Microfinance: Dreams and Reality

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Microfinance: Dreams and Reality

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Contents

List of Terms

MFI	Microfinance Institution
TML	Traditional Money Lender
NGO	Non-Government Organisation
CSR	Corporate Social Responsibility
KPI	Key Performance Indicator
ROE	Return on Equity

Abstract

Microfinance is an area of research whose popularity is reflected by the unique potential for wide ranging socioeconomic outcomes which support political goals unmatched by alternative avenues for financial support. However, despite the large amounts of financial resources funding microfinance across the world, and glorious potential economic benefits, there is no consensus regarding the success or failure of microfinance in achieving socioeconomic political goals. This paper examines the empirical literature on microfinance to establish where microfinance has developed from, the organisation of MFI's, the success or failure of microfinance, and future research methodological possibilities. It has been found that the success or failure of microfinance depends on the benchmarks to which it is measured. From a social empowerment perspective, microfinance success has been observed. However, from an economic development perspective the results are equivocal. The success of microfinance is related to the mission of DQ because of the interdisciplinary approach to research and the effects of microfinance across social and economic fields. Further, microfinance continues to be an avenue for the practical realisation of CSR organisational goals and thus it is of relevance to evaluate success in this industry to ensure the efficient and continued achievement of political goals.

1. Introduction

The inequality in global wealth and access to social resources is one of the most discussed issues in the world today. The development of global social morals (Linklater, 2007) has resulted in the formalisation of political and cultural goals towards equality and fairness. Despite the rationality challenges these morals pose to traditional economists, the efficient achievement of socially based moral goals via regulation has wide ranging effects, including on financial inclusion in developing countries (Augsburg, De Haas, Harmgart, & Meghir, 2012; Gibson & Tsakalotos, 1994). The fact that most of the world's population does not have access to a social safety net or a formal banking system has led to the development of microfinance to fill this gap in services (Sharma, 2005). Microfinance has seen exponential growth over the last twenty years because of its ability to provide the poor with capital to facilitate income generating self-employment activities and to smooth consumption expenses (Ahlin & Jiang, 2008). This has effectively mobilised household savings and encouraged emerging small scale entrepreneurs (Rogerson, 2001), which has a potential effect on economic growth because the impetus to achieve economic growth needs to come from within the developing country, not be imposed from the outside (Collier & Dasgupta, 2007). This concept is congruent with microfinance, which has the potential to enable economic growth if regulated efficiently, bypassing external aid and internal political issues in the process.

It is important to understand that those in poverty have had access to finance prior to the emergence of Microfinance Institutions (MFI's) through Traditional Money Lenders (TML's). Loans through TML's such as banks were rarely approved because of the high transaction costs associated with small loans, no collateral, no credit history, or no business plan (Shankar, 2007; Sharma, 2005) (pp 1337 and pp 295 respectively) and those through loan sharks may have had extortionately high interest rates and the possibility of physical harm in the instance of late or non-payment. Given the emergence of MFI's to fill this gap in financial services, there is little information as to how MFI's are regulated and the subsequent effect on economic development.

Microfinance is a topic of research, popular in the existing literature because of the potential wide-ranging and long-lasting effects on a majority of the poor people on Earth. However, there is little empirical research which focuses on the economic benefits of microfinance. This is due to sample selection bias, i.e. it is not possible to compare borrowers from MFI's and those who don't borrow (Aggarwal, Klapper, & Singer, 2012). However, various authors have found direct social benefits from microfinance programs (Affleck & Mellor, 2006; Cabello, 2008; Hossain & Knight, 2008; Husain, 2008; Mayoux, 1999; Molyneux, Hutchison, Chuma, & Gilson, 2007;

Roper, 2005; Sharma, 2005). In addition, authors have found that microfinance has the potential to reduce individual and regional poverty levels (Emeni, 2008; Hossain & Knight, 2008; Mogale, 2007; Mwenda & Muuka, 2004; Sharma, 2005). However, the requirements for development to be achieved at a micro and macro level require not only microfinance, but savings of the resulting profits (Opoko, Dzene, Caria, Teal, & Zeitlin, 2009; Rogerson, 2001). Ahlin and Jiang (2008) have gone so far as to say that microfinance will have no effect on GDP unless there are long-term saving patterns by borrowers. The research on the socioeconomic benefits of microfinance will be reviewed in more detail in the coming sections of this paper.

In contrast, The World Bank (2003) has found that most microfinance is used to meet basic needs (such as housing and food) rather than to generate income via investment activities. In addition to this, critics of microfinance generally comment on the mechanism not meeting the needs of the 'bottom of the pyramid' chronic poor (Hartungi, 2007; Molyneux et al., 2007; Roper, 2005; Sykes & Quesenberry, 2009; Webb, Kristiani, & Olaru, 2009; Weiss, Montgomery, & Kurmanalieva, 2003), and does not actually reduce poverty at all (Rogerson, 2001; Zeller & Meyer, 2002). It is clear from the literature that there are a number of factors which affect individual and regional outcomes, which are not limited to microfinance such as agricultural cycles and government policy (Baulch & Hoddinott, 2000; Mwenda & Muuka, 2004; Sharma, 2005). The equivocality of the research findings regarding the socioeconomic benefits of microfinance provides motivation for: clarifying the origins and current situation of microfinance and establishing the areas where future research would be of most benefit. This paper contains a positive analysis which seeks to describe the microfinance environment in terms of establishing success benchmarks and determining the empirical findings regarding success or failure to date. Although the system has existed for hundreds of years (Mercy-Corps, 2006) and is theoretically a method to reduce poverty and advance economies through entrepreneurship, in reality there has been little positive recorded effect of MFI's over a large amount of time (Buera, Kaboski, & Shin, 2012).

Existing literature shows no consistency in findings regarding the existence or magnitude of social benefits or poverty reduction as a result of microfinance (eg. Arch (2005)). Further, the interrelationship between microfinance and legal institutions is still not clearly understood. These main issues will be discussed in this paper in order to establish the existing empirical findings which may illustrate structural or methodological reasons for literature discrepancies. This paper aims to contribute to a gap in the existing literature by presenting the historical and empirical analysis of microfinance with a view to future research approaches.

The current paper aims to discuss the empirical evidence regarding the success or failure of microfinance. In order to present a structured analysis of this area of research the following format will be followed. The discussion will cover: what defines microfinance, history, economic and non-economic goals of microfinance; the organisation, corporate governance and distribution of MFI's; geographical trends in microfinance; the empirical literature on microfinance success or failure, success influencers; and why microfinance may benefit from a law and economics methodological approach to research.

2. What is Microfinance?

In a World Bank microfinance impact assessment, Karlan and Goldberg (2007) define microfinance as '…*the provision of small-scale financial services to people who lack access to traditional banking services'* (pp 10). The provision of microenterprise loans has been diversified to include the provision of other financial services such as micro-insurance, micro-pensions, deposits and loans for education and medical expenses. The term microfinance thus refers to a range of small sum financial services provided to the poor, and the primary service is usually loans for the establishment and expansion of micro-enterprises. Microfinance has been formally developed in recent decades with the explicit motivation of providing financial services to the poor. Low balance transactions and high operating costs result in unprofitable relationships from the banks' perspectives, and have led to potential borrowers being un-serviced. The development of the microfinance industry has been primarily motivated by socioeconomic goals.

There is a potentially large effect on economic development from microfinance because it supports small scale entrepreneurship which is a vital first step towards the creation of larger businesses which achieve operating efficiency and employ more people. In order for the economies of developing countries to grow there must be businesses employing people and using economies of scale to ensure sustainable profit (Carree & Thurik, 2005). The development of microenterprises into businesses employing people generally requires increasing amounts of credit at strategic growth points in the life cycle of the business. Microfinance thus supports the establishment and growth of microenterprises with the goal that some might become fully fledged businesses contributing to regional and national economies.

2.1 Why is there Microfinance?

2.1.1 History

Despite the recent popularisation of microfinance as a tool for the socioeconomic advancement of a majority of the world's poor, microfinance is not actually a new concept. Although our modern understanding of microfinance can theoretically be traced to Jonathan Swift (Hollis, 1999), the famous author and Irish nationalist, savings and credit groups have actually existed for centuries all over the world (Mercy-Corps, 2006).

It is not surprising that small scale informal savings and credit groups existed long before the establishment of formal microfinance institutions. Indeed there are many aspects of society which emerged simultaneously and without collaboration all over the world before small scale trends became a wide ranging system. For example, farming and medical care were present at a family level before expanding to the industries they are today. It is understandable that before formal banking institutions were developed groups of people collaborated to support each other's savings and credit requirements. In particular, we know of savings and credit groups in India (Chit Funds), Indonesia (Arisan) and West Africa (Tontines) (Mercy-Corps, 2006). It is important to recognise the existence of quasi-MFI's centuries ago because it reinforces the important role that banking services have played in rural and poor communities throughout recent human history.

In the case of microfinance it can be seen that without the regulatory support savings and credit would have been provided to the poor in a decentralised and village based system. This is because a lack of regulation may have theoretically had effects not only on the functioning of capital markets, but also on NGO's (Non-Government Organisations) who administer a majority of microfinance. The success of these systems will be discussed in further detail at a later stage of the current paper. This village-based system may be unable to allow for the scope of entrepreneurship because the amount of available finance is limited to the savings of other group members. However, this is not the case in Peru where most MFI's are primarily funded by domestic deposits (Carrasco, 2006; Etzensperger, 2012), and has been ranked as the best environment for microfinance in the world (Economist-Intelligence-Unit, 2012). This is particularly important in developing countries where the imposition of external aid has not yielded economic success because of a range of psychological and corruption related factors (Buscaglia, 2011). There is doubt about the efficiencies of donor aid, which serves to provide further support for the importance of internal sources of growth, of which entrepreneurship supported by microfinance is arguably one.

The development of microfinance in Western Europe followed a trend which reflects the current waning and waxing of banking services to different market sectors. Of note for this chapter is the Irish Loan Fund system, established and initially financed by Jonathan Swift, to provide small loans to rural farmers unable to guarantee collateral. This system began in the early 1700's and was widespread in the middle of the 19th Century with loans to 20% of Irish families every year (Hollis, 1999).

In the middle of the 19th Century on continental Europe a similar trend developed in Germany backed by the altruistic wealthy and unions. With the motivation of improving welfare and helping the poor reduce their reliance on money lenders, rural community credit unions and savings co-operatives increased their clientele (Mercy-Corps, 2006). During this period the co-operatives were also successful in obtaining funds from donors, a key ingredient for the scale of MFI's which lies within the legal and economic environment. Western Europe's focus on the development of microfinance has a foundation in the union movement and the underlying socialist nature of many of the states over the past centuries. However, elsewhere in the world a similar trend has been developing (Hollis, 1999).

In Indonesia there has been a formal MFI in operation since 1895 (Mercy-Corps, 2006), showing that also in developing countries, it is the media coverage of the sector which is new and not necessarily the sector itself. However, if microfinance has been present at a large-scale in Indonesia for more than a hundred years, it is fair to question how that country still remains in the development phase.

Over the last 50 years the development of microfinance has become very particular for each country and it is not accurate to present a general overview of progress because there are such wide differences in uptake, service provision, and effects across a number of the key microfinance countries. It can be argued that what we now consider microfinance was pioneered by Nobel Peace Prize winner Professor Muhammad Yunus in 1974, then a professor of economics at the University of Chittagong in Bangladesh. In collaboration with graduate students and designed as a somewhat experimental design, initial loans were provided to groups of poor villagers (Shukran & Rahman, 2011). The success of the pilot study and observed positive effects on empowerment of the poor, especially of women, alongside the self-sustaining model when funded by deposits resulted in the creation of the Grameen Bank in 1983 (Zapalska, Brozik, & Rudd, 2007). Initially the bank was forced to be self-sustaining because donor and investor funds were difficult to establish in the unchartered waters in which microfinance was being formally established. Built on a solid foundation of self-sustaining financial services has allowed the bank to light the way for many more large sized MFI's and for international financing to be widespread from both donors and investors (Hulme, 2008). The product foundation on group-lending has ensured that the risk of the loans are low while the poorest in society are sought to be reached (Shukran & Rahman, 2011).

Although some aspects of microfinance, such as group lending, have evolved little as a result of their continued ability to meet the needs of the poor, some aspects of microfinance have needed intentional creation in order to achieve socioeconomic goals. Throughout the history of microfinance the system has only really provided benefits to those who are poor but still above the poverty line, and has not been able to address the needs of the 'Bottom of the Pyramid' poor who don't even have the ability to seek microfinance (Hartungi, 2007; Molyneux et al., 2007; Webb et al., 2009; Weiss et al., 2003). Authors have discussed the chronic poor, and recommend that microfinance be distributed directly to them (Sykes & Quesenberry, 2009) and that associated services be provided to reduce the higher than average drop-out rates for those in extreme poverty (Roper, 2005). Thus, MFI's such as the Grameen Bank have initiated programs designed to directly support the destitute members of society, for whom the traditional microfinance programs are of little use (Hulme, 2008). The historical development has showed that microfinance is able to adapt to relevant societal issues. The intentional creation of programs to meet the needs of the poorest in society while still maintaining a self-sustaining business model illustrates that the motivation for microfinance development is strong.

It is understandable that people, who are generally risk averse (Hofstede, 1983) would prefer to have a stable income-producing job than have the risk associated with a microenterprise and associated debt. Thus, the fact that most microfinance is used to finance living expenses is an expected outcome and reflects risk aversion which exists across all countries (World Bank, 2003). It is with reflection on risk tolerance that it can be understood how only a small portion of microfinance borrowers graduate to obtaining a loan to fund the establishment and expansion of microenterprises, despite increasing growth over the last 50 years.

2.2 Reasons behind the Development of the Microfinance Industry

Microfinance has existed in some form for centuries. However, the organisational structure of microfinance did not adapt to serve a greater number of people, and it is only in recent times that sheer scale of borrowings has been achieved. The reasons for the development of microfinance into the form we recognise today is based on economic and non-economic reasons. This section discusses the reasons for microfinance, followed by the logistics of how the microfinance system has developed.

Given the fact that microfinance has reached increasing amounts of borrowers across most developing countries, it can be assumed that there are also a larger number of microenterprises funded by microfinance each year. Thus, although most microfinance borrowers are not micro-entrepreneurs but are rather using the credit to smooth consumption, as the amount of people served by the financial system grows, so will the total amount of people who borrow to form micro-enterprises. It is this that ensures the theoretical positive effect of microfinance will continue to increase in magnitude and scope. Thus, the historical underperformance of microfinance on the economies of developing countries may indeed be because of a combination of adverse regulation, and also that the outreach to borrowers needs to be greater.

2.3 Goals of Microfinance

For microfinance to be successful in the socioeconomic objectives defined by each MFI support needs to be maintained from national and international governing bodies. From a political perspective it can be said that development and credit availability are primary goals and that the regulation of MFI's theoretically supports the achievement of these goals.

The goal of development is an important reason for research in this field. Given the sheer sums of money invested in microfinance it is critical to ensure that the system is efficient, which means benefiting the poor relative to the costs associated with doing so. Research in this field may contribute to ensuring that the microfinance system is efficient and that the goals of microfinance are achieved, effectively a cost benefit analysis. Further, by supporting financial institutions which can support development there are fewer burdens on the governments of developing countries so they can focus on other key aspects of raising the standard of living such as through health care or education. Critics of microfinance have followed this line of reasoning in commenting that it is simply a privatisation of welfare (Mallick, 2012). Microfinance is such an important area for research because there are potential flow-through effects to other areas of a developing countries economy. In this way it can be logically extended that helping to allow people to raise themselves out of poverty has positive effects on the health care and education systems because these individuals may then be able to afford private health care, or indeed be healthier than when they were in poverty. Further, there may be increased rates of education, especially of girls when parents can afford the school fees. The link with economic development goals and political social goals is blurred, and political goals of microfinance are in this way often aligned with development goals. Thus the wide ranging positive effects of microfinance on economic development are key reasons for research in this area.

2.3.1 Economic Reasons for Microfinance

Economic reasons for the development of microfinance follow the development economics trend of argument which provides that economic growth is more surely achieved from business growth within a country rather than the imposition or provision of aid from external sources (Collier & Dasgupta, 2007). This argument further lends itself to support that economic development needs a foundation of sustainability and this is achieved most efficiently from internal impetus in the country. The widely referenced work of Amartya Sen illustrates the advantages and the pitfalls of globalisation in the current world (Sen, 2001, 2002). It can be seen that in the age of globalisation, economic development benefits all.

It can be argued that development is the overall aim of microfinance from an economic perspective. It may be of benefit to developed countries to raise individual wealth and reduce poverty, as wealthier countries may be more politically stable and ensure the societal objectives of governments are upheld (Bowles, 2008). Behavioural economics, game theory and experimental economics seek to explain the behaviour toward supporting moral values financially (Roth, Prasnikar, Okuno-Fujuwara, & Zamir, 1991; Tomer, 2007). Importantly, modern societies uphold certain moral values which, regardless of their efficiency or rationality, seek to be achieved across the globe (Hofstede, 1983; Kinnier, Kernes, & Dautheribes, 2000). Indeed, it is this sense of fairness and moral obligation which drives many large scale government funded NGO's in the world today (Schwartz, 2007). The relevant question regarding this issue is not whether the moral values of fairness are appropriate, rather whether the model of microfinance achieves the morally founded development goals.

The model of microfinance which we recognise today has been designed and supported by particular regulation because of development goals. Governments of developing countries recognise that if self-sustaining MFI's are able to increase entrepreneurship and reduce poverty (Al-Azzam, Mimouni, & Ali, 2012), that will in turn reduce the amount of funding and monitoring required by the government, allowing more focus on other social objectives such as education or health care. It is thus very strategic for governments of developing countries to provide a regulatory environment which supports microfinance.

Indeed it can be theoretically argued that the financial support of microfinance by NGO's, the governments of developed countries and external investors is very efficient in promoting development. This is because the money that is used by MFI's has exponential effects by providing support for entrepreneurship which further stimulates the economy. Although investment in education, health, and other areas where developing economies need assistance is also vital, it is microfinance's ability to stimulate internal growth which ensures its on-going attraction for external funding. As we will discuss, there are many practical issues which mean that this theory of internal growth support is not always the case, however, there are few avenues for financial support which offer such promising outcomes at all societal and economic levels, as microfinance.

Various studies have found that entrepreneurship and the development of large businesses is key for the economic development of countries (Hartungi, 2007; Sharma, 2005). This is not surprising given the logical economies of scale achieved when businesses are able to employ hundreds of wage earning people while generating a profit. The role of microfinance in this system of economic development occurs at various stages of the entrepreneurship lifecycle. It has been established that microfinance doesn't generally support the destitute members of developing countries, but rather those who are just above the poverty line of US$1.25 per day (in 2005) (The-World-Bank, 2009). Indeed, The World Bank estimates that there are 1.4 billion people living below this poverty line, and thus out of the scope of microfinance services. Microfinance has the ability to smooth the consumption of those who are just above the poverty line so they are potentially able to save some money in the form of micro-deposits. Of the millions of borrowers who use microfinance for consumption expenses such as education or medical costs, some of those borrowers will 'graduate' to obtaining loans to establish microenterprises (Roper, 2005). Of those who obtain loans for microenterprise establishment, 90% will continue to obtain microfinance for working capital (Roper, 2005). In an ideal microfinance situation, a proportion of these borrowers go on to obtain microfinance in larger amounts at strategic points in their business life cycle to allow for expansion. As these businesses expand, they employ more and more people and generate more and more cash flow and profit which allows them to graduate completely from the microfinance system and join the formal financial system.

This ideal structure of microfinance leading into fully fledged businesses is a model on which goals of development are based. This is because large businesses provide more economic benefit to countries than small businesses (Carree & Thurik, 2005). However, as discussed it is only a small portion of borrowers who borrow to fund microenterprises. This is one of the many shortcomings of microfinance and one of the foundations of criticism by research on the topic.

The economic motivations of the microfinance industry revolve around the mobilisation of household savings for economic development via small business growth. The theory efficiently aims to provide a financial and psychological empowerment foundation from which all members of developing countries are able to contribute to economic development. As the impetus for entrepreneurship will come from within the country it is thought that the effects will be self-sustaining into the future.

2.3.1.1 Development

Throughout history microfinance has been used as a tool for the poor to meet unexpected costs, and to smooth their consumption expenses. It is the ability of microfinance to meet the various needs of the poor that has ensured its wide-ranging success. However, authors have noted that it is the ability of microfinance to fund microenterprises and provide on-going credit through expansion phases which provides the real potential benefits to the regional and national economies.

Microfinance was designed in modern times to mobilise household savings in order to smooth the consumption of the poor. Primarily, microfinance serves as a tool for economic development. Indeed, much of the evidence indicates that microfinance reduces poverty (Emeni, 2008; Hossain & Knight, 2008; Mwenda & Muuka, 2004). These findings have been supported by research in retail mortgage markets of developed countries which have found that there is a relationship between net worth and economic activity (Caplin, Freeman, & Tracy, 1997), and microfinance research which indicates that often the borrowed funds are used to smooth consumption and increase consumer spending (Aggarwal et al., 2012; Buera et al., 2012). However, other authors have commented that most microfinance is used to meet basic needs and the smoothing of consumption outlays which postpone expenses but don't increase wealth (World Bank, 2003). Further, authors have specified that long term positive effects of microfinance requires on-going savings, and that this will not have an effect on GDP (Ahlin & Jiang, 2008). However, despite the ambiguity of the effect on development, authors have also found that there may be both macro and micro benefits of microfinance (Sharma, 2005). In terms of the development motivation for the design of microfinance we can conclude that authors have found it is an accepted development agent (Hartungi, 2007) and that it contributes to both financial stability and social outreach (Cabello, 2008).

When discussing the macroeconomics of microfinance, authors have found that microfinance increases equilibrium wages and reduces interest rates, in general equilibrium models (Buera et al., 2012). In quantitatively assessing the macroeconomic effects of microfinance these authors identify that general equilibrium analyses are now possible in many countries as a result of the large increase in microfinance. The flow-through effect on redistribution from an increase in equilibrium wages means that there are macroeconomic positive effects on the economic development of the poor (Buera et al., 2012).

The research on the development reasons for microfinance indicates that the effect on development is not as grand as the goals microfinance is designed to support (Aggarwal et al., 2012). It has been found that there are increases in equilibrium wages and redistribution of wealth to some extent and in some circumstances (Buera et al., 2012). However, authors have also found that the theoretical conditions under which microfinance can lead to aggregate development are narrow and not commonly present in developing countries (Ahlin & Jiang, 2008). The research on development shows that although the economic effects from microfinance are often non-existent and small when they are, nonetheless there are potential positive effects and this ensures that the development reasons for microfinance will remain even if indeed the scale of benefit is small.

2.3.1.2 Credit Availability

Microfinance directly influences the amount of credit available to the poor in developing countries. Credit availability is linked to the theoretical foundation on efficiency in this field. It can be argued that credit availability is a key driver of entrepreneurship in both developing and developed countries (Aggarwal et al., 2012; Berg, 2012). Microfinance thus has a potential direct influence on entrepreneurship, which can have wide ranging and long lasting effects on economic development. This effect on credit availability makes the study of microfinance from a law and economics perspective particularly useful in future research.

The role of credit availability in business growth (and subsequent economic growth) has been documented in a World Bank report where it is stated that limited access to finance is often a constraint to business growth in developing countries (Aggarwal et al., 2012). It can be seen from this research that the availability of credit may have a significant effect on small businesses. Indeed, foundation research by Banerjee, Duflo, Glennerster, and Kinnan (2009) found in a randomised experiment that the provision of microfinance in slums results in 32% more businesses created than in slums with no microfinance implemented. These authors further found that there is a clear difference between households with a propensity to be entrepreneurial and those who aren't, which provides further support for a criticism of microfinance that the provision of credit is not enough to create businesses and business growth (Banerjee et al., 2009).

Research has found that during real economy shocks credit availability is reduced whereas in a funding shock credit availability remains constant although borrowers are discouraged from applying in the first place (Berg, 2012). However, the same research does find that microfinance increases credit availability for the vulnerable in society. Credit availability is a result of microfinance which has wide ranging implications and this topic appears at various points in this paper.

2.3.2 Non-economic Reasons for Microfinance

2.3.2.1 Social

The focus of much of the research to date on microfinance has been on the social motivations and benefits of the system and the potential for sustainable socioeconomic transformation (Sharma, 2005). This is not surprising given that since inception modern MFI's have had explicit social goals. There goals generally relate to empowerment of women and a broad based increase in the standard of living. Authors have pointed out that the definition of poverty relies on socially acceptable wealth standards (Husain, 2008). Thus the measurement of microfinance success is built on a foundation of societal values. In the case of microfinance and other mainly externally funded development initiatives it is thus important that donor countries do not impose their own standards of poverty on those of other countries, and rather allow the internal definition to support development from within.

One of the abilities of microfinance to foster development from within is to provide capital to those in countries where donor funds don't reach (Hudon, 2009). There are some countries which for political, corruption, or economic reasons, donor funds don't reach those intended (Mersland, 2011). However, microfinance has the ability to mobilise the household savings of those in the country itself, without relying on external financing. In this way microfinance has the non-economic ability to bypass corruption or non-existent donor capital flows to support the social development of the poor (van Bastelaer, 2000). The theory of microfinance organisation allows for this potential; however the social objectives move the attention from sustainability as explicit goals of MFI's.

The potential for social outreach of microfinance has been documented (Cabello, 2008). Authors have emphasised that microfinance is a socioeconomic financial mechanism (Hossain & Knight, 2008) and as such needs to measure and take into account social performance (Roper, 2005). It has been found that microfinance has a positive effect on health outcomes (Molyneux et al., 2007), female empowerment (Hossain & Knight, 2008) and in reducing social exclusion (Affleck & Mellor, 2006). However, longitudinal and large scale cross-sectional studies have not been published which confirm these findings generally consistent in the literature. Although the research regarding the effect on poverty and economic growth are ambiguous there is consensus that the social effects of microfinance are wide ranging and present in most countries which have microfinance.

2.3.2.2 Empowerment

In terms of the empowerment benefits of microfinance research has yielded equivocal results. Much of the research on empowerment focusses on female empowerment in developing countries, and indeed that is the strategic focus of many MFI's. However, it has also been found that microfinance doesn't itself increase female empowerment because women already have high social networks on which to rely (Mayoux, 1999). It is the development of social capital which provides much of the theoretical appeal of microfinance. On the other hand, it has been found that microfinance does increase women's empowerment (Mwenda & Muuka, 2004). Research has elaborated that the increase in empowerment comes from higher levels of income, independence and self-reliance (Roper, 2005). It can be logically extended that empowerment of women and poor societies have the potential to increase the standard of living for a wide range of community members. Development goals generally aim to raise the wealth of individuals in society not solely so they are wealthier, but also because it has been found that there is a general trend supporting happiness and wealth to a certain level (Diener & Biswas-Diener, 2002). However, authors have also supported the need to measure life satisfaction in order to ensure that there isn't an assumed association between wealth and happiness in the poor (Rojas, 2009).

3. Microfinance Organisation

Microfinance companies are organised around corporate objectives in the same way that banks in developed countries are structured. However, the content of these objectives varies widely to reflect the goals of the organisation. For example, while a large bank such as Barclays may have the motivation of being admired and innovative (Barclays, 2012), MFI's generally have goals of meeting social objectives and operating efficiently, as is the case of KIVA, a large MFI with established web presence (Kiva, 2012). MFI's have a mission to fight poverty and often operate as non-profit entities without underlying legal owners (Spahr, Ashraf, Scannell, & Korobov, 2011). MFI's are generally promoted by international NGO's, a financial reliance which continues to be a concern for the sustainability of microfinance (Spahr et al., 2011). MFI's focus on the provision of credit to those who, without collateral or evidence of being able to service the loan, are otherwise rejected by the formal financial system. This general goal of credit availability is built on a foundation of flow-through social goals such as increases in empowerment, education and health care.

In discussing the organisation of MFI's it may be relevant to consider the marketing strategies involved. In general the marketing strategies by NGO's in developed countries seem quite sophisticated in their methods to extract donations from the population. However, descriptive data research in Ghana has found that MFI's don't use targeted marketing strategies to attract borrowers (Brafu-Insaidoo & Ahiakpor, 2011). Rather than being indicative of the relative failure of MFI's, this research may indicate the large scope of potential future borrowers if marketing strategies were employed. Thus, although the marketing strategies of MFI's are not as advanced as the design of financial products to suit the poor, it does provide scope for expansion of the sector even more.

Further, the financial incentives and KPI's (Key Performance Indicators) given to MFI staff has the potential to impact overall borrower outcomes. Jiwani (2007) has found that staff incentive programs result in fewer arrears and when structured correctly can increase the number of new borrowers and increase average loan sizes.

The research indicates that MFI's may be too focussed on their social objectives without adequate consideration of how efficiency can help achieve them. This is supported by Waweru and Spraakman (2012) who found that there is also bottom-up demand by clients to know about performance measurement because of joint liability. In this case study research of three MFI's in Kenya found that well-developed performance measures also resulted in increased support for the small business borrowers. Waweru and Spraakman (2012) found that MFI best practice involved performance measures which can lead to MFI sustainability. This research goes on to detail that there needs to be a balance between financial and non-financial performance measures and that in MFI's output measures are more common than process measures.

3.1. Financial Organisation

3.1.1. Group Lending

The financial model in which microfinance has been built is one of group lending (Rogerson, 2001). This is generally where the MFI supports groups of people who save together and then lend out the deposited amounts to each other as needed. Understandably, repayment rates are very high with this model because in effect the loans are from family and friends to whom the borrower is accountable on a social as well as financial level (Ahlin & Jiang, 2008; Besley & Coate, 1995; Mayoux, 1999; Molyneux et al., 2007; Opoko et al., 2009). These levels of responsibility also provide explicit and implicit insurance as the risk is shared (Torkestani & Pari, 2008). However, this also raises one of the issues of microfinance, which is that it is only those who are above the poverty line who have the opportunity to join these borrower groups. On the other hand, this financial service has not required great evolution since it was common practice in savings and credit groups hundreds of years ago (Hollis, 1999). In this way, this model of microfinance services may be one of the aspects of this industry which requires less legislation than the direct provision of loans to the poor or for the regulation of the MFI itself.

Group lending has been a service provided since the first microfinance evolved across the world to meet the demands of groups of rural villagers without access to the formal banking sector. Given the prominence of this service through history it can be seen that it is a core aspect of microfinance and a feature which requires little adaptation or control by regulation.

3.1.2 Financial Trends

The organisation of MFI's differs widely. Given that most MFI's have a similar goal around the provision of credit to the poor, this is especially interesting. Despite a common goal, the method of achievement doesn't follow a set model. As often unregulated and international organisations, MFI's have the flexibility of being able to innovate and develop business structures which creatively achieve the final goal. The increasing use of the internet means that MFI's are able to utilise web-based peer-to-peer lending systems which connect the poor directly with the financial provider. For example, organisations such as United Prosperity, rather than providing finance to the borrower, guarantee the borrower's loan with the traditional bank. United Prosperity claims that this system enables financial leverage over and above traditional microfinance and also results in greater long term financial freedom as the borrower builds a relationship directly with the bank which may increase the chance of 'graduating' from the microfinance system (United-Prosperity, 2012).

The trend toward the mobilisation of small donations from individuals in developed countries supports microfinance programs overseas based on a peer-to-peer model. This is an innovation which leverages off existing technology and the increasing awareness of the benefits of microfinance in meeting social goals. Indeed, it is innovations in the financial organisation and strategy of MFI's which may provide results for the success or failure of microfinance which other models have been unable to quantify. Future research may benefit from MFI comparison based on the method of financing loans.

Di Bella (2011) has explained that the trend towards sustainability has increased exposure to international capital markets (especially for non-regulated MFI's) and made MFI's more similar to traditional financial firms. This illustrates the theoretical and practical clash between achieving social goals and reducing reliance on donor funds. Further, regulated MFI's have average higher loan sizes, yet there is no difference in ROE (Return on Equity) between regulated and non-regulated MFI's. Di Bella (2011) suggests that regulation seeking to reduce interest rates is more useful to instead create an environment where MFI's can develop through competition and lending technology innovation.

3.2 Corporate Governance

The corporate governance of MFI's is a topic related to the regulation of the same institutions, and thus relevant for this paper. However, research is inconclusive regarding the optimal corporate governance structure, nor the regulation which enforces it in MFI's (Spahr et al., 2011). Indeed, authors in reviewing the literature on the area have found that there isn't consensus regarding whether regulation should enforce corporate governance structures or whether agency costs can be minimised in ways other than by reducing the vertical relationship between owners (or the board of directors where individual ownership doesn't exist) and management (Spahr et al., 2011). Spahr et al. (2011) further discusses how boards are more important in non-profit MFI's and how board members are generally different to the demographics of the borrowers in that they are composed of the educated middle and upper classes. This difference allows the altruistic motivations of board members to be satisfied.

3.3 Distribution

The concept of the distribution of services and products is dependent on the location within which the analysis is made. For example, the distribution of sim cards and mobile phone calling credit in developed countries generally requires a shop authorised to provide the relevant companies products. However, in developing countries these products are generally provided by lone sellers who can be found at many street intersections or in makeshift stalls on the side of the road. The distribution of different products is adapted depending on the market.

This flexibility and diversity of the distribution of otherwise identical products depending on the country in question is directly relevant for microfinance trends. In developing countries where a majority of the banking research is focussed, the banking system is based on a system of physical branches and intermediaries such as post offices. However, this model of banking for microfinance would not translate well in developing countries for a number of reasons. The main reason that a transplant of the banking distribution model favoured in developed countries would not necessarily work well for MFI's developing countries is because the scale of operations in MFI's requires a lot of small balance customers over wide rural areas and a formal distribution system requires excessive operating expenses to allow self-sustainability.

Further, there are psychological factors which may impede potential borrowers from entering a formal looking MFI. This effect has been noticed in the design of churches in countries such as Australia where the general population feel intimidated by imposing church structures and may never enter them for regular worship. However, when the churches are designed to look like large community halls equipped with sports facilities and child playgrounds, the population feel no hesitation at joining a community for worship. In this sense, the physical environment in which MFI's operate may be critical for their outreach success.

The current distribution of microfinance is adapting to recognise the challenges faced by financial services distribution in developing countries. In order to scale out from the traditional branch model of permanent credit issuing staff MFI's such as Accion are developing 'Alternative Channels'. The motivation for the development of new distribution models is that the branch model physically limits the potential number of borrowers to those who are willing and able to enter a branch for the administration of the loan. Indeed, it is a poignant moment to recognise that it is the rural destitute who are in most need of microfinance, and are simultaneously those who are not serviced by the distribution and product model as it stands (Hartungi, 2007; Molyneux et al., 2007; Webb et al., 2009). There is a need to innovate to distribute microfinance directly to the chronic poor (Sykes & Quesenberry, 2009). The innovations in development aim for 'massive outreach' by establishing MFI brokers in supermarkets and pharmacies across the developing world. Further, Accion has the motivation of reducing costs (which traditionally are heavily in human resources) by finding a balance between personal one-on-one service and transactional services such as those which utilise mobile phone technology. The reduction of cash in the microfinance system has the added benefit of increasing transparency and reducing the risk of corruption or fraud, providing more security for depositors and borrowers (Mesarina, 2012).

Indeed, potential scope for microfinance can be built on the foundation of increasing mobile phone uptake in the developing world. It has been found that the amount of mobile phones in use in Africa will increase from 16 million in 2000 to 1 billion in 2016 (USAID, 2012). Further, USAID (2012) have found that mobile phone use in developing countries is associated with increasing GDP growth by 1.2% for a 10% increase in mobile phone uptake. Further, mobile phone users, especially women, feel safer (93%), more independent (85%), and increase their income and professional opportunities (43%). Importantly, mobile phones provide financial inclusion to those who have a phone but don't have physical access to a bank account (USAID, 2012).

An aspect of distribution which should be stated is the potential for the provision of other socioeconomic goal driven services. Although outside the scope of the current paper it needs to be recognised that the distribution of microfinance is important not only because of the implications for the provision of the services to those who really need it, but also because of the potential scope for the cross-provision of other services. For example, education can be considered as a potential cross-provided product, and indeed some MFI's do provide other services such as education (Mesarina, 2012). In the way that religions in modern Australia seek to first make people feel welcome and give them a space where they can play sport or organise community groups, so may microfinance operate in a similar manner. This potential scope in the strategy of distribution of microfinance not only allows for customers who would otherwise have remained unaware, but also for efficiencies of scale in supporting other socioeconomic motivated strategies.

The distribution of microfinance to those who require credit to smooth consumption or to finance microenterprises is an important consideration. The distribution of microfinance services has the potential to be affected by MFI regulation which is specific to each country. Further, developments in distribution of microfinance to the 'bottom of the pyramid' poor are required to ensure scale of the development model to achieve socioeconomic goals.

4. Geographical Trends in Microfinance

The geographical spread of microfinance is built on a foundation of the historical and natural development of loan societies in communities all over the world. As a result of the home grown evolution of microfinance it is not surprising that the system enjoys success in most developing countries where the legal institutions allow it.

Research into microfinance has generally been based in specific countries. Although many of the results are valid across other developing countries where rigorous methodology has been documented and undertaken, it is the case that there is a lot of country specific research. Research has been conducted in Peru (Etzensperger, 2012; Pait, 2009),El Salvador (Cabello, 2008), Indonesia (Hartungi, 2007; Webb et al., 2009), Nigeria (Emeni, 2008), Bangladesh (Eichner, 2012a; Hossain & Knight, 2008; Weiss et al., 2003), Africa (Mayoux, 1999; Mwenda & Muuka, 2004; Rogerson, 2001), South Africa (Mogale, 2007; Sykes & Quesenberry, 2009), Kenya (Molyneux et al., 2007), Ghana (Opoko et al., 2009), India (Eichner, 2012b; Shankar, 2007; Sharma, 2005), Kyrgyzstan (Struyk & Roy, 2006), Iran (Torkestani & Pari, 2008), Israel (Felsenstein & Schwartz, 1993), Guatemala (Kevane & Wydick, 2001), Argentina (Pereiro, 2001), China (Rahman & Luo, 2011; Zhang, 2008), Tanzania (Satta, 2003, 2004), and Pakistan (Eichner, 2011). The countries in which research has primarily been conducted are of interest because it is indicative of the countries which have available data of MFI's, economic growth and a supportive regulatory environment.

Much of the focus of microfinance research has been on Asia, in particular Bangladesh and India, and Africa. This is because these 'hot spots' have not only the most developed microfinance systems, but also most of the people in need of financial services. Although the major source of finance across the globe is borrowing money from family and friends, in Africa the countries with large amounts of microfinance proportional to other sources of finance are Chad, Malawi and Sierra Leone (Aggarwal et al., 2012). Of relevance for the current analysis is that Peru and Bolivia have been identified as having the most supportive regulation for microfinance (Economist-Intelligence-Unit, 2012; Etzensperger, 2012).

5. Overview of the Empirical Literature

This section seeks to determine the success or failure of microfinance given the goals which it has sought to achieve. In considering microfinance from an empirical perspective the influences of microfinance will also be discussed, along with market failure motivations for the introduction of laws. However, it is important to consider the limitations of the underlying data on which empirical research is conducted. Microfinance-Information-Exchange (2010) have documented that it is difficult to compare country data when reporting periods differ across the year from March (India) to July (Nepal) and other months depending on the country.

5.1 Microfinance: Success or Failure?

The political goals regarding microfinance are generally centred on the socioeconomic advancement of the population, as covered in previous sections of this paper. It has been discussed that it is not the reason for the political goals that is a relevant discussion, rather whether the political goals have been achieved or not. Thus, it is the effectiveness, rather than the motivation behind these goals which is relevant (Allott, 1981).

Given the political goals of microfinance and the previous analysis of impact, it can be seen that there is inconsistent evidence regarding the success of microfinance. Based on the benchmarks identified, political goals around poverty alleviation and social goals of financial inclusion and distribution have been partially met. Indeed, the research has indicated that only 1% of borrowers each year are lifted out of poverty (Shukran & Rahman, 2011), yet most borrowers are female and there are high levels of increased empowerment (Mayoux, 1999). Other authors have found the figure to be 1.5% of borrowers lifted out of poverty between the years of 1991/92 and 1998/99 in Bangladesh (Khandker, 2005). Long term effects of microfinance are complicated because loan terms are generally so short and so the direct effect cannot be reliably established, as all borrowers don't continue to take further loans (Sharma, 2005). Indeed, the movement of a large number of people in and out of poverty (Baulch & Hoddinott, 2000) make the effect on poverty further complicated to measure. Given these high social achievements and low economic achievements it is up to the funders of MFI's to decide if the project is money well spent.

Microfinance has developed and provided outcomes for the world's poor, which are measurable as small statistical increases in socio-economic benefits. Research has indicated that only 1% to 1.5% of microfinance borrowers are lifted out of poverty each year (Khandker, 2005; Shukran & Rahman, 2011). Considering the historical increases in the amount of borrowers per year this indicates a positive result. This is because it is the ability of microfinance to serve millions of people rejected by the traditional financial system which provides its true strength. When we consider the number of borrowers served by microfinance thirty years ago, we can see that the figure of 1.5% being lifted from poverty each year (between the period of 1991/92 and 1998/99) (Khandker, 2005)(pp 284) is quite small when there are only a few million borrowers. But now, with ever-increasing millions of borrowers all over the world (Satta, 2004) the benefit to society as a whole is increasing constantly. Indeed, the result of this is an estimated 10,000 to 15,000 people per year lifted out of poverty because of microfinance. This increasing outreach to more and more borrowers also indicates that the overall impact on microenterprises is also increasing.

If, for example, only 1% of borrowers graduate from consumption based loans to obtaining loans to microenterprises, this is a disheartening result for those who plan on microfinance being the economic driver of development. However, when the increasing amount of borrowers is considered this figure has much more positive impact than when considered in isolation.

The economic development of developing countries has lagged behind theoretical models considering the provision of microfinance and donor funds (Shukran & Rahman, 2011). Indeed, World Bank reports have found that the economic gains from microfinance are lower than would be expected (Aggarwal et al., 2012); however there is an overall increase in wages (Buera et al., 2012). Thus, in an empirical economic sense the success of microfinance is unconfirmed. However, theoretical arguments continue to support microfinance as a method to support micro entrepreneurship and that this may have future economic benefits.

From a social perspective, microfinance has been relatively successful, with much of the previous research indicating an increase in empowerment of borrowers and increased access to finance, especially for female borrowers (Mayoux, 1999; Mwenda & Muuka, 2004). Although the research confirming the qualitative success of microfinance is equivocal, varying research methods and countries may indicate that results are not directly comparable and this may explain the discrepancy. Indeed, it is the social equality and fairness aspect of political goals which continue to motivate governments to support microfinance, both in and out of the developing world. Considering that the political goals are primarily social it can be extended that the analysis of whether microfinance is a success or failure should be limited to social benefits. From this perspective, microfinance has achieved success benchmarks.

5.2 Success Influencers

The process of describing microfinance requires that as well as identifying whether it is successful, the influencing factors also need to be identified. Previous literature on the influencing factors of development have illustrated that it is institutions which play a main role (North, 1990), and this is integral for our understanding. Other factors which influence development have been found such as reproduction and female employment (Benería & Sen, 1981), health and nutrition (Strauss & Thomas, 1998) and science, skills and incentives (Jovanovic, 2001). However, it is outside of the scope of the current paper to delve into these details.

5.2.1 Institutions

The literature in the field of institutional economics indicates that institutions impact microfinance success in developing countries (North, 1989, 1990). Research has indicated that the relevant institutions are broader than those related to the black letter law, and include the political and social institutions found in each country (Lee & Kim, 2009). Indeed, when considering the political institutions it needs to be considered not only the formal regulations, but also the informal regulations such as the soft law which is implemented via the Corporate Social Responsibility (CSR) programs of large corporations.

It is the relevance of institutions, in particular legal institutions, for the potential success or failure of microfinance which indicates this topic may benefit from a law and economics research approach. The role of legal institutions in supporting financial institutions to provide products to their customers has been well documented (Diamond & Dybvig, 1986). Research in this field has focussed on developed countries and found that financial regulation increases transparency between customers and banks and decreases risks for both parties (Diamond & Dybvig, 1986; Satta, 2004). Indeed the research into the role of legal institutions is widespread in developed countries, and is an emerging area of research for developing countries. The potential impact that legal institutions have on MFI's and subsequently on economic development is large. This is related to the political motivations for research which examine the way in which legal institutions achieve the goal of supporting credit availability for the poor in developing countries.

In terms of developing countries, it is often the cultures and national identities which affect the success of markets and the transplant of legal systems. Indeed, research has identified the legal institutions which foster growth as property law, contract law, corporate law and banking and investment law (Beck & Levine, 2005). In terms of the current analysis of legal institutions it is the banking and investment law, which affects the sources of money, which is of most relevance. The discussion regarding legal institutions leads to preliminary questions regarding the role of law and how legal institutions can promote microfinance.

5.2.2 Microfinance stakeholders

The stakeholders of microfinance are important to consider for the current paper because the perspective of each group differs, and this can have an effect on the success of microfinance and the regulation under which MFI's fall. Mori (2010) has identified the stakeholders in microfinance in order to determine the role they play in strategic board decision making as clients, employees, governments, donors, creditors, and owners. These stakeholders have the potential to affect microfinance in different ways and thus the consideration of different points of view is relevant.

5.3 Market Failure

The theoretical and practical concept of market failure is at the heart of law and economics in that it provides a precursor to the establishment of law. In the context of microfinance, market failure can be considered in terms of whether the political goals would be realised without law. If it is the case that the political goals of social and economic development would not be realised, or at least facilitated by law, then this is market failure. Where law is justified by market failure this is an issue that needs to be examined. In the situation of market failure the incentives provided by legislation can be adapted to support political goals.

In terms of microfinance, market failure is indeed present. Research has found that in Tanzania the legislation supresses the microfinance industry (Satta, 2004). Considering the role that legislation can play on the success of the microfinance industry, research into this field may benefit from a law and economics approach.

6. Conclusion

Microfinance is an avenue of financial support which provides donors the ability to leverage the social benefit on the personal resources of the poor. The result of such a program is wide publicity and an increasing body of knowledge on the topic. Indeed, microfinance has wide ranging potential benefits such as female empowerment and access to credit for those previously excluded from the financial system. The dreams of microfinance are further extended to include economic development, for if the poor are provided with access to credit to start microenterprises then economic growth can be driven from the millions of people previously unable to realise their entrepreneurial goals. The dreams of microfinance are grand. However, research into microfinance is one sided towards the social benefits of microfinance, as the program is, after all, a socially motivated program. The few studies which do examine the economic benefits of microfinance do not paint such a rosy picture as those which examine social benefits.

This paper has presented an analysis of the background of microfinance in terms of the historical progress along with the reasons for microfinance development. The microfinance literature is divided in terms of the social and economic benefits. Further, the interrelationship between microfinance and legal institutions is still not clearly understood. These main issues have been discussed with reference to the existing literature in order to provide an indication of why there is such a division in the one-sided literature and to provide a foundation from which future research can build. Indeed, although research has not consistently supported the positive effect on social or economic political goals, there are few avenues for financial support which in theory offer such promising socioeconomic outcomes as microfinance.

Microfinance aims to address the issues regarding financial system inclusion and reducing the financial burden of governments in developing countries so capital can be used in other ways such as in supporting health care or education. It is through microfinance that the poor can potentially gain financial self-sufficiency, through the availability of microsavings and microcredit. These specific products are aimed to increase the standard of living of people across the world increase female empowerment. The microfinance model is built on the harnessing of social pressure and loan contracts which require support from other society members, bypassing the need for collateral or evidence of income. This model aims to make microfinance an engine of development by increasing credit availability and the distribution of financial services.

In reality, microfinance is generally achieving the social goals it is designed for, with well-established increases in female empowerment (Al-Azzam et al., 2012; Kevane & Wydick, 2001) and access to credit (Al-Azzam et al., 2012; Brau & Woller, 2004). In support of microfinance authors have found very high repayment rates (Di Bella, 2011) and general equilibrium wage increases across society (Buera et al., 2012). However, on the other hand authors have found that microfinance fails to reach those who need it most, the chronic poor (Aggarwal et al., 2012), which excludes the bottom 1.4 Billion people in the world from the benefits of microfinance (The-World-Bank, 2012). In terms of lifting people out of poverty it has been found that between 1% and 1.5% of borrowers are lifted from poverty each year, and this means around one million people per year (Khandker, 2005; Shukran & Rahman, 2011). The reality of microfinance is that the economic benefits of the programs are yet to be confirmed while the social benefits, especially for female empowerment, are confirmed.

Future research may benefit from the law and economics structure of analysis to model how efficient institutions should be shaped in order to stimulate microfinance. Previous research has documented the success and failure of microfinance in achieving social and economic political goals and that legal intervention does impact the success of microfinance. However, research has not identified which particular legal rules and interventions or institutions are most successful in promoting microfinance. This methodological perspective may provide richness to the research in this field because it provides a basis of analysis that previous studies have overlooked. The potential impact on microfinance performance through appropriate regulation is large.

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