates were high by mainstream banking standards and multiples of the rates associated with government-subsidized credit programmes.

Indeed, loan interest rates of 20 per cent or more are standard in microfinance. Rather than denoting usury, they are indicative of small average loan sizes and of the tyranny of relatively fixed transaction costs. It costs little more to set up and administer a loan for US $1,000 than one for US $100, but recovering this cost from the lower sum requires an interest rate that can be more than 10 times as high. This is why the bane of microfinance providers worldwide are governments that set maximum interest rates and therefore make it impossible for microfinance providers to recover costs, let alone secure margin, without subsidies.

2.3.6: Microfinance products and services must respond to client and market needs

A comprehensive list of the products – loans, savings, money and risk management – and financial services offered by microfinance providers would be impossible to complete. Virtually every day, a new variation is created in a bid to meet changing circumstances and shifting market and professional environments. The needs of street vendors, artisans or waste-pickers, for instance, are not similar. Microfinance providers have early on spotted the need for seasonal loans offering lump sum repayment options at the end of the season combined with regular interest payments on the outstanding loan. Further variety has, of course, to do with loan maturities, which can be as short as a single day but rarely longer than 12 months. The exception is housing loans.

As far as savings are concerned, microfinance providers have, again, had to design products and services tailored to the unique characteristics of each market and client circumstance. Target programmes helped them build up savings without having to go into debt. In other cases, microfinance providers met clients' needs for simple insurance schemes to manage health risks or respond to trauma.

Money management services, such as fund transfers, have become more important as more household members travel away for work opportunities. Seasonal contract work, urban construction projects and emigration generate remittances which microfinance providers can handle for clients safely and at reasonable cost.

The variety and complexity of products and services offered by microfinance providers can grow with demand and capacity to deliver, but success will remain a function of providers' ability to deliver what clients want and need.

CHAPTER 3 MICROFINANCE AS A STRATEGY FOR POVERTY REDUCTION

3.1 THE ADVANTAGES AND STRENGTHS OF MICROFINANCE FOR POVERTY REDUCTION

Microfinance is tailored to the needs of those households unable to access the services and products offered by mainstream financial sector institutions. As for the Millennium Development Goals, their primary target is none other than the economically poor, and especially those for whom this predicament is of a chronic nature.

3.1.1 Managing transactions costs is critical to pro-poor microfinance

The defining feature of microfinance is the delivery of financial services and products to clients who need only small-size services. These will include money management (transfers, savings deposits and withdrawals), loan disbursal and repayments, sale and management of insurance products, or the exchange of financial assets such as debt notes, documents relating to asset holdings, and housing bonds. The provision of loans against collateral substitutes has become one of the more visible expressions of the way microfinance institutions have facilitated small transactions, usually on a profitable basis[1].

Microfinance providers abide by conventional financial services rules, but administrative arrangements must be suited to the management of small financial transactions. Typically this involves special arrangements to accommodate borrowers without collateral, or use of client-engaged service delivery mechanisms and repayment procedures, in order to control transaction costs, as well as unique risk management regimes that are client-centered or possibly even client-delivered/managed. Unlike conventional banks or other financial institutions, microfinance providers rely on non-cash, 'in-kind', and contributions to transactions costs by clients, and have far fewer opportunities for economies of scale to make services more cost-effective for clients.

More efficient money management can make a big difference to the daily livelihoods of poor households, because 'every penny counts' when you are chronically poor. Even for those surviving on US $1 per day, the range of financial services is very similar to those for incomes above the poverty line. The poor save, invest, maintain a daily liquid store of cash and working capital, budget for the future and take steps to manage risk and the costs of ill fortune or illness. Typically the poor undertake these financial transactions without assistance from a mainstream financial institution. Consequently, the financial life of a poor individual or household does not extend much beyond = subsistence, except for very small extra amounts of cash. Microfinance institutions can play a catalytic role in ensuring that the efforts of the poor are as productive as possible.

The transaction costs to the poor of money management, money handling, investment and transfer can be very high indeed. In many developing countries, informal savings

1 A variety of examples of the way microfinance meets the needs of the poor are reported in Sabiha 2010; Collins et al., 2009; Rutherford 2000 and 1995; and Remenyi 1991.

collectors charge clients for the safekeeping of their savings, instead of rewarding them with even only a modicum of interest rates, because mainstream financial institutions will not accept small deposits from the poor. Similarly in the case of loans, when poor people access finance from private money-lenders, the cost on an annualised basis can easily be many times the amount borrowed[2]. Microfinance institutions can benefit the poor with simple, much less costly savings services and loans at rates that are a fraction of those charged by private money-lenders.

3.1.2 Escape from poverty requires ongoing partnerships between microfinance providers and target clients

A microfinance institution's best efforts to keep a lid on transaction costs and interest charges cannot guarantee overnight escape from poverty for clients. This is a longer term endeavour, typically requiring successive rounds of saving, borrowing, investing and repayments. Each step ahead is as small as the transaction that initiated the process, but it can also bring a client closer to overcoming poverty as measured in terms of both income and assets.

Sustainable poverty reduction requires improvements in both income and household capital resources. Increases in income may be seasonal or insecure, in which case asset accumulation is the means by which financial resilience is achieved; this resilience can be called upon to weather temporary setbacks in production/employment income. Microfinance institutions can add to these two primary sources of pro-poor outcomes, and this can take the form of additional social capital arising from community-wide benefits such as improved sanitation or access to potable water, that do not derive from specific individual saving, borrowing or other financial transactions.

3.1.3 How does microfinance help people escape from poverty?

The main microfinance mechanisms that can pave the way for escape from poverty are well known and relatively well understood, as follows:

(i) Reductions in the costs of financial services improve income through lower costs of living, enabling poor households (a) to escape from the poverty trap associated with debt-financed consumption, and (b) to increase capacities to save and invest.

(ii) The accumulation of savings creates an asset that poor households can use to maintain their livelihoods above what they can afford on current income, without the need to go into debt.

(iii) Savings with a microfinance institution enable poor households to make investment plans. Microfinance providers have been particularly successful in transforming the capacity of poor people to convert their micro-savings into usefully large loans, the availability of which opens doors for investment in self-employment or improved living standards. All three strategies lose in effectiveness if access to lower finance and transaction costs and a capacity for regular savings are one-off events or seriously interrupted.

2 Consider the following: if the cost of a loan is a fix US \$10, irrespective of the size or duration of a loan, and the administration cost for maintaining the loan account is a minimum US \$10, rising with the length of the agreed term of the loan, then a US \$100 loan requires an interest rate charge of no less than 20 per cent to achieve break-even, while a US \$1,000 loan requires an interest rate of only 2 per cent to achieve break-even. Add the costs of loan distribution, borrower supervision and repayment processes, and it is clear that a core challenge to microfinance providers is to find 'sustainable' ways to contain and meet the burden of transaction costs. Typically, private money-lenders set the interest owing on a loan in absolute, not relative terms. On a US \$100 loan, a money lender may well set the 'interest' at US \$20 per month, with the first interest payment deducted at the time of loan disbursal, to ensure that transaction costs are recouped from the outset. If the loan maturity is a full year, the interest charge will have amounted to US \$240 on a loan of only US \$100.

3.1.4 Microfinance challenges the belief that the poor are not 'bankable'

The emergence of microfinance in the mid- to late 1970s came as a remarkably slow response to one of the most pernicious and obvious market failures in the economics of development. Conventional banks eschewed the poor, describing them as 'high risk', operating in markets where transaction amounts are so small as to beggar belief that banking with the poor could ever be profitable. Mainstream banks were blinkered by the convention that collateral was a prerequisite for borrowing, and minimum deposit rules one for savings accounts.

Grameen Bank and its many replications and imitators broke the mould, rejecting conventional financial collateral and transaction management rules. A broader definition of what is acceptable collateral (including personal reputation, peer support, demonstrated capacity to save and group-based savings mobilization and loan management) microfinance providers made financial services available to the poor. Moreover, as they recognised that the poor can have some control over transaction costs by providing 'in-kind' collateral, microfinance providers did more than reap the benefits of client loyalty or build on a valuable source of self-interested volunteer labour: abiding by the cardinal rule of banking, 'know your customer', they gathered, information about borrowers and depositors that can only enhance risk management.

In most developing countries, rural credit was the main if limited financial service on offer to the poor in the decades before microfinance providers came onto the scene after 1980. The delivery mechanisms of the regulated financial sector varied across institutions, but whether it was a bank, a cooperative or a non-government organization, rural credit followed procedures that aped the restricted norms of the financial mainstream. These norms promoted little in the way of client 'ownership'. Moreover, regulated financial institutions did business with the rural poor with a blatant male bias, as female members of farm households were not allowed to contract loans.

The record of rural credit during the period 1950-80 is a sad one. Major defaults and high costs beset almost all of rural credit schemes, with little real return to the borrowers or the community at large. Microfinance, on the other hand, which also started in rural settings as 'microcredit' and subsequently expanding into urban-based slum communities, has only relatively recently concentrated on bringing income diversification and asset accumulation to poor households. In some cases, microfinance providers refused to lend for staple crop production, seeing these as the least productive investment option open to the rural poor. However, experience soon showed that borrowers would use any available funds to do what they believe was in their best interests, the declared purpose of the loan notwithstanding. It is now conventional wisdom in the microfinance sector that it is far more important to assess capacity and commitment to repay than to evaluate the stated purpose of a loan.

3.1.5 Major lessons learned from village money lenders and the poor

Behind the well-documented successes of microfinance providers, some very effective lessons have been taken from the practices of village money lenders and the indigenous money management culture typical of poor households, i.e., *group-based lending, social collateral* and *peer pressure*. Group-based lending mobilizes self-interest and peer pressure for the purposes of grassroots financial transaction monitoring and contract enforcement. Group lending has also been found to have favour female empowerment, apart from important community development benefits. Group-based lending is not unlike the financial transactions that are commonplace between members of an extended family. Small groups can act as robust instruments for efficient, risk-reducing client identification and targeting among the chronically poor. Because everyone knows everyone, social collateral is brought into play, reducing the danger of over-lending and in the process improving the prospects of loan recovery. Peer pressure is also a powerful tool for client discipline in loan repayment and savings mobilization.

Risk management is core to mainstream financial sector best practice. This is no less so in the poverty economy of microfinance clients. Microfinance providers are able to reduce risk using social collateral for group member selection and close interaction with the targeted community. Providers have used small-group dynamics to maintain high repayment rates and minimal costs for lending, savings mobilization and repayment collections. "On the basis of these lessons microfinance providers have come to understand that banking with the poor can be profitable, but only if costs are contained, risks are managed and clients are treated as active partners in the conduct of the business of the microfinance enterprise itself", (Remenyi 2003).

3.2 THE EFFECTIVENESS OF MICROFINANCE FOR POVERTY REDUCTION

The relationship between microfinance and poverty reduction is a multifaceted and complex one. Income, asset, social and environmental poverty and pro-poor economic growth are linked together. Improvements in the environment, quality of life, added income, enhanced asset accumulation, and growth in social capital are associated with increased access by poor people to microfinance.

A long history of scheme reviews shows that poor people engage in microfinance because they value the way in which providers (a) deliver means by which they can borrow against future savings to access sustainable and usefully large (i.e., productive) loans; (b) offer interest-bearing and 'safe' savings accounts; (c) provide less costly money management arrangements; and (d) offer more effective social capital support systems arising from better organised community groups, locally based social welfare interventions and stronger, grassroots based social development organizations. Poverty reduction trends come from a combination of these sources, even where the initial gain in earnings cannot be immediately identified as the direct result of more work at current wage rates or increased earnings from the sale of goods produced at higher prices.

The evidence of the relationship between poverty reduction and microfinance is unequivocal for the vast majority of practitioners and microfinance users: microfinance gives poor people greater control over their lives, typically leading to higher earnings, greater asset accumulation and lower vulnerability because of better risk management. Microfinance practitioners appear to encounter little evidence to challenge their assumption that the results of greater outreach to the poor are improvements in nutrition, health, planning, education retention rates, life choices and gender relations. The hard evidence, however, is not as unequivocal. In part this is because research tends to confine their assessments of the positive consequences of microfinance to those that lift clients above the poverty line, dismissing positive outcomes that leave microfinance clients better off but still poor, that is, living below the poverty line. Poverty line research also dismisses the importance of changes to household and individual balance sheets, in the process diminishing the importance of asset accumulation for sustainable poverty reduction and economic resilience.

Many microfinance impact assessment studies are deficient because it is so difficult to separate the short- and long-term impacts of microfinance on income, asset accumulation, quality of life, risk management, access to social capital and diversity of equity and justice outcomes. The reality of life in poverty is that relapse is so easy, even for an economically poor individual makes the right decisions and does the right things. Today's positive outcome can easily be negated by the effects of tomorrow's misfortune, or the unexpected consequences of bad public policies, and over which microfinance providers or their clients have no control.

The anecdotal evidence showing that microfinance is a necessary if not a sufficient condition for sustainable escape from poverty is strong. It is not difficult to identify communities where microfinance has enabled children to stay at school longer, where age of marriage for young girls has been significantly increased, where female clients behave differently because they have been empowered to do new things and take greater charge of their lives. Giving poor people greater 'real' choices enables microfinance to add to the quality of life and the certainty with which participants can plan ahead for themselves, their children and their communities. It is also clear that the longer clients remain with a given microfinance scheme, the greater is the benefit derived from involvement. *Prima facie*, the evidence is that progress toward achievement of the Millennium Goals is more significant in countries where microfinance penetration is greatest.

It is important to remember that the Millennium Goals call not only for a reduction in poverty but also a halving of the incidence of *extreme* poverty. The question remains: can microfinance make a difference for the 1.1 billion extremely poor people in the world? Has microfinance a reasonable prospect of reaching and helping these 1.1 billion chronically poor people? What constraints must be overcome if microfinance is to be able to serve this mass of potential clients?

In Bangladesh, many microfinance providers have managed to reach out to the extreme poor, including the Adventist Development and Relief Agency, the Association for Social Advancement, the Bangladesh Rural Action Committee, SafeSave, and Grameen. The country's apex microfinance provider, Palli Karma Sahayak Foundation, has supported experiments by microfinance providers to determine how best to reach out to, and serve, the poorest of the poor. Similar experiences have been led in Cambodia, Indonesia, India, the Philippines, Nepal, Mongolia, Vietnam, Kenya, Ghana, Uganda, Brazil, Mexico, Bolivia, Peru and Central Asia. In these countries, streamlined microfinance schemes have increased the numbers of clients that can be served by a single programme officer to 200 and above. Annual reports and independent evaluation also show that outreach to the extreme poor has not compromised microfinance provider viability or return on assets. There is no evidence to indicate that outreach to all 1.1 billion of the world's extreme poor is not possible, if the will and the resolve to fund this outreach are there and are sustained.

3.3 MICROFINANCE AND INCOME GENERATION FOR THE POOR

The primary reason for the establishment of a microfinance programme is income generation for target participants. It was much later in the evolution of microfinance that other goals, including money transfers and enterprise expansion loans, took on greater significance. The following real-world examples illustrate how microfinance can make a difference to the daily economics of poverty. The five case studies illustrate a variety of typical situations before and after a micro loan (all exchange rates as at late September 2010).

Case study No. 1: Rickshaw Driver, Dhaka, Bangladesh

Amount borrowed: Taka (BDT) 3,000 (or US $43) Loan duration: 12 months Interest rate: 12% per annum			
Loan used to buy a second-hand rickshaw for BDT3,500 (US $50)			
(a) Before the loan		(b) After the loan	
Daily earnings	BDT50 (42 US cts)	Daily earnings	BDT 50 (42 US cts)
Less (daily)		Less (daily)	
Rickshaw rental	BDT20 (29 US cts)	Interest & loan repayment	BDT 10 (0.14 US cts)
Rickshaw repairs	BDT5 (0.7 US cts)	Rickshaw repairs	BDT5 (0.7 US cts)
Daily surplus for living	BDT25 (29 US cts)	Daily surplus for living	BDT35 (0.36 US cts)

Source: Remenyi 1990: 102. This example is taken from a savings-linked solidarity group, operated by the Christian Commission for Development. The solidarity group assesses all loan requests, on the basis of which loan recommendations are made to CCD loan staff. Loans sizes ranged from BDT1,500 (US $22) to a maximum of BDT3,500 (US $50) with maturities of six or 12 months and repayments negotiated by group members on a case by case basis, but typically weekly and made at weekly group meetings.

In this example, daily income has increased by 60 per cent, yet the outcome leaves the borrower below the US $1 per day universal poverty line (US $1 = BDT69.5). However, the borrower now has a rickshaw valued at BDT3,500 (US $50) and loan which he repays daily. The borrower's potential increase in capacity to save has been raised by at least 40 per cent. The impact on the borrower's balance sheet is significant, while earnings increase as the same work is carried out in a more productive, cost-effective, way as owner-operator. The fact that the improvement has not lifted the borrower above the poverty line should not blind us to the significant reduction in poverty that he does experience, albeit at an income and consumption level that remains too low.

Case study No. 2: Unemployed single mother of five, Singaraja, Bali, Indonesia

Amount borrowed: Rupiahs (IDR) 350,000 (or US $35)			
The borrower was unemployed, living off earnings from scavenging and sale of wood or other 'fuel' sources. The loan was used to purchase a fridge-freezer and insulated containers to manufacture 'icey-poles' for sale in the hot dry season. The borrower sold the icey poles through street vendors – primarily school-age children who earned a commission of IDR5 (0.06 US ct) per icey pole sold at IDR25 (0.28 US ct) each. The loan was repaid in only four months.			
(a) Before the loan		(b) After the loan	
Daily earnings from scavenging	IDR500 (5.6 US cts)	Daily sales of icey poles	IDR 12,500 (US $1.45)
		Less	
		Commissions to sellers	IDR 2,500 (US $0.28)
		Production costs	IDR 5,000 (US $0.56)
		Loan repayments	IDR3,500 (US $0.39)
Daily surplus for living	IDR500 (5.6 US cts)	Daily surplus for living	IDR1,500 (US $0.17)

Source: Remenyi 1990:103. This example is taken from a Protestant church-based enterprise development programme called Maha Bhoga Marga, ('Way to Prosperity'). The programme's average loan size was IDR165,000, repayable over six months at an annual interest rate of 25% plus a 2.5% transaction service fee payable on loan agreement. Church pastors vet potential borrowers and monitor repayment discipline.

At the time this example was documented, the borrower was extremely pleased with her new business and took pride in the fact that not only was her own income much improved, but she was also able to augment the income of the unemployed street children with whom she was in partnership in her venture. She looked to expand her business and to increase the number of street vendors working for her under commission. Here again, poverty has been dealt a blow, even though neither the borrower nor any of her commission-earning partners earned incomes above the international poverty line. Without the microfinance loan, however, their poverty situation would continue at the previous, much lower incomes, with lower savings capacity and lower asset accumulation.

CASE STUDY NO. 3: **Automotive parts recycling cooperative, Solo, Indonesia**

Amount borrowed: IDR24 million (US $2,680)

The borrower is a self-managed group of second-hand automotive parts recyclers. The business is based on the capacity of group members to bid for wrecked vehicles that are disassembled and useable parts sold to repair-shops and panel-beaters. The loan is needed to finance cash flow on a quarterly loan cycle, with interest at a flat 3% per month and principal repayable quarterly over 12 months. At the time the loan was taken out, the group consisted of 140 members, each of whom employed an average two full-time aides.

Impact indicator:	(a) Before the loan	(b) After the loan
Group daily net income	IDR1.87 million (US $209)	IDR2.64 million (US $295)
Total group members	140	180
Total group employees	280	540
Average daily wage	IDR2,000 (US $0.22)	IDR3,000 (US $0.33)

Source: Remenyi 1990:103. This example is taken from a microfinance assistance programme operated by the Indonesian Welfare Foundation (Yayasan Indonesia Sejahtera) targeting cooperatives that were unable to expand because of lack of flexible sources of working capital. At the time this loan was documented, the Foundation had a portfolio of micro loans to 228 cooperative groups that varied in size from 28 to 150 members. The Foundation leaves it to the group to determine how the loan is distributed among members, but the group is responsible for managing loan repayments by members and payments to the Foundation, which lends at 1.5% per month (but the cooperative on-lends to members at up to four times this rate).

By the end of the first year after the loan had been taken up, the group had expanded to 180 members with an average three full-time employees per member. The average wage had increased to IDR3,000 (US $0.33) per worker per day, but the daily net income of each group member (i.e., the enterprise owner) had increased 10 per cent to IDR14,770 (US $1.65). However, the 12 months also saw to collapse in the exchange rate between the US dollar and the Indonesian rupiah, leaving both the borrowers and their employees well below the poverty line. The balance sheet for each enterprise did, nonetheless, reflect growth in the stock of recycled parts and no increase in debt as the loan was fully repaid on time.

Case study No. 4: Balut (boiled fertilised egg) producer, Valenzuela, Philippines

Amount borrowed: Peso (PHP) 20,000 (or US $455) + PHP20,000 follow-up loan

The borrower is a woman with 10 dependants, including an unemployed husband and elderly parents. The first loan was to establish the business together with 12 regular street vendors. The second loan was to expand the business to take up two contracts to supply two 'dealers' who undertook to take 1,200 balut (hen/duck fertilised) eggs between them per day. The 12 regular street vendors take 1,800 eggs per day retailing at PHP3.75 (8 US cts) each, at a profit margin of Peso 0.8 (or under one US cent) per egg. At a wholesale price of PHP2.95 (7 US cts) per egg, the borrower earns a net return of PHP180 (US $4) per day, which is three times the going wage rate for unskilled work in Valenzuela, a slum area on the outskirts of Metropolitan Manila. The borrower makes weekly contributions to a Valenzuela orphanage that supports homeless children aged 10 or younger.

Impact indicator:	(a) Before the loan	(b) After the 1st loan
Borrower daily net income	Peso 0	PHP180 (US $4)
Number of street vendors	0	12
Total employees	0	All family members (10)
Street vendor daily income	0	PHP120 (US $2.7)
		(c) After 2nd loan
Borrower daily net income		PHP270 (US $6)
Daily wholesale balut sales	0	PHP8,850 (US $201)

Source: Remenyi 1990:104. This case reflects the work of Tulay Sa Pag-unlad Inc. ('Bridge to Progress'), which operated a microfinance assistance programme in the slums of Valenzuelas. Tulay Sa specialised in business establishment and micro-enterprise expansion loans with borrowers identified by church communities and cooperating pastors. Funds were sourced by Tulay Sa from Christian business people, primarily from the USA and locally. Tulay Sa's average loan size was between $500 and $1,000, which is high by microfinance standards but average for an enterprise-support programme. Tulay Sa used going commercial interest rates as its pricing policy guideline, which in this case amounted to an effective 26% per annum plus an up-front fee extracted from the loan principal at the time of loan disbursal. Repayments could be negotiated but typically were weekly or monthly for six-month and one-year loans.

The second loan funded the rental of a hen-house fitted with rice-husk-fired ovens, which allowed production to be raised by 1,800 to 3,000 eggs per day. All family members worked in the enterprise. The expansion funded by the second loan did not increase employment for street vendors, but did allow the enterprise to expand without substantially increasing the management challenge faced by the borrower. , while increasing her net earning well above the international poverty line. The loan not only funded the establishment and expansion of this micro-enterprise, but also strengthened the social capital links between the borrower and her street vendors, while also generating support for a local orphanage. Each of these outcomes is positive for reduction in income poverty, asset accumulation and community development, even though not all poor stakeholders in the *balut* business earned incomes above the poverty line. Both loan 1 and loan 2 were repaid ahead of schedule.

There was no intention on the part of Adventist Development and Relief Agency or funding partners that individual self-help groups or even the collective of self-help groups should evolve into a formal microfinance provider. Rather, the strategy was that each self-help group would become a self-sustaining entity able to assist members with their savings programmes and, over time, with loans drawn from an accumulating revolving fund managed by members. The role of the supervising Agency was to assist with group formation, work with groups to identify and address the causes of chronic poverty arising from gender inequity, environment (sanitation/potable water) and maternal health issues, skills for new income-generation opportunities (home gardens,

Case study No. 5: Group savings-led community development, Women's Empowerment Project, Phase II, Mymensingh, Bangladesh

Amount borrowed: BDT21.6 million (US $310,680) in 3,700 loans @ 12% flat, over 3 years		
This case documents an Adventist Development and Relief Agency (ADRA) funded and supervised self-help gender-awareness group, (formally known as Gender awareness raising, Enabling Environment, Savings mobilization, Skills acquisition, Health promotion, Institution building and Microfinance).. The project involved some 3,600 women in 167 small groups for the purposes of savings-based poverty reduction, including mandatory group member participation in health, hygiene, sanitation, home gardening, literacy and numeracy classes. Each group established a savings account with a local commercial bank, on the basis of which group loan entitlements were earned from the supervising self-help group via an ADRA revolving fund. Each group administered its own savings collections, loan disbursals and repayment processes, with ADRA mentoring group-executed poverty analysis, health- and environment=based community development initiatives and group member training.		
Impact indicator:	(a) Before loan	(b) After loan
Average member savings	BDT100 (US $1.4)	BDT800 (US $11.5)
Average loan size	BDT0	BDT5,800 (US $83)
Primary school attendance	30%	100%
Group morbidity rate	high	low
Group participation	nil	twice per week
Change in:		
Household income		+60%
Household savings		+50%
Household spending		+94%
Percent of self-help group members with:		
-a loan	0	100
-a home garden	0	100
-easy access to potable water	10	85
-good sanitation	0	100
-income below the local poverty line	100	80

Source: Remenyi 2007, ADRA Bangladesh Microfinance Program Evaluation Report, DPI Pty Ltd, Geelong, p. 29. The total micro-loan budget was BDT57.2 million (US $1.3mlllion). Loans were disbursed to group members at a flat 12% interest rate for durations of up to one year.

fish ponds, sewing, waste recycling, etc.) and savings/loans for investment purposes.

The project targeted able-bodied, married women from poor villages, and also included a 'husband programme'. Each participant had to make a commitment to save at least BDT10 (0.14 US cts) per week, be able to subscribe a one-off group membership fee of BDT20, come from a landless household and commit to attending two group meetings per week (one for health and literacy classes and one for savings and loan activities).

The link between microfinance and the Millennium Goals is clearer in Case Study No. 5 than in the more individual-loan-oriented examples. Even though Empowerment Programme restricted group membership to women willing to commit to a modest savings of BDT5 or 10 (0.7 or 0.14 US cts) per week, the Empowerment Programme did not lead with microfinance. Once group members were identified, Programme staff began addressing morbidity issues common to group members, which typically meant that staff had to work with all villagers to upgrade sanitation conditions and access to potable water. Group members received basic health education, literacy and gender-relations awareness training, while husbands were invited to information sessions to secure their support for group member savings and cooperation in sanitation and water systems upgrading.

As part of Programme evaluation, a relatively large sample of participants was asked to assess the impact that the Programme had on the most significant 'new' sources of income deriving from their involvement. The women reported as follows:

As many as 84 per cent of groups reported petty trading or small village shops as the main source of the income increases they had experienced in the three years or so since joining the Programme. The response from group members on the importance of home gardening understates the contribution to real income because it ignores home consumption of home garden production. Further information also confirmed that profitability was greatest where the household was able to invest in transport or the creation of a new 'self-employed' job. Respondents also cited examples where several group members acted in partnership to overcome the constraints of relatively low Programme loan limits to purchase 'lumpy' items of equipment that they could share and then rent out to others. In one case, eight women joined together to purchase a threshing machine; in another five women purchased a hand-held two-wheel tractor. They shared the equipment for their individual needs, and then sub-contracted out to others on a fee basis. Such examples are not rare, but their importance serves to highlight new productive relations between partner households that would not arise without access to financial assistance and the social development dimensions of the Programme's microfinance scheme.

Table 3.1: Sample Respondent Assessment of Major Sources of Increased Income Arising from Women's Empowerment Programme II

Main Source of Increase in Income:	% of Groups
Improved returns from petty trading	84
New job	62
Earnings from transport business	62
Increase in livestock and fish production	46
Improved productivity in crop production	38
Sale of handicrafts	38
Sale of home garden produce	31

Source: Remenyi 2007, Bangladesh Microfinance Programme Evaluation, and Part 4: Women's Empowerment Project Phase II, ADRA, Bangkok.

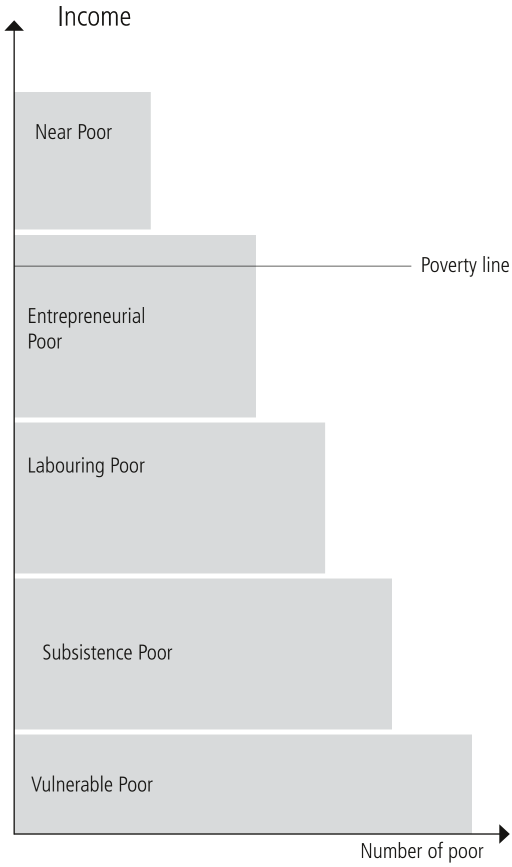
Much could be drawn from the experiences reported by the participants in Case Study No. 5. As they assessed the benefits of the Programme, participants had the advantage of up to three years' experience. With the benefit of hindsight, there was an unequivocal view that their neighbours regarded them as lucky because they were chosen to participate. Furthermore, participants were keen to point to the items they had purchased for the home, such as beds, household furniture, TVs, CD and cassette players, in addition to income-generating assets including treadle sewing machines, rickshaws, livestock and tree crop seedlings. With pride, they reported on the very serious decline in spending on health problems following Programme community action to improve village sanitation and secure a safe source of drinking water for everyone, not just Programme savings group members.

3.4 THE MAIN LESSONS FROM CASE STUDIES 1 TO 5

The foregoing five successful cases are not exhaustive of the many ways in which microfinance is or can be a factor for Millennium-Goal-oriented pro-poor development. They go to highlight the diversity in the linkages between microfinance and poverty reduction.

The cases also remind us that poverty is a pyramid (see Figure 1), with greater numbers at the bottom than at or immediately below the poverty line.

Figure 1: The Poverty Pyramid



(Source: Remenyi, 1991)

If access to financial products and services is a 'human right', as Grameen Bank founder and Nobel Prize winner Prof. Mohammad Yunus has long argued, it is as much a necessary requirement for the 'vulnerable -poor' at the bottom of the poverty pyramid as it is necessary but not sufficient for permanent escape from poverty by the 'entrepreneurial' and 'near-poor' who survive just below or just above the local poverty line. Access to microfinance is no less important, however, for the 'subsistence-poor', largely farmers who live off the fruit of their own labours, or the often better-off but still deprived 'labouring-poor', or the 'entrepreneurial-poor' who are self-employed and sometimes also employ others but for whom microfinance is the only possible source of the finance they need for enterprise investment or expansion.

The five case studies reflect the importance of gender in the way we assess and intervene to promote poverty reduction. This is not to say that microfinance must be gender-biased if it is to be pro-poor. The overwhelming proportion of microfinance clients is female, but there is no gender bias in the population of microfinance beneficiaries. Rather, microfinance institutions have found that women were their best (i.e., least risky) clients, so it is little wonder that women dominate their loan and savings portfolios. However, there remains a male-biased gender ceiling when it comes to individual loans for small enterprise expansion, and a female dominance in client lists when it comes to retirement schemes, long-term savings and insurance.

Each of the five case studies also demonstrates how important it is not to ignore or dismiss the significance of reductions in poverty at the individual or household level, even where these reductions are not sufficient in the first, second, third, fourth or subsequent rounds of savings and loan product delivery to lift the participant above the local poverty line. Grameen Bank and other leading microfinance providers have found that it can take in excess of eight rounds of loans before a client is able to secure an income above the poverty line, yet even at that point the risk of backsliding into poverty remains very real.

Poverty reduction is a process, not a one-step, overnight magical transformation from poor to non-poor. This is especially so where poverty is the consequence of systemic factors such as gender inequity or lack of access to financial services. Lack of access to microfinance is a very important but much neglected systemic market failure affecting the poor around the globe.

Case Study No. 5 brings to the fore the widespread belief that the causes of poverty are usually not a mystery. The self-help group[3] strategy of the Women's Empowerment Programme was consistent with Millennium Development Goals. Far from being deliberate, this reflects a widely held view among social development professionals that poverty is multi-dimensional and the causes find their roots in both individual and institutional behaviour patterns. Case studies 1 to 5 demonstrate that microfinance can address these behavioural issues, pave the way for pro-poor social development and eventually advance Millennium Goals.

Grameen Bank claims that an average 5 per cent of clients graduate out of poverty every year. If this is the case and a similar record applies to other microfinance providers, then the critical challenge to donors and all who support the Millennium Goals is to ensure that microfinance extends to all poor people, especially the 1.1 billion extremely poor subsisting on less than US $1 a day.

3.5 MICROFINANCE AND THE PROMOTION OF SMALL- AND MEDIUM-SIZED ENTERPRISES (SMES)

From the very outset, microfinance and enterprise development have been synonymous. As early as 1979, the Committee of Donor Agencies for Small Enterprise Development (CoDASED), which regroups 20 bilateral agencies from 16 countries, 16 multilateral agencies and three international development organizations, was founded to share knowledge and best practice in support of small enterprise.

Microfinance-supported income generation has traditionally supported owner-operated enterprise. Microfinance promotion of small- and medium-sized enterprises takes this traditional relationship to a new and more challenging level, because support cannot be pursued in isolation from market and policy environments.

Differences between micro-, small- and medium-size enterprises are typically based on employee numbers: five employees, five to 50, and up to 250, respectively. Profitability is affected by factors like the business environment, access to financial services and working capital, as well as investment and operational functions such as leasing, marketing, staff development and information services. Larger operators have a greater stake in business regulation, contract enforcement, the tax environment and consulting services. At the lower end of the enterprise spectrum, microfinance providers have tended to

3 The self-help groups focus on gender awareness raising,an enabling environment, savings mobilization, skills acquisition, health promotion, nstitution-building and microfinance (GEESHIM).

specialize in training to upgrade management skills and planning, credit lines, and dialogue with the public sector to represent the special circumstances of small and medium size enterprises.

Dedicated schemes for this type of enterprise aim to increase income for owners and employees. Productivity gains can support higher wages, but as far as Millennium Goals are concerned, expansion of wage employment seems to be a better option as away out of poverty that is directly tied to the multiplier effect of growth in small-enterprise investment and development at the bottom of the poverty pyramid, even if the enterprise owner may not be poor. Pro-poor growth based on enterprise investment and business expansion is facilitated if the target area is well served by non-governmental organisations with a strong commitment to poverty reduction. The risk is always that a focus on business development and associated services will divert attention towards the upper strata of the poverty pyramid, although there is every reason to believe that entrepreneurs at the bottom of that pyramid have no less need for assistance in enterprise planning, investment analysis, enterprise budgeting, product marketing and staff development, though on a different scale.

The conventional wisdom is that one needs to know only three things to succeed in business: know your market, know your market, and know your market. The importance of this adage cannot be too highly emphasised. Microfinance providers have learnt this lesson the hard way, having all-too often sought to 'pick winners' on behalf of clients. The reality is that small/medium-size enterprise investment decisions must be made by those responsible for debt repayment, and the consequences if things go wrong. Besides, microfinance providers have also learnt that often know more about the markets they serve or look to serve than anyone else. What they may not know is the full range of management options and technologies that could more successfully produce and deliver product/services to the market. Local entrepreneurs typically have a very good and accurate appreciation of the constraints and obstacles that must be addressed if business growth is to happen. The microfinance provider's role in overcoming these constraints and obstacles is to facilitate discussions with local entrepreneurs, listen carefully to clients and help them design strategies to rise above these issues. Where there is common cause among many clients, there is a basis for the microfinance providers to lobby government or local authorities on behalf of clients.

There are significant differences between the way in which a microfinance provider must respond to the financial needs of micro-enterprise operators compared with small and medium enterprise operators. Micro-enterprises are usually family businesses or self-employed individuals operating in the informal sector of the economy. It is a step up for an unemployed individual to be able to use a microfinance provider loan to establish themselves as a micro-enterprise operator. However, short of continuing assistance from the microfinance provider, micro-enterprises have little chance of growing into larger firms or to graduate into mainstream bank and finance. In contrast, small- and medium-sized enterprises often operate in the formal sector, where they are subject to government supervision and regulation and where they access significant proportions of their production inputs, including labour and marketing services. Where a microfinance provider is supporting a small/medium-sized enterprise, this is most likely to be because the business has grown out of 'micro' status. Being profit-driven, microfinance providers are not prepared to lose their most successful customers to formal commercial service providers. However, for microfinance providers relying solely on group-based lending and deposits, retention of successful clients can be difficult. The dilemma is that sticking with more successful clients diverts resources away from assistance to the chronic poor. This is where donors can play a strategic role, ensuring that funds remain available to the poorest while clients seeking repeat business continue to be serviced.

It can be argued that the impact of microfinance providers on sustainable poverty reduction is limited if their attention is restricted to micro-enterprises only. This is so because micro-enterprises operate almost exclusively in the informal sector of developing country economies, where the economics of poverty creates ceilings on market penetration and opportunities for growth. Consequently, microfinance providers must help micro-enterprises to access markets, and expand, beyond the informal sector.

The evidence is not conclusive, but there are reasons for believing that microfinance support to small/medium-sized enterprises is justified because these are a greater and more efficient source of growth in wage employment than *micro*-enterprises. In the case of owner-operators this is clearly not so, but for employment growth beyond the smallest of firms, it is difficult to believe that migration from the informal to the formal sector is not associated with poverty reduction. However, the primary reason why donors and developing country governments should be interested in micro/small/medium-sized enterprises in the battle to reduce poverty is because they collectively account for a very large share of firms and employment. In this respect, it is also possible to identify public sector interventions in priority order, i.e., (i) competition policy to ensure open access to markets, especially where public-private partnerships are involved; (ii) market development to regularize the informal sector and improve the capacity of formal markets to be inclusive of informal sector firms; (iii) target public interventions at market failures; (iv) invest in public goods such as public infrastructure and information services; (v) reduce any regulatory or administrative interventions that discriminate against small/medium-sized enterprises or do little but increase the costs of conducting business; and (vi) gear public sector budget allocations to the growth and performance of small/medium-sized enterprises.

Increasing the supply of financial and non-financial services suited to the special characteristics of small enterprises calls for higher numbers of financial institutions that find lending to those types of business profitable. Governments have a role here as they can reduce the risks and transaction costs associated with lending to this segment of the market, strengthen the capacity of financial institutions to serve small-scale clients, and increase competition in the market for banking/financial services. However, public intervention must begin with a good understanding of the structure and performance of existing markets, in order better to build upon what is already in place.

Human resource development has a strong role to play in enterprise development. One cannot rely on market forces to ensure that the investment in training required for the long-term health of the enterprise sector will be forthcoming. This is especially so in leadership development and the skills associated with innovation. Governments must step in to ensure that microfinance providers complement the training available via industry associations and established providers. In addition to in-house training, there is a need for public spending on local and regional training infrastructure.

3.6 MICROFINANCE AND LOW-INCOME HOUSING

Low-income housing is a challenge for most microfinance providers. Poor households invest in improvements to their own living conditions as a matter of priority. Spare cash, if any, will often be spent on home building materials that can be held as a store of value or used for upgrading. However, microfinance providers tend to view investment in housing as a form of consumption spending. As a result, it is usual for home-finance lending to be tied to the borrowerís capacity to save, including allowance for any savings on rent where the new house is a substitute for rented accommodation.

The housing needs of the extreme poor are closely linked to their vulnerability to natural disasters, such as floods, tsunamis, fire or storms. The quality of these homes is such that the cost of rebuilding can be low and may not include land ownership. As a result, housing loans can be small (typically under US $1,000), may not require collateral and may be repaid in a relatively short time (two or three years). Where the housing loan is provided to help poor households recover from some misfortune, however, the microfinance provider must allow for the possibility that the client's income-earning potential or productivity have not been left unaffected. Floods destroy not only homes, but also crops and carry away the stuff of which markets are built. Public subsidies to aid recovery are essential in such situations.

Relative to the Millennium Goals, microfinance housing loans are not a marginal issue. Where natural disasters destroy the houses of the poor, extreme poverty can be the outcome if assistance to rebuild or replace a lost home is not rapidly forthcoming. The impact on the household balance sheet cannot be ignored. Moreover, refurbishment of low-income housing creates opportunities to improve sanitation and upgrade access to potable water, with immediate positive effects on morbidity, school attendance and maternal welfare. In this sense, support for housing is also support for the 'habitat' of the poor, including livelihoods. In a very real sense, microfinance involvement in housing finance can be seen as leveraging off one of the highest multiplier effects on the employment, quality of life and asset accumulation prospects facing poor communities. Even in the poorest and most marginal of circumstances, regularization of housing, clarification of tenancies or ownership, improvements to access to essential services such as water, power, communications, education, health and transport, have backward and forward linkages that are strongly pro-poor, and therefore good for the advancement of the Millennium Goals.

Demand for housing loans in poor economies can be split into demand for new housing and demand for improved housing. The latter is invariably a multiple of the former, which would suggest that the low-income housing finance market is significantly distorted. Some of the distorting factors, which can be seen as market failure in the housing finance market, are well known. They include the following:

Affordability is a constraint on all poor communities, with the costs of land as important as those of construction and building materials. It is not unusual for the cost of the simplest basic house-and-land deal to be a multiple of 50 to 100 of the local individual annual income; this turns the pursuit of affordability into one of the major factors behind demand for rented accommodation and, where unavailable, behind the growth in squatter and slum housing;

Legal titles are often missing or not available to poor households even when they have occupied the home for many decades if not generations. Lack of a title will exclude a potential borrower from formal housing finance markets;

Undocumented and highly variable income sources exclude many poor households from traditional housing mortgages, because the provider perceives them as unable to sustain any long-term repayment schedule;

Imperfect competition is rife in the housing finance market, with monopoly power biased toward the local money lender whose collateral demands are often punitive and designed to keep borrowers forever beholden and in debt;

The size of the housing finance problem is often so overwhelming that solutions such as subsidized mortgages are beyond the ability of non-government providers to meet demand, and/or the costs of effective targeting to the neediest households are prohibitive, undermining the 'affordability' of the scheme; and

Undervalued externalities surround housing. In particular, housing finance is often perceived as needed by only the better-off members of society, because the chronic poor are itinerant or squat or live 'rough'. The fact is that housing finance in the circumstances of the chronic poor must rather be seen as a 'one room at a time' process. Repairs, renovations and additions to a home are just as much a part of the world of the chronic poor, no matter how humble the abode, as they are important to middle- and high-income households.

The approach taken by relatively recent innovations in housing microfinance is different from the traditional mortgage-lending model. Based on what can be observed in poor communities on a regular basis, the approach to housing finance can be split into its successive, upgrading stages. Every step can be the target of a separate, affordable loan, with discrete amounts for specific purposes such as improvements to existing rooms, adding a new room, installing electricity, connecting potable water, etc. Step by step, brick by brick, the 'home' is completed in a manner that is manageable and more affordable. This process requires less technical input from microfinance providers, enabling them to concentrate on the best ways borrowers can contain costs, which adds to the pace of repayment and client satisfaction with the outcome.

Donor support to housing microfinance can increase the effectiveness of providers for the benefit of poor borrowers, depositors and entrepreneurs. Because housing loans are typically larger and for longer durations than regular micro-loans, the economies of scale available in the delivery of housing loans can improve provider profitability. Greater profitability means increased capacity for further market penetration and a stronger basis on which to build financial viability.

CHAPTER 4 THE CHARACTERISTICS OF MICROFINANCE OUTREACH

4.1 LIMITED OUTREACH, LIMITED IMPACT

Microfinance can be a powerful tool for poverty reduction. As suggested in Cases Studies 1 to 5 above, it is not difficult to demonstrate that microfinance can transform individual lives as income increases and asset accumulation accelerates. However, for microfinance to be a powerful tool for poverty reduction at the macro level, the number of poor beneficiaries must be large if the effects are to be discernible and measurable. This cannot be the case unless microfinance 'outreach' to poor households is substantial.

Microfinance outreach defines not only the extent of microfinance availability, but also the penetration rate of microfinance providers into poor households. For our purposes, therefore, a critical degree of outreach must be realized if the effect is to be clearly discernible and measurable; this degree of outreach can be defined as follows: the proportion of the population or households served is equal to the relative incidence of poverty in the country or region concerned. In other words, if the incidence of chronic poverty is 40 per cent of the population, then outreach must involve 40 per cent of that same population.

In a seminal 2004 research paper, the Consultative Group to Assist the Poorest (CGAP) found that across the developing world as a whole, only 13 per cent of the Asia's population (five billion) had a deposit or a loan account of some sort with a financial institution, including all microfinance providers, credit unions, village banks and government-sponsored rural financial institutions. The Consultative Group's database recorded only 3,000 registered financial institutions offering microfinance products and services to the poor, the top five of which served as many as two-thirds of account holders, and the top 10 almost 80 per cent. The addition of informal microfinance schemes operated by non-governmental organizations would improve these numbers though not radically. In effect, the Consultative Group's survey shows that overall microfinance outreach by all providers (including commercial banks, credit unions and other non-bank financial intermediaries, among which microfinance providers represent about one-third market share) remains at less than 15 per cent of the target population. Growth in the microfinance sector since 2004 will not have materially changed this ratio.

Table 4.1: The Global Outreach of Registered Microfinance Institutions, 2004

Region	Number of Active (millions):		% of Accounts
	Loans	Deposits	
Africa and Middle East	4.0	4.0	5.2
South Asia	22.4	18.7	27.0
Central and South America	4.5	1.3	3.8
East Asia and Pacific	18.3	78.7	63.6
Europe and Central Asia	0.4	0.2	0.4
Total	49.6	102.9	100.0

Source: CGAP

Table 4.1 summarises microfinance provider outreach by main region.

Table 4.1 shows that in 2004 as many as income-poor households across the developing world maintained over 150 active loan and deposit accounts with microfinance providers. If there were a complete overlap of depositor and borrower households, which we know there is not, the number would be closer to 100 million. In contrast, based on a US $2/day poverty line, the number of potential clients in the developing world is around three billion. Microfinance providers are, therefore, reaching out to only 5 per cent of their potential client base. In other words, this crude indicator of microfinance outreach suggests that on a global basis, microfinance penetration must increase by a multiple of 24 if all economically poor people in the world are to have the benefit financial services.

Table 4.2: The Microfinance Outreach Index

Region	Outreach Index (%)*	Expansion Needed for Critical Outreach**
Africa and Middle East	8	x 12
South Asia	13	x 8
Central and South America	15	x 7
East Asia and Pacific	24	x 4
Europe and Central Asia	48	x 2

**Expressing the relationship between the proportion of the population in a region that is below the poverty line (the headcount index), and the proportion of people in the region with a loan or a savings account. When the two ratios are equal, outreach can be said to have reached a 'critical' level. In Africa, the gap between the two ratios remains wide, to the extent that a twelve-fold increase in penetration is required before 'critical' outreach is achieved.*
***Critical outreach is achieved when the outreach index is 1*
Source: The outreach index is calculated using CGAP data on microfinance and World Bank data on the headcount index.

Table 4.2 combines data on the percentage of the population in every region of the developing world with a loan/savings account, with data on the global distribution of poverty in the world as measured by the headcount index[1]. Based on these data, 'critical' outreach can be defined as the point where the number of people in a region with a loan/deposit account equals the number of those living in poverty. On this basis, an index of microfinance provider outreach for each region can be calculated, as appears in Table 4.2, and current results compared with the 'critical' outreach level. The outreach index turns 'critical' (i.e., 1 the moment the proportion of the headcount index for a region exactly equals the ratio of numbers with a loan or deposit account and poverty numbers in a given region.

The numbers in Table 4.2 show that the highest degree of microfinance outreach can be found in the transition economies of Europe and Central Asia, followed by East Asia and the Pacific, Central and South America, South Asia and Africa in declining order. If the 'critical' measure as defined by the index were to be met, it would take a four-fold increase in outreach to poor households in East Asia and the Pacific, compared with an eightfold increase in South Asia, a sevenfold increase in Central and South America and a doubling in the transition economies of Europe and Central Asia. In Africa, however, the increase in outreach needed to achieve critical universal

1 Defined as the percentage of the population below the poverty line.

access to microfinance by the poor is more than 12 times that achieved by the end of 2004. These results are well below the 20-fold increase suggested by a simple interpretation of the data in Table 4.1, but they still highlight the urgent need for added investment in pro-poor microfinance in every region of the developing world.

The distribution of the efforts required to bring microfinance outreach to critical levels is greatest where the locus of global poverty is most urgent. Consider Table 4.1 again: 45 per cent of all loan accounts are concentrated in South Asia, with a further 37 per cent in East Asia and the Pacific. Only 5 per cent of active loan/deposit accounts are in Africa and the Middle East, although they are hosts to one -fifth of the world's population. Global poverty is moving inexorably to Africa, especially south of the Sahara.

Traditional approaches to microfinance outreach have concentrated on the credit side of the market. However, the Consultative Group's 2004 survey of microfinance sheds additional light on the relative role of savings and the demand for loans in the outreach challenge yet to be met. The same survey found that the number of active savings accounts exceeded the number of active loan accounts by a factor of more than two. Should this be taken as a good reason to conclude that demand is greater for savings services than for loans among poor households? The answer is unequivocally negative because, at best, this finding confirms that poor people not only save but must save to plan ahead if they are to cope with specific events, unexpected expenditures and the costs of misfortunes. Poor households use saving facilities where these are available. Loans, too, are taken up where available, but as one might expect the amount borrowed is always a significant multiple of the average savings balance held as a deposit with a financial institution.

The absolute amounts of savings by poor households are small. This is characteristic of all communities of savers who are keen to convert their small streams of savings into usefully large sums by borrowing against future earnings. The data in Table 4.3 show, for example, that in East Asia and the Pacific the average size of a saving deposit is only 9 per cent of gross national income per head for the region. In contrast, the average size of a loan account in East Asia and the Pacific is 14 per cent of gross national income per head (i.e., 56 per cent higher). The corresponding figure for South Asia is 70 per cent, while in all other parts of the developing world, average loan size relative to the average level of savings is typically at least twice as large, rising to almost five times as large in Africa[2].

2 The data raise many questions about the relationship between average microfinance savings and income per head. It would be easy to speculate on the reasons that, for example, the ratio for East Asia and the Pacific is so much lower than for other regions, but to do so would be trite and unlikely to be consistent with the results of more rigorous research, which remains to be carried out.

Table 4.3: The Market for Loans and Savings – Developing world

Region	Micro loan/savings ratio	Average micro-savings as % of income per head
Africa and Middle East	1.6	9
South Asia	1.7	10
Central and South America	2.7	25
East Asia and Pacific	2.9	15
Europe and Central Asia	4.7	29

Source: Calculated from CGAP and World Bank data

The figures in Table 4.3 suggest a significant excess demand for loans by poor households, the hostility of the poorest among them to taking on added debt notwithstanding. But then, such excess demand being a dimension of poverty, it cannot come as a surprise, and this pattern can also be found across the developed world (with consumer credit, for instance). The further up the poverty pyramid one moves, the more essential is access to credit sources for continued progress up, and out of, the poverty pyramid. Moreover, the closer the ratio of loans to savings comes to 1; the closer is the point of equilibrium between loans with the supply of savers' funds that can be lent. Therefore, while excess demand for loans persists, poor households, when given the opportunity, will borrow to gain access to usefully large sums that their savings rates can service. As happens in the world's most developed economies (the USA comes to mind), borrowing only enables households in poor countries to bring forward future earnings in order to fund current expenditures.

The foregoing should not be interpreted as implying that savings, relative to credit, are of lesser importance. Savings are a complement to credit, where each is one side of the basic business of banking and of wealth creation more generally. Though small in absolute amounts per individual, the savings rates of the poor are remarkably high and indicative of significant untapped mobilization potential. However, the realisation of this potential will only assist the poor if the savings mobilized are recycled as loans to other (poor) people. It happens all-too often that schemes like Indonesia's Unit Desa have been extremely successful with savings mobilization from poor households, but much less so when it came to recycling those savings as loans to other poor households. It benefits the poor little if savings collected by microfinance providers are invested in government bonds or held as fixed deposits with commercial banks, thereby sucking much-needed liquidity from the markets that service the rural and urban poor. Yet, all-too often this is exactly what has happened.

Therefore, a major supply constraint restricts the outreach capacity of microfinance institutions. Savings mobilization can help relieve this supply constraint, but this does not diminish the strategic and critical contribution that donors can make by directing additional resources at product- and service-specific microfinance outreach schemes that are tailored to the unique needs of clients at every level of the poverty pyramid, and especially those at the bottom. The liquidity constraint that faces the poor on a daily basis gives rise to the truism that poverty is about 'not having enough money'. The higher the proportion of savings from the poor that is not recycled as loans and services to other poor households, the more pressing, pernicious and chronic the liquidity constraint.

Donors should increase the supply of funds which microfinance providers can on-lend to the poor if the current excess demand is to be satisfied. When donors make these resources available to lending that is geared to Millennium Goals (i.e., as tailored microfinance for the purposes of child health, sanitation, primary education, potable water, female participation in governance, reforestation, erosion control, community-driven natural resource management, etc.), they simultaneously strengthen not only the microfinance sector but also the likelihood that microfinance outreach will pave the way for achievement of the Millennium Goals to the benefit of the poor.

In order for critical outreach to be associated with unequivocal and measurable poverty reduction in the terms defined by the Millennium Development Goals, it will be essential for a range of economic and social development reforms to complement efforts in the microfinance sector. In particular, pro-microfinance banking reforms must continue: interest rate ceilings that stymie microfinance profitability must be removed, along with central bank- or government-prescribed collateral requirements on lending to the poor; and restrictive entry requirements that prevent mainstream financial institutions from competing for the clients of microfinance providers must be seriously loosened. While this agenda demands government attention, it is also the case that far greater energy and effort must be invested by microfinance providers in the design of financial products and services that target the more important Millennium Development Goals, especially with regard to health, education, housing and employment-linked enterprise development.

4.2 TAKING THE MILLENNIUM DEVELOPMENT GOALS TO THE POOR

If microfinance is to boost efforts to achieve the Millennium Goals, the sector must be given the capacity to be pro-active in the design of new, more effective services to the poor. For this to happen, it is important for the donor community and leading microfinance providers to support changes in the microfinance sector that:

(i) address the rise of urban poverty, which remains a neglected market for microfinance in many developing economies;

(ii) strengthen competition in the microfinance sector through institutional reform, skills up-grading, entry into the sector by new providers with more accountable and cost-efficient modes of operation, as well as the type of innovation that can facilitate the deployment of existing schemes on a greater scale;

(iii) expand access by poor households to a more diverse range of microfinance products and services, especially money transfer facilities, insurance, budgeting and money-management skills training, as well as longer-term asset creation vehicles such as housing loans tailored to every stratum of the poverty pyramid;

(iv) provide new ways for the more underprivileged client groups (such as those at the bottom, of the poverty pyramid, isolated children without adult support, homeless single mothers, and households affected by HIV-AIDS) to become active participants in microfinance;

(v) enhance microfinance providers' capacity to be more commercial-minded in their approach to cost control, pricing policies and product/service design;

(vi) improve the relationship between microfinance providers and mainstream financial institutions, without compromising the commitment of tmicrofinance to its social mission as a pro-poor operator giving voice to the poor; and

(vii) broaden the range of templates available to microfinance providers to increase the supply of Millennium Goal-targeted services and products, especially for the poorest.

The seven changes to strategic directions in microfinance listed above are aligned with the Millennium Goals. It is time to ensure that additional donor and private sector financial resources directed at the microfinance sector are applied to the core Millennium Goals that target extreme poverty. The efforts and resources of the microfinance industry must be brought back on track to enable poor borrowers and savers to invest in their own futures, with a range of products and service that achieve the following:

- promote basic health;
- foster universal education for all children;

- enable poor communities to adopt sustainable environmental development strategies; and
- build and maintain pro-microfinance strategic alliances, especially between financial intermediaries in the formal and informal sectors, donors, microfinance providers as well as those government officials responsible for pro-poor policy development and planning.

4.3 ADDRESSING THE SPECIAL NEEDS OF THE EXTREME POOR

For all the worthy intentions, microfinance has not established any solid track record of outreach to those at the bottom of the poverty pyramid. There are reasons for this failure, but none are insurmountable. Prominent among these reasons is the importance that existing microfinance providers give to the needs of existing clients, especially repeat borrowers, including those that have climbed above the bottom rungs of the poverty pyramid to become part of the 'near-poor'. Current practice seems to suggest that outreach to the poorest of the poor cannot be allowed to threaten the gains made by the success stories of microfinance, whose beneficiaries now enjoy life above the poverty line. One can understand this view and there is merit in this concern for those past clients whose precarious journey out of poverty is threatened by the prospect of backsliding. There is no easy solution to this dilemma as long as additional resources to fund outreach to the poorest of the poor are not forthcoming. This is not a dilemma that microfinance providers are in a position to deal with without support from donors or socially responsible investors. Microfinance can boost achievement of the Millennium Development Goals, though not without paying serious attention to the financial constraint. Microfinance providers lack the financial 'depth' to meet both the needs of existing clients and those of further market penetration, even if savings were to be raised to their limits. Injection of additional supplies of loanable funds and subsidies to pay for the things that the poor should not be asked to pay for, are essential. If microfinance is to be put in a stronger position to promote Millennium Development Goals, providers must secure adequate resources to back up further market penetration and design products and services that well tailored to the specific needs of those at the bottom of the poverty pyramid. The microfinance sector now has more than four decades of experience to draw upon. A consistent lesson is that credit-based microfinance products often do not feature among those most sought-after by the poorest clients, for whom priorities instead include savings, help with risk management, secure money transfers and training in budgeting and cash-flow management. Responding to these needs is not a costless exercise, nor is it a ready source of profit for microfinance providers. In order to accelerate outreach, therefore, some degree of cross-subsidisation or external donor support is essential. Across the globe, microfinance providers have shown that working with the poorest of the poor is time-consuming, even where a good deal of the work is carried out by community/group leaders or members under the supervision of microfinance provider staff. The fact of the matter is that it takes time for members of the poorest households to build the skills and knowledge that put them in a better position to make the most productive use of credit-based products.

A core lesson is that subsidized outreach to the extreme poor is no anathema to the growth of sustainable microfinance. The lack of readily available subsidies from donors or governments in support of microfinance outreach to the extreme poor is a basic reason that so far, so few microfinance schemes (including the Association for Social Advancement (ASA), the Bangladesh Rural Action Committee (BRAC), Grameen Bank and SafeSave in the heartland of microfinance, Bangladesh) have not managed to place the needs of those extreme poor at the core of their business. The reality is that those at the very bottom of the poverty pyramid are not an easy client group to mainstream with market-based lending products. If their needs and requirements are to take centre stage in microfinance, more social development and market research are in order. Microfinance providers can only succeed when their approaches are well grounded in the details of the physical, health, cultural, institutional and economic conditions and constraints that are unique to every strata of the poverty pyramid. To do this, microfinance staff must become experts at *active listening.* There is no alternative to a *participatory* approach; similar to the participatory strategies that are the foundations of pro-poor programme designs the world over. Just as donor agencies now must ensure adequate funding in support of participatory approaches to pro-poor development, so they must lead the way with support to pro-poor microfinance.

Microfinance is an alternative to welfare spending and non-sustainable social security schemes. Microfinance is a real alternative because it can achieve the following:

- ensure that farmers have the resources they need to buy from the marketplace;
- help poor village residents to establish local potable water and sanitation systems that are within their own capacity to service and maintain;
- act as a valuable source of funding for individual health expenditures by poor people, ensuring that they have the surplus labour power within their households to take up economic opportunities when these come their way;
- smooth out seasonal variations in the cash flows available to poor households, to ensure that when school fees fall due they can be paid and children kept in the education system; and
- act as a crucial source of working capital to empower poor people, especially millions of women, to become self-employed, even if only on an opportunistic and part-time basis.

Governments do good and do well when microfinance is in a position to provide services to the poor that complement those of the public sector. Public-private partnerships, such as have been used with success by the Palli Karma Sahayak Foundation in Bangladesh, are an important way forward, showing that active collaboration between donors, microfinance providers and government is essential for such success.

Public-private partnerships in microfinance would enable donors, governments and microfinance providers to move beyond indiscriminate development expenditures that do little more than throw money in the direction of the poor. History is replete with examples of rural development finance or urban slum renewal projects, high-tech hospital developments and public sector subsidies for technology transfers and new industries that have generated little if any benefit for the poor in developing countries. Microfinance, on the other hand, has proven its ability to target the more able-bodied and entrepreneurial poor. The evidence is overwhelming that all classes of poor people, including the disabled, the young, the elderly, the pregnant and the infirmed can be reached and can benefit on a sustainable basis from inclusion in microfinance schemes.

Donor support for development is predicated on the belief that poorer country governments want to establish local economies that service the needs of all the population, not least the extreme poor. In order to maintain consistency in pursuit of this goal, donors and all members of the international community cannot be seen to tolerate chronic poverty, whatever the factors behind it. But then, we do tolerate poverty when we remain silent in the face of systemic factors that institutionalize it, as is the case when economically poor people are denied access to financial services.

Markets have their failures, and therefore not all market-driven results will be optimal. Market forces discriminate against those economic agents that are in no position or capacity to respond to opportunities when they arise. The reverse is also true. Market forces favour those in a position to respond to investment and savings opportunities. Microfinance schemes provide an open door to clients who would otherwise be disadvantaged by market forces. Policies that are blind to market forces, be they formulated on the basis of goodwill, greed or malice, typically result in greater disasters and more sub-optimal outcomes, especially for poor people. The door that microfinance opens for clients also enables policymakers to see more clearly into the murky world of markets that involve, serve or even exploit the poor. Failure to make use of this new window on the world of the poor is irresponsible and bound to commit poor countries to the mire of poverty for several more generations. In many respects, the success of China with poverty reduction, with the incidence of chronic poverty reduced from more than 60 per cent to less than 10 per cent in only one generation, can be traced to the vigorous way in which participation has been integrated into development planning.

CHAPTER 5 MAIN MICROFINANCE PRODUCTS FOR POVERTY REDUCTION[1]

There is no limit to the variety of microfinance products and services that can be designed to meet the needs of potential clients. Loan products can be varied to fulfill any number of market-driven demands, be these, for example, seasonally driven cash flow needs, production cycle, interest-only pricing strategies, group loans or targeted investments in enterprise expansion. Similarly, savings products can be designed to cater to individual, group, enterprise or community circumstances, including the unique situations faced by victims of natural disasters, or those faced with the rigours of life as a refugee, etc. Money and cash flow management services, such as the handling of remittances, or pensioners in need of an advance against a delayed payment, are special circumstances with limited implications as far as boosting Millennium Goal achievement is concerned. Therefore, the following sections concentrate on those microfinance products and services that do lend themselves to Goal-oriented pro-poor development.

Most microfinance providers select the products and services that they offer on the basis of assessed client needs and program sustainability. Microfinance providers face a double imperative: they must know the markets in which they will operate, and they must be at least as financially viable as their clients. To this end, they must ensure that on-time repayment rates remain high, typically well above 90 per cent, and that savings mobilisation is an increasingly important source of loan portfolio growth. In some instances, the microfinance provider will engage in client capacity building as a prerequisite for lending or savings mobilization. Where spending on client training is found to be necessary, external funding is usually essential as it is not fair to expect costs of this sort to be an imposed on the poor. As a result, the microfinance sector consists of providers that deliver both financial and non-financial products and services, with those that deliver the most non-financial services having the highest donor dependence. There is little in the way of evidence available, however, to determine whether the microfinance providers that devote more attention to the delivery of non-financial services are more effective in poverty reduction than those that concentrate on minimalist banking with the poor. The following is a brief description of the more widespread microfinance products and services.

Microcredit: Microcredit is the main product in any microfinance scheme. It is microcredit is the 'established' identity of microfinance. Some pioneer providers still like to keep the name microcredit, though they also provide other financial services along with savings and credit. The essential characteristic of microcredit is a small loan (typically less than US $100 for no more than 12 months, often only one to three months); to fund an activity that has a positive contribution for family income. Small loans to support consumption spending are unlikely to have an important role in boosting achievement of the Millennium Goals.

1 Data on the proportion of microfinance products that is distributed by the microfinance sector are not readily available. Suffice it to say that loan products exceed savings products, in value terms, in most countries for most microfinance providers, probably in a ratio of 60:40. However, no data is available on insurance products, housing loans or or the amounts of micro-enterprise development finance extended by microfinance providers. It would be useful if data were available on the distribution of loans by purpose, but none is readily available on an aggregated basis across the microfinance sectors of countries or regions.

There are many types of microcredit products, linking features indicative of the target group, nature of the economic activity, type of lending methodology , the sector of the economy in which the activity is to take place (e.g., agriculture), the nature of the investment supported (e.g., microenterprise creation or expansion), or repayment arrangements. Some microfinance providers have been brave enough to enable an individual borrower to service more than one loan at a time.

Over time, individual microfinance providers have found it profitable to change the nature of the credit products they offer in terms of loan duration, repayment grace periods, number of repayment installments and repayment mode (Ledger 1999; Meyer 2002). What has not changed is the suitability of group-based lending for the poorest clients; larger amounts go better with individual loans, for which group guarantees and very frequent, even daily, repayment schedules have proven to be less effective than with small loans. In all cases, regular and predictable repayments linked to the capacity to save, which determines the capacity to pay interest on, and repay the principal of, a loan, have been a benchmark of best practice.

Microsavings: Savings is one the best financial services to start a dialogue with the poor before providing any credit. Some in the microfinance sector believe that to 'lead with savings' is the optimal approach to sustainable pro-poor microfinance.

The experience of microfinance providers has confirmed that poor people value very highly the opportunity to save 'productively'. Savers in developed economies take it for granted that they will be able to save and earn a positive rate of interest on their deposits. Moreover, those savers able to access the deposit taking facilities of mainstream financial institutions take it for granted that their deposits are safe and that their money management plans can be built around guaranteed access to their own savings as interest-earning demand deposits. Microfinance providers attempt to extend these same privileges to poor clients, and to add value to their planning by providing livelihood support in time of special need or emergencies. When a natural disaster destroys a harvest, or an economic asset like livestock or a fish pond, the resulting loss of income and assets can leave households unable to afford the seed, fertilizer and other inputs needed to restore production in the following season or to restart an established income-generating activity. In such circumstances, the ability to draw on accumulated microsavings can do a lot to restore business activity (UNDP 2007).

Microfinance providers offer a wide range of savings services to the poor in order to nurture demand-driven savings products, including both mandatory and voluntary savings. Economic robustness in the face of financial setbacks is enhanced if the client has access to both highly liquid demand deposit accounts and time-bound deposits in addition to 'overdraft' style loan and drawing facilities. If a microfinance provider can offer clients financial products such as insurance, leasing and remittances/money transfer , economic robustness in the face of financial setbacks is further enhanced (Nagarajan & Brown 2000; Rutherford 2000).

Microinsurance*:* The poor are risk-averse. Even so, there are very few risk management services or products to which they have access. Microinsurance addresses this need with affordable insurance products tailored to the circumstances of low-income individuals and groups. It is an emerging tool for reducing vulnerability of the poor (Ahmed, 2008). Opportunity, empowerment and security for the poor are the primary pillars of any poverty reduction strategy. A perfect social security safety net is impossible without insurance services, though one can argue that the potential contribution of microinsurance to 'sustainable' poverty reduction has not been effective yet because of the failure of the public sector to recognize the role government subsidies can play in bringing social security to the poor through microinsurance. Risk management provision to a large number of people through microinsurance schemes can secure them protection against misfortune at an annual cost that is within the household budgets of many poor families (World Bank 2001).

Microfinance first introduced microinsurance to deal with the risk of death of borrowers. A 'death risk' premium was collected at the time of loan disbursement, the purpose of which was to discharge the loan liability of the borrower in the case s/he died before the loan came to maturity. The experience was so positive that microfinance providers took to offering life insurance and basic health cover, though the link to loan liability has not been severed. The risks associated with disasters are typically not covered, but it is recognized that microinsurance can be an important tool of social protection and even involve both formal insurance companies and microfinance providers (UNDP 2007).

***Microleasing*:** In the very beginning of microfinance, conventional wisdom, (as drawn from experience with earlier rural credit programmes) was that it was not necessary to give borrowers the money they sought to borrow if the products or services they were going to purchase could be provided instead. The idea was that giving the borrower the fertilizer, tractor, sewing machine or other production equipment, the programme could use the 'buying-power' of bulk purchasing to save on cost. Gradually, the concept evolved to embrace rental or leasing arrangements as alternatives to major capital outlays, further spreading the investment risk to levels that borrowers and microfinance providers could more easily accommodate. In the leasing business, microfinance providers use the same norms as conventional formal companies, but it has also been found that leasing is an effective way of overcoming capital constraints (Dowla 1998; Alamgir 1997). Leasing has also been found to have a strong contribution to make to post-disaster restoration programmes where equipment must be replaced if the poor are to return to work (Berold 2003).

***Remittance Transfers*:** Migration, both domestic and international, plays an important role in most developing economies. Developing countries with surplus labour encourage people to migrate to other countries for work and send remittances to families back home (International Network of Alternative Financial Institutions 2007; Siddqui & Abrar 2003). In rapidly developing countries such as China, India and Brazil, migrant remittances are an increasingly important source of village livelihood support (ILO 2000).

CHAPTER 6 CONCLUSIONS AND RECOMMENDATIONS

Any recommendations made in the body of this report will not be repeated here. Suffice it to stress that more basic research is needed on the most successful initiatives of individual microfinance providers in outreach and product/services design. However, research results remain ineffectual if they are not acted upon by those in a position to make a difference.

The Millennium Development Goals are not the preserve of microfinance providers. They are the primary responsibility of governments and donor agencies. Consequently, it is incumbent on governments and donor agencies to open a dialogue with microfinance providers with a view to boost the achievement of the Millennium Goals.

Dialogue between government and microfinance providers should not, however, be a one-way street. There is much that governments need to discuss with microfinance providers, such as the issue of competition policy and the need to ensure that it is complementing other pro-poor development strategies, including competition within the microfinance sector as well as with mainstream financial institutions. Similarly, government dialogue with microfinance providers could ensure that financial sector regulation does not lead to perverse outcomes for microfinance providers, or constrain economic growth in the informal sector.

The microfinance sector is dominated by attitudes that eschew the relevance of social protection and social development goals as mainstream to microfinance. The received wisdom that has emerged is that minimalist microfinance is the preferred strategy and that providers that embrace social goals above institutional profit have no long-term future in microfinance. The evidence suggests that this received wisdom must be challenged. Microfinance providers do need to operate in ways that will allow them to recoup operational costs, but this does not mean that they are not an appropriate vehicle to deliver subsidies to the more vulnerable among the poor or where market failures justify government or donor assistance. A significant service to the microfinance sector would be research on the role of subsidies in microfinance, especially when reaching out to the poorest of the poor that are targeted by the Millennium Goals.

Donor and government pressure in favour of microfinance financial sustainability has forced providers to target the least risky, least costly and relatively 'easy' profit segments of the market. As a result, the poorest of the poor have not been the primary targets of microfinance providers. The lowest fruit on the tree have been favoured, with households and entrepreneurs operating at the higher levels of the poverty pyramid as the main beneficiaries. In like manner, microfinance providers have been encouraged to embrace repeat business, even with clients who are no longer poor and instead well established in the ranks of the near poor or even higher in the economic hierarchy of savers and borrowers. Microfinance providers must be put in a position again to focus on the poorest among the poor.

Public spending is a significant driver of development. Infrastructure outlays achieve long-term goals but deliver immediate gains to people at large. Sector-specific spending by government on health, education, information services and public administration can discriminate in favour of target populations. Governments have an opportunity to fine-tune their spending priorities and processes in ways that will make it easier for microfinance providers to engage with and service poor households at the bottom of the poverty pyramid. An example is in the area of human settlements and environmental protection.

Many microfinance providers offer housing loans, but many more do not. There is reason to believe that microfinance providers are under-investing in housing loans because of the substantial multiplier effect housing can have on other borrowing needs (e.g., household equipment), . However, it is also likely that greater spending on housing for the poor would have complementary benefits for gender-, health-, education- and environment-related Millennium Development Goals. Microfinance can have a positive impact on poverty reduction in many ways, but there is every reason to believe that a significant increase in funding to microfinance providers for housing for the poor can deliver a larger and more sustained impact on poverty.

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THE GLOBAL URBAN ECONOMIC DIALOGUE SERIES

Microfinance has ushered in a new understanding of the needs of the poor and the potential for financial services to enable the poor to escape from poverty. Current literature argues over the way how microfinance has enabled users to climb above the poverty line. This report explores how microfinance could boost current efforts to achieve the Millennium Development Goals. The relationships between specific Goal and microfinance are explored, together with the potential for mutual benefits between both. Why this potential has not been a higher priority for the microfinance sector is also considered. This report argues that substantial synergies are yet to be realized between microfinance and Goals, based on careful, well- targeted approaches that are not only pro-poor, but also focus on the unique situation of the *chronic poor.*

Microfinance providers so far have responded to demand where it has been the strongest, which, paradoxically, has not been from the lowest rungs of the poverty pyramid where the import of the Goals is most crucial and relevant. As a demand-driven sector, microfinance has not been in a position to reach out to the poorest of the poor in order to expand. Tthe bulk of growth in microfinance client numbers has so far emanated from households in the upper reaches of the poverty pyramid, rather than the poorest among the poor. In other words, demand from the chronically poor at the bottom of the poverty pyramid has remained largely unrequited or ineffective, compared with the capacity of relatively less poor households to take advantage of microfinance.

This report argues that if microfinance is to benefit the chronically poor, deliberate action is needed to design products that are geared to the Millennium Goals and grant selective subsidies to compensate for market deficiencies that are detrimental to the chronically poor. The proposition is made that donors have a pivotal role to play if such market deficiencies are to be smoothed out and the capacity of microfinance to concentrate on the chronically poor is to be enhanced.

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