

May 01, 2010

## Political institutions & grassroots development : the political economy of microfinance

Kristen Hudak  
*Northeastern University*

---

### Recommended Citation

Hudak, Kristen, "Political institutions & grassroots development : the political economy of microfinance" (2010). *Political Science Dissertations*. Paper 1. <http://hdl.handle.net/2047/d20000140>

This work is available open access, hosted by Northeastern University.

**POLITICAL INSTITUTIONS & GRASSROOTS DEVELOPMENT:  
THE POLITICAL ECONOMY OF MICROFINANCE**

A dissertation presented

by

Kristen Hudak

to

The Department of Political Science

In partial fulfillment of the requirements for the degree of Doctor of Philosophy

In the field of

Political Science

Northeastern University

Boston, Massachusetts

April 2010

## **ABSTRACT**

When and under what conditions has microfinance been most successful? Microfinance institutions have been widely credited as an important tool for alleviating poverty, but what is it that affects them, their success and survival, their ability to reach the poorest clients? This project addresses an untapped area of political economy by bridging the gap between grassroots development and the broader macro-level political environment. Going beyond gender discussions, economic explanations, and normative policy prescriptions which have dominated the microfinance literature, this research argues that the regulatory framework and democratic institutions have a key role to play through empirical testing of these relationships. Microfinance can only do so much to assist the poor and support entrepreneurs if legal structures do not create an enabling environment. Cross-national regression models, institution-level microfinance data and detailed case studies of Sri Lanka and Nepal confirm that it is indeed the institutional environment that shapes microfinance and its ability to reach the poor population. Alternative explanations of gender equality and the presence of international and local microfinance networks fail to sufficiently explain differences across states. In some ways, microfinance has achieved much in bringing financial services to the poor in spite of adverse political conditions with inefficient markets and ineffective governments. However, it is also positively influenced by political freedoms, stability and policies that create more opportunities for funding and protect borrower and lender rights.

**Key Words:** microfinance, microcredit, entrepreneurship, economic development, political economy, finance, regulation, governance, political institutions, gender, networks

## ACKNOWLEDGEMENTS

This dissertation project would not have been possible if not for a great deal of guidance, support and fortuitous acquaintances. Thank you first and foremost to my advisors: Douglas Snow of Suffolk University for not only your support but your enthusiasm for the project; W.D. Kay for your stories and your positive outlook on my academic career since the beginning; and especially Kirstin Rodine-Hardy for all of the drafts and edits, criticism and encouragement, guidance and advice in both my research and professional development.

In fact, I really need to thank everyone for making the political science program what it is. During my time at Northeastern I have been both impressed and most grateful for just how supportive this faculty is of the graduate program. For those professors who have taken the time to provide personal attention in both my research and professional development – in particular Professors John Portz, Ronald Hedlund and Amilcar Barreto and Dean Christopher Bosso – I am most grateful. To my fellow students who have made my day-to-day bearable, intellectually stimulating and hilarious, I certainly never could have wished for such amazing colleagues, let alone such great friends. Thank you especially to Alison Uzdella, Diane Bulpett, Christopher Cunningham and Adam Mosher (known collectively, and affectionately, as Tolstoy Reader).

The field research for this project was perhaps the most rewarding experiences of my life. It would not have been possible without the kindness of both friends and strangers. Thank you to Northeastern's own Tej Karki, who put me in touch with his in-laws in Nepal and to his daughter who translated an important policy for me. Thank you to Chandrani Jayasekera, for not only being a caring co-worker and friend at a part-time job that paid the bills, but for introducing me to her sister and arranging for my lodging in Colombo.

Special thanks to my hosts in both countries. In Sri Lanka – to Dilki and Thenuka my fun hosts in Colombo, to Kumari & Sumedhe for showing me more of the country, to the staff at the Polhena Reef Garden Hotel in Matara, and to all my friends there who made Sri Lanka feel like home for me for that short while. In Nepal – to the Khatri Family, who made me feel like one of their own.

Thank you to Jaho, the wonderful, cozy coffee house in Salem, Massachusetts where I was always able to get the majority of my work done over many cups of tea. For all those hours and extra hot water – thank you, thank you.

To Jenn Osiecki and Danielle Mador, who were always patient with me, and whose friendship I could never do without. To Luis Daniel Rosero who came along just at the right time, and whose understanding, caring and encouragement amaze me. Finally, but most importantly, a tremendous thanks to my family, who unquestionably support and cheer on everything I do.

## TABLE OF CONTENTS

Abstract	2
Acknowledgments	3
Table of Contents	5
List of Tables	6
List of Figures	7
List of Abbreviations	8
Chapter 1 – Introduction: Creating Opportunities for the Poor	9
Chapter 2 – A Political Economic Theory of Microfinance	31
Chapter 3 – Models of National Level Microfinance Outreach	55
Chapter 4 – Microfinance Institutions in Context	80
Chapter 5 – Sri Lanka: Outreach in the Face of War and Natural Disaster	104
Chapter 6 – Nepal: A Regulatory Framework for Microfinance	134
Chapter 7 – Conclusions: Connecting Top-Down and Bottom-Up Development	161
Appendices	172
Works Cited	191

## LIST OF TABLES

Table 3.1 – Modeling National Levels of Outreach	64
Table 3.2 – Correlation Results	70
Table 4.1 - Scale & Outreach of MFIs, by Regime & Capacity Measures	88
Table 4.2 - Legal Designations for MFIs, by Scale & Outreach	90
Table 4.3 – Number of Regulated MFIs by Country	91
Table 4.4 - Regulation by Legal Designation & Region	92
Table 4.5 - The Client Base in Regulated versus Unregulated MFIs, by Level of Outreach	93
Table 4.6 - Percentage of MFIs where Funding Includes Savings Deposits, by Regulation and Legal Status	96
Table 4.7 - Which Institutions Focus on Women?	97
Table 4.8 - Network Membership	100
Table 5.1 - South Asia: Case Comparison (2006)	107
Table 5.2 - Growth in Microfinance Outreach	108
Table 6.1 - Quantitative & Qualitative Analysis Comparison	160

## LIST OF FIGURES

Figure 2.1 – Theoretical Model	36
Figure 3.1 - Simpler Procedures to Start a Business: The effects on Microfinance Outreach	72
Figure 3.2 - Microfinance Services Needed Where Contract Enforcement is Most Difficult	74
Figure 3.3 - Targeting Women Where Contract Enforcement is Most Difficult	75
Figure 4.1 - Median Number of Borrowers by Region	82
Figure 4.2 - Median Financial Self-Sufficiency, by Scale of Operations	84
Figure 4.3 - Portfolio at Risk (>30 days), by Lending Methodology	86
Figure 4.4 - Median Gross Loan Portfolio (US\$), by Financial Intermediation	94
Figure 4.5 - Median Operating Expenses (as a percent of the Loan Portfolio), by Financial Intermediation	95
Figure 4.6 - Median Percent of Female Clients, by Region	99
Figure 6.1 - Variations in Microcredit Interest Rates	147
Figure 6.2 - Economic Growth and Conflict	157

## LIST OF ABBREVIATIONS

ADB	Asian Development Bank
BAFIA	Bank and Financial Institution Act (Nepal)
CBSL	Central Bank of Sri Lanka
CGAP	Consultative Group to Assist the Poor
CMF	Centre for Microfinance (Nepal)
FINGO	Financial Intermediary Non-Governmental Organization (Nepal)
GBB	Grameen Bikas Banks (Nepal)
GEM	Gender Empowerment Measure
GNI	Gross National Income
GTZ	German Technical Cooperation
MCDB	Microcredit Development Bank (Nepal)
MFI	Microfinance Institution
MIFAN	Microfinance Association of Nepal
NBFI	Non-Bank Financial Institution
NDTF	National Development Trust Fund (Sri Lanka)
NEFSCUN	Nepalese Federation of Savings and Credit Unions
NGO	Non-Governmental Organization
NRB	Nepal Rastra Bank (Central Bank)
RDB	Regional Development Banks (Sri Lanka)
RMDC	Rural Microfinance Development Centre (Nepal)
ROSCA	Rotating Savings and Credit Association
UNDP	United Nations Development Program

## **I. INTRODUCTION: CREATING OPPORTUNITIES FOR THE POOR**

*"Credit is of fundamental importance if we are to build a just society where all human beings can live with dignity. I am convinced that credit is a basic human right. All other basic rights - food, shelter, education, health - are denied when a person is poor. Credit unlocks the door." (Yunus 1997)*

One of the most puzzling problems faced by social scientists is why some countries remain underdeveloped and so much of the world's population mired in poverty. The question of what spurs development or perpetuates underdevelopment remains important not least of all because of the large numbers of people who still live in poverty and the levels of inequality which have only increased both within and between countries. This is the broad question: why has development here failed? Explanations in the political science literature run the gamut from cultural determinations to theories which focus on exploitative dependency relationships, but have as yet proven insufficient.

This research seeks to add to the broader academic debate on development by assessing the relationship between grassroots development efforts and those made at the national level. In the development industry, there remains a schism between those that seek to promote development from the top-down and those that emphasize a bottom-up approach. According to Dichter (2003), during the early 1960s, there was a transition from a consensus for "trickle-down" development to a push for more grassroots efforts, in which "the two parts of the development endeavor ignored each other and rarely came into contact" (61). Even now the two approaches seem to coexist, with little attempt to reconcile them. Thus the consideration of development as a dependent variable remains incomplete.

To answer this question, this research will focus on a more specific dependent variable, microfinance. The idea of providing credit at the grassroots level brings opportunities for development directly to the people. Despite its modest means and local focus, at its core

microfinance is a response to the problem of poverty and is therefore very much concerned with the larger question of development. The microfinance industry throughout the world has been widely praised for its potential to alleviate poverty and contribute to development. Microfinance Institutions (MFIs) are more frequently being considered one of many important means of encouraging entrepreneurship and economic development at the grassroots level. Today there are over 3,000 MFIs serving over 100 million clients in some of the most impoverished countries of the world (Daley-Harris 2006). When viewed in terms of assets, these organizations may not seem like significant players in most countries. However, as Robert Peck Christen (2004), currently Director of Financial Services for the Poor at the Bill & Melinda Gates Foundation, points out, “the picture is much different when one counts citizens rather than money” as they may in some cases account for the majority of financial system clients. No less important is the fact that these institutions are part of and embedded in a larger context.

Addressing the question of microfinance from a political science perspective can offer insight into the nature of the relationship between grassroots practices and development. Yet political studies of microfinance are rare. To date, much of the literature on microfinance has come from sociology, economics or the industry itself (Brau and Woller 2004; Morduch and Haley 2002; Sebstad and Chen 1996). The focus has primarily been on how these institutions operate, how credit services impact their clients, and whether they are reaching the poorest of the poor. In other words, these microcredit institutions are an interesting independent variable in assessments of poverty-alleviation efforts. If it can be established that microfinance is indeed a useful tool for development, then the next step is to analyze microfinance success as a dependent variable made up of three factors: outreach, sustainability and impact. Which are the most important factors in determining microfinance success, its survival and its ability to reach the

poorest of the poor? Furthermore, why have some developing countries been more successful than others in meeting demand for microfinance services?

This question speaks to an untapped area of political economy and to answer it, there is a need to expand the literature, to reconcile the question of microfinance as a grassroots level tool for development with the larger macro-level political environment. This is an opportunity to bring the question of microfinance into the political realm, to step back from normative policy prescriptions and really consider the complex politics of grassroots development efforts. To do this, the research must go beyond gender discussions and economic interest-based explanations which do not sufficiently explain the relationship between microfinance and the larger political context. Rather, I argue that while gender and interests may have a role to play, it is primarily the institutional environment which shapes the political economy of microfinance. In particular, this research seeks to illustrate that the success of microfinance as a tool for development is primarily determined by a market-enhancing institutional environment where effective state institutions provide an appropriate regulatory framework.

### **Background: What is Microfinance?**

Microfinance refers to small scale financial services offered to the poorest populations, often in areas where banking options may be limited or not available at all. MFIs can be banks, cooperatives, credit unions, non-governmental organizations (NGOs), or non-bank financial institutions (NBFIs) (Helms 2006). Typically, microcredit services aim to provide working capital which can help the recipient to start or improve a small-scale business and thus improve the livelihood of themselves and their family. It is based on the premise that providing small loans to those living in poverty can provide them with the capital they need to become self-sufficient. Microfinance also refers to a broader range of financial services, with some MFIs

also offering savings and insurance (Helms 2006). While small-scale financial institutions operate throughout the world, the microfinance movement is most often associated with the developing world, where arguably these services have a much more profound significance. Although there are certainly poor and unbanked populations in the developed world, they make up a much smaller portion of the population, whereas in the case of low and middle-income countries, microfinance can play an important role in bringing financial services to an underserved majority (Honohan 2004b).

Microcredit has actually existed in various forms throughout economic history, usually as part of the informal sector itself, as is the case of local money lenders. Credit unions and rotating credit associations (ROSCAs) have a long history. Very broadly defined, microcredit might even include informal loans from friends or family members (Helms 2006). In the 1960s, the usurious rates charged by moneylenders led many involved in development efforts to think that the only way to get credit to the poor was to provide it cheaply, through subsidized, state-led rural credit programs. However, these efforts have had a disappointing track record. In their assessment, for example, Hoff and Stiglitz (1990) point out that the creation of these institutional alternatives failed to either drive out the moneylenders or reduce the interest rates they charged. These subsidized credit programs not only damaged the financial sector by distorting incentives, but often times ended up subsidizing the nonpoor (Holt and Ribe 1991). Besides making these banks “flabby,” government subsidies have also been thought to have resulted in loan allocation based on politics or social concerns, rather than the credit-worthiness or productivity of the recipient (deAghion and Morduch 2005).

Modern microfinance institutions emerged as part of a wider trend toward grassroots development efforts that were critical of the state-led, top-down approaches which had

dominated until the 1960s. Advocates of grassroots projects generally pointed to the inability of “trickle-down” economics to reach the poorest populations and instead focused on small-scale, local community-driven approaches (Friedman 1992; Kingsbury 2004; Schumacher 1973). More recent critics argue that the main failure of development policy has been to ignore the informal sector and thus has done little to increase the productivity of the poor (DeSoto 2000; Woller and Woodworth 2001). From these arguments, microfinance emerged from the “vacuum created by the failure of the old models of development finance” (Rhyne 2001). The ineffective initial attempts of state-subsidized rural credit have given way to a microfinance sector dominated by NGOs and private operation, with far less state involvement (Woolcock 1998). Since the 1970s, efforts to formalize small-scale lending have taken off. They drew particular attention in the last few decades with the emphasis on neoliberal policies and hands-off approaches to the economy. The UN declared 2005 to be the “international year of microcredit,” with more than 100 countries participating in activities including more than 350 conferences (“International Year of Microcredit 2005: Final Report” 2006). In 2006, the Grameen Bank, the establishment which is often likened with the start of the current microcredit movement, received the Nobel Peace Prize for its development efforts and consequently brought much attention to the industry as a whole (Nobel Foundation 2006).

By lending to the poor, often to people working in the informal sector, in rural areas or urban slums, MFIs take on exceptional risks, risks often deemed too high by regular commercial banks. The poor lack collateral and in many cases, even official documentation. Yet the success of microfinance efforts has overturned several long-held assumptions about the poor. The poor are indeed credit worthy. Clients have shown a willingness to pay high market rates of interest on their loans in order to invest in their businesses and their family’s well-being. What is more,

they show a remarkable consistency in repayment (Arsyad 2006; Patten et al. 2001). In fact, Grameen Bank has reported repayment rates as high as 98 percent, compared to the average for other Bangladeshi banks of only 27 percent! (Yunus 1997) Additionally, it has been found that when given the opportunity, the poor do save and would greatly benefit from having a safe place to keep their savings. As Rhyne writes in her case study of Bolivia, “The poor participate actively in their betterment. They are not passive recipients of assistance, not simply refugees from a failed formal sector, but economic actors out to improve the quality of their lives, and as such, they are potential contributors to economic growth” (Rhyne 2001).

In order to address the unique financial needs of the poor, MFIs have tended to be characterized by group lending models and mobile and decentralized structures. These institutional features are designed to address some of the fundamental difficulties of lending to the poor – namely that there is no documentation to assess credit-worthiness or likelihood of default and that very poor clients lack the typical kinds of collateral which can be used to insure the loan. While group lending structures are not utilized in all MFI organizations, they have been shown to be a reliable alternative. In the widely replicated Grameen Bank’s model for example, lending groups consist of five people who meet once a week and work to mutually reinforce the discipline of the members. The design of this group system is such that no collateral is necessary from the borrowers. As Yunus (1997) explains, “Social collateral replaces material collateral. Individual greed is suppressed by collective responsibility” (14). Group lending has been found to reduce transaction costs and allows the organization to build upon existing social groupings. Most importantly, for areas where credit information is lacking and contract enforcement mechanisms tend to be weak, mutual group reinforcement provides a reliable alternative to the lack of sufficient legal mechanisms (Woolcock 2001).

Another lesson from the Grameen model and a central aim of microfinance worldwide is the idea of taking banking directly to the poor. As Yunus has explained, one of the problems with the formal financial sector is that bankers are “unwilling to step out of their offices.” (Yunus 1997). In practice, this means small local organizations, or in the case of larger microfinance organizations like Grameen, highly decentralized management systems. By quite literally bringing services to the poor (the Grameen Bank is noted for its idea of “bankers on bikes” for example), banking can be made available even in areas considered risky due to lack of infrastructure and physical distance from a head office or even other financial institutions. In this way, microfinance is designed to bring credit and other services to areas previously thought to be too challenging an environment for such developments. Additionally, one study even found that the “greater physical and financial proximity of microfinance institutions to their clients” was a major contributing factor in their ability to withstand economic crises (Muriel et al. 2006).

Another important feature of many MFIs is the focus on women borrowers. In some cases this is part of an effort to correct a neglect of women in development policy. In other cases, such as in Muslim societies like Bangladesh, lending to self-employed women challenges traditional social roles. Yet often it is the poorest women who need credit most but are unlikely to get it for both financial reasons and as a result of gender bias. Not only have microfinance programs been said to have a positive impact on women’s empowerment, but women have often proven to be the better customer. Several studies found that women faithfully repay while the delinquency rate is much higher among the men who borrow (Panjaitan-Drioadisuryo and Cloud 1999; Wahid 1994). Another reported that female branches were more efficient, as women tended to be more risk-averse and to use their loans more effectively (Hassan and Tufte 2001).

Even with these efforts, the majority of the world's population does not have regular access to formal financial services (Helms 2006). This represents a substantial barrier to conducting everyday economic transactions, which others take for granted. Without formal access to credit they have few opportunities to seek capital to start or expand their businesses, or to cover the costs of unexpected misfortune; the death of livestock, or even home repairs. Without a safe institution in which to keep their earnings, there is little motivation or opportunity to save.

### **A Political Science Perspective**

This is where political science becomes critical to our understanding of microfinance. How can the safety of these institutions be guaranteed? How can countries create an environment in which microcredit markets can thrive and provide financial access to more people? Despite social agendas and often non-profit status, MFIs are very much economic actors and will respond to the legal and regulatory framework in which they operate. Consideration of microfinance as a dependent variable thus holds important lessons about the role of the state. The legitimacy of microfinance institutions is influenced by their legal context. Where they can obtain their funds and the extent to which they can control their operating costs can also be limited by state interventions. Much of the literature on microfinance contains normative policy prescriptions, but this analysis seeks to test these relationships more closely. The lessons to be learned can tell us the extent to which the same policies can promote grassroots improvements in financial services as well as more efficient markets and broader economic development. It can also determine the extent to which governments in the developing world have the capacity to implement these policies effectively. More broadly, while microfinance has proven to be

successful in even the most adverse conditions, to what extent can MFIs benefit from greater political freedom and stability?

A more thorough understanding of microfinance, and by extension grassroots development and entrepreneurship, stems from a consideration at multiple levels of analysis. At the level of the institutions themselves, we can take a closer look at their outreach, sustainability and impact on clients, as influenced by the political environment. At the national level, we can consider strides achieved in financial access by national microfinance industries. The extent to which increased and improved financial services can facilitate entrepreneurship and small business development has implications for broader economic development. Moreover, microfinance continues to be become increasingly globalized, with multi-national networks of MFIs and flows of international capital both from the developed world and across the developing world itself. Thus the implications extend to even the international level of analysis and provide important lessons for international development.

As microfinance increasingly becomes an accepted tool for development worldwide, it is critical at this juncture to step back and consider these questions. This research tackles the timely question of microfinance and analyzes these factors systematically through review of the literature, quantitative analysis and case studies. The merits of microfinance must first be established by sketching the relationship between it and the broader dependent variable of development. That is, rather than assuming that microfinance is a useful tool for development, this will first be established through systematic assessment of the available literature. Once this is established, it provides a stronger basis for analysis of the political economy of microfinance. Thus the remainder of this chapter will provide a comprehensive review of the microfinance literature. Chapter two will then explore the political economy of microfinance, drawing from

the political economic literature on development, finance and entrepreneurship, thus building the theoretical perspective. Chapter three begins with a quantitative analysis of institution-level data. Expanding then to a national level of analysis, chapter four provides an analysis of the microfinance industry across countries. Chapters five and six are a detailed, qualitative exploration of the cases of Sri Lanka and Nepal, respectively, followed by a comparison of the two to gain insight into critical differences between their microfinance industries. Finally, chapter six concludes with the lessons learned and potential policy implications.

### **Microcredit: A Grassroots Level Tool for Development**

It is important to note that microfinance should not be viewed as a panacea. There is a tendency, as Boudreaux and Cowen (2008) put it, to overestimate the “micromagic of microcredit.” For one thing, deAghion and Morduch (2005) warn that rigorous impact studies have been few and have had mixed results. Microfinance is also simply not appropriate for every situation and every individual. What it can do is help to take control over rural credit out of the hands of moneylenders. It may not be able to single-handedly reduce poverty, but it can contribute to poverty reduction by increasing the productivity of self-employment in the informal sector (McGuire et al. 1998). It may not make substantial changes to individual income but it may allow a family to keep a child in school, pay for medical expenses or build up more secure savings (Boudreaux and Cowen 2008). In other words, what it can do is put resources in the hands of the poor and provide them the opportunity to make those everyday decisions (Helms 2006).

Most in the industry acknowledge that microfinance is not a magic bullet and do not seek to promote microfinance in this way at all. According to the Consultative Group to Assist the Poor (CGAP), the central goal is to make permanent access to high-quality financial services a

real possibility for as many poor and near-poor households as possible. To that end, they name the following four dimensions of achieving that goal:

- Breadth of outreach: Providing access to as many people as possible
- Depth of outreach: Reaching as far down the income scale as practical
- Service quality: Offering a suitable variety of financial products (savings, loans, remittances, and insurance) that are well-matched with the real needs of clients
- Financial sustainability: Pricing financial services so that their costs are covered and they do not disappear when donors or governments are no longer willing or able to subsidize them (Helms 2006)

How effective have these strategies been? Rather than assuming that microfinance (while not a panacea) is still a useful tool for development, what kind of evidence is available to illustrate this? As indicated earlier, much of the available literature focuses on microfinance as the independent variable. That is, it examines the question of how the institution affects its clients, what kind of clients it is reaching, and the nature of its operations – in particular whether or not it has achieved sustainability. These studies typically cross a number of academic fields and include a vast number of studies commissioned within the microfinance field itself. Several large-scale literature reviews have been published previously (Brau and Woller 2004; Morduch and Haley 2002; Sebstad and Chen 1996). In order to first establish the merits of microfinance, this research also undertook a comprehensive review of the literature which considers the effectiveness of microfinance as a tool for development.

Over 120 studies were reviewed. Over 80 of these appeared in peer reviewed journals, while the rest included studies done by the World Bank and various NGOs. Notably, even the journal articles cross a number of disciplines. While there are some economic journals represented, very few studies have appeared in political science journals. The majority appeared in entrepreneurship oriented or development studies journals, such as *World Development* (23 of the studies reviewed appeared here). In terms of methodology, most results were based on either

detailed case studies of a particular MFI or surveys of clients and practitioners. Additionally, while this review includes studies from Asia, Latin America, Africa and Eastern Europe, there is a heavy concentration of assessment on Bangladesh. In particular, successful MFIs there, like Grameen Bank and BRAC, tend to receive a great deal of attention. It should also be noted here that while the following discussion speaks to microfinance generally, most of the studies reviewed focus primarily on credit-based programs. This is most likely due to the fact that despite a lot of attention, few institutions (and therefore fewer studies) have expanded to additional financial services.

### *Outreach*

Recent efforts to measure the level of microcredit outreach represent an important starting point. One of the most notable studies is a recent report produced by CGAP. The authors of this study identified over 750 million savings and loan accounts in what they considered to be “alternative financial institutions” (Christen et al. 2004). These included accounts from a number of other types of state-owned and member-owned financial institutions in addition to those which are typically referred to as MFIs, though all maintain a focus to reach those who typically do not have access to financial services. The MIX Market, another CGAP effort collects self reported financial data from microfinance institutions throughout the world. According to their data, there were over 28 million active borrowers in 2004 (Rhyne and Otero 2006). Other efforts include the Global Microcredit Summit Campaign’s annual survey of microfinance institutions. Using this data, Honohan (2004b) finds that there is an apparent threshold to MFI penetration which is difficult to surpass. He finds that in only eight countries has microfinance manage to reach more than two percent of the population, with Bangladesh

being the most notable at 13.1 percent. These patterns also persist even when using the larger dataset developed by Christen and his fellow authors.

Besides the impressive breadth of outreach that has been achieved, there is also the question of depth: whether the institutions are actually reaching the poorest people. Quite a number of studies have actually found that despite broad outreach in terms of numbers, there is not as much of a focus on reaching the poorest, or a tendency for the very poor to still be excluded (Chowdhury and Alam 1997; Gulli and Berger 1999; Marcus 1999; Mosley 1996; Servon 1997; Todd 1996). One study of the PULSE program in Zambia for example is consistent with these other studies which suggest that recipients of microcredit tend to be “bunched around the poverty line,” though with more above than below it (Copestake et al. 2001). One study suggests the problem is an emphasis on quantity over quality (Wright 1999), while another finds that some MFIs tend to approach less poor clients in order to achieve better repayment rates (Ahmad 2003).

Still, others have found that outreach to the poorest has in fact been successful (Alamgir 2000; Evans 1999; Yaron et al. 1998). Hashemi (1997) argues that the poorest can be reached, but not all; microcredit is simply not a solution for everyone. Several others have found that depth of outreach can still be achieved, even if not all clients are among the poorest (Matin 2005; Seibel and Torres 1999). Although it has also been argued that depth of outreach may be achieved only at the price of breadth (Cull et al. 2006), others point out that new practices or additional services can lead to better outreach (Matin and Hulme 2003; Richardson 2000).

On the other hand, a distinction must be made between reaching the poor and reaching the poor who are actually interested in obtaining credit. A study by Navajas and co-authors (2000) also finds that clients tend to be closer to, or just above the poverty line, but point out that

this should not necessarily imply that they are doing a bad job. Group lending has been effective at reaching the poorest and there is deeper outreach in urban areas. Yet they also acknowledge that the poorest are less likely to be creditworthy, or to even demand loans, and the non-poor can borrow elsewhere. The key is in ensuring that they are lending to the poorest of those demanding loans and who are creditworthy, a far more difficult thing to measure. Joanne Fairley (1998) argues that outreach is often a problem of not only the organization being unable or unwilling to reach the poorest, but also a problem of the poor being discouraged from seeking microcredit services. Sometimes the poorest individuals simply do not want to assume the risks involved. Opportunities for productive use of the loans may be limited, and the task of repayment may involve too high a risk for some potential clients (Wright et al. 1997). Thus failures to reach the poorest might be explained by a “self-selection bias” with some of the very poor choosing not to seek out credit services if the risks are deemed too high (Barnes et al. 1999). Jeffrey Sachs (2008) agrees, arguing that microcredit is perhaps most suitable for those a few steps above the bottom of the pyramid, rather than those at the very bottom whose most basic needs must be met first. Best practices encourage increasing understanding of the market, and it would seem microfinance is well within its capability to reach this target market.

### *Sustainability*

One of the central reasons why MFIs have gained so much attention is because of their self-sustainability. Despite some early pessimism (Adams and VonPischke 1992), MFIs have generally flourished and studies more often than not report how these institutions have maintained their financial self-sufficiency (for example Mosley 1996; Rashid 1997; Schreiner 1997, 2003; Seibel and Torres 1999). One point of contention is whether this sustainability is compatible with successful depth of outreach to the poorest clients. Those who argue that the

two are incompatible have found that targeting the extreme poor is not financially effective for the MFI (Ahmad 2003; Lucarelli 2005; Rogaly 1996). DeAghion and Morduch (2005) have warned that even where financial self-sufficiency of the institution can be attained while achieving depth of outreach, this may not be possible everywhere, particularly in areas where it is more costly to work. Hulme and Mosley (1997) argue that as credit programs are expanded and professionalized, the incentive structure does detract from depth of outreach. Yet they also indicate that certain practices, like tapered interest rates (charging smaller borrowers higher interest rates), may help to offset those tendencies. Other studies support this idea, finding that the ability to profitably reach large numbers of poor clients could be attributed to organizational design (Chaves and Gonzalez-Vega 1996). Gibbons and Meehan (2000) argue that it can be achieved through detailed business planning, accurate monitoring and maintenance of loan portfolio quality. In fact a number of others have argued that outreach and sustainability need not be mutually exclusive and have actually found a positive relationship (Fruman and Paxton 1998; Paxton 2003; Woller 2003).

The question of subsidies is also at the heart of the debate about sustainability. Certainly some studies have found institutions capable of successful operation without subsidies (Yaron et al. 1998 for example). A 2006 World Bank study argues that profitability “is at the heart of the promise that microfinance can deliver poverty reduction while not relying on ongoing subsidy” (Cull et al. 2006). The study finds that over half of the institutions surveyed were indeed profitable while others had nearly achieved financial self-sufficiency. In fact, though, many if not most MFIs rely on donor subsidies to cover costs (Chamlee-Wright 2005). In fact, there is somewhat a polarization between those who advocate commercialization and complete financial self-sufficiency and those who are more willing to accept subsidies in order to achieve the social

mission of the organization. Certainly inappropriate donor subsidies have been found to be a central challenge to building a commercial microfinance industry (Campion 2002). Yet subsidies do not necessarily hurt the prospects of the MFIs, which in some cases may even be dependent on their use to maintain sustainability (Fruman and Paxton 1998). The notable Grameen Bank has been found to owe much of its success to subsidies (Morduch 1999). Important examples, like Grameen, may illustrate that such funds can be put to good use, but there is still the risk for wasteful use of public funds (Schreiner 1997). While Pollinger et al (2007) do find that subsidies make it difficult to maintain long-term sustainability, they also argue that once a subsidy is justified, the responsibility is on the organization to ensure operational efficiency. The success of so many MFIs seems to suggest that effective use of subsidies may be possible and does not have to detract from the sustainability of the institution. This is also demonstrated in more detail and placed in the political context in the case studies presented in chapters five and six.

Subsidized or not, the vast number of microfinance institutions are notable for their sustainability. A wide assortment of explanations is present in the heavy emphasis of the microfinance literature on establishing best practices. Institutions with superior business practices have certainly been found to be more sustainable than others (Tucker 2001). Among the important business practices which have been identified are maintaining loan portfolio quality, maximizing institutional and staff efficiency through formal business planning, and providing both customized financial products and long-term banking relationships with clients (Gibbons and Meehan 2000; Patten et al. 2001). Others have suggested that the degree to which the MFI is embedded with other local organizations (Snow 1999) or has integrated other

developmental activities is a factor in the ultimate success of the organization (Hassan 2002; Woller 2000).

### *Impact*

The ability of microfinance institutions to reach the poor in a sustainable business model is only meaningful if it has a positive impact on the clients that they purport to help. There have been studies that question the ability of microcredit to lift people out of poverty or even suggest that it traps people in debt. Yet most researchers and those in the industry seem to agree that it has an overall positive impact on client and household well-being and income. Critics argue that credit services could actually be creating dependency among borrowers or increasing the debt-liability of households (Adams and VonPischke 1992; Ahmad 2003; Rahman 1999). Dichter (2007) argues that most microcredit is used for consumption, rather than investment, thus wiping out any long-term affects. Rogaly (1996) holds that microfinance overemphasizes a single-sector approach to alleviating poverty while Ahmad (2003) argues that too much emphasis on microcredit could lead to the neglect of other important social services such as education and health. This is not the argument presented here and many other studies do confirm a positive impact on clients.

Many found that those households starting out with a higher income simply benefited more than the poorest (Copestake 2002; Matin and Hulme 2003; Montgomery et al. 1996; Shaw 2004; MKNelly and Lippold 1998; Zaman 2000). While the findings are indeed mixed, over forty of the reviewed studies found a positive impact on clients or at least mixed results, while only seven noted a negative impact on clients. Kaboski and Townsend's (2005) study of Thailand qualifies the positive impact of MFIs by illustrating that institutions with better policies tend to be the ones that have better impact on clients. Generally, though, there were findings of

substantial improvements in the socio-economic conditions of borrowers (Chowdhury 2008; Wahid 1994) or a higher per capita income among clients vs. non-clients (Dunn 1999; Kamal 1996), even improvements in health, education and housing (MkNelly and Lippold 1998).

Other criticism has argued that even where income may be improved, the loans do not necessarily help protect vulnerability; that is, the client's ability to withstand emergencies and sudden financial problems. Mosley (2001) warns that credit might actually increase vulnerability if borrowers are overleveraged, while Rahman (1999) points out that there is a need to specifically address vulnerability if poverty alleviation is to work. More often than not, though microcredit was found to decrease vulnerability as well as improve incomes (see Holcombe 1995; Marcus 1999; Matin et al. 2002; MkNelly and Lippold 1998; Patten et al. 2001; Walker and Matin 2006). Others have even found that vulnerability of bank members was reduced even if there was no clear evidence that poverty in general was being reduced (Develtere and Huybrechts 2005; Zaman 2000). Differences in findings might vary on the basis of the individual client. As Copestake (2002) found, while vulnerability could in some case be reduced, it could also make those who struggled with the loan worse off. Wright (1999) argues that part of the variation in findings might be attributed to measurement, arguing that impact assessments do not always properly assess vulnerability.

Much microcredit is specifically aimed at small-business generation and ownership. Studies which have considered the impact of microcredit on client business, in terms of income generation, profits and employment, have been overwhelmingly positive (for example, see Buckley 1996; Copestake et al. 2001; MkNelly and Lippold 1998; Barnes et al. 1999; Khandker et al. 1998; McKernon 1996). Of those studies reviewed, only two had mixed results when it came to improvements in the client's business (Bolnick and Nelson 1990; Wydick 2002). The

most important impact observed is simply alleviating the financial constraints of microenterprises, allowing them to better invest in their business (Hartarska and Nadolnyak 2008). Results of impact assessments have also found improved business skills (sometimes linked to training programs included as part of the loan), as well as improved business sustainability (Fairley 1998) and even employment creation (Mosley 1996).

The practice of MFIs to lend primarily to women has also been promised as a means to empower them to help not only themselves but also their families. Critical studies caution that female clients are still subject to male dominant social norms (Rahman 1999) and money from loans may actually still be controlled by male relatives (Goetz and Gupta 1996; Johnson and Kidder 1999). Either that or microcredit tends to encourage women to focus on small-scale businesses, thus perpetuating gender roles (Ehlers and Main 1998; Johnson 2004). Other studies argue that for microcredit to truly empower, it must be matched by broader social empowerment efforts and changes in gender relations (Hedrick-Wong et al. 1997; Hunt and Kasynathan 2001; Rankin 2002). Despite this, the results of most studies are positive: over twenty of the reviewed studies found a positive impact on female clients' positions, while only six found a negative impact on women (studies finding a positive impact on women's empowerment include Hashemi et al. 1996; Fairley 1998; MKNelly et al. 2001; Mwenda and Muuka 2004; Naved 1994). By providing direct resources to women, Kabeer (2001) argues, microcredit can help to overcome past barriers to entrepreneurial potential and lay the groundwork for women to tackle other injustices. Studies like Honohan's (2004a) point out positive impacts in terms of self-esteem. One study that considered violence against women, also found microcredit to have an empowering effect (Moodie 2008). Others, like Bernasek and Stanfield (1997) and Moodie (2008) focus on the positive impact the group-lending format has on empowerment through

women's relations with each other. According to Bernasek and Stanfield, "As contrasted to a conventional individually based credit system, the group lending practice therefore operates to counteract the negative feedback effects of social discrimination by creating alternative sources of social placement and self esteem for women."

A general consensus also seems to be that women tend to use the loans better (Schuler et al. 1998). Not only do they repay the loans and put them to efficient use, but the focus on women has potential for long-term development as women are the "main brokers" of children's health and education (Pitt and Khandker 1998). In fact, a number of case studies found a positive impact from the loans on children's health and education (Chowdhury and Bhuiya 2004; Panjaitan-Drioadisuryo and Cloud 1999; Todd 1996; UNICEF 1997), though Wydick's (1999) results on schooling were mixed. Several studies even found a link between participation in microfinance programs and increased contraceptive use (Panjaitan-Drioadisuryo and Cloud 1999; Schuler and Hashemi 1994; Schuler et al. 1997; Steele et al. 2001).

At a broader level, microcredit programs have also been found to have a positive impact on overall development and economic growth (Gulli and Berger 1999; Weijland 1999; Woller and Parsons 2002). Wahid (1994) cites the impact on job creation as a potential factor. Khandker has found that not only is there a positive impact at the village level (Khandker 2003), but that there are implications at the national level as well. He finds a five percent annual poverty reduction for program participants and argues:

About half of the poor people in Bangladesh are eligible to participate in microcredit programs. Of those eligible about 45 percent participate. This means that microcredit programs effectively benefit only 20 percent of the population, and about 1 percent of the population (5 percent of 45 percent of 50 percent) can lift itself from poverty each year through such programs (Khandker 1998).

On the other hand, some authors actually point to the increasing inequality between clients and non-clients (Hashemi 1997). Similarly, Copestake's (2002) study of Zambia pointed to a growing inequality between a few clients who have done particularly well and those who have not, or worse, have actually become financially worse-off. A crucial problem with measuring the macro-impact of microcredit programs is of course methodological. For example, Honohan (2004a) points out that access to financial services may even have results positive for development that are simply not evident in the limited timeframe of most impact studies. Similarly, Sobhan (1997) argues that it is methodologically difficult to address the relationship between micro level interventions on the macro economy and thus there is a gap in the literature.

### **Making Connections: Where the Twain DO Meet**

A consideration of the political economy of microfinance will help to fill this gap. If development efforts are to succeed, this schism must be addressed. Grassroots development stemmed from the perceived failures of the state. Meanwhile grassroots projects like microcredit have been criticized for detracting from efforts to improve legal and regulatory capacity and promoting small-scale employment and informal work at the expense of modern enterprises that would provide employment opportunities (Karnani 2008). Both arguments show a fundamental disregard for the relationship between grassroots development and improvements to the efficacy and capacity of the state. What if one cannot be successful without the other? They certainly need not be mutually exclusive. How can the state possibly address all of the immediate needs of the poor without deferring to markets and local level initiatives? How long can grassroots developments hope to succeed without improvements in the environment in which they operate?

I have shown that the literature on the impact of microcredit is mixed, though generally positive. Even if microcredit is at the very least a stop gap for those living in extreme poverty,

this does not invalidate it. Microfinance may not solve all of the problems of the poor, but it can offer opportunities where there were once very limited options or none at all. From the larger perspective, these opportunities and everyday economic decisions drive growth. This is why expanding the outreach of formalized, reliable financial institutions is such an important element of development. It is by no means that simple, however. Financial institutions throughout the world, as well as the clients they serve, face barriers to entry and regulatory quagmires.

Microfinance does not become irrelevant as a result of or detract from improvements to the broader political economic context. This is evidenced by the existence of small scale credit programs in even the most developed countries in the world. Likewise, improvements to regulatory frameworks and simplification of business policies only make it easier for MFIs to conduct business and reach those with a demand for financial services. So while microfinance may serve as an important counter strategy at the grassroots level, macro-level policies remain necessary for development, not least of all because of the dynamic that exists between the two.

What is needed is a theory of microfinance that can incorporate political, systemic and institutional factors that place these efforts in a broader political economic context. This study provides such a theory.

## II. A POLITICAL ECONOMIC THEORY OF MICROFINANCE

*“Every human being has enormous capacity, enormous potential. Many people never get a chance to discover what capacity they have and how far they can go. This is not the fault of the poor person - he or she has to exert great effort and develop skills merely to survive. The fault lies instead with the societal arrangements that we have made, with the institutional designs we have introduced...” (Yunus 1997)*

There seems to be little place in the current political science literature on development for explaining small-scale grassroots efforts like microfinance. At the same time, the literature currently available on microfinance does not address the question either. As illustrated, in most of the available policy literature, it is assessed as an independent variable to determine the degree to which microfinance institutions (MFIs) do in fact target the poorest communities, the impact microcredit loans have on clients, and the way in which the organizations are structured and operated. There is far less available that considers the factors which affect the MFIs themselves, and even less which takes a distinctly political approach to the analysis.

For example, sociologists have explored the nature of group-lending schemes that characterize many MFIs from the perspective of groups and individuals (Anthony 2005; Woolcock 1999). Others have concerned themselves with the social impact of microcredit efforts, and particularly the empowerment of female clients (Anthony and Horne 2003; Bernasek and Stanfield 1997; Hunt and Kasynathan 2001). Likewise, economic assessments tend to focus on the economic impact on clients (Armendariz de Aghion and Morduch 2005; Develtere and Huybrechts 2005; Wahid 1994) or the efficiency and sustainability of the institution (Hassan 2002; Khandker et al. 1994; Rai and Sjostrom 2004). Moreover, although the literature on microfinance has grown among academics and practitioners, they seem to be separate dialogues (deAghion and Morduch 2005). Even the growing literature on whether and how to regulate microfinance tends to be normative in nature, offering more recommendations than analysis of

how things are done presently. Considering the political economy of microfinance presents an opportunity to both shift perspective and expand the larger political science literature on development. Such a venture must start by situating microfinance in the larger framework of comparative political economy.

I first seek to draw a theoretical connection between microfinance and development by exploring the factors which impact not only the organizations themselves, but also the entrepreneurs and small businesses they fund and the broader financial industry within the country. As Baumol (1968) states in his famous piece on entrepreneurship, it is difficult to consider the differences between developed and developing countries “without taking into consideration differences in the availability of entrepreneurial talent and in the motivational mechanism which drives them on” (66). Entrepreneurship has been called the “missing link” between economic freedom and economic growth (Kreft and Sobel 2005). Daniels (1999) study of Kenya for example found that micro and small enterprises had a considerable contribution to employment and national income, employing one-third of all workers and contributing thirteen percent to GDP. Put another way, "Small business is big business in less developed countries" (Remenyi 1991, 36). Thus the business environment, particularly for small and medium enterprises (SMEs), is necessary for understanding the political economy of microfinance as MFIs not only assist these businesses but often fall into this category themselves.

Further, it would be neglectful to consider microfinance without placing it in the context of what goes on in broader financial markets. World Bank studies have found that financial intermediaries have been shown to have a positive impact on GDP, and even in reducing income inequality (Beck et al. 2000; Beck et al. 2004). Financial development reduces income inequality by disproportionately boosting the income of the poor. A developed and competitive

market of financial intermediaries also encourages entry of new enterprises and reduces dependence of those new entrants on personal capital. A political economic theory of microfinance can thus be built by identifying the common factors which drive development, finance, and small business development.

### **The Framework**

The microfinance industry is a response to the failure of larger financial systems to reach the poor and is based on the notion of “small is beautiful” (Schumacher 1973). So to consider the political economy of microfinance might seem oxymoronic. But even for the small-scale nature of microfinance, the larger picture is important. While microcredit efforts may have their roots in practices that skirt markets, they do not operate in isolation. And as these institutions become more and more mainstream – even as they remain small and focused – the larger institutional context in which they operate becomes more and more important.

It is here we will find the connection between grassroots development and the top-down political environment. Small NGOs and local grassroots efforts have a role to play, but they can only go so far on their own: as Snow and Buss (2001) point out, “NGOs cannot make national policy.” Even in Friedman’s look at alternative development (1992), he acknowledges that “local empowering action requires a strong state” (7), going on to specify that a strong state “is not top heavy with an arrogant and cumbersome bureaucracy; it is, rather an agile and responsive state, accountable to its citizens” (35). Governments most definitely have an important role to play in facilitating a favorable policy environment for microfinance, and therefore there are strong normative implications to this kind of study. Unfortunately, too little has been done up to this point to step back and assess the affects of the institutional environment.

To do this, this research project will consider microfinance as a dependent variable. For the purpose of an empirical research design, the conceptualization utilized here is the extent to which microfinance institutions are successfully providing financial services to their target clients. “Success” can be understood according to the three indicators discussed in the previous chapter: outreach, sustainability and impact. Indicators for each of these are increasingly being made available for MFIs around the world. Most importantly for our interests here, we can consider aggregated outreach at the national level as an indicator of the extent to which the industry as a whole is meeting demand. That is, conceptually, this provides a comparison of the relative operation and success of national microfinance industries.

My argument is grounded in the research tradition of new institutionalism (Ethington and McDonagh 1995; Hall 1997; Katznelson and Weingast 2005; March and Olsen 1984; Moe 1990; Olsen 2001). The theoretical framework applied throughout blends rational-choice institutionalism, which allows us to consider the grassroots efforts of MFIs within the context of the institutional environment, combined with a more historical consideration for the capacity and effectiveness of those institutions. From this perspective, the demand and provision of microcredit services is shaped by a rational need to secure credit and improve livelihoods, but constrained or influenced by government institutions and policies which impact that industry. The following will illustrate too that, although often more normative in nature, most of the literature on microfinance falls into this category. Yet there are few studies which systematically address the institutional constraints on MFIs. In fact, there is little available which discuss the constraints on small-businesses and entrepreneurial efforts generally. The contributions here then is to further explore the intersection of the various branches of new institutionalism, by

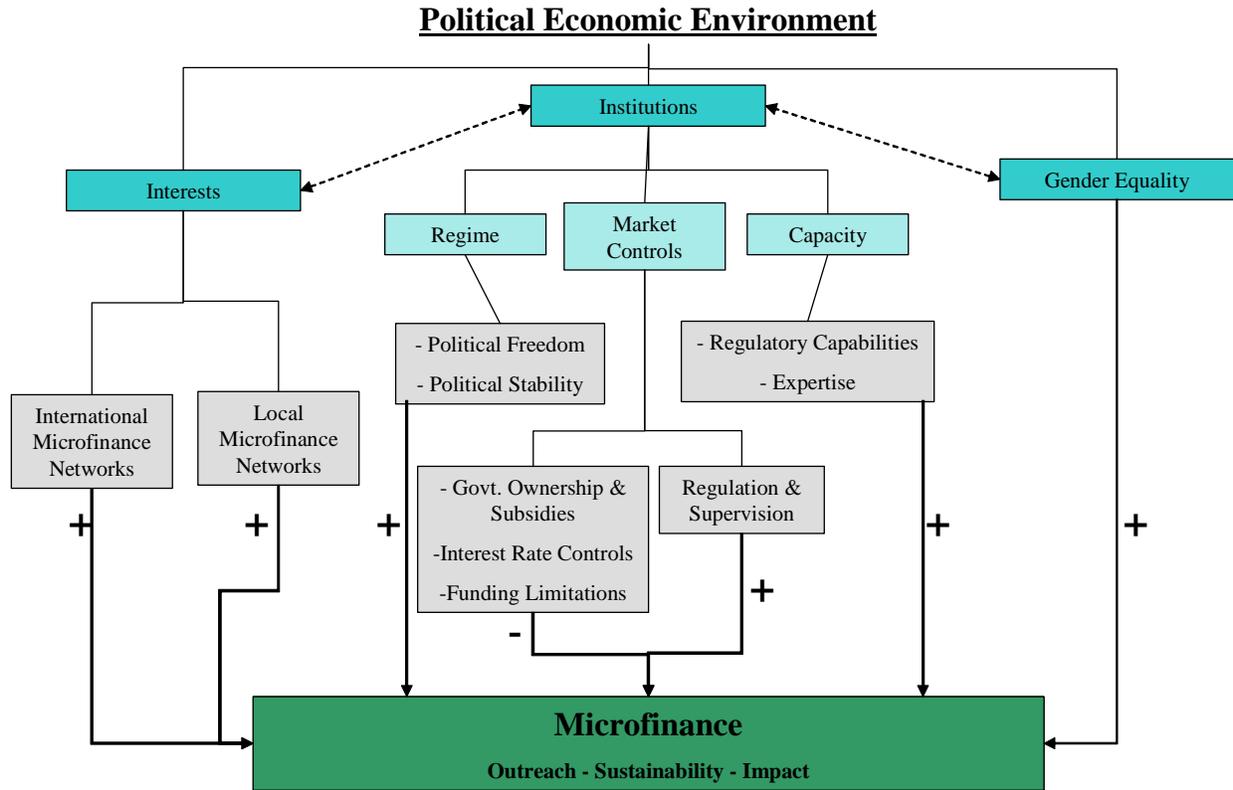
showing that the historical and rational-choice views are both compatible and necessary for a more complete understanding.

I conceptualize the very broad independent variable of “institutions” according to three components: the regime itself, the degree of state intervention, and the capacity of government institutions. First, despite the ability of microfinance institutions to adapt to adverse environments, it is hypothesized that both political freedom and stability will have a positive impact on microfinance success. Furthermore, the extent to which a government has the capacity to effectively implement policies that might affect that industry will also have a positive impact. Finally, achieving an optimum balance of state intervention is perhaps most important. Specifically, while regulation and supervision can have a positive effect on MFIs, excessive government ownership and controls (over interest rates for example) and policies that limit sources of funds available to MFIs can have a negative effect.

Against this framework, the analysis also tests major alternative explanations which can also be said to influence microfinance. First, given the emphasis on women as clients, and the prevalence of gender discussions in the microfinance literature, this cannot be ignored. The subsequent analysis therefore considers the possibility that broader trends of gender equality might also have a positive effect on microfinance. In addition, the presence of international, regional and local networks of MFIs should be taken into consideration. The interests of international networks and other involved aid agencies and NGOs often manifest themselves in capital flows and transference of best practices, and can therefore have a positive impact on microfinance. Likewise, the presence of local networks and practitioner associations allow MFIs to organize and promote their interests at the national level. The model below provides a visual

representation of the more specific operationalizations of each variable and the hypothesized relationship to microfinance success.

**Figure 2.1 - Theoretical Model**



While gender equality and the pressures of organized interest might indeed have a direct impact on the success of microfinance, they must also operate through the institutional environment themselves. Thus the central research hypothesis is that it is primarily the institutional environment which shapes the political economy of microfinance. I further argue that the success of microfinance as a tool for development is primarily determined by a market-enhancing institutional environment where effective state institutions provide an appropriate regulatory framework. To test this, the analysis utilizes both quantitative and qualitative assessment to consider the relationship between the measures of microfinance success and each

of operationalized components of regime, state interventions, and capacity against the relationships between interests and gender equality. A review of the political economic literature provides the foundation for this theoretical framework and the hypotheses that have been presented here.

### **Alternative Explanations**

#### *Gender*

Of the many constructivist approaches which might be applied to a political economic theory of microfinance, the most relevant is the gender-based perspective. Indeed, there are countless examples of feminist literature which addresses the phenomenon of microfinance. While other approaches are considered below, such as cultural explanations and the role of international norms, these do much less to provide strong explanations for how grassroots level microfinance efforts are tied to the national political environment.

Culturally deterministic explanations for underdevelopment have long persisted (Weber 1930; Landes 1998; Pye and Verba 1965; Hofstede 1980; Inglehart 1997). In fact the culturalist arguments were perhaps among the first to link entrepreneurship with development. Most notably are those, following Weber's lead, who argue that some cultures are predisposed to a particular work ethic and entrepreneurial traits (Hofstede 1980; Landes 1998; McClelland 1961; Weber 1930). Yet this approach is not particularly helpful in developing a political economic theory of microfinance, particularly when one considers that microfinance has succeeded across a wide range of culturally disparate areas. Furthermore, as Hernando de Soto (2000) has insisted, despite long-held popular beliefs, the poor everywhere are quite capable of entrepreneurial skill – an idea upon which the microfinance movement around the world has

been founded. Carl Scramm (2004) has argued against fatalistic cultural arguments, asserting that culture can change as incentives and conditions change and that developing countries would do well to follow the U.S. system which actively encourages entrepreneurship through proactive policies. If we are to be equitable and assume that there is no shortage of creativity and enterprising spirit in any group of people, then the usefulness of this approach for our purposes here is questionable. Likewise, though some have pointed to cultural practices and social norms, such as the involvement of village leaders or agents, to explain high rates of repayment in microfinance organizations (Arsyad 2006; Fuentes 1996), repayment rates are notably high for microfinance throughout the world. Even this fails to provide a complete picture.

Microfinance might even be considered to be influenced by the development of international norms. For example, such constructivist approaches have explained support for development efforts in terms of broader notions of humanitarian conviction and altruism (Lumsdaine 1993; Monroe 1996). The role of international organizations also becomes important for spreading ideas about sustainable development norms (Park 2007) or global financial regulation (Porter 2002). Microfinance has also been placed by some into this context. Heloise Weber (2004) for example, has argued the push for microfinance is “strategically embedded” in the push for neoliberal restructuring. Likewise, Rankin (2001) holds that the microfinance industry can be seen in light of a shift in “development rationality”, from state-centric to self-help ideas. Hossain (2007) sees a norm shift from a view of women as “destitute mothers in need of public support to grassroots entrepreneurs” (9). All of these help to explain the growth and spread of microfinance, but not necessarily its success. Another constructivist view might be found by applying Finnemore and Sikkink’s (1998) framework in which figures like Muhammad Yunus, founder of Bangladesh’s Grameen Bank, might be viewed as a “Norm

Entrepreneur” whose “platform” of microfinance as a tool for development has gained support from both international governmental and non-governmental organizations and thus evolved as an international norm. This might then explain microfinance success in terms of the degree to which states have embraced and encouraged microfinance as an international norm. Even this approach, however, does not fully explain the links between the success of microfinance institutions and the larger political environment.

The cultural practices and norms that are perhaps most relevant to a political economic theory of microfinance would be the influence of gender norms or ideas. Given its emphasis on providing credit to women, gender related studies may provide unique insight. Feminist studies have considered the unique contributions of women to development and therefore development efforts must correct for gender biases (Boserup 1970). Others have argued that attention to the role of women in local community development projects must be matched with changes in policy which correct for discrimination (Hunt 2004; Moser 1993). VanStaveran (2001) has found that gender biases in financial systems reinforce inequalities and can even have a negative impact on the larger economy. Lending credence to microfinance’s focus on women, Marlow and Patton (2005) found that even in developed countries such as the United States and Britain, female entrepreneurs are negatively impacted by discrimination in terms of initial financing for their ventures.

Since microfinance efforts generally have targeted women, it could be argued from this perspective then that the most successful efforts have been matched with gender-focused reforms which come from the top-down. Thus, those who are critical of the ability of microfinance to automatically empower women will be justified in a more feminist explanation of its success. Perhaps MFIs will be most successful at empowering women if they truly operate as alternative

financial institutions, incorporating feminist economic theories rather than replicating existing banking systems (as argued by Kidder 1999). That is, microfinance will only be successful in empowering female clients if there are sufficient norms or practices in place that provide for empowerment in a broader socio-economic and political context. However, this explains only a very specific aspect of the link between grassroots development and the macro political environment.

### *Interests*

As economic institutions, there is an easy tendency to consider MFIs as purely rational economic actors seeking to maximize their interests. The rational choice literature is dominated by economists but has also found much application in political science (Becker 1978; Downs 1957; Dunleavy 1991; Tsebelis 1990). Certainly the rational-choice literature has played an important role in explaining efficiency of markets and larger trends of development, disparities in wealth and even the decision-making of the poor. However, the context for microfinance is much more complex. Were it simply a matter of supply and demand, there would not be widespread, unbanked populations. Nor do Marxist explanations of financial exclusion help to explain disparities across the periphery. The interests that *do* matter for this framework are the organized interests of microfinance and related groups. That is, the extent to which national microfinance industries are shaped by international pressures and organized local interest groups.

Classical and neoliberal economics explain growth in terms of open markets (Hayek 1944; Lal 2008). Likewise, this logic is often applied to financial markets<sup>1</sup> and the efficiency of markets for creating new businesses. Rational-choice approaches have also been used to

---

<sup>1</sup> Though in light of the recent global financial crisis, it is likely that these ideas will be increasingly questioned.

highlight the unique situation of the “optimizing peasant.”<sup>2</sup> However, if it were simply rational MFIs seeking to meet demand, one would expect microcredit to be available anywhere it was needed, and this is certainly not the case. Often, too MFIs are not in fact considered to be purely rational actors; indeed it can actually be irrational and even unprofitable to lend to the poor (Arun 2005; Christen et al. 2004; Khandker et al. 1994; Morduch 1999). So while money should flow from rich investors to poor consumers, this is not the case because of the risks involved (deAghion and Morduch 2005). The assumption about rational economic actors and individual optimization is important, but as Mancur Olsen (1996) has pointed out, “it is not enough by itself” (22). More to the point of the larger question, this kind of rational choice model based on personal interests does not account for the larger macro-political environment at all and therefore does little toward reconciling this with grassroots development efforts.

Marxist and Dependency Theory frameworks which place primacy on the role of competing interest and class groups are helpful in explaining why the poor are excluded from financial systems, but still do not provide a complete picture. Dependency theorists take their cue from Lenin’s notions of imperialism and view the problems of underdevelopment as the result of dependency on the already industrialized world (Cardoso and Faletto 1979; DosSantos 1970; Lenin 1920). Yet it is not particularly constructive to our theory to simply blame the problems of the developing world on the industrialized, wealthier nations. It does little to explain important variations between developing countries and it becomes difficult to place microfinance into this framework. The matter of who controls wealth and capital however does become relevant to the structure and dynamics of the larger financial system. A Marxist

---

<sup>2</sup> According to Lipton’s thesis, without the prospect of new factors of production (i.e. irrigation, education), poor farmers will tend to be risk-averse, maintaining traditional methods that have worked (Lipton 1968). Popkin (1979) later expands on the idea of the “rational peasant” by pointing out that, although risk-averse, they are capable and likely to make investments.

perspective views the SME sector as handicapped compared to larger, more powerful concentrations of wealth and, as Friedman (1992) argues, local grassroots development is constrained by “global economic forces, structures of unequal wealth, and hostile class alliances” (vii). It would follow that the need for microfinance as a correction for wealth concentrations inherent in capitalist economic systems. Still, while this approach may be useful in helping to explain why the poor are excluded from financial systems, it is reasonable to acknowledge that there must be other factors besides simply the oppressive interests of big capital at work. Moreover, microfinance institutions have by no means saturated the financial markets for the poor and do not present a serious threat to larger financial or industrial interests.

Most relevant to the framework utilized here, then, are not just the rational interests of microfinance institutions as economic actors, but how those interests are being organized. Drawing from Olsen’s logic of collective action (Olsen 1965), it is valuable to consider how the dialogue between microfinance institutions or groups and the national government have shaped the environment in which these organizations operate, as Titus (2000) explored in the case of India. Within this framework, for example, the regulations which impact financial institutions and small businesses have been viewed as being determined by pressure groups (Berry 1982). Interest group theories also explain the relative success of development efforts as the balance of international donor pressures and the national government’s efforts to meet local interests (Hossain 2007). The growth of the microfinance industry throughout the world has led to the creation of various local, regional and international microfinance association and networks.

Thus it also becomes important to distinguish between international and local interests, as Frieden and Lake distinguished between societal influences at the domestic level verses those present at the international level (Frieden and Lake 2000). That is, global factors such as

technology, multinational corporations, and private international finance transactions can be significant influences (Frieden and Lake 2000; Strange 2000). The attraction of foreign direct investment is an important element not only to both international economic relations and development, but even to microfinance operations. Other international organizations which offer technical assistance and support also present potential influence, particularly in so far as they are located in the more developed countries (Obanyan 2007). With the microfinance movement's growing voice in a globalizing world, it is easy to see how the influence of international capital and the support of both local and international NGOs and businesses might be critical to its success.

### **Why Institutions Matter**

As discussed in the previous sections, gender certainly remains important to our understanding of a political economic theory of microfinance, but it explains only a very specific part of the picture. After all, the problem of financial access is common to poor men and women. In addition, local and international organized interests play an important role in the field of microfinance and cannot be ignored. Yet still the framework is incomplete. Most critically, insofar as gender and interests matter, they must also operate through political institutions. The state therefore remains most critical to explaining the success of microfinance because it shapes the rules of the game in which these institutions operate.

### *Regime*

A focus on institutions leads naturally to the analysis of the relationship between regime type and economic development. As microfinance is a tool for development, it is quite relevant to explore the connections. While much research has centered on the correlation between

democracy and economic growth, the findings are quite mixed. There are the proponents of Modernization Theory, who assert that economic development leads, or at the very least, contributes to democratization (Barro 2000; Lipset 1981). Others hold that while economic growth does not necessarily lead to democracy, it is necessary for its survival over time (Przeworski and al 1996). Yet there is also a rich literature which consider the opposite causal relationship, that the type of regime is a determinant of the level of growth achieved (Gupta et al. 1998; Quinn and Woolley 2001; Scully 1988). The case of China, which has achieved remarkable strides in its economic development while continuing to limit political freedom stands out as an important counterpoint however. This disparity, which has also been a question regarding the Newly-Industrialized Countries of East Asia, led Chan to distinguish between political and economic freedom in her conception of democracy (Chan 2002). Thus while political freedom may be an important factors, it may be less important than other institutional aspects.

Certainly when it comes to some development projects, it is not the straightforward relationship one might expect. Hossain (2007) found that in the case of Bangladesh, the authoritarian regime was in fact quite supportive of the Vulnerable Group Development Programme, initiated in 1974 and targeted at the poorest women. The program benefited from the regimes insulation from other competing demands, the regimes efforts to gain support, and a need to pursue alternative development programs given a lack of international aid. Similarly and especially given its propensity to exist in unfavorable environments, regime appears not to be of vital concern for microfinance either. In one of the few mentions of this concern, Hulme and Mosley (1996) simply warn in their book *Finance Against Poverty*:

...under both democratic and authoritarian conditions innovative financial institutions have to consider not only the influence of (and their relationship with) those who hold

state power, but also of those who, by fair or foul means, seek to hold power in the future (the opposition). (143)

Perhaps more important to consider, then, is not just political freedom but also political stability. That is, the stability of the regime itself as a separate consideration than the stability of democracy. Bates (2001), for example, has argued that the taming of violence is critical to both political and economic development. Others have qualified the relationship between democracy and economic growth by considering the extent to which antidemocratic events tend to create economic volatility, while democratic regimes tend to be more stable over time and are thus more conducive to growth (Gupta et al. 1998; Quinn and Wolley 2001; Roll and Talbott 2003). On the other hand, arguments that authoritarian regimes can be effective at promoting development can be said to stem from the degree of stability they are capable of maintaining.

One might also consider discussions of strong states versus weak states and the connection here to state capacity as well (Migdal 1988; Nordlinger 1987). Staudt (1991) has argued that for development projects, a serious consideration of the state context must extend beyond the regime itself to factors such as the strength of the state and its stability, citing a study by Bossert (1983). Here it is argued that the ability of the government, regardless of regime type, to maintain stability is an important consideration.

### *State Interventions & Market Control*

Institutionalist views of economic growth and development also focus on the loaded question of how and to what degree the state should be involved in the markets. On the one hand, businesses flourish and stimulate growth in an environment of economic freedoms and minimal government interference. On the other, they must be provided with some kind of regulatory support system. As Lindblom has pointed out, even the most market-oriented private

enterprise systems are not in fact predominantly based on market forces (Lindblom 1965). That is, the state plays a large role as purchaser, coordinator and economic administrator. In fact, Schonfield distinguished “modern” capitalism as being characterized by increased government involvement in terms of economic planning, providing social welfare and taming the markets through regulation and controls (Schonfield 1965).

Thus a political economic theory of microfinance must consider this question of the balance of state involvement. The debate over how much involvement has been particularly salient in the development literature for over a half century.<sup>3</sup> Yet in the debate between a heavy handed development state and a hands-off neoclassical approach, there is also a moderate view which is helpful to the framework here. Gilpin has recommended that a “compromise must be found somewhere between the two extremes of abandonment of neoliberalism and total reliance on the market” (Gilpin 2001). According to Bates, economic development results when the state creates incentives which make it in the private interest to behave in ways that enhance collective welfare (Bates 2001). So while the development debate has traditionally set the state against the market, the moderate view is that the two should actually complement one another (Rapley 2002; Vogel 2008). State interventions may be necessary, but should enhance and not repress the market.

How then to assess the balance between not enough involvement and too much? There is certainly much in the literature to support the notion of maximizing economic freedom.

Economic freedom and openness often works to the advantage of entrepreneurs and even the

---

<sup>3</sup> The post-World War II era saw considerable emphasis on state-led development, emphasizing policies like import-substitution. Explanations of successful industrialization have also cited how financial systems and the organization of capital have often been influenced by heavy-handed state efforts to direct industrialization such as the keiretsu model in Japan (Gilpin 2001) or the close relationship between banks and major firms during Germany’s industrialization (Hall 1986). The push for state-directed development gave way in the face of the economic woes of the 1970s, responding with neoliberal calls for structural adjustment and government non-intervention. More recently, the Asian Tigers were lauded for their successful model of state-directed development, only to be met with more neoliberal reforms after the Asian Financial Crisis.

day-to-day operation of general small businesses (Kreft and Sobel 2005). One study even found that encouraging economic freedom was more effective than state attempts to specifically encourage entrepreneurship, arguing that “the most effective activities for governments are to facilitate dynamic markets, develop workforce skills, and stand back” (Begley et al. 2005, 51). In finance too, freedom has its merits. Policies such as interest-rate ceilings, subsidized credit and different tax structures are often designed to target certain industries and firms and provide low-cost capital to spur development. However well-intentioned they may be, these policies also created the equivalent of financial repression, distorting financial markets and creating inefficiencies (Ledgerwood 1999). This is particularly hard on small scale entrepreneurs who are more likely to lack collateral, credit history and connections and therefore find it even more difficult to overcome the information asymmetries, high transaction costs and contract enforcement deficiencies which characterize these countries (Beck et al. 2005).

For the microfinance industry, freedom from market controls has been more of a happy accident. In many cases, MFIs have not been considered to be part of the mainstream financial system and so are treated with a kind of “benign neglect” (Christen et al. 2004). Hatarska’s (2005) study of microfinance in Eastern Europe for example found that audit, rating and supervision by central bank authorities played a limited role. Rhyne and Otero’s (2006) study of Bolivia points out that the state’s “main contribution to the industry was to stay out of the way by closing state banks and avoiding directives” (206) as opposed to the alternative where efforts to define regulations for microfinance risk stifling innovation. A 2008 study addresses this issue more specifically, pointing out that although MFIs operate primarily in countries with a relatively low degree of economic freedom, programs are more successful when there is a greater level (Crabb 2008). Specifically, the author found that countries with high levels of government

ownership and more intervention in the banking industry had less successful MFIs. They were less efficient and less likely to reach sustainable levels.

Economic freedom is not simply the absence of state intervention in the economy however; it includes the promotion of good policies and avoidance of bad ones. Well-designed policies can encourage investors to take risks and support small businesses.<sup>4</sup> Often in the developing world, burdensome policies and regulations serve more to hinder than encourage entrepreneurs and small businesses. A study of Ghanaian entrepreneurs found that overall, the regime at the time was perceived to be “intrinsically antagonistic” to private business, and even displayed apprehensiveness toward private economic activity (Aponsah 2000). Throughout the developing world, the biggest problem seems to be that policy is either lacking or too complex, in many cases compounded by excessive, overworked or even corrupt bureaucracy. Property rights, licensing, contract enforcement and taxation are recurring themes (Chu et al. 2007; Fjeldstad et al. 2006; Kiggundu 2002; Ledgerwood 1999). The emphasis on well-protected property rights in particular is part of a strong tradition in the literature on political economy (Bryant 1998; DeSoto 2000; North 1990). The lack of sufficient legal frameworks can create a challenging playing field for SMEs, not to mention the financial institutions that serve them. As one article on microfinance put it: “We now understand that the entrepreneurs were there all along. What they need is an institutional environment that will allow them to play their part in the development process” (Chamlee-Wright 2005, 5).

In finance, even where structural adjustment policies have included the abandonment of interest rate controls and selective credit allocation policies are discouraged, there remains an emphasis on prudential regulation which focuses on stability and protecting depositors (Arun

---

<sup>4</sup> Examples of policies which facilitate the environment for entrepreneurship and small businesses include straightforward licensing regulations, bankruptcy laws which make it easy to shut down unsuccessful businesses and open new ones (Peng et al. 2008), and policies which make it easier to both hire and fire employees.

2004). Even the most successful economies still have highly regulated financial markets, but these regulations are intended to “ensure fair competition, protect consumers, provide for the safety and soundness of financial institutions, and ensure that underserved groups have access to capital” (Stiglitz and Squire 2000, 389). In fact, it has been found that these same regulations:

1. force accurate information disclosure
2. empower private-sector corporate control of banks, and
3. foster incentives for private agents to exert corporate control

also serve best to promote bank development, performance and stability (Barth et al. 2004, 245).

The presence of credit bureaus and protection of borrower and investor/creditor rights are also considered key elements of a highly developed and transparent financial system.<sup>5</sup> Specifically, the kinds of assurances associated with better developed financial intermediaries include effective contract enforcement and comprehensive and accurate financial reporting (Levine 1999).

The right balance of regulation and freedom from excessive market controls in the broader financial system has often been cited in the microfinance literature.<sup>6</sup> Many of the policy areas discussed above have direct applications to MFI operations. Brigit Helms of CGAP points out that a favorable policy environment allows a range of financial service providers to compete in offering high quality, low-cost services to poor clients (Helms 2006). A common assumption is that the general independence of the financial industry from political influence ensures a conducive environment for the development of the microfinance industry (Caracciolo and Buss 2001; Hassan and Renteria-Guerrero 1997; Mahajan and Ramola 1996). More specifically is the

---

<sup>5</sup> Credit bureaus or registries offer a clearinghouse of information, which allow financial institutions to assess the credit-worthiness of potential clients. In addition to the presence of private credit registries, better creditor rights are associated with both wealthier countries overall and a higher ratio of private credit to GDP (Djankov et al. 2007).

<sup>6</sup> Many articles and reports offer very specific policy and regulation recommendations for the microfinance industry (Barry 1995; Campion 2002; Caracciolo and Buss 2001; Chaves and Gonzalez-Vega 1994; Counts and Sobhan 2001; Hardy et al. 2003; Helms 2006; McGuire et al. 1998; Rock and Otero 1997), but most remains quite normative in nature.

reduction of interest rate controls (Caracciolo and Buss 2001; deAghion and Morduch 2005; Helms 2006; Ledgerwood 1999). This is particularly important for microfinance organizations which assume the risks associated with lending to the poor and must seek to cover costs. Likewise, it has also been pointed out that improvements in the legal framework for microfinance also help the performance of the wider financial system (Honohan 2004a). For example, easier and cheaper access to reliable personal credit information and contract enforcement also make it easier for financial institutions to extend outreach to the poor (deAghion and Morduch 2005). It is from these themes specifically from which the operationalization of market controls stems.

As mentioned earlier, many microfinance institutions continue to operate in the informal sector, and have therefore not been subject to any regulations at all.<sup>7</sup> While some hold that MFIs should maintain their informal status if this allows them to avoid a repressive policy environment (Seibel 2001), the consensus seems to be that microfinance would also benefit from prudential regulation which seeks to protect both depositors and creditors. That is, while burdensome regulation would certainly be a problem, it would be appropriate to maintain minimum performance and reporting standards. Although microfinance might not seem to represent a large enough segment of the financial sector (in terms of assets) to warrant regulator's attention, in many developing countries MFIs play a very substantial role in terms of the large number of clients and the impact they may have on the larger financial system (Arun 2005; Christen et al. 2004; Gallardo 2002). A report by the Asian Development Bank observed that the central banks

---

<sup>7</sup> The question is often posed whether MFIs cannot simply be placed under the jurisdiction of existing supervisory structures. The consensus seems to be that the nature of the clientele and small-scale operations creates different risks and therefore requires a unique regulatory framework (Counts and Sobhan 2001; Cuevas 1996; Jansson and Wenner 1997; Kirkpatrick and Maimbo 2002; Ledgerwood 1999; McGuire et al. 1998; Vogel 1994). A tiered approach has been recommended, allowing for MFIs to follow a lesser set of regulations rather than the full regulatory requirements of banks (Gallardo 2002; Meagher 2002).

of many developing countries have taken an interest in devising ways to encourage microfinance and recommends that central banks take the lead in determining regulation practices (McGuire and Conroy 2000).

Freedom from government interference, where it has meant a legally ambiguous position,<sup>8</sup> has actually proven detrimental for microfinance, namely in that it prevents MFIs from collecting savings (and in some cases accessing foreign capital) and thus becoming more self-sustainable institutions. There is general agreement that financial institutions should only be regulated if they accept deposits (Christen and Rosenberg 2000; Cracknell 2000; Kirkpatrick and Maimbo 2002; Ledgerwood 1999). However, this has in many cases created a catch-22, wherein MFIs are prevented from accepting deposits for the very reason that they are not considered to be a regulated financial institution (Arun 2004). Because they are not considered financial institutions, they tend to be more likely to be dependent on donor funds and find it difficult to scale up operations (Yunus 2004; Arun 2005). Additionally, they fail to provide a very basic and needed service: access to a safe, interest-bearing account to grow savings (Holt and Ribe 1991). Access to better savings as well as credit are deemed equally important in providing access to financial services to the poor (deAghion and Morduch 2005). Commercialization or transformation from informal institution or NGO to a deposit-taking financial institution is often impossible within the current framework (Campion 2002; Sriram and Upadhyayula 2004), though the process has been facilitated in Ghana and the Phillipines for example (Gallardo 2002). Thus the literature presents a reasonable framework for assuming that while market

---

<sup>8</sup> It should be noted that some states have in fact made efforts to legitimize the work of MFIs and to set up regulatory schemes specific to their microfinance industry. For example, Nepal recently implemented a Microfinance Policy and its regulatory framework includes licensing for microfinance specific institutions. In South Africa, microfinance was legalized in 1992 under an exemption to the Usury Act (Daniels 2004). However, information on existing microfinance regulation is still difficult to compare. CGAP has initiated efforts to this end, maintaining a Comparative Database on Microfinance Regulation and Supervision with information on fifty different countries.

freedoms limit undue costs and increase efficiency, some legal framework is necessary to ensure the interests of clients are protected and financial standards are met.

### *Capacity*

The consistent pursuit of any policy, even market friendly ones, requires effective institutions. Increasingly in the literature, the capacity of the state is being recognized as a critical factor in assessing the problems of underdevelopment (Chaudhry 2008; Kohli 2004; Stiglitz and Squire 2000). Thus for the political economy of microfinance it is not enough to assess the institutions which are in place, but also their effectiveness. As Evans has pointed out, however, state capacity to perform administrative and other functions is a scarce good, often growing more slowly than tasks expand. In fact, in the developing world, states are required to do much more than they are really capable of doing (Evans 1992). The problem faced by many developing countries is that neoliberal austerity recommendations have resulted in “emaciated states with demoralized civil services, reduced political legitimacy and capacity, and encouraged the brain drain to the North” (Mkandawire 2002). The governments of the lesser developed countries are thus being asked to operate more effectively with even less resources. It would seem then that there is a need to reconstruct these states so that they are capable of sufficiently supporting market-based growth. In respect to the political economy of microfinance, the effectiveness of the institutions that have to potential to impact MFIs (such as the Central Bank and other regulatory bodies) are an important consideration.

Often the legal void in which microfinance operates is a result of this lack of capacity on the part of government institutions. So while there is a strong argument in favor of regulating microfinance, “The most carefully conceived regulations will be useless, or worse, if they can’t be enforced by effective supervision” (Christen and Rosenberg 2000, 2). In his comparison of

regulatory frameworks for microfinance in eleven countries, Staschen (2003) identified the capacity, autonomy and accountability of regulators to be among the primary concerns. Limits in state capacity have hampered efforts to bring MFIs more mainstream and push out competition from informal moneylenders (Tsai 2004). In some cases, the lack of enforcement has enabled “unscrupulous operators” to register as microfinance institutions, taking advantage of clients and undermining the efforts of other MFIs which seek to operate legitimately (McGuire et al. 1998, xvi). Since they are often classified differently than other financial institutions, supervision is often less rigorous and inferior to that applied to commercial banks (Christen et al. 2004). Many central banks do not have a microfinance-specific department in their organization, and financial regulators may not have a proper understanding of the unique qualities of microfinance institutions (Campion 2002; McGuire and Conroy 2000; McGuire et al. 1998). In the developing world, skilled regulators are a scarce resource as it is (Arun 2004; Hardy et al. 2003). Additionally, the cost of supervising additional financial institutions may be prohibitive, not least of all because MFIs tend to be small, numerous and remote (Hardy et al. 2003). Thus it may be reasonable to argue, as one report puts it: “Don’t regulate what you can’t supervise” (Hannig and Katimbo-Mugwanya 2000). Still, how effective a state is in regulating the microfinance sector may have an important role in determining the success of the industry there.

### **Applying the Theoretical Framework**

The preceding review of the literature highlights the specific operationalization of the independent variable by drawing connections from microfinance to the literature on development, entrepreneurship and finance. The Political Economy of Microfinance thus places central importance on institutions; specifically, a consideration for the nature and stability of the

political regime, the presence of relevant policies and regulations (such as interest rate controls and subsidies), and not least of all the capacity of the relevant institutions to implement them. The analysis does not discount the possibility that gender and interests groups may also have a role to play, but argues that the institutional framework is of greater importance to our understanding of the dependent variable, microfinance success. The hypothesis then follows that microfinance success is a function of the political regime, its policies and capacity.

To test this, I make use of both quantitative and qualitative analysis to test the relative effects on indicators of outreach, sustainability and impact of microfinance. In chapter three, I use regression models of cross-national data to test the relative effects of the institutional variables and the alternative explanations of gender equality and the presence of microfinance networks on aggregated outreach data. This cross-sectional look at the relative success of industries in meeting demand presents important empirical results in support of the hypothesis. This is supplemented with a descriptive look at success indicators at the institution level data in chapter four. By comparing microfinance institutions according to their scale, legal and regulatory status, further details on these relationships are fleshed out.

Finally, qualitative comparative analysis of the cases of Sri Lanka and Nepal and interviews with practitioners, associations and regulators allow for a still more detailed look at these connections. While countries like Bangladesh and India provide exceptional examples of important microfinance innovations, Sri Lanka and Nepal are more typical examples of rural, developing countries where microfinance services are in demand. Similarities in terms of location, population, and experiences with conflict allow for a number of important factors to be controlled for so that differences in the relative success of their microfinance industry can be systematically explored.

### III. MODELS OF NATIONAL-LEVEL MICROFINANCE OUTREACH

Few cross-national studies have been done in regards to microfinance. Much of this has to do with the lack of information, but with an increased focus on transparency and more data becoming available, it is an exciting opportunity to test the political economic theory of microfinance and to contribute to what we can know about the industry worldwide. Here, I have constructed a cross-national dataset of 93 countries. Utilizing cross-sectional linear regression analysis and correlations, the following considers the proportion of a country's poor population that has access to microfinance services and tests seven separate hypotheses on the specific role of the political variables. In contrast to measures of gender equality and the presence of microfinance networks, the analysis finds that in keeping with the theoretical framework, it is political institutions which have the strongest influence on this measure of microfinance success. However, the matter of *which* institutions leads to richer and more detailed conclusions than originally hypothesized. Most notably, the level of political freedom and stability proved among the most significant, while measures for market interventions provided a more complicated story.

#### **Measuring Microfinance Success**

As seen in the previous discussions, operationalizing the dependent variable, microfinance success, ideally includes three components: outreach, sustainability and impact. This analysis focuses primarily on outreach as it is difficult to measure sustainability and impact on clients at an aggregate level and to find comparable data across countries. Consideration of these components, then, can be addressed at a different level of analysis – that of the microfinance institutions (MFIs) themselves, and qualitatively in the case studies of Sri Lanka and Nepal.

Assessing the level of outreach, however, provides a particularly useful indicator of what can be accomplished at the national level by a variety of microfinance providers working to meet market demand.

Microfinance data is available through a CGAP initiative known as the MIX Market (Microfinance Information Exchange), a publicly available online database designed to promote transparency and peer review in the microfinance industry (MIX Market 2009b). These data are self-reported by participating MFIs, but go through a comprehensive review process and represent one of the largest sources of microfinance data available. Indeed, although more and more data on microfinance are becoming available, most are self-reported. Therefore, there are a potentially large number of institutions without the capacity or desire to report and which go unaccounted for.<sup>9</sup> Still, current efforts allow for excellent estimates on the number of clients served in each country. When taken as a proportion of the poor population, this provides a useful measure of the extent to which microfinance has been able to saturate the market.

As indicated, for this national-level analysis, the dependent variable ‘outreach’ considers the extent to which the microfinance industry in a country is reaching the target population. That is, the extent to which they are meeting demand. To estimate this, the total number of borrowers and savers per country is derived from data available through the MIX Market (MIX Market 2009b). However, for this level of analysis, measurement of microfinance outreach must be comparable across countries with disparate populations and levels of development – and, ideally, indicate the extent to which these institutions are meeting demand. Since demand for these services is difficult to measure, I will instead estimate the extent to which MFIs in each country

---

<sup>9</sup> It should also be noted that similar information on commercial banks is often hard to come by, making comparisons with the microfinance industry difficult (Christen et al. 2004).

are reaching their targeted population by using the ratio of borrowers and savers to the poor population.

The poor population is estimated in two ways utilizing data available from the United Nations Development Program's (UNDP) Human Development Report (2008): the population living below the poverty line and below \$1.25 per day. Depth of outreach will also be estimated using the ratio of poor clients to total clients, as reported by the Global Microcredit Summit Campaign (Daley-Harris 2006, 2007). That is, the extent to which the poorest of the poor are being reached. The poverty line threshold provides a more general view of the population most likely in demand of microfinance services. The \$1.25 per day threshold refers to one of the central goals of the Microfinance Summit Campaign: to lift the world's poorest families above the US\$1/day threshold (Daley-Harris and Awimbo 2006). It is important to note, however, that not all institutions report statistics on the income status of clients, or indeed are able to calculate them. Results therefore may be affected by the selective nature of reporting.

Finally, to account for the focus on women as clients, the analysis will also consider outreach to women. This is calculated as the total number of female borrowers reported per country divided by the total number of borrowers (MIX Market 2009b).

### **The Political Economic Environment**

The political economic environment for microfinance is operationalized according to variables for the relative effects of the regime, market interventions, and government capacity on the one hand, and the alternative explanations of gender and interests on the other. Estimating these political variables is of course an inexact science. However, this study has brought together a rich set of well known and widely used measures from leading studies and international organizations. These represent some of the most reliable and accurate measures available.

## *Institutions*

In keeping with the theoretical framework, the institutional effects of the state are operationalized into three components: the regime itself, market interventions, and capacity. The regime component is broken down into political freedom and stability. The political freedom rating comes from the score assigned by the Freedom House organization, recoded so that higher valued scores represent more freedom (Freedom House 2007). Political stability is measured utilizing the World Bank's governance indicators (Kaufmann et al. 2008).<sup>10</sup> This measure was originally designed on a scale of -2.5 to 2.5, with higher scores indicating better governance. For ease of interpretation, this measure has also been recoded to be on a scale of 0 to 5.

A number of specific market interventions are considered, including the degree of government ownership and involvement in the financial sector, the degree to which funding opportunities are limited, and the nature of regulation. Government involvement in financial markets is measured using one of the Heritage Foundation's Economic Freedom indicators,<sup>11</sup> Financial Freedom, which rates countries on a 100 point scale, with higher scores indicating higher levels of freedom (less government interference) (Miller and Holmes 2009). Likewise, limitations on funding opportunities are measured according to the Investment Freedom indicator, which rates countries on the same scale according to limitations placed on capital flows, and particularly international investments.

The analysis takes into consideration not just freedom from government involvement but also the presence of good policies and the quality of regulation generally applied to markets.

---

<sup>10</sup> These indicators are based on compiled survey data from enterprise, citizen and expert respondents, as reported by a series of survey institutes, think tanks, non-governmental organizations, and international organizations.

<sup>11</sup> This conservative think tank's report rates countries on a 100 point scale in ten different areas: business freedom, trade freedom, fiscal freedom, government size, monetary freedom, investment freedom, financial freedom, property rights, freedom from corruption, and labor freedom. While the source implies some possibility of bias, the ultimate measure – of less government involvement in these areas – serves the purposes of this operationalization well.

This is measured here using the Regulatory Quality governance indicator, again from the World Bank's study. This measures "the ability of the government to provide sound policies and regulations that enable and promote private sector development" (Kaufmann et al. 2008). Like the political stability measure, countries are given a score on a continuous scale of 0-5, with higher scores indicating better quality regulation.

Expanding on the market interventions component, data from the World Bank's Doing Business Report (World Bank 2006, 2007)<sup>12</sup> estimate the effect from specific policy areas, namely: credit, starting a business, contract enforcement and taxes. Logically, one would expect a strong relationship between the overall policy environment which determines access to credit and success of microfinance. More broadly, policies which affect the ease of starting a new business speak directly to the institutional environment for entrepreneurship – and one of the goals of microfinance. By considering the effect of contract enforcement, we can the extent to which the microfinance framework has successfully addressed issues in this area and test assertions put forward in the literature. Finally, testing the relationship to tax policies will provide a sense of the impact of the financial burden on these institutions, many of which are NGOs and non-profits. Additionally, these measures also account for the amount of red tape involved with different practices in terms of the number of procedures and time involved, and therefore speak to government effectiveness also.

The final component, capacity, is operationalized using another measure from the Worldwide Governance Indicators Project (Kaufmann et al. 2008). The government effectiveness index provides a quantitative measure of the capacity and political independence of

---

<sup>12</sup> This report provides quantitative measures of specific regulations and their enforcement, based on the applicable laws, regulations, and fee schedules for each country in the study. It also makes use of written surveys of legal practitioners and professionals.

the civil service in each country. It has also been recoded to be on a scale of 0-5, with higher values representing greater effectiveness.

### *Microfinance Networks*

To capture the influence of organized microfinance interests, the country-level assessment takes into consideration the presence of organized microfinance networks operating in the country. Network activities can include financial and technical services, research and development and policy advocacy. Two indicators are used. The first considers the number of international networks operating in that country. The other is a dummy variable that indicates whether or not there is a locally based microfinance network operating from that country. These indicators were developed utilizing data from the MIX Market (MIX Market 2009c).

### *Gender Equality*

The measure used to group institutions according to the degree of gender equality in the country is the Gender Empowerment Measure (GEM) available through the UNDP's Human Development Report (UNDP 2008). This index is measured on a continuous scale of 0-1 and based on a series of indicators measuring women's relative economic and political participation. For example, one component of this measure is the percent of female professionals in the workforce. At first glance, this may actually seem to be a more specific and valid measure to estimate the effect of gender equality on the dependent variable. However, this measure does not necessarily account for women in the informal sector – the very segment which microfinance serves. It should be noted that this index is not available for all countries and therefore not all institutions in the dataset will have this variable available.

### *Control*

Because microfinance has been applied in a wide variety of countries of varying levels of development, this will be controlled for in the analysis. Development is estimated utilizing the country's gross national income (GNI) per capita (World Bank 2009).

### **Modeling the Political Economy of Microfinance**

These indicators have been compiled into a single dataset. The analysis utilizes data for year-end 2005 and year-end 2006, controlling for the year. This allowed for a larger sample size totaling 155, weighted for population. These years were selected based on the completeness of the information available across variables. Valid samples for the different tests do vary, due to the availability of data on each of the independent variables. In particular, availability of Gender Equality Measures is limited. Thus the actual N for the models ranges from 72-78. Appendices 1 and 2 provide the list of countries in the dataset and descriptive information on each variable.

Linear regression analyses were used to test the relative effects of the institutional variables against the alternative explanatory factors of gender equality and microfinance networks. As the summary data in Appendix 3 attests, there is a great deal of variation in the extent of outreach across countries, with some countries, like Bangladesh, having far more microfinance clients than others. In order to account for this, the outreach measures used here were transformed by taking the square root. Preliminary analysis of the individual variables then suggested that the relationships observed could be expected to be direct. Bivariate relationships between variables can be found in Appendix 4. The regression analyses included robustness checks for collinearity and potential interactions among the independent variables. The model is represented as follows:

$$MF = B_0 + B_1 \textit{ Political Rights} + B_2 \textit{ Political Stability} + B_3 \textit{ Financial Freedom} + B_4 \textit{ Investment Freedom} + B_5 \textit{ Regulatory Quality} + B_6 \textit{ Govt. Effectiveness} + B_7 \textit{ GEM} + B_8 \textit{ Intl. Networks} + B_9 \textit{ Local Networks} + B_{10} \textit{ GNI per capita} + B_{11} \textit{ Year Dummy} + u$$

Based on the theoretical framework and utilizing these models, the central hypothesis being tested is as follows:

H1: The institutional variables will prove to be of greater significance and strength than the variables representing interests and gender equality.

More specifically, the analysis seeks to test the following:

H2: Countries with greater political freedom will have greater microfinance outreach

H3: Countries with greater political stability will have greater microfinance outreach

H4: Countries with greater financial freedom will have greater measures of outreach

H5: Countries with greater investment freedom will have greater measures of outreach

H6: Countries with greater regulatory quality will have greater measures of outreach

H7: Countries with greater government effectiveness will have greater measures of outreach

By testing these hypotheses, the regression analysis demonstrates that the effect from political institutions is stronger and more significant than from the alternative explanations offered.

Furthermore, it allows for more detailed consideration of institutional components relevant to the microfinance industry. Finally, correlation analyses with the Doing Business indicators considered the relationship of certain policy areas to microfinance outreach, in order to further explore the government involvement and capacity variables.

## **Results**

Overall, the results of the quantitative analysis confirmed the first hypothesis. In addition to remarkably strong R-square values, the results indicate strong support for the central hypothesis. Institution variables generally had the highest beta values and levels of significance. Political rights and stability most consistently had the strongest and significant effects, followed closely

by government effectiveness. Financial freedom and regulatory quality were surprisingly not particularly significant across the three models and various indicators of the dependent variable. Networks, both international and local, remain important and were often significant, though rarely had the strongest effect. The results did not however consistently support all of the supplementary hypotheses, and indeed some relationships were the reverse direction as predicted.

GNI per capita was significant in some models, but not all, indicating that the level of development of the country does matter. The dummy variable indicating year was also significant in the majority of cases, suggesting that the results were affected by the year from which the data happened to be drawn. However, where significant, this is likely due to changes in reporting. That is, it may be capturing both an overall increase in the outreach measures as well as additional MFIs reporting. Due to the interrelationships between the independent variables, some degree of collinearity was to be expected. However, robustness checks for collinearity indicated that this was not a significant problem.<sup>13</sup>

Table 3.1 presents the model results for general measures of microfinance outreach as well as outreach among female clients.

---

<sup>13</sup> VIF < 10 for all variables. The highest values were 8.57 for political rights and 9.62 for government effectiveness.

**Table 3.1 - Modeling National Levels of Outreach**

	Borrowers / Population Below Poverty Line		Borrowers / Population Below \$1.25/day		Depositors / Population Below Poverty Line		Depositors / Population Below \$1.25/day		Female Clients / Total Clients	
	<i>b</i>	$\beta$	<i>b</i>	$\beta$	<i>b</i>	$\beta$	<i>b</i>	$\beta$	<i>b</i>	$\beta$
<b><u>Institutional Variables</u></b>										
Political Rights	0.545 *** (0.109)	0.724	0.244 (0.178)	0.244	0.123 *** (0.016)	1.015	0.081 *** (0.019)	0.652	-0.505 * (0.193)	-0.661
Political Stability	1.109 *** (0.229)	0.498	0.969 * (0.374)	0.327	0.131 *** (0.034)	0.364	0.087 * (0.040)	0.237	-1.744 *** (0.404)	-0.772
Financial Freedom	-0.006 (0.012)	-0.043	0.010 (0.020)	0.055	0.000 (0.002)	0.023	0.003 (0.002)	0.126	0.007 (0.021)	0.053
Investment Freedom	-0.023 (0.013)	-0.142	0.000 (0.022)	-0.002	-0.013 *** (0.002)	-0.488	-0.011 *** (0.002)	-0.402	-0.054 * (0.023)	-0.327
Regulatory Quality	1.145 (0.749)	0.190	2.580 * (1.223)	0.322	0.260 * (0.111)	0.267	0.366 ** (0.131)	0.367	-0.426 (1.322)	-0.070
Government Effectiveness	-3.141 *** (0.747)	-0.646	-6.626 *** (1.220)	-1.025	-0.169 (0.111)	-0.215	-0.473 ** (0.131)	-0.588	-0.809 (1.319)	-0.164
<b><u>Alternative Explanations</u></b>										
Gender Empowerment Measure	-0.609 (2.090)	-0.026	8.658 * (3.412)	0.278	-1.473 *** (0.309)	-0.390	-0.366 (0.366)	-0.095	1.208 (3.689)	0.051
Number of Intl. Networks	-0.060 (0.051)	-0.120	0.022 (0.084)	0.034	-0.007 (0.008)	-0.087	0.000 (0.009)	0.001	0.269 ** (0.091)	0.532
Local Network Present (Y/N)	-1.295 ** (0.356)	-0.265	-2.094 ** (0.582)	-0.322	0.025 (0.053)	0.032	-0.088 (0.062)	-0.109	-1.678 ** (0.629)	-0.338
<b><u>Control Variables</u></b>										
GNI per capita	-0.001 *** (0.000)	-0.605	0.000 (0.000)	-0.185	0.000 *** (0.000)	-0.688	-9.17E-05 ** (0.000)	-0.443	0.001 *** (0.000)	1.032
Year Dummy	0.629 ** (0.175)	0.226	0.975 ** (0.286)	0.264	0.101 *** (0.026)	0.225	0.123 *** (0.031)	0.268	-0.302 (0.310)	-0.107
<i>R-Square</i>	0.856		0.763		0.879		0.839		0.565	
<i>Adjusted R-Square</i>	0.829		0.742		0.856		0.808		0.483	
<i>N</i>	77		72		78		74		78	

Notes: Each column presents unstandardized (*b*) and standardized coefficients ( $\beta$ ) for separate OLS regression results. Standard errors are given in parentheses. Variables are weighted by population. Dependent variable values reflect square-root transformation. \*  $p < .05$ ; \*\*  $p < .01$ ; \*\*\*  $p < .001$ .

### *Gender Equality & Networks*

Confirming the central hypothesis, the alternative independent variables of gender equality and the presence of microfinance networks had much weaker explanatory value across multiple measures of outreach. Where significant, they were among the weaker partial effects as measured by the standardized coefficients. The gender equality measure was significant in only two instances. Interestingly, it did not have a significant effect even on female outreach. Where it was significant, it had opposite effects: although it had a positive effect on the depth of borrower outreach, it had a negative effect on general savings outreach. This makes it difficult to draw solid conclusions as to the influence of the broader trends in gender equality on the microfinance industry.

The presence of a local network had a significant effect on both measures of borrower outreach as well as female outreach, though not deposits. However, contrary to expectations, the relationship is actually negative. Countries with a local network actually had fewer borrowers on average. Based on the coefficients, the difference in the transformed ratio of borrowers to poor population was several percentage points. A more detailed look at the role of local microfinance networks and associations are explored in the subsequent chapters, but based on this assessment, they are certainly not a particularly helpful explanation for differences across states.

International networks, though generally not significant, did have a relatively strong effect on female outreach. This suggests that membership in these networks may promote this particular focus of microfinance services. Again, though it is not a sufficient explanation for differences across states.

Neither gender equality nor microfinance networks should be ignored in assessing the success of national levels of outreach. However, the analysis does suggest that it is the

institutional framework which is the more important component in a political economic theory of microfinance.

### *The Political Regime*

Perhaps the more interesting story lies in *which* institutional variables were most significant and the direction these take. Contrary to what was expected, that the various market interventions would be important to understand differences in outreach across countries, it is political rights and stability which had the most consistent effects. Indeed, political rights consistently had the largest beta value for measures of both borrower and depositor outreach. As hypothesized, both these variables had a positive effect on outreach in terms of both borrowers and depositors, general outreach and deeper outreach. The effect is sizable too. Given that outreach in terms of borrowers as a percentage of the population below the poverty line ranges only from 0-32 percent, a change of 1.1 percent in the transformed measure for a one point increase on the political stability scale is considerable. The range for depositor outreach is even smaller, only 0-0.88 percent, thus the coefficients for political rights and political stability (0.123 and 0.131, respectively) are no small effect. Phrased more simply, greater freedom and stability means significantly more people with access to financial services.

On the other hand, although political rights and stability also have strong effects on female outreach, the direction of the relationship is reversed. The negative coefficient indicates that for every one point increase in political stability, for example, the (transformed) proportion of female clients decreases by 1.744 percent. Rather than indicating that women have less access to financial services in freer and more stable regimes, it is more likely that they then have improved access to financial services in general and need not be targeted by MFIs. Under adverse political conditions, it becomes that much more difficult for women to access formal

financial services. Under these circumstances, microfinance institutions become that much more important for targeting women specifically. By all measures of outreach, the strong, significant effects from political rights and stability are impressive. Yet they are still not the whole story.

### *Capacity*

Indeed, not all of the relationships supported the hypotheses in terms of direction. One in particular which was particularly strong, but negative, is the relationship with government effectiveness. On borrower outreach in particular, this has a very considerable impact. For every less point on the government effectiveness scale, there is a 3 percentage point difference in the transformed general outreach variable and over 6 percentage point difference for depth of outreach. This may not be particularly surprising when one considers that it likely has to do with the level of development of the countries under consideration. Developing countries generally have less capacity and are also the same areas with more microfinance demand. Certainly, MFIs are credited with being able to operate in very adverse conditions, including, perhaps, where government institutions are lacking in capacity and effectiveness. However, when contrasted with the positive effects from freedom and stability, it would seem that this is only true up to a point. That is, even with this ability, they certainly can benefit from a stable and open political environment.

### *Market Interventions*

Quite contrary to what was originally theorized, the indicators of market interventions in the regression model had the least explanatory value of the institutional variables. In spite of this, interesting findings do emerge. Financial freedom did not prove at all significant. This could be due to the wide mix of the extent and use of government subsidies – and even

government run programs – in the microfinance sector. Indeed, the fact that the relationship is *not* significant indicates that there is no clear cut answer to the question of government-run or subsidized programs being right or wrong.

Though not a factor for outreach in terms of borrowers, investment freedom had a significant, but negative effect on the measures of depositor outreach as well as female outreach. This particular indicator is meant to capture the extent to which microfinance funding options might be limited. It might be concluded that to the extent that countries with greater investment freedom have increased financial opportunities, there is less demand for microfinance specific institutions. It might also be interpreted to illustrate the need for savings. If a MFI has access to savings deposits, it would be less in need of other investment opportunities such that the Investment Freedom index measure captures. Taken another way, institutions that face restrictions in collecting savings are certainly at a disadvantage.

Regulatory quality also did not have a very strong relationship to outreach. Still the effect is significant and positive. Thus in spite of free market arguments and the notion of benign neglect in the microfinance industry, the industry can benefit from an improved regulatory environment. It is especially interesting to note that greater regulatory quality has a positive effect on depth of outreach in particular. The depth of borrower outreach for example benefits 0.37 percentage point increase for every one point increase in regulatory quality.

While not as significant as the other institutional variables, these findings provide an interesting starting point. It may be because these are very general indicators of market interventions in the economy as a whole, and are therefore perhaps not specific enough to the microfinance sector to have a strong, significant impact. The following section investigates the

relationship to specific policies and practices. Subsequent chapters also provide additional insight into the nature of these relationships.

### *Other Policy Areas*

The World Bank's Doing Business indicators help to further explore government involvement and effectiveness in the economy. It also affords a better understanding of which kinds of regulation are appropriate, namely by allowing us to discount the ones that did not prove significant. This series of measures takes into account various aspects of policies which either help or hinder business operations in each country. The following analysis looks at the strength of correlations between specific policy areas and the various measures of microfinance success (See Table 3.2).

The first aptly considers the relationship between access to credit and the success of microfinance efforts, yet there is actually not as much correlation as one might expect. There is a positive relationship between the strength of borrower and lender legal rights and the various indicators of microfinance outreach, but it is generally weak. The strongest relationship observed is between public credit registry coverage and the measure of poor clients to total clients. Here the negative relationship may speak to the fundamental design aspect of many MFIs to account for lack of credit information on their clients. Interestingly, there is a positive, albeit weak, relationship between private credit bureau coverage and loan outreach. This could indicate that despite their operational design, there is still some benefit to be had from having a central source of credit information.

**Table 3.2 - Correlation Results**

	<b>MFIs</b>	<b>Borrowers / Population Below Poverty Line</b>	<b>Depositors / Population Below Poverty Line</b>	<b>Poor Clients / Total Clients</b>	<b>Borrowers / Population Living Below \$1.25/day</b>	<b>Depositors / Population Living Below \$1.25/day</b>	<b>Female Clients / Total Clients</b>
<b><u>Getting Credit</u></b>							
Strength of Borrower and Lender Legal Rights	.395(**) 156	.180(*) 149	-0.019 152	.246(**) 134	0.127 135	0.013 141	.215(**) 156
Depth of Credit Information Index	-0.096 155	0.048 149	-0.052 152	-.293(**) 134	0.080 135	-0.061 141	-0.025 155
Public Credit Registry Coverage	-.352(**) 155	-0.053 149	0.016 152	-.626(**) 134	0.051 135	0.019 141	-0.144 155
Private Credit Bureau Coverage	-0.095 154	.202(*) 148	-0.005 151	-0.167 132	.201(*) 134	-0.036 140	-0.048 154
<b><u>Starting a Business</u></b>							
Number of Procedures to Start Business	-0.152 155	-.238(**) 149	-0.110 152	-.369(**) 134	-.248(**) 135	-0.116 141	-0.125 155
Time Required to Start Business (days)	0.107 155	.296(**) 149	.425(**) 152	-.450(**) 134	.249(**) 135	.412(**) 141	0.007 155
Cost to Start Business (% of income per capita, excludes bribes)	.271(**) 155	.197(*) 149	.225(**) 152	0.130 134	0.075 135	.208(*) 141	.252(**) 155
Minimum Capital Requirement to Start Business (% of income per capita)	-.359(**) 155	-.316(**) 149	-.192(*) 152	0.118 134	-.291(**) 135	-.201(*) 141	-.200(*) 155
<b><u>Contract Enforcement</u></b>							
Number of Contract Enforcement Procedures	.671(**) 155	.206(*) 149	-0.009 152	.349(**) 134	0.132 135	-0.013 141	.471(**) 155
Time Required for Contract Enforcement (days)	.838(**) 155	.247(**) 149	0.018 152	.395(**) 134	0.133 135	0.027 141	.601(**) 155
Cost Required for Contract Enforcement (% of claim)	.306(**) 155	.535(**) 149	.775(**) 152	-.251(**) 134	.337(**) 135	.714(**) 141	0.102 155
<b><u>Taxes</u></b>							
Total Number of Tax Payments (annual)	.484(**) 156	-0.091 149	0.070 152	.196(*) 134	-.192(*) 135	0.061 141	.177(*) 156
Time Required to Prepare, Pay Taxes (hours per year)	-4.666(**) 156	-0.126 149	-0.132 152	-.455(**) 134	-0.024 135	-0.134 141	-.321(**) 156
Total Tax Rate (% of commercial profits)	0.026 156	-.533(**) 149	-.441(**) 152	0.083 134	-.490(**) 135	-.454(**) 141	0.129 156

Notes: Pearson Correlation statistics and N are reported. Variables are weighted by population. Dependent variable values (with the exception of MFIs) reflect square-root transformation. \* Correlation is significant at the .05 level (2-tailed); \*\* Correlation is significant at the .01 level (2-tailed).

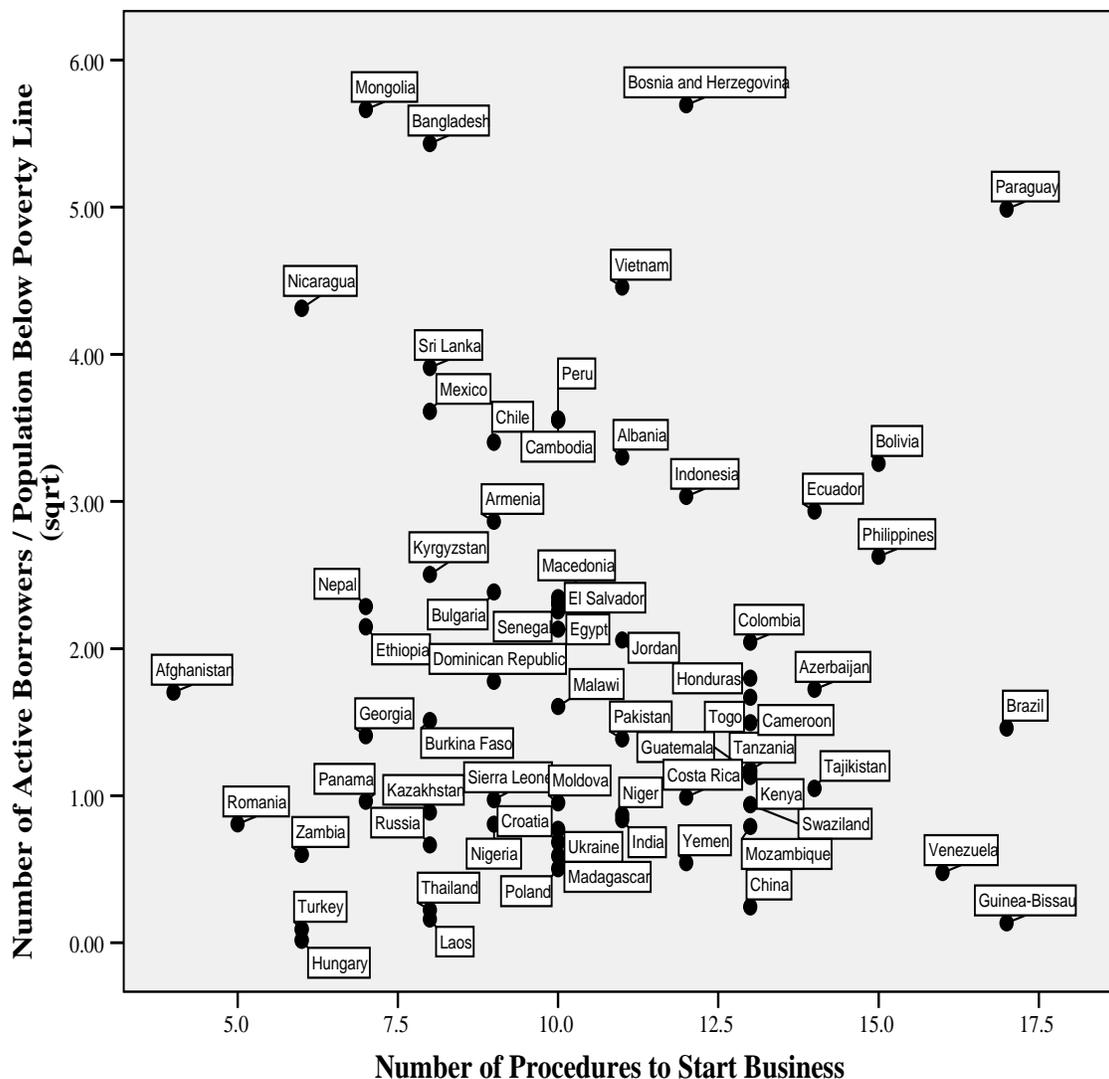
Another policy area salient to the political economy of microfinance would be those that affect the ease of starting a business. As the goal in microfinance is often to support poor entrepreneurs in starting and expanding business, this is a key component to understand. The results here are quite mixed. The time and cost required to start a business are positively associated (with one exception) with the different measures of microfinance outreach. This would indicate that there is more microfinance in countries where it is more challenging to start a business. This is perhaps not too surprising however, as these are the areas most likely to be in demand of such services.

On the other hand, there is a consistently negative relationship with the number of procedures it takes and the minimum capital requirements. Figure 3.1 below visually demonstrates the relationship between general borrower outreach and the number of procedures it takes to open a business. This seems to indicate that in some areas, beneficial changes for entrepreneurs have also meant more successful microfinance efforts. Given studies which have shown positive effects from microfinance on clients businesses,<sup>14</sup> from income generation to employment, it could be expected that these improvements would be far more difficult in circumstances where the entrepreneur must struggle to start their business. Indeed, microfinance can play an important role in providing minimum capital requirements, but only where those are reasonable. Studies which have considered the impact of microcredit on client business, in terms of income generation, profits and employment, have been overwhelmingly positive.

---

<sup>14</sup> (for example, see Buckley 1996; Copestake et al. 2001; MKNelly and Lippold 1998; Barnes et al. 1999; Khandker et al. 1998; McKernon 1996).

**Figure 3.1 - Simpler Procedures to Start a Business:  
The effects on Microfinance Outreach**

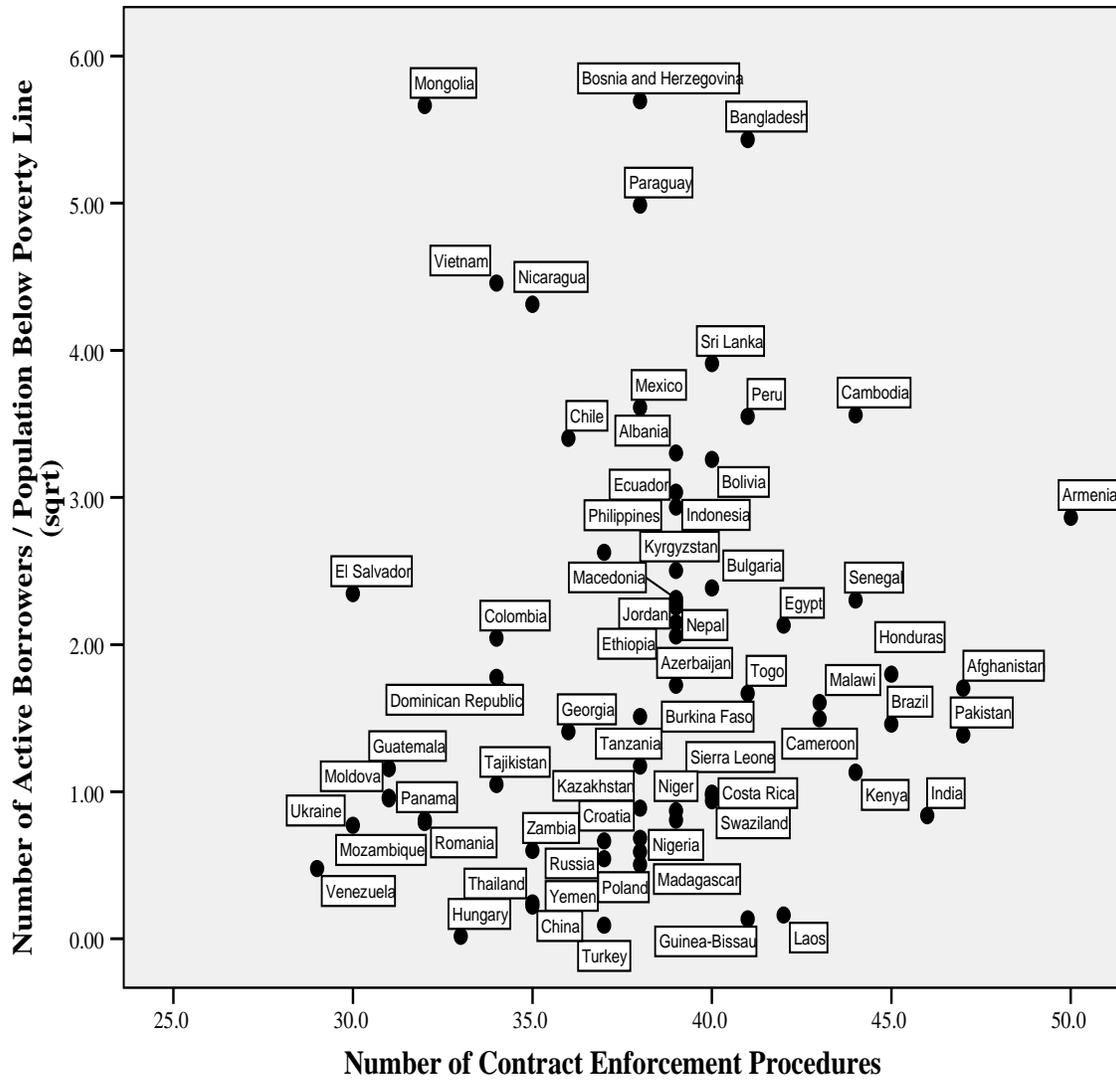


*Notes:* Scatterplot presents data from 2006. Variables are weighted by population. The dependent variable values reflect square-root transformation.

Given the operational design and practices of MFIs that allow them to circumvent poor contract enforcement, it is interesting to test this relationship. Here we see especially strong relationships to the microfinance measures. The positive relationship to factors which make contract enforcement more difficult seem to confirm that their small scale and group lending practices do indeed allow MFIs to circumvent a lack of contract enforcement practices. Figures 3.2 and 3.3 illustrate this well. In particular, there is additional targeting of women as clients in areas where contract is most difficult. This stems well from arguments that the group lending models for women work especially well at creating a social contract and making paper contracts unnecessary. Interestingly, the one negative relationship, though not particularly strong, seems to indicate that the cost of contract enforcement can make it difficult to reach the poorest clients.

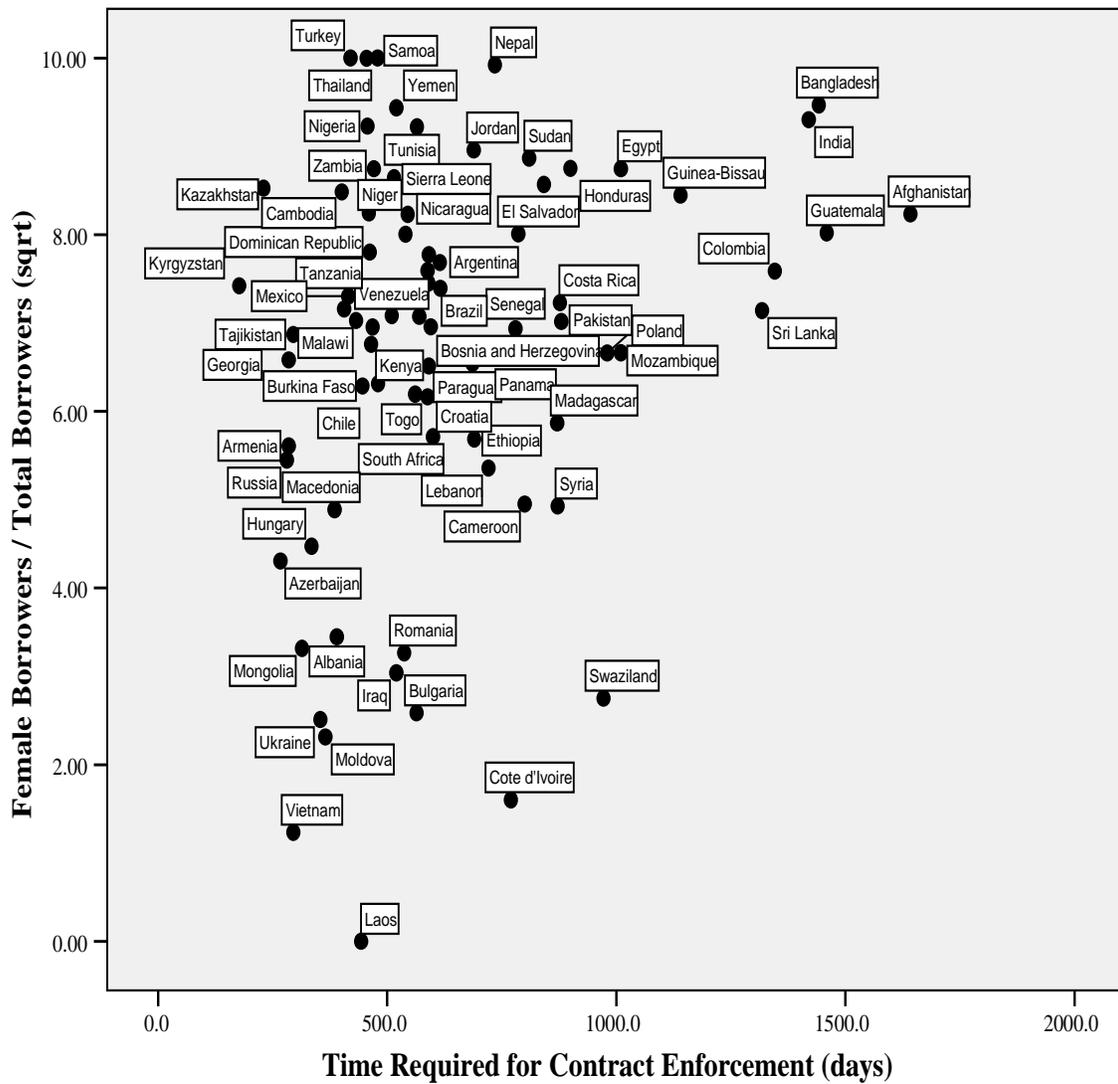
Finally, while many MFIs maintain a non-profit status, their registration and status is often ambiguous. How then might these small scale operations be impacted by a tax burden? The following table presents the result of the correlations with the Doing Business Report's measures of this factor. There is a negative relationship observed between the time required to prepare and pay taxes and two of the measures. Certainly, for small scale operations, with a minimum number of employees, excessive procedures for filing tax payments can take away from their operations. A moderate, negative relationship is also observed between the total tax rate and measures of outreach, implying that the tax burden does hamper microfinance success in a country.

**Figure 3.2 - Microfinance Services  
Needed Where Contract Enforcement is Most Difficult**



*Notes:* Scatterplot presents data from 2006. Variables are weighted by population. The dependent variable values reflect square-root transformation.

**Figure 3.3 - Targeting Women Where Contract Enforcement is Most Difficult**



*Notes:* Scatterplot presents data from 2006. Variables are weighted by population. The dependent variable values reflect square-root transformation.

Though most of the correlations observed are moderate, they do help to further illustrate the importance of certain policy areas and government effectiveness. Policies and regulations, as well as the amount of red tape involved, do matter. However, the differences in direction in the various relationships again present a more complex puzzle. While in some areas, a more conducive business environment is indeed associated with greater microfinance success, in others, microfinance has succeeded in the worst business environments. As with the regression model, then, there is more to the effect of institutions than originally hypothesized.

### **Conclusions**

The above analysis represents a considerable contribution as one of the first such quantitative cross-country assessments of microfinance. Moreover, by confirming a political economic theory of microfinance that asserts that institutions indeed matter, it provides a greater understanding for the kind of connections that exist between the larger macro-level environment and grassroots development operations. As the framework suggests, it is not just a matter of rational economic actors responding to institutional constraints on the part of the state. It is also the historical development of those institutions, specifically in terms of their capacity, that is important to our understanding of these connections. In contrast, gender empowerment rarely proved to be a significant factor, even for female outreach. Both international and local microfinance networks were significant, but had opposite effects. While international networks generally had a positive effect, the presence of a local network actually had a negative influence. These dynamics are explored in greater detail in the case studies on Sri Lanka and Nepal. The evidence presented here however shows that while certainly worth addressing, the partial effects from networks are not as strong as from key institutional variables.

Not only do institutions matter, but *which* institutional factors are most significant is particularly intriguing. The most consistently significant and strongest effects came from political freedom and stability and government effectiveness. Thus even for grassroots projects meant to operate in the direst of circumstances, not only stability, but democracy is an important consideration. Yet MFIs are still capable of achieving much in terms of outreach in developing countries where institutional capacity is lacking, as indicated by the significant, but negative relationship with government effectiveness. Since the focus here is on developing countries, this is a common problem. Moreover, the negative relationship with GNI per capita, indicates that perhaps there is less demand for microfinance as a complement to the formal financial system as a state becomes more developed. Still, no less importantly, we might predict that microfinance will do particularly well in democratic, stable regimes, even where resource limitations and lack of expertise mean less effectiveness from those institutions.

The role of market interventions is more complex. Investment freedom proved significant to national levels of savings outreach, but contrary to the original hypothesis, it is a negative relationship. So we see less microfinance depositors in countries with greater investment freedoms. This indirectly speaks to the need for savings. If a MFI has access to savings deposits, it would be less in need of other investment opportunities. This relationship can be explored in further detail by considering the institutions themselves (this is addressed in the next chapter). There is also the weakness of using such a broad measure. This index measures ease of foreign investment for the economy as a whole. Though foreign capital flows have become increasingly important to microfinance, small local institutions may not be seeking large investments from abroad. .

Finally, despite debates about government ownership, subsidies, and price controls, as well as how and when to regulate microfinance, the evidence here may not be so clear. Financial freedom was not a significant factor. Where regulatory quality was significant, it did have a positive partial effect in keeping with the hypothesis. Still the relationship was not as common, nor as strong, as the other institutional variables. It might be conjectured that there is room for flexibility in these areas. That is, government ownership or the use of subsidies can be done well. On the other hand, microfinance might still benefit from benign neglect. In these areas in particular, it may be more important to consider the situation on a case by case basis. Thus the case studies on Sri Lanka and Nepal can provide a better understanding. Additionally, a closer look at which institutions are regulated and which are not, as the next chapter will demonstrate, also help to shed light on this particular aspect.

A particularly interesting conclusion that stems from these mixed results is that there is a duality between MFIs succeeding in spite of their circumstances, and MFIs succeeding because of a positive environment. The analysis confirms the idea that microfinance successfully brings services to clients who need it most; those who live in lesser developed countries, with limited financial and investment freedom, and ineffective governments. It is penetrating markets where there is demand, where contract enforcement is lacking and starting a business is time consuming and expensive. Perhaps it serves a very specific purpose in creating access in adverse conditions.

Still, we see that microfinance success is also associated with general political freedoms, greater stability, regulatory quality, stronger protection of borrower and lender rights, simpler procedures and lower minimum capital requirements for starting a business, and simpler tax preparation. There appears to be a disconnect between what microfinance has been able to achieve in spite of a difficult political economic environment and what can be achieved with the

application of good policies. Could microfinance be even more successful given improved policies and regulations? If the microfinance industry is to succeed in bringing financial services and opportunities to more of the poorest people, the emphasis should be on determining how to create optimal institutional arrangements, state policies and incentive structures.

#### IV. MICROFINANCE INSTITUTIONS IN CONTEXT

In order to further investigate the relationships identified in the previous chapter, we can make use of the rich set of information available on the microfinance institutions themselves. Using a dataset of 928 institutions in 99 countries, the following presents descriptive information on which institutions are operating where, what their legal designations are, the extent of their outreach and scale of operations. The analysis confirms findings from the previous chapter and sheds additional light on the relationships that exist between political variables and microfinance and suggests areas for future research. By considering the microfinance industry from a different level of analysis, that of the institutions themselves, more nuanced variations are identified. In particular, it allows for a more detailed look at the link between regulation and the availability of funding for microfinance institutions.

##### **Microfinance Institutions**

The data on individual microfinance institutions once again is drawn from the MIX Market online database (MIX Market 2009b). The following considers longer term trends available through the website's regularly released MicroBanking Bulletins, as well as more detailed assessments of data as of 2006 in the context of the political economic environment. The following descriptive analysis will consider information about these institutions' outreach, sustainability and impact.<sup>15</sup> The microfinance institutions in this dataset can also be broken down according to their legal status: Non-Bank Financial Institution (NBFI), Rural Bank, Non-Profit (NGO), Cooperative and Credit Union, and Bank. Once again it is important to note that

---

<sup>15</sup> A list of countries represented and descriptions of the variables used here are provided in Appendices 5 and 6, respectively.

these data are self-reported, but subject to independent review. However, the following does present a comprehensive picture of microfinance institutions worldwide.

### *Outreach*

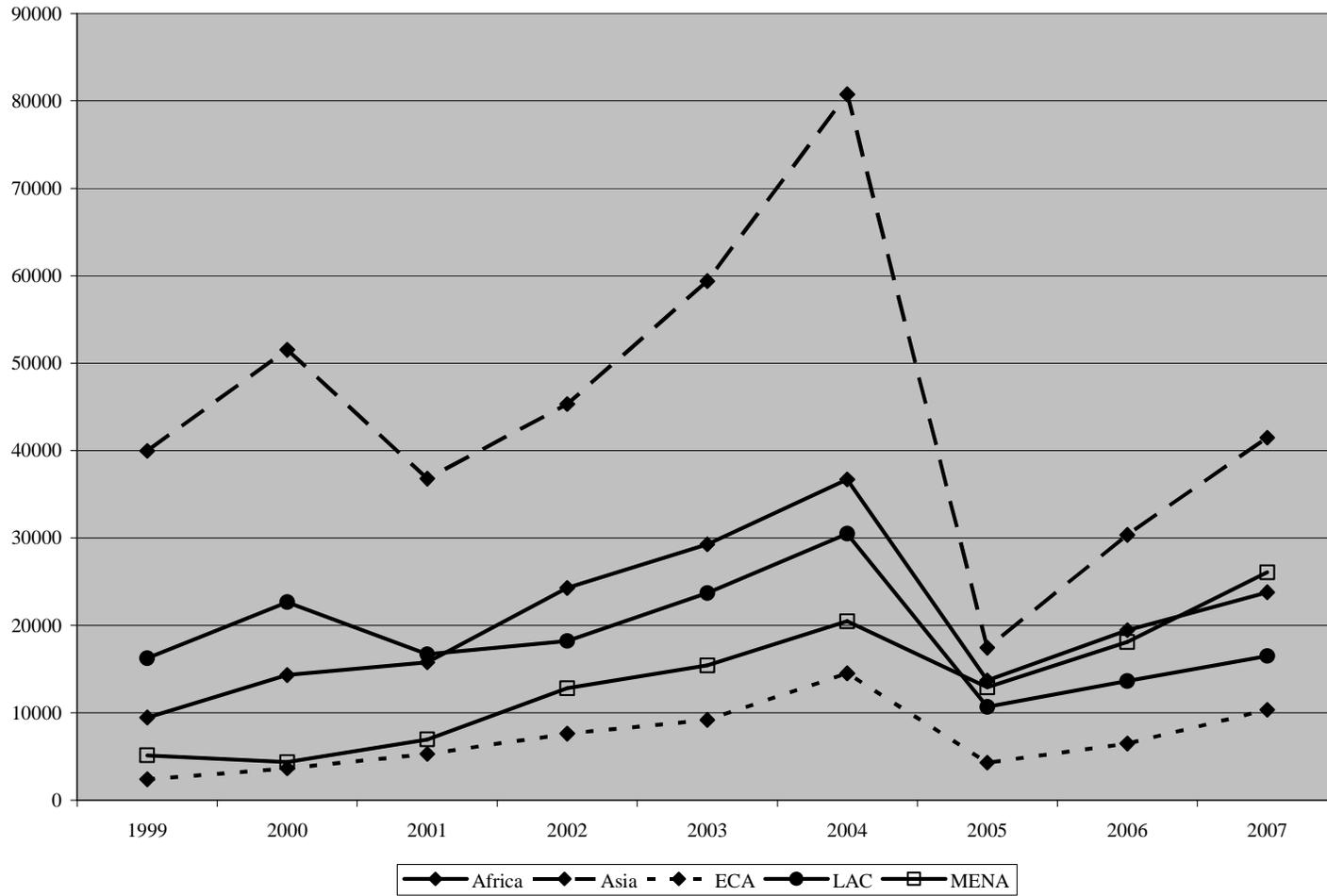
In contrast to national levels of outreach, at this level of analysis, outreach refers to the number of clients being served by each individual microfinance institutions. Each institution's outreach can be measured most simply in terms of the total number of active borrowers and savers being served. This serves to illustrate how successful each institution is in developing their client base. The following analysis also groups institutions according to outreach peer groups developed by the MicroBanking Bulletin (MIX Market 2009a). These categories group institutions as large, medium and small outreach according to their outreach in terms of the number of borrowers.<sup>16</sup>

The graph below presents trends in outreach across regions. It should be noted that the dip in 2005 observed across all regions is at least partly due to methodological changes in data collection on the MIX Market website. Even with this irregularity a clear pattern emerges as far as the median outreach levels. Asia's MFIs have consistently led the way, while those in Eastern Europe and Central Asia have typically been much smaller. Those in the Middle East and North Africa have seen steady growth. Further assessment below will assess the political context for varying levels of outreach.

---

<sup>16</sup> The outreach peer groups are as follows: large institutions have greater than 30,000 borrowers, medium have borrowers between 10-30,000 borrowers, and small have less than 10,000 borrowers.

**Figure 4.1 - Median Number of Borrowers by Region**



Notes: ECA = Eastern Europe & Central Asia; LAC = Latin American & the Caribbean; MENA = Middle East & North Africa.

Source: MIX Market. 2010. *The Microbanking Bulletin* [cited 16 February 2010]. Available from <http://www.themix.org/microbanking-bulletin>.

## *Sustainability*

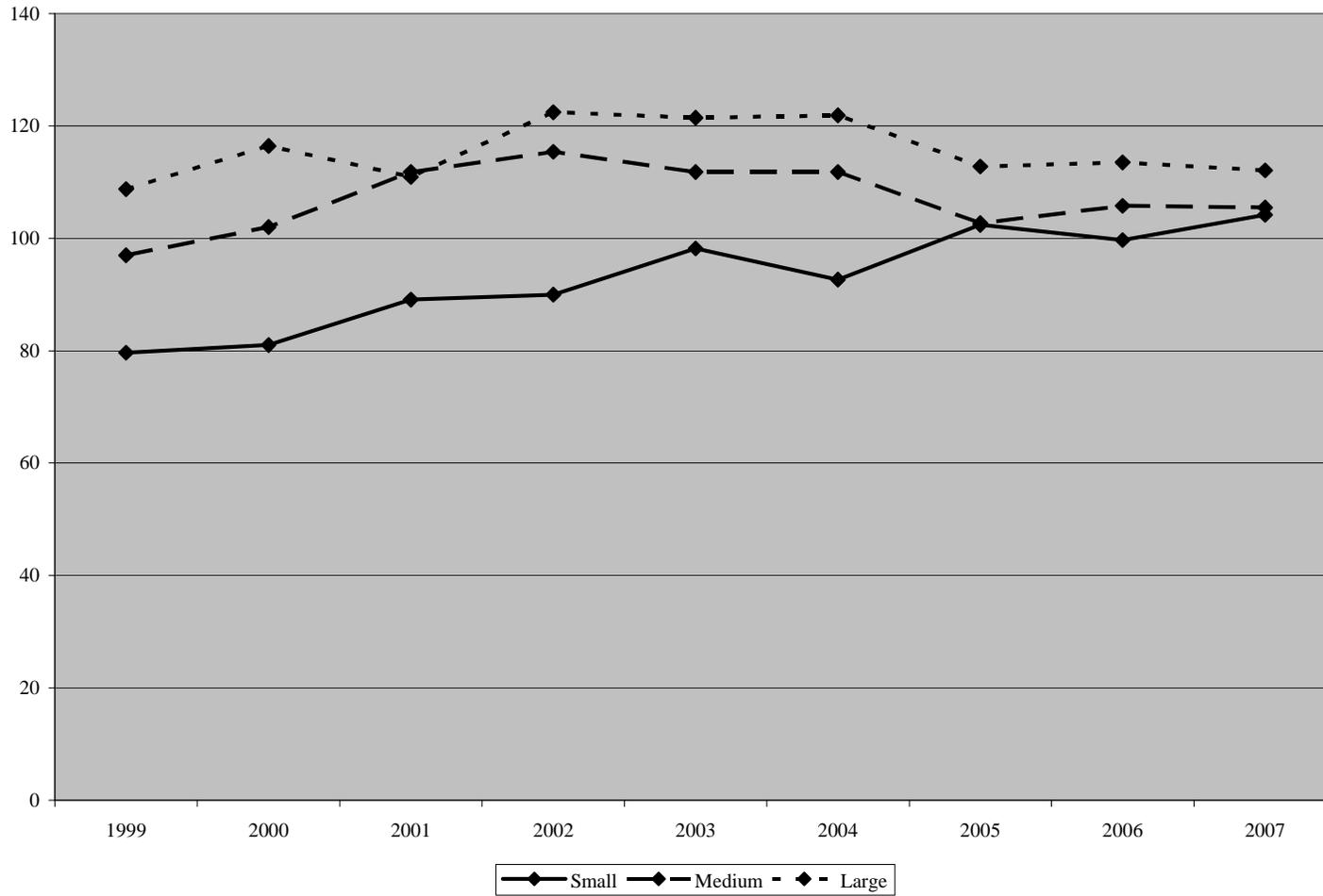
Much of the focus of the data reported to the MIX Market is on financial performance information that can be utilized by investors and donors. There is therefore a wealth of information in regards to the operational performance and sustainability of each institution. Several are considered here. First, trends are shown comparing institutions which have achieved financial sustainability and those that have not, that is, those that are over 100 percent self-sufficient verses those that are not. The MicroBanking Bulletin's peer groups also allow us to break down the institutions according to the scale of their operations in terms of the size of their gross loan portfolio.<sup>17</sup> Operating expenses for each institution were also considered as a ratio to its loan portfolio.

The figure below presents trends in sustainability over the last decade according to the institution's scale of operations. It demonstrates that there does appear to be some benefit to achieving economies of scale in the microfinance industry. Medium and large scale enterprises (in terms of their gross loan portfolios) have generally been able to maintain financial self-sufficiency ratios above 100 percent. It is impressive to note that over time, though, even the small scale operations have been able to achieve sustainable levels. This also demonstrates well one of the reasons why microfinance has been so widely praised as a tool for development. That is, these institutions are capable of achieving sustainability.

---

<sup>17</sup> The scale peer groups are as follows: large institutions have portfolios greater than US\$8 million, medium institutions have portfolios between 2-8 million and small have portfolios less than 2 million. For Latin America, the categories are slightly higher to reflect differences in income levels and are as follows: large is greater than 15 million, medium is between 4-15 million and small is less than 4 million.

**Figure 4.2 - Median Financial Self-Sufficiency, by Scale of Operations**



Source: MIX Market. 2010. *The Microbanking Bulletin* [cited 16 February 2010]. Available from <http://www.themix.org/microbanking-bulletin>.

## *Impact*

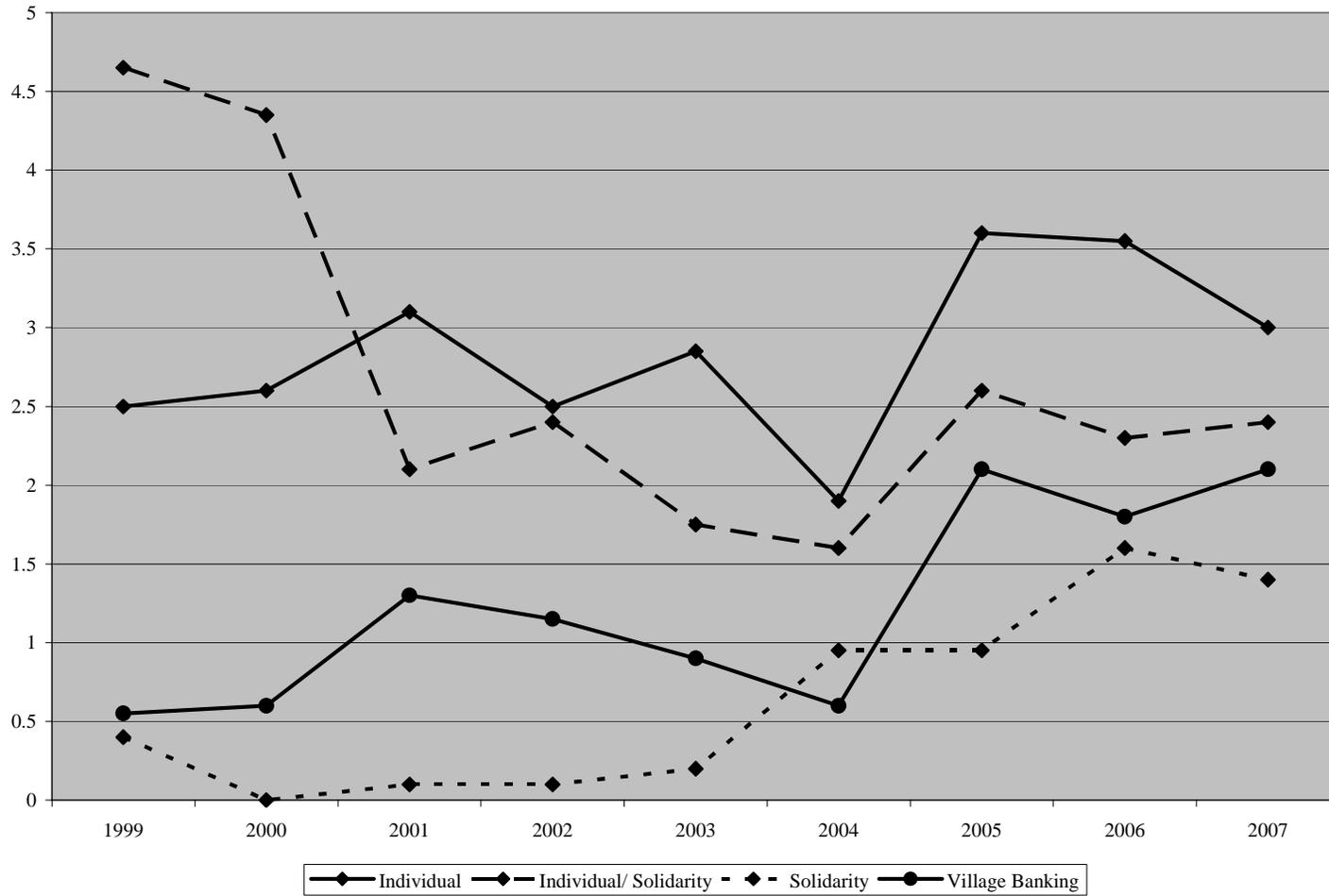
Measuring impact is perhaps the most challenging aspect of the dependent variable. Much work is being done to develop reliable impact assessments that can be implemented for microfinance clients. However, at present, these can vary considerably and there is no central depository of such information. Two indicators are therefore used to estimate impact to the best extent possible. The first of these is a financial measure, portfolio at risk.<sup>18</sup> This measures how many clients default or are at risk of defaulting on their loans. While situations may vary, presumably these clients are not receiving a positive impact from the microfinance services if they are unable to repay the loans. The figure below considers trends on this measure according to the lending methodology used by the MFI. This confirms the ideas advocated in the industry that the village banking and “solidarity” group models encourage repayment and as a result have maintained the lowest default rates. In contrast individual lending models present the highest risk to the MFI.

A second indicator attempts to estimate impact on women, certainly one of the central goals of microfinance as described in Chapter 1. Again, due to the emerging nature of impact assessments and inherent difficulties with this concept, it is difficult to quantitatively measure the empowerment or independence achieved by female microfinance clients as a result of their loans. This particular component of microfinance success is therefore simply measured as the percentage of clients being served by the institution who are women. The following analysis looks in particular at institutions for which 100 percent of the client base is women as well as those serving over 75 percent women.

---

<sup>18</sup> the percentage of the loan portfolio that is overdue more than 30 days (MIX Market 2010)

**Figure 4.3 - Portfolio at Risk (>30 days), by Lending Methodology**



Notes: ECA = Eastern Europe & Central Asia; LAC = Latin American & the Caribbean; MENA = Middle East & North Africa.  
 Source: MIX Market. 2010. *The Microbanking Bulletin* [cited 16 February 2010]. Available from <http://www.themix.org/microbanking-bulletin>.

## **The Political Economic Environment**

In applying a political economic theory of microfinance to the institution-level data, a methodological problem presents itself. Indeed it is the same difficulty that has been cited in microfinance studies that attempts to measure the impact of these programs on broader economic development (Sobhan 1997). That is, in considering the impact of political factors on individual microfinance institutions that are not randomly distributed across countries, how can we account for these disparate levels of analysis? Several countries, India and Peru for example, have far greater numbers of MFIs reporting data. While recognizing this limitation, the analysis below confirms several of the findings from the previous chapter, allowing in some cases for an even deeper understanding. Moreover, indicators which measure the funding sources and regulation status of individual MFIs still allow us to draw valuable conclusions about the national level context.

### *The Big Picture: Political Rights, Stability & Capacity*

The regression models in the previous chapter revealed political rights, stability and government effectiveness to be the most consistently strong and significant factors affecting national levels of microfinance outreach. What can assessment of the individual institutions themselves add to this? Well, for one it confirms that the relationship is still there. Moreover, it shows that it affects institutions differently. The table below presents a cross-tabulation of the scale and outreach peer groups by ordinal measures of political freedom, stability and government effectiveness. These measures make use of the same indicators used in the previous chapter (See Appendix 6 for more details). Chi-square statistics demonstrate that there are indeed significant relationships with outreach across groups.

**Table 4.1 - Scale & Outreach of MFIs, by Regime & Capacity Measures**

	<u>Political Freedom</u>			<u>Political Stability</u>				<u>Government Effectiveness</u>			
	Not Free	Partly Free	Free	very low	low	moderate	high	very low	low	moderate	high
<u>Scale</u>											
Large	17.6%	26.0%	26.4%	25.3%	26.4%	21.3%	26.9%	12.5%	26.4%	22.2%	50.0%
Medium	22.0%	27.5%	23.1%	29.1%	25.1%	23.7%	19.2%	25.0%	25.9%	23.7%	30.0%
Small	60.4%	46.6%	50.5%	45.6%	48.5%	55.1%	53.8%	62.5%	47.7%	54.1%	20.0%
N	159	393	299	79	458	287	26	8	432	401	10
	<i>Chi-Square = 10.116*</i>			<i>Chi-Square = 5.057</i>				<i>Chi-Square = 8.916</i>			
<u>Outreach</u>											
Large	12.6%	21.7%	21.5%	32.9%	20.6%	16.0%	13.8%	12.5%	20.6%	18.4%	54.5%
Medium	12.0%	26.9%	20.3%	29.3%	22.7%	19.3%	10.3%	0.0%	24.7%	19.6%	0.0%
Small	75.4%	51.4%	58.2%	37.8%	56.8%	64.7%	75.9%	87.5%	54.8%	61.9%	45.5%
N	167	401	316	82	472	300	29	8	442	423	11
	<i>Chi-Square = 29.907***</i>			<i>Chi-Square = 24.480***</i>				<i>Chi-Square = 17.546**</i>			

\* Chi-Square is significant at the .05 level

\*\* Chi-Square is significant at the 0.01 level

\*\*\* Chi-Square is significant at the 0.001 level

Based on this, it would appear that there is also a relationship between broad political factors and the outreach levels of individual microfinance institutions as well. Indeed, the relationship between each of these institutional variables and the outreach peer groups is significant. What is interesting is how the relationship is different depending on the level of outreach. As political freedom increases, the proportion of MFIs that have large levels of outreach increases. On the other hand, the relative proportion of MFIs with small levels of outreach decreases. It might be concluded that freer conditions make it easier for MFIs to expand their client base. A similar pattern is apparent at levels of government effectiveness. Greater effectiveness may then also make it easier to expand their client base.

In contrast, although political stability had a positive effect on national levels of outreach, there is a greater concentration of small MFIs under more stable regimes. This does not necessarily contradict the findings at the national-level however. Many small MFIs may indeed cover a substantial market share of the total poor population. What can be said is that MFIs with

different levels of outreach respond differently to the political environment. It may be that MFIs that maintain smaller client bases find it easier to operate under conditions of less freedom and government capacity.

### *The Link Between Savings and Regulation*

While the above presentation provides some insight into the relationship between the political environment and institution-level outreach, we are limited by the disparate levels of analysis being investigated. In contrast, information on the legal status, whether or not it is regulated, and funding sources is available for each of the MFIs in the dataset. This allows for an important elaboration on the findings from the regression results. At the institution-level, identifying how regulation and legal status affect operations is important to our understanding of how national level political arrangements influence grassroots level organizations.

Table 4.2 presents a breakdown of the scale and outreach of the various types of microfinance institutions. According to this snapshot of the microfinance industry worldwide, several things are worth noting. First, although specific registration procedures might vary, the majority of MFIs are considered either NGOs or NBFIs. Secondly, with the exception of banks (and the “other” category), all types of MFIs tend toward small scale operations and low levels of outreach. That is, they tend to maintain a small client base. This is even more apparent among cooperatives and credit unions which tend to have specific membership guidelines.

**Table 4.2 - Legal Designations for MFIs, by Scale & Outreach**

	<b>NBFI</b>	<b>Rural Bank</b>	<b>NGO</b>	<b>Coop/ CU</b>	<b>Bank</b>	<b>Other</b>
All MFIs	32.8%	4.3%	37.9%	18.0%	4.8%	2.2%
<u>Scale of Operations</u>						
Large	32.9%	12.5%	13.7%	17.1%	77.3%	33.3%
Medium	25.7%	30.0%	25.1%	23.4%	15.9%	38.9%
Small	41.4%	57.5%	61.1%	59.5%	6.8%	27.8%
N	292	40	342	158	44	18
<u>Outreach Level</u>						
Large	19.7%	20.0%	17.3%	9.0%	62.2%	20.0%
Medium	22.4%	15.0%	24.7%	10.8%	24.4%	35.0%
Small	57.9%	65.0%	58.0%	80.2%	13.3%	45.0%
N	304	40	352	167	45	20

Legal status in and of itself however, does not reveal much about the success of microfinance. However, it is a key factor in determining whether or not a microfinance institution is regulated. MFIs reporting to the MIX Market indicate whether or not they are regulated. This indicator therefore allows for some consideration of the impact of operating either legally or in a “grey area.” Using this information, Table 4.3 presents an overview of the percentage of MFIs regulated per country. Table 4.4 looks at the percentage of institutions that are regulated according to their legal designation and compares this across regions. The relationship between legal status and regulation is significant for all MFIs in the dataset and in several regions. Across the board, NGOs are the least likely to be regulated. It is significant then, that NGOs make up such a large proportion of MFIs worldwide.

**Table 4.3 – Number of Regulated MFIs by Country**

	% Reg.	N		% Reg.	N
<u>Latin America &amp; the Caribbean</u>			<u>Middle East &amp; North Africa</u>		
Argentina	0.0%	7	Egypt	33.3%	6
Bolivia	37.5%	24	Iraq	0.0%	1
Brazil	45.5%	11	Jordan	16.7%	6
Chile	50.0%	4	Lebanon	50.0%	2
Colombia	21.4%	14	Morocco	22.2%	9
Costa Rica	0.0%	11	Palestine	50.0%	6
Dominican Republic	40.0%	5	Tunisia	100.0%	1
Ecuador	30.0%	40	Yemen	0.0%	3
El Salvador	15.4%	13	<i>Region Total</i>	29.4%	34
Guatemala	0.0%	15			
Haiti	14.3%	7	<u>East Europe &amp; Central Asia</u>		
Honduras	30.8%	13	Albania	100.0%	2
Hungary	100.0%	1	Armenia	83.3%	6
Jamaica	0.0%	1	Azerbaijan	100.0%	12
Mexico	18.9%	37	Bosnia and Herzegovina	100.0%	12
Nicaragua	14.3%	21	Bulgaria	20.0%	5
Panama	0.0%	3	Croatia (Hrvatska)	100.0%	2
Paraguay	60.0%	5	Georgia	77.8%	9
Peru	66.0%	50	Kazakhstan	26.3%	19
Venezuela	100.0%	1	Kosovo	87.5%	8
<i>Region Total</i>	31.1%	283	Kyrgyzstan	100.0%	20
			Macedonia	66.7%	3
<u>Africa</u>			Moldova	100.0%	1
Angola	50.0%	2	Mongolia	100.0%	3
Benin	90.0%	10	Montenegro	100.0%	1
Burkina Faso	100.0%	3	Poland	0.0%	2
Burundi	100.0%	2	Romania	66.7%	6
Cameroon	85.7%	7	Russia	71.9%	32
Central African Republic	100.0%	1	Serbia and Montenegro	100.0%	2
Chad	100.0%	1	Tajikistan	86.7%	15
Congo	66.7%	3	Turkey	0.0%	1
Congo, Dem. Rep.	85.7%	7	Ukraine	100.0%	2
Cote D'Ivoire	100.0%	1	Uzbekistan	25.0%	8
Ethiopia	100.0%	13	<i>Region Total</i>	73.7%	171
Gambia, The	100.0%	1			
Ghana	71.4%	7	<u>South Asia</u>		
Guinea	80.0%	5	Afghanistan	10.0%	10
Guinea-Bissau	100.0%	2	Bangladesh	28.6%	14
Kenya	45.5%	11	India	37.7%	61
Liberia	0.0%	1	Nepal	76.9%	13
Madagascar	100.0%	8	Pakistan	100.0%	9
Malawi	66.7%	6	Sri Lanka	42.9%	7
Mali	100.0%	12	<i>Region Total</i>	43.9%	114
Mozambique	57.1%	7			
Niger	100.0%	5	<u>East Asia &amp; the Pacific</u>		
Nigeria	75.0%	4	Cambodia	100.0%	12
Rwanda	60.0%	5	China	40.0%	5
Senegal	100.0%	10	East Timor	0.0%	1
Sierra Leone	0.0%	4	Indonesia	69.4%	36
South Africa	66.7%	3	Laos	100.0%	1
Swaziland	100.0%	1	Papua new Guinea	100.0%	1
Tanzania	16.7%	6	Philippines	25.0%	32
Togo	60.0%	5	Samoa	0.0%	1
Uganda	60.0%	10	Thailand	50.0%	2
Zambia	40.0%	5	Vietnam	16.7%	12
<i>Region Total</i>	75.0%	168	<i>Region Total</i>	50.5%	103

**Table 4.4 - Regulation by Legal Designation & Region**

		<b>NBFI</b>	<b>Rural Bank</b>	<b>NGO</b>	<b>Coop / CU</b>	<b>Bank</b>	<b>Other</b>	<i>Chi-Square</i>
All	% Reg.	72.2%	80.0%	17.7%	68.4%	97.7%	41.2%	269.94 *
	N	284	40	333	155	44	17	
Latin America & the Caribbean	% Reg.	63.2%	0.0%	2.9%	39.1%	100.0%	20.0%	127.463 *
	N	76	0	139	46	17	5	
Africa	% Reg.	80.7%	50.0%	40.0%	94.2%	100.0%	100.0%	45.311 *
	N	57	2	45	52	11	1	
Middle East & North Africa	% Reg.	20.0%	0.0%	29.2%	0.0%	0.0%	40.0%	0.484
	N	5	0	24	0	0	5	
Eastern Europe & Central Asia	% Reg.	74.0%	0.0%	58.3%	76.7%	100.0%	100.0%	5.985
	N	96	0	24	43	7	1	
South Asia	% Reg.	73.5%	77.8%	20.8%	22.2%	75.0%	40.0%	31.168 *
	N	34	9	53	9	4	5	
East Asia & the Pacific	% Reg.	87.5%	82.8%	10.4%	80.0%	100.0%	0.0%	58.327 *
	N	16	29	48	5	5	0	

\* Chi-Square is significant at the 0.001 level

The link between the legal status of a microfinance institution and whether or not it is regulated takes on particular importance when one considers the impact that regulation has on operations. Table 4.5 compares the average number of borrowers and savers between regulated and unregulated institutions according to their outreach peer groups. Those advocating benign neglect may in some ways be vindicated by this. On average, unregulated institutions tend to have more borrowers and significantly more among the small institutions. On the other hand, unregulated institutions have far fewer savers. This is especially true for both medium and small MFIs. This not only has statistical significance, but also important implications for the way MFIs can do business. Savings deposits can be a critical source of funds for these institutions. Generally financial institutions seek to collect deposits and lend them out in the form of loans. In the absence of deposits as a funding source, MFIs are reliant on loans from other financial institutions, subsidies and grants. This results in higher risk portfolios because their asset base is not diversified. Indeed, regulated institutions even have significantly lower operating costs on

average: 25.1 percent of the gross loan portfolio versus 34.1 percent for unregulated (t=4.362, p=.000).

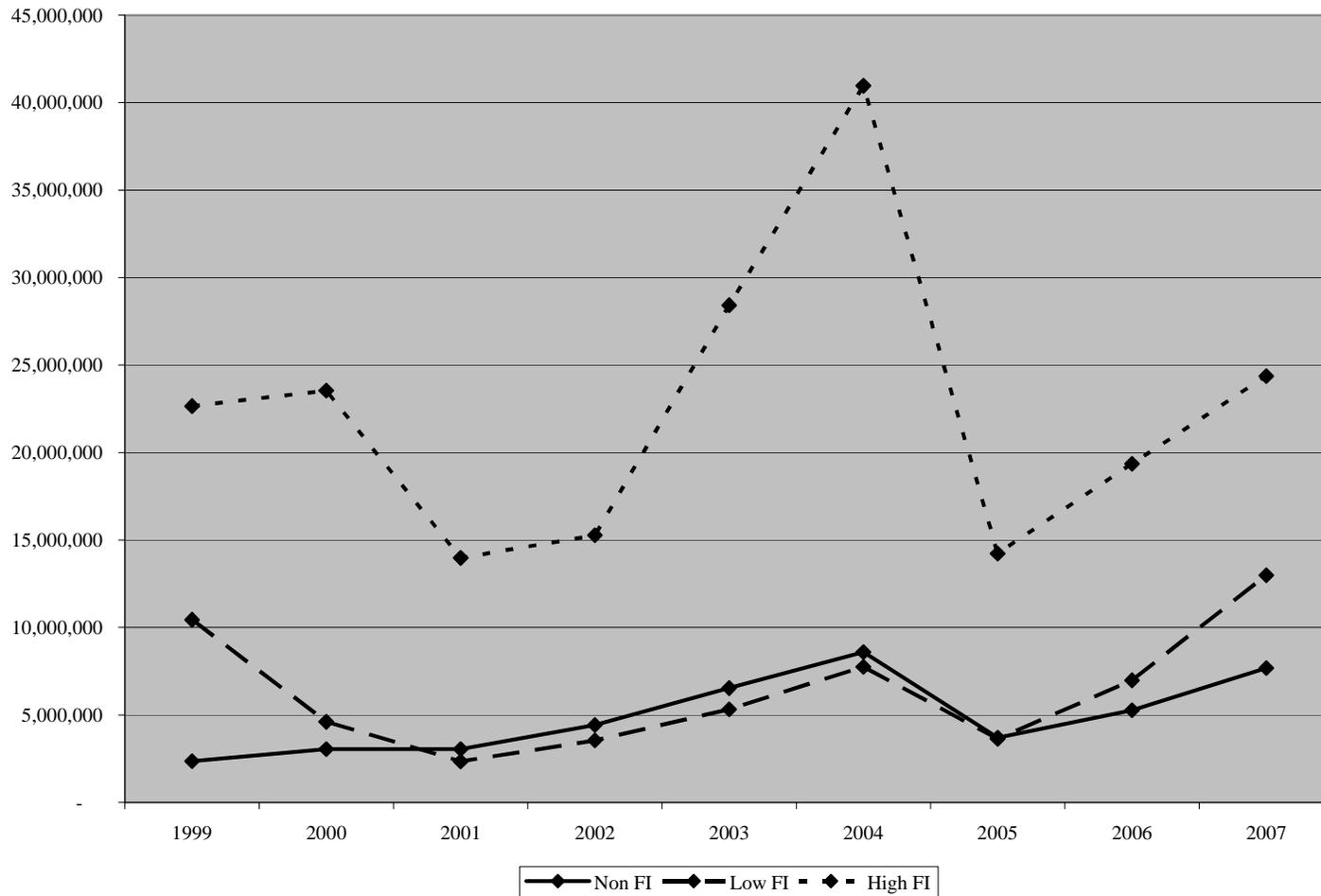
**Table 4.5 - The Client Base in Regulated versus Unregulated MFIs, by Level of Outreach**

<b>Outreach</b>	<b>Average Borrowers</b>		<b>Average Savers</b>	
	Regulated	Unregulated	Regulated	Unregulated
<u>Large</u>				
mean	165,328.02	440,622.43	276,545.84	321,443.15
N	155	47	153	46
s.e.	40,119.45	190,934.33	202,094.50	202,887.97
	t = 1.41		t = 0.12	
<u>Medium</u>				
mean	16,075.28	19,955.04	15,368.60	3,501.17
N	105	109	103	108
s.e.	2,021.90	1,997.57	3,492.74	1,025.85
	t = 1.36		t = 3.26*	
<u>Small</u>				
mean	2,890.18	5,063.56	2,639.05	953.72
N	182	243	176	232
s.e.	311.73	324.85	455.82	237.96
	t = 4.83*		t = 3.28*	

\* Difference is significant at the 0.01 level

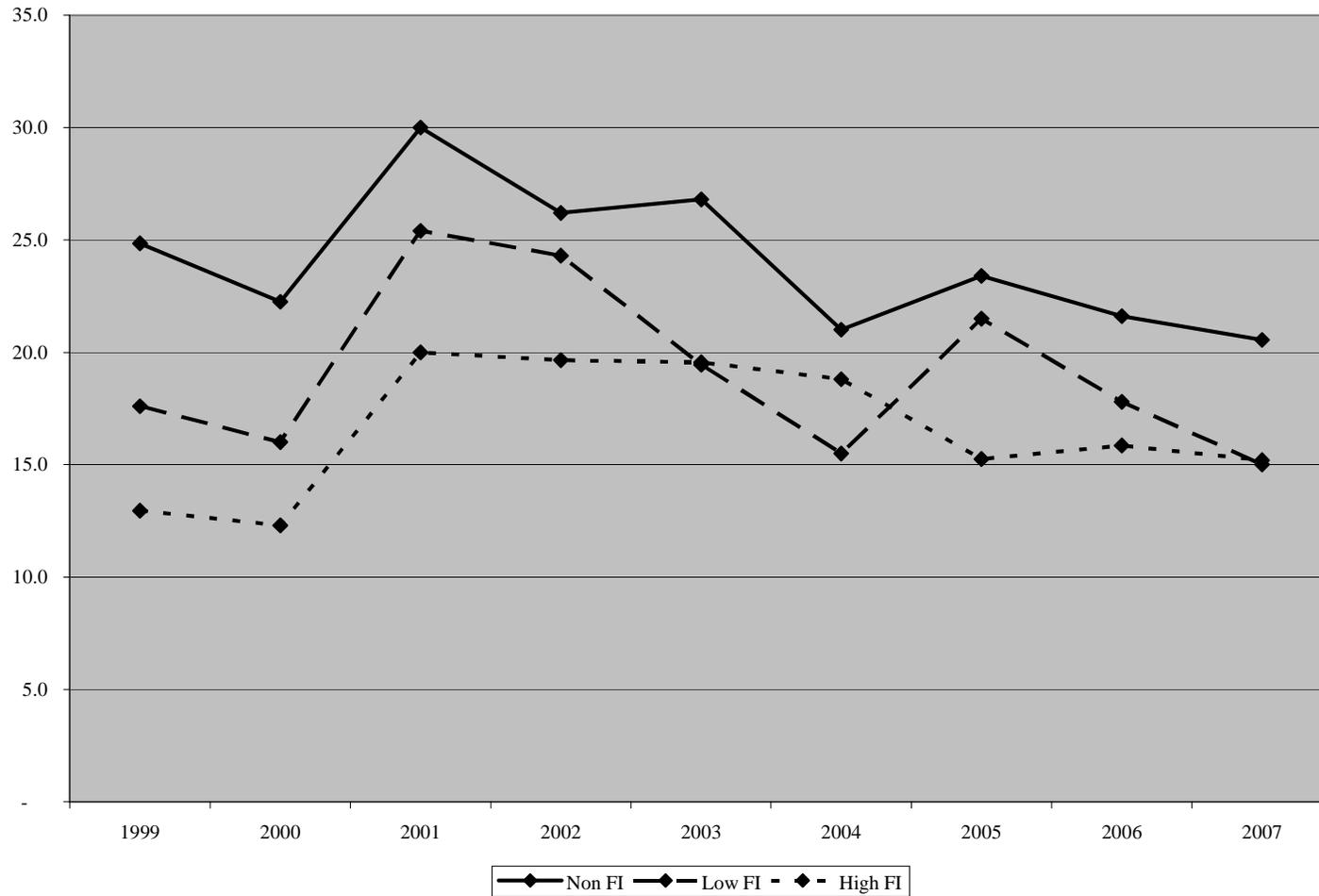
It is worth considering in further detail then this relationship between regulation and savings. For example, Figure 4.4 compares trends in the median gross loan portfolio according to the MicroBanking Bulletin's financial intermediation peer groups. This indicator refers to the extent to which a MFI funds loans through mobilized deposits based on the percentage of total assets funded by savings. Those institutions with high levels of financial intermediation have tended to have consistently larger loan portfolios. Even low levels of financial intermediation do not allow for the same scale of operation. Figure 4.5 then considers trends in operating expenses

**Figure 4.4 - Median Gross Loan Portfolio (US\$), by Financial Intermediation**



Source: MIX Market. 2010. *The Microbanking Bulletin* [cited 16 February 2010]. Available from <http://www.themix.org/microbanking-bulletin>.

**Figure 4.5 - Median Operating Expenses (as a percent of the Loan Portfolio),  
by Financial Intermediation**



Source: MIX Market. 2010. *The Microbanking Bulletin* [cited 16 February 2010]. Available from <http://www.themix.org/microbanking-bulletin>.

over time. Those microfinance institutions that intermediate between savers and borrowers have consistently had lower operating expenses as well. Institutions using deposits also had a significantly lower percentage of the loan portfolio at risk: 5.4 percent on average versus 7.7% (t=2.357, p=.019).

So how strong is the link between regulation and savings? Based on information from the MIX Market that gives each institution's sources of funding (MIX Market 2009b), a dummy variable was created based on whether or not this included savings deposits. Table 4.6 looks at the percentage of regulated versus unregulated institutions which utilize savings deposits as a source of funding. The results are broken down by the legal status and reveal quite a bit a significant relationship between regulation and the utilization of deposits for all the MFIs in the dataset.

**Table 4.6 - Percentage of MFIs where Funding Includes Savings Deposits, by Regulation and Legal Status**

	Unregulated		Regulated		Chi-square
	%	N	%	N	
All	23.5%	383	49.0%	404	55.147 *
NBFI	11.1%	72	31.3%	182	11.063 *
Rural Bank	62.5%	8	65.4%	26	0.022
Non-Profit (NGO)	15.5%	245	22.6%	53	1.587
Coop	76.6%	47	83.8%	99	1.109
Bank	100.0%	1	73.0%	37	0.367
Other	20.0%	10	28.6%	7	0.168

\* Chi-Square is significant at the 0.001 level

Generally speaking, a larger percentage of regulated institutions are able to make use of savings deposits as a source of funding. NBFIs and NGOs more often than not do not utilize savings accounts, but for those that are unregulated, the percentages are considerably smaller than for other types of institutions. Indeed the difference between unregulated and regulated NBFIs specifically is significant. For NGOs, the vast majority remain unregulated and even those that

are tend not to utilize savings. Once again, because these two types of institutions make up the majority of MFIs around the world, this connection between regulation and savings becomes quite critical to our understanding of the conditions under which microfinance can succeed.

### *The Gender Issue*

With the focus on female clients an emphasis in the microfinance literature, it is worth looking more closely at these patterns among the microfinance institutions in the dataset. Table 4.7 considers the number of institutions which focus exclusively on women, as well as those with a predominant focus on women.

**Table 4.7 - Which Institutions Focus on Women?**

	<u>100% female clients</u>		<u>≥ 75% female clients</u>	
	%	N	%	N
All MFIs	11.6%	928	34.2%	928
<u>Legal Status</u>				
Non-Bank Financial Institution	10.5%	266	28.9%	266
Rural Bank	18.8%	32	25.0%	32
Non-Profit (NGO)	20.2%	327	57.2%	327
Cooperative/Credit Union	3.6%	140	20.0%	140
Bank	5.3%	38	23.7%	38
Other	5.6%	18	44.4%	18
	<i>Chi-Square = 30.86**</i>		<i>Chi-Square = 84.87**</i>	
<u>Scale of Operations</u>				
Large	9.6%	198	27.8%	198
Medium	14.2%	204	39.7%	204
Small	14.4%	410	43.2%	410
	<i>Chi-Square = 2.94</i>		<i>Chi-Square = 13.51*</i>	
<u>Outreach Level</u>				
Large	18.0%	161	49.7%	161
Medium	20.1%	184	48.9%	184
Small	8.8%	476	30.9%	476
	<i>Chi-Square = 18.93**</i>		<i>Chi-Square = 28.57**</i>	

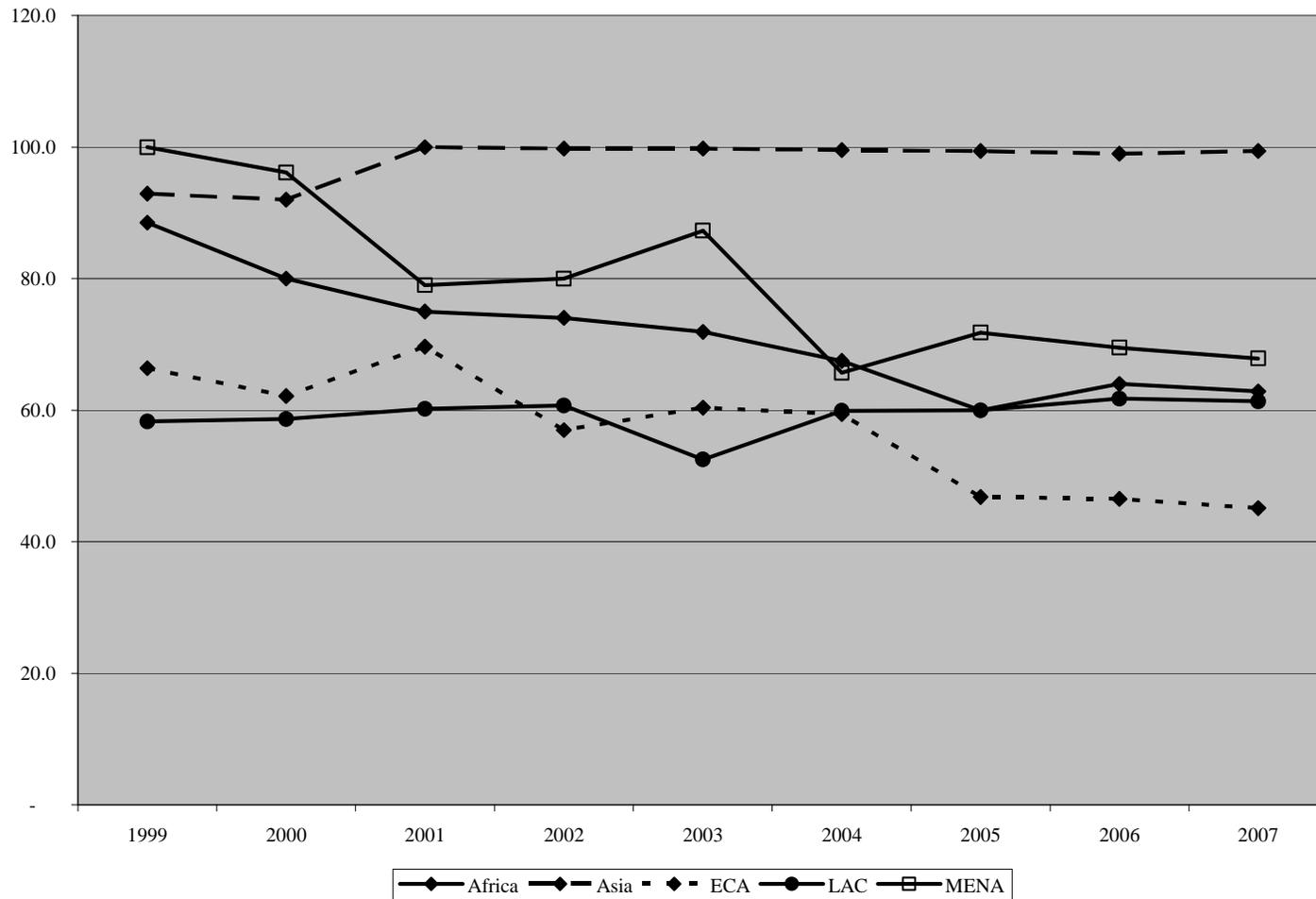
\* Chi-Square is significant at the .01 level

\*\* Chi-Square is significant at the .001 level

First, only about 11 percent of all the microfinance institutions in the dataset reported having a client base made up entirely of women. Even those that have a majority of female clients make up a minority of all the MFIs. By further breaking down the MFIs by their legal status, it would seem that NGOs have tended to focus more exclusively on women. Interestingly, although the MFIs which tend to focus on women have tended to be small in scale in terms of the size of the gross loan portfolio, they have also tended to be the larger institutions in terms of outreach. The chi-square statistical tests also indicate that all but one of the relationships is significant.

The fact that not as many institutions focus exclusively on women as much of the global notion of microfinance would lead one to believe might also help explain why gender equality does not prove to be a significant explanatory factor for national levels of outreach. Indeed, Figure 4.6 shows that in some areas that the percentage of female clients has decreased considerably over the last decade or so. The figure considers the median percent of female clients by region over time. Asia is the only area which has consistently maintained close to 100 percent female outreach. African MFIs have maintained a consistent focus on women, at only 60 percent. The other three regions have shown consistent negative trends, though female clients of MFIs in the MENA region and Latin America still represent over 60 percent of clients. The proportion of female clients in Eastern Europe and Central Asia on the other hand has dipped below 50 percent.

**Figure 4.6 - Median Percent of Female Clients, by Region**



*Notes:* ECA = Eastern Europe & Central Asia; LAC = Latin American & the Caribbean; MENA = Middle East & North Africa.

*Source:* MIX Market. 2010. *The Microbanking Bulletin* [cited 16 February 2010]. Available from <http://www.themix.org/microbanking-bulletin>.

## Microfinance Networks

Data on individual microfinance institutions worldwide also help to provide more detail on the relationship to local and international microfinance networks. Again, based on the information reported by the MFIs to the MIX Market, dummy variables were created to indicate whether each institution in the dataset was a member of an international or local microfinance network. The percentage of MFIs engaged in a network is presented below according to their legal designation, scale and outreach level.

**Table 4.8 - Network Membership**

	<u>Local Network Member</u>		<u>International Network Member</u>	
	%	N	%	N
Total	45.4	928	25.4	928
<u>Legal Status</u>				
Non-Bank Financial Institution	67.3%	205	43.4%	205
Rural Bank	100.0%	7	0.0%	7
Non-Profit (NGO)	65.7%	248	41.9%	248
Cooperative/Credit Union	90.5%	105	15.2%	105
Bank	39.1%	23	82.6%	23
Other	56.3%	16	50.0%	16
	<i>Chi-Square = 38.46**</i>		<i>Chi-Square = 51.14**</i>	
<u>Scale of Operations</u>				
Large	54.5%	156	56.4%	156
Medium	67.3%	162	43.2%	162
Small	78.3%	267	28.8%	267
	<i>Chi-Square = 26.27**</i>		<i>Chi-Square = 32.01**</i>	
<u>Outreach Level</u>				
Large	58.9%	129	60.5%	129
Medium	71.2%	139	41.7%	139
Small	73.2%	336	29.8%	336
	<i>Chi-Square = 9.22*</i>		<i>Chi-Square = 37.45**</i>	

\* Chi-Square is significant at the 0.01 level

\*\* Chi-Square is significant at the 0.001 level

For both, the relationship with the MFIs' legal status, scale and outreach level are all significant. We can observe the growing influence of these microfinance networks, with the total of 45 percent of all MFIs in the datasets members of a local network. Cooperatives and credit unions are far more likely to be members of a local network, though the majority of NBFIs, NGOs and even the small number of rural banks are also involved in local networks. The relationship between the type of institution and involvement in international networks is even more pronounced.

Interesting relationships with the scale and outreach of the institutions also emerge. In general, it is smaller institutions in terms of both scale and outreach that are members of local networks. In contrast, a greater proportion of large institutions are members of international networks. It is impossible of course to draw a causal relationship here. However, it could very well be that rather than membership influencing scale or outreach, it is actually the size of the institution that might motivate a MFI to join a network.

## **Conclusions**

This analysis represents an initial attempt at utilizing emerging international data to explore the relationships identified at the national level at the level of the microfinance institutions themselves. First, in keeping with the theoretical framework, we see that the same factors have significant relationships at the institution-level as well. They also allow for additional light to be shed on the nature of those relationships. The above assessment allowed for a snap shot of which kinds of institutions have membership in local and international networks. Importantly, it was also revealed that only a minority of MFIs worldwide focus exclusively on women.

By grouping institutions according to the levels of political rights, stability and government effectiveness in which they are operating, significant relationships with individual

institution outreach provided further confirmation for the analysis from the previous chapter. The total client base of an individual MFI is of course a very different thing than national levels of outreach. However, these significant relationships reveal that certain size institutions are more likely to operate under different political contexts. Specifically, larger MFIs in terms of the number of borrowers tend to be found under politically free and effective governments. On the other hand, smaller institutions seem to have thrived in situations of political instability. Still, even this descriptive analysis presents some problems with the disparate levels of analysis. Future research will seek to apply more advanced statistical techniques to better test the relationship between macro-level political factors and MFI-level indicators of success.

The above assessment does provide insight into a few critical relationships. Although the relationship between national levels of outreach and investment freedom and regulatory quality were nonexistent (in the first case) and weak (in the second), considering funding sources and regulation at the institution level leads to some important conclusions. The institution level of analysis reveals the importance of regulation and savings, as well as the relationship between the two. Regulation has significant effects on the number of savers at an institution, as well as the use of those savings deposits as a source of funding. Moreover, utilizing savings in terms of financial intermediation has apparent effects on the scale achieved by the institution, operating costs and even the percentage of loans at risk of default. As discussed in the first chapter, often MFIs are prohibited from collecting savings because they fall into the gray area of unregulated financial institutions. Indeed in this dataset, only 23.5% of unregulated institutions reported savings as a funding source. This is especially true for the NBFIs and NGOs, which also happen to be the most common legal designations for MFIs. Regulated institutions had even lower operating expenses on average, likely due to this correlation between savings and regulation.

Thus this chapter has shed additional light on the question of market interventions. Limitations on funding have important consequences, and the connection to regulation should therefore not be ignored. There is a need to address what to do – from a legal standpoint – with NBFIs and NGOs in particular, not least because these are the most common types of MFIs worldwide. The case studies in the following chapter continue to delve into these issues which find further confirmation among practitioners.

## V. SRI LANKA: OUTREACH IN THE FACE OF WAR AND NATURAL DISASTER

While chapter four was able to provide a quantitative look at what is going on at the institution-level for microfinance institutions worldwide, a more qualitative look can provide an even better perspective on when and how microfinance institutions (MFIs) succeed on the ground. Case studies of the industry in Sri Lanka and Nepal, including interviews with those directly involved round out the analysis and provide further confirmation of the central hypothesis. Once again, political stability, regulation and capacity become key factors in explaining differences in microfinance success between the two countries.

Given their rural characters and the levels of development, there is a great deal of demand for microfinance services in both Sri Lanka and Nepal. Both countries have a history of informal credit systems and have in recent years seen impressive growth in this industry, with a wide variety of players getting involved. This includes, in both cases, some involvement on the part of the government. Generally though, microfinance is viewed as an important private sector tool which contributes to national agendas that emphasize poverty alleviation and rural services. One practitioner in Nepal even went so far as to call microfinance “the only successful program in the country.” Yet, by several measures, Sri Lanka has done a better job at meeting demand. Why?

An in-depth qualitative analysis of the microfinance industries in Nepal and Sri Lanka offers an opportunity to address some of the questions raised and left unanswered by a purely quantitative analysis. Utilizing information from interviews with practitioners, central bankers and other stakeholders,<sup>19</sup> and supplemented with industry reports, the analysis follows the same

---

<sup>19</sup> Information was gathered through elite interviews with chief executive officers or branch managers of MFIs who could speak of the organization’s general business plan and performance as well as contacts with regulators and the impact of the legal framework. Interviews were also conducted with officers of national microfinance associations,

theoretical framework and finds that, once again, institutions do matter. Moreover, simply having a regulatory framework is not helpful if it is not matched by sufficient capacity. The cases of Nepal and Sri Lanka also shed additional light on the growing influence of local microfinance interest groups, but this is a developing phenomenon and the domestic institutional framework remains key to understanding the differences between their respective microfinance industries. The end of chapter six concludes with a comparison of the key points in each case. In the end we see practitioners actually calling for regulatory frameworks that can help to legitimize their work and concerns expressed on the capacity of the government offices to actually implement the frameworks. Practitioners are frustrated that the fuzzy legal gray area in which they are operating frustrate efforts to offer savings accounts and thus expand their operations. The following qualitative assessment thus serves to better tie together the quantitative findings from chapter three which highlighted the significance of regime and capacity with the important connections between regulation and savings found in chapter four.

### **Microfinance in South Asia: Why Sri Lanka & Nepal?**

The South Asian region as a whole is notable for spearheading the microfinance movement, thanks in part to Muhammad Yunus' efforts in Bangladesh. Countries like Bangladesh and India are certainly exceptional, Bangladesh because of exceptionally large and notable institutions like BRAC, ASA and the Grameen Bank, and India for its sheer size. Nepal and Sri Lanka, on the other hand, serve as more typical examples. These two states are similar not only in terms of their South Asian location, varied cultural makeup, and population size, but also in terms of the institutional components of interest here. They are similarly ranked in terms of economic

---

central bankers and officers of other related government agencies. Altogether, I met with 25 individuals in Sri Lanka and 22 in Nepal. Refer to Appendix 7 for sample interview schedule.

freedom as well as political rights (Although the table below represents data from 2006, the most recent Freedom House report (2009) gives Sri Lanka and Nepal equal scores of four for Political Rights). Even the countries' experiences with violent and lengthy internal conflicts provide another similarity. Yet poverty rates and microfinance outreach are dissimilar.

Thus by providing for a “most-similar” approach, these cases provide an important opportunity to delve into the details of the macro-level context for microfinance. Sri Lanka appears to be the obvious success case in terms of dependent variables. The following analysis shows that it also has an advantage in terms of relative political stability, capacity and gender equality. However, Nepal has the advantage of a formal regulatory framework for microfinance, so the real story is more complicated.

Generally the existing literature on both Sri Lanka and Nepal is somewhat limited. The focus of much of the political science literature is on their respective civil wars. Political economic studies are rare and, where available, outdated. Studies which address microfinance in these countries in particular are limited to case studies of particular institutions and assorted industry and NGO reports. Comparisons of the two are also limited to assorted NGO and Asian Development Bank (ADB) reports on the South Asian region. Thus these cases represent not only an important component to establishing a political economic theory of microfinance, but also an opportunity to contribute to the political science literature on these countries.

**Table 5.1 - South Asia: Case Comparison (2006)**

	Sri Lanka	Nepal	Bangladesh	India	Pakistan
<u>Development &amp; Microfinance</u>					
Population below poverty line (%) <sup>1</sup>	22.7	30.9	49.8	28.6	32.6
GNI per capita (US\$) <sup>1</sup>	1350	320	450	820	800
Total Borrowers <sup>2</sup>	682,879	418,316	20,848,587	2,244,618	974,179
Microfinance Outreach (%) <sup>3</sup>	15.3	5.23	29.52	0.7	1.92
<u>Political Environment</u>					
Political Freedom Score <sup>4</sup>	4	3	4	6	2
Political Stability <sup>5</sup>	0.88	0.41	1.05	1.56	0.52
Financial Freedom Score <sup>6</sup>	40	30	20	30	40
Investment Freedom <sup>6</sup>	30	30	30	40	50
Regulatory Quality <sup>5</sup>	2.4	1.88	1.63	2.31	2.06
Government Effectiveness <sup>5</sup>	2.19	1.68	1.72	2.44	1.95

<sup>1</sup> Source: UNDP. 2008. "Human Development Report 2008 Statistical Tables." UNDP.

<sup>2</sup> as reported to the MIX Market. Source: MIX Market. *Microfinance Institutions: Indicators* 2009 [cited 15 September 2009]. Available from <http://www.mixmarket.org/>.

<sup>3</sup> borrowers / population below poverty line. Source: MIX Market. *Microfinance Institutions: Indicators* 2009 [cited 15 September 2009]. Available from <http://www.mixmarket.org/>; UNDP. 2008. "Human Development Report 2008 Statistical Tables." UNDP.

<sup>4</sup> Source: Freedom House. 2007. "Freedom in the World: Comparative scores for all countries from 1973 to 2006." Freedom House.

<sup>5</sup> Source: Kaufmann, Daniel, Aart Kraay, and Massimo Mastruzzi. 2008. "Governance Matters VII: Governance Indicators for 1996-2007." Washington, DC: World Bank Policy Research.

<sup>6</sup> Source: Heritage Foundation. 2009. "Index of Economic Freedom." Heritage Foundation & Wall Street Journal.

### *Meeting Demand: The Relative Success of Microfinance*

A key point of comparison between Sri Lanka and Nepal is the extent of outreach or market saturation that has been achieved. By any measure, it is Sri Lanka's microfinance sector which has more successfully managed to meet demand. The following table approximates growth of the microfinance sector in Sri Lanka and Nepal using the number of MFIs reporting to the MIX Market from 2000 to 2007. It is interesting to note that even with more individual institutions reporting from Nepal, the number of active borrowers and the gross loan portfolio in Sri Lanka is considerably higher.

**Table 5.2 - Growth in Microfinance Outreach**

	Sri Lanka			Nepal		
	active borrowers	gross loan portfolio (US\$)	MFI reporting	active borrowers	gross loan portfolio (US\$)	MFI reporting
2000	234,143	6,745,772	1	27,215	1,770,901	2
2001	na	na	na	31,712	2,418,936	2
2002	306,890	45,039,329	8	43,754	3,661,485	4
2003	384,961	59,244,319	10	209,766	23,824,238	15
2004	430,106	78,774,933	10	252,316	28,545,208	22
2005	682,879	149,729,145	11	313,621	40,519,362	26
2006	786,718	183,369,984	12	420,728	54,205,648	34
2007	711,165	225,861,625	13	475,789	79,385,276	32

na: not available

Source: MIX Market online database by CGAP (MIX Market 2009b)

As far as other measures of microfinance success, in both Sri Lanka and Nepal, most MFIs seem to have been able to achieve operational sustainability, but few are financially sustainable. This means that while they are able to cover operating expenses, they are not necessarily profitable. As one practitioner in Nepal put it, “microfinance is very common – everybody is doing it if they’re sustainable or not.” Government-run programs in Sri Lanka are considered supply-led and not commercially viable (Charitonenko and Silva 2002), while Nepal’s government-owned Grameen Bikas Banks (GBBs) have also suffered from poor financial performance (Shrestha 2008). Most of those interviewed attributed sustainability issues to various concerns about funding arrangements. For financial institutions, the most readily available source of funds comes from their clients’ savings, but MFIs in both countries are limited by unclear rules and regulations. As a result, they are reliant on loans from other financial institutions.<sup>20</sup> However, the risk is that this makes it difficult for MFIs to diversify their portfolios. Another sustainability issue noted in both countries was the difference between small

<sup>20</sup> Both countries do also have access to apex organizations which provide wholesale loans: for example, the National Development Trust Fund (NDTF) in Sri Lanka and Rural Microfinance Development Centre (RMDC) in Nepal.

and larger players in the market. Where there seemed to be a notable difference in sustainability was in the area of business management, capacity building and professionalism; all prerequisites for good financial performance. Indeed, professionalism and institutional capacity building seemed to be far more of a concern among those interviewed in Nepal than in Sri Lanka, though one practitioner in Sri Lanka warned that there has been a shift from focusing on the sustainability of clients to the sustainability of the institutions.

Generally, microfinance impact studies tend to be limited, so a comparison on this particular component of microfinance success is difficult. Individual institutions in both Sri Lanka and Nepal were generally found not to have conducted full-scale impact assessments of clients and did not necessarily have the available resources to do so. However, the need for assessments was widely recognized. As one practitioner pointed out, there is a need to know whether the impact is sufficient relative to the investment, while another pointed out that if they are “not conducting a proper impact assessment, [we] don’t know if you have really helped the poor or if you have left a legacy of indolence.” Attracting social investors and therefore improving sustainability is also tied to the ability to conduct these assessments. A great deal of reported success in terms of impact on clients comes from anecdotal evidence. Even if it is sometimes difficult to assess how the loans are being used, practitioners generally seem to feel that they are succeeding in “bringing banking to the unbankable.” Practitioners in both countries also speak of a “credit plus” approach that seeks to help clients beyond financial services. Truly building entrepreneurial ability through technology, access to markets and improved business management have been observed as necessary for clients to break out of loan cycles and graduate to greater investment opportunities. On balance, it would appear that microfinance in both countries seeks and manages to achieve similar impacts on its clients.

It should be noted, however, that while these issues are cited in both countries, Nepal also faces a unique problem in reaching the “missing middle,” as several practitioners referred to it. That is, while microfinance services exist for poor business operators and large commercial loans are available for larger, more established business, financial services are lacking for the SME sector. It is therefore difficult for poor entrepreneurs to grow their operations.

In comparing the relative success of the microfinance industries in Sri Lanka and Nepal, then, both countries face similar difficulties in achieving depth of outreach, financial sustainability and providing credit plus services to ensure positive impact on clients. The major differences are in the extent of outreach, professionalism and capacity, and the problem of the “missing middle.” In each of these areas, Sri Lanka seems to have the advantage. Thus here the question can again be posed: why do we observe these differences in the success of microfinance industries? As before, it is hypothesized that the answer lies more in the political institutional framework than in the presence of international and local interests or differences in gender equality. Drawing from the interviews conducted with key stakeholders in each country as well as industry reports and documents, each of these alternative explanations are considered in turn.

#### *Explaining the Differences: The Political Economic Framework*

Following from the theoretical framework applied to the institution and national levels of quantitative analysis, the same arguments can be applied to a qualitative comparison of these two cases. The analysis takes into consideration the possibility of gender-based explanations and considers the relative state of gender equality in Sri Lanka and Nepal. Conversations with practitioners reveal possible explanations for why gender equality has not been a consistent or particularly strong explanatory factor in the quantitative analysis. The emphasis is in fact far more on the effect microfinance has on empowering women than on the reverse relationship.

Observations of the Sri Lankan and Nepalese microfinance industries also shed additional light on the role of both international and local interests. While the influence of foreign capital was minimal, there was involvement on the part of international NGOs providing both grants and technical support. Local influences that were highlighted by those interviewed included political pressures and the budding role of national microfinance practitioner associations. These associations function as both capacity-building, supportive institutions as well as lobbying organizations for the industry. Their influence, though still emerging, was perhaps one of the more interesting findings from the field research.

However, the key to understanding the differences between the microfinance industries in Sri Lanka and Nepal once again lies in the institutional frameworks in which they operate. The regime, and in particular, the stability of that regime has important consequences. Years of violent conflict have had an impact on outreach in both cases, but the consequences for microfinance have been quite different. Government involvement in financial markets affects the microfinance industries in Sri Lanka and Nepal in a number of ways, ranging from how MFIs are licensed to direct government ownership. Indeed in both countries a considerable number of microfinance programs are offered by the government itself.<sup>21</sup> In addition, policies such as interest rate controls, debt forgiveness and tax rates have affected markets in both countries. Interviewees in both countries also pointed to issues of obtaining funding for loans due to confusing or non-existent policies. While it is interesting to note how many of the same institutional issues affect MFIs in both countries, important differences are manifest in varying degrees of government involvement, in the legal frameworks and in the capacity of regulatory bodies.

---

<sup>21</sup> It should also be noted that in both countries, this involvement in the financial sector is not limited to microfinance; there are several publicly owned large commercial banks as well.

To illustrate these important differences, this chapter first presents the case of Sri Lanka. Beginning with an overview on the state of microfinance, the political and regulatory environment in which they operate, gender equality and the representation of interests, this overall context is followed by a more detailed discussion of the key issues. Chapter 6 similarly presents the case of Nepal, followed by a comparison of the two cases.

## **The Case of Sri Lanka**

### *Microfinance*

As in many countries, contemporary microfinance in Sri Lanka has roots in traditional informal credit structure and cooperative organizations. While the history of informal credit is quite long, microfinance itself can be dated back to 1906, when the first Sanasa society was formed (Conroy 2000). Microfinance in its present incarnation was recognizable in Sri Lanka by the 1980s (Tilakaratna et al. 2005). The formal financial system in Sri Lanka is made up of commercial and specialized banks, finance companies and leasing companies (Central Bank of Sri Lanka 2009). Institutions relevant to microfinance include rural development banks, the Sanasa Development Bank, Samurdhi Bank Societies, various rural cooperatives, the Thrift and Credit Cooperatives of the Sanasa movement and assorted NGOs, altogether representing over nine thousand separate outlets or branches (GTZ 2009). Though the government of Sri Lanka remains a major provider of financial services, through the Samurdhi societies and state-owned regional development banks, a recent country-level assessment by CGAP cited the diverse institutions and services available as a key strength of the microfinance sector (Duflos et al. 2006). In addition, commercial banks, finance and leasing companies are increasingly getting involved as well. For example, Hatton National Bank's *Gami Pubuduwa* ("Village Awakening")

microfinance program, established in 1989, is a leading model of how large commercial banks can scale down operations and incorporate a microfinance component into their business model; an answer to criticism that commercial banks often do not have the expertise to do so (Vogel 2006). One practitioner pointed out that even with the largest banks paying attention to microfinance, there is still a role for other types of institutions, like leasing companies.

The variety of institutions involved includes different microlending models and business strategies and has contributed to the impressive degree of financial access in Sri Lanka. Key findings of one particular survey of the Sri Lankan microfinance industry included note of its broad based coverage of microfinance throughout the country, high levels of supply relative to the overall population, high levels of savings mobilization (including an increase among the poorest), increased competition and wide range of products (Gant et al. 2002). It has been estimated that by 1999/2000, 70 percent of poor households had access to some form of savings services and 26 percent borrowed from various formal, semi-formal and informal loans, the same distribution as all other households (Alailima 2007). Increases in outreach have also been impressive, with 51 percent growth in the number of deposit accounts from 2000 to 2004 (Duflos et al. 2006). Though there has been mention of more limited outreach in rural areas (Tilakaratna et al. 2005), even these areas are reported to have access to a range of services. As one consultant pointed out, most villages have access to at least two service providers, though perhaps not microfinance specifically. There are also lower levels of outreach in the north and eastern regions of Sri Lanka, areas where the conflict has been concentrated, (Gant et al. 2002; Tritschler and Bartocha 2007) though Jaffna is among districts with the highest coverage (Duflos et al. 2006).

Even where outreach has been successful, depth of outreach to the poorest has proven more difficult. One officer with the Regional Development Department at the Central Bank of Sri Lanka (CBSL) suspected “leakage,” with people trying to take advantage of lower interest rates offered on micro-loans. She suggested that it might be possible that the poorest cannot be helped by the loans if they do not have the kind of entrepreneurial activities microfinance programs seek to fund; they may instead require a special model. A more critical opinion expressed was that while the local organization is there, MFIs do not necessarily reach the hardcore poor because they are operating a business, reflecting the widely held belief that depth of outreach is incompatible with commercialization. On the other hand, Sri Lanka’s Institute of Policy Studies found that MFIs were in fact reaching the poor and poorest groups, though a significant portion of clients were non-poor (Tilakaratna et al. 2005). A more recent study by the German Technical Corporation (GTZ) found that the Samurdhi Bank Societies and NGO-MFIs appeared to have achieved the greatest depth of outreach, compared to other types of institutions and that competition in the financial industry was also encouraging “financial deepening” to lower income clients (GTZ 2009).

Though few Sri Lankan MFIs can be considered financially sustainable, they are in many cases operationally sustainable. Concerns in this regard seem common to MFIs generally, including concerns about funding sources and the competitiveness of smaller MFIs. One report noted that the existence of many small MFIs in Sri Lanka diverts resources away from sustainable microfinance (Duflos et al. 2006). Smaller institutions find it more difficult to achieve scale and meet minimum capital adequacy requirements. They also have a tendency to get stuck in a “chicken/egg situation” as it was put in one interview. That is, they do not have

the experience or capacity to be eligible for a lot of funding, but without that funding it is difficult to achieve those requirements.

Concerns about professionalism and the institutional capacity of MFIs were also a particular concern. As one practitioner pointed out, where microfinance institutions are weak, they do not necessarily have the funding or services to meet demand. Another pointed to a lack of experts, with microfinance employees often having jumped from other fields in a relatively short amount of time. A 2002 Asian Development Bank report noted that at least half of MFIs in Sri Lanka had weak institutional capacity and aversion to commercial approaches. This was attributed to negative perceptions about commercialization that prevented MFIs from sufficiently balancing commercial and social missions as well as achieving sustainability (Charitonenko and Silva 2002). Another report pointed to weaknesses like lack of transparency, fragile institutions, and lack of specialization in financial services, but also indicated that there was increasing transparency among a group of leading MFIs, such as the ones that are regularly reporting to the MIX Market (Duflos et al. 2006). In fact, Sri Lanka is also seeing increased availability of finance and microfinance training, such as that offered by the Centre for Banking Studies. The availability of industry specific training has been listed as a strength in several reports on Sri Lanka's microfinance industry (GTZ 2009; Conroy 2000), and has been called a "key ingredient to reducing MFIs fragility" (Duflos et al. 2006, 22).

The importance of impact assessments is also recognized by practitioners, though they are often not feasible for MFIs to properly implement. Impact studies are being conducted by the CBSL on their own loan programs and assessments of specific programs and regions by various independent agencies generally found positive results (Hulme et al. 1996; Sear and Simon 2001; Tilakaratna et al. 2005). One report noted that MFIs in Sri Lanka were particularly

helpful in assisting clients affected by the tsunami, rescheduling loans and helping clients to settle insurance claims and access savings (Duflos et al. 2006). Some caveats were given. For example, one survey found that although the loans had a positive impacts on clients' small businesses, they were not creating new businesses and therefore substantial increases in income were unlikely (Colombage 2004). Another pointed out that without access to skills, technology and markets, self-employment and microcredit might actually perpetuate poverty for women living in rural communities (ADB 2003). Certainly, there was emphasis among practitioners on the more "credit plus" approach to meet the additional needs of their small business clients. For example, a banking survey for the Small and Medium enterprise (SME) sector there found that beyond difficulties in obtaining formal finance, these business are constrained by the absence of technical and management skills, marketing constraints, inadequate infrastructure and outdated technology ("Banking Survey" 2007).

Still, simply having access can help people to come out of poverty, even if it takes several loan cycles. Success stories in Sri Lanka speak to improving savings habits, graduation of clients to commercial banking, and general improvements in livelihood. A publication by ProMiS, a local microfinance network coordinated by GTZ, highlights stories of individuals and families for whom microfinance has succeeded in empowering, ensuring education, supporting lives in conflict-affected areas, improving housing conditions, enhancing entrepreneurship, and even strengthening families (ProMiS 2008). As one practitioner pointed out, just providing financial access is important: "that single intervention is going to make a huge impact" in terms of things like income, health, etc.

### *Institutional Framework*

Despite criticism for an increase in a more authoritarian style of rule on the part of President Rajapaksa during the climax of the civil war (Freedom House 2009b), Sri Lanka has a strong legacy of democracy, extending back to independence in 1948 and in keeping with the 1978 constitution. As University of Colombo Professor Laksiri Fernando put it, “Compared to many post-colonial countries of similar age after independence, Sri Lanka today demonstrates a considerable maturity in its democratic institutions and practices” (Fernando 2000, 77). Though it has a strong executive and has fluctuated between Freedom House Scores of “free” and “partly free,” it has maintained an impressively stable regime.

Now, with Sri Lanka’s long civil war declared over, there was a lot of talk of expanding microfinance services in the North and East. People there, said one practitioner, would now be in a position to go into new avenues of activities, and presumably would then be in demand of increased financial services. One CEO spoke of banking in all 3 languages,<sup>22</sup> emphasizing that “communication is very important.” Up until very recently, in spite of obvious demand, many had not expanded operations because of perceived barriers (Tritschler and Bartocha 2007), but this seems to be changing. The prevailing view seems optimistic, with MFIs eager to contribute to the recovery by providing a needed service. In addition to poverty alleviation, social and community development, a broad range of microfinance organizations also see it as a “multi-faceted intervention tool in areas affected by conflict” (Gant et al. 2002). The government has already seen to it that basic banking services have been provided through mobile banking units, though one central bank official did point out that immediate concerns, such as the clearing of land mines, would have to be addressed before expansion of services could be started. President Rajapaksa also reportedly announced that his government’s “Awakening North” package would

---

<sup>22</sup> Sinhalese, Tamil and English

include a \$26 million microfinance loan program (Naaraayana 2009). As one branch manager pointed out, because of the huge amounts of money that went to the war, the private sector will have a particular role to play in providing these services. While the standard caution that microfinance is no panacea still applies (Tritschler and Bartocha 2007), the microfinance industry in Sri Lanka seems to have embraced the end of the conflict as an opportunity to contribute to the recovery as part of a wider development strategy.

Indeed, microfinance does appear to be viewed as an important tool for development and therefore often receives at least lip-service in national agendas. Several practitioners interviewed in Sri Lanka were quick to reference the current President's platform, which includes a commitment to the sector. This agenda recognizes that the lack of a formal microfinance policy has resulted in weak institutions and the absence of an institutionalized mechanism for coordinating microfinance with other development efforts (GTZ 2009). Several practitioners even pointed to the support received from local government offices, particularly in identifying and supporting training programs for clients.

Still, at least in terms of the legal framework, the Microfinance Industry in Sri Lanka was described by one practitioner as "no one's baby." Another indicated that there was neither support nor prohibition from the government as far as microfinance; something typical of the kind of benign neglect microfinance generally receives, and which often stems from a lack of capacity. While there is no specific policy framework, there are no significant barriers to entry either (Alailima 2007). Generally, organizations seeking to offer microfinance services are encouraged to register under the non-bank division as a specialized bank or finance company (see table below for applicable laws in both countries). However, institutions that fall under the Department of Non-Bank Financial Supervision are still not subject to proper regulatory

mechanisms. Still other MFIs are neither licensed nor regulated by the CBSL or Ministry of Cooperatives and are instead registered as societies, companies or NGOs.

The result is diffused responsibility for microfinance, which as one report noted, makes it difficult for the government to pursue a “common vision on microfinance” (Duflos et al. 2006). The general approach is self-regulation in a free market environment. The arguments for this approach are common for microfinance around the world: that MFIs are still seen as being early in their development, that they constitute only a small part of the overall financial system, that a hands-off approach has so far been adequate and that the larger MFIs must meet minimum standards for support from donors (Wijewardena 2003).

While MFIs in Sri Lanka enjoy a range of registration choices and minimal supervision, there are several concerns. For one, the choice of registration is often limited by minimum capital requirements but may also determine the extent of services that can be offered or funding sources available. For example, it may be beneficial for MFIs, once established, to switch registration if they are able to meet the minimum capital requirements for a finance company, or even a specialized bank (with even higher requirements). This would then allow those institutions to collect savings and make it easier to obtain foreign loans. However, for many small MFIs, the minimum requirements are too high. As one practitioner put it, “this is good for the big boys” but too difficult for others. Supervision and regulatory requirements that are in place vary based on the MFIs registration. While all registered companies and financial institutions are subject to independent audit requirements, many MFIs however are not subject to any kind of onsite supervision and do not necessarily have to submit any financial statements to the Central Bank unless it is directly involved in the loan program. For most MFIs in Sri Lanka,

contact with the Central Bank therefore appears to be in a more unofficial capacity, such as for training programs or as specific issues arise.

### *Gender Equality*

By most measures, gender inequality is less of a problem in Sri Lanka than anywhere else in South Asia. The most recent Freedom House report does mention a lack of representation in politics and civil service in Sri Lanka and discrimination in salary and promotions in the private sector (Freedom House 2009b). An ADB report pointed out that female-headed households and women in the conflict-affected areas have proven particularly vulnerable (ADB 2003). As one practitioner pointed out, “among the poor, women are poorer.” Another, the female head of an NGO, highlighted the traditional male-dominated family structure saying that “men feel threatened if their wives are associated with me.” Still, Sri Lanka is notable in the region for being more progressive in this area, with those interviewed eager to point this out (Appendix 11 highlights several indicators of gender equality).

In terms of the relationship between gender inequality and microfinance, it can certainly be said that it does play an important role in creating demand for microfinance and inspiring targeted outreach. Women often face limitations in accessing credit through commercial banks due to collateral requirements. It was even suggested that going to one of the larger banks was a scary prospect for women. Said one, “Taking a poor woman to a bank is not easy, but it is possible here.” As a result, MFIs in their various forms play an important role in serving the female market. A GTZ report found that the MFIs accounted for the majority of both female borrowers and savers (GTZ 2009). From interviews, it was clear that widows in the north would be a priority for CBSL sponsored microcredit programs. At the same time, practitioners were

often unable to draw a direct connection between gender inequalities and the *success* of microfinance to meet demand, focusing instead on successes in empowering their female clients.

### *Representation of Interests*

The influence of international interests generally seemed to be benign, though Sri Lanka has shown itself to be particularly wary of international influence. Practitioners considered international contacts to be good for promoting best practices. International aid agencies and NGOs seem to play more of a supportive role in terms of providing capital, training and capacity building without undue pressure on the way the MFIs do business. As one manager in Sri Lanka said, their international donors were “kept in their place.” Still, the microfinance industry in Sri Lanka has benefited from the presence of ProMis for example, a microfinance network that is the result of a collaboration between the Sri Lankan Ministry of Finance and the German Technical Cooperation (GTZ) and which promotes training, best practices and capacity building, policy advocacy, research, and networking (ProMiS 2009a). Organizations like the Asian Development Bank (ADB) also seek to promote a conducive policy environment for microfinance. In Sri Lanka though, this involvement has by some accounts been rejected. Specifically, the proposal for a separate Microfinance Act had originally been connected to an ADB loan. It was suggested by several of those interviewed that a general suspicion of international organizations<sup>23</sup> and desire on the part of the Sri Lankan government to do things their own way may be one of the reasons the Act has stalled. One even indicated that once the money came in, the idea just got shelved altogether, though another argued that the government deemed the original ADB strategy for regulation “not as tough as we thought.” A few practitioners suspected that delays

---

<sup>23</sup> The Sri Lankan government was particularly suspicious of international aid agencies as the conflict came to climax. In fact aid agencies, which had provided support for those displaced by the war, were asked to leave the northern part of the country in September 2008 (Freedom House 2009b).

with the Microfinance Act were due to a particular suspicion of international NGOs and negative attitudes toward NGOs in general, who would be empowered by such legislation.

In addition, the microfinance industry in Sri Lanka was negatively affected by the influx of donor funds following the 2005 tsunami. Besides the tragic loss of clients, as well as property and records, the “distribution spree” that followed was seen as particularly damaging, a “catastrophe” for the industry. While the increased availability of funding was beneficial for many, it also led to the multiplication of many small microfinance programs which proved to be unsustainable. A GTZ report on the impact of tsunami on microfinance noted that there was a lack of coordination among multi-lateral and bi-lateral donors, International NGOs and the government; unequal distribution of funds, with the Eastern areas most affected receiving less support; and concerns that the flood of grants had created dependency at the client level (Srinivasan 2008). Several programs imposed interest rate ceilings to limit what clients could be charged but also made it difficult for MFIs to cover costs. Additional confusion stemmed from the fact that post-tsunami aid included a mix of loans, grants and various combinations, which led to misunderstandings and frustration among recipients (Duflos et al. 2006).

More locally based interests manifest themselves in terms of the political pressures and conflicting opinions on the part of legislators and government officials. For example, the delays on Sri Lanka’s microfinance act were attributed to a lack of urgency for legislators, who do not see microfinance as a big enough issue or systematic danger to larger financial system. Between criticism and a lack of priority on the part of the government, at least one stakeholder stated, “I don’t believe it will come.” There were concerns that, particularly given the lack of policy, there have been incidents reported of politically motivated enforcement. For example, despite the widespread collection of savings by MFIs, one organization in particular was reportedly targeted

and instructed to return savings to the clients. Said one stakeholder: “this is the political risk when there is no law.” Another indicated that for government officials, interest in microfinance is more politicized than concerned with the sector as a means of development, saying “I firmly believe that they are not serious and don’t have that much knowledge on how the microfinance sector can improve the economic environment.”

As one practitioner in Sri Lanka put it, “We are in a bit of a funny state because the government thinks we are extortionists and the banks think we are philanthropists, do-gooders.” A similar comment pointed out that there are still some people at the central bank who view microfinance as “fishy.” As the Democratic Socialist Republic of Sri Lanka, there are many who are suspicious of leaving pro-poor, development activities to the private sector and instead promote the use of subsidies and interest rate controls. The result is that the government “has been supporting and critical of microfinance at the same time” and practitioners observe different departments in the same building disagreeing on the legality of what they are doing. One area where this has become particularly problematic is in the area of interest rate controls, with one particular report indicating that credit is “too often politicized” through the various subsidies that work to keep interest rates low (Duflos et al. 2006). Stakeholders report a perception among some government officials that higher interest rates would have a negative affect on the poor, and indeed may be considered morally wrong. This was apparent in one interview with an official who held that it is a “crime to charge too much to the poorest.” Practitioners responded by saying that the politicians “don’t understand” and point to their ignorance about how microfinance is meant to work. Said one: “microfinance is not about interest rates but about access,” while another argued that politicians “need to face the reality of higher rates because of costs.” Even more problematic are politically motivated loan write-offs or debt forgiveness,

something cited in several reports on Sri Lanka and by practitioners interviewed there (Charitonenko and Silva 2002; Duflos et al. 2006; ProMiS 2009b). As one of these reports pointed out, all instances of debt forgiveness have an adverse affect on general attitudes about repayment (Charitonenko and Silva 2002).

Perhaps the most interesting phenomena, however, has been the recent formation of a national microfinance practitioners association and its emerging role in articulating and representing the interests of MFIs in Sri Lanka. Initiated in 2006, the Lanka Microfinance Association promotes membership among all microfinance institutions throughout Sri Lanka. Its mission is “To build the capacity of institutions engaged in microfinance to serve poor communities in a viable and sustainable manner.” Among its stated objectives are “to advocate for a policy environment that is conducive to the growth and development of the micro finance sector” and “to mobilize resources and to network with Government, Donors, Funding Agencies, Investors and Commercial Loan Providers in order to enhance the development of the Microfinance Sector” (Lanka Microfinance Association 2009). When asked about the association, practitioner responses included for example that the “main goal is to represent the members” and “to be a voice to the industry.” Many mentioned the focus on policy and capacity building and more generally that it was for, “the promotion of microfinance and to eradicate poverty.”

The association has made progress in terms of bringing MFIs together. Prior to the association, lobbying by individual institutions and small groups were reportedly not as successful. As one practitioner pointed out, in 100 years of microfinance, while some were “singing their own song,” there was no common voice until the association. Another precedent, a UNDP organized network where “everything was given by the UNDP, even the cup of tea,”

ultimately disintegrated because it was not home grown. Representatives from the association as well as the Central Bank pointed to positive interaction between the two institutions. They report meetings and appeals to particular departments, with the association playing a particularly helpful role in facilitating an industry-wide survey of MFIs. In addition, the Association has been particularly involved in promoting the passage of the Microfinance Act, seeking to improve the image of microfinance by ensuring it is properly legalized. It contributed to drafting the Act, seeking to ensure it is “friendly for all stakeholders.” Practitioners interviewed were generally happy that the Association was able to provide input, though the Act has yet to pass. More generally, the Association has been able to establish itself as the sector’s representative in the country. In the short period it has been in operation, this was cited as an important achievement. It has established “cordial relations” with legislators, developed “trust and friendship” among practitioners, and its presence is according to some “strongly felt now.”

### **Key Issues**

Given the context for microfinance in Sri Lanka, what are the key issues for the industry there? Conversations with practitioners, stakeholders and officials revealed consistent themes, discussed in more detail below. Moreover, these themes are in keeping with the hypothesis on the relative importance of institutions.

### *Stability & Conflict*

Interviews took place quite literally within weeks of the official end of Sri Lanka’s lengthy and bloody civil war. The impact of the war, as well as its aftermath, are therefore an important consideration. A GTZ report on Microfinance and Conflict in Sri Lanka points to some of the immediate effects on the Sri Lankan microfinance industry. It maintains that the

supply of microfinance in the North and East is not sufficient. Cooperatives, which have been the most important providers in the conflict affected areas, are performing poorly. Those national-level NGO-MFIs that have maintained operations in these areas still make a comparatively small contribution, while commercial banks are “practically absent” though Hatton National Bank, Seylan Bank as well as People’s Bank have maintained a presence (Tritschler and Bartocha 2007). Based on interviews with practitioners, the conflict has also reportedly resulted in some funding issues, with some donors scared off by the political situation. The report also cites additional challenges faced by MFIs in post-conflict situations. These include limited human resources, risk reduction, and higher costs. Additionally, there is a need to ensure advocacy for strong sustainable microfinance operations to separate them from relief operations and perhaps an influx of NGOs and aid. MFIs must also be cautious of being involuntarily viewed as part of the problem, by ensuring transparency and accountability (Tritschler and Bartocha 2007).

### *Government Ownership & Controls*

Perhaps the most manifest occurrence of market interference in the microfinance sector is direct involvement on the part of the government. An ADB report on the role of Central Banks in microfinance notes that the CBSL has played a very direct role in terms of interest rate controls and direction of credit (Conroy 2000). Government programs include the Samurdhi program, a large scale microfinance operation which caters to those below the poverty line and is widely praised for its outreach, though from discussions with stakeholders in the industry, it is less clear that it is able to cover its costs. The publicly owned regional development banks (RDB) have struggled in the past but are currently deemed to be doing well. One RDB manager suggested that many MFIs are not necessarily “steady” while the RDB is *because* of the

government control. There are also countless government-run microfinance schemes associated with various ministries; as one interviewee put it “every ministry – you name it, they have it.” These programs are generally regarded as unsustainable. Sri Lanka’s National Development Trust Fund (NDTF) is a government-funded wholesale lender that highlights this country’s emphasis on public provision of microfinance. Because of its government mandate, the NDTF plays a very active role in ensuring cheap credit reaches the poorest. Indeed, the emphasis there is on the inability to rely on the private sector to ensure that the poorest are reached in a sustainable manner. A practitioner from a private MFI noted however that funding from NDTF was “not enough.” Furthermore, it has been argued that the availability of cheap credit from government programs is actually responsible for crowding out private microfinance NGOs and other providers that may not have access to subsidies (Charitonenko and Silva 2002). Rather than withdrawing from direct involvement in microfinance programs, the CBSL is expanding outreach. International aid agencies cite these government managed programs and high subsidies as among the key issues facing the microfinance sector in Sri Lanka (Gant et al. 2002) and recommend minimizing direct interventions (Charitonenko and Silva 2002).

A separate issue that stems from subsidies and other government involvement is that they effectively cap interest rates below market. In Sri Lanka, public microfinance institutions benefit from either overt or hidden subsidies (Kneiding and Rosenberg 2008). In addition, private MFIs and commercial banks with microfinance divisions can take advantage of central bank loan programs or funding from the NDTF to offer cheap loans to clients as well. However with the large number of government run or sponsored programs, it is difficult for private institutions which are not receiving subsidies to compete. The result of these programs is, in effect, imposed

interest rate ceilings on loans to the poor. This increases costs for MFIs and makes it that much more difficult to achieve sustainability.

### *A Regulatory Framework*

From the review of the literature (Chapter 2), it is apparent that the nature of prudential supervision is critical to a consideration of how market interventions impact the success of the microfinance industry. The process of auditing and monitoring the performance of financial institutions ensures safety and soundness and protects the interests of public deposits. In Sri Lanka, the lack of a formal regulatory framework and sufficient supervisory institutions means that microfinance institutions find themselves in a gray area when it comes to collecting public deposits. Without prudential supervision to ensure the protection of depositors' savings, technically Sri Lankan MFIs are prohibited<sup>24</sup> from offering a much needed service to their clients. Without savings, ensuring sustainability becomes much more difficult. MFIs without deposits find themselves dependent on obtaining funds through loans from other financial institutions. This creates a Catch-22 in that some institutions will not lend to the MFIs because their liquidity is not sufficient. However, this has generally not been enforced and indeed the government has previously *encouraged* the collection of savings through microfinance programs. Many MFIs therefore continue to offer various compulsory or voluntary savings programs. The consensus among practitioners seems to be that their savings programs should simply be limited to existing members only. With no clear policy, though, there is the uncertainty of legal sanctions. Many of those interviewed cited a need for more clarity on this issue and for a legal way to mobilize existing savings in order to protect depositors.

---

<sup>24</sup> According to the Central Bank, there are only three major categories of institutions that are subject to licensing, regulation and supervision by the Central Bank and are therefore legally permitted to collect public deposits: commercial banks, specialized banks and registered finance companies (Central Bank of Sri Lanka 2004).

Sri Lankan MFIs also face difficulties in diversifying their portfolios because of limitations on borrowing foreign capital. Because microfinance is classified as a money lending business, it is presently restricted from obtaining offshore investments, a fact that has had a negative impact on some of the larger but unregulated MFIs that might otherwise be able to scale up operations (GTZ 2009). A proposed Microfinance Act would have exempted licensed MFIs but this has not as yet been implemented. For now, approval for foreign capital is not typical and, as one practitioner complained, can take “ages.” Streamlining the process has been recommended by CGAP consultants (Duflos et al. 2006) and would as he hoped “let it come sooner, faster, easier.”

As a result, there was a consistent call among practitioners for a clear and comprehensive regulatory framework. The fact that they were “missing clear guidelines” was mentioned as a main concern by many of those interviewed there and many spoke of the need to pass the Microfinance Act, which was at that time still being revised. Not only has the lack of a clear legal framework made it difficult to collect savings and obtain foreign funds, but it has also been blamed for a fragmented rural finance sector, poor performance of MFIs and “strengthen[ing] the tendency to operate on regulatory arbitrage” (ADB 2003). It also makes it difficult for commercialization and transformation of microfinance institutions and limits the diversification of services (Charitonenko and Silva 2002; ADB 2003). Moreover there is the danger that, with microfinance playing an increasingly important role in the larger financial system, any major or widespread failures of unregulated MFIs could result poor households losing their savings or even more systemic failures (Charitonenko and Silva 2002; Wijewardena 2003; ProMiS 2009b). This fear is echoed by practitioners who view regulation as a means of achieving greater legitimacy. Particularly in light of recent scandals and cases of fraud involving Sri Lankan

institutions ostensibly providing “microfinance” services, practitioners see it as an opportunity to set themselves apart from these incidents. Regulation is viewed as the way to help free interest rates, provide a legal framework for savings collection, increase opportunities for foreign funding, and create greater transparency in the industry. As one practitioner pointed out “as the situation in the west illustrates – deregulation can be bad, so some regulation is good.” Another official indicated, “in my view, if we have any regulatory system, the benefit is going to the institutions and the poor people.”

### *Regulatory Capacity*

As mentioned, Sri Lanka has drafted a Microfinance Act. The need for a comprehensive policy has already been noted, not least of all because of, as one practitioner called it, the “moral obligation” to correct the gray area that characterizes savings mobilization. A central act would also help to bring together disparate types of MFIs as well as what regulation is already present, allowing established providers to register with the Central Bank as regulatory authority. Several steps toward these goals have been taken including the drafting of the Act as well as the establishment of a new department for development finance under the Ministry of Finance (ProMiS 2009b). The CBSL Department of Non-Financial Supervision has also sought to reach out and gather information on all the different types of organizations operating in the sector. However, under the first draft of the Act, a large number of providers were excluded (GTZ 2009) and it has been since delayed several times.

One of the reasons suggested for delays with Sri Lanka’s Microfinance Act was concern about the large numbers of MFIs and whether it would be logistically feasible to regulate all of them. Of regulation, one practitioner indicated “We welcome it, but the government is not prepared.” Certainly regulating the large number of MFIs is “no easy task” and there have even

been suggestions that small MFIs be encouraged to merge with larger ones so that there are fewer to be supervised. In addition, hundreds of cooperatives fall under cooperative law and are not monitored by the CBSL. Though many are sustainable, varied performance and a lack of standard accounting and reporting practices have been reported (Charitonenko and Silva 2002). There is concern that the level of expertise among coop inspectors is not in line with the central bank. It was suggested that if the Microfinance Act were to pass, this would help to resolve some issues, for example by potentially bringing greater supervision to the Samurdhi societies. Yet this only adds to the problem of having too many MFIs to monitor.

One practitioner suggested that delays and talks of abandoning the Act are due to a realization that there is simply not the capacity, calling it “typical third world bureaucracy.” Critical assessment of the CBSL includes calls to strengthen management capabilities and ensure independence from politicians and foreign agencies (Karunatilake 2004). A GTZ report on the microfinance industry indicated that methods and standards of supervision vary widely and the absence of a single regulatory and supervisory authority has resulted in a lack of uniform standards and no common direction (GTZ 2009). Moreover, there are simply not enough personnel at present. The CBSL’s supervisory capacities have been noted to be fully stretched and any additional obligation to supervise MFIs difficult given resources (Conroy 2000). One ADB report suggested that CBSL personnel should be redirected to the development or effective supervision rather than direct implementation of microcredit projects (Charitonenko and Silva 2002). At present capacity concerns continue to be “maybe the biggest obstacle” according to one consultant. As in Nepal, there is the suggestion that a separate supervisory division or institution may be necessary. Of course, the question again is capacity. Thus encouraging a

more self-governing system that would be less of a burden for the government remains a favored option by many.

### *The National Association*

Finally, there is the emerging role of the Lanka Microfinance Association. While this organization is playing an important role in providing a voice to the industry and facilitating discussions with the government, it is still establishing itself and does not, as yet, play a critical role in the success of the microfinance in Sri Lanka. For example, some have reported that the industry has not done enough to keep the government well-informed and that disagreements among different segments of the industry were to blame for the Act stalling. Generally, the Central Bank did not appear to face much pressure from the Association. One practitioner even suggested that Sri Lankans are generally very passive and therefore “aggressively lobbying for things is not in our nature.” One expert argued that the Association was “not yet recognized as *the* body of the microfinance industry.” Indeed, at the branch level and in more remote areas, there is less familiarity with the association at all. The variety of institutions involved in microfinance and lack of common ground has made it difficult to speak with one voice and some remain excluded from the association (namely large commercial banks and smaller NGOs).<sup>25</sup> Still, there is much optimism and the Association “has a long way to go and a strong role to play.” In particular, practitioners saw it as an important player for getting the Microfinance Act to pass. Moreover, they have a role to play in increasing capacity: “to get members to a level where they can be ready for regulations... [it] won’t help if we’re not ready.”

---

<sup>25</sup> The association does not appear to exclude these organizations from involvement, however, and commercial banks like Hatton National Bank have been involved while unable to maintain formal membership.

The case of Sri Lanka has highlighted the need for a clear regulatory framework for microfinance. With all of the success in the industry, this is still lacking, and moreover, continues to frustrate practitioners. In the following chapter, we will see that Nepal has such a framework, but has still not made the strides Sri Lanka's industry has. The discussion of capacity then, becomes much more critical.

## VI. NEPAL: A REGULATORY FRAMEWORK FOR MICROFINANCE

The salience of the key issues presented at the end of Chapter 5 becomes that much clearer when contrasted with the picture in Nepal. This chapter presents the context for microfinance in Nepal, and contrasts the important themes that emerged from research there with that from Sri Lanka. The final section presents a comparative assessment and discusses the lessons that can be learned from the contrasting cases of Sri Lanka and Nepal.

### **The Case of Nepal**

#### *Microfinance*

Nepal's formal financial system can be traced back to 1937 with the establishment of the Nepal Bank Limited and the first credit cooperative in the 1950s (Sinha 2000). Microfinance has its roots in the *desla guthis*, groups of artisans who maintained a credit fund for members, as well as the *dhikuri* systems which are similar to other Rotating Savings and Credit societies (Zivetz 1992), but would not emerge in its present form until the 1990s with the emergence of a democratic system. Nepal has a more limited range of institution types engaged in microfinance than does Sri Lanka, but is unique in the region with specific regulatory designations for microfinance institutions. In addition to cooperative societies, which are separately licensed, there are financial intermediary NGOs (FINGOs), microcredit development banks (MCDBs) and regional rural development banks (Sinha and Sagar 2007). Though commercial banks are not directly involved as they are in Sri Lanka, they do provide wholesale lending to the various MFIs. The Nepal Rastra Bank's 2007 Annual Bank Supervision Report also reported that banks are "gradually but surely" expanding networks to reach rural clients (Nepal Rastra Bank 2008).

The following table compares relevant institutions in both countries based on information from the Asian Development Bank's report on the role of central banks in microfinance.

As noted in Chapter 5, Nepal's microfinance sector continues to have trouble meeting demand. A World Bank study of Nepal's financial sector found inadequate banking services for the poor, estimating outreach in 2002 as only 6.5 percent of the total poor, after a decade of microfinance (World Bank 2002). Although the financial sector has expanded, institutional credit is still meeting only about 20 percent of total demand, leaving the other 80 percent to come from informal sources (Thapa 2008). There is concern that even an increase in the number of cooperatives has not seen a resulting increase in clients. One person suggested that since these institutions are member-based, their like-minded members are not necessarily seeking to expand outreach. The CEO of the Rural Microfinance Development Centre (RMDC), an apex body, has noted that "the outreach (in both depth and scale) of most MFIs is very low compared to what needs to be done" (Shrestha 2008). Indeed mentions of unmet demand was far more common among Nepalese stakeholders interviewed than Sri Lankan. Some optimistically saw this as an opportunity – describing microfinance as having a "bright future" and "going to be a success."

Geography certainly plays an important role and was mentioned as a particular concern in about half of the interviews conducted there. There is considerably more access to finance in the plains and accessible hills. So while there has been an increase in outreach, MFIs are not necessarily moving to the hills. Operations there are considerably higher risk and more costly, with several practitioners citing that it could take up to five years for offices there to be considered viable. In fact, banking services in the rural areas have actually decreased as commercial banks have withdrawn (Thapa 2008). Thus the question of how to expand services

to more inaccessible areas to meet demand is a critical challenge to achieving outreach in Nepal. Sri Lanka's geography is varied, but does not nearly present the same challenge to outreach.

As in Sri Lanka, Nepal's MFIs do face concerns about achieving depth of outreach, as well as breadth. The World Bank's report was particularly critical of Nepal's "diffused focus," noting that "the overall focus of micro-credit by MFIs has not been the absolute poor" (World Bank 2002). The intent of these programs to reach the poor was not lost on those interviewed however and their interest in expanding to the more distant, hilly – and poorer – areas spoke to this. As one put it: "reaching the poor makes us successful."

Nepal also shares similar concerns regarding sustainability. Improving the professionalism and quality of the microfinance institutions themselves was a particular concern, and was highlighted in many of the interviews there. A recent World Bank report on Nepal was also critical on this point, noting low profitability and weak technical capacity (in areas such as accounting and auditing, strategic planning, financial analysis and human resource management) among central concerns. It goes on to point out that the lack of commercial orientation and slow professionalization may be due to a view of microfinance as primarily a charitable activity (Ferrari et al. 2007).

Impact assessments of specific programs have found similar results to those conducted on programs in Sri Lanka and are generally positive (Kerer 2008; Sharma et al. 2001; Sharma et al. 2005). In addition, The Centre for Microfinance (CMF) is conducting studies on the Grameen model banks as well as clients from Nirdhan, one of the leading microfinance providers there. In one report, positive impacts were said to be limited to the extent that expansion into the hilly areas was insufficient (Bhatta 2001). Generally practitioners did note that clients are also more empowered, organized and have more resources – with the more organized villages even less

affected by Maoists during the conflict. RMDC reports that its microfinance partners have seen clients become micro-entrepreneurs, women more respected and becoming involved in economic activities and making household decisions, and children going to school (Shrestha 2008). MFIs in Nepal also seek to provide services beyond the financial. Some organizations, like CCODER in Nepal, specifically focus on a “holistic approach” and actively seek to look for income generating activities for clients, such as CCODER’s tourism program. It has also been found that microfinance projects have been more effective where there is a “packaged approach” with linkages to capacity building and technical training. Despite these positive assessments, there was concern among some practitioners there that it was difficult to provide services for medium size enterprises. So while microfinance has been able to assist the poor with small business operations, there lacks sufficient financial infrastructure to provide bigger loans and help these businesses to grow, a problem dubbed as the “missing middle.”

### *Institutional Framework*

The political situation in Nepal has improved from the state of emergency adopted by King Gyanendra as a result of the Maoist insurgency, during which Parliament remained dissolved from 2001 to 2006 (Freedom House 2009a). Still, Nepal’s regime has been much more characterized by instability, with several periods of absolute monarchic rule and several dismissals of Parliament. Its present interim constitution, which abolished the monarchy, was adopted only in 2007. Resumed violence in late 2009, delays and political disputes threaten to prevent the country from meeting the May 2010 deadline for a formal constitution (Jolly 2009). Everyday life, and the day-to-day operations of microfinance institutions are very much characterized by the legacy of the Maoist insurgency and persisting instability. Economic

activity continues to be hampered by violence in rural areas and the widespread occurrence of *bandas* or strikes.

Despite the conflict, however, it is important to note that the overall growth in credit and deposits in the financial system of Nepal has remained positive throughout the conflict (Hansen 2008). One practitioner was able to point out that although there was a decrease in commercial banks during the conflict, there was an increase in MFIs. Another pointed to good repayment despite the conflict and strikes. Generally coping mechanisms have included information campaigns at all levels and indirect dialogue with the Maoists, increased security arrangements for cash and document management and immediate reconstruction and relaunch of services (Wehnert and Shakya 2003).

Nepal is unique among many developing countries in that it has a regulatory framework specifically for microfinance institutions. According to the Bank and Financial Institutions Act, there are four categories of banks supervised by the central bank: Commercial Banks (Class A), Development Banks (Class B), Finance Institutions (Class C) and Microfinance Development Banks (Class D). There are also the FINGOs, which are registered differently. As in Sri Lanka, then, there is a range of registration choices for MFIs. For example, bank status recognition – specifically as a Class D Microfinance Development Bank – can make it easier to mobilize resources and provide additional services. Yet, again, there are minimum capital requirements that are difficult for those that start out as NGOs to reach.

In addition to formal designations for MFIs, the Nepalese Government successfully passed a National Micro Finance Policy in 2007. The goal of the policy is “to reduce poverty through sustainable, simple and accessible small financial policy,” with stated objectives that include making microfinance services more reliable, to prepare microfinance legislations and to

develop appropriate institutional arrangements (Nepal Rastra Bank 2007a).<sup>26</sup> As for the general regulatory environment, one practitioner commented: “so far, it is friendly.” One practitioner simply noted “The government is neutral as far as microfinance is concerned – neither are they blocking our movement, neither are they supporting it.” In Nepal, the country’s central bank, known as the Nepal Rastra Bank (NRB) addressed the expansion of microfinance outreach as one of its goals in its strategic plan for 2006-2010, also indicating general support of the sector (Nepal Rastra Bank).

### *Gender Equality*

Gender inequality is decidedly more of a problem in Nepal. Freedom House reports that “women rarely receive the same educational and employment opportunities as men” (Freedom House 2009a). The higher percentage of female representation in Nepal’s parliament can in fact be attributed to quotas (Quota Project 2009). An ADB report on poverty alleviation indicated that “Gender-based exclusion in Nepal is pervasive and deep-rooted, with discrimination against women reducing their physical survival, health and educational opportunities, ownership of assets, mobility, and overall status” (ADB 2002). Another report found that women entrepreneurs are at a significant disadvantage due to lack of access to land and property, lack of personal security, risk of sexual harassment, and not least of all social and cultural barriers that for example leave exclusive responsibility for household work and place restrictions on mobility. The report concludes that “Lack of access to, and control over, productive resources is one of the major factors that hamper women's equal participation in economic activities and the decision-making process” (ADB 1999, 25). In interviews, practitioners echoed these issues, indicating

---

<sup>26</sup> See Appendix 8 for complete Policy text.

that “In remote areas, women don’t decide their business, their activities” and that “women are always deprived even within the household.”

Once again, although it is difficult to draw a direct relationship between gender inequality and the success of microfinance, it plays an important role in creating demand. In addition to exclusion from commercial banking due to collateral requirements, illiteracy and lack of education are a particular problem for women. Consequently, in Nepal almost all MFIs exclusively target women and RMDC was working on an initiative to specifically target single women, with a focus on education and creating opportunities for them to stay in the country rather than leaving for work elsewhere. Though practitioners were rightfully proud of their efforts to target female clients and confident in microfinance’s positive impact on empowerment, the reverse relationship is harder to detect.

### *Representation of Interests*

Nepal seems to have been even less influenced by international interests than Sri Lanka. Certainly, MFIs there have received less in foreign capital (due to cost) and have not been subject to the kind of post-disaster influx as Sri Lanka. Involvement from international aid agencies and NGOs is focused on the establishment and promotion of best practices, and serve an important role in terms of providing capital, training and capacity building. At the same time, MFIs do not appear to feel pressured to conduct business according to specific internationally sanctioned models. As one practitioner indicated, they would simply not go with a donor that tried to influence their homegrown business model. Like Sri Lanka, Nepal has also benefited from international efforts to create or facilitate microfinance networks or support organizations, namely the Center for Microfinance (CMF). CMF was originally implemented by the Canadian Centre for International Studies and Cooperation (CECI) and funded by a USAID grant, but is

now an autonomous, sustainable and privately owned Nepali company that promotes training, capacity building, and advocacy, research, and networking services (Center for Microfinance).

Locally, microfinance in Nepal is similarly influenced by political pressures and conflicting opinions among politicians and regulators. Practitioners were concerned that microfinance was deemed too small a part of financial concerns and one spoke of a lack of commitment from the government. Even where the potential for microfinance is recognized, another argued that the government still needed to “make a linkage,” indicating that this needed to be “translated into action.” Not only indifference, but concerns about political influence were also expressed. At the 2008 Microfinance Summit in Nepal, one major player indicated “It would be very difficult to find an organization in Nepal, which is free from political influence” and this has affected some MFIs’ managerial and financial performance (Shrestha 2008).<sup>27</sup> Practitioners there spoke of politicians operating on vested interests and too much political interference at the local level. Indeed, one practitioner suggested that this was the most important issue, saying “it’s not just structure, it’s people – it doesn’t matter what the legal framework is if the people aren’t good.” He referenced a corrupt political culture and need for human resource development and changes in attitude.

Suspicious and conflicts of opinion also concern practitioners in Nepal. For example, while the NRB recognizes that it should be playing a more supervisory role, it is subject to pressure from the government to play a more involved role. One consultant pointed out that while the government sees the promise of private sector development, it is also hesitant to let go of its own operations. There is less certainty on the part of the government on how things should be, so there tends to be variation among individuals who feel differently on the question of what

---

<sup>27</sup> It also makes the important point that the RMDC has been able to remain autonomous, in contrast to the NDTF, a semi-government institution.

should be public and what should be private. This again influences the debate over interest rates. According to a CGAP report which noted how low interest rates were in Sri Lanka and Nepal, independent observers have reported “palpable pressure from the political arena” to keep interest rates low (Kneiding and Rosenberg 2008). For example, there is reportedly pressure from the Maoists to keep interest rates low because of the nature of their work with the poor. These kind of perceptions have been partially attributed to the interest rate limitations stemming from the Deprived Sector Credit Program (Sinha 2000). Politically motivated limitations and interventions can be problematic, with some practitioners referring to a recent loan waiver as a “disaster” to the microfinance sector. Still, one interviewee did point out that while positions can vary by the range of political parties, they at least agree on reform, increased efficiency and the ability for the MFIs to stand on their own.

The organization of microfinance interests by practitioner associations is also taking place in Nepal. There, the interests of microfinance organizations are represented by a range of networks that align the different types of institutions, including the Microfinance Development Bank Association, the Microfinance Association of Nepal (MIFAN, which represents the FINGOs), the Nepalese Federation of Savings and Credit Unions (NEFSCUN), and even the Grameen Network Nepal which sought to bring together all those MFIs which were based on the Grameen model. According to practitioners and other stakeholders who were interviewed, like the Lanka Microfinance Association, the intent of these networks and associations is advocate and lobby on behalf of members, provide sector support and capacity building, and promote networking. As one expert put it, “If I go alone, they will not listen to me – if we go as group they will listen.”

Practitioners generally saw practitioner associations as facilitating more effective policy dialogue with the NRB. It provides a more central contact point for the Central Bank and makes it easier to disseminate information to the industry as well. It has also, as one practitioner found in the case of the Microfinance Development Banks, “created a forum for microfinance banks to meet in one place and share problems and solutions.” Lobbying efforts have focused on the issue of tax rates, incentives for expansion to rural, hilly areas, and clarifying public deposit issues. In some cases, practitioners reported that the government had been conducive to proposals, listening to demands and adjusting laws, but not in all. According to some, the Central Bank was reportedly more responsive than the government and specifically the Ministry of Finance. One complained that on the tax issue in particular,<sup>28</sup> change was promised by multiple administrations with no results. Another consultant held that the focus should be less on lobbying the government and more on joint consultations on important issues, something he suggested may have helped the Microfinance Policy.

### **Key Issues**

The themes that emerged from conversations with Nepalese practitioners, stakeholders and officials were remarkably in line with those in Sri Lanka. From the details of these themes, though, can be drawn the explanations for the differences in the two countries’ respective ability to meet demand.

---

<sup>28</sup> MFIs are often required to pay the same tax rates as larger companies and banks, despite in many cases their status as non-profit organizations. Because of their small scale and social agenda, this is viewed by practitioners as not only unfair but with consequences for sustainability as it adds to operational costs. It should be noted that Nepal’s recently passed Microfinance Policy includes an intention to “adopt flexible policy in the income tax earned by the microfinance agencies and the tax rates on the interests earned by the disadvantaged groups from their deposits” (Nepal Rastra Bank 2007a).

## *Stability & Conflict*

Having also spent decades engaged in a civil war, the conflict and resulting instability of the regime has been an important factor for microfinance operations. A USAID report on Nepal argued that “the success of MFIs in conflict-affected countries often hinges on their willingness and ability to adapt management systems, operations and products to respond effectively to changing client needs and political evolutions” (Hansen 2008). Among the lessons learned from the case of the Nirdhan Uttan Bank was that “staying put” increases client loyalty. In Nepal however there was considerably more emphasis on how the conflict directly affected operations. Nearly every practitioner interviewed spoke of this, in contrast to conversations held in Sri Lanka. One leading practitioner reported that because of the Maoists, 10 years had been lost. Another, whose organization relies on community-based organizations for its microfinance services, indicated that ten years of conflict had “really destroyed the cohesiveness of community.”

MFIs continue to face heightened operational risks and regular disruption of services. In addition to being detrimental to outreach (Ferrari et al. 2007; Shrestha 2008), MFIs have in many cases been directly targeted by the Maoist insurgents. The head of RMDC has reported that the field staffs of MFIs “live and work under constant fear and pressure” and are “scared and demoralized” (Shrestha 2008, 11). Branches have been burned, looted and threatened. A leading MFI reported an employee killed as recently as November 2008. One report found that six out of 34 attacked Small Farmers Agriculture Cooperatives Ltds. were completely destroyed by the Maoists (Wehnert and Shakya 2003). With an estimated 20 to 30 percent of their branch networks looted and vandalized, the three largest banks have withdrawn services from rural areas (Hansen 2008). The microfinance providers that remain have had to spend a considerable

amount of time explaining to the Maoists how their services benefit the population (Ferrari et al. 2007). While in some cases, they have been tolerant of NGOs and community-based credit programs (Wehnert and Shakya 2003), MFIs that are viewed as having links to foreign donors or the government are especially targeted. In those cases, the insurgents have threatened MFIs to discontinue operations or reduce interest rates, and even encouraged clients to stop paying back loans (Hansen 2008; Shrestha 2008).

### *Government Ownership & Controls*

An ADB report on the role of central banks in microfinance points out that like many developing country central banks, the mandate of the Nepal Rastra Bank (NRB) includes providing for rural credit provision (Sinha 2000). Thus government-run programs have been a part of, and indeed instrumental to, the development of the microfinance industry there. A 2002 World Bank report highlighted “excessive” government ownership in the financial sector and estimated that at that time the public sector controlled 59% of microfinance outreach (World Bank 2002). The government remains active in microfinance primarily through several of the regional Grameen Bikas Banks (GBBs).<sup>29</sup> Publicly owned and among the first MFIs in Nepal, these institutions are generally regarded to be suffering from weak financial performance and management capacity. One report noted “It would be a disaster if the GBBs are not rehabilitated soon, as they have already reached a large number of poor families,” going on to suggest that “the concerned parties have not shown adequate seriousness in bringing them to track” (Shrestha 2008, 11).

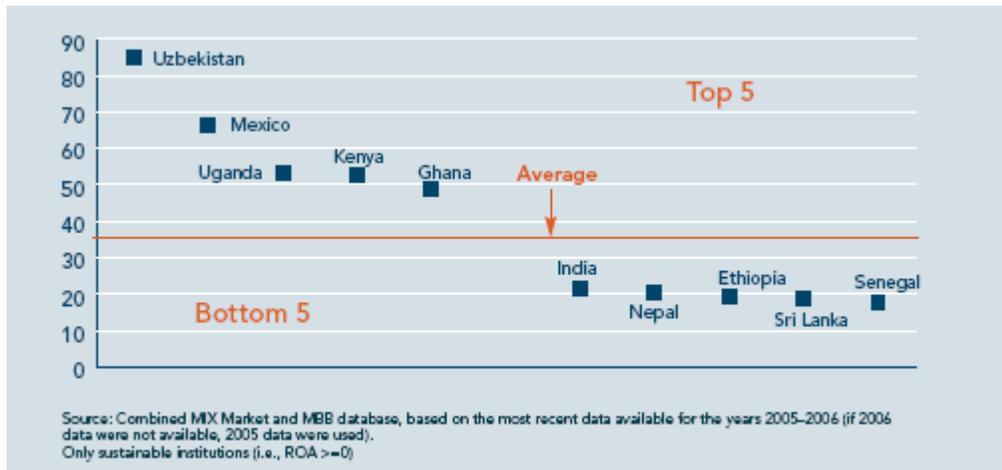
---

<sup>29</sup> These banks are modeled on the Grameen Bank business model, but are not directly affiliated with the Bangladeshi company.

However, the Nepalese government has increasingly been moving toward a more supportive, rather than direct, role in microfinance. Of the original five GBBs, several are seeking the option of privatization. Additionally, the establishment of the Rural Microfinance Development Centre (RMDC), an apex body that provides wholesale lending, has provided an opportunity for the NRB to focus less on direct promotion and more on providing for the overall functioning of the financial system (Sinha 2000). A newly refocused emphasis on creating an enabling environment is evident in the recently implemented Microfinance Policy and the NRB's stated mission for microfinance: to "make micro-finance services more accessible to the poor and weaker section of the society in a sustainable and competitive way" (Nepal Rastra Bank 2007b).

Policy interventions do remain that result in pulling down interest rates. While at least one practitioner in Nepal suggested that paying market rates would make it difficult for the MFIs to stay sustainable, limitations on interest rates have led to inefficiencies and "unnecessary expectations among market participants," hindering efforts to increase outreach and the growth of the microfinance sector in general (Uprety 2008). Even RMDC's efforts to become a viable funding source for MFIs in Nepal were initially hampered by fixed interest rate requirements (Shrestha 2008). In fact, a recent CGAP Brief found that both Sri Lanka and Nepal were in the bottom five of average microfinance interest rates worldwide due to various controls (see graph below).

**Figure 6.1 - Variations in Microcredit Interest Rates**



Source: "Variations in Microcredit Interest Rates" (Kneiding and Rosenberg 2008, 1)

### *A Regulatory Framework*

Despite the formal designations and regulations for MFIs in Nepal, institutional provisions for supervision of MFIs are lacking. The NRB maintains both on-site and off-site supervision units, but the policy which has been adopted is for on-site examination specifically for commercial banks once a year (Nepal Rastra Bank 2008). A FINGO director there also felt that greater attention is paid to the Microfinance Development Banks and that the NRB had more motivation to protect those institutions. In both countries, cooperatives are registered and report to a separate government office, which has led to additional regulatory complications and lack of supervision for those institutions.

Also in spite of the regulatory framework, funding has also been a problem in Nepal. The Financial Intermediary Societies Act of 1998 which governs FINGOs has been criticized because it did not provide guidance on either public or member deposits (Sinha 2000). Though some clarification has since been offered, several MFIs have sought to transition to or create sister institutions that are registered as Microfinance Development Banks. Under the Bank and

Financial Institutions Act (BAFIA), they are then permitted to access public deposit with NRB approval (Uprety 2008). In the recent Microfinance Policy, it indicates an intention to adopt flexible policy on deposit collection based on the MFIs quality and extent of services and their share capital. Meeting these criteria has continued to lead to stumbling blocks for MFIs. The desire among practitioners interviewed was that if they meet certain criteria, this provision should be activated. Indeed, one practitioner pointed out that in some cases B Class Banks with less capital were being permitted to collect deposits, while microfinance institutions continued to have to seek approval.

Nepal's MFIs do benefit from a government mandated directed lending program. Due to initial (and continuing) concern that commercial banks would be unwilling to lend to MFIs, the NRB directed that three percent of commercial bank portfolios should be lent to the poor under what is known as the "Deprived Sector Credit Program." Banks that fail to meet the target are assessed heavy penalties (Pradhan 2005). This program thus assures microfinance institutions of a source for wholesale lending, as few commercial banks lend directly to the poorest. However, there have been unintentional consequences of this policy as well. One particular concern is that the loans from the commercial banks tend to go primarily in bulk to the larger MFIs they trust and that have performed well. Smaller MFIs tend not to benefit from the policy and find it more difficult to obtain funding and expand operations. It also contributes to keeping interest rates artificially low by limiting rates charged to the end borrower. Another problem which has been noted is that often these funds are directed not to the loan portfolios but to other safe investment options on the part of the recipient MFIs. In some cases, this has resulted in FINGOs and MCDBs having investments that exceed their loan portfolios (Sinha and Sagar 2007). A further concern has now arisen that adjustments to the policy are diverting these funds away from

microcredit. What has been called a “populist” policy move on the part of the Maoist government has directed that part of this three percent be redistributed to other social programs like hospitals, youth employment and housing programs. There was some concern expressed among those interviewed that this would result in a resource problem for MFIs, which has hastened efforts to push for clarification on the collection of public deposits and the possibility of foreign investment. Generally, feelings about this policy from practitioners seemed mixed.

Though notable for its attention to providing a policy framework for microfinance, Nepal also faces calls for a clearer regulations. For example, the RMDC has cited the “lack of conducive policy and legal environment” as one of the reasons that outreach has been low (Shrestha 2008). Another stakeholder pointed out that it is “still a very weak sector because it doesn’t have a clear policy on how best to deliver finance to the poor.”

### *Regulatory Capacity*

These concerns are closely tied to the issue of capacity. As one practitioner put it, it is not a regulatory problem but an implementation problem. Though widely praised, Nepal’s unique regulatory framework for microfinance has actually led to some confusion in the industry. Concern was expressed by independent observers that its piecemeal introduction created a “situation that is confusing for regulators, microfinance practitioners, and the public alike” (Sinha and Sagar 2007, 7). A speaker at Nepal’s 2008 Microfinance Summit indicated that “Some regulatory provisions, changed frequently by various regulators, has caused panic to various categories of MFIs” going on to blame the “absence of clear cut policy” and “non compliant behavior of some of the market participants” (Uprety 2008). The Microfinance Policy just implemented speaks of a “need for a microfinance policy that provides credit to rural areas by reforming institutional arrangements” (Nepal Rastra Bank 2007a). The document lays out a

series of policy goals for the microfinance industry, but how it will be implemented remains a question. Said one stakeholder: “In principle, the policy sounds fine, but in practice it is not doable.” For example, there is a proposal to create a special, “second-tier” institution to regulate MFIs but it is unclear how feasible this is. Another concern is that there are different interpretations and even “dual messages” in the policy. That is, while there is an emphasis on microfinance as the realm of the private sector, it also speaks of a “National Micro Finance Development Fund” which would in effect be an apex fund that would channel all external funds. The drafting of a separate Act, currently underway, is hoped to provide the coordination mechanism deemed necessary by those in the sector to ensure the policy’s implementation.

Concerns about the capacity of regulatory agencies exist in Nepal as well, though here the criticism is perhaps even more severe and the qualifications and expertise of officials more frequently called into question. In terms of the regulatory framework for the microfinance sector and even for BAFIA more generally, the “problem is the institutional capacity of the central bank to actually enforce that law.” In 2002, a World Bank report pointed to weaknesses of the central bank, indicating that “it has failed to perform adequately as a supervisor and regulator of the system” and that supervision is “random and perfunctory at best” and “At worst, it is so lax as to be virtually nonexistent (World Bank 2002, 30). A more recent report found supervision of microfinance institutions to be inconsistent and prudential requirements not even necessarily binding, calling into question the stability of the sector (Ferrari et al. 2007). The Microfinance Association of Nepal recently indicated increased supervision, minimization of overlap and upgrades in capacity of the regulatory authority among major areas needing improvement (Microfinance Association of Nepal 2009). Yet, like the CBSL, the NRB is noted by both independent reports and practitioners in the country to be overstretched, with much of its existing

resources directed toward the commercial sector. In fact, this is just one of the reasons why the implementation of a second tier institution to monitor microfinance would be problematic. Limited staff capacity, in both numbers and expertise makes it difficult to ensure sufficient supervision (Sinha 2000; Sinha and Sagar 2007). On-site inspections have fallen behind, taking place only every 2-3 years, with one development bank indicating that it was more like every 3-5 years.<sup>30</sup> Particularly of concern was the lack of microfinance-specific training and expertise of government staff. Though heads of the microfinance department at the NRB have received training and have specialized knowledge, the same cannot be said for the staff. Indeed one report pointed to the culture of transferring supervisors which, though intended to stem corruption, also prevents specialization and development of expertise (Sinha and Sagar 2007). In a recent Annual Report, the NRB did recognize that among its challenges was enhancing supervisory capacity and indicated that efforts are being made to ensure trainings at both the national and international level (Nepal Rastra Bank 2008). However, it does not appear that the same level of infrastructure exists to provide this training as it does in Sri Lanka (with the Centre for Banking Studies).

The question of cooperatives also seemed to be causing even more concern in Nepal than in Sri Lanka. The savings and cooperative societies there play an important role in microfinance and NEFSCUN, the national federation for these organizations has been actively promoting microfinance specific programs to be incorporated into existing activities. Reportedly nearly one hundred cooperatives have been involved in incidents where the institution was dissolved and member savings lost (Uprety 2008). There is concern that these programs are not being sufficiently monitored. As in Sri Lanka, cooperatives fall under the authority of a different

---

<sup>30</sup> Several practitioners did point to the role being played by the RMDC as “mini-regulator.” The wholesale lender carefully monitors partners to protect its own interests and as a result more closely follows the operations of MFIs than do the regulatory authorities.

regulatory body, currently the Department of Cooperatives in the Ministry of Agriculture and Cooperatives. The NRB holds some responsibility, only when financial support is provided. In some cases, though, the requirements of the Cooperative Department and NRB are contradictory (Sinha and Sagar 2007). More problematically, the capacity of the Cooperative Department to actually play a monitoring role was often called into question. Practitioners and stakeholders suggested that massive restructuring and capacity building was necessary if it were to fulfill its mandate. There is no staffing for actually regulating the institutions under its authority. As one NRB official said in reference to the coops, “no one knows what they’re doing, no one is supervising,” so as the cooperative sector mushrooms, people’s savings are increasingly at risk. One microfinance organization, registered as a cooperative because of its use of the savings and cooperative model has been making a serious effort to create a new designation to set itself apart. To resolve these issues, more effort needs to be placed on aligning standards and practices between agencies, as has been suggested in the case of Sri Lanka (Conroy 2000).

### *The National Association*

While once again, the representation of microfinance interests by national practitioner associations is an important development, there are issues that should be considered here as well. On balance, microfinance interests in Nepal actually appear even less institutionalized than in Sri Lanka, particularly in light of the variety of practitioners associations that exist. Moreover, at different times, a number of these have been inactive. Criticism there stems from the range of associations, each trying to promote themselves as an apex organization while failing to cover all MFIs. Some are discouraged by member fees, particularly without sufficient perceived benefits. Another major problem is capacity and resources. Practitioners reported lack of resources and staff as a problem for the relevant associations. One development bank operating outside of the

Kathmandu valley pointed out that it is often difficult for members too, particularly operating in the far eastern and western areas to attend meetings and actively participate in practitioners associations. In one interview, it was even suggested that the main goal of the associations is simply “carteling,” seeking to control the market and interest rates rather than protecting clients and developing businesses. “It’s not their fault” he explained, “This is the environment in Nepal, how all professional associations work.” As in Sri Lanka, these associations are a relatively new development, but the outlook in Nepal is somewhat less optimistic. In fact, one practitioner predicted that MIFAN, the association for FINGOs “is likely to die,” though this may have more to do with the changes in registration to Microfinance Development Banks. Still, another pointed out that it is still young, and “there is hope that they will do something to benefit MFIs and play some advocacy role.”

### **Conclusions: Sri Lanka & Nepal Compared**

#### *Alternative Explanations*

In both cases, it is difficult to trace a direct connection between the state of gender equality and the relative success of the two countries’ respective microfinance industries. When asked what effects gender inequality might have on their operations, practitioners were generally unable to identify anything, focusing more instead on how their services have been beneficial to their female clients.<sup>31</sup> Practitioners in both Sri Lanka and Nepal were quite proud of their efforts to target female clients and efforts to promote both economic and social empowerment, reporting increased opportunities, awareness, skills, leadership, decision-making, changes in attitude and benefits filtering down to their children. They suggested that women can “secure their equality”

---

<sup>31</sup> It should perhaps be pointed out here that nearly all of those heads of microfinance institutions interviewed were themselves men.

by seeking out these loans, that women are the “key to change at the local level” and that their clients were “sensitized now, more active and empowered in local society.” However, one observer in Sri Lanka agreed with a number of reports that while microfinance does empower women, it does so in their traditional roles, and that this may actually minimize broader social change (ADB 1999; Kottegoda 2003; Rankin 2002). Many also liked to point out that women were simply better clients, the “responsible channel” – more reliable, honest, likely to repay on time and use the money for their family. A few industry leaders in Sri Lanka even suggested that this has in some cases become the main justification for focusing on women, that it is simply good business practice.

While these are important observations on the impact these MFIs have on women, assessing how the MFIs are affected by gender is much more difficult. One possibility is in shaping the operations of the organization. Many practitioners in both countries pointed out that their female clients worked particularly well in the group lending system. While these group lending systems have frequently been shown to have a positive effect on performance, it does not necessarily follow that overall gender equality contributes to microfinance success. What can be said is that gender inequalities play an important role in creating demand for microfinance. In both countries, access to institutional credit through commercial banks is limited by collateral requirements. Awareness of inequalities has inspired increased outreach in both countries. Practitioners in both countries suggested that more empowerment could bring more microfinance. One suggested that the process does indeed work both ways: not only the female clients, but the NGOs themselves have been strengthened due to the contribution of women in their community groups. A more interesting suggestion was that substantial increases in gender equality could mean that “microfinance might actually find an end” becoming simply formalized

banking. Based on these observations, microfinance institutions are indeed affected by gender inequalities. However, increased demand does not necessarily lead to success if that demand cannot be met. The connection between gender inequalities appears to be much more indirect.

In terms of interests, where there does appear to be a significant difference between Sri Lanka and Nepal is in the formation and articulation of local interests. On balance, international influences cannot sufficiently explain the differences in outreach and overall success of their respective national microfinance industries. Both benefit from foreign capital, training and technical support. More practitioners in Sri Lanka than Nepal did report utilizing foreign funds from international donors, yet the influx of donor funds following the tsunami actually became a problem. The question of international influence also simply drew far less response from those interviewed as other issues.

At the local level, however, differences are apparent in the growing capacity of national practitioner associations to play an important role in the success of microfinance. With other local pressures that stem from political interests and differences of opinion among legislators, there is not enough variation between the two cases to provide a reasonable explanation for the relative success of their respective microfinance industries. The practitioner associations highlighted in the previous discussions represent not only the financial interests of microfinance institutions, but also their efforts to alleviate poverty and create opportunities for poor entrepreneurs. They also offer the possibility for organized local interests to have a critical role in microfinance success. In fact, at least one practitioner suggested that the organized promotion of these interests was indeed more important than the political and legal situation. In Nepal, he argued, they more or less had the enabling environment from the government, but the important

next step was for the microfinance association(s) to organize. A more independent observer noted while the overall regulatory framework needs to be there, MFIs must also be capable of building capacity to operate in that framework, saying that they “both need to go hand in hand.”

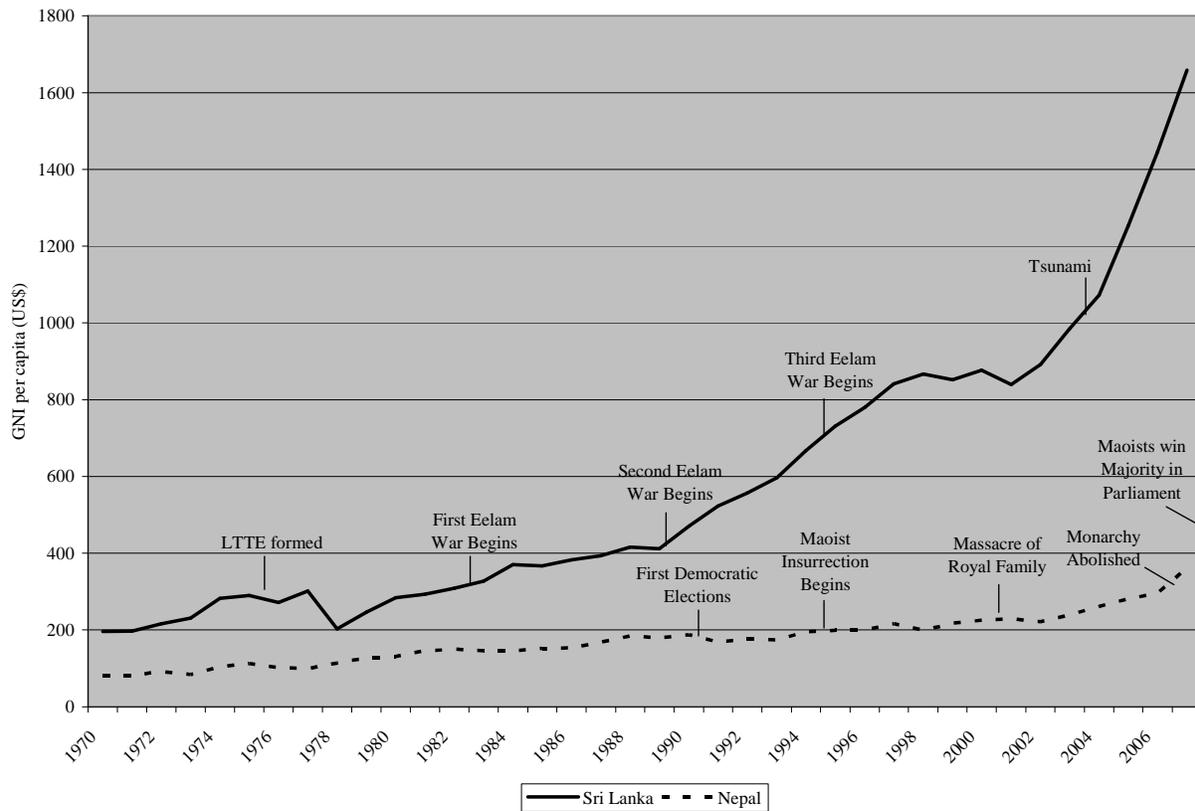
How effective are these associations then? Have they made a difference for their respective microfinance markets? Based on assessments by those interviewed, the results are mixed. A central problem seems to be one of institutionalization. These national practitioner associations are still very much in their nascent stages. Having moved beyond informal networks, they are still seeking legitimacy among members. Yet, as one interviewee put it, “something is better than nothing – at least their voice has been raised.” Certainly the prospect of organized interests in the microfinance industry would do much in the way of both building that capacity and promoting a more suitable policy framework. At this stage, however, these organizations are still too new to be attributed as a significant factor to success. For now, institutions remain the important explanation for differences across states.

### *Institutions Matter*

The themes that came up again and again in interviews with practitioners and other stakeholders were matters of the institutional environment and its effect on the microfinance industry. While those interviewed were rightfully proud of microfinance’s success in empowering women and in bringing together interests under national practitioner associations, these were not among the most important concerns. While many of these concerns were common to both countries – the consequences of war, government ownership and subsidies, funding limitations, the need for a clear regulatory framework and the capacity to implement it – in these also lays the clues for the differences observed in the relative successes of outreach, sustainability and impact.

First, we can observe that despite both experiencing prolonged and bloody civil wars, the effects on the microfinance industries in each country were quite different. Despite microfinance growth and successes throughout the conflicts, regime instability and conflict-related challenges faced by MFIs in Nepal seem to decidedly outweigh those in Sri Lanka. There, the concerns for day-to-day operations were ever present in the minds of microfinance practitioners. To make an ever starker comparison, we can consider the impact of the conflicts on overall economic development. A look at the major events of the wars superimposed on overall economic performance in each country illustrates that Sri Lanka's overall success has been quite good in spite of the war (see graph below).

**Figure 6.2 - Economic Growth and Conflict**



Source: UN data (UN)

Important differences are also noted in the degree and nature of market interventions. In both Sri Lanka and Nepal, financial services are provided by a range of both regulated and unregulated institutions. However, it is Nepal that has a formal regulatory framework for the microfinance sector. Indeed, having incorporated microfinance into a formal regulatory framework and increasingly withdrawn from overt involvement and direct support of the industry, Nepal seems to have the advantage in this particular area.

Practitioners in both countries were careful to point out however that while regulation is needed, they would prefer less direct government involvement in the sector. Said one director in Sri Lanka: “we don’t want government to do anything but create a friendly, enabling environment.” One person interviewed in Nepal went so far as to say that “whenever government is involved it leads to failure,” going on to suggest that “government should just be a facilitator, not an actor.” Where MFIs would like to see assistance is with training and technical assistance. This was indicated by practitioners in both Sri Lanka and Nepal. Many in Nepal also expressed an interest in the government assisting with outreach to rural, hilly areas. While the NRB maintains that MFDBs operating in rural areas receive top priority (Nepal Rastra Bank 2007b), practitioners still appeared to view expansion to these areas as too expensive and risky, estimating that achieving viability could take up to five years (or may indeed never be possible). Thus there were several calls for incentives, training and infrastructure development to encourage the private sector to expand operations there, a suggestion which has also been made by the World Bank (World Bank 2002).

This leads to the final piece of the puzzle, however: that of the capacity of government institutions. Although both countries face concerns regarding staffing and expertise, this appeared to be much more of a concern in Nepal. Thus calls for training and infrastructure

development are limited by the ability of the Nepal Rastra Bank and other offices to meet those demands. Certainly capacity is a pervasive problem throughout the developing world. In this particular assessment, however, it is a critical factor in terms of relative success between two comparable cases. So although Nepal has a more formal regulatory system, it appears that simply having the policy is not in itself enough. After all, Sri Lanka's microfinance sector has achieved much without one. On the one hand, this seems to support the free market principles of microfinance, that less intervention is beneficial. On the other hand, calls from practitioners for a more clearly laid out framework in both countries should not go unheeded. Particularly when it comes to diversifying sources of funds, it may be necessary for continued growth and success. This is why capacity is necessary for the success of microfinance related policy. As one report on Nepal pointed out, "regulation is appropriate only in situations where it will be effective" (Sinha and Sagar 2007, 10). In this regard, while both countries face difficulties in terms of resources and staffing, Sri Lanka again has the advantage.

Among the lessons learned here then are that among the institutional variables, regime and capacity play more of a role than do market interventions. This serves to confirm and strengthen the findings of the quantitative analysis. The table below provides a brief comparison of the key explanatory factors as they were found in both the quantitative analysis in chapter three and the case studies presented here in chapters five and six. Indeed, the qualitative comparison of these two cases sheds additional light on the complexity of assessing the impact of market interventions. It is certainly not simply a matter of regulation or freedom from excessive market controls. Sri Lanka's microfinance sector has done well in spite of government-run programs and a lack of regulatory structure. Yet practitioners express a desire for a more clear regulatory framework, particularly as it relates to ensuring funding sources for

their operations. Nepal has such a regulatory framework, but this too has received criticism. It is not enough then to have a policy if there is not the capacity to support it. Once again, it might be speculated that microfinance institutions are particularly adept at operating in a range of adverse political environments, but to succeed and grow in the long term, the institutional framework cannot be ignored.

**Table 6.1 - Quantitative & Qualitative Analysis Comparison**

<u>Variable</u>	<u>Data Analysis</u>	<u>Case Study Comparison</u>
Political Freedom	Strong, positive	
Political Stability	Strong, positive	✓
Financial Freedom	No significance	
Investment Freedom	Negative effect on savings outreach	
Regulation	Weak, positive	✓
Government Capacity	Strong, negative	✓
Gender Equality	mixed	
Microfinance Networks	mixed	

## VII. CONCLUSIONS: CONNECTING TOP-DOWN AND BOTTOM-UP DEVELOPMENT

*“We have to build a network of social-consciousness-driven entrepreneurs through building supportive institutional arrangements, state policies, education systems and incentive structures and through creating international support systems” (Yunus 1997).*

The Economist magazine recently called microfinance “an increasingly bright light in the gloom of the financial world” (Abruzzese 2008). While by no means a magic bullet for development, microfinance institutions have been demonstrated to have a positive affect on clients and to be a sustainable, cost-effective means of promoting entrepreneurship and livelihoods in general. They have also made great strides in outreach, providing financial services to millions of impoverished people who otherwise might not have any at all. The institutions provide an example of grassroots development projects that target assistance where it is needed most and strive for a "trickle up" rather than "trickle down" approach. In underdeveloped countries with limited infrastructure, microfinance loans have found their way to the rural and urban poor to start or improve businesses, and sustain families. Where property rights and contract enforcement are lacking, the methods employed by MFIs find ways around this to provide quality financial services to those denied access to the formal financial system. Indeed, the simple solutions offered by small microfinance organizations are now being adopted and integrated into the formal financial institutions that were once unattainable for the poor. For all these reasons, microfinance provides important lessons for international development in terms of what works, best practices, and making small changes that make a big difference.

Despite progress, though, microfinance has not saturated all markets where there is demand among the poor for financial services. Some areas have better met demand than others. Why? When and under what conditions have microfinance institutions been most successful at

bringing financial services to the poorest populations? To answer this question, we have looked to the state. What microfinance can teach us about the role of the state has larger implications for better understanding the relationship between grassroots development projects and policies directed from the top down. Why should the two be separate considerations? This analysis shows clearly that they are very much connected. Microfinance can only do so much to assist the poor if the policy and regulatory framework is limiting operations. The institutional framework matters here.

### **Insufficient Explanations**

For a political economic theory of microfinance, institutions matter relative to other political explanations. The preceding analysis took into consideration the possibility that broader trends of gender equality and the influence of organized microfinance interests may have an important role to play. Neither explanation should be discounted altogether, but neither are they sufficient to explain differences across states.

Gender equality ultimately proved to have weak explanatory value. However, it remains an important outcome of microfinance practices. From conversations with practitioners, I found that while gender inequality certainly creates demand for microfinance services and inspires their work, it does not sufficiently explain differences in countries' ability to meet that demand. That is, gender empowerment still appears to be more a consequence than a cause of microfinance success.

Organized microfinance interests in the form of networks and practitioner associations had more apparent, but still not sufficient explanatory value. From the quantitative analysis, we see a positive association between international networks and female outreach and a tendency for the larger MFIs in both scale and outreach to be members. In addition, practitioners interviewed

in Sri Lanka and Nepal generally felt their influence was fairly benign. They were regarded as helpful in terms of sources of capital and best practices.

At the local level, we see a majority of MFIs of all sizes joining networks, particularly the smallest institutions. Though the presence of a local network had a negative effect in the regression models, conversations with practitioners in the field revealed the developing importance of organized interests. These associations are relatively new and still building influence, but playing an increasingly important role in seeking to influence policy and regulatory practices. However, because they are such new developments, they are also lacking organization and still working toward formalizing their operations. As a result, little can be concluded about their influence at this point, though it will be interesting to see how their development influences microfinance industries going forward.

### **Why Institutions Matter**

While gender equality and organized interests are important considerations and cannot be ignored, they do not provide enough of an explanation for differences observed across states.

Rather, it is institutions that matter here. As Snow and Buss write,

Sound bottom-up development policy requires a long-term increase in human capabilities. People need education. Businesses need infrastructure, a regulatory environment that will not stifle risk taking, and a financial sector that can meet the needs of the smallest and the largest players in the market. Ultimately, development must be sustainable on a national scale. Programs undertaken at the village level are important, especially in a bottom-up development model. But national policies determine the environment for local development.  
(Snow and Buss 2001)

What this means is that we cannot neglect to consider the macro-level political institutions even when considering very small scale grassroots development programs. The institutional context is important for understanding the barriers that face the day-to-day operations of not only the

microfinance institutions under study here, but also the small businesses they serve. It is the legal and regulatory framework that determines how a MFI is registered, whether it is supervised and whether it can collect public deposits. Moreover, government institutions have to have the capacity to implement those legal and regulatory frameworks.

### *Political Freedom & Stability*

In contrast to what was suggested in the literature, the nature of the regime itself proved particularly important to the success of microfinance across countries. In the quantitative national level analysis of chapter three, these two variables were among the strongest and most frequently significant variables across multiple indicators of microfinance success. The more freedom and stability, the more microfinance outreach. From chapter four, we see a greater percentage of large MFIs operating under politically free regimes, though institutions that maintain small client bases were dominant under politically unstable regimes. In the comparison of Sri Lanka and Nepal – both recently emerging from extended and bloody civil wars – relative political stability was one of the most important distinctions. While certainly MFIs operating in the Northern areas of Sri Lanka have been affected by the conflict, they have continued operations and the central bank has ensured that financial services have been set up for the internally displaced refugees from the war. In contrast, Nepal's MFIs are still very much affected by the conflict; day to day operations continue to be interrupted by continued violence and bandas or strikes. In fact, far more of the practitioners interviewed there reported this.

The debate over the connections between democracy and economic development is an old one. This study makes its own contribution by suggesting that political freedom and stability really do matter – for both microfinance and development in general. Perhaps this is an obvious point in the end, but it is worth reemphasizing in the development literature. There have been

studies that explore the contributions of grassroots organizations to democracy, but as the preceding analysis shows, those organizations are also affected. This should provide fresh insight to studies of democratization and political development more broadly.

### *Market Interventions*

In terms of market interventions, the relationship is more complex than originally supposed and far less typical of the kind of laissez-faire economics which are often seen in microfinance discussions. It is not simply a matter of market friendly policies. Indeed in the regression analysis, financial freedom proved not to be significant at all. Thus the question of government ownership and subsidies may continue to be debated. Many MFIs worldwide are still very much dependent on government subsidies. Despite criticism of heavy involvement in the sector by the Sri Lankan government, it has received impressive outreach. There is of course, the multiple dimensions of microfinance success however. While government subsidies and programs may help to expand outreach, there is the question of how sustainable those institutions are. This was a central criticism of Nepal's Grameen Bikas Banks for example.

Perhaps one of the most important findings however highlighted the connections between regulation and funding sources. The ability to hold public deposits creates opportunities for greater loan outreach. The figures in chapter four showed that utilizing savings for financial intermediation had positive affects on the gross loan portfolio, reduced operating expenses and even a lower percentage of the loan portfolio at risk. In other words, savings has positive consequences for outreach, sustainability and impact on clients. Not least of all, providing savings accounts is a needed service and would provide the poor population of previously "unbanked" a safe place to keep their savings.

More often than not, however, MFIs are not utilizing savings as a source of funds. Instead, they are reliant on subsidies, grants and loans from other financial institutions. In fact, the negative effect from investment freedom on savings outreach in the regression analysis speaks to the idea that where foreign capital is readily available, there are less microfinance savers. Where this becomes a problem is when the microfinance institution is barred from collecting savings by virtue of its ambiguous legal status. Only about half of all MFIs are regulated, leaving the rest often operating in an ambiguous legal grey area. This is particularly a problem for NBFIs and NGOs, the vast majority of microfinance institutions. Moreover, there is a significant relationship between whether or not the institution is regulated and whether it is utilizing savings for financial intermediation. This problem was made particularly clear by practitioners in Sri Lanka, where microfinance is “no one’s baby” and lacks a clear regulatory framework. As a result, it has not been clear whether MFIs should be collecting public deposits. Without supervision, too, there is fear that those deposits would be at risk.

Proper regulation thus becomes central to microfinance achieving more. The trick of course is to achieve proper balance while still allowing for that expansion. After all, although weak, there was a positive relationship between regulatory *quality* and microfinance outreach. To the extent that regulation would allow for some prudential supervision and allow the collection of savings, it appears to be welcome. Certainly the biggest concern brought up with practitioners in both Sri Lanka and Nepal was the need to have a consistent and clear regulatory framework for microfinance. It should also be made clear, however, that while there is a need for some degree of regulation, practitioners would still prefer less direct government involvement in the sector. This relates back to the theoretical framework that while market freedoms are helpful to an extent, an appropriate regulatory framework is indeed necessary here.

### *Capacity*

A lack of capacity on the part of government institutions is a major problem in the developing world. We saw from the regression analysis in chapter three that there is a negative relationship between government effectiveness and national levels of outreach. This indicates that microfinance has indeed been able to reach large portions of the poor population in spite of weaknesses in government capacity, perhaps the very places where it is needed most. Yet this is not the whole story. A regulatory framework for example is meaningless if the government in question does not have the capacity to properly implement it. From the case studies, we see that increased capacity is a focus of proposed improvements. So while Nepal has a regulatory framework in place, it is Sri Lanka that has achieved more microfinance outreach and overall success. Much of this comes down to the capacity of the political bodies to actually implement those policies. This confirms then the importance of capacity to the political economic theory of microfinance.

### *Making Connections*

A central theme throughout this study has been that there is a disconnect between what microfinance has been able to achieve in spite of a difficult political economic environment and what can be achieved with the application of good policies. On the one hand, negative relationships with things like the overall development of the country and government capacity indicate that microfinance has indeed lived up to its promise of bringing financial services to those that need it most. Of course we see more microfinance in lesser developed countries, as well as places where there is limited financial and investment freedom and ineffective governments. Additionally, correlations with other business practice indicators shows that it does well where contract enforcement is lacking and it is difficult to start a business. Thus in

these situations, people can turn to microfinance institutions, where funds are available to start small businesses without requiring collateral and the dynamics of the group lending systems eliminate the need for contracts. From this we might even conclude that microfinance simply serves a very specific purpose in creating access in adverse conditions. However, this is not the whole story.

Although microfinance has done well in adverse conditions, it can be positively influenced by political freedoms, greater stability and regulation. Other policies that had a positive influence were things like stronger protection of borrower and lender rights, simpler procedures and lower minimum capital requirements for starting businesses, even simpler tax preparation. Although we see successful microfinance outreach in underdeveloped countries with governments lacking capacity, increased capacity is certainly not going to hurt. We can return here to the example of Nepal, which has the regulatory framework but not the capacity to see it through to the satisfaction of practitioners there.

Microfinance has been shown to be what it purports to be, but it can do better with a better policy framework. Thus a consideration of the institutional framework remains important for understanding how to achieve long term growth and success for microfinance.

### **Implications**

The results of this study find important lessons for both theory and practice. By connecting grassroots level development to the macro-political context of the state, it not only provides support for institutionalist approaches to political economy, but also take-away lessons for policymakers in regards to not only microfinance in particular, but also business and economic development generally.

### *For Theory*

The theme that has come up again and again throughout this study is that institutions do indeed matter. While gender equality and the organized interests of microfinance institutions provided interesting contexts and important considerations, they do not sufficiently explain differences across states. Thus the institutional framework is critical to our understanding of development. However, it is not just a matter of how economic actors respond to those institutions, as the rational-choice approaches to institutionalism would argue, it is also the context, in this case the relationship between underdevelopment and the capacity of those governing institutions. We must continue to explore then, the connections between rational-choice and historical institutionalism if we are to have a better understanding of how the state influences economic actors.

Another important implication for theory is in drawing those connections between the “trickle-down” theories of development and apparently discrete ideas of grassroots development. They are not so separate after all. Theoretical approaches to development need to begin to repair this schism. Local efforts to spur economic development from the base are just as important as the macro-level actions taken at the state level. Development requires the interaction of both. This study has brought together two seemingly disparate theoretical approaches to development and has attempted to show that the two are very much connected. The state cannot address all of the immediate needs of the poor without deferring to markets and local level initiatives. At the same time, it is clear that grassroots development projects can do more in light of improvements to the political environment in which they operate. While microfinance may serve as an important role as a counter development strategy at the grassroots level, macro-level policies remain necessary for development, not least of all because of the dynamic that exists between the

two. Exploring the linkages to political rights and stability, to government capacity and to the balance of regulation and economic freedom is critical then to development which is spurred from both the top-down and the bottom-up.

### *For Policy*

The preceding analysis lends credence to many of the normative policy prescriptions that have been advocated in the microfinance literature. For example, government run programs and subsidies need not necessarily be bad; they can be done right. Policymakers should therefore look to successful models for best practices. Where the attention should be is on creating a legal framework for microfinance institutions without necessarily limiting their ability to grow and innovate. By removing interest rate controls and any kind of limitation on access to funds, states can make it easier to run the business and lend to more clients. Providing a regulatory framework and prudential supervision is critical to addressing a major part of the funding problem, that of savings. However, the importance of providing legitimacy and oversight to MFIs should not be overlooked either. Particularly in light of the global financial crisis, if nothing else, too little regulation can have serious consequences for financial markets.

What does all this mean for international development policy? Certainly foreign capital and international networks are beneficial, but they are not the whole story. Microfinance and development more broadly could benefit from support for government capacity in the form of training and other assistance. There is thus an important role here for the international community in terms of sharing best practices and encouraging capacity improvements. Moreover, the importance of promoting democracy and stability should not be neglected.

## **Further Considerations**

This project represents an important starting point for multiple avenues of research. The rich sources of data becoming available represent opportunities to further delve into the nuances of the relationships observed here. For example, future quantitative analysis will seek to control for operational factors at the institution level and utilize more advanced statistical techniques to consider the disparate levels of analysis and draw better conclusions about the relationship between national-level political factors and institution-level measures of success. In addition, future research will also look into the evolving role of microfinance practitioner networks as a unique example of collective action for poverty-alleviation and development.

Muhammad Yunus (1997) wrote: “I have seen bowed and subdued people transformed into proud and creative entrepreneurs when credit has come in to change their lives” (12). Microfinance may not solve all the problems of the poor, but it can be a useful tool for grassroots level development. This study has tested a theory of microfinance that places these efforts in a broader political economic context. The resulting connections between grassroots level development and macro-level political action can be generalized not only across the developing world, but also hold lessons for the developed world as well. This research speaks to the need for appropriate regulation in financial markets, and in particular to how that regulatory framework can help to improve access to financial services. By paying attention to the policy framework and overall institutional context, this can help to ensure financial access for all and spur entrepreneurship to stimulate the economy from the grassroots level.

## APPENDIX 1: COUNTRIES INCLUDED IN COUNTRY-LEVEL DATASET

Afghanistan	Hungary	Rwanda
Albania	India	Samoa
Argentina	Indonesia	Senegal
Armenia	Iraq	Sierra Leone
Azerbaijan	Jordan	South Africa
Bangladesh	Kazakhstan	Sri Lanka
Benin	Kenya	Sudan
Bolivia	Kosovo	Swaziland
Bosnia and Herzegovina	Kyrgyzstan	Syria
Brazil	Laos	Tajikistan
Bulgaria	Lebanon	Tanzania
Burkina Faso	Macedonia	Thailand
Burundi	Madagascar	Togo
Cambodia	Malawi	Tunisia
Cameroon	Malaysia	Turkey
Chile	Mali	Uganda
China	Mexico	Ukraine
Colombia	Moldova	Uzbekistan
Congo, Dem. Republic	Mongolia	Venezuela
Costa Rica	Morocco	Vietnam
Cote d'Ivoire	Mozambique	Yemen
Croatia	Myanmar	Zambia
Dominican Republic	Namibia	Zimbabwe
Ecuador	Nepal	
Egypt	Nicaragua	
El Salvador	Niger	
Ethiopia	Nigeria	
Gambia	Pakistan	
Georgia	Panama	
Ghana	Paraguay	
Guatemala	Peru	
Guinea-Bissau	Philippines	
Guinea	Poland	
Haiti	Romania	
Honduras	Russia	

## APPENDIX 2: DESCRIPTION OF VARIABLES (COUNTRY-LEVEL)

<u>Dependent Variable: Microfinance Outreach</u>	
Borrowers / Population Below Poverty Line	Calculated as the ratio of total borrowers reported to the MIX Market online database for years 2005-2006, aggregated to the national level, to the total population living below the poverty line. MIX promotes transparent reporting and currently provides data on over 1,400 microfinance institutions. Financial, operational and social performance data reported to MIX is self-reported, but reviewed by regional experts. <i>Source: MIX Market. Microfinance Institutions: Indicators 2009</i> [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> ; UNDP. 2009. <i>Statistics of the Human Development Report</i> . UNDP 2009 [cited 16 November 2009]. Available from <a href="http://hdr.undp.org/en/statistics/">http://hdr.undp.org/en/statistics/</a> .
Borrowers / Population Below 1.25/day	Calculated as the ratio of total borrowers reported to the MIX Market online database for years 2005-2006, aggregated to the national level, to the total population living below \$1.25/day. <i>Source: MIX Market. Microfinance Institutions: Indicators 2009</i> [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> ; UNDP. 2009. <i>Statistics of the Human Development Report</i> . UNDP 2009 [cited 16 November 2009]. Available from <a href="http://hdr.undp.org/en/statistics/">http://hdr.undp.org/en/statistics/</a> .
Depositors / Population Below Poverty Line	Calculated as the ratio of total depositors reported to the MIX Market online database for years 2005-2006, aggregated to the national level, to the total population living below the poverty line. <i>Source: MIX Market. Microfinance Institutions: Indicators 2009</i> [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> ; UNDP. 2009. <i>Statistics of the Human Development Report</i> . UNDP 2009 [cited 16 November 2009]. Available from <a href="http://hdr.undp.org/en/statistics/">http://hdr.undp.org/en/statistics/</a> .
Depositors / Population Below 1.25/day	Calculated as the ratio of total depositors reported to the MIX Market online database for years 2005-2006, aggregated to the national level, to the total population living below \$1.25/day. <i>Source: MIX Market. Microfinance Institutions: Indicators 2009</i> [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> ; UNDP. 2009. <i>Statistics of the Human Development Report</i> . UNDP 2009 [cited 16 November 2009]. Available from <a href="http://hdr.undp.org/en/statistics/">http://hdr.undp.org/en/statistics/</a> .
Female Borrowers / Total Borrowers	Total female clients as a ratio of the total number of clients reported per country. <i>Source: MIX Market. Microfinance Institutions: Indicators 2009</i> [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> .
<u>Institutional Variables:</u>	
<i>Regime</i> Political Freedom Score	Dataset includes scores for 2005-2006 for each country. Original scale of 1-7 was inverted so that 1 represents the lowest level of freedom, 7 the highest. Scores are based on an average of expert ratings by for electoral process, civil society, independent media, national democratic governance, local democratic governance, judicial framework and independent, and corruption. <i>Source: Freedom House. 2007. "Freedom in the World: Comparative scores for all countries from 1973 to 2006." Freedom House.</i>
Political Stability & Absence of Violence/Terrorism	Dataset includes scores for 2005-2006 for each country. Original scale of -2.5-2.5 was adjusted to 0-5 to eliminate negative scores, with higher scores representing more stability. This index measures perceptions of the "likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically-motivated violence and terrorism." Scores are based on compiled survey data from enterprise,

	<p>citizen and expert respondents, as reported by a series of survey institutes, think tanks, non-governmental organizations, and international organizations. <i>Source:</i> Kaufmann, Daniel, Aart Kraay, and Massimo Mastruzzi. 2008. "Governance Matters VII: Governance Indicators for 1996-2007." Washington, DC: World Bank Policy Research.</p>
<i>Market Controls</i>	
Financial Freedom Index	<p>Dataset includes scores for 2005-2006 for each country. Scores are from 0-100, with higher scores indicating higher levels of freedom (less government interference). This index is a component of the broader economic freedom index and distinguishes from prudential supervision and is based on the extent of government ownership and intervention in banks and other financial institutions. <i>Source:</i> Heritage Foundation. 2009. "Index of Economic Freedom." Heritage Foundation &amp; Wall Street Journal.</p>
Investment Freedom Index	<p>Dataset includes scores for 2005-2006 for each country. Scores are from 0-100, with higher scores indicating higher levels of freedom (less government interference). This index is a component of the broader economic freedom index and rates countries according to limitations placed on capital flows, and particularly international investments. <i>Source:</i> Heritage Foundation. 2009. "Index of Economic Freedom." Heritage Foundation &amp; Wall Street Journal.</p>
Regulatory Quality	<p>Dataset includes scores for 2005-2006 for each country. Original scale of -2.5-2.5 was adjusted to 0-5 to eliminate negative scores, with higher scores representing greater quality. This index measures perceptions of "the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development." Scores are based on compiled survey data from enterprise, citizen and expert respondents, as reported by a series of survey institutes, think tanks, non-governmental organizations, and international organizations. <i>Source:</i> Kaufmann, Daniel, Aart Kraay, and Massimo Mastruzzi. 2008. "Governance Matters VII: Governance Indicators for 1996-2007." Washington, DC: World Bank Policy Research.</p>
<i>Capacity</i>	
Government Effectiveness	<p>Dataset includes scores for 2005-2006 for each country. Original scale of -2.5-2.5 was adjusted to 0-5 to eliminate negative scores, with higher scores indicating greater effectiveness. This index measures perceptions about "quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies." Scores are based on compiled survey data from enterprise, citizen and expert respondents, as reported by a series of survey institutes, think tanks, non-governmental organizations, and international organizations. <i>Source:</i> Kaufmann, Daniel, Aart Kraay, and Massimo Mastruzzi. 2008. "Governance Matters VII: Governance Indicators for 1996-2007." Washington, DC: World Bank Policy Research.</p>
<u>Alternative Explanations</u>	
Number of International Networks Present	<p>The total number of international microfinance networks reported to be operating in each country. Networks represent organizations of individual microfinance institutions. Activities can include financial and technical services, research and development and policy advocacy. <i>Source:</i> MIX Market. <i>Networks</i>. 2009 [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a>.</p>
Local Network Present	<p>Dummy equals 1 if there is a locally operated microfinance network operating within the country. <i>Source:</i> MIX Market. <i>Networks</i>. 2009 [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a>.</p>

Gender Equality Measure (GEM)	Dataset includes scores for 2005-2006 for each country. Scores are on a continuous scale of 0-1, with higher scores representing greater equality. This index is based on a series of indicators measuring women's relative economic and political participation, including share of parliamentary seats, shares of positions as legislators, senior officials and managers, share of professional and technical positions, and estimated earned income. <i>Source:</i> UNDP. 2009. <i>Statistics of the Human Development Report</i> . UNDP 2009 [cited 16 November 2009]. Available from <a href="http://hdr.undp.org/en/statistics/">http://hdr.undp.org/en/statistics/</a> .
-------------------------------	----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

**APPENDIX 3: SUMMARY STATISTICS (COUNTRY-LEVEL)**

	<u>Variable</u>	<u>N</u>	<u>Min.</u>	<u>Max.</u>	<u>Mean</u>	<u>SD</u>
<b>Dependent</b>	<u>Outreach</u>					
	Borrowers / Population Below Poverty Line	149	0.00	32.44	3.24	5.90
	Depositors / Population Below Poverty Line	152	0.00	0.88	0.06	0.19
	Borrowers / Population Below 1.25/day	135	0.01	129.97	5.03	13.00
	Depositors / Population Below 1.25/day	141	0.00	1.39	0.06	0.16
	Female Borrowers / Total Borrowers	156	0.00	100.00	61.58	24.53
<b>Independent</b>	<u>Institutions</u>					
	<i>Regime</i>					
	Political Freedom Score	157	1.00	7.00	3.69	2.20
	Political Stability & Absence of Violence/Terrorism	157	-0.39	3.65	1.77	0.62
	<i>Market Controls</i>					
	Financial Freedom Index	154	10.00	70.00	36.79	11.82
	Investment Freedom Index	154	10.00	70.00	39.04	10.41
	Regulatory Quality	157	0.17	3.93	2.19	0.38
	<i>Capacity</i>					
	Government Effectiveness	157	0.65	3.77	2.27	0.40
<u>Alternative Explanations</u>						
Number of International Networks Present	134	1.00	21.00	13.53	5.57	
Local Network Present	157	0.00	1.00	0.83	0.38	
Gender Equality Measure (GEM)	99	0.13	0.73	0.50	0.08	

### APPENDIX 4: CORRELATIONS (COUNTRY-LEVEL)

		Total MFIs reporting to MIX	Number of Active Borrowers / Population Below Poverty Line (square root)	Total Depositors / Population Below Poverty Line (square root)	Poor Clients / Total Clients (square root)	Number of Active Borrowers / Population Living Below \$1.25/day (square root)	Total Depositors / Population Living Below \$1.25/day (square root)	Female Borrowers / Total Borrowers (square root)	Political Rights	Political Stability No Violence	Financial Freedom Index	Investment Freedom Index	Regulatory Quality	Government Effectiveness	Number of international networks	Local Network(s) Present	Gender Empowerment Measure
Total MFIs reporting to MIX	Pearson Correlation	1	.245(**)	0.095	.335(**)	0.097	0.086	.569(**)	.647(**)	-.273(**)	-.241(**)	.281(**)	0.100	0.064	.883(**)	.237(**)	-0.012
	Sig. (2-tailed)		0.003	0.246	0.000	0.264	0.313	0.000	0.000	0.001	0.003	0.000	0.214	0.427	0.000	0.003	0.904
	N	156	149	152	141	135	141	156	156	153	153	153	156	156	132	156	98
Number of Active Borrowers / Population Below Poverty Line (square root)	Pearson Correlation	.245(**)	1	.727(**)	-.231(**)	.908(**)	.770(**)	-.072	.382(**)	-.278(**)	.174(*)	.174(*)	-.147	-.397(**)	.173(*)	-.177(*)	-0.134
	Sig. (2-tailed)			0.000	0.009	0.000	0.000	0.384	0.000	0.001	0.034	0.034	0.075	0.000	0.050	0.031	0.193
	N	149	149	149	129	131	134	149	149	149	148	148	149	149	129	149	96
Total Depositors / Population Below Poverty Line (square root)	Pearson Correlation	0.095	.727(**)	1	-.397(**)	.538(**)	.957(**)	-.085	.332(**)	-.280(**)	0.118	-0.079	-0.099	-.281(**)	0.138	-0.065	-0.107
	Sig. (2-tailed)				0.000	0.000	0.000	0.298	0.000	0.000	0.149	0.335	0.224	0.000	0.115	0.423	0.299
	N	152	149	152	130	132	138	152	152	152	150	150	152	152	131	152	97
Poor Clients / Total Clients (square root)	Pearson Correlation	.335(**)	-.231(**)	-.397(**)	1	-.352(**)	-.437(**)	.439(**)	0.044	-.323(**)	-.108	0.157	-0.106	-0.122	.233(**)	-0.152	-0.115
	Sig. (2-tailed)					0.000	0.000	0.000	0.617	0.000	0.216	0.073	0.223	0.159	0.007	0.080	0.312
	N	132	129	130	134	124	127	132	134	134	132	132	134	134	134	134	79
Number of Active Borrowers / Population Living Below \$1.25/day (square root)	Pearson Correlation	0.097	.908(**)	.538(**)	-.352(**)	1	.636(**)	-.132	.295(**)	-.188(*)	.295(**)	.271(*)	-0.119	-.375(**)	0.029	-.216(*)	-0.210
	Sig. (2-tailed)				0.000		0.000	0.127	0.001	0.029	0.001	0.168	0.000	0.000	0.752	0.012	0.060
	N	135	131	132	124	135	135	135	135	135	135	135	135	135	124	135	81
Total Depositors / Population Living Below \$1.25/day (square root)	Pearson Correlation	0.086	.770(**)	.957(**)	-.437(**)	.636(**)	1	-.111	.310(**)	-.329(**)	.177(*)	-0.081	-0.156	-.366(**)	0.106	-0.121	-0.144
	Sig. (2-tailed)				0.000	0.000		0.189	0.000	0.000	0.036	0.343	0.065	0.000	0.235	0.154	0.188
	N	141	134	138	127	135	141	141	141	141	140	140	141	141	127	141	85
Female Borrowers / Total Borrowers (square root)	Pearson Correlation	.569(**)	-.072	-.085	.439(**)	-.132	-0.111	1	.384(**)	-.290(**)	-.237(**)	0.139	0.082	0.108	.472(**)	-.084	-.263(**)
	Sig. (2-tailed)				0.000	0.127	0.189		0.000	0.000	0.003	0.086	0.312	0.179	0.000	0.296	0.009
	N	156	149	152	132	135	141	156	156	156	153	153	156	156	132	156	98
Political Rights	Pearson Correlation	.647(**)	.382(**)	.332(**)	0.044	.295(**)	.310(**)	.384(**)	1	-0.130	.269(**)	.559(**)	.323(**)	0.088	.761(**)	-0.032	0.008
	Sig. (2-tailed)				0.000	0.001	0.000	0.000		0.104	0.001	0.000	0.000	0.276	0.000	0.691	0.934
	N	156	149	152	134	135	141	156	157	157	154	154	157	157	134	157	99
Political Stability No Violence	Pearson Correlation	-.273(**)	-.278(**)	-.280(**)	-.323(**)	-.188(*)	-.329(**)	-.290(**)	-0.130	1	0.068	0.042	.553(**)	.664(**)	-0.078	.294(**)	.505(**)
	Sig. (2-tailed)				0.000	0.029	0.000	0.000	0.104		0.405	0.604	0.000	0.000	0.370	0.000	0.000
	N	156	149	152	134	135	141	156	157	157	154	154	157	157	134	157	99
Financial Freedom Index	Pearson Correlation	-.241(**)	.174(*)	0.118	-0.108	.295(**)	.177(*)	-.237(**)	.269(**)	0.068	1	.415(**)	.394(**)	0.021	-0.055	-.260(**)	0.098
	Sig. (2-tailed)				0.034	0.001	0.036	0.003	0.001	0.405		0.000	0.000	0.793	0.534	0.001	0.336
	N	153	148	150	132	135	140	153	154	154	154	154	154	154	132	154	99
Investment Freedom Index	Pearson Correlation	.281(**)	.174(*)	-0.079	0.157	.271(**)	-0.081	0.139	.559(**)	0.042	.415(**)	1	.374(**)	0.105	.404(**)	0.045	-.265(**)
	Sig. (2-tailed)				0.073	0.001	0.343	0.086	0.000	0.604	0.000		0.000	0.195	0.000	0.579	0.008
	N	153	148	150	132	135	140	153	154	154	154	154	154	154	132	154	99
Regulatory Quality	Pearson Correlation	0.100	-0.147	-0.099	-0.106	-0.119	-0.156	0.082	.323(**)	.553(**)	.394(**)	.374(**)	1	.859(**)	.363(**)	.252(**)	.232(*)
	Sig. (2-tailed)				0.223	0.168	0.065	0.312	0.000	0.000	0.000	0.000		0.000	0.000	0.001	0.021
	N	156	149	152	134	135	141	156	157	157	154	154	157	157	134	157	99
Government Effectiveness	Pearson Correlation	0.064	-.397(**)	-.281(**)	-0.122	-.375(**)	-.366(**)	0.108	0.088	.664(**)	0.021	0.105	.859(**)	1	.211(*)	.340(**)	.387(**)
	Sig. (2-tailed)				0.159	0.000	0.000	0.179	0.276	0.000	0.793	0.195	0.000		0.014	0.000	0.000
	N	156	149	152	134	135	141	156	157	157	154	154	157	157	134	157	99
Number of international networks	Pearson Correlation	.883(**)	.173(*)	0.138	.233(**)	0.029	0.106	.472(**)	.761(**)	-0.078	-0.055	.404(**)	.363(**)	.211(*)	1	.383(**)	.273(*)
	Sig. (2-tailed)				0.007	0.752	0.235	0.000	0.000	0.370	0.534	0.000	0.000	0.014		0.000	0.015
	N	132	129	131	134	124	127	132	134	134	132	132	134	134	134	134	79
Local Network(s) Present	Pearson Correlation	.237(**)	-.177(*)	-0.065	-0.152	-.216(*)	-0.121	-0.084	-0.032	.294(**)	-.260(**)	0.045	.252(**)	.340(**)	.383(**)	1	.290(**)
	Sig. (2-tailed)				0.080	0.012	0.154	0.296	0.691	0.000	0.001	0.579	0.001	0.000	0.000	0.000	0.004
	N	156	149	152	134	135	141	156	157	157	154	154	157	157	134	157	99
Gender Empowerment Measure	Pearson Correlation	-0.012	-0.134	-0.107	-0.115	-0.210	-0.144	-.263(**)	0.008	.505(**)	0.098	-.265(**)	.232(*)	.387(**)	.273(*)	1	1
	Sig. (2-tailed)				0.299	0.312	0.060	0.188	0.009	0.934	0.000	0.336	0.021	0.000	0.015	0.004	0.004
	N	98	96	97	79	81	85	98	99	99	99	99	99	99	79	99	99

\*\* . Correlation is significant at the 0.01 level (2-tailed).

\* . Correlation is significant at the 0.05 level (2-tailed).

## APPENDIX 5: COUNTRIES INCLUDED IN MFI DATASET

Afghanistan	Indonesia	Swaziland
Albania	Iraq	Syria
Angola	Jamaica	Tajikistan
Argentina	Jordan	Tanzania
Armenia	Kazakhstan	Thailand
Azerbaijan	Kenya	Togo
Bangladesh	Kosovo	Tunisia
Benin	Kyrgyzstan	Turkey
Bolivia	Laos	Uganda
Bosnia and Herzegovina	Lebanon	Ukraine
Brazil	Liberia	Uzbekistan
Bulgaria	Macedonia	Venezuela
Burkina Faso	Madagascar	Vietnam
Burundi	Malawi	Yemen
Cambodia	Mali	Zambia
Cameroon	Mexico	
Central African Republic	Moldova	
Chad	Mongolia	
Chile	Montenegro	
China	Morocco	
Colombia	Mozambique	
Congo	Nepal	
Congo, Democratic Rep.	Nicaragua	
Costa Rica	Niger	
Cote D'Ivoire	Nigeria	
Croatia	Pakistan	
Dominican Republic	Palestine	
East Timor	Panama	
Ecuador	Papua New Guinea	
Egypt	Paraguay	
El Salvador	Peru	
Ethiopia	Philippines	
Gambia, The	Poland	
Georgia	Romania	
Ghana	Russia	
Guatemala	Rwanda	
Guinea-Bissau	Samoa	
Guinea	Senegal	
Haiti	Serbia and Montenegro	
Honduras	Sierra Leone	
Hungary	South Africa	
India	Sri Lanka	

## APPENDIX 6: DESCRIPTION OF VARIABLES (MFI-LEVEL)

<u>Dependent Variable</u>	
Type	Indicates the legal status of the MFI, as reported to the MIX Market online database. Categories include Non-bank Financial Institutions (NBFIs), Rural Banks, Non-Profits (NGOs), Credit Unions / Cooperatives and Banks. MIX promotes transparent reporting and currently provides data on over 1,400 microfinance institutions. Financial, operational and social performance data reported to MIX is self-reported, but reviewed by regional experts. <i>Source:</i> MIX Market. <i>Microfinance Institutions: Indicators</i> 2009 [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> .
<i>Outreach</i>	
Total Active Borrowers	Total number of clients who currently have an outstanding loan balance reported by the MFI to the MIX Market online database. <i>Source:</i> MIX Market. <i>Microfinance Institutions: Indicators</i> 2009 [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> .
Total Depositors	Total number of clients with any type of savings account, reported by the MFI to the MIX Market online database. <i>Source:</i> MIX Market. <i>Microfinance Institutions: Indicators</i> 2009 [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> .
Outreach (peer groups)	Groups microfinance institutions according to the MicroBanking Bulletin's peer group classifications. Large MFIs serve > 30,000 borrowers; Medium > 10,000 and < 30,000; Small <10,000. <i>Source:</i> MIX Market. <i>Microfinance Institutions: Indicators</i> 2009 [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> ; MIX Market. 2010. <i>The Microbanking Bulletin: Methodology</i> 2010 [cited 16 February 2010]. Available from <a href="http://www.themix.org/microbanking-bulletin/methodology">http://www.themix.org/microbanking-bulletin/methodology</a> .
<i>Sustainability</i>	
Financial Self-Sufficiency	Adjusted financial revenue as a percent of the adjusted sum of financial expenses, impairment losses on loans and operating expenses. For details on the components of this indicator, see above. <i>Source:</i> MIX Market. 2010. <i>The Microbanking Bulletin: Methodology</i> 2010 [cited 16 February 2010]. Available from <a href="http://www.themix.org/microbanking-bulletin/methodology">http://www.themix.org/microbanking-bulletin/methodology</a> .
Scale (peer groups)	Groups microfinance institutions according to the MicroBanking Bulletin's peer group classifications for scale of operations. For Latin America, large MFIS have a gross loan portfolio > US\$15 million; medium 4-15 million; small < 4 million. For all other regions, large > 8 million; medium 2-8 million; small < 2 million. The differences in breakdown are to reflect differences in income levels across regions. <i>Source:</i> MIX Market. <i>Microfinance Institutions: Indicators</i> 2009 [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> ; MIX Market. 2010. <i>The Microbanking Bulletin: Methodology</i> 2010 [cited 16 February 2010]. Available from <a href="http://www.themix.org/microbanking-bulletin/methodology">http://www.themix.org/microbanking-bulletin/methodology</a> .
Operating Expense / Loan Portfolio	Total operating expenses as a percentage of the gross loan portfolio. Operating expenses include all personnel expense, depreciation and amortization, and administrative expense. <i>Source:</i> MIX Market. <i>Microfinance Institutions: Indicators</i> 2009 [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> .

<i>Impact</i>	
Portfolio at risk > 30 days	The portfolio at risk as a percentage of the gross loan portfolio. The portfolio at risk is the value of all loans outstanding that have one or more installments of principal more than 30 days overdue, including loans that have been restructured or rescheduled. <i>Source:</i> MIX Market. <i>Microfinance Institutions: Indicators 2009</i> [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> .
% of clients who are women	The number of active women borrowers as a percent of total borrowers. <i>Source:</i> MIX Market. <i>Microfinance Institutions: Indicators 2009</i> [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> .
Women Only	Dummy equals 1 if the MFI serves 100% women borrowers. <i>Source:</i> MIX Market. <i>Microfinance Institutions: Indicators 2009</i> [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> .
>75% Female Clients	Dummy equals 1 if the MFI serves > 75% women borrowers. <i>Source:</i> MIX Market. <i>Microfinance Institutions: Indicators 2009</i> [cited 15 September 2009]. Available from <a href="http://www.mixmarket.org/">http://www.mixmarket.org/</a> .
<u>Institutional Variables:</u>	
<i>Regime</i>	
Political Freedom Score	Dataset includes scores for 2005-2006 for each country. Original scale of 1-7 was converted to an ordinal measure based on the Report's methodology: Ratings 1.0 to 2.5 are considered Free, 3.0 to 5.0 Partly Free, and 5.5 to 7.0 Not Free. Scores are based on an average of expert ratings by for electoral process, civil society, independent media, national democratic governance, local democratic governance, judicial framework and independent, and corruption. <i>Source:</i> Freedom House. 2007. "Freedom in the World: Comparative scores for all countries from 1973 to 2006." Freedom House.
Political Stability & Absence of Violence/Terrorism	Dataset includes scores for 2005-2006 for each country. Original scale of -2.5-2.5 was converted into a five category scale: very low, low, moderate, high and very high (notice that none of the countries represented in this dataset fell into the fifth category). This index measures perceptions of the "likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically-motivated violence and terrorism." Scores are based on compiled survey data from enterprise, citizen and expert respondents, as reported by a series of survey institutes, think tanks, non-governmental organizations, and international organizations. <i>Source:</i> Kaufmann, Daniel, Aart Kraay, and Massimo Mastruzzi. 2008. "Governance Matters VII: Governance Indicators for 1996-2007." Washington, DC: World Bank Policy Research.
<i>Capacity</i>	
Government Effectiveness	Dataset includes scores for 2005-2006 for each country. Original scale of -2.5-2.5 was converted into a five category scale: very low, low, moderate, high and very high (notice that none of the countries represented in this dataset fell into the fifth category). This index measures perceptions about "quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies." Scores are based on compiled survey data from enterprise, citizen and expert respondents, as reported by a series of survey institutes, think tanks, non-governmental organizations, and international organizations. <i>Source:</i> Kaufmann, Daniel, Aart Kraay, and Massimo Mastruzzi. 2008. "Governance Matters VII: Governance Indicators for 1996-2007."

Washington, DC: World Bank Policy Research.

*Market Controls*

Deposits

Dummy equals 1 if the MFI reported that one of its main sources of funding includes savings deposits. *Source: MIX Market. Microfinance Institutions: Indicators 2009* [cited 15 September 2009]. Available from <http://www.mixmarket.org/>.

FI (peer groups)

Groups microfinance institutions according to the MicroBanking Bulletin's peer group classifications indicating the extent of financial intermediation. This measures the extent to which the MFI fund loans through mobilized deposits. The financial intermediation figure is a percentage of total assets funded by voluntary savings. Non FI institutions have no voluntary savings. Low FI have voluntary savings < 20% of total assets; High FI > 20%. *Source: MIX Market. Microfinance Institutions: Indicators 2009* [cited 15 September 2009]. Available from <http://www.mixmarket.org/>; MIX Market. 2010. *The Microbanking Bulletin: Methodology 2010* [cited 16 February 2010]. Available from <http://www.themix.org/microbanking-bulletin/methodology>.

Regulated

Dummy equals 1 if the MFI is reported to be regulated. Initial form completed by MFIs creating a profile includes the question. "Are you regulated?" followed by "If so, by whom?" However, answers to the later question are not displayed in online profiles for the MFIs. *Source: MIX Market. Microfinance Institutions: Indicators 2009* [cited 15 September 2009]. Available from <http://www.mixmarket.org/>.

Alternative Explanations

Member of  
International  
Network

Dummy equals 1 if the MFI is a member of an international network. Networks represent organizations of individual microfinance institutions. Activities can include financial and technical services, research and development and policy advocacy. *Source: MIX Market. Networks. 2009* [cited 15 September 2009]. Available from <http://www.mixmarket.org/>.

Member of Local  
Network

Dummy equals 1 if the MFI is a member of a local network. Networks represent organizations of individual microfinance institutions. Activities can include financial and technical services, research and development and policy advocacy. *Source: MIX Market. Networks. 2009* [cited 15 September 2009]. Available from <http://www.mixmarket.org/>.

## APPENDIX 7: INTERVIEW SCHEDULE

Tell me a bit about your operations...

### Specifics

- What is the number of clients?
- How high is the repayment rate?
- What is your overall capitalization?
- How many branches / locations?
- How many MFIs are operating in your country?
- What kind of staff does the organization maintain?
- Where / How were employees trained?
- What is the primary use of the loans? (i.e. establishing/expanding business, home repairs, etc)
- What other services does your MFI offer (insurance, job training, public health, etc)?

### Gender

- Are you targeting women in your operations? What is the ratio?
- What is the status of women in this country?
- Are the financial interests of women equally protected under law?
- Is your organization impacted by the status of women? Do you think the microfinance industry is affected by the status of women?
- Would more equal status of women benefit the microfinance industry? Alternatively, how has the empowerment of women impacted microfinance?

### Type of Organization

- How would you classify your organization (NGO, non-profit, etc)?
- When was your institution established? By whom? Tell me a bit about / What was the process of establishing your organization?
- Is your institution part of, or associated with, a larger financial or governmental institution?
- Are you associated or a member of other local organizations? In general, how influenced is your institution by local organizations or interests?
- Are you associated or a member of any larger international organizations? (trade, NGOs, etc) In general, how influenced is your institution by international organizations or interests?

### Funding

- Does institution offer savings programs?
- What were original sources of financing? What are they now?
- What kind of funding is available to MFIs? How reliant on donations?
- What kind of foreign investment/capital is being attracted (if any)?

### Regulations

- What is the nature of independent audit? By private ratings agencies? By regulators?
- How closely is microfinance monitored? What is the nature of supervision (if any)?

- How often is your organization in contact with government regulators?
- What kind of government regulations are MFIs subject to? What kind oversight are financial institutions subject to? Does the same apply to MFIs?

#### Interactions with Government

- What kind of assistance does your government offer to MFIs (if any)?
- What kind of assistance would you like to see offered by the government?
- What kind of changes do you think would be beneficial to the operation of MFIs?
- How would you rate the government's overall interest in microfinance efforts in your country?

#### Promotion of Interests/ Involvement with Associations

- Who has typically spoken for the interests of MFIs in your country? (local, international, association, etc)
- Are you involved with (\_\_\_\_\_) in any way? Do MFIs have to seek membership in this association?
- What is the primary role of the microfinance association in your country?
- What kind of services does the association offer (advocacy vs. technical training, etc)?
- Does the association offer any financial support to MFIs?
- How often do MFIs and association interact?
- How is information shared between the association and MFIs / between MFIs?
- What is the nature of the relationship between the government and the microfinance association?
- How effective have efforts to appeal to the government on particular issues been? How effective would you consider the microfinance association in advocating for MFIs?
- How would you rate the overall strength of the microfinance movement in your country?
- In general, what kind of positive support do your institution / microfinance in general receive?
- In general, are there any negative pressures facing your institution / microfinance in general?

#### Biggest Concerns

- What are the most pressing concerns faced by your organization / MFIs in general in terms of daily operation? How do these problems compare with two years ago?
- What kind of issues face clients operating their own small business?
- Has the global financial crisis been a concern at all for the microfinance industry?
- Is there any concern about the impact of failures of MFIs on the larger financial system?

#### General / Sum

- What do you see as the main goal of microfinance? Do you think it is succeeding?
- How would you rate outreach? Impact? Sustainability?
- What do you see as some of the pros and cons of microfinance in your country?
- Institutions vs. Interests?

## **APPENDIX 8: NATIONAL MICROFINANCE POLICY - NEPAL**

National Micro Finance Policy 2064 (2007)  
(Issued by the government of Nepal in April 2007)

Nepal Rastra (National) Bank Central Office

Microfinance Department

Baluwatar, Kathmandu,

Nepal

### National Micro Finance Policy 2064

#### **1. Background:**

According to the quality of life survey of the Central Department of Statistics, 2003/2004, the proportion of people living under poverty level was 30.8 percent in Nepal. This shows that poverty is the main problem to Nepal's economic development. Addressing this problem requires a long term policy to reduce the level of poverty. Under the policy, there is a need to mobilize available resources and small savings primarily in rural and underdeveloped regions. It is appropriate to implement vocational based employment programs, improve access to credits, increase self-confidence of the disadvantaged group of people (poor), and eventually enhance the economic development of the entire nation.

#### **2. Past Efforts:**

In Nepal, formal credit programs for the disadvantaged groups began in 1974. Commercial banks started the program: "Small Area Credit Program" under the directives of the Nepal Rastra (National) Bank (NRB). The credit flow to "Small Area" began after the NRB directed commercial banks to invest certain portion of their credit to priority sectors: agriculture, cottage industry, services and disadvantaged groups. Small credit programs grew, in real sense, in the Fifth Five Year Plan (1975-1980), after implementation of Small Farmers Development Program by the Agriculture Development Bank. Now, the priority sector credit program is abolished. Providing loans to the priority sector has been made optional to the commercial banks. Thus, there has been a need for a microfinance policy that provides credits to rural areas by reforming institutional arrangements.

#### **3. Current Status:**

Institutionally, the organizations involved in microfinance in Nepal are: commercial banks, rural development banks, private microfinance development banks, rural self-dependent funds, non governmental organizations involved in financial mediation and microfinance programs. The programs of these organizations have significantly benefitted disadvantaged families and groups. However, despite the increase in microfinance organizations, access to credit to the disadvantaged groups has not been as expected.

Hence, looking into the increasing local demand for financial resources, attempts have been made to simplify the flow of micro-credit and increase the access to micro-credits to the disadvantaged groups (mainly people living below poverty level). At the national level, there is a need to make arrangements for the national coordination, facilitation, promotion, bylaws development and monitoring. As the current institutional organization and legal arrangements are inadequate to enhance micro-credits to the disadvantaged groups, Nepal government has issued "National Micro Finance Policy, 2064" in order to establish institutional and legal arrangements for increasing access to micro-credit to the disadvantaged groups.

#### **4. Problems and Challenges:**

In Nepal, institutional financial services are insufficient to meet the financial needs of the disadvantaged groups. Institutional financial services have provided only 20 percent of the total rural credit demand, according to the latest rural credit survey. There is a 130 billion Nepalese Rupees shortfall of the total rural credit demand according to the Asian Development Bank's study. This shows that there is insufficient supply of rural credits compared to the total demand. Past political conflicts has further enlarged the gap between the rural credit demand and supply. It has been proved that the disadvantaged group-targeted micro-credit agencies such as rural development banks and private microfinance banks can improve the socio-economic status of disadvantaged groups. Thus, there is enough ground to believe that by launching such programs in an integrated and coordinated fashion, Nepal can achieve a significant success in the area of poverty reduction.

#### **5. Need for a New Policy:**

Microfinance appears to be a very useful policy for Nepal in the context of the nation's geographic and social structure, and resource mobilization ability. It is also an important tool to reduce poverty—the nation's prime agenda of economic development. Thus, it is important to formulate a microfinance policy as an important instrument to reduce poverty in Nepal. To provide necessary finance and resources to geographically and socio-economically disadvantaged people and utilize their capability and entrepreneur skills for income earning opportunities, through microfinance services is the need of the hour. Institutional structure and legal arrangements are made by formulating national microfinance policy in order to create opportunity to develop the skills of the disadvantaged families, integrate them in the national development stream, and to establish financial services under one umbrella.

#### **6. Definition and Jurisdictions:**

Micro finance means a financial service that helps to provide self-employment opportunities to the disadvantaged people through the programs such as micro-saving, micro-credit and micro-credit insurance. The microfinance policy will also include social and community services. Implementation of this policy will help make flexible policies to cater to the needs of people of different geographical and socio-economic regions. This policy will provide a legal basis for lenders and borrowers to work in a coordinated and cooperative manner.

#### **7. Goals:**

To reduce poverty through sustainable, simple and accessible small financial policy is the goal of the National Micro Finance Policy-2064.

#### **8. Objectives:**

The objectives of the National Micro Finance Policy-2064 are as follows:

- 8.1 To make microfinance more accessible to the disadvantaged and weak families and women groups and increase self-employment opportunities
- 8.2 To make microfinance services of the microfinance organizations more reliable and accessible
- 8.3 To help increase the capacity of the microfinance organizations for a sustainable microfinance services
- 8.4 To help prepare microfinance legislations
- 8.5 To develop appropriate institutional arrangements to make microfinance services more accessible and disciplined

#### **9. National Micro Finance Policy:**

The policies to make microfinance accessible, competitive and inclusive of the active participation of private sector are as follows:

- 9.1 To simplify micro finance services for disadvantaged people of different geographical regions, rural and urban
- 9.2 To prepare clear guidelines to identify the disadvantaged groups for microfinance and arrange and enhance collateral and non-collateral based (group collateral) finance
- 9.3 To provide assistance to microfinance agencies in social mobilization and empowerment activities and encourage bulk credit providing financial agencies in micro finance activities
- 9.4 To integrate poverty reduction programs with the National Micro Finance Policy and carryout activities in a coordinated manner
- 9.5 Coordinate with the established organizations to develop micro-enterprise skills of the targeted groups
- 9.6 To establish legal provisions to endorse the works of the local level micro-financing organizations
- 9.7 To encourage the disadvantaged groups in saving mobilization and increase the disadvantaged group's access to microfinance
- 9.8 To establish a separate organization to monitor and evaluate the microfinance activities under the direct supervision of the NRB and make the microfinance simple and sustainable
- 9.9 To establish National Micro Finance Development Fund for a sustainable resource mobilization in the microfinance sector. To mobilize all national and international funds for microfinance under the National Microfinance Development Fund.
- 9.10 To carryout a survey to have the information of microfinance organizations working in the nation, and their services
- 9.11 To enhance the professional skills of people engaged in microfinance by launching various training programs
- 9.12 To adopt flexible policy on deposit collection based on the microfinance agency's quality and quantity of services and their share capital
- 9.13 To adopt flexible policy in the income tax earned by the microfinance agencies and the tax rates on the interests earned by the disadvantaged groups from their deposits.

10. **Strategy and Action Plan:** x

11. **Institutional Structure:**

For institutional development of micro finance, a separate agency will be formed to monitor and supervise microfinance activities

12. **Economic aspect:**

Encourage private sector to establish microfinance agencies and launch microfinance programs

13. **Legal aspect:**

Laws and regulations will be formulated to implement activities under the National Micro Finance Policy 2007

14. **Monitoring and Evaluation:**

The NRB will monitor and evaluate the implementation of the National Microfinance Policy 2007

15. **Risks:** X

## APPENDIX 9: FORMAL FINANCIAL INSTITUTIONS RELEVANT TO MICROFINANCE

<u>Sri Lanka</u>	<u>Nepal</u>
<ul style="list-style-type: none"><li>▪ Commercial Banks</li><li>▪ Savings and Development Banks</li><li>▪ Regional Development Banks (RDBs)</li><li>▪ Savings Banks</li><li>▪ Cooperative Rural Banks (CRBs)</li><li>▪ Thrift and Credit Cooperative Societies (TCCs)</li><li>▪ Sanasa, the federation of the TCCs</li></ul>	<ul style="list-style-type: none"><li>▪ Commercial Banks</li><li>▪ Development Banks</li><li>▪ Regional Rural Development Banks</li><li>▪ Urban-based Finance Companies</li><li>▪ Nongovernment Organizations</li><li>▪ Cooperatives</li></ul>

Source: *The Role of Central Banks in Microfinance in Asia and the Pacific*, ed. P. McGuire and J. Conroy. Manila: Asian Development Bank.

## APPENDIX 10: LAWS THAT APPLY TO MICROFINANCE INSTITUTIONS

Sri Lanka	Nepal
Money Lending Ordinance No. 2 of 1918 (as amended through 1963) Co-operatives Societies Law, No. 5 of 1972 and Amendments Voluntary Social Service Organizations Act, No. 31 of 1980 Banking Act No. 30 of 1988 (as amended through 2006) Monetary Law Act (as amended through 2006) Finance Companies Act No. 78 of 1988 and Amendment of 1991 Regional Development Banks Act No. 6 of 1997 Compendium of Regulations Issued to Finance Companies of 2006 Companies Act, No. 07 of 2007 Compendium of Regulations Issued to Licensed Commercial Banks of 2008 Compendium of Regulations Issued to Licensed Specialised Banks of 2008	Nepal Company Act 1991 Cooperatives Act, 1992 VAT Act 1995 Financial Intermediary Societies Act 1999 Income Tax Act 2000 Nepal Rastra Bank Act 2002 Directives for Cooperative Societies Holding a Limited Banking Transaction License, 2002 Banks and Financial Institutions Ordinance 2004 Banks and Financial Institutions Act 2006 Microfinance & Cooperative Transactions Ordinance Registration of Associations Act Registration of Associations Rules Nepal National Microfinance Policy

*Source:* CGAP. *Comparative Database on Microfinance Regulation*. IRIS Center, University of Maryland [cited 22 December 2009]. Available from [www.microfinanceregulationcenter.org](http://www.microfinanceregulationcenter.org).

### APPENDIX 11: MEASURES OF GENDER EQUALITY

	Sri Lanka	Nepal
Gender-Related Development Index (GDI) 2006	0.735	0.517
Life Expectancy at Birth 2006 (%, Female/Male)	111.1	101.4
Adult Literacy Rate 1999-2006 (% aged 15 & above, Female/Male)	96.1	60.6
Combined Gross Enrollment in Education 2006 (%, Female/Male)	106.5	91.6
Estimated Earned Income 2006 (PPP US\$, %, Female/Male)	38.8	50.4
Gender Empowerment Measure (GEM)	0.371	0.485
Seats in Parliament Held by Women (% of total)	5.8	33.2
Female Legislators, Senior Officials and Managers (% of total)	21	14
Female Professional and Technical Workers (% of total)	48	20

*Source:* UNDP. "Human Development Report 2008 Statistical Tables."

## WORKS CITED

- Abruzzese, Leo. 2008. "Small is Beautiful." *Economist, Special Edition: The World in 2009*, 144.
- Adams, Dale W., and J.D. VonPischke. 1992. "Microenterprise credit programs: Deja vu." *World Development* 20 (10):1463-70.
- ADB. 1999. "Women in Nepal." Manila: Asian Development Bank.
- . 2002. "Poverty Reduction in Nepal: Issues, Findings, and Approaches." Manila: Asian Development Bank.
- . 2003. "Report and Recommendation of the President to the Board of Directors on Proposed Loans to The Democratic Socialist Republic of Sri Lanka for the Rural Finance Sector Development Project." Manila: Asian Development Bank.
- Ahmad, Mokbul Morshed. 2003. "Distant Voices: the views of the field workers of NGOs in Bangladesh on microcredit." *The Geographical Journal* 169 (1):65-74.
- Alailima, Patricia. 2007. *Growth, Distribution & Poverty Alleviation*. Peradeniya, Sri Lanka: Kandy Books.
- Alamgir, Dewan A.H. 2000. "Financing the Microcredit Programs of Non-Governmental Organizations (NGOs): A Case Study." *Journal of Developmental Entrepreneurship* 5 (2):157-68.
- Anthony, Denise. 2005. "Cooperation in Microcredit Borrowing Groups: Identity, Sanction, and Reciprocity in the Production of Collective Goods." *American Sociological Review* 70 (3):496-515.
- Anthony, Denise, and Christine Horne. 2003. "Gender and Cooperation: Explaining Loan Repayment in Micro-Credit Groups." *Social Psychology Quarterly* 66 (3):293-302.
- Aponsah, Nicholas. 2000. "Ghana's Mixed Structural Adjustment Results: Explaining the Poor Private Sector Response." *Africa Today* 47 (2):8-33.
- Armendariz de Aghion, Beatriz, and Jonathan Morduch. 2005. *The Economics of Microfinance*. Cambridge: MIT Press.
- Arsyad, Lincoln. 2006. "Assessing Factors Affecting the Repayment Rate of Microfinance Institutions: A Case Study of Village Credit Institutions of Gianyar, Bali." *Gadjah Mada International Journal of Business* 8 (2):247-73.
- Arun, Thankom. 2004. "Regulation of Microfinance." In *The Regulation of Development and the Development of Regulation*. University of Illinois, Department of Economics.
- . 2005. "Regulating for Development: The Case of Microfinance." *The Quarterly Review of Economics and Finance* 45:346-57.
- Barnes, Carolyn, Gayle Morris, and Gary Gaile. 1999. "An Assessment of Client of Microfinance Programs in Uganda." *International Journal of Economic Development* 1 (1):80-121.
- Barro, Robert J. 2000. "Rule of Law, Democracy, and Economic Performance." In *2000 Index of Economic Freedom*, ed. M. K. Kim R. Holmes, Gerald P. O'Driscoll Washington DC: Heritage Foundation.
- Barry, Nancy. 1995. "The Missing Links: Financial Systems that Work for the Majority." *Focus (CGAP)*.
- Barth, James R., Gerard Caprio Jr., and Ross Levine. 2004. "Bank regulation and supervision: what works best?" *Journal of Financial Intermediation* 13:205-48.

- Bates, Robert H. 2001. *Prosperity & Violence: The Political Economy of Development*. New York: W. W. Norton.
- Baumol, William J. 1968. "Entrepreneurship in Economic Theory." *The American Economic Review* 58 (2):64-71.
- Beck, Thorsten, Asli Demirguc-Kunt, and Ross Levine. 2004. "Finance, Inequality and Poverty: Cross-Country Evidence." In *World Bank Policy Research Working Paper Series: World Bank Policy Research Working Paper 3338*.
- Beck, Thorsten, Asli Demirguc-Kunt, and Maria Soledad Martinez Peria. 2005. "Reaching Out: Access to and Use of Banking Services Across Countries." In *Policy Research Working Paper*. Washington, DC: World Bank.
- Beck, Thorsten, Ross Levine, and Norman Loayza. 2000. "Finance and the sources of growth." *Journal of Financial Economics* 58:261-300.
- Becker, Gary S. 1978. *The Economic Approach to Human Behavior*. Chicago: University of Chicago.
- Begley, Thomas M., Wee-Liang Tan, and Herbert Schoch. 2005. "Politico-Economic Factors Associated with Interest in Starting a Business: A Multi-Country Study." *Entrepreneurship Theory and Practice* January:35-55.
- Bernasek, Alexandra, and James Ronald Stanfield. 1997. "The Grameen Bank as Progressive Institutional Adjustment." *Journal of Economic Issues* 31 (2):359-66.
- Berry, William D. 1982. "Theories of Regulatory Impact: The Roles of the Regulator, The Regulated, and the Public." *Policy Studies Review* 1 (3):436-41.
- Bhatta, Gambhir. 2001. "'Small Is Indeed Beautiful but ...': The Context of Microcredit Strategies in Nepal." *Policy Studies Journal* 29 (2):283.
- Bolnick, Bruce R., and Eric R. Nelson. 1990. "Evaluating the Economic Impact of a Special Credit Programme: KIK/KMKP in Indonesia." *The Journal of Development Studies* 26:299-312.
- Boserup, Ester. 1970. *Women's Role in Economic Development*. New York: St. Martin's Press.
- Bossert, Thomas John. 1983. "Can We Return to the Regime for Comparative Policy Analysis? or, The State and Health Policy in Central America." *Comparative Politics* 15:419-41.
- Boudreaux, Karol, and Tyler Cowen. 2008. "The Micromagic of Microcredit." *The Wilson Quarterly*:27-31.
- Brau, James C., and Gary M. Woller. 2004. "Microfinance: A Comprehensive Review of the Existing Literature." *Journal of Entrepreneurial Finance and Business Ventures* 9 (1):1-26.
- Bryant, Coralie. 1998. "Property Rights for the Rural Poor: The Challenge of Landlessness." *Journal of International Affairs* 52 (1):181-205.
- Buckley, Graeme. 1996. "Financing the Jua Kali Sector in Kenya: The KREP Juhudi scheme and Kenya Industrial Estates Informal Sector Programme." In *Finance Against Poverty*, ed. D. Hulme and P. Mosley. New York: Routledge.
- Campion, Anita. 2002. "Challenges to Microfinance Commercialization." *Journal of Microfinance* 4 (2):57-65.
- Caracciolo, John, and Terry F. Buss. 2001. "Microcredit and Rural Finance." In *Microcredit and Development Policy*, ed. D. R. Snow, G. Woller and T. F. Buss. Huntington, NY: Nova.
- Cardoso, Fernando Henrique, and Enzo Faletto. 1979. *Dependency and Development in Latin America*. Berkeley: University of California.

- Center for Microfinance. 2010. *Introduction*. CMF [cited 17 January 2010]. Available from <http://www.cmfnepal.org/>.
- Central Bank of Sri Lanka. 2004. "A Guide to Financial Services in Sri Lanka."
- . 2009. *About the Financial System*. CBSL 2009 [cited 22 November 2009]. Available from [http://www.cbsl.gov.lk/info/05\\_fss/f\\_1.htm#2](http://www.cbsl.gov.lk/info/05_fss/f_1.htm#2).
- Chamlee-Wright, Emily. 2005. "Fostering Sustainable Complexity in the Microfinance Industry: Which Way Forward?" *Economic Affairs* 25 (2):5-12.
- Chan, Sylvia. 2002. *Liberalism, Democracy and Development*. Cambridge: Cambridge University.
- Charitonenko, Stephanie, and Dulan de Silva. 2002. "Commercialization of Microfinance." Manila: Asian Development Bank.
- Chaudhry, Kiren Aziz. 2008. "The Myths of the Market and the Common History of Late Developers (1993)." In *The Political Economy Reader: Markets as Institutions*, ed. N. H. Barma and S. K. Vogel. New York: Routledge.
- Chaves, Rodrigo A., and Claudio Gonzalez-Vega. 1994. "Principles of Regulation and Prudential Supervision and Their Relevance for Microenterprise Finance Organizations." In *The New World of Microenterprise Finance: Building Healthy Financial Institutions for the Poor*, ed. M. Otero and E. Rhyne. West Hartford, CT: Kumarian.
- . 1996. "The design of successful rural financial intermediaries: Evidence from Indonesia." *World Development* 24 (1):65-78.
- Chowdhury, A. Mushtaque, and Abbas Bhuiya. 2004. "The Wider Impacts of BRAC Poverty Alleviation Programme in Bangladesh." *Journal of International Development* 16:369-86.
- Chowdhury, A. Mushtaque R., and M. Aminul Alam. 1997. "BRAC's Poverty Alleviation Efforts: A Quarter Century of Experiences and Learning." In *Who Needs Credit? Poverty and Finance in Bangladesh*, ed. G. D. Wood and I. A. Sharif. New York: Zed.
- Chowdhury, M. Jahangir Alam. 2008. "Poverty and Microfinance: an Investigation into the Role of Microcredit in Reducing the Poverty Level of Borrowing Households in Bangladesh and the Phillipines." *The Whitehead Journal of Diplomacy and International Relations* 9 (2):19-36.
- Christen, Robert Peck, and Richard Rosenberg. 2000. "The Rush to Regulate: Legal Frameworks for Microfinance." In *Occasional Paper*. Washington, DC: Consultative Group to Assist the Poor.
- Christen, Robert Peck, Richard Rosenberg, and Veena Jayadeva. 2004. *Financial Institutions with a 'Double Bottom Line': Implications for the Future of Microfinance*. Washington DC: CGAP, Occasional Paper 8.
- Chu, Hung Manh, Cynthia Benzing, and Charles McGee. 2007. "Ghanaian and Kenyan Entrepreneurs: A Comparative Analysis of their Motivations, Success Characteristics and Problems." *Journal of Developmental Entrepreneurship* 12 (3):295-322.
- Colombage, S. S. 2004. "Microfinance as an Instrument for Small Enterprise Development: Opportunities and Constraints." ed. C. f. B. Studies: Central Bank of Sri Lanka.
- Conroy, John D. 2000. "Sri Lanka." In *The Role of Central Banks in Microfinance in Asia and the Pacific*, ed. P. McGuire and J. Conroy. Manila: Asian Development Bank.
- Copestake, James. 2002. "Inequality and the Polarizing Impact of Microcredit: Evidence from Zambia's Copperbelt." *Journal of International Development* 14:743-55.

- Copestake, James, Sonia Bhalotra, and Susan Johnson. 2001. "Assessing the Impact of Microcredit: A Zambian Case Study." *Journal of Development Studies* 37 (4):81-100.
- Counts, Alex, and Sharmi Sobhan. 2001. "Recommendations for the Creation of a Pro-Microcredit Regulatory Framework." Washington, DC: Grameen Foundation USA.
- Crabb, Peter. 2008. "Economic Freedom and the Success of Microfinance Institutions." *Journal of Developmental Entrepreneurship* 13 (2):205-19.
- Cracknell, D. 2000. "Microfinance regulation in Bangladesh - a long path to progress." *Small Enterprise Development* 11 (4):42-51.
- Cuevas, Carlos E. 1996. "Enabling Environment and Microfinance Institutions: Lessons from Latin America." *Journal of International Development* 8 (2):195-209.
- Cull, Robert, Asli Demirguc-Kunt, and Jonathan Morduch. 2006. "Financial Performance and Outreach: A Global Analysis of Leading Microbanks." Washington, DC: World Bank.
- Daley-Harris, Sam. 2006. "State of the Microcredit Summit Campaign Report." Washington, DC: The Microcredit Summit Campaign.
- . 2007. "State of the Microcredit Summit Campaign Report." Washington, DC: The Microcredit Summit Campaign.
- Daley-Harris, Sam, and Anna Awimbo, eds. 2006. *More Pathways out of Poverty*. Bloomfield, CT: Kumarian Press.
- Daniels, Lisa. 1999. "The Role of Small Enterprises in the Household and National Economy in Kenya: A Significant Contribution or a Last Resort?" *World Development* 27 (1):55-65.
- Daniels, Reza C. 2004. "Financial Intermediation, Regulation and the Formal Microcredit Sector in South Africa." *Development Southern Africa* 21 (5):831-49.
- deAghion, Beatriz Armendariz, and Jonathan Morduch. 2005. *The Economics of Microfinance*. Cambridge: MIT Press.
- DeSoto, Hernando. 2000. *The Mystery of Capitalism: Why Capitalism Triumphs in the West and Fails Everywhere Else*. New York City: Basic Books.
- Develtere, Patrick, and An Huybrechts. 2005. "The Impact of Microcredit on the Poor in Bangladesh." *Alternatives* 30:165-89.
- Dichter, Thomas. 2007. "A Second Look at Microfinance: The Sequence of Growth and Credit in Economic History." In *Development Briefing Paper*. Washington, DC: CATO Institute.
- Dichter, Thomas W. 2003. *Despite Good Intentions: Why Development Assistance to the Third World has Failed*. Amherst: University of Massachusetts.
- Djankov, Simeon, Caralee McLiesh, and Andrei Shleifer. 2007. "Private credit in 129 countries." *Journal of Financial Economics* 84:299-329.
- DosSantos, Theotonio. 1970. "The Structure of Dependence." *American Economic Review* 60 (2):231-6.
- Downs, Anthony. 1957. *An Economic Theory of Democracy*. New York: HarperCollins.
- Duflos, Eric, Joanna Ledgerwood, Brigit Helms, and Manuel Moyart. 2006. "Country-Level Effectiveness and Accountability Review: Sri Lanka." Washington, DC: CGAP.
- Dunleavy, Patrick. 1991. *Democracy, Bureaucracy and Public Choice: Economic Models in Political Science*. London: Pearson.
- Dunn, Elizabeth. 1999. "Microfinance Clients in Lima, Peru: Baseline Report for AIMS Core Impact Assessment." In *Assessing the Impact of Microenterprise Services*. Washington, DC: Management Systems International.

- Ehlers, Tracy Bachrach, and Karen Main. 1998. "Women and the False Promise of Microenterprise." *Gender and Society* 12:424-40.
- Ethington, Philip, and Eileen McDonagh. 1995. "The Eclectic Center of the New Institutionalism: Axes of Analysis in Comparative Perspective." Duke University Press on behalf of the Social Science History Association.
- Evans, Peter. 1992. "The State as Problem and Solution: Predation, Embedded Autonomy, and Structural Change." In *The Politics of Economic Adjustment: International Constraints, Distributive Conflicts, and the State*, ed. S. Haggard and R. R. Kaufman. Princeton: Princeton University.
- Evans, Timothy G. 1999. "Demystifying nonparticipation in microcredit: A population-based analysis." *World Development* 27:419-30.
- Fairley, Joanne. 1998. "New Strategies for Microenterprise Development: Innovation, Integration, and the Trickle Up Approach." *Journal of International Affairs* 52 (1):339.
- Fernando, Laksiri. 2000. "Three Phases of Political Development After Independence." In *Sri Lanka's Development Since Independence: Socio-Economic Perspectives and Analysis*, ed. W. D. Lakshman and C. A. Tisdell. Huntington, NY: Nova Science Publishers.
- Ferrari, Aurora, Guillemette Jaffrin, and Sabin Raj Shrestha. 2007. *Access to Financial Services in Nepal*. Washington, DC: World Bank.
- Finnemore, Martha, and Kathryn Sikkink. 1998. "International Norm Dynamics and Political Change." *International Organization* 52 (4):887-917.
- Fjeldstad, Odd-Helge, Ivar Kolstad, and Knut Nygaard. 2006. "Bribes, Taxes and Regulations: Business Constraints for Micro Enterprises in Tanzania." Bergen, Norway: Chr. michelsen Institute.
- Freedom House. *Freedom in the World: Methodology* 2007 [cited 26 November 2006]. Available from <http://www.freedomhouse.org/template.cfm?page=35&year=2007>.
- . 2009a. "Freedom in the World - Nepal." Washington, DC: Freedom House.
- . 2009b. "Freedom in the World - Sri Lanka." Washington, DC: Freedom House.
- Frieden, Jeffry A., and David A. Lake. 2000. *International Political Economy: Perspectives on Global Power and Wealth*. Belmont: Wadsworth Thomson.
- Friedman, John. 1992. *Empowerment: The Politics of Alternative Development*. Cambridge: Blackwell.
- Fruman, Cecile, and Julia Paxton. 1998. "Outreach and Sustainability of Savings-First vs. Credit-First Financial Institutions: A Comparative Analysis of Eight Microfinance Institutions in Africa." Washington, DC: World Bank.
- Fuentes, Gabriel A. 1996. "The Use of Village Agents in Rural Credit Delivery." *The Journal of Development Studies* 33 (2):188-209.
- Gallardo, Joselito. 2002. "A Framework for Regulating Microfinance Institutions: The Experience in Ghana and the Phillipines." Washington, DC: World Bank.
- Gant, Richard, Dulan de Silva, Anura Atapattu, and Steve Durrant. 2002. "National Microfinance Study of Sri Lanka: Survey of Practices and Policies." Colombo: AusAID, GTZ.
- Gibbons, David S., and Jennifer W. Meehan. 2000. "The Microcredit Summit's Challenge: Working Towards Institutional Financial Self-Sufficiency while Maintaining a Commitment to Serving the Poorest Families." Washington, DC: Microcredit Summit.
- Gilpin, Robert. 2001. *Global Political Economy: Understanding the International Economic Order*. Princeton: Princeton University.

- Goetz, Anne Marie, and Rina Sen Gupta. 1996. "Who takes the credit? Gender, power, and control over loan use in rural credit programs in Bangladesh." *World Development* 24 (1):45-63.
- GTZ. 2009. "Microfinance Industry Report: Sri Lanka." Eschborn: German Development Cooperation (GTZ).
- Gulli, H., and M. Berger. 1999. "Microfinance and poverty reduction - evidence from Latin America." *Small Enterprise Development* 10 (3):16-28.
- Gupta, D.K., M.C. Madhavan, and A. Blee. 1998. "Democracy, Economic Growth and Political Instability: An integrated perspective." *Journal of Socio-Economics* 27 (5):587-611.
- Hall, Peter. 1986. *Governing the Economy*. New York City: Oxford University Press.
- . 1997. "The Role of Interests, Institutions, and Ideas in Comparative Political Economy of the Industrialized Nations." In *Comparative Politics: Rationality, Culture, and Structure*, ed. M. I. Lichbach and A. S. Zuckerman. Cambridge: Cambridge University.
- Hannig, Alfred, and Edward Katimbo-Mugwanya. 2000. "How to Regulate and Supervise Microfinance? - Key Issues in an International Perspective." In *Financial System Development (FSD) Project*. Kampala: Bank of Uganda - German Technical Cooperation
- Hansen, Lene. 2008. "Nepal Case Study: Adapting Approaches and Products to Persevere During Conflict." Washington, DC: USAID.
- Hardy, Daniel C., Paul Holden, and Vassilli Prokopenko. 2003. "Microfinance Institutions and Public Policy." *Policy Reform* 6 (3):147-58.
- Hartarska, Valentina. 2005. "Governance and Performance of Microfinance Institutions in Central and Eastern Europe and the Newly Independent States." *World Development* 33 (10):1627-43.
- Hartarska, Valentina, and Denis Nadolnyak. 2008. "An Impact Analysis of Microfinance in Bosnia and Herzegovina." *World Development* doi:10.1016/j.worlddev.2008.01.015.
- Hashemi, Syed M. 1997. "Those Left Behind: A Note on Targeting the Hardcore Poor." In *Who Needs Credit? Poverty and Finance in Bangladesh*, ed. G. D. Wood and I. A. Sharif. New York: Zed.
- Hashemi, Syed M., Sidney Ruth Schuler, and Ann P. Riley. 1996. "Rural credit programs and women's empowerment in Bangladesh." *World Development* 24 (4):635-53.
- Hassan, M. Kabir, and Luis Renteria-Guerrero. 1997. "The experience of the Grameen Bank of Bangladesh in community development." *International Journal of Social Economics* 24 (12):1488-523.
- Hassan, M. Kabir, and David R. Tufte. 2001. "The X-Efficiency of a Group-Based Lending Institution: The Case of the Grameen Bank." *World Development* 29 (6):1071-82.
- Hassan, M.K. 2002. "The Microfinance Revolution and the Grameen Bank Experience in Bangladesh." *Financial Markets, Institutions & Instruments* 11 (3):205-65.
- Hayek, F.A. 1944. *The Road to Serfdom*. Chicago: University of Chicago.
- Hedrick-Wong, Yuwa, Bosse Kramsjo, and Asgar Ali Sabri. 1997. "Experiences and Challenges in Credit and Poverty Alleviation Programs in Bangladesh: The Case of Proshika." In *Who Needs Credit? Poverty and Finance in Bangladesh*, ed. G. D. Wood and I. A. Sharif. New York: Zed.
- Helms, Brigit. 2006. *Access for All: Building Inclusive Financial Systems*. Edited by CGAP. Washington, DC: World Bank.
- Hoff, Karla, and Joseph Stiglitz. 1990. "Imperfect Information and Rural Credit Markets: Puzzles and Policy Perspectives." *The World Bank Economic Review* 4 (3):235-50.

- Hofstede, G. 1980. *Culture's consequences: International differences in work related values*. Beverly Hills: Sage.
- Holcombe, Susan. 1995. *Managing to Empower: The Grameen Bank's Experience of Poverty Alleviation*. Dhaka: University Press Limited.
- Holt, Sharon L., and Helena Ribe. 1991. "Developing Financial Institutions for the Poor and Reducing Barriers to Access for Women." Washington, DC: World Bank.
- Honohan, Patrick. 2004a. *Financial Sector Policy and the Poor: Selected Findings and Issues*. Washington, D.C.: World Bank.
- . 2004b. "Measuring Microfinance Access: Building on Existing Cross-Country Data." In *Data on the Access of Poor and Low Income People to Financial Services*. Washington, DC: UNDP/World Bank/IMF.
- Hossain, Naomi. 2007. "The politics of what works: the Case of the Vulnerable Group Development Programme in Bangladesh." Manchester: Chronic Poverty Research Centre.
- Hulme, David, Richard Montgomery, and Debapriya Bhattacharya. 1996. "Mutual Finance and the Poor: A study of the Federation of Thrift and Credit Co-operatives (SANASA) in Sri Lanka." In *Finance Against Poverty*, ed. D. Hulme and P. Mosley. New York: Routledge.
- Hulme, David, and Paul Mosley. 1996. *Finance Against Poverty*. Vol. 1. New York: Routledge.
- . 1997. "Finance for the Poor or Poorest? Financial Innovation, Poverty and Vulnerability." In *Who Needs Credit? Poverty and Finance in Bangladesh*, ed. G. D. Wood and I. A. Sharif. Dhaka: The University Press Ltd.
- Hunt, Janet. 2004. "Gender and Development." In *Key Issues in Development*, ed. D. Kingsbury, J. Remenyi, J. McKay and J. Hunt. New York: Palgrave MacMillan.
- Hunt, Juliet, and Nalini Kasynathan. 2001. "Pathways to Empowerment? Reflections on Microfinance and Transformation in Gender Relations in South Asia." *Gender and Development* 9 (1):42-52.
- Inglehart, Ronald. 1997. *Modernization and Postmodernism*. Princeton: Princeton University Press.
- "International Year of Microcredit 2005: Final Report." 2006. New York: United Nations Capital Development Fund.
- Jansson, Tor, and Mark Wenner. 1997. "Financial Regulation and its Significance for Microfinance in Latin America and the Caribbean." Washington, DC: Inter-American Development Bank.
- Johnson, S., and T. Kidder. 1999. "Globalization and gender - dilemmas for microfinance organizations." *Small Enterprise Development* 10 (3):4-15.
- Johnson, Susan. 2004. "Gender Norms in Financial Markets: Evidence from Kenya." *World Development* 32 (8):1355-74.
- Jolly, Joanna. 2009. "Growing fragility of Nepal's peace process." *BBC News*, 21 December 2009.
- Kabeer, Naila. 2001. "Conflicts Over Credit: Re-Evaluating the Empowerment Potential of Loans to Women in Rural Bangladesh." *World Development* 29 (1):63-84.
- Kaboski, Joseph P., and Robert M. Townsend. 2005. "Policies and Impact: An analysis of village-level microfinance institutions." *Journal of European Economic Association* 3 (1):1-50.

- Kamal, A. 1996. "Poor and the NGO Process: Adjustments and Complicities." In *1987-1994: Dynamics of Rural Poverty in Bangladesh*, ed. H. Z. Rahman, M. Hossain and B. Sen: Bangladesh Institute of Development Studies.
- Karnani, Aneel. 2008. "Romanticizing the Poor Harms the Poor." *The Whitehead Journal of Diplomacy and International Relations* 9 (2):57-70.
- Karunatilake, H. N. S. 2004. "Banking Sector Reform." In *Economic Policy in Sri Lanka: Issues and Debates*, ed. S. Kelegama. New Delhi: Sage Publications India.
- Katznelson, Ira, and Barry R. Weingast, eds. 2005. *Preferences and Situations: Points of Intersection Between Historical and Rational Choice Institutionalism*. New York: Russell Sage Foundation.
- Kaufmann, Daniel, Aart Kraay, and Massimo Mastruzzi. 2008. "Governance Matters VII: Governance Indicators for 1996-2007." Washington, DC: World Bank Policy Research.
- Kerer, Jan. 2008. How to Measure Social Performance? The Challenge of the Double Bottom Line in Nepal. Paper read at Nepal Microfinance Summit, 14-16 February 2008, at Kathmandu.
- Khandker, Shahidur, Baqui Khalily, and Zahed Khan. 1994. "Is Grameen Bank Sustainable?". Washington, DC: World Bank.
- Khandker, Shahidur R. 1998. *Fighting Poverty with Microcredit: Experience in Bangladesh*. New York: Oxford University.
- . 2003. "Microfinance and Poverty: Evidence Using Panel Data from Bangladesh." Washington, DC: World Bank.
- Khandker, Shahidur R., Hussain A. Samad, and Zahed H. Khan. 1998. "Income and Employment Effects of Micro-Credit Programmes: Village-Level Evidence from Bangladesh." *Journal of Development Studies* 35:96-124.
- Kidder, Thalia. 1999. "Alternative Financial Institutions? Sustainability, Development, Social Reproduction, and Gender Analysis." *Development in Practice* 9 (4):482-7.
- Kiggundu, Moses N. 2002. "Entrepreneurs and Entrepreneurship in Africa: What is Known and What Needs to be Done." *Journal of Developmental Entrepreneurship* 7 (3):239-58.
- Kingsbury, Damien. 2004. "Community Development." In *Key Issues in Development*, ed. J. R. Damien Kingsbury, John McKay and Janet Hunt. New York: Palgrave Macmillan.
- Kirkpatrick, Colin, and Samuel Munzele Maimbo. 2002. "The Implications of the Evolving Microfinance Agenda for Regulatory and Supervisory Policy." *Development Policy Review* 20 (3):293-304.
- Kneiding, Christoph, and Richard Rosenberg. 2008. "Variations in Microcredit Interest Rates." *CGAP Brief* July 2008.
- Kohli, Atul. 2004. *State-Directed Development: Political Power and Industrialization in the Global Periphery*. New York: Cambridge University.
- Kottegoda, Sepali. 2003. "Interventions in Poverty Alleviations: Women Recovering from Poverty or Women Recovering the Family from Poverty?" In *Poverty Issues in Sri Lanka*. Orugodawatte: Centre for Poverty Analysis, IMCAP, SLAAS.
- Kreft, Steven F., and Russell S. Sobel. 2005. "Public Policy, Entrepreneurship, and Economic Freedom." *CATO Journal* 25 (3):595-616.
- Lal, Deepak. 2008. "The Poverty of 'Development Economics' (1983)." In *The Political Economy Reader: Markets as Institutions*, ed. N. H. Barma and S. K. Vogel. New York: Routledge.

- Landes, David S. 1998. *The Wealth and Poverty of Nations: Why some are so rich and some are so poor*. New York: W.W. Norton.
- Lanka Microfinance Association. 2009. *Objectives of Lanka Microfinance Practitioners' Association* Lanka Microfinance 2009 [cited 8 March 2009]. Available from [http://lankamicrofinance.com/objectives\\_of\\_microfinance\\_in\\_sri\\_lanka.htm](http://lankamicrofinance.com/objectives_of_microfinance_in_sri_lanka.htm).
- Ledgerwood, Joanna. 1999. *Microfinance Handbook: An Institutional and Financial Perspective*. Washington D.C.: World Bank.
- Lenin, Vladimir I. 1920. *Imperialism: The Highest Stage of Capitalism*. London: Junius.
- Levine, Ross. 1999. "Law, Finance, and Economic Growth." *Journal of Financial Intermediation* 8:8-35.
- Lindblom, Charles. 1965. *Politics and Markets: The World's Political-Economic Systems*. New York: Basic Books.
- Lipset, Seymour Martin. 1981. *Political Man: The Social Bases of Politics*. Baltimore: John Hopkins University.
- Lipton, Michael. 1968. "The Theory of the Optimising Peasant." *Journal of Development Studies* 4 (3):327-51.
- Lucarelli, Bill. 2005. "Microcredit: A Cautionary Tale." *Journal of Contemporary Asia* 35 (1):78-86.
- Lumsdaine, David Halloran. 1993. *Moral Vision: The Foreign Aid Regime, 1949-1989*. Princeton: Princeton University Press.
- Mahajan, Vijay, and Bharti Gupta Ramola. 1996. "Financial Services for the Rural Poor and Women in India: Access and Sustainability." *Journal of International Development* 8 (2):211-24.
- March, James G., and Johan P. Olsen. 1984. "The New Institutionalism: Organizational Factors in Political Life." 78 (3):734-49.
- Marcus, Rachel. 1999. *Money Matters: Understanding Microfinance*. London: Save the Children.
- Marlow, Susan, and Dean Patton. 2005. "All Credit to Men? Entrepreneurship, Finance, and Gender." *Entrepreneurship Theory and Practice* 29 (6):717-35.
- Matin, Imran. 2005. "The very poor who participate in microfinance institutions and those who never have." *Small Enterprise Development* 16 (3):51-7.
- Matin, Imran, and David Hulme. 2003. "Programs for the Poorest: Learning from the IGVGD Program in Bangladesh." *World Development* 31 (3):647-65.
- Matin, Imran, David Hulme, and Stuart Rutherford. 2002. "Finance for the Poor: From Microcredit to Microfinancial Services." *Journal of International Development* 14:273-94.
- McClelland, D.C. 1961. *The Achieving Society*. Princeton: Van Nostrand.
- McGuire, Paul B., John D. Conroy, and Ganesh B. Thapsa. 1998. *Getting the Framework Right: Policy and regulation for microfinance in Asia*. Brisbane: The Foundation for Development Cooperation.
- McGuire, Paul, and John Conroy. 2000. "The Role of Central Banks in Microfinance in Asia." Manila: Asian Development Bank.
- McKernon, Signe-Mary. 1996. "The impact of microcredit programs on self-employment profits: Do noncredit program aspects matter?" *The Review of Economics and Statistics* 84:93-115.

- Meagher, Patrick. 2002. "Microfinance Regulation in Developing Countries: A Comparative Review of Current Practice." University Park, MD: IRIS Center.
- Microfinance Association of Nepal. 2009. "An Outlook." Kathmandu: Microfinance Association of Nepal.
- Migdal, Joel. 1988. *Strong Societies and Weak States: State-Society Relations and State Capabilities in the Third World*. Princeton: Princeton University Press.
- Miller, Terry, and Kim R. Holmes. 2009. "Index of Economic Freedom." Washington, DC: Heritage Foundation.
- MIX Market. 2009a. "Introduction to the Peer Groups and Tables." *MicroBanking Bulletin*, December 2009, 45-53.
- . *Microfinance Institutions: Indicators* 2009b [cited 15 September 2009]. Available from <http://www.mixmarket.org/>.
- . *Networks* 2009c [cited 15 September 2009]. Available from <http://www.mixmarket.org/>.
- . 2010. *The Microbanking Bulletin: Methodology* 2010 [cited 16 February 2010]. Available from <http://www.themix.org/microbanking-bulletin/methodology>.
- Mkandawire, Thandika. 2002. "Incentives, Governance, and Capacity Development in Africa." *African Issues* 30 (1):15-20.
- MkNelly, Barbara, and Karen Lippold. 1998. "Practitioner-Led Impact Assessment: A Test in Mali." In *AIMS Project Report*. Washington, DC: Management Systems International.
- MkNelly, Barbara, Gayle Morris, and Gary Gaile. 2001. "Practitioner-Led Impact Assessment: A Test in Mali." In *Microcredit and Development Policy*, ed. D. R. Snow, G. Woller and T. F. Buss. Huntington, NY: Nova.
- Moe, Terry M. 1990. "Political Institutions: The Neglected Side of the Story." Oxford University Press.
- Monroe, Kristen Renwick. 1996. *The Heart of Altruism: Perceptions of a Common Humanity*. Princeton: Princeton University Press.
- Montgomery, R., D. Bhattacharya, and D. Hulme. 1996. "Credit for the Poor in Bangladesh: The BRAC Rural Development Programme and the Government Thana Resource Development and Employment Programme." In *Finance Against Poverty*, ed. D. Hulme and P. Mosley. New York: Routledge.
- Moodie, Megan. 2008. "Enter Microcredit: A new culture for women's empowerment in Rajasthan?" *American Ethnologist* 35 (3):454-65.
- Morduch, Jonathan. 1999. "The Role of Subsidies in Microfinance: Evidence from the Grameen Bank." *Journal of Development Economics* 60:229-48.
- Morduch, Jonathan, and Barbara Haley. 2002. "Analysis of the Effects of Microfinance on Poverty Reduction." In *NYU Wagner Working Paper No. 1014*. New York: New York University.
- Moser, Caroline. 1993. *Gender Planning and Development: Theory, Practice and Training*. London: Routledge.
- Mosley, Paul. 1996. "Indonesia: BKK, KURK, and the BRI unit desa institutions." In *Finance Against Poverty*, ed. D. Hulme and P. Mosley. New York: Routledge.
- . 2001. "Microfinance and poverty in Bolivia." *The Journal of Development Studies* 37:101-32.
- Muriel, Armando, Victoria Muriel, Giulissa Franco, and Elsa Martin. 2006. "Microfinance Institutions in Times of Crisis: Impact, Actions, and Lessons Learned." In *An Inside View*

- of Latin American Microfinance*, ed. M. Berger, L. Goldmark and T. Miller-Sanabria. Washington, DC: Inter-American Development Bank.
- Mwenda, Kenneth Kaoma, and Gerry Nkombo Muuka. 2004. "Towards best practices for microfinance institutional engagement in African rural areas: Selected cases and agenda for action." *International Journal of Social Economics* 31 (1/2):143-58.
- Naaraayana, Naagesh. *Microfinance to provide succour to Lankan Tamils*, 15 July 2009 [cited 24 November 2009]. Available from [www.microfinancefocus.com](http://www.microfinancefocus.com).
- Navajas, Sergio, Mark Schreiner, Richard L. Meyer, Claudio Gonzalez-Vega, and Jorge Rodriguez-Meza. 2000. "Microcredit and the Poorest of the Poor: Theory and Evidence from Bolivia." *World Development* 28 (2):333-46.
- Naved, Ruchira T. 1994. "Empowerment of Women: Listening to the Voices of Women." *Bangladesh Development Studies* 22 (2&3):155-79.
- Nepal Rastra Bank. "Nepal Rastra Bank Strategic Plan 2006-2010." Nepal Rastra Bank.
- . 2007a. "National Micro Finance Policy 2064." ed. M. Department: Nepal Rasta Bank.
- . 2007b. "Some Glimpses of Micro-Finance Activities in Nepal ", ed. M. Department: Nepal Rastra Bank.
- . 2008. "Annual Bank Supervision Report 2007." ed. B. S. Department: Nepal Rastra Bank.
- Nobel Foundation. 2010. *The Nobel Peace Prize 2006* 2006 [cited 27 April 2010]. Available from [http://nobelprize.org/nobel\\_prizes/peace/laureates/2006/](http://nobelprize.org/nobel_prizes/peace/laureates/2006/).
- Nordlinger, Eric A. 1987. "Taking the State Seriously." In *Understanding Political Development*, ed. M. Weiner and S. P. Huntington. Boston: Little, Brown & Company.
- North, Douglass C. 1990. *Institutions, Institutional Change and Economic Performance*. Cambridge: Cambridge University Press.
- Obanyan, Anna. 2007. "The Politics of Microcredit." UN Vision Project on Global Public Policy Networks.
- Olsen, Johan P. 2001. "Garbage Cans, New Institutionalism, and the Study of Politics." American Political Science Association.
- Olsen, Mancur. 1965. *The Logic of Collective Action : Public Goods and the Theory of Groups*. Cambridge: Harvard University Press.
- . 1996. "Distinguished Lecture on Economics in Government: Big Bills Left on the Sidewalk: Why Some Nations are Rich, and Others Poor." *Journal of Economic Perspectives* 10 (2):3-24.
- Panjaitan-Drioadisuryo, D.M. Rosintan, and Kathleen Cloud. 1999. "Gender, Self-Employment and Microcredit Programs: An Indonesian Case Study." In *Quarterly Review of Economics and Finance*.
- Park, Susan. 2007. "The World Bank Group: Championing Sustainable Development Norms?" *Global Governance* 13:535-56.
- Patten, Richard H., Jay K. Rosengard, and Jr. Don E. Johnston. 2001. "Microfinance Success Amidst Macroeconomic Failure: The Experience of Bank Rakyat Indonesia During the East Asian Crisis." *World Development* 29 (6):1057-69.
- Paxton, Julia. 2003. "A poverty outreach index and its application to microfinance." *Economics Bulletin* 9 (2):1-10.
- Peng, Mike W., Yasuhiro Yamakawa, and Seung-Hyun Lee. 2008. "Bankruptcy Laws and Entrepreneur-Friendliness." In *International Entrepreneurship: Do Institutions Matter?* Conference: Northeastern University, Boston, MA.

- Pitt, Mark M., and Shahidur R. Khandker. 1998. "The impact of group-based credit programs on poor households in Bangladesh: Does the gender of the participants matter?" *The Journal of Political Economy* 106:958-96.
- Pollinger, J. Jordan, John Outhwaite, and Hector Cordero-Guzman. 2007. "The Question of Sustainability for Microfinance Institutions." *Journal of Small Business Management* 45 (1):23-41.
- Popkin, Samuel L. 1979. *The Rational Peasant: The Political Economy of Rural Society in Vietnam*. Berkeley: University of California Press.
- Porter, Tony. 2002. "Politics, Institutions, Constructivism and the Emerging International Regime for Financial Regulation." *The review of Policy Research* 19 (1):53-79.
- Pradhan, Krishna Kumar. 2005. "Development Finance." In *Nepal Rastra Bank in Fifty Years*, ed. N. R. Bank. Kathmandu: NRB.
- ProMiS. 2008. "Adding value to the future: How Microfinance Improves Lives in Sri Lanka." Colombo: GTZ.
- . 2009. *Mission*. ProMiS 2009a [cited 4 March 2009]. Available from <http://www.microfinance.lk/mission.php>.
- . 2009. *Overview*. ProMiS Promotion of the Microfinance Sector 2009b [cited 4 March 2009]. Available from <http://www.microfinance.lk/microsri.php>.
- Przeworski, Adam, and et al. 1996. "What Makes Democracies Endure?" *Journal of Democracy* 7 (1):39-55.
- Pye, Lucian, and Sidney Verba. 1965. *Political Culture and Political Development*. Princeton: Princeton University Press.
- Quinn, D.P., and J.T. Wolley. 2001. "Democracy and National Economic Performance: The Preference for Stability." *American Journal of Political Science* 45 (3):634-57.
- Quinn, D.P., and J.T. Woolley. 2001. "Democracy and National Economic Performance: The preference for stability." *American Journal of Political Science* 45 (3):634-57.
- Quota Project. 2010. *Global Database of Quotas for Women*. International IDEA, Stockholm University and Inter-Parliamentary Union 2009 [cited 23 January 2010]. Available from <http://www.quotaproject.org>.
- Rahman, Aminur. 1999. "Micro-credit Initiatives for Equitable and Sustainable Development: Who Pays?" *World Development* 27 (1):67-82.
- Rai, Ashok S., and Tomas Sjoström. 2004. "Is Grameen Lending Efficient? Repayment Incentives and Insurance in Village Economies." *Review of Economic Studies* 71:217-34.
- Rankin, Katharine N. 2001. "Governing development: neoliberalism, microcredit and rational economic woman." *Economy and Society* 30 (1):18-37.
- . 2002. "Social Capital, Microfinance, and the Politics of Development." *Feminist Economics* 8 (1):1-24.
- Rapley, John. 2002. *Understanding Development: Theory and Practice in the Third World*. 2nd ed. Boulder: Lynne Rienner.
- Rashid, A.K. Aminur. 1997. "The ASA 'Self-Reliant Development Model'." In *Who Needs Credit? Poverty and Finance in Bangladesh*, ed. G. D. Wood and I. A. Sharif. New York: Zed.
- Remenyi, Joe. 1991. *Where Credit is Due: Income-Generating Programs for the Poor in Developing Countries*. Boulder: Westview Press.
- "Results of the Banking Survey of the SME Market in Sri Lanka 2006/7." 2007. Colombo: International Finance Corporation and South Asia Enterprise Development Facility.

- Rhyne, Elisabeth. 2001. *Mainstreaming Microfinance: How Lending to the Poor Began, Grew and Came of Age in Bolivia*. Bloomfield, CT: Kumarian Press.
- Rhyne, Elisabeth, and Maria Otero. 2006. "The Changing Face of Microfinance: Closing the Quality Gap." *MicroBanking Bulletin* 13:1-7.
- Richardson, David C. 2000. "Unorthodox Microfinance: The Seven Doctrines of Success." *MicroBanking Bulletin* 4:3-7.
- Rock, Rachel, and Maria Otero. 1997. "From Margin to Mainstream: The regulation and supervision of microfinance." Boston: ACCION International.
- Rogaly, Ben. 1996. "Micro-Finance Evangelism, 'Destitute Women', and the Hard Selling of a New Anti-Poverty Formula." *Development in Practice* 6 (2):100-12.
- Roll, Richard, and John R. Talbott. 2003. "Political Freedom, Economic Liberty and Prosperity." *Journal of Democracy* 14 (3):75-89.
- Sachs, Jeffrey D. 2008. "The Merits of Microfinance as a Viable Solution for Poverty Alleviation: An Interview with Jeffrey Sachs." *The Whitehead Journal of Diplomacy and International Relations* 9 (2):11-8.
- Schonfield, Andrew. 1965. *Modern Capitalism: The Changing Balance of Public and Private Power*. New York City: Oxford University Press.
- Schramm, Carl J. 2004. "Building Entrepreneurial Economies." *Foreign Affairs* 83 (4):104.
- Schreiner, Mark. 1997. A Framework for the Analysis of the Performance and Sustainability of Subsidized Microfinance Organizations with Application to Bancosol of Bolivia and Grameen Bank of Bangladesh. Dissertation, Graduate Program in Agricultural Economics and Rural Sociology, Ohio State University, Columbus.
- . 2003. "A Cost-Effectiveness Analysis of the Grameen Bank of Bangladesh." *Development Policy Review* 21 (3):357-82.
- Schuler, Sidney Ruth, and Syed M. Hashemi. 1994. "Credit programs, women's empowerment and contraceptive use in rural Bangladesh." *Studies in Family Planning* 25:65-76.
- Schuler, Sidney Ruth, Syed M. Hashemi, and Shamsul Huda Badal. 1998. "Men's violence against women in rural Bangladesh: Undermined or exacerbated by microcredit programmes?" *Development in Practice* 8:148-57.
- Schuler, Sidney Ruth, Syed M. Hashemi, and Ann P. Riley. 1997. "The influence of women's changing roles and status in Bangladesh's fertility transition: Evidence from a study of credit programs and contraceptive use." *World Development* 25 (4):563-575.
- Schumacher, E.F. 1973. *Small is Beautiful: Economics as if People Mattered*. New York: Harper Perennial.
- Scully, Gerald W. 1988. "The Institutional Framework and Economic Development." *Journal of Political Economy* 96 (3):652-62.
- Sear, Jane, and David Simon. 2001. "Indigenous Microcredit and Enterprise Establishment: A Sri Lankan Case Study." Royal Holloway, University of London.
- Sebstad, J., and G. Chen. 1996. "Overview of studies on the impact of microenterprise credit." In *AIMS Paper*. Washington, DC: Management Systems International.
- Seibel, Hans Dieter. 2001. "Rural Finance: Mainstreaming Informal Financial Institutions." *Journal of Developmental Entrepreneurship* 6 (1):83-95.
- Seibel, Hans Dieter, and Dolores Torres. 1999. "Are Grameen Replications Sustainable, and Do They Reach the Poor?" *Journal of Microfinance* 1 (1).
- Servon, Lisa J. 1997. "Microenterprise programs in US inner cities: Economic development or social welfare?" *Economic Development Quarterly* 11:166-80.

- Sharma, Namrata, Nav Raj Simkhada, and Roshan Shrestha. 2005. "Impact Assessment of SACCOSs in Nepal's Hill Districts." Kathmandu: Centre for Microfinance (CMF).
- Sharma, Suresh, Krishna Bahadur Bhattachan, and Rajendra Prasad Shrestha. 2001. "Institutional Sustainability & Impact of Small Farmer Co-operatives Limited." Kathmandu: Agricultural Development Bank of Nepal and the German Technical Cooperation.
- Shaw, Judith. 2004. "Microenterprise Occupation and Poverty Reduction in Microfinance Programs: Evidence from Sri Lanka." *World Development* 32 (7):1247-64.
- Shrestha, Shankar Man. 2008. Microfinance in Nepal: Experiences of RMDC as an apex microfinance institution. Paper read at Microfinance Summit Nepal, at Kathmandu, Nepal.
- Sinha, Sanjay. 2000. "Nepal." In *The Role of Central Banks in Microfinance in Asia and the Pacific*, ed. P. McGuire and J. Conroy. Manila: Asian Development Bank.
- Sinha, Sanjay, and Swetan Sagar. 2007. "The Regulation Muddle in Nepal." In *Essays on Regulation and Supervision*. College Park, MD: IRIS Center.
- Snow, Douglas R. 1999. "Microcredit: An institutional development opportunity." *International Journal of Economic Development (Online journal)* 1 (1).
- Snow, Douglas R., and Terry F. Buss. 2001. "Development and the Role of Microcredit." *Policy Studies Journal* 29 (2):296.
- Sobhan, Rehman. 1997. "The Political Economy of Micro-Credit." In *Who Needs Credit? Poverty and Finance in Bangladesh*, ed. G. D. Wood and I. A. Sharif. New York: Zed.
- Srinivasan, Giriga. 2008. "Review of Post-Tsunami Micro Finance in Sri Lanka." Colombo: ProMiS (GTZ).
- Sriram, M.S., and Rajesh S. Upadhyayula. 2004. "The Transformation of the Microfinance Sector in India: Experiences, Options and Future." *Journal of Microfinance* 6 (2):89-112.
- Staschen, Stefan. 2003. "Regulatory Requirements for Microfinance: A Comparison of Legal Frameworks in 11 Countries Worldwide." Eschborn: GTZ.
- Staudt, Kathleen. 1991. *Managing Development: State, Society, and International Contexts*. Newbury Park: Sage.
- Steele, Fiona, Sajeda Amin, and Ruchira T. Naved. 2001. "Savings/credit group formation and change in contraception." *Demography* 38:267-82.
- Stiglitz, Joseph E., and Lyn Squire. 2000. "International Development: Is it Possible?" In *International Political Economy: Perspectives on Global Power and Wealth*, ed. J. A. Frieden and D. A. Lake. Belmont: Wadsworth.
- Strange, Susan. 2000. "States, Firms, and Diplomacy." In *International Political Economy: Perspectives on Global Power and Wealth*, ed. J. A. Frieden and D. A. Lake. Belmont: Wadsworth.
- Thapa, Govinda Bahadur. 2008. "Nepal's Financial Sector Development and WTO " *Nepalese Economic Review* 1 (1):19-20.
- Tilakarathna, Ganga, Upali Wickramasinghe, and Thusitha Kumara. 2005. "Microfinance in Sri Lanka: A Household Level Analysis of Outreach and Impact on Poverty." Colombo: Institute of Policy Studies.
- Titus, M. 2000. "Building the regulatory framework for microfinance in India." *Small Enterprise Development* 11 (4):24-9.
- Todd, Helen. 1996. *Women at the Center*. Colorado: Westview Press, Inc.

- Tritschler, Fabian, and David Bartocha. 2007. "Microfinance and Conflict in Sri Lanka: Towards a Sustainable Socio-Economic Development in the North and East." Colombo: Promis, GTZ.
- Tsai, Kellee S. 2004. "Imperfect Substitutes: The Local Political Economy of Informal Finance and Micrfinance in Rural China and India." *World Development* 32 (9):1487-507.
- Tsebelis, George. 1990. *Nested Games: Rational Choice in Comparative Politics*. Berkeley: University of California Press.
- Tucker, Michael. 2001. "Financial Performance of Selected Microfinance Institutions: Benchmarking Progress to Sustainability." *Journal of Microfinance* 3 (2):107-23.
- UN. 2010. *UN data*. United Nations [cited 29 January 2010]. Available from <http://data.un.org/>.
- UNDP. 2008. "Human Development Report 2008 Statistical Tables." UNDP.
- UNICEF. 1997. "Give Us Credit." ed. P. a. P. Division of Evaluation: UNICEF.
- Uprety, Tulasi Prasad. 2008. Policy and Regulatory Issues in Microfinance. Paper read at Microfinance Summit Nepal - 2008, 16 Februrary 2008, at Kathmandu.
- VanStaveren, Irene. 2001. "Gender Biases in Finance." *Gender and Development* 9 (1):9-17.
- Vogel, Robert C. 1994. "Other People's Money: Regulatory Issues Facing Microenterprise Finance Programs." Miami: International Management and Communications Corporation.
- . 2006. "From Agricultural Credit to Rural Finance: In Search of a New Paradigm." In *Beyond Microfinance: Building Inclusive Rural Financial Markets in Central Asia*, ed. M. B. Lamberte, R. C. Vogel, R. T. Moyes and N. A. Fernando. Manila: ADB.
- Vogel, Steven K. 2008. "Why Freer Markets Need More Rules." In *The Political Economy Reader: Markets as Institutions*, ed. N. H. Barma and S. K. Vogel. New York: Routledge.
- Wahid, Abu N. M. 1994. "The Grameen Bank and Poverty Alleviation in Bangladesh: Theory, Evidence and Limitations." *The American Journal of Economics and Sociology* 53 (1):1-15.
- Walker, Sarah, and Imran Matin. 2006. "Changes in the lives of the ultra poor: an exploratory study." *Development in Practice* 16 (1):80-4.
- Weber, Heloise. 2004. "The 'new economy' and social risk: banking on the poor?" *Review of International Political Economy* 11 (2):356-86.
- Weber, Max. 1930. *The protestant ethic and the spirit of capitalism*. New York: Scribners.
- Wehnert, Ulrich, and Roshan Shakya. 2003. "Microfinance and Armed Conflict in Nepal: The Adverse Effects of the Insurgency on the Small Farmer Cooperatives Ltd. (SFCLs)." Kathmandu: Rural Finance Nepal (RUFIN).
- Weijland, Hermine. 1999. "Microenterprise clusters in rural Indonesia: Industrial seedbed and policy target." *World Development* 27:1515-30.
- Wijewardena, W A. 2009. *Microfinance Policy and Regulatory Framework: Experience and Perspective of South Asian Region - Sri Lanka, Bangladesh, Nepal and India*. ProMIs 2003 [cited 2 November 2009]. Available from <http://www.microfinance.lk/pdf/1220855564.pdf>.
- Woller, Gary. 2000. "Reassessing the Financial Viability of Village Banking: Past Performance and Future Prospects." *MicroBanking Bulletin* 5:3-8.
- . 2003. "Poverty Lending, Financial Self-Sufficiency, and the Six Aspects of Outreach." Washington, DC: The SEEP Network: Poverty Lending Working Group.
- Woller, Gary M., and Warner Woodworth. 2001. "Microcredit as a Grass-Roots Policy for International Development." *Policy Studies Journal* 29 (2):267.

- Woller, Gary, and Robert Parsons. 2002. "Assessing the community economic impact of microfinance institutions." *Journal of Developmental Entrepreneurship* 7:133-50.
- Woolcock, Michael. 1998. *Social Theory, Development Policy, and Poverty Alleviation: A Comparative-Historical Analysis of Group-Based Banking in Developing Economies*. dissertation, Sociology, Brown University, Providence, RI.
- . 2001. "Microenterprise and social capital: a framework for theory, research and policy." *Journal of Socio-Economics* 30:193-8.
- Woolcock, Michael J.V. 1999. "Learning from failures in microfinance: what unsuccessful cases tell us about how group-based programs work." *The American Journal of Economics and Sociology* 58 (1).
- World Bank. 2002. "Nepal: Financial Sector Study." Washington, DC: World Bank.
- . 2006. "Doing Business." Washington, DC: World Bank.
- . 2007. "Doing Business." Washington, DC: World Bank.
- . *Data & Research*. World Bank 2009 [cited 11 March 2009]. Available from <http://www.worldbank.org/>.
- Wright, Graham A.N. 1999. *Microfinance systems: designing quality financial services for the poor*. Dhaka: University Press Limited.
- Wright, Graham A.N., M. Hossain, and S. Rutherford. 1997. "Savings: Flexible Financial Services for the Poor (and not just the Implementing Organization)." In *Who Needs Credit? Poverty and Finance in Bangladesh*, ed. G. D. Wood and I. Sharif. Dhaka: University Press Limited.
- Wydick, Bruce W. 1999. "The effect of microenterprise lending on child schooling in Guatemala." *Economic Development and Cultural Change* 47:853-69.
- . 2002. "Microfinance among the Maya: Tracking the progress of borrowers." *Development and Change* 33:489-509.
- Yaron, Jacob, McDonald Benjamin, and Stephanie Charitonenko. 1998. "Promoting Efficient Rural Financial Intermediation." *The World Bank Research Observer* 13 (2):147-70.
- Yunus, Muhammad. 1997. "The Grameen Bank." In *Reasons for Hope*, ed. A. Krishna, N. Uphoff and M. J. Esman. West Hartford: Kumarian.
- . 2004. "Expanding Microcredit Outreach to Reach the Millenium Development Goal - Some Issues for Attention." In *Attacking Poverty with Microcredit*. Dhaka.
- Zaman, Hassan. 2000. "Assessing the Poverty and Vulnerability Impact of Micro-Credit in Bangladesh: A Case study of BRAC." Washington, DC: World Bank.
- Zivetz, Laurie. 1992. *Private Enterprise and the State in Modern Nepal*. Madras: Oxford University Press.