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Microfinance: A Time to Deliberate

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Microfinance promises to reduce poverty through income-generating activities for the underprivileged segment of the population that has been excluded from the main banking system. To achieve that goal, microfinance institutions have to become socially-financially???, sustainable businesses: simply put, reconcile their conflicting objectives. To that end, this special issue contains empirical contributions that deal with the impact evaluation of microfinance institutions on both a household and business level; financial sustainability and clients default risk.

The prominent role played by microcredit in poverty alleviation is unchallenged. It provides significant revenues for micro-businesses that are at the heart of the fight against poverty. Yet, it is widely recognized that raising microcredit for such micro-enterprises via the traditional financiers is quasi-impossible because they lack the necessary asset base to support their micro-financing. To overcome this impediment that undermines and jeopardizes the poverty alleviation, micro-entrepreneurs turn to microfinance institutions (MFI) which are tailored to the needs of micro-enterprises.

Microcredit and, by extension, microfinance, is an activity involving the investment of small money in micro-businesses by microfinance institutions. The microfinance institutions expect that their participation in the micro-investment will add value, meaning that it will allow the entrepreneurial micro-entrepreneurs to launch and sustain income-generating activities that will allow them and their immediate relatives to improve their well-being over time.

As with any activity that is heavily supported by donors, microfinance institutions are not immune to changing priorities of donors. Therefore, raising funds through the market to nurture micro-enterprises (Krauss & Walter, 2009; Cull *et al.*, 2009) for the fight against poverty has become one of the front major battles for microfinance institutions because they can no longer afford to be just socially sustainable but must become financially sustainable to fulfil their dream. As financial sustainability has become the main driving force for the survival of microfinance institutions, it has become clear that microfinance institutions have to seriously resort to mechanisms that allow them to overcome the myriad of drawbacks that plague their contractual relationship with their micro-borrowers. To that end, credit risk management (Ayayi, 2012) group lending assorting matching, peer monitoring, threat of termination, regular repayment schedules, monitoring and relationship building and dynamic lending with joint liabilities have to be coupled with advice, counsel, needed skills and expertise in the micro-entrepreneur's micro-project, as well as a substantial amount of time in the management to improve the chance of the investments, ultimate success¹.

From a policy perspective, a better understanding for the in and out of microfinance is paramount for the design and implementation of good regulations that will ultimately contribute to reduction of the financial risk burden of the microfinance institutions and by the same token, promote a viable pro-finance mechanism that will enhance the well-being of underprivileged populations.

To shed light on the some of the aforementioned issues, the following special issue of *Asian Economics and Finance Review* deals with the sustainability of microfinance programmes, the

¹ For a recent comprehensive review on each of these points, see: (Ayayi, 2012, Ayayi & Sene, 2012; Galariotis Villa & Yusupov, 2011 ; Cull, Demirgüç-Kunt, & Morduch 2009)

business level and household level impact of microfinance programmes and bad credit management.

The prominent issue raised in the literature on microfinance deals with the measurement of the contribution of microfinance programmes in the poverty reduction role of microfinance since it has emerged as a powerful poverty alleviation instrument in countries with a paucity of bank infrastructures and, more importantly, in the countryside and towns for the underprivileged that wished to develop an income-generating economic activity to increase their well-being and that of their immediate family (Ayayi & Séné 2011). The inclusive results in the literature have contributed to the questioning of the effectiveness of microfinance programmes. The studies by Polk and Johnson (2012) and Babajide (2012) provide a new dimension on the existing literature with regard to the impact evaluation of microfinance programmes.

Polk and Johnson (2012) provide an empirical study on the determinant of the impact of microfinance on a household level, using information of 18 000 female micro-finance clients of the Negros Women for Tomorrow Foundation (NWTf), a database using the Progress out of Poverty (PPI) Scorecard as a measure of poverty. Their analysis indicates that loan size, duration, and the economic activity supported significantly contribute to poverty alleviation. Furthermore, the results indicate that the impact is greatest with fewer, larger loans in particular economic sectors but require patience as each additional year increases the client's average change in poverty score.

Babajide (2012) investigates the effects of microfinance on micro and small business growth in Nigeria. Babajibe (2012), using panel data and multiple regression analysis to analyze a survey of 502 randomly selected enterprises financed by microfinance banks in Nigeria, shows that access to microfinance does not enhance growth of micro and small enterprises in Nigeria. Second, the results indicate that business size and business location have positive effects on enterprise growth. This finding is in line with Polk and Johnson (2012) who find similar results in their OLS and quantile multivariate regression.

Alam and Mola (2012), based on information from a sample of 555 current microcredit borrowers, investigate productivity of microfinance in Bangladesh. To ensure the representative-ness of the sample, Alam and Mola (2012) stratified the sample in urban (32.4%), semi-urban (27.2%), and rural (40.4%) areas covering 61 sample sub-districts of 28 sample districts in the 7 administrative divisions of Bangladesh by taking into consideration the size of the micro borrowers micro-enterprises and various categories of economic operations involved. From the empirical setting of the model, they found that when self-employed family labour is paid wages at market rate, under the framework of economic-profit counting, economic productivity of credit for about 48% of the borrowers is not enough to support payment of any interest. Second the results indicate that job creation and women's empowerment is marginal. These findings support the hypothesis that microcredit is a means of socio-political empowerment to avoid compromising socio-political rights and potentials at the hands of local moneylenders or friends and relatives if credits are obtained from them.

Providing microfinance is a costly business due to high transaction and information costs (Hermes & Lensinh, 2007). Because donors will not be there forever to pump money into non- financially sustainable microfinance institution (Ayayi, 2012), it has become clear that microfinance institution have to become fully, financially sustainable to fulfil their primary dream of poverty reduction. Ayayi and Sene (2010), Nadiyaa Olivares-Polancob and Ramannc (2012) find revenue generation factor, cost efficiency factor and growth factor to have a positive influence on the OSS of Indian MFIs. Nadiyaa Olivares-Polancob and Ramannc (2012), based on the same set of 800 odd MFIs in India, show that adjusted impairment loan loss allowance ratio, a portfolio risk factor and average loan size per borrower, a development factor, have a negative impact on OSS of Indian MFIs.

The use of good money for chasing bad money, i.e., the cost-benefit analysis to retrieve bad loans, seems unprofitable for MFIs. In this respect, the high default rate remains one of the challenges with which the sector has to deal. Peprah (2012), in a qualitative analysis on selected interviewed microfinance institutions in Ghana, points out that part of the problem lies with the involvement of management, staff and Board in loan processing and approval. To achieve goal congruency, Peprah (2012) contends that Board, staff and management are strongly encouraged to desist from the practice of influencing loan application and approval processes for friends and relations.

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