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Alleviating poverty through microfinance: Village banking outcomes in Central America

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Abstract

Our research reports on Brigham Young University (BYU) field studies carried out in Central America to assess the impacts of village banking on indigenous families. We first introduce the growing movement of microfinance institutions (MFIs), organizations that provide small loans as start-up capital for the unemployed poor in Central America. We briefly describe the native nongovernmental organizations (NGOs) that allocate their financial resources. Our methods are described and the survey instrument we created is analyzed, as well as the process of data collection. Finally, we report our findings and interpret their conclusions and implications, as well as suggest further studies on poverty alleviation.
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1. Introduction

There is a growing debate as to the best strategy for alleviating global poverty. A major thrust in recent years is the rise of radically innovative approaches from the grassroots. One tool is known as village banking, which refers to tiny loans to the Third World poor. This has grown from a small program in the 1970s in Bangladesh to a worldwide movement. Such microloans are usually provided through nonprofit, humanitarian organizations such as Freedom From Hunger (2004) and CARE (2004). These new mechanisms are often referred to as nongovernmental organizations (NGOs) whose focus is on empowering poor families. According to the recent Microcredit Summit (Daley-Harris, 2003), this effort has mushroomed to over 3,600 microlending organizations, mostly in Africa, Asia, and Latin America. Collectively, these microfinance institutions (MFIs) have given out over 18 billion dollars in loans (Lapenu & Zeller, 2000) to more than 67 million individuals, 79% of whom are women.

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Yet this strategy is not without its critics. Initially, large multilateral organizations such as the World Bank, the World Trade Organization (WTO), and the African Development Bank all rejected this movement as of little consequence—too little money, given to poor families who are unemployable, and who are not credit worthy. Instead, these institutions favored large-scale, top–down methods in which huge loans were given to governments and large corporations. It was assumed they would enjoy economies of scale, invest capital in creating employment in the private sector, and that poverty would gradually be reduced. Yet Joseph (2000) and others have argued that changes in the international political economy, Third World dissatisfaction with such multilateral institutions, and growing power among developing states have combined to break up "stasis" and push for change.

In short, the top–down approach has not delivered intended results. Hence, in recent years, the World Bank, for example, has come to be impressed by the feasibility of village banking and has provided over a billion dollars to NGOs. Likewise, the U.S. Agency for International Development (USAID), the United Nations, and others have begun channeling microloan funds through small NGOs because of their impressive results. Initially, many national governments seemed to support NGOs and the voluntary services carried out by concerned citizens. In fact, considerable funding from governmental sources supported NGO activities such as the 1992 Earth Summit in Rio de Janeiro, the Social Development Summit in Johannesburg in 2002, and the work of specific groups such as Catholic Relief Services, AFRICARE, and so on. Government leaders tended to appreciate civil involvement and saw NGOs as more flexible and rapidly mobilized to address human problems. These NGO strategies were seen as fostering democratic values and the building of civil society in the process.

But currently, there is criticism about the work of NGOs. Fears that NGO labors are extremely diverse and often quite critical of the establishment have led to major questions. Much of the concern about this derives from the American Enterprise Institute (AEI), a Washington, DC think-tank. Policy experts at AEI (2004) have begun to challenge the NGO movement and its processes. They question whether these nonprofits should be getting so much funding, and worry more about their power and societal influence. Certain NGOs such as Human Rights Watch and the American Friends Service Committee are seen as leftists, or at least too liberal, and too critical of big business.

AEI is increasingly voicing criticism of all NGOs as dangerous, too populist, and too participative (AEI, 2004). The institute has now linked up with the arch-conservative Federalist Society to establish a new monitoring institution called "NGO Watch" as a means of fighting the growing influence of international NGOs. Its sponsors are tracking thousands of NGOs around the globe, holding conferences to criticize their work, attempting to warn corporations and governments that these grassroots movements are dangerous. By arguing that NGOs now need to be regulated and/or controlled seems to be a curious proposal coming from avowed free market advocates.

However, regardless of the criticisms or advocacy of NGO efforts in fighting poverty, for now at least, the trend continues for fueling village banks to provide credit among the poor of the Third World. This paper reports on the authors' field research in Central America regarding the impacts of village banking in reducing poverty.

Increasingly, major donors are asking NGOs to evaluate the effectiveness of poverty lending. Does it work? How does it impact various family challenges? Does it improve people's quality of life? Does microcredit help build greater family self-reliance? Our study attempts to shed light on such questions.

2. Research

In Summer 2003, our Brigham Young University (BYU) research team conducted impact assessments of three village banking NGOs in Central America. The investigation's objective was to observe what impact village banking may have on poverty. To accomplish the goal, we measured the socioeconomic and financial status of three groups: New Clients, Current Clients and Ex-Clients. Our assumption was that if village banking helped the poor become less poor, the New Clients would likely be the poorest, followed by the Current Clients, and finally by the Ex-Clients. After deciding upon which client groups to analyze, we created a survey instrument and determined the criteria we would use to measure poverty. More about this will be discussed in the methodology section.

3. Village banking NGOs

The NGOs we studied were started in 1984, 1988, and 1998, and collectively they had some 43,000 poor clients in rural and/or urban areas. They received funding from foreign and national governments, global foundations, and private donors. All three required clients to participate in personal savings programs, and the deposits became an additional pool of financial resources. The total loan portfolio was approximately $26 million in 2002. Only one village banking program offered training and consulting services. Together the three NGOs enjoyed a loan repayment rate of above 90%.

4. Methods

The BYU field study of these microfinance institutions generated the data used in this paper. We collected surveys from three groups of persons who had received loans: New Clients (defined as those who had been in the program for less than a year and were only on their first or second loan); Current Clients (those who had been in the program for more than a year); and Ex-Clients (those who had been in the program, but later withdrew). The research team created a field survey instrument that obtained three types of measures: socioeconomic data, daily per capita expenditure (DPCE), and daily minimum wage equivalent (DMWE). These three criteria composed the study's poverty level indicators.

4.1. Survey instrument

The socioeconomic criteria were designed to measure the social impacts of poverty that are often overlooked when conducting economic analyses. Accordingly, the study measured important indicators of economic status by using six criteria that affix a rank to social status. These included the following: Food Security, Health, Housing, Education, Empowerment (women only), and Social Capital (women only). The six criteria with their definitions were as follows: Food Security assessed the client's food quality and quantity; Health measured the client's access to healthcare; Housing measured the client's living standards; Education measured the client's children's access to formal schooling; Empowerment captured the female client's ability to voice her opinion in the home, receive respect, and take part in family decisions; and finally, the Social Capital criterion measured the client's relationships with her neighbors and her ability to count on them in emergencies. A relatively new term, Social Capital is increasingly seen to consist of relationships, trust, and support (Crowell, 2004).

The criteria were based on an ordinal scale from 1 to 4. For example, in Food Security, a 4 meant the respondents reported that they had enough and the kinds of food they wanted, whereas a 1 signified they often did not have enough to eat. Similar ordinal scales were used for Health, Housing, Education, Empowerment, and Social Capital, respectively. These six criteria have been established by global institutions such as the United Nations Development Program (UNDP, 2003) as legitimate poverty indicators. The field survey instrument we used attempted to encompass both the absolute dimensions of poverty, measured by the Food Security, Health, Housing, and Education criteria, and the relative dimensions of poverty, measured by the Empowerment and Social Capital criteria.

Traditionally, the first and foremost ranking of poverty is defined by how much a person earns daily—the daily per capita income (DPCI). The World Bank and the United Nations have classified absolute poverty as those who earn less than $1 (USD) a day or, in other words, those who have a DPCI of less than $1 a day. The "universal" poverty line is classified as those who have a DPCI of $1–$2 (USD) a day. Through extensive field-testing by various development institutions, it was found that the poor usually do not know exactly how much they earn, but they do know how much they spend in a day, a week, or a month (UNFPA, 2002). This is the case because the poor usually have many different sources of income to sustain the family (i.e., from children working, overseas remittances, etc.) which, when received, are then turned around and immediately spent on food, education, and housing. To reflect how much money the poor earn, we decided to use the daily per capita expenditure—how much a person spends per day—to most accurately represent one's daily per capita income.

The final economic factor we used to gage poverty was the daily minimum wage equivalent. Using the classifications set by the United Nations and Central America governments, the researchers took the daily household income (i.e., the monthly income divided by 30) and standardized it using the Guatemalan definition of household poverty—less than 40.9 quetzals per day. Those with scores of less than 1.00 were the "poorest of the poor," as designated by the government. Those households with scores between 1.00 and 2.00 were classified to be in "universal" poverty, and those families which scored higher than 2.00 were not considered to be "poor."

4.2. Data collection

Upon entering the country and making initial contact with each MFI, the field investigators randomly selected village bank groups—capturing both rural and urban areas. We then accompanied the MFI representative to the respective borrower group meetings. There we conducted one-on-one interviews in a private location, and asked the questions from the survey instrument, since many participants were illiterate. These interviews included all members from the New and Current Clients. Group sizes ranged from 15 to 30 clients. After concluding the interviews at the village bank meeting, we accompanied the MFI representative to visit with Ex-Clients who had once been part of an MFI group, and we conducted interviews with them at their respective houses and/or microenterprise locations.

5. Results of socioeconomic and economic findings

The research team used a Kruskal–Wallis one-way analysis of variance test to analyze the socioeconomic criteria. We found no significant differences among New, Current and Ex-Clients in the socioeconomic criteria as shown in Table 1.

Table 1 displays the six criteria with their corresponding mean rank for each clientele group. The higher the mean rank, the higher the client scored on the socioeconomic scale of 1–4. Although no criteria indicated a significant difference among the three categories of clientele, Ex-Clients scored highest on Education (104.2), followed by Current Clients (88.0), and then by New Clients (80.5).

We also conducted a one-way analysis of variance test to analyze the economic criteria. Significant differences at the .05 level among the groups were noted in the daily per capita expenditure criterion, and in the daily minimum wage equivalent at the .10 level. Hence, the data indicated that some groups differed in the DPCE and DMWE measurements. In Table 2, the daily per capita expenditure scores showed that the New Client spending mean was \$.94 a day, the Current Client mean was \$1.28, and the Ex-Client spending mean was \$1.01 a day.

Table 1
Socioeconomic results

Mean rank						
Group	Food Security	Health	Housing	Education	Empowerment	Social Capital
New Clients	86.2	87.7	81.3	80.5	78.1	80.1
Current Clients	88.1	88.8	91.3	88.0	76.4	75.5
Ex-Clients	86.4	75.7	74.4	104.2	86.5	90.4
F	0.03	0.45	1.21	1.71	0.90	1.20
p	.9716	.6364	.3018	.1835	.4077	.3047

Table 2
Economic results

Group	DPCE*	DMWE**
New Clients	0.939	0.942
Current Clients	1.282	1.381
Ex-Clients	1.007	1.178
F	5.45	2.79
p	.0051*	.0639**

* Significant at .05.

** Significant at .10.

Subsequently, using a least significant differences comparison of means test on the data, we found the DPCE New Client mean to be significantly different from the DPCE Current Client mean. Current Clients ($1.28) were significantly less poor than New Clients ($.94), with Ex-Clients ($1.01) not being significantly different from either Ex-Clients or New Clients.

The daily minimum wage equivalent indicated similar trends, with Current Clients being the least poor, earning $1.38 a day, followed by the Ex-Clients earning $1.18, and finally the New Clients being the poorest, earning a mere $.94 a day. We conducted a least significant differences comparison and found that Current Clients were significantly different from New Clients, but Ex-Clients were not significantly different from either the New or Current Clients.

6. Discussion and conclusion

Empirical studies based on surveys for these three Central American NGOs could reveal promising results for village banking. As a consequence of these reported data, microfinance may have had a positive impact on poverty in the DPCE and DMWE economic criteria. According to economic measurements, Current Clients who have participated in their village bank for more than a year were observed to earn more money daily, and hence, were less poor, than those who had recently joined the microfinance program. It would also appear that those who stay in the microfinance program improve much more than those who leave.

A possible interpretation as to why Current Clients are economically better-off than Ex-Clients could be due to investment decisions, as shown in research conducted by Helms (2003) on microentrepreneurial women. His study indicates that in many cases, the purpose of a microentrepreneurial woman's business is not to grow, capitalize, or create employment. Instead, the small business allows the woman to invest her earnings, not in her business, but in other "asset-building activities such as children's education, fixing a leaky roof, better nutrition, dealing with emergencies, and the like" (ibid). Helms also suggests that the female microentrepreneur may not want her business to grow because she is simply too busy with the "15 other responsibilities she attends to every day to keep the household afloat" (ibid). Thus, lower investment in the small business after client graduation, may translate into lower profits and daily income to the microentrepreneur, as profits and accumulated savings are invested in assets other than her business. Although Helms' interpretation could shed light on why Guatemalan Current Clients earn more daily than Ex-Clients, more studies are certainly warranted.

This article provides observational evidence on the important role that poverty lending can play in international development. By conducting interviews with these Central American NGOs, our study indicates that microfinance clients' socioeconomic and economic levels had increased due to their continued participation. Village banking may be viewed as a hand-up instead of a hand-out policy, and as such, it is becoming more popular among developers and donors. Microcredit appears to improve the lives of those who are poor by increasing their buying and investing capability, thus lifting them onto a higher economic plane. Accordingly, these small loans seem to positively affect poverty by creating entrepreneurship and greater self-reliance among the poor.

Widely-held stereotypes about the global poor are that they are lazy, that they don't work hard, that they have too many children, and that they overrun natural resources. Ridgeway and

Jacques (2002) argue that such views generate and perpetuate myths that, in essence, end up "blaming the poor for poverty." But, village banking suggests another perspective: That the poor do, in fact, labor to survive; that a key problem in explaining their poverty is lack of working capital; and that empowered by microloans, many are able to improve their quality of life.

In conclusion, we reflect on the idea promoted by Professor William Foote Whyte (1982) of Cornell in his presidential address to the American Sociological Association. He argued that the social sciences ought not to merely study what is, but what *ought* to be. His was a clarion call for new "social inventions" to solve human problems. Global poverty is one the most crushing problems of the modern world. It seems to us that village banking services to very poor microentrepreneurs may come to be one of the most promising social inventions in this new 21st century.

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