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Impact of Microfinance on Poverty: A Case of Pakistan

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Abstract: Present study examined the role played by microfinance in poverty alleviation using concepts like education of children, housing, security of food, expenditure by households and assets owned by households. A sample of 384 customers of four microfinance institutions was selected using multi-stage cluster sampling. The results reveal a positive and significant effect of microfinance programs on children education and household expenditure, whereas, there was no significant impact of microfinance on housing conditions, consumption of food items and ownership of household assets.

Key words: Microfinance · Poverty · Children Education · Housing · Food Security · Household's Expenditure · Household Assets

INTRODUCTION

Microfinance: The idea of giving loan to poor was believed to be ridiculous. However, financial services were required by a lot of poor households as they were concerned with saving maximization, decreased risk and to have a shelter due to uncertain situations often provoked by financial crisis, sickness and tragedies. Their investment was in business run at smaller scale, children education services, health facilities, purchased assets and improved their living style. The proper financial intermediaries like commercial banks usually were less beneficial for these households because at the first place, their business models were commonly inappropriate for a microfinance business. Secondly, conventional lending is offered by them based on collateral (generally not in access of the unbanked) requirement and high screening and monitoring costs [1]. Moreover, it is unjustly believed that the households are reluctant or incapable of paying back loans. Unavailability of credit was one of the main reasons for the people to remain poor in developing economies.

The financial services have been used as a development tool since last 25 years. Such services have several forms such as microfinance organizations extending loans to mainly female micro-entrepreneurs, rural credit schemes providing to subsidize loans to poor farmers and a number of organizations offering a range of monetary services like offering loans, savings and facilities of insurance, in order to facilitate poor maximize their earnings as well as decreasing exposure to variations in income [2].

The concept of microfinance started gaining importance in 1980s. These programs were introduced in various developing economies during the past ten years. Renowned examples include a bank in Bangladesh by the name of Grameen Bank, bank in Bolivia named as Banco Sol and an Indonesian bank, Bank Rakyat [1]. Recently, policy makers and academicians paid a lot of attention to the concept of microfinance. It is considered as a flourishing approach for development and has a significant policy proposition concerning reduction of poverty, income allocation and attainment of goals related improvements [3]. The number of microfinance associations increased from 618 to 3,133 during December 1997 to December 2005, whereas, the people (84% women) receiving the loan from them mounted from 13. 5million to 113.3 million [4].

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The great deal of research available on microfinance is unable to find a universally agreed definition. To a majority, microfinance is providing financial services to the ones who are debarred from the prescribed financial organization due to lack of wealth and societal, cultural and gender hurdles. Yunus [5] described microfinance as the expansion of small loans to the people who are unable to qualify conventional bank loans. So, it proved to be a practical and acceptable measure in the long-lasting effort against poverty.

Micro lending or micro-loan is providing finances to the poor in activities leading to generation of income frequently attached with additional financial services, including savings and insurance [6]. Its focus is to lend without any condition of collateral. The difference between micro-credit and microfinance is that micro-credit deals with clients loan and credit needs and microfinance deals with financial services generating a broad range of success opportunities.

Last decade was considered as a decade of micro finance development. A number of opportunities for income and employment were created in developing countries such as ACCION's BancoSol in Bolivia, Bank Rakyat Indonesia's (BRI) Unit Desa program in Indonesia and the Bangladeshi bank Grameen Bank [7]. In Pakistan the terms 'microfinance' and 'micro-credit' are used interchangeably [8].

Microfinance and Poverty: Microfinance is considered a solution to fight poverty through offering a secure amount to be repaid in six months. These small loans bring social uplifts for the poor families as they move to a better house, eat better food and afford schooling for children. According to a research by World Bank study the clients of Grameen Bank were escaping poverty at the rate of 10,000 per month [9].

Microfinance is considered as an effective strategy for development as it played a major role in reducing poverty, income distribution and achieving development goals [3]. Past precedence revealed that microfinance helped the poor boost their income, establish potential businesses, decrease their susceptibility to external shocks and it also emerged as an instrument of self empowerment by facilitating poor to turn into change agents. Microfinance played an important role in reducing poverty as it increases income of poor households [10, 11].

Several studies in the past have reported positive impact on poverty indicators through microfinance participation. Examples are Bangladesh Rural Advancement Committee, Grameen Bank, Bank Raykat and BancoSol [12-15].

Education of children, housing, security of food, expenditure by households and assets owned by households are considered as variables to evaluate the effect of micro-finance on poverty.

Education of Children: Households utilize funds for activities essential for generating income occasionally savings, schooling of children and expenditures [16]. Improving the educational level can directly help lessen poverty and also through teaching ways of income generation, awareness for heath improvement and reducing family size [17]. Thus, a positive role is played by education in poverty alleviation.

Housing: Micro finance programs were found to affect housing positively [18,19]. Access to sanitation and clean water and "value" of the house are important indicators of housing [10,21]. Housing also played a positive role in reducing poverty.

Food Security: Several researches reveal significant association between micro-finance and food security [22,23,20]. This indicator is aimed at searching the track of poverty in terms of food consumption of the household.

Household's Expenditure: While judging the impact of micro finance on poverty Mosley [24] established a positive effect. Income approach may be used to measure the level of income (i.e. supply and levels of income) or expenditures approach (i.e. total expenditure by household). The later approach is usually understood to be more precise and consumes less time [25]. Microfinance Institutions (MFIs) increase the level of income and consumption of the household, decrease income disparity and improve well being [26].

Household Assets: A positive link was found between household assets and participation in microfinance programs [27-29]. In order to indicate differences in relative poverty, an important role is played by the value of consumer assets [30]. Thus, household assets play a vital role in poverty alleviation.

Microfinance in Pakistan: To set up strong foundations of microfinance in Paksitan the Government of Pakistan established the first specialized microfinance bank by the name of Khushhali Bank in 2000. Microfinance Institutions Ordinance was established in 2001 to regulate microfinance institutions licensed by State bank of Paksitan. Six microfinance banks have started operations in Pakistan in the last six year. At the country level Khushhali Bank, The First Microfinance Bank Ltd., Tameer Microfinance Bank Ltd and Pak-Oman Microfinance Bank Ltd. are operative, whereas, Rozgar Microfinance Bank Ltd. and Network Microfinance Bank Ltd. is functioning at the district level. Other types of organizations such as expert microfinance bodies, non government organizations, rural support programs and commercial financial institutions are also providing microfinance along with Microfinance banks. Pakistan Poverty Alleviation Fund was created in 1999 to facilitate these non-bank microfinance providers.

In Pakistan the Pakistan Microfinance Network not only provides microfinance but also tries to expand its access and generates prospects for the poor people to grow and prosper. Microfinance banks are recently allowed by State bank of Pakistan to issue term finance certificates. A report by World Bank claims that Poverty Alleviation Fund Programs in Pakistan are achieving their set goals. Microfinance borrowers have increased from 60,000 to 1.5 million and helped 9 million people in 111 districts throughout the country [31].

The role of microfinance in reducing poverty cannot be ignored. Despite some difficulties, it is important to recognize microfinance as an anti poverty device and find its effect if differing environments [32]. The past literature concerning with microfinance's effect on poverty reduction raises a need for a detailed empirical research. As a surprise there are only few empirical studies on the probable poverty decreasing effects of microfinance [33].

As the effect of microfinance programs on poverty in developing countries remains a strongly discussed issue, several researches have evaluated the impact. Past literature reveal mixed evidence: there are studies revealing positive impacts, [34, 15, 35,36] while others find negative impacts, [37,38]. This calls on for more research in this area. The current study fills the gap by finding the impact of microfinance on poverty using concepts: like household income/expenditure, education, asset holdings and diversity in Pakistani culture.

Consistent with the literature following hypotheses were formulated:

H 1: Microfinance programs have positive impact on the level of children education.

H 2: Microfinance programs lead to improve housing conditions.

H 3: Microfinance programs lead to increase the consumption of food item

H 4: if there are microfinance programs then there would increase in household expenditure on household items.

H 5: Microfinance programs have positive impact on ownership of household asset.

MATERIALS AND METHODS

Sample: A sample comprising 384 respondents from four major microfinance service providers (i.e. National Rural Support Programme, Khushhali Bank, The First Microfinance Bank Ltd. and Pak-Oman Microfinance Bank Ltd.) was selected by using multi-stage cluster sampling. The study had a cross sectional design using household as the unit of assessment. The new entrants within the organization were the control group whereas the experienced persons with two or more years experience with the MFI were treated as the treatment group.

Instrumentation

Children Education: The variable of children education is measured by using items developed by Pitt and Khandker [39] and Todd [18].

Housing: Housing is measured by using items developed by Nelson [40], Copestake *et al*. [10], Herny *et al.* [30] and Morris *et al*. [41].

Food Security and Household's Expenditure: Food security and Household expenditure are measured by using items developed by Nelson [40].

Household's Assets: Items developed by Zaidi *et al*. [8] are used to measure household assets.

RESULTS

The main aim of the study was to examine the impact of microfinance on poverty using concepts like children education, housing, food and security, household expenditure and household assets.

This study uses a newly developed scale so the reliability coefficients lie between 0.53 (Food and security) to 0.98 (Children education).

Table 1: Reliability Statistics

Variables	Number of Items	Cronbach's Alpha Coefficient
Household Income	9	0.98
Asset Ownership	8	0.77
Children Education	3	0.98
Food Security	6	0.53
Housing	2	0.56
Overall	28	0.79

Source: Field Data

Table 2: Results of Chi-square Test

	Pearson Chi-Square		
Variables	Value	df	Asymp. Sig. (2-sided)
Children Education	8.730	3	.033
Housing	.576	2	.750
Food Security	4.748	5	.450
Household Expenditure	7.057	1	.008
Household Assets	10.922	9	.280

Source: Field Data

Table 2 reveals a positive and significant effect of microfinance programs on education of children χ^2(3, n = 384) =. 033, p<.05 and expenditure by household χ^2 (1, n = 384) = 0.008, p <.05, whereas, no significant effect was found on conditions of housing, consumption of food items and ownership of household assets. Hence this study accepts the hypothesis H1 and H4 and rejects the hypothesis H2, H3 and H5.

DISCUSSION AND CONCLUSION

The literature revealed mixed evidences regarding the impact of microfinance. The results may differ due to the use of different methodologies, various subjective interpretations and particular features of the programs under study [42]. The projects undertaken by using loans from micro-credit programs were not able to produce adequate revenues to increase the income of households as it was not the most appropriate approach to eliminate poverty [43].

The first hypothesis anticipated that Microfinance programs have a positive impact on the level of children education. The results reveal a significant and positive relationship between children education and microfinance participation. This hypothesis was thus substantiated. These results are consistent with the findings of previous studies [44,45,42,20,46,29]. Though, the findings are against several studies [47,48].

Second hypothesis predicted that Microfinance programs lead to improve housing conditions. The results reveal no significant effect on housing conditions due to participation in microfinance programs. This hypothesis was rejected. The findings are in line with Kondo *et al*, [48] and oppose some of the studies [23,20]. The difference in the housing conditions was not found due to the illegal construction of the houses by most of the microfinance clients. Similar conditions were observed by a research conducted in Bolivia where some of the clients lived in houses illegally constructed in areas of slide risk [24]. The major market of microfinance in developing countries is constituted of these people. Therefore, housing cannot be taken as a very strong indicator for poverty.

The third hypothesis anticipated that microfinance programs lead to increase the consumption of the food items. Results reveal no significant relationship between consumption of food item and microfinance programs thus rejecting the hypothesis. Few researches support these results [48]. Yet, several contradict [22,45,27,20,46].

Forth hypothesis predicted that if there are microfinance programs then there would increase in household expenditure on Household items. The results reveal a significant positive effect of microfinance programs on expenditure on household items so, this hypothesis was accepted. Evidence on this variable is in line with the previous studies where a positive effect of microfinance on household expenditure was revealed [49,45]. However, Morduch [50] disagreed. According to him households availing microfinance facility had noticeably fewer consumption levels than those not availing the facility.

The fifth hypothesis anticipated that microfinance programs have a positive impact on ownership of household assets. It is concluded from the results that there is no significant effect of microfinance on household assets. Thus the hypothesis is rejected. The results are aligned with Kondo *et al.* [48] whereas they contradict the findings of others who found a significant effect [27, 28,29,51]. The reason for these contradictions is that the selection bias is controlled by using new customers as a control group.

This research has explicitly taken household variables to assess the impact of microfinance and provides very useful information about the usage of microcredit at the grass root level thus providing a strong inference for microfinance institutions. The study provides a useful insight of microfinance impact and an addition to the body of knowledge in the literature, specifically in Pakistani context.

Just like any other study, present research has some limitations. Cost of conducting interviews is undoubtedly the biggest issue, particularly when interviews are conducted in the rural areas. Clients reside at a considerable distance from one another ranging from 1-6 kilometers. Apart from traveling expense other related costs include photocopying, taking interview time from clients and sometimes waiting for them when they were not available. Since the customer loan officer (CLO) usually accompanies during the interview which makes the responses biased and reaching clients without their help is impossible. Future researches may consider these issues.

Present research has taken the time period spent in the program for microfinance participation. In the future, number of loan cycles and the amount of micro credit can also be taken to assess the program participation. Furthermore, in-depth analysis can be done by applying econometric models.

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