
The Political Economy of Microfinance

Research Design

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1. Introduction

During the last decade, the microfinance movement has considerably changed the financial landscape around the world. It has inspired new banking concepts that have given hope to the poor households for the betterment of their livelihoods through their own efforts and labour. Recent figures indicate that 85% of the global total of current borrowers (numbering at 113 million) lives in Asia, the birthplace of microfinance (Gardner, 2008). However, in the process of the development of the microfinance ideology, the rhetoric of win-win situation (making profits while reducing poverty) (Morduch 2000, p. 617) has moved much faster than the empirical evidence and the claims have yet to be really substantiated.

Beyond this background, it is important to investigate further into the determinants of successful microfinance. There is already a vast theoretical and empirical literature on the topic that mostly focus on the success of micro finance institutes (hereafter MFIs), as far as sustainability and outreach is concerned, but some potentially important factors have so far been fully neglected. Among other things, the functioning of the MFIs is influenced through the actions and interests of various stakeholders who are directly or indirectly associated with them. Such interests are as diverse in nature as are the institutes or organisations that present or signify them and one needs to systematically differentiate the different tiers and levels of the complex environment in which they normally operate. In particular, the institutional infrastructure of the country of operation (comprising of the bureaucracy, the law keeping agencies and the politicians), the informal societal structures (comprising of the form of society be it feudal, patriarchal or traditional, in addition local money lenders etc.) and also external agencies like the NGOs and the donor aid agencies,, both at the local and at the national level need to be taken into account. It is the objective of this Ph.D. project to shed some light on this aspect.

This Ph.D. project will aim to contribute to the success of MFIs by empirically evaluating the working of MFIs with emphasis on the multi tiered power structure of governments and societies, on governance and developmental aid. This implies, in particular, an analysis of the incentive structures and interests of the stakeholders at the international, national and local level - that ranges from religious factions to international donor organisations... The objective here will be to assess how this context of MFIs (in terms of multi-faceted interests from various tiers of stakeholders) is related to the success of the MFIs. More specifically, the objective of this project is to answer the following questions:

1. Is it possible to explain the success of the MFIs in terms of outreach to the poor and financial sustainability based on the external societal and political economic framework?
2. Taking into consideration the interests of the different stakeholders, could the MFIs serve their objective of poverty alleviation more effectively?
3. To what extent (if at all) are the working of MFIs “adjusted” because of the intervention of the intricate societal and power structures in different regions?

2. State of Research

2.1. Need for Microfinance

For the provision of credit, the poor have often turned to informal commercial lenders - local traders, employers and landlords, commodity wholesalers, pawnbrokers and moneylenders of various types (Robinson 2001, p. 13). Many have argued that these informal money lenders are well suited to the rural conditions (Von Pischke, Adams & Donald 1983, p. 8), still others maintain that these informal finance agents provide valuable services at a reasonable cost and can do so 'because the informal sector is the natural environment for rural people' (Bouman 1989, pp. 8-9; see also Gonzalez-Vega 1993, p. 23). If this were true, why should there be a need for the establishment of special MFIs to unnecessarily change the natural environment of the people?

Advocates of MFIs argue that rural environments often conceal not only vast inequalities in income but also shield far reaching economic, legal and gender disparities and injustices, which is anything but natural (Robinson 2001, p. 15). Unofficial moneylenders have been reported to offer credit at exorbitant interest rates as high as 200 – 400% per annum (Boudreaux and Cowen 2008, see also Robinson 2001, p. 16). The existence of such usurious interest rates for credit to the poor has been blamed on the lack of appropriate MFIs that would cater to the demands and needs of the poor (Robinson 2001, p.17). Furthermore, loans from moneylenders are often extended only over short-term periods of less than a month and used as a short-term patch to meet pressing consumption needs. In contrast, microfinance loans are held for several months at minimum and are targeted as business investment (Cull, Kunt and Morduch, 2009, p. 171). The micro-finance movement exploits new contractual structures and organisational forms that reduce the riskiness and costs of making small, un-collateralised and cheap loans (Morduch 2000, p. 617). This is achieved through different mechanisms and lending methods like group lending or individual progressive lending (see Morduch 1999; and Aghion & Morduch 2000), employed by the Grameen Bank of Bangladesh and BancoSol of Bolivia, to name only two of the most famous MFIs, and other local credit institutions like the rotating savings and credit associations (ROSCAs) (Wood and Sharif 1997, p. 372; Rutherford 1997, pp. 368-369, and Mayoux 1995, p. 59). Furthermore, the paradigm that held for a long time that financial institutions for the poor with a savings side are unlikely to be sustainable, no longer applies. With the introduction of its rural savings product (SIMPEDES), the Bank Rakyat of Indonesia (hereafter BRI) has not only achieved self sufficiency and sustainability but also proved that there is a market niche for demand oriented savings products for the poor (Maurer 1999, pp. 13-14, see also Robinson 2001, p. 58). This goes on to prove Schmidt and Zeitinger's point that deposit facilities are needed by all groups in society, including the poor and the micro enterprises and should therefore be offered (Schmidt & Zeitinger 1997, pp.11-12). More importantly impressive statistics back MFIs in reaching 14.2 million women classified as amongst the poorest of the world (Cheston and Kuhn 2002, p. 4). Women empowerment and other impacts of MFIs, targeting women have been a strong force in the promotion of the whole 'microfinance revolution ' (Robinson 2001; see also Littlefield, Morduch & Hashemi 2003, p. 7). However commercial programmes aiming mainly at profit seem to have a lower targeting of women borrowers as clients and empirical evidence has proved that non-profit programs and those with more subsidies serve more women (Cull, Kunt, and Morduch, 2009, p. 174- 175)

Hence, microfinance serves as a tool to mitigate the financial market shortcomings. According to some assumptions based on the World Bank's *World Development Report 1999/2000*, some 80 percent of the 900 million households in low and lower middle-income countries in 1998, did not have access to formal financial services (Robinson 2001, pp. 10-11). It is obviously a market failure, to have ignored a potential demand that has been proved profitable by institutions like the BRI of Indonesia or Mibanco of Peru, among others (see Robinson 2001; and Fernando 2003). The existing number of MFIs does not even scratch the surface of the demand for financial services by the lower income groups. It remains an open question why this "absurd gap" (Robinson 2001, foreword xviii) between the demand for and supply of microfinance cannot be closed if MFIs are financially viable and thus sustainable even on a privately financed basis. The idea that allures most of the supporters of microfinance is because the institutions that adopt the rationale of good banking will automatically also serve the task of poverty reduction or alleviation. This has been termed as the win-win proposition (Morduch 2000, p. 617). According to this argument, MFIs that are financially sustainable and shun or avoid subsidies in the end will have more outreach and serve their purpose better because there would be no limitations imposed on them from the donor side. Here the link between "targeting" of the MFIs client base adapted or influenced by the donor/ aid agencies can be clearly established. For example when donor agencies try to invest more in one and less in another program simply because it targets women for example, (as explicitly outlined in the UNs Millennium Development Goals in 2000). Thus, the aim of poverty alleviation of the MFIs is thus 'adjusted' in alignment with the objectives of the donor agencies¹. Furthermore, the key paradigm is that low-income households need to have approach to credit and not 'cheap credit'. Hence, high interest rates do not come at the cost of outreach. In the light of this argument, poverty can thus be reduced without costs to governments or donors and may even bring in profits (ibid.).

Other practitioners however are not so easily convinced. The mere existence of the "absurd gap" gives some support to their arguments. The fact remains that, most poverty alleviation programs are subsidised. For example; an extensive survey of all MFIs targeting the poorest clients in 1998 revealed that they yield revenues that would only cover 70 percent of their total costs (Micro banking Bulletin 1998, pp. 18-23). Subsidy rates do not necessarily fall with the age or scale of the institutes, in fact some donors believe that a little more than 5 percent of the programs will be financially sustainable ever (Morduch 2000, p. 618)². The critics argue that the win-win logic is much more complicated in nature than it seems, with success depending on aspects that have been mostly ignored like the occupations of the borrowers or the use of the loans, to name just a few. They argue that so far, comparisons have been inadequate and that assumptions are too quickly generalised without reliable evidence.³ When it comes to the comparison of the outreach of MFI, for instance, simply looking at loan size is not sufficient. The adequate loan size is obviously linked with other factors such as the borrowers' type of occupation. For example, a sister institution of BRI, the Indonesian Bank Kredit Desa's (BKD) has been successful despite the small average loan size as its clients are primarily petty traders, small restaurant owners or tailor shops, i.e., small entrepreneurs who engage in activities with high margins and quick turnaround

¹ This means that the MFIs will then outline their objectives and mechanisms according to the donor agencies' whims, in order to receive the aid/ grant.

² It should be noted that private commercial banks or credit unions like the Indonesian BKD's are not included in this rough speculation but just the concerned NGO programs (Morduch 2000, p. 627)

³ Hulme and Mosley 1996a/b, however are an exception and provide an excellent and detailed study with special emphasis on client attributes like income, occupations, loan uses etc.

investments that enable them to make repayments with interest rates as high as 55 percent on short term loans (Morduch 1999, p. 1874).

Successful MFIs like the Grameen Bank and BancoSol, have successfully employed technologies like joint liability lending that inculcates and benefits from mechanisms like peer selection and peer monitoring (reducing screening and monitoring costs) (Khawari 2004, pp. 19-21). Still others like the BRI and its sister organisations have cashed in by addressing the savings side of micro banking and also from geographical proximity to their clients. Almost all MFIs practise progressive lending (dynamic incentives) (see Khawari 2004, pp. 21-23). Furthermore, for a successful MFI there are a number of other elements in the general economic set up, social structures, political and production relationships to be taken into account (Sobhan 1997, p. 135). In fact, the whole political, economic and social context of microfinance is to be taken into consideration.

2.2. MFI success and incentive problems

There is a vast literature on determinants of successful MFIs (see Zeller 2003; Zeller & Meyer 2002; Robinson 2001; Sharma 2001; Morduch 2000; Aghion & Morduch 2000; Morduch 1999; and Ravicz 1998 among others). However, most of this literature is limited to the analysis of the direct borrower-creditor relationship. As incentive problems within the borrower-creditor relationship cannot be solved independently of their context, some authors suggest a more comprehensive approach. According to Schmidt and Tschach (2003, pp. 40-41) the incentive relationships, play a decisive role on three levels, i.e., not only the borrower creditor relationship but also the employee-employer relationship and the relationship of the governing body (stakeholders like those who govern an MFI, credit suppliers and donors offering technical assistance). They argue that the incentive mechanisms on all levels do not exist in a vacuum but rather react and interact with one another, making them interdependent. Thus the success or failure of a set of mechanisms on one level can be the cause of the same for a set of mechanisms on another level (chain reaction), explaining why so many micro-credit programs fail; because not enough attention is given to the varying interests of all the participants within the overall system (Schmidt & Tschach 2003, pp. 65-67). That misaligned incentives lead to institutions that are costly, inefficient and not particularly effective in reaching the poor has also been outlined amongst the risks inherent in micro lending (Cull, Kunt, and Morduch, 2009, p. 169). Michaelowa (2003) outlined the various stakeholders at the international, national and local level within the MFI framework, that range from religious factions to international donor organisations and who are most likely to influence the impact that these MFIs are to have on the poor. It has been argued that the form of power structure and their interaction with other informal forms of authority within the society can have a strong significant effect on the working of MFIs (Tsai 2004, p. 1503). As Girma and Shortland rightly emphasise, “Political systems governed by narrow elites obstruct the development of the financial system [...] financial development may therefore be a deliberate policy choice by incumbents” (Girma and Shortland 2004, pp. 2-4). The outreach of MFIs in countries where the governments’ intervention is minimum and NGOs (providing microfinance services) self-govern is much higher than the outreach of their counterparts in countries where the same freedom is not rendered (Tsai 2004, p. 1491). Girma and Shortland also show empirically that in democracies the influence of lobbies is reduced through systems of checks and balances, as they increase the number of veto players that have to be bribed. Likewise in authoritarian systems the incumbent elite is more likely to block reforms, as opposition demands for more equal access to resources can be ignored (Girma and Shortland 2004, p. 8).

This research project aims to explicitly find out to what extent the local forces; power structures and the general institutional set up interfere with the functioning of the MFIs.

3. Conceptual Framework

3.1. Stakeholder behaviour analysis of MFIs

Drawing an analogy to the traditional goods market here, where trade takes place between the sellers and the buyers, in the rational choice approach, the exchange would be that of political goods traded on the political markets where the traders are the different stakeholders in interaction (see Shams 1987, p. 3). Here the utility function of the stakeholders could be the quest for power, gain of influence, comfortable working conditions or the moral satisfaction from the improvement of living conditions of a third party (R. Durth et al, 2002). As far as optimisation calculations are concerned, the actors with similar behaviour or with similar preferences can be categorised into three main groups.

3.1.1. Government: national and local governmental bodies

Governmental bodies are primarily composed of the bureaucracy and the politicians. According to the rational choice approach, the bureaucracy is (typically) assigned a utility function of possessing power and control, the power to carry out discretionary decisions and to control the behaviours of people dependent on them in one way or the other. In many cases, the relationship between the bureaucrats and MFIs (or NGOs providing these services) might be tense or even hostile, for the following reasons: First, the bureaucracy may believe that MFIs who promote the poor could cause an additional burden to government finances. Second, they can open channels for alien values in the traditional society. Third, they may object that MFIs are allocated development aid that could / should be distributed more in accordance with the government's (i.e. their own) objectives and priorities (Pischke, Schneider and Zander 1997, p. 21). The bureaucracy also has the incentive to hinder MFIs from establishing themselves, as MFIs render services, which normally fall in the government's dominion, and hence they can be regarded as rivals of the existing traditionally state owned rural agricultural financial infrastructure (Gonzales-Vega and Graham 1995, p. 11). With competition on the market, the privileges of bureaucrats within the rural development banks, including discretionary power opening up various opportunities for corrupt practices, may be at risk. Further, the entire existence of these often highly inefficient rural state banks and hence the future of the bureaucrats' career is at stake.

The politicians on the other hand have their own interests to follow. Similar to the bureaucracy, the politicians are also interested in having control and power - that comes to them through their being elected to office. While it is important in a democracy, to have the majority of voters electing them, in a dictatorship, it is of utmost importance to have protection from a single or group of rivals who might challenge their power position (Kirsch, 1997, pp. 323-324). The politicians would therefore want to sustain their ruling status, making them dependent on the voters. Hence, it is important that in a proper democratic set up, where governance is comparatively better and the citizens enjoy political rights and civil liberties that the government would at least try to have a proper functioning of poverty reduction schemes. Good governance and government effectiveness for the MFIs would mean that their industry for example, acts as an important link to the market that the politicians want to reach. Politician would want to implement measures that have a profound impact – such as the reduction of poverty – for their own political benefit.

3.1.2. Society: economic, religious and societal interest groups

The fight for power and authority does not end at the higher ranks of the politicians and bureaucrats. It is deep rooted within the society to the extent that not only those with an official mandate or a title exercise it but is also to be seen within the communal relationships from the top to the bottom of the societal hierarchy, that could nonetheless have a significant impact on the performance of MFIs. Starting at the upper end of the hierarchy, the individual local or regional interest groups like the feudal lords, the so-called 'elite' or local moneylenders would oppose to the mere concept of an MFI. For them the establishment of an MFI would mean an eventual end of their overpowering relationship with and/or authority over the poor (see Hashemi and Schuler 1997, p. 16). In many developing countries, the 'feudal lords' are mostly the custodians of the poor. They are therefore the 'lenders of last resort' when it comes to the provision of credit which places them in an advantageous position to exploit the poor, for example, as 'cheap labour' on their farms etc., making the poor dependent on these so called elites. MFIs would then endanger the interests of such groups who would then discourage or hinder any potential alternative prospects for credit to the poor. The complexity of the hindrances does not end here. Local moneylenders would naturally oppose MFIs as they endanger their monopoly within the rural market set up. Moreover, even within the poor, certain groups might act against the efficient working of MFIs. Most MFIs have been observed to target women, leading to their 'empowerment' in the sense that they have more say in household decision making as a result of their financial contribution to the family's income (Cheston & Kuhn 2002, p. 4). This could lead to a conflict with respect to the power positions of the men within a patriarchal society, hence making the men within the households insecure and therefore adversaries of MFIs (see Michaelowa 2003, p. 79). Moreover, this finance is intended to allow them to engage in new income generating activities providing them the opportunity to escape bonded labour on the fields of feudal lords or other activities under often humiliating conditions. Obviously, this is against the interest of those who previously enjoyed this cheap labour (see Michealowa 2003, p. 79). In addition, the fact that most of the poor are also illiterate makes the case worse.

Coming down the ladder to the inner circles of the family, the desire of men wanting to have a dominating relationship over women is also an interest in a patriarchal society affecting the MFIs. In this context, MFIs' specific targeting of women may cause problems. Focussing on women, just as focussing on the poor in general, is not always a welcome move for it is seen as a disruption of the power hierarchy within the communal life. Understanding the details of the interests underlying people's actions and reactions in this area becomes even more complex when considering that these interests are partially disguised and given the name of a struggle for religious or cultural ideals and their preservation. This has often resulted in a prohibitive and derisive attitude towards MFIs from the religious factions who initiate such demeanour (see Hashemi and Schuler 1997).

3.1.3. Donors: international and non-governmental developmental aid agencies and organisations

An extensive survey of MFIs in 1998 revealed that most of them are subsidised and dependent on donations, i.e. funds from different donors (Microbanking Bulletin 1998, pp. 18-23). Here a distinction should be made between donor organisations (backed by individual or a group of aid giving countries) allocating budgets for different socio-political purposes and agencies (usually non-governmental) that among other things administer or manage the funds prescribed for development or other similar purposes. Donor

organisations follow their own interest, which may not necessarily be conducive to a (sustainable) success of MFIs. Their interest and role in the whole construct is usually less altruistic than what is typically claimed.⁴ These organisations are traditionally embedded in bureaucratic structures, where power and authority is dependent to a great extent on the size of the budgets at their disposal (Michaelowa 2003, pp. 79-80). Therefore expanding rather than shortening of their budgets would be a rational step for these organisations hence the incentive to exhaust their current budgets. This means that the donor organisations too have to justify their spending (to their auditors, the state and other financiers) so as to ensure the perpetuation of fund flows which would in turn guarantee their preservation of status/ projects/ networks etc. In the quest of wanting to increase their funds or to avoid shortening of the prevailing annual funds, it can be of utmost importance that the respective budgets are totally exhausted (Michaelowa 2003, p. 80). It should be noted that though this appears philanthropic at the first instance but could have dire consequences for the MFI in the end such that it hinders the eventual self-sufficiency of the MFI through aid/ donation/ grant input (see Morduch 2000, p. 617). In addition, there might be other interests at hand, which the donors (or their respective countries) might want to pursue. This could range anywhere from influencing the financial policy of the recipient country in the bigger picture to the institutional building/ structuring at the micro level (for details see Michaelowa 1998). Another aspect of the donor side is the “flag raising” phenomenon. Since the idea of microfinance stands synonymous to poverty alleviation, for the donors it pays to compete for sponsoring MFIs in the quest of winning positive publicity from the public and therefore eventually financiers. However, this brings a twofold negative implication with it. One is the danger of “rival lending”⁵ and second it leads to enthusiastically replicating programmes that are successful in one set of circumstances in areas where other conditions prevail. This perspective on replication is rather naive as risks may not be similar across areas, populations, cultures, demography, target groups and donors or other sponsors (Pischke et al. 1997, p. 30).

On the other hand are the NGOs or local project staff, who administer the funds of MFIs and in the rational approach would typically aim at prolonging the projects so that the managers and field employees keep their jobs.⁶ The subsidising of MFIs through grants and aid guarantees the steady flow of funds and hence ensures its financial dependence. Here a paradox is to be seen at work, in that contrary to the objective of financial self-sufficiency, long term and excessive subsidies for the MFIs are expected. This high subsidisation then serves to attract a large number of clients, which make the MFI appear quite successful on the surface (ibid.).

It is therefore quite evident that due to political economic reasons, the results of donor interventions may end up quite contrary to the actual objective of the MFIs, be it serving the poor, women empowerment or operational self-sufficiency in the long run. In the succeeding sections, the construction of incentives will be investigated, given the framework or rational choice approach to examine the determinants of success/ effectiveness of MFIs in different countries. Table 1 gives an overview of who makes up these groupings and what interests they pursue.

⁴ See the large literature on recipient need versus donor interest in aid allocation developed from the 1970s onwards. For early studies, see McKinlay and Little 1977 and for a more recent one see Barthelemy, 2006)

⁵ Here the driving force behind the provision of micro-loans would be purely supply-driven which in the long run might hinder the sustainability of the project (Pischke et al. 1997, p. 28)

⁶ At the higher levels of the hierarchy the allocation of jobs in financial organisations (with it a continuous flow of resources) is of great significance (Hulme and Mosley 1996, Vol. 1, p. 145)

Table 1: Stakeholder interests with implications on microfinance

Stakeholders/ groupings	Who makes them up	interests
Government	Bureaucracy, politicians, law keeping agencies	preserving the status quo, aiming to stay in power, additional sources of income (corruption),
Society	The societal structure (feudal, traditional, patriarchal etc.), lobby's/ pressure groups, money lenders, family members (women and men paradigm), community	Power positions, material benefits in the form of cheap labor for example, perpetual dependence and hence exploitation, effecting policy making, shunning competition, having control over women etc.
Donors/ Agencies	Aid organisations, NGOs, local project staff	"flagship", perpetuation of projects and extension of work contracts, budget expansion (requiring exhaustion of project funds), etc.

4. Hypotheses

Based on the above theoretical discussion, hypotheses can now be derived on factors having a positive or a negative influence on the success of MFIs. However, in the first place, the dependent variable of "success" remains to be defined.

Successful MFIs are usually regarded as the ones that have a better outreach and / or are financially sustainable. The objective of outreach can be broken down further to identify whom the MFI is reaching out to. Usual target groups are women and clients below the national poverty line. Overall, we thus get to the following four success criteria:

a) (General) outreach (in terms of the number of clients), b) Sustainability, c) Number of women borrowers, d) Clients below the national poverty line.

According to the stakeholder behaviour discussed in section 2, one might expect that the four success criteria for the MFIs as listed above will be influenced by the special interests and involvement of all the groups that have been outlined in that section. Significant importance to the juxtaposition of power of different groups having or showing interest in the MFIs will be outlined. These groups ranging from the kind of political regime to the bureaucracy that it relies upon to well organised resource rich elite / moneylenders, to communal and religious groups and external agencies like international organisations or their local representatives will act individually or together to possibly steer the MFIs in the direction that would propagate their interests or aid in serving their goals respectively. This may however not necessarily serve to have more outreach, or the MFI services may not necessary be available over a longer time period, or reach the maximum number of the women or serve the poorest within the country to alleviate poverty respectively. Furthermore identification of the groups having special interests alone will not be enough but also the conditions in which they prevail, among others governance, the prevalence of basic rights and liberties in the country, the level and effect of education of the borrowers

and demographic make-up of the countries are the most important ones. Taking these into consideration would help illuminate the success characteristic(s) in terms of the political economic set up of MFIs.

a) Outreach: Empirical evidence from the political economy of financial development suggests that a higher level of democracy or in other words better political rights would curb the perpetuation of power in the hands of the narrow/ political elite (Girma and Shortland 2004, p.2). In a number of the poor countries, most of the poor lack access to any other economic activities than agriculture, mostly in rural areas, left with little choice but to depend on feudal lords who own all the land and rely on the poor as an inexpensive means of working for them at best under exploitative conditions and at worst under bonded slavery. In addition to these rich landlords, the poor also rely largely on local moneylenders (“loan sharks”) in the case of financial emergencies. These local money lenders usually lend out money to these needy on usurious rates, which eventually leaves the poor paying for a long time, and leave them poorer than ever before in the end. To make matters worse the poor are quite likely to be illiterate and the only law or authority they know is that of their masters or the exploitative loan sharks who thanks to the wide spread corruption in most of these less developed countries, buy their way through the local law enforcing machinery . Taking up the assertion of prevalence of more rights and higher education levels having a better effect on the success of MFIs, the following hypothesis can be derived:

Hypothesis 1: The MFIs outreach is positively related to the higher degree of democracy/ freedom and education.

Having more outreach would also mean that MFIs would be better known to not only the internal government agencies but also to the external agencies like international aid donors. Contrary to popular belief, subsidies flowing into the MFIs tend to undermine the outreach of the MFIs (see Sinha 2000, p. 66). International donor organisations that pledge funds to the MFIs do so for a number of reasons. However of interest here are the ones that might not necessarily be compatible with the outreach objective of MFIs, but rather serve the interest of the donors in other ways like the perpetuation of their projects so that the steady flow of funds and the associated jobs of the project managers or the field workers respectively are guaranteed. Not to forget that the budgets of the donor organisations themselves are subject to the amounts that they spend on different developmental issues and so one might say micro financing in this case is a good marketing strategy. In the light of this argumentation, the second hypothesis can be formulated to see the effect of the amount of foreign aid flowing to the MFIs:

Hypothesis 2: The MFIs outreach is negatively related to the volume of aid flowing in.

Whether the availability of credit alternatives other than the debt bondage (that is often the case in many less developed countries, see Churchill and Guerin, 2004) would inflame negative sentiments for the MFIs on behalf of the feudal/ elites or the richer strata of the society/ community. Economically weak members within a society when faced with a financial are often forced to accept menial / exploitative and partly degrading jobs, dictated to them from those higher up the economic ladder, against debt from their “custodians/ keepers” (see Daru, Churchill, Beemsterboer, 2005). Asserting that strong feudal structures oppose the establishment of MFIs the third hypothesis can be formulated as:

Hypothesis 3: The MFIs outreach will be more difficult when the feudal structure is very strong.

Within the same framework, one can also assume that, local moneylenders and other “loan sharks” would oppose the very existence of MFIs, as it would mean more competition for them within the local set up. With less dependence on the local and traditional moneylenders by the poor, in the presence of MFIs, it is expected that the MFIs will face very strong resistance from the local moneylenders (see Crawford 2007, p. 15-16). The fourth hypothesis can thus be stated as:

Hypothesis 4: The outreach of the MFI is negatively influenced by a strong establishment of local traditional moneylenders.

b) Sustainability: Empirical evidence from a study by Hulme and Mosley (1996) backs the fact that MFIs having more tendency towards financial sustainability have lower arrears rates and subsidy dependent indices than those that are less financially sustainable. Here it is expected that not just subsidies from the respective governments of the MFIs but also flow of aid (ODA) from international donor organisations will jeopardise the long-term financial sustainability of the MFIs. Funds readily available on the market from donors for poverty reduction projects, will lead to proliferation of the MFIs that in turn can lead to intense competition between the micro-lenders. The donor agency’s interest is that of perpetuating their poverty alleviating projects in order to avoid any cuts in their own future budgets together with the aim to serve as the pioneers in the practice on-site. For the MFIs, this means availability and supply of funds on comparatively easy terms to the borrowers and will only end up weakening the MFIs. This comes about such that the borrowers have many alternative sources of credit and hence a threat of collective non-repayment of loans arises leading to spiralling default rates (McIntosh and Wydick 2002, pp. 5-6). This over funding, and what has been called rival-lending (too many MFIs as competitors in a particular region) often has the objective of serving the goals or strategic interests from the donors’ side, which in most cases is a general conditionality for the aid granted. Here of particular interest is for example the insistence of the donors to serve a particular part of the population like the women for example⁷ or borrowers who are willing to work in a particular sector like agriculture or construction. These so-called strategic interests serve bigger international goals/ objectives like the “Millennium Development Goals (MDGs)”. Whether the same is accomplished is another issue given the dynamics of the demographic and cultural set ups of the rural areas where most of the MFIs are. These limitations or conditionality can however on the one hand lead to curbing the MFIs potential to lend to the more credit worthy or needy clients and on the other hand negatively affecting the flexibility of the MFIs to cover for its bad debts through more responsible borrowers with higher repayment rates. In the light of this, one can argue that MFIs that avoid subsidies/ aid in the long run will be more capable to attain financial sustainability and hence serve their purpose better because there would then be no limitations imposed (like serving a particular group or part of the population) on them from the donor side (Morduch 2000, p. 617; see also Khawari 2004). The fifth hypothesis can be formulated as follows:

Hypothesis 5: The sustainability of the MFIs is negatively influenced by the volume of aid in the long run.

Taking the financial sustainability argument a little further to control for governance, one can argue that governments can create a policy environment conducive to microfinance innovations or they can introduce policy distortions that make it difficult for MFIs to

⁷ A good example here is the World Bank multi-donor ‘Consultative Group to Assist the Poor (CGAP)’, where among other requirements; MFIs have to demonstrate that women make up at least 50% of their client base to be eligible for their funds (McIntosh and Wydick 2002, pp. 6).

innovate or have sustainable operations (Llanto and Fukui 2003, p. 13). The politicians making up the government have a whole range of economical/ political instruments at their disposal that may go on to serve their personal interests and at the same time affect the success of MFIs (Michaelowa 2003, p.78). One such measure on behalf of the government could be for example fixing the interests rates such that it makes it difficult if not impossible for the MFI to meet its operating costs and eventually render profits. Another damage done to the MFIs by the twisted policy making is the creation of obstacles that hinders easy admission into the banking industry and thus hampers healthy competition which in turn slows down the pace of innovative procedures, of utmost importance in the MFI practice as the demographic and with it the social structures change (see Llanto and Fukui 2003, p. 13, see also Michaelowa 2003). A good example for this is the creation of hurdles for MFIs establishment in regions where state owned rural banks already exist. The bureaucrats and other government officials involved in the maintenance and running of these rural state owned banks have their professional careers to think of and hence can strictly oppose measures that would give the MFIs an upper hand over them. Therefore, a well functioning government with a transparent administrative system (or simply good governance) is expected to have a positive influence on the MFIs success. The sixth hypothesis can be stated as follows:

Hypothesis 6: The sustainability of the MFIs is positively related to good governance.

c) Number of women borrowers: This paradigm of the MFIs is more complex than the outreach or financial sustainability criteria of success. Given the premise that women are amongst the lowest income earning tier of the social set up as outlined by the WDI of the World Bank (2004), they would make up the majority of lower paid, unorganised informal sector of most economies and are also prone to facing hardships in having access to any other alternatives of income (Cheston and Kuhn 2002, p. 8). The absence of alternatives to ensure their financial needs places the women in a vulnerable position, as there are always others who will profit from situations like these; like the richer land owners who rely on them as cheap labour to work their land (more or less similar to the case of the first hypothesis) or the local money lenders who prosper on usurious return rates on small credits that they give out to them etc.. MFIs would therefore face opposition in any such set up where not only the poor in general are extremely exploited as cheap source of labour through the authority exercised by the financially powerful but where the women are specifically targeted more so within their own male dominated intimate spheres like the family or community. With access to credit to invest in their micro businesses, that they would operate themselves, women will eventually have more financial independence and confidence and hence more say once they contribute to the family's income (Cheston and Kuhn 2002, p. 4). Therefore, where MFIs tend to 'disrupt' the formal and informal power structures regarding women within the social construct, they are bound to face hardships and resistance. Should civil society provide for structures where an ordinary person in general is at comparative ease in having equal opportunities as far as the basic rights are concerned, MFIs where women are the main target group will benefit in their functioning in this regard. Therefore in a country where the people in general enjoy relatively more civil liberties and where the government is comparatively more effective than the others, the number of women borrowers tends to grow and benefit more from the MFIs and the MFIs in turn tend to function and serve their poverty alleviation objective better than in countries where this is not the case. Taking this into consideration the seventh hypothesis can be stated as follows:

Hypothesis 7: The number of women borrowers is positively correlated to the degree of freedom and good governance.

Remaining within the same set up of power positions regarding women, however on the micro level, one can also test/ check for pressures that the women would face from their male counterparts within the family structure. Because MFIs have been targeting women in many regions and now it is seen as an instrument of “empowerment” or “emancipation” for them, it would be by all means possible for them to face pressures (even violence) from their husbands/ other male family members who might want to control them or want a say on how to spend the funds after the women have them (Rogers and O’Farrell, 2008, p. 2). Expenditure decisions, on behalf of the women, might not prioritize men (or male children) and thus cause conflicts with the men, who at best would want to preserve the status quo (Ibid). Hence MFIs makes it possible for women to have more say in financial and other matters, and carry out decisions that they could not before (see IDS paper, 2008). It is therefore assumed that men would not favor the establishment of MFIs in their traditional set up. Having said this, the hypothesis can be stated as:

Hypothesis 8: The stronger the power position of men in the family (society), the more difficult is outreach to women.

International donor organisations that have committed to poverty alleviation through funding MFIs where most of the clients are women are assumed to have their own interests at stake. The concept of MFIs targeting mostly women as clients is in line with a lot of the international development objectives of the international organisations like the United Nations and its sister organisations. With the outlining of the Millennium Development Goals (MDG’s) of the UN, where ‘women empowerment’ is one of the foremost objectives, (in: <http://www.undp.org/mdg/abcs.shtml>) all or most international donor agencies now try to align their project themes to invest more in programmes where women are targeted and allegedly benefit more. In addition, the donors themselves will have to ascertain their funding; and poverty reduction, which empowers women at the same time, is one of the most famous themes that have caught the attention of developmental aid agencies for quite some time now. This individual interest of the donors make them particularly keen to raise flags for funding MFIs where a majority of the clients are women so as to be the first ones to break ground in the sector. In addition, the premise that women borrowers have a positive correlation to government effectively and civil liberties help the informal financial sector to benefit from international donors should the MFIs country score positive on these. This would mean that the donors would then be competing to pledge funds/ financial aid to the MFIs where the government policies aid in proper functioning of these. This leads to the formulation of the next hypothesis to see the effect of funds (official developmental aid) and/or subsidies to the MFIs on the number of women borrowers:

Hypothesis 9: The number of women borrowers is positively correlated to volume of aid.

d) Clients below the national poverty line: Although women might make up the poorest tier of the social strata of the MFIs, not always is this a holistic composition of the poor. There are still others who are defined by their earnings per day, which is another good measure of the poor in general. To see how the political economic interests of the different parties/ role players effects the poor, those below the national poverty line, the last characteristic of MFIs as an output variable, namely the clients below the national poverty line, will be taken. Governance here would play a major role as the MFIs serving the poorest would then need a considerably arduous task of monitoring for repayments and therefore all means available have to be invested for the proper functioning of the MFIs. Any restrictive measures/ actions

on behalf of the local government bodies would put this at risk. This also goes on to explain why demographic characteristics of different regions play such a vital role in the success of MFIs world-wide and the simple replication equation might not necessarily work everywhere simply because the region does not offer the same demographic construct as those where MFIs do succeed. The following hypothesis can therefore be formulated as:

Hypothesis 10: The number of poor clients (those below the national poverty line) of MFIs is positively correlated to good governance.

By now, one of the main interest of the international donor agencies as outlined are those of flag raising and image marketing to expand their own yearly budgets from their primary sources for international projects of poverty alleviation. However, unlike in the case of women borrowers, the extremely poor as a target group are less attractive to serve the purpose of poverty reduction and empowerment in the same way as women borrowers. The poorest clients in general may also fail to attract the same attention as women simply on behalf of the fact that they are not necessarily as well organised or timely as women when it comes to repayments of their loans.⁸ It is therefore expected that the relationship between the number of the poorest clients of MFIs and that of aid volume would be negative. Similarly, financial sustainability is also expected to show a negative tendency towards the number of the poorest of the clients. Interest rates have to be comparatively low if the poorest of the clients are to be served in addition to this the costs per borrower for monitoring the loan repayments amongst the poorest of the clients is expected to be high and hence in the absence of any government subsidies to ease the situation or to provide for a steady flow of loan disbursements the MFIs would not be able to financially support themselves in the long run. Though interestingly if this were to happen, i.e., government subsidies or aid from donors were to guarantee for the regular loan disbursements of such MFIs that do not aim to make profit centres out of their services, their outreach would be expected to boost and serve more of the poorest among the clients. However this is not the case and this is one reason why it is increasingly argued that microfinance fails to serve the poorest of the poor (Morduch 1998). Coming to the last and final hypothesis, the effect of aid on the poorest clients of the MFIs is to be controlled for as under:

Hypothesis 11: The number of the poorest clients of MFIs is to be negatively correlated to the volume of aid and sustainability.

5. Empirical Analysis

To assess the above hypotheses, my research method will be based on a mix of qualitative and quantitative methods. At the macro / micro level (the unit of analysis being the MFI) I will undertake an econometric analysis based on a large international data set (see below for details). Testing whether explanatory variables measurable at the national and the MFI level (such as good governance, civil and political liberties, aid flows and education) have an influence on the success of MFIs. This quantitative analysis is followed by a qualitative analysis in order to test for the intimate power structures and successful working of MFIs. This requires field studies with a focus on the very specific social, economic and cultural fabric of the local environment of selected MFIs.

⁸ For example, in USAID-funded microfinance programmes, which served 3.5 million clients with \$1.3 billion in active loans in 1998, a client base of 84 per cent women maintained repayment rates of 95 per cent (UNCDF 2002).

5.1. Quantitative Analysis

For the cross-national analysis, I plan to use a panel data set for a large sample of MFIs over the 1998 to 2006 period. The number of MFIs worldwide registered with the “Microfinance information Exchange” will mainly define sample size (<http://www.mixmarket.org>). Methodically, the dataset will be analyzed by standard statistical tools, including descriptive statistics, correlations, contingency tables and multivariate panel data analysis.

The data is compiled from a number of sources. Data for the dependent variables and for MFI related control variables is available from the Microfinance Information Exchange, which is a global web-based microfinance information platform.⁹ The panel data covers indicators for various MFIs outreach and sustainability over a period of nine years namely from 1998-2006 across different countries. Data for governance covers variables taken from Freedom House that includes listings of countries with an index on political rights and civil liberties for the consecutive years 1998-2008. In addition the World Bank Governance Indicators (2007)¹⁰ includes data for every second year, namely for the years 1998, 2000, 2002 etc. Data for demographic features of the MFIs countries is taken from World Development Indicators (2008). To capture the flow of funds from donors to both formal and informal financial sector data are available from the Credit Reporting Systems (CRS) compiled by the DAC secretariat (OECD/DAC 2008).

5.2. Qualitative Analysis

In order to provide a deeper understanding of the results obtained in the statistical analysis, how an MFI performs in a specific set up of actors will also be analyzed qualitatively. The pressures that the MFIs might face on a micro level, and which may induce them to “adjust” their lending strategies and/ or customer/ client targeting can only be analyzed qualitatively. In this context, the project will proceed with two case studies in different regions of South Asia. With respect to specific MFIs, initial contacts have been established with the National Bank for Agricultural and Rural Development (hereafter NABRAD) in India and the Taraqee Foundation in Quetta, Pakistan. NABRAD is among the leading micro credit lenders in India and a pioneer in the establishment of self-help groups (SHG). Some of the necessary local level data is covered by the already available database and publications from NABRAD itself. This () data deals with the performance of the branches/ offices all over India and their performance subject to the structure of the social-political set up and the institutional infrastructure. NABRAD's wide base all over India. Moreover, some information is available on alternative lending facilities, e.g., through traditional moneylenders. However, this needs to be complemented by additional data collection, assisted by NABRAD's regional office in Hyderabad and NABRAD's district offices in Uttar Pradesh.

The field study in Pakistan will be carried out in co-operation with Taraqee Foundation, a microfinance organisation in Balochistan. Taraqee is one of the many replication programmes of the Grameen Bank of Bangladesh. Set up with the co-operation of Grameen Trust and other donors like the UNDP, GTZ and CARE in 1994, Taraqee has been targeting the local poor in Balochistan, Pakistan’s biggest but least developed province. They have been working mostly with poor women of two local tribes, namely the Baloch and Hazara.

⁹ Also called the MIX Market providing information to sector actors and the public at large on MFIs world-wide, public and private funds that invest in microfinance, MFI networks, raters/ external evaluators, advisory firms, governmental and regulatory agencies. The MIX Market currently provides data on 1367 MFIs, 104 investors and 182 partners (Microfinance Information Exchange 2009)

¹⁰ Namely: voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, corruption control, political rights and civil liberties

The aim would be mainly to check on the user and provider side of microfinancing, by outlining what exactly are their expectations from the MFI. Beyond that, to find out through interviews, what pressures the MFIs and their clients face within the social framework, both external and internal. For this purpose, an additional instrument would also be to extend the spectrum, to see what the local/ national media and newspapers have to report about the issue. Furthermore, to check for the targeting and/ or mechanisms of MFIs as a criteria for the allotment of the loans to the poor will also be assessed so as to guarantee that other important factors, for example: land size, ethnic and religious background, number of people in the family, age or gender of the borrower, occupation etc are also considered. The objective is also to explain why a particular set of mechanisms/ framework of factors would work in their respective societal settings. The elaboration of the questionnaires will be based on prior work by Hulme and Mosley (1996b), but extended to cover the political-economic factors discussed above.

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