LITERATURE REVIEW

Research on micro-finance and micro-credit had a relatively short history in economics. The foundation of this programme although was laid in the seventies by the eminent Nobel Laureate Md. Yunus in Bangladesh as has already been stated, the academic interest in the area, however, grew later mainly since the nineties. Microfinance and microcredit have although become economists’ domain now-a-days, the research in the area began in the 1990’s through the pioneering study of Joseph Stiglitz (1990) who explains that under a group lending methodology, the group plays such a role; since group members agree to shoulder a monetary penalty in the case of default by a peer, the group members have incentives to monitoring each other and can potentially threaten to impose “social sanctions” when risky projects are chosen.

Later on, many researchers have made many valuable contributions in this field of study. Some of these studies are worthy enough of reviewing in the present context. Among those studies, review of the following has been done to gain some insight on this issue

Armendáriz de Aghion and Morduch (2005, 2010) microcredit has evolved over the years and does not only provide credit to the poor, but also now spans a myriad of other services including savings, insurance, remittances and non-financial services such as financial literacy training and skills development programmes, microcredit is now referred to as microfinance. Overall, it is widely acknowledged that no well-known study robustly shows any strong impacts of microfinance.

Churchill (1995) undertook a study entitled “Get Ahead Foundation Programme” to assess the impact of micro-enterprise credit on the small scale enterprises, on the living conditions of entrepreneurs and their families and on the benefits to the next generation in the programmes of the Get Ahead Foundation in South Africa. The study points out that micro-credit has a positive impact on the monthly profit but little impact on job creation.
Creve, Ndour and Thiam (1995) analysed the impact of enterprise providing micro-credit to participants, enterprise performance, individual income and family well-being. They had come to the following conclusions:

i) Micro-credit has a positive impact on enterprise income for repeat borrowers but no impact on assets and employment.

ii) At the household level, there is no overall impact on the household assets except on running water in houses and no impact on children’s education. This study has established that micro-credit has created a positive impact on enterprise income.

Montgomery, Bhattacharya and Hulme (1996) in their study “Government Thana Resource Development and Employment Programme (TRDEP)” analyse the impact of the credit programme on income, productivity and poverty in Bangladesh. They find that significant change in household income has led to a decrease in the percentage of expenditure on food, and that the better off among the poor benefit more from credit. To use credit effectively, the household has to reach a minimum economic level.

McKernan, Signe-Mary (1996) have found that program participation can exert a large positive impact on self-employment profits.

Pitt and Khandker (1998) also states that program credit has a significant impact on the well-being of poor households and that this impact is greater when credit is targeted to women.

Amin et al. (1998) use qualitative and quantitative evidence in Bangladesh to show that membership in microfinance programs among other factors is positively related to women's empowerment.

Navajas et al. (2000) analyze the outreach of five Bolivian MFIs. The authors find that most clients were near the poverty line (i.e., the marginally poor). They also find that group lenders
had more depth of outreach than individual lenders, that urban poorest were more likely borrowers, but that rural borrowers were among the poorest of all borrowers.

Mosley (2001) shows that assets and income increased commensurate with initial poverty levels, but also that MFI services may increase vulnerability if borrowers over-leverage.

Puhazhendi and K. C. Badatya (2002) in their present study covering a sample of 115 households found that SHG Bank Linkage Programme has made significant contribution to social and economic improvement of the member households of SHGs. The 4 pillar of this study are as follows:

1. Structure, Conduct and Performance of SHGs
2. Savings and Loan Products SHG
3. Economic Impact of SHG
4. Social Impact of SHG

They also argue that SHG led by banks were less effective compared to the SHG’s led by NGO’s. They further suggests that village infrastructure should be improved, bank should participate and try to reach the needy areas as far as possible and last but not the least they mainly emphasized on the human resource development of the member groups.

Gomez and Santor (2001) in an empirical study of 612 group borrowers and 52 individual borrowers in Canada, they report that group lending and the presence of neighbours have a positive correlation with self-employment earnings. It follows that borrowers with higher earnings will have an easier time of servicing their microloans.

Muhammad Abdul Latif (2001) statistically proved that micro credit has significant independent effect on household savings. He also insisted to continue with the current micro credit programmes and extend them beyond the land poor.

Woolcock (2001) addresses the issue of group-lending design. Analyzing five cases of MFI failures in Ireland, Bangladesh, and India, he concludes that group performance depends on
MFI lending policies, cost structures, nature and extent of social relations among group members, and MFI staff.

**Mallick (2002)** criticizes the impact of microfinance on women in society and suggests that microfinance services can result in gender conflict in Bangladesh.

**Rena, Ravinder and GhirmaiTesfy (2006)** in their study showed that there is a fundamental linkage between microfinance and poverty eradication, in that the latter depends on the poor gaining access to, and control over, economically productive resources, which includes financial resources. They emphasized that previously implemented programs not produced good results due to the non-involvement of the peoples for which the programs was designed (the poor). Microfinance can have a multiplier effect on people's standard of living and the way for permanent reduction of poverty through the provision of health services, education, housing, sanitation water supply and adequate nutrition. Therefore the implementation of the Poverty Reduction Strategy in Eritrea (Africa) did not help in raising living standard and the exacerbation of poverty. Thus they conclude by saying that microfinance is not a universal remedy for poverty and related development challenges, but rather an important tool in the mission of poverty eradication

**Sreyashi Sen (2008)** found that there is a positive impact of micro credit on the generation of income consumption, savings and externalities. The study further states that micro credit is an effective programme to eradicate poverty by properly channelizing the funds with the help of the NGO’s and Banks. Though the study was an attempt to explore this relation between micro credit and its impact but many variables were not analyzed in the purview of this study. The model of micro credit studied in this paper is a highly simplified abstraction of reality as only the impact of the grant provided has been studied and repayment of subsequent loans has not been analyzed.
Bruno Crépon et al. (2011) in their study in the rural areas of Morocco found out that microcredit increases only minimal access to financial markets. This impact study presents the results of an impact evaluation of a microcredit program in rural areas using a randomized experiment. The treatment villages and controlled villages were selected randomly each treatment group villages were offered microcredit through an MFI Al Amana, while the control villages were not offered credit. They also asserted that micro finance had an effect on livestock activities and agricultural income.

Deaton (1990) mentions at least four reasons for studying savings in developing countries. They are as follows:

First, at the microeconomic level, households tend to be large and poor with income prospects more uncertain than in developed countries.

Second, at the macroeconomic level, few developing countries have fiscal systems that allow deliberate manipulation of personal disposable income to stabilize output and employment.

Third, the postwar literature sustains that saving is too low in developing countries, and that this impedes development.

Fourth, saving is even more difficult to measure in developing countries that in advanced economies.

Srinivasan (2009) observed that groups created under SGSY do not seem to have a long existence. He has observed that 3.13 million groups were created under SGSY programme up to October 2008 across different states of India. However only 21% of the total number of groups created took up economic activities.

Abhijit Banerjee et.al (2009) through a randomized evaluation of the impact of introducing microcredit in a new market of 104 slums in Hyderabad found that microcredit does have important effects on business outcomes and the composition of household expenditure. The effects of Micro Credit access are as follows:
First, households with an existing business at the time of the program invest more in durable goods, while their nondurable consumption does not change.

Second, households with high propensity to become new business owners increase their durable goods spending and see a decrease in nondurable consumption.

Third, impact was zilch on measures of health, education, or women’s decision-making.

**Zeller, M.; Meyer, Richard L (2002)**. Zeller and Meyer have concluded their study that savings and credit facilities help individuals or households build up or acquire funds for all kinds of investments.

**Mosely and Hulme (1998)** estimated the impact of 13 microfinance intermediaries in seven developing countries and the study was one of earlier done across the international boundaries. Their study revealed that for each of the intermediaries, the impact of lending on the recipient household’s income increases with the debtor’s income and asset position improved.

**Mohammad Arifujjaman Khan and Mohammed Anisur Rahaman (2007)** in an impact assessment study through their survey analysis observed that that almost 84% clients of MFIs are women and most of them just had primary education. They also stated that most of the women started their business by taking loan from MFIs as compared to other sources. They also found that income and savings are positively correlated which further implies that if there is a rise in income than there is an obvious increase in the savings. In addition the study also states that MFI’s effect the creation of employment.

They asserted that the result cannot be generalized throughout the world, since result will differ from one country to another depending on the culture and social system.

**James Copestake and Richard Williams (2011)** argued that microcredit cannot, on its own, be relied upon to deliver sustained income growth and falling poverty rates, and that it can indeed be harmful to a significant minority of recipients. Evidence of impact on intermediate
indicators including business activity, business profitability and asset ownership is generally more positive, but this in turn has not been shown to increase income or reduce poverty, not least because of the opportunity cost of time taken up with such activities.

They suggest the following four broad propositions for more focused investigation.

a. Microcredit on its own cannot be relied upon to deliver sustained income growth and falling poverty rates:

   This is supported by the evidence that methodologically the most rigorous studies have not yielded clear evidence of positive average impact. There also appears to be limited rigorous evidence of positive impact on direct wellbeing measures such as health expenditure and nutrition.

b. Evidence of impact on intermediate indicators including business activity, business profitability and asset ownership is generally more positive:

   However this in turn has not been shown to increase income or reduce poverty, at least in the short term (with studies over the longer term not yet available).

c. Microcredit can be harmful to a significant minority of recipients:

   Poor people are no different from other people in having very unequally distributed entrepreneurial flair. Some will prosper but many will have neither the ability nor the inclination to generate sufficient surpluses to pay back commercial loans.

   They opined that there is a need to broaden the criteria on the basis of which the impact of MF should be assessed.

   **Rosenberg (2010)** emphasizes by asking “are we looking for impact in the right place?” He goes on to suggest that the most important role of microfinance may ultimately be to enable many poor households to smooth rather than augment consumption, as highlighted particularly by Rutherford (2001) and Collins et al.(2009)
Ajay Tankha (2002) stated that impact assessment in microfinance, and more especially of community organizations in microfinance, such as SHGs and federated structures based on them, is still undeveloped. He further asserted that the impact was more pronounced on social aspects rather than economic aspects, which was found to be stronger in the case of groups promoted by NGOs than in groups promoted by banks. He suggests for an accurate impact study, which can be realized by comparing the group of intended beneficiaries and another similarly placed group not covered by the project. He argues that past studies were more concerned with monitoring outputs rather than observing impact in a scientific or systematic manner moreover credible impact studies are virtually non-existent even among the best practice NGOs.

Tanmoyee Banerjee (Chatterjee) (2009) observed that income generation through group activities has improved the average income of group members but the inequality of distribution of income is high among the group members than that of the non-group members. It was also found that there has been a significant decline in the medical expenditure and school dropout rate in the families of group members than that of non-group members.

Shahidur R. Khandker (2000) in an econometric analysis of household survey data from Bangladesh observed that micro-borrowing has indeed reduced borrowing from informal sources, thereby signifying microfinance as an effective alternative source of finance to the poor. He also found there was an increase in voluntary savings among the households. He further stated that impacts of microfinance vary by the gender of borrowers. The savings impact of micro-borrowing is more pronounced for women than for men. In contrast, the informal finance impact is more pronounced for men than for women.

Noreen, Umara (2010) through a sample survey of four microfinance institutions, using concepts: like household income/expenditure, asset holdings and diversity, education and
various measures of vulnerability at household and enterprise level found that micro finance has a strong positive impact on children education and enterprise financial performance, and no impact has been observed on housing and income smoothening of enterprise.

Rena, Ravinder and GhirmaiTesfy (2007) argues that poverty alleviation is not well structured, there are also evidences that the non poor (rich) got benefited from this programme. They further asserted that lack of financial services is not the only limiting factor in income generation: other pervasive social, economic, and political barriers also play a key role. They conclude by saying that, there is a fundamental linkage between microfinance and poverty eradication in that the latter depends on the poor gaining access to, and control over, economically productive resources, which includes financial resources.

Karlan & Zinman (2010) through a randomized evaluation study where the treatment group were the people who were offered credit and the control group are the applicants who were not offered credit found that there is no significant effect on household income, poverty, and quality of food. They also observed that there was a significant increase in profit of household business when borrowers are men and there was an increase in school enrollments of the children i.e. the income formerly brought in by children is being replaced by added business income.

Karlan D & Zinman J. (2010) studied the effect of access to credit for the salaried poor in South Africa using randomized supply decision, where applications of potential borrowers who were rejected initially were reconsidered for lending and being treated as the treatment group and the control group contained individual who were not reconsidered for borrowing. In this study they observed that the loans were mostly used for household consumption purpose. They also found that there was positive effect on job retention, income, improvement of food quality. They further interpreted from the findings that though the loan was mostly used from consumption purposes but it enhanced welfare of the borrowers.
Kathleen Odell (2010) through a survey of several significant micro finance impact assessment studies found that there is no single study which gives proper evidence on the effectiveness of the micro finance universally. She further proposed that individual study on impact of microfinance should be viewed on the following aspects such as:

1. Whether the study should be conducted on micro credit, micro savings or any other financial services.
2. Methodology should be properly selected where sample selection biasness will be minimal.
3. Time frame of the study is an essential parameter, whether enough time was being provided before predicted positive effects can actually work (pre mature study).
4. Whether the study can be revisited after certain time period to understand the performance.

Further the study concludes by saying that microfinance is good for micro business and still it has a long way to go.

J.U.J. Onwumere et.al (2012) found that micro finance institution through their financial intermediation role in Nigeria Economy did not really assist in poverty alleviation but it really helped in the developing the human capital. Human development index is a comparative measure of life expectancy, literacy, education and standards of living for countries worldwide and a standard means of measuring well-being. They further recommended that micro finance institutions need to be more robust in their functioning and should attract more deposits from depositors; increase share capital of microfinance banks; better policy directives on microcredit in Nigeria and enthronement of a regime of corporate governance which in turn will not only enhance human capital development but may ultimately assist in poverty alleviation in Nigeria.
Abdul Latif et.al (2011) in this study from 200 respondents who availed the micro credit service in Pakistan found that there is a positive impact of micro credit on poverty alleviation. They observed that 40% of the respondents have started their business using micro loans. They asserted that poor governance and deterioration in law and order situation which effects both economic activity and quality of is the key underlying cause of poverty and government should hold all these things in check, while devising poverty reduction strategy through spreading network of micro-credit finance institutions across the country.

Mark M. Pitt and Shahidur R. Khandker (2001) examined the effect of group-based credit for the poor in Bangladesh on the seasonal pattern of household consumption and male and female labor supply. They have found that Group-based production credit can help smooth seasonal consumption by financing a new productive activity (nonfarm activity) whose income flows and time demands do not seasonally covary with the income generated by existing activities of households. As a consequence, the self-employment activities that are financed are unlikely to generate income streams that highly covary with income from agricultural pursuits. In addition it was also found that results for women’s labor supply do not suggest important differences in the effect of credit on women’s labor supply but suggests men’s credit reduces men’s labour supply.

Bakhtiari (2006) concluded that micro credit and microfinance have received extensive recognition as a strategy for poverty reduction and for economic empowerment particularly in rural areas having poor population. Providing poor people the small amounts of credit at reasonable interest rates give them an opportunity to set up their own business at small scale.

Mawa (2008) conducted a research study focusing the issue under discussion and concluded that microfinance is an innovative step towards alleviating poverty. The author mentioned that microfinance facilities provided to the people help them to use and develop their skills
and enable them to earn money through micro enterprises. Moreover provision of micro finance helps them to smooth their consumption level and manage unexpected risks. Micro finance helps the poor to built assets, educate their children and have a better quality of life.

Shastri (2009) revealed that there is no way better then micro finance in the war against poverty. Creating self employment opportunities is one way of attacking poverty and solving the problems of unemployment. The authors reported that there are over 24 crore people below the poverty line in India. The Scheme of Micro-finance has been found as an effective instrument for lifting the poor above the level of poverty by providing them self-employment opportunities and making them credit worthy.

Shirazi and Khan (2009) showed that two type poor were taken in consideration such as the poor and the extreme poor. The authors examined the impact of micro credit on poverty alleviation. Micro credit had reduced the overall poverty level by 3.07 percentage points (from 6.61 percent to 3.54 percent) and the borrowers have shifted to higher income groups during the reported period. The poverty status of the extremely poor borrowers has been marginally increased (by 0.63 percentage point), showing obviously no effect of micro credit on poverty status of these households. The reason behind no effect of micro credit on extremely poor is that, the extreme poor get the loan for protective purposes not for further income or self employment.

Knight and Farhad (2008) mentioned that micro finance directly improves quality of life and promotes poverty reduction. By getting loans the client become self employed and protect himself for the external threats. By getting employment they become raised from the poverty line and the poverty decreased. Micro finance is in the initial stages and in these stages most of the peoples do not know about the reality of micro finance. Some peoples take that example of micro finance where the result of micro finance is negative. It is more important that the examples where the result of micro finance is more positive then negative
should be highlighted so that more and more peoples get benefit from micro finance and cross the poverty line.

**Muhammad Kashif Khan Durrani et.al (2011)** in their study shows that maximum of the respondents are in favor of introducing and enhancing micro finance activities across the country. Based on analysis they expressed that micro finance is an effective tool to fight against poverty. It was also observed from the data collected through respondents that Fifty five (80.88%) out of 68 respondents were in the opinion that micro finance is very helpful tool in getting prosperity. They concluded that micro finance is not only helpful to generate income but it also facilitates to improve the social standard of poor people.

**Matovu (2006)** asserts that micro finance play an important role in poverty alleviation but the part of micro finance in poverty alleviation is like a drop of water in a sea. Micro finance helps in improving the standard of living of peoples. The author further said it is very difficult to find the poor people and help them, which requires a deeper analysis to find the poor people and help them through micro finance. Next hurdle was the kind of poor peoples. It was difficult to divide the poor into different portion and what be the base for this division. The further criticizes that along with positive role, micro finance has also a negative role because micro finance only finds out the symptoms not the real causes. Other portion that is not well developed till now is the woman empowerment by the help of micro finance. It requires much more research for the real empowerment of women by giving a chance to them to get access to the micro financial institutions.

**Gopalan (2007)** found that micro finance increase the self confidence of the poor by meeting their emergency requirements, ensuring need based timely credits and making the poor capable of savings. The study also shows the credibility of microfinance in health related issues in a positive manner. It has been postulated that by making policy towards income generation and enhancement, ultimately to eradicate poverty alone can improve the health
status through better, timely and easy access of health care. The survey shows that people do not consider micro finance as a helpful tool for health problems which indicated that a small portion of peoples take loans for health facilities. Thus he concludes by saying that people do not consider micro finance as a necessary tool and thus they cannot control poverty and health problems.

Abiola & Salami (2011) in their study mentioned that a lot of literature is present on the positive role of micro finance in poverty alleviation, but every time and everywhere, micro finance is not so profitable. Many scholars wrote that micro finance is a good tool for poverty alleviation but in many occasion the result is opposite. The main reason behind the negative effect of the micro finance on poverty alleviation is due to the time shortage. The time is not enough for generating the income i.e. the shortness do not give room for loan to generate future income. The author mentioned that at the repayment time the loan taker is not in the position to repay the loan. He shows through the respondents that in many cases before the end of the loan the business almost have collapsed.

Wright & Dondo (2001) in their study stated that the poorest of the poor are rarely served by microfinance institutions even by the people that use the catchphrase so often. He asserted that the majority of MFIs world-wide are not reaching the poorest of the poor even in the more microfinance - friendly and population-dense environments such as Bangladesh.

Scully (2000) he states that donors and advocates consistently exaggerate the power of microcredit and related assistance, while ignoring key structural issues that are far more pertinent to the long term problems of poverty and of poor people, especially women.

Dipankar Datta(2004) explored the reasons why microcredit programme inspite of being one of the effective programme in eradicating poverty and empowerment of women rarely reaches the poorest of the poor in Bangladesh. The reasons have been divided into five categories: (1) supply, (2) demand, (3) NGDOs’ norms and social issues, (4) voluntary and
involuntary dropouts, and (5) sustainable financial services. This paper also argues that microcredit alone is not necessarily the best way to help the poorest of the poor.

Sengupta and Aubuchon (2008) states that the joint liability contract creates social pressure. If one of the group members does not repay the loan on time the rest of the group is denied any access to future loans. This not only serves as a problem in itself, but also causes shame for the borrower who defaults. Since most borrowers live in small rural villages, this form of societal pressure is very important for successful lending.

Wright and Dondo (2001) argue that MFIs are not reaching the poorest percentage of the population and that they do not expect this trend to improve in the future since it is becoming more and more accepted by society.

Scully (2004) also criticizes the microcredit programme by concluding that the extreme poor are not reached by microcredit programs.

Morduch and Haley (2002) provide an extensive analysis on the effectiveness of microfinance. In contrast to the papers discussed before, they state that microfinance has proven to be an effective and powerful instrument for reaching people in all levels of poverty. It appears that microfinance reaches both the moderate poor and the extreme poor. They further states that microfinance programs are not for everyone. Only people who are motivated, and have entrepreneurial skills are suited to receive loans by MFIs. They state that there is no empirical evidence that the extreme poor would have less of these characteristics and they therefore should be treated the same as the moderate and best-of poor in their application for microfinance programs.

Khandker (2005) comes to the conclusion by stating that access to microfinance programs contributed to the reduction of both moderate and extreme poverty of individuals, and that these programs are especially successful in reaching women in different levels of poverty.
Coleman (2005) recommends that MFI’s strategies should be specific in targeting the extreme poor and they should be very clear in communicating their eligibility criteria and program rules. These results prove that microfinance is in most cases effective in reaching people in different levels of poverty and not solely in the group of the poor living just above the poverty line, as stated by the critics of microfinance.

Zaman & Hasan (2000) finds proof that people living in different levels of poverty appear to have the same ability to save money and the same borrowing patterns. Indicating that the extreme poor are not more risky than other groups of poor and that there is no motivation in this matter to exclude them from group lending.

Dunn (1999) studied the effects of MFIs in Peru and found that the average income of participants in microfinance programs is 50 percent higher than the income of nonparticipants also 41 percent of the non-participants are living in extreme poverty to 28 percent of the program participants.

Lucarelli (2005) discusses several case studies in Asia and the Pacific to test the effectiveness of microcredit. This paper shows that families who have access to credit have a higher income than families who do not have access to credit. In Indonesia for example, the average annual income of participants in a local microfinance project increased by 12.9 percent in contrast to a 3 percent increase in average annual income of non-participants.

Chavan and Ramakumar (2002) study on several developing countries found that microcredit programs did result in a marginal improvement of the borrower’s income.