



# IS MICROFINANCE THE PANACEA FOR POVERTY

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## **Introduction**

Poverty is often the result of individual or collective play of factors such as unemployment, underemployment, disease, abuse, degradation, and disenfranchisement leading to physical, mental and emotional disability, limited skills, low educational levels, lack of confidence, resentment, aggression and truncated vision. As Amartya Sen has observed, “poverty must be seen as the deprivation of basic capabilities rather than merely as low incomes”<sup>1</sup>

Nonetheless, statistics on income provide us a fair guide to poverty as it exists in the world today. 60% of the world’s population lives on 6% of the world’s income while almost one half of the world’s population lives on less than US\$ 2 per day. 1.3 billion people live on less than US\$ 1 per day<sup>2</sup>

In Sub Saharan Africa 48% of the population lives on less than US\$ 1 per day while in South Asia more than half a billion people still live below the poverty line.

Governments worldwide have adopted various strategies at different times to address the complex and difficult task of alleviating poverty. Of these the most common macro economic strategy can be said to be the adoption of policies to achieve a steady high rate of growth in the economy over the long term in the expectation that its benefits such as high income, improved educational levels, better health facilities, and other improved standards and conditions of living, including improved access to financial facilities, will trickle down to those at the lower levels of income.

It cannot be denied that rapid and continuous macro economic growth is a necessary strategy to reduce poverty. However, countries experiencing such growth have had mixed results in achieving this objective in the absence of other strategies to ensure equitable distribution of the benefits of growth. While some countries do have success stories to relate, many others show ample evidence that macro economic growth has widened the gap between the haves and the have-nots and led to worsening the position of the poor, indicating that macro economic growth alone has not been successful in alleviating poverty. Often cited success stories come from Malaysia and South Korea which countries were able to reduce absolute poverty from over 50% to a very low level below 6% within about four decades<sup>3</sup>. It is also reported that China with its high growth rate and modest growth elasticity, reduced poverty headcount by 8% annually during



1990-2001<sup>4</sup>. However, in many other countries this process has ended up widening the gap between the rich and the poor leaving a challenge for governments to develop specific tools with respect to redistribution of income and to address poverty issues. India is a case in point. As “The Banker” of April 2007<sup>5</sup> points out, India’s economy is growing at its fastest ever rate, at 9.2%, yet the poor have been left behind: endemic poverty persists and economic inequality is growing. In fact, this disparity was highlighted by none other than Prime Minister Manmohan Singh when, in his address to the nation on India’s Independence Day this year, he stated that “India cannot become a nation with islands of high growth and vast areas untouched by development where the benefits of growth accrue only to a few” and declared that the eradication of this disparity is the foremost challenge faced by India today. Such experiences lend credence to the comment of Garson that “macroeconomic policies linked to structural adjustment processes, although subsequently oriented in ways that tended to limit or minimize social problems, could hardly bring about a lasting solution”<sup>6</sup>

Apart from targeting overall growth as a poverty alleviation strategy, many governments have also introduced safety nets in a variety of ways focused on the poorer segments of society. Outright grants to the poor have been widely practised over a number of decades as a means of alleviating poverty. This strategy had several inherent weaknesses, the main being the disincentive provided by the grant to unleash the economic potential of those who received such grants, especially those who are economically active. Public money transferred to the poor can provide only short term relief to the situation of the poor as public funds are not in infinite supply and although such measures provide short term relief, by and large, they have failed to bring any sustainable economic benefits to the poor, to society and to governments. In the long run they have had, in fact, greater negative social impacts.

In addition to grants, governments of many developing countries have, at various times, adopted different social welfare programmes targeting the poor. For instance, Sri Lanka introduced many such schemes over the years, including the Rice Ration Scheme, Food Stamp Scheme, Janasaviya and Samurdhi Programmes. In addition there were several other welfare programmes introduced to reduce malnutrition among school children and pregnant mothers as part of the strategy to address poverty issues. Basically, many such schemes are founded on a concept of ‘hand-outs’ rather than self help and while they provide immediate relief to those in need, are not designed to result in sustainable improvement of the quality of life of the poor.

In comparatively recent times, the lack of access to reliable financial services has also been recognized as a major constraint to the reduction of poverty, especially in rural areas. The lacunae in such services led to the intervention by governments the world over in the financial market by compelling or granting incentives to lending institutions to lend to targeted groups or sectors, by providing grants and subsidies to lenders to reduce the on-lending rates, and by making available to them back-to-back finance. International donor agencies and lending institutions, too, made available funds to governments, lending institutions and non-governmental organizations at concessionary rates of interest towards economic activities by these targeted groups or sectors. Nonetheless, these schemes remained very much a part of conventional banking and did not fall



in to the category of 'micro' finance as understood today either in terms of quantum or social orientation.

## **Microfinance**

The modern mainstream microfinance concept began in the mid '70s, in Bangladesh in response to abject poverty conditions, when the Grameen Bank, begun by Prof. Mohammed Yunus, began giving small loans to the poor, mainly to be connected to the formal financial systems to which they had no recourse. Since then, this micro finance model has been a source of ideas and models for many organizations in the field of microfinance which have sprung up internationally and is used in many developing countries as a key strategy for poverty reduction.

The basic principle on which microfinance is based has been described as a process in which poor families borrow relatively large amounts of money at one time and repay the amount in a stream of small, manageable payments over a realistic time period using social collateral in the short run and institutional credit history banking in the long run.<sup>7</sup>

From its inception, micro-finance has evolved in astounding ways, incorporating social and development concepts together with principles underlying financial markets. The concept has undergone a long period of innovation in an attempt to meet the varying challenges and needs of different target groups during several phases in the 80s, 90s and since 2000 and has therefore no single blueprint model.

While the exact definition of microfinance varies from country to country, the Asian Development Bank - (ADB 2000) defines microfinance as "the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor, low-income households and their micro-enterprises"<sup>8</sup>. The Consultative Group for Assisting the Poor (CGAP) states that "microfinance is the category of financial services offered to lower income people, where the unit size of the transaction is usually small (micro), typically lower than the average GDP per capita."<sup>9</sup>

A large number of different types of institutions with a varying degree in the extent of outreach are engaged in providing microfinance worldwide. They include "formal institutions such as, rural banks, co-operatives, semiformal institutions such as non-government organizations and informal sources such as money lenders and shop-keepers"<sup>10</sup>. In addition to credit and savings, the wide range of financial and non-financial services provided under microfinance world over include remittances or money transfers, insurance, leasing, market information, keeping its clientele afloat and getting them cohesively integrated into the society.

Perhaps, in this sense, none of the definitions or descriptions of microfinance given above capture, for us Asians, the essence of the almost revolutionary banking concept introduced by



Prof. Yunus in the same way that the term 'barefoot banking' does. Microfinance reaches out to the helpless at his/her own level in an environment which is familiar. It takes account not only of good banking principles, but also of cultural and social realities.

Thus a majority of microfinance programmes, implemented especially in the Asian region, has focused attention on women due to the wide belief that women are better borrowers and they are also the link to upgrading the economy of poor families. Professor Yunus in his 12<sup>th</sup> Anniversary speech at the National Development Trust Fund in Colombo in August, 2007 stated "I have seen that women are better handlers of money and the culture of South Asian countries is such that they give more to the family than the men. It is women who stay with the families in times of finance and famine. Thus, lending to women always brought more benefits to the family".

### **Microfinance - Expectations**

Until the 1980s only a handful of organizations offered credit and savings services to poor people in developing countries. Today, microfinance institutions' membership is more than 7000 world over, a level unimaginable 20 to 25 years ago, serving more than 70 million people. "By 2005, microfinance covered at least 35 million of some 270 million families in the region (South Asia) and met around 15% of the overall credit requirements of low income families.<sup>11</sup>

Recently, international multilateral organizations such as the World Bank, the IMF, ADB and the United Nations and several other international donor agencies have focused their attention on different strategies to eradicate poverty – microfinance being the focus of their attention.

In December, 1998 the United Nations General Assembly designated the year 2005 as the "International Year of Microcredit" (resolution 53/197) stating that the year will be an important opportunity to give impetus to microfinance programmes throughout the world. Presently, microfinance is considered worldwide as "one of the practical development strategies and approaches that should be implemented and supported to attain the bold ambition of reducing world poverty by half <sup>12</sup>.

Microfinance has also been identified as a major contributor in achieving the 7 Millennium Development Goals (MDGs) by 2015 i.e. (i) reducing the proportion of people living in extreme poverty by one half; (ii) enrolling all children in primary school (iii) eliminating gender disparities in primary and secondary education (iv) reducing infant and child mortality rates by two thirds (v) reducing maternal mortality ratios by three quarter (vi) providing access to all who need reproductive health services (vii) reversing the loss of environmental resources. The central theme of MDGs is reduction of poverty in all its forms. Microfinance underpins the achievement of these MDGs and plays a key role in many MDG strategies.

Microfinance had a prominent place on the agenda of the 60<sup>th</sup> High-level Plenary Meeting



of the United Nations General Assembly (2005 World Summit) in 2005. The outcome document adopted by the gathering states “we recognize the need for access to financial services, in particular for the poor, including through microfinance and microcredit<sup>13</sup>.

Support for microfinance has also been implied in the endorsement by the Summit of the 2002 Monterrey Consensus, which states: “Microfinance and credit for micro, small and medium-sized enterprises, including in rural areas, particularly for women, as well as national savings schemes, are important for enhancing the social and economic impact of the financial sector<sup>14</sup>

Thus it can be seen that microfinance has established itself as an important aspect of global strategies for poverty alleviation and that much hope is pinned on it in the world’s battle against poverty.

### **Impact of Microfinance- Empirical Evidence**

Measuring the impact of microfinance on development aspects on clients is a complex and difficult task and, due to this, such impact assessments have received wide attention. The ability of microfinance to make an impact on poverty requires continuous access to a wide range of financial as well as non financial services by a greater number of people and any study on the impact of microfinance on the poor has to undertake a rigorous investigation into a wide array of variables. Some argue that the provision of sustainable microfinance does not necessarily result in poverty alleviation and that debt financing is not a good tool. They maintain that although microfinance has demonstrated the potential to reduce poverty and has changed and revitalized the lives of a large number of people, its impact worldwide has varied. Unarguably, the positive impact of microfinance is not spread equally among all microfinance borrowers and they vary in different degrees even within the same institution.

There is a large number of microfinance impact assessment studies undertaken, mainly in Asian and African countries. Studies on Asia have tended to concentrate on Bangladesh and primarily assess impact on income levels.

A majority of the studies on microfinance have their own methodological flaws due to the complexities involved. Isolating the impact of microfinance and comparing clients to non clients of microfinance programmes are the most common problems encountered in such studies.

Based on MDG indicators, poverty eradication can be identified broadly as increase in savings and housing/household assets, improved diet, improved primary health care and education, reduced dependence on money lenders, increase in productive assets, improved profits, increased employment and other backward linkages from increased enterprises activity. On the above basis, several assessment studies have come up with evidence that the provision of microfinance services has responded to opportunities, assisted in organizing finances and thereby has helped to increase income and assets creating wealth and decreasing the vulnerability of poor in several countries.



Credito Con Educacion Rural in Bolivia found that incomes of two thirds of its clients had increased after joining the programme<sup>15</sup>. Clients of Bangladesh Rural Advancement Committee (BRAC) who stayed in the programme for more than four years increased household expenses by 28% and assets by 112%. Society for Helping Awakening Rural Poor through Education (SHARE) in India documented that 75% of its clients who participated for longer periods saw significant improvements in their economic well-being and that half of the clients moved out of poverty. By the end of 2005 it is reported that half of nearly 3.4 million borrowers of Grameen Bank in Bangladesh, which had granted loans with a value of more than \$ 4.3 billion, had crossed over the poverty line<sup>16</sup>. Prof. Yunus in his speech at the Nobel Prize Award Ceremony in Oslo on 10.12.06, stated that according to Grameen Bank's internal survey of the nearly 7.0 million poor people to whom US\$ 6 billion micro loans had been given, 58% had crossed the poverty line. The survey carried out by the Central Bank of Sri Lanka (CBSL) in 2005 on a sample of 1200 households comprising of beneficiaries from the districts of Kandy, Puttalam, Galle and Matara who had been in the Small Farmers and Landless Credit Project (SFLCP) for a minimum period of 5 years, indicates that around 63% escaped poverty while around 2/3rds of beneficiaries were satisfied with their improved living conditions. The annual sample survey carried out by the CBSL at the end of 2006 of the Poverty Alleviation Microfinance Project beneficiaries in 6 districts namely Kalutara, Hambantota, Nuwara Eliya, Badulla, Matale, Kurunegala indicate that the overall quality of housing, availability of latrine facilities, and access to safe drinking water have improved notably. Since these beneficiaries have been with the project for less than 2 years it was not sufficient a period to make a significant improvement in economic and living conditions. Microfinance also has the ability to shift clients from irregular, low-paid daily labour to more diversified sources of income with a strong reliance on small businesses.

In an impact of microfinance on poverty alleviation study undertaken by Khandker<sup>17</sup> based on two surveys in 1991/92 repeated in 1998/99 it has been revealed that each additional 100 taka of credit to women by Grameen Bank, BRAC and RD-12 with a large outreach in Bangladesh has led to an increase in total annual household expenditure by more than 20 taka, 11.3 taka in food expenditure, 9.2 taka in non food expenditure. It has further revealed that moderate poverty in all villages covered has declined by 17 percentage points and among programme participants who had been members since 91/92 poverty rates have declined by more than 20 percentage points, about 3 points per year. Khandker states that more than one half of this reduction is directly attributable to microfinance. The impact study of the SEWA<sup>18</sup> Bank in India carried out for the USAID-AIMSD project in 2001 indicated that credit services raise household income by increasing revenues of loan supported micro-enterprises. In Pakistan, a survey of about 3000 clients of Khushhali Bank showed an increase in income for both rural and urban members. Remenyi notes that in Indonesia a 12.9% annual average increase in income by borrowers compared to 3% increase in non borrowers.<sup>19</sup> In Mali, women borrowers have reported increase in income of 50%. There are numerous other studies carried out in Vietnam, Phillipines, China and several African countries indicating similar economic improvements in microfinance beneficiaries over the years inducing reduction in poverty levels.

Impact analyses also have strong evidence to indicate that microfinance has a positive impact on several specific socio-economic variables such as education, household nutrient status



and women's empowerment in a large number of countries including in South Asia. Improved income derived from micro enterprises, together with the ability to save, allow poor people to better plan and invest in their children's future. "Insights 51" of December, 2004 reports that "one of the first things poor people all over the world do with new income from micro-enterprises is invest in their children's education". The magazine further reports that Bangladesh Rural Advancement Committee (BRAC), SEWA (India), Save the Children (Honduras) saw the clients' children were more likely to go to school, stay in school longer and have lower drop-out rates. A study in 1996 in two villages in Bangladesh has shown that all the girls from Grameen Bank member households had received some schooling, compared to only 60% in non member households. A longitudinal study conducted in BRAC, operational areas from 1992-95 had reported higher rate of improvement in basic competency of children in BRAC member households as compared to non members<sup>20</sup>.

In Bangladesh, literary rates among the children of BRAC clients aged 11-14 at baseline 1992 and then 1995 increased from 12 to 27% in 3 years compared to 14% among children of non client households. H. Todd in "Women at the Center (1996) notes that 81% of the Grameen boys have had some schooling compared to just 54% outside after 10 years with Grameen Bank.

When compared with non borrowers The Impact Assessment Survey of the CBSL on the SFLC project 2005 states that "A substantial proportion of school going children in beneficiary families were found to be attending private tuition classes and weekend religious instructions classes. Over a quarter of all beneficiary households were found to have at least one computer literate member".

"In Pakistan, the study of microfinance clients of Khushshali Bank shows higher expenditure on schooling, especially for girls, and children of clients were more likely to remain enrolled in schools longer than their counterparts in non client households"<sup>21</sup>. Similar experience is witnessed in several other countries including Indonesia in the area of education especially in situations where the borrower is a woman. Studies in India, report slightly higher enrollment and literacy levels of sons and daughters of women borrowers, in comparison with children of non clients. It is reported that this is more significant at the primary school level and that women's group membership leads to more daughters attending school<sup>22</sup>.

Although there is limited evidence for the impact of microfinance programmes on health, the conclusion reached in all these studies indicate that in the long run the impact indeed is positive. The most common benefit is the tendency of these clients to access better healthcare and educational facilities after being in microfinance programmes for some time. Access to microfinance leads to higher as well as more stable income thereby facilitating to preventive healthcare and treatment of health problems at an early stage. The study on Self Help Groups (SHGs) in India (GTZ-2005) has reported that SHG members accessed better health care facilities after joining the programme, resulting in higher expenditure on medical care<sup>23</sup> while the study of Khushshali Bank clients in Pakistan also has indicated results on similar lines. Almost 95% of clients of Foundation for Credit and Community Assistance in Uganda engaged in improved



health practices for their children compared to 72% of non clients. Almost all the beneficiaries of the SFLC project in Sri Lanka have had improved latrines in all 4 districts in which the project was implemented. Evidence has also been drawn from several countries on improved diet, nutritional status, sanitary and other habits.

The other strong positive impact of microfinance in relation to alleviating poverty is in the area of gender equality and women's empowerment.

As pointed out earlier many microfinance programmes design their services focusing on women. For example, of the total 7.21 million borrowers of Grameen Bank as at end June, 2007, 97% were women<sup>24</sup>. This is not only because women are better borrowers, it is also with a view to addressing gender inequality. Helping women to gain additional income improves the condition of the entire household. Because of the interconnection of financial power, poverty and women, microfinance has an active role in improving economic equality. Research of UNDP and World Bank has shown that gender inequalities, inter alia, inhibit overall economic growth and development. Access to microfinance services opens up greater livelihood opportunities for women, leading to enhancement of their role in economic development. A recent World Bank report confirms that societies that discriminate on the basis of gender pay the cost of greater poverty, slower economic growth, weaker governance and a lower living standard for all people<sup>25</sup>. It is believed that increased economic power enables women to further improve several areas of their - and their children's - lives. In India, results from impact of SHG-Bank Linkage Programme report dramatic increase in self confidence and decision making habits of women after participation in the group credit and savings activities. At the High Level Policy Conference on microfinance in India in May 2005 the Chairman NABARD, Dr Y S P Thorat, stated that their project has empowered women by enhancing their contribution to household income, increasing the value of their assets and generally by giving them better control over decisions that affect their lives. In Nepal, the Women's Empowerment program has revealed that 68% of its members are making decisions hitherto made by men - Cheston and Kuhu (2002). In the provision of microfinance under group systems women develop the capacity to manage group transactions and find, through groups, opportunities for social networking.

In general in almost all microfinance schemes spread throughout the world with special attention on women have enabled social and economic inclusion of women. Susan Holcombe states that Grameen members were less likely to take informal credit from local money lenders and concludes that members were protected from impoverishing debt by the assets they had accumulated as a result of credit supported businesses<sup>26</sup>. Hashemi states that women's access to credit was associated with an overall reduction of domestic violence<sup>27</sup>.

Khandker<sup>28</sup> having studied the impact of microfinance in Bangladesh in comparison with other social welfare programmes concludes that microcredit is more cost-effective than formal rural financial intermediation, targeted food interventions and rural infrastructure development projects in Bangladesh.



In addition, there are wider impacts of microfinance on borrowers. They result mainly from the provision of savings and insurance services by microfinance institutions. The Foundation for International Community Assistance in Uganda has demonstrated that micro insurance increases income stability of both clients and non clients within the community as the local economy benefits from a more stable circulation of money and increased trade. Bank Rakyat Indonesia, a MFI, although not recording strong direct impacts on poverty through provision of microfinance has recorded excellent indirect impacts through generation of labour market opportunities to the poor. Thus the benefits of expanding access to a wide range of financial services to the poor and underprivileged cannot be underestimated.

As opposed to the empirical evidence on the positive impact of microfinance, there is also some evidence of its negative impact. Loans for enterprises, asset acquisitions, consumption etc. lead to increasing debt and often over a long period of time, customers continue to be debtors. It is argued that in most cases, they have been unable to get out of the debt trap and that these micro loans also encourage debt for high non essential expenditure. Microfinance schemes focused on women increase pressure on them to take up low profit activities thereby increasing their work burden. It is also pointed out that these schemes encourage both parents to work increasing pressure on children or neglecting them. Another criticism leveled against microfinance programmes is that men use women as a conduit for loans.

In comparison to the empirical evidence of the positive impact of microfinance, the negative factors may appear generalized and almost unavoidable side effects for a minority of borrowers. Nonetheless, these factors have to be recognized in the longer term strategy for poverty alleviation. It must be recognized that while impact assessments carried out on the work of a large number of microfinance institutions world over underscores the ability of microfinance services to make a positive contribution towards alleviating poverty, for any such programme to have a significant contribution they must reach a wide clientele over a considerable period of time and must be complemented by infrastructural development programmes. In fact, many of the case studies on which the empirical evidence is based support this position.

Credit with Education is a development intervention created by Freedom from Hunger. It blends the provision of basic information on health, with the provision of microfinance. Surveys conducted on these programs in Ghana and Bolivia have provided evidence of very successful results in the areas of nutritional status, children's diet, breastfeeding, treatment of diarrhea and immunization. Graham Wright<sup>29</sup> says ill health is the biggest problem facing even those poor clients involved in microfinance programmes. For this reason Grameen Bank has started a health insurance along with credit while BRAC complements its credit with health programmes and special loans for latrines.

Susan Johnson and Ben Rogaly in their book titled 'Microfinance and Poverty Reduction 1997' perhaps sum up succinctly the viewpoint of many involved in the area of microfinance when they say: 'concentration on a single intervention mechanism, say credit, is much less effective in poverty reduction than simultaneous credit, primary health, and education work.'



They argue that the particular combinations, that will be most effective, will depend on the nature of poverty in a specific context.

Literature on microfinance and its impact also brings out the point that microfinance, if it is to succeed, must be appropriately targeted. Rachel Marcus<sup>30</sup> state that “where market opportunities are constrained by low population density and limited purchasing power or are flooded with similar goods and services - training, technological development or assistance with marketing may have a greater impact than microfinance. Even where market opportunities are promising, basic services and infrastructure that improve the productivity of existing livelihood activities - such as agricultural extension or veterinary services - improved natural resource management, and irrigation, or health services which prevent sickness destroying livelihoods, may be more appropriate than microfinance”. Basically, if a microfinance programme is to be successful, credit should be targeted at borrowers with entrepreneurial skills and ability to initiate activities with growth potential but who lack capital.

Eugene Versluysen in his book titled ‘Defying the Odds: Banking for the Poor’ - 1999 takes the argument further by saying: “banking for the poor cannot be a surrogate social safety net”. He concludes that the aged, infirm and totally indigent who are unemployable do not belong in microfinance programs, because they would never be able to use loans productively, and would be burdened with debts.

Nimal Fernando (2004) has expressed the views of microfinance practitioners from one extreme of pessimism situation to the other extreme situation of optimism, with a group in the mid stream. Those in the pessimists’ camp are of the view that microfinance on a sustainable basis is unable to reach the bottom half of the poor because their problems have been aggravated not due to unavailability of financing. Those at the other extreme firmly believe that microfinance reaches the bottom half of the poor and that there is an effective demand for microfinance from the poor. The group in the middle believes that microfinance reaches out to the bottom half to a limited level and hence the ability of microfinance to alleviate poverty is limited. It is therefore argued that building an effective model for the purpose of serving all poor categories alike has to be continued and microfinance in this regard has to be used with its known limitations.

## **Conclusion**

Based on empirical evidence and literature on issues relating to microfinance, some of which are discussed here, one can conclude that micro finance in the modern sense is indeed a step forward in the fight against poverty. Its use, however, must be well targeted and must also be complemented by improved infrastructural facilities and interventions in areas such as education, health, transport, communication and natural resource management. It must also be recognized that the poorest of the poor requires more direct interventions to sustain even the minimum quality of life.



Macro economic growth is a sine qua non for the sustainability of any poverty alleviation programme, whatever form it takes. However, experience is now disclosing that such growth is not the 'be all and end all' of poverty alleviation but a tool to be used to bring about equity in a world where, as stated earlier, 60% of the population lives on 6% of the world's income. The recognition by the world's leaders that overall numbers do not tell the full story, and that even greater challenges loom ahead, augurs well for the future.

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