Multidimensional Poverty and Expanding Role of Microfinance Institutions

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ABSTRACT

The idea of providing microcredit loans to enterprising people stuck in perpetual poverty was successful in its limited approach and the financial conditions of loan recipients started to improve. However, the chronic problems associated with a culture of poverty have persisted including lack of health care, education, quality of housing, infrastructure, access to utilities, civic and cultural amenities and many other factors associated with quality of life. "State of poverty is a state of deprivation with respect to health and nutrition, education and security, housing and credit, and all the other conditions which are essential to human well-being."[1]

The Microfinance Institutions are evolving and going beyond the initial reductionist one-dimensional approach of seeking to eradicate poverty through providing microcredit with little attention to the non-economic dimensions associated with chronic poverty. The institutions are beginning to address quality of life issues. They are capitalizing on the relationships developed with their clients (loan recipients) to improve their quality of lives by providing them and their families with better opportunities to seek education, health care and social and cultural amenities. Additionally, the Microfinance Institutions[2] have started offering risk management (insurance) services to their clients to protect both, the loan recipients and lenders against accidents or calamities.

We have developed an organogram based on the premise of expanding services being offered by Microfinance Institutions to their targeted clients. The organogram delineates feedback mechanism between the lending institutions and their clients. The purpose is to develop quality control mechanisms and to ensure best practices. The feedback process provides constant evaluation of interaction between an institution and its clients to keep the process sustainable and viable. The organogram could be used as an instrument to maintain quality control and sustain best practices through constant feedback mechanism.

[1] His Highness the Aga Khan, FMFB. Pakistan, March, 11, 2002

[2] FMFB First Micro Finance Bank (AKDN) and Grameen Bank

INTRODUCTION

The MFIs (Microfinance institutions) in the developing countries have raised high expectations that their inclusive approach to reach out unbanked, uneducated and marginalized segments of the society will alleviate poverty; through micro loans MFIs have achieved some success in alleviation of poverty. However, in contemporary society the definition of poverty is deeper than simply putting food on the table.

Generally where MFIs have operated, their intervention has had positive financial impact on the population they have served. By loaning seed monies to financially marginalized but enterprising individuals, they have created legions of small business men and women who are now making more money than is necessary for basic survival. But that is not helping them and their families out of entrenched cycle of poverty. However, their small businesses are generating discretionary incomes that they did not have before MFI intervention.

The poverty trends show that poverty results from low capital, low skills, low income and subsequently low self esteem. Reducing poverty requires investing in both human and physical capital to enhance income, productivity and hence self esteem of their impacted parties. The investment strategies in the field of microfinance can transform poor into active agents of economic and social change. J. Sachs (2005) explicates that ‘poverty is caused by lack of capital and it further depletes human and natural capital thereby expanding the trap of poverty’. According to Nobel Prize Winner, Professor Muhammad Yunus, microfinance is ‘social business’ that ‘creates economic and social development from below’ (Khoja, Lutafali, 2008). These services not only help the ‘unbankable’ improve their financial condition, but they also connote the benefits of financial independence. This benefit of financial independence creates opportunities to tackle the mired causes of poverty, including lack of access to good health, education, infrastructure and other factors that define the quality of life including self esteem, importance of savings and physical and human asset accumulation (Burjojee, Deshpande, & Weidemann,2002; Deshpande & Burjojee, 2002).

Research Objective

Now, therefore, the research question and objective is: How to pull people out of the cycle of poverty? To answer the question, we have to define poverty in objective and quantifiable terms.

Today some 40% UN member nations are categorized as "failed states," unable to meet popular aspirations for a better quality of life (UNDP.hdr. 2009). The recent global crisis along with the world food crisis has sharply accentuated these problems. Currently, in the countries of Asia, Africa and Central Asia, 70% of the population is rural. As the World Bank recognized in its recent Poverty study (2009), local concerns must be targeted, providing roads and markets; sharpening the capacities of village and local governments, working to alleviate social inequalities and improving access to health, education and social services. Poverty is about inability to sustain specified level of well being. The very definition of poverty is the economic and social exclusion of poor on the grounds of absence of social quality of life indicators in rural and urban societies.

Having defined poverty, how can microfinance institutions contribute toward poverty alleviation? They can become effective by becoming lean, flexible and adaptive to their cliental environment. Currently, some of the challenges facing MFIs are:

1. How can MFIs help in alleviating poverty through providing financial and nonfinancial services and reach the poor in the remote areas of the targeted regions?
2. How to make these services accessible at a price affordable by the target group?
3. After providing access to poor populations, including those in the remote areas and helping them generate incomes in excess of mere sustenance, how can MFIs (microfinance institutions) provide assistance to such poor who have some discretionary income to pull out of poverty.

Assessment of Microfinance Institutions currently operating in the Developing world

The concept of providing microcredit to the poor is a very potent idea. Initially when introduced in urban areas and accessible rural areas of the developing countries, the concept of providing microcredit to poor inhabitants to help them start small businesses and grow out of poverty had some limited success.

However, significant poor populations in the developing world are located in the remote and inaccessible areas. MFIs used models of main stream banking of building imposing bank facilities to provide access to remotely located marginalized and ultra poor potential cliental base. This approach of reaching clients did not succeed. It faltered on several levels. Such facilities were too imposing and intimidating for the poor rural clients who were hesitant to even go into these facilities, let alone conduct business of borrowing monies. The facilities built to access clients, failed to attract clients. Additionally, such facilities have capital cost to build and operate. The capital that could have been utilized to give out loans and provide other services to the clients, got tied up in facilities that neither support the institutions nor benefit the targeted population (potential client). For MFIs to successfully reach their target client population, they have to device unconventional contact zones where they can access their clients and conduct business with them. The success of such contact zones will depend upon mental comfort and security of these zones will provide to all parties conducting business including the marginalized client base. The idea of unconventional banking contact zones is a topic of another paper.

Making Products (loans) Affordable and Accessible

Another impediment in reaching out to the marginalized and ultra poor target population is making the financial products available at a price that ultra poor can afford; products such as saving accounts, credit, insurance schemes, education loans, health insurance etc. The insurance products also serve as risk management strategies. In other words, keeping the interest rates and other terms and conditions for obtaining loans and insurances affordable and accessible. For the ultra poor clients with limited education and understanding of financial transactions. This ties into the earlier assertion of keeping the MFIs overheads low by not building expensive facilities similar to the conventional banking institutions, but creating low cost contact zones similar to existing infrastructures of those remote areas where the locals feel comfortable to go and conduct business of borrowing capital/getting loans. With low overheads and other creative means, the MFIs can provide their products and process services at more affordable prices than the conventional banking sector. Making loans available at an affordable price is dealt in detail in another research paper.

Beyond the Basic Microfinance Loans

In many areas of the developing world, MFIs microfinance institutions have successfully reached the marginalized populations and provided micro loans to ultra poor enterprising people to start small business thereby improving their financial situation. Such successful business men and women are now generating incomes greater than necessary for survival of their families. However, these individuals and their families are still stuck in the generational cycle of poverty.

As defined earlier, the definition of poverty is more than meeting the basic survival needs of food and shelter. It includes health, education for the young and vocational and skill improvement training for adults, child care facilities for the working parents, and adequate housing needs for the family, utility services including electricity, water sanitation and telecommunication. Transportation needs including means of transportation (bicycle, motor bike etc.) and roadway, railways and other basic and contemporary necessities of life. Risk management (insurance) is another important financial service necessary to hedge against material losses.

Those individuals who have been helped by MFIs through micro-loans and are now generating incomes above what is required for basic survival, have opportunities to use such discretionary incomes to materially change their 'quality of life' by availing opportunities available in contemporary society. However, to do so successfully they can be helped by MFIs they have partnered with to obtain micro-loans for their businesses.

The main thesis of this research study is to propose mechanisms to reduce poverty by identifying MFIs as the change agents and adding employing best practices to their existing services.

Research Model

MFIs (Microfinance institutions) can use their existing client base who have discretionary income to provide them with additional financial services, which could be used to directly improve the client's quality of life.

The World Bank (2009) and the Aga Khan Development Network (AKDN, 2010) in their poverty studies, illustrate that the local concerns must be targeted providing housing, education, health services. These studies have recognized the importance of increased social and economic interconnectivity that has the potential to reduce poverty and foster economic progress. The MFIs along with government and its supporting agencies NGOs and PVOs,[3] could work to eradicate social inequality by improving quality of life indicators e.g., access to education, health and housing services in their targeted regions.

We studied a few pioneering microfinance institutions such as Grameen Bank in Bangladesh, and Self–Employed Women Association (SEWA) of India (Khoja, Lutafali, 2008) and in the current study First Microfinance Bank Pakistan (FMFBP), who provide social enterprise opportunities to marginalized populations to portray the changing roles, activities, portfolios and responsibilities of microfinance institutions.

[3] NGOs and PVOs are used interchangeably, but PVOs referred to international private voluntary organizations e.g., Aga Khan Development Network. FMFB (First Microfinance Bank) is the bank established by AKDN. NGOs referred to indigenous specific country based non-governmental organization.

The purpose of MFIs must be to make saving and borrowing instruments available to the greatest possible number of marginalized population of the society. The goal must be to explore emerging trends of eradicating poverty by maximizing economic and social inclusion and assisting the marginalized population by developing business and social ventures.

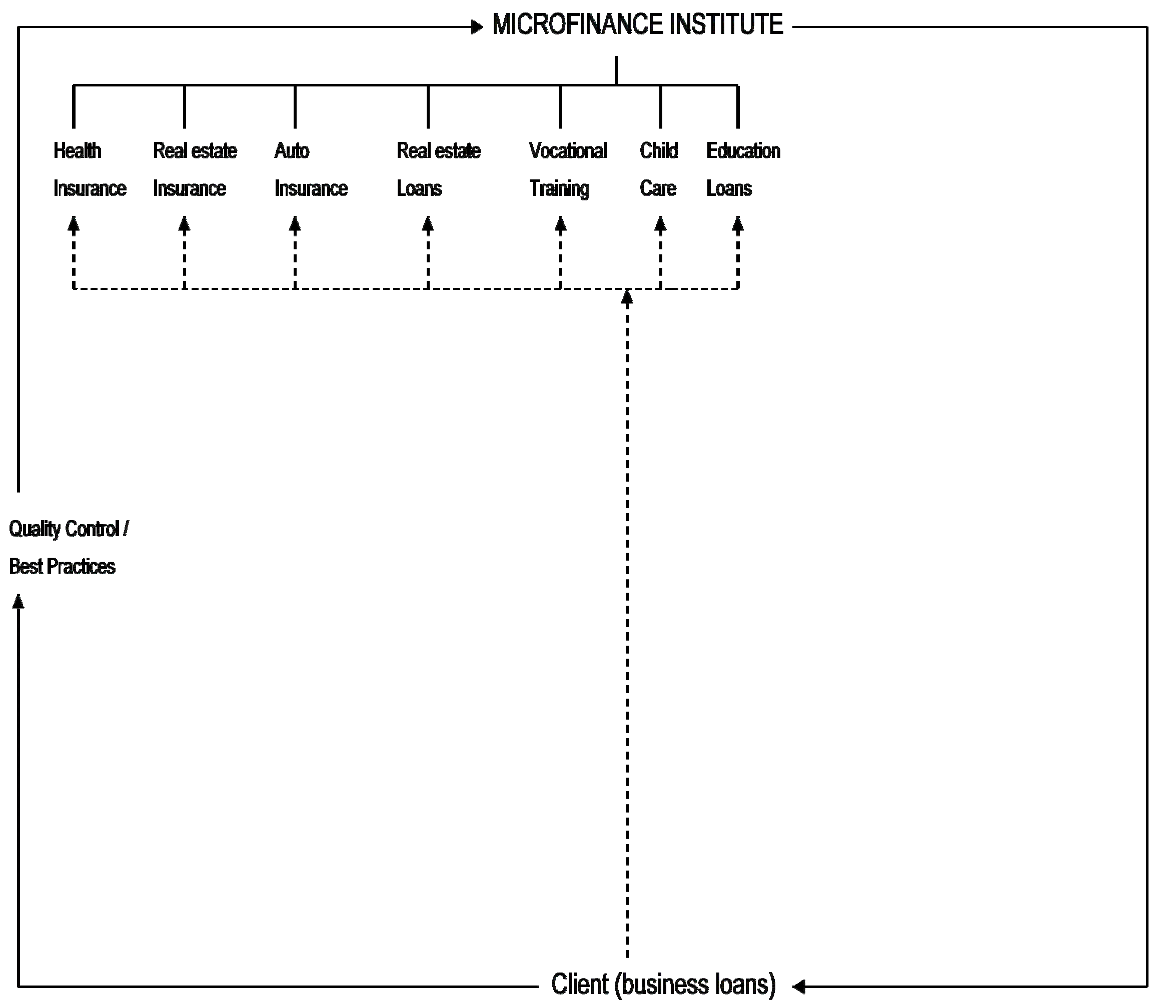
The future of MFIs development lies in transition of borrower’s dependency on lending agencies to a market based approach of development which entails that once the loans and financial assistance is provided, communities themselves take up the onus of social and economic change. The sustainability of socio-economic development cannot be ensured without empowering the poor to become the agents of change, instead of being the mere recipients of loans and credit.

We have created/framed an “Organogram” Fig. 1 to identify some of the financial services that MFIs can provide to their clients to improve their quality of life and help these people out of perpetual cycle poverty of generational and multi-sectoral and multi-dimensional poverty.

Although our proposed Organogram model is gender neutral and can be applied to any context, in this paper our focus is on all deprived and impoverished segments of the population. In addition, there might be certain variations in the model in urban and rural settings.

Fig.1

ORGANOGRAM



The Organogram is based on the following two assumptions:

i. MFIs have identified its cliental base on the notion of credit, loans and other services extended to them in the past.

ii. MFIs have targeted neighborhoods and communities who are working in tandem with MFIs subsidiaries and other NGOs and PVOs bringing social awareness about the importance of education, health, improved housing and other products to improve their social status.

The success and sustainability of MFIs are largely attributable to the team building methodologies adopted by Grameen Bank, particularly SEWA and FMFBP[4]. In general, institutions discussed above have transformed the lives of its targeted clients simply by providing microfinance services to marginalized and deprived urban and rural population by employing 'best practices', providing non-financial services and support packages, exploring social entrepreneurship to induce employment/or enhance existing business.

Financial services MFIs can provide to their clients:

- Health Insurance
- Education Loans
- Loans to access Vocational Training programs
- Promote Child Care facilities through collective cliental participation
- Transportation loans for clients to buy transportation vehicles
- Real Estate Loans to buy or improve residences
- Real Estate insurances

[4] FMFB Pakistan is the result of AKRSP's (Aga Khan Rural Support Program) successful experience in the Northern areas of Pakistan, where WO (women organization) and VO (men Organization) were formed respectively so they can work and learn together as a team in the rural setup. Unlike other institutions , the FMFB has a deep rooted social objective rather a profit maximizing commercial motive-it is her to carry the dream forward—the dream to create an impact on the lives of poor and give hope for future. SEWA introduced cluster approach, whereby women clients, workers are organized in their respective groups such as poultry, dairy, garment or indigenous business or manufacturing.

- Transport vehicle insurance

Such holistic approach to tackle poverty is the only sure way to eradicate it and free people trapped in perpetual cycle of chronic generational poverty.

Conclusion

The research study portrays a participatory and cooperative feedback model that may not only assist in the long-term sustainable economic development of the members or clients of MFIs while empowering them but allow for a strong voice to impact the assessment process. In other words, the suggested model is likely to have a two-pronged effect. First reduce the vulnerability and isolation of individual household and foster development of an equitable and self-sustaining socio economic system. Second, allows for increased and continuous diversified opportunities, growth and increased revenue generation avenues for institution itself. Hence, it will encourage the microfinance institutions to offer products and services by identifying what is it their clients need and want to enhance their socio-economic status, reducing their vulnerability and poverty level.

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