What is the impact of microfinance on poor people in sub-Saharan Africa?

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Executive Summary

Background

Microfinance is a term used to describe financial services for those without access to traditional formal banking. It incorporates the provision of loans, often at interest rates of 25% or more, to individuals, groups and small businesses – i.e. micro-credit. More recently it has also been extended to include the provision of savings accounts – micro-savings – as well as insurance and money transfer services.

These interventions have been hailed by many as a solution to poverty alleviation, which allows market forces to operate, enabling the poor to invest in their futures and bring themselves out of poverty. The advocacy movement behind these initiatives is powerful and many evaluations highlight the benefits of these services. The expectations amongst donor agencies and the clients they serve are high – microfinance organisations bear names in local languages reflecting these expectations, meaning for example 'hope' and 'mustard seed'.

There is however growing concern amongst academics that these expectations are not being met. Rigorous research approaches, employing randomised trial designs, have begun to suggest that microfinance may not be the golden bullet that many had hoped. With a current expansion of microfinance services in sub-Saharan Africa, and an increased focus on how best to extend these services to the poorest of the poor, there is an imperative to establish whether micro-credit and micro-savings are helping or harming the poor people they purport to serve.

Objectives

We set out to review empirical research on the impact of microfinance (specifically micro-credit and micro-savings) on poor people in sub-Saharan Africa to enable policy-makers, donors and practitioners to understand the nature of the evidence available.

Methods

We developed a protocol for this review which was peer reviewed and published at the start of the project. During the course of the project we drew on the expertise of potential users of the review, including researchers, policy advisers and microfinance organisations, particularly seeking their input on where to search for relevant literature, on our initial findings and on how best to disseminate this work.

In order to identify all the relevant literature, we searched systematically for evaluations of micro-credit or micro-savings in sub-Saharan Africa, looking in three specialist systematic review libraries, 18 electronic online databases, the websites of 24 organisations and an online directory of books. We also contacted 23 key organisations and individuals requesting relevant evidence, conducted citation searches for two key publications and searched the reference lists of initially included papers.

Our search results were screened in two stages: initially we were overinclusive and then collected full texts of papers which were scrutinised in more detail by two researchers. Those papers which met our inclusion criteria were then coded by the same two researchers, working closely together, querying and discussing any uncertainties to ensure accuracy, avoid bias and maintain clarity. All relevant studies were assessed using predetermined quality criteria, and the findings of those studies judged to be of high or medium quality were extracted.

The findings of these studies were then synthesised using two approaches: identification of whether micro-credit or micro-savings were having positive, negative, varied or no effects on the lives of poor

people, and narrative synthesis of qualitative findings. Lastly, we developed a causal chain to unpack how microfinance impacts on poor people and mapped the available evidence of effectiveness on to this causal chain. This enabled us to draw out recommendations for policy and practice in the region.

Details of the included studies

We identified 35 studies which compare the impact of having a loan or a savings account with *not* having either. The quality of these 35 varied, with 20 excluded either due to poor reporting, poor methodology or both. A further eight were excluded due to poor quality methods. Eleven studies were medium quality and four high quality. These 15 studies were considered 'good enough' quality and included in the in-depth review.

The 15 studies included four randomised controlled trials, two non-randomised controlled trials and nine case control studies. Eleven of the studies included in our in-depth review were of micro-credit interventions, two were of combined credit and savings interventions and two were of savings schemes alone. They include evaluations of microfinance programmes within Ethiopia, Ghana, Kenya, Madagascar, Malawi, Rwanda, South Africa, Tanzania (Zanzibar), Uganda and Zimbabwe, and include both rural and urban initiatives.

Synthesis results

The available evidence suggests that micro-credit has mixed impacts on the incomes of poor people and that micro-savings has no impact. Both micro-credit and micro-savings have positive impacts on the levels of poor people's savings whilst they also both increase clients' expenditure and their accumulation of assets. Both micro-credit and micro-savings have a generally positive impact on the health of poor people, and on their food security and nutrition, although the effect on the latter is not observed across the board.

The evidence of the impact of micro-credit and micro-savings on education is varied, with limited evidence for positive effects and considerable evidence that micro-credit may be doing harm, negatively impacting on the education of clients' children. Micro-credit does not appear to increase child labour, so we presume children are not being taken out of school to work, but because clients have difficulties paying school expenses. There is some evidence that micro-credit is empowering women; however, this is not consistent across the reviewed studies. Both micro-credit and micro-savings have a positive impact on clients' housing. There is little evidence that micro-credit has any impact on job creation, and there are no studies measuring social cohesion.

In summary, whilst both micro-credit and micro-savings have the potential to improve the lives of the poor, micro-credit in particular, also has potential for harm. Micro-savings may therefore be a safer investment for development agencies.

Having reviewed the evidence of effectiveness, we were able to develop and test a complex causal chain for how micro-credit and micro-savings impact on poor people. The logic model developed shows how some potential benefits, whilst desirable, are not essential to the cycle of increasing wealth, specifically increasing social cohesion, women's empowerment and long-term benefits, particularly investments in children.

It also shows how micro-credit and micro-savings clients can choose to spend their money in different ways. Whilst investing in the immediate future and spending consumptively with scope for productivity both have the potential for increased income, investing in the long-term future and spending on non-productive consumption do not.

Failure to increase income, which can be determined by external factors as well as how clients spend their money, can lead clients into further debt, leaving them unable to invest in their savings accounts and / or reliant on further cycles of credit. Successful increases in income, the successful repayment of loans, and the accumulation of financial wealth are all feasible, but the causal model shows how these are not always achievable.

Conclusions

1. We conclude that some people are made poorer, and not richer, by microfinance, particularly micro-credit clients. This seems to be because: they consume more instead of investing in their futures; their businesses fail to produce enough profit to pay high interest rates; their investment in other longer-term aspects of their futures is not sufficient to give a return on their investment; and because the context in which microfinance clients live is by definition fragile.
2. There is some evidence that microfinance enables poor people to be better placed to deal with shocks, but this is not universal.
3. The emphasis on reaching the 'poorest of the poor' may be flawed. There may be a need to focus more specifically on providing loans to entrepreneurs, rather than treating everyone as a potential entrepreneur.
4. Micro-savings may be a better model than micro-credit, both theoretically (because it does not require an increase in income to pay high interest rates and so implications of failure are not so high) and based on the currently available evidence. However, the evidence on micro-savings is small and further rigorous evaluation is needed.
5. The rhetoric around microfinance is problematic and damaging. 'Clients' could also be called 'borrowers' or 'savers' and 'micro-credit' might just as well be called 'micro-loans' or even 'micro-debt'. There is an obligation amongst donors and policy-makers not to falsely raise expectations with development aid in this way. The apparent failure of microfinance institutions and donors to engage with evidence of effectiveness perpetuates the problems by building expectations and obscuring the potential for harm. A growing microfinance industry may as easily be a cause for concern as one of hope.

Recommendations for policy:

- Consider carefully the causal chain to ensure that the potential for both harm and good are taken into account in decisions to extend microfinance services in sub-Saharan Africa.
- Introduce greater requirements for rigorous evaluation of pilot programmes before roll-out to minimise the risks of doing harm.
- Avoid the promotion of microfinance as a means to achieve the Millennium Development Goals.

Recommendations for practice:

- Be cautious about offering clients continuing loans.
- Avoid contributing to the rhetoric of the success of microfinance and instead encourage decision-making based on rigorous evidence.

Recommendations for research:

- Conduct further thorough evaluations.
- Improve consistent and detailed reporting of microfinance interventions.
- Develop and employ greater standardisation of outcomes measured, and of measures used.
- Compare and reflect on the results of related systematic reviews when they are published in 2011.
- Report rigorous outcome evaluations to existing research databases.
- Undertake further systematic reviews in international development.

This Executive Summary is based on the following DFID-funded systematic review:

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