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Financing the Poor: Can microcredit make a difference? Empirical observations from Bangladesh

Farhad Hossain[1] **and Tonya Knight, February 2008**

farhad.hossain@manchester.ac.uk

[1] **IDPM, School of Environment and Development, University of Manchester, Manchester**

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Abstract

Over the last three decades microcredit has gained enormous success in reducing poverty on a global scale. As an efficient financial mechanism, microcredit enables various governmental and non-governmental actors to realise the millennium development goals (MDGs). Based on our recent field-research on microfinance in central Bangladesh, this paper empirically examine and analyse the role of microfinance institutions (MFIs) in promoting rural livelihoods in the country. The study reflects on recent arguments against microcredit and shows that despite some criticisms, microfinance is making significant contribution in uplifting the livelihoods of disadvantaged rural communities.

Keywords: Microcredit, Poverty Alleviation, Community Development, Bangladesh

Farhad Hossain is Lecturer and Programme Director, MSc in Organizational Change and Development at the Institute for Development Policy and Management, School of Environment and Development, University of Manchester**.**

Tonya Knight is Project Analyst at Caribbean Financial Services Corporation

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1. Introduction

By adopting microfinance as a central element in their development programmes, several development organisations, among them governmental and non-governmental organisations (NGOs), aim to decrease global poverty while simultaneously enhancing the profile of women and other underprivileged communities (Hossain, 2002). Current literature has underscored the growing importance of microfinance as an essential poverty alleviation mechanism (Navajas *et al*., 2000; Ahmad, 2001 and 2002; CGAP 2003a; Brau and Woller, 2004; Lashley, 2004; Chowdhury, Ghosh and Wright, 2005). This has been achieved by the creation of opportunities for entrepreneurship, which enable the poor to eliminate unemployment and poverty by fulfilling their creative potential (Yunus, 2001). CGAP (2003) defines microfinance as 'the supply of loans, savings, and other basic financial services to the poor'. Microcredit, a central theme of microfinance (Greene and Gangemi, 2006), is broadly recognised as 'the practice of offering small, collateral-free loans to members of cooperatives who otherwise would not have access to the capital necessary to begin small businesses (Hossain, 2002: 79). Successful adoption and implementation of microfinance programmes in development organisations such as ACCION in the United States, ASA and BRAC in Bangladesh and BRI in Indonesia has further increased the interest in microfinance phenomenon (ASA, 1997; Navajas *et al*., 2000). Muhammad Yunus initially developed this innovative technique by the creation of Grameen Bank in Bangladesh. On experiencing several challenges in lending to the poor via the traditional banking system, Yunus established Grameen Bank in 1983, and this has been followed by subsequent adoption of microfinance by almost 70 countries worldwide. Recent years have recorded further successes in microfinance practice. The year 2005 was named the 'International Year of Microcredit' by the United Nations. In the following year, the 2006 Nobel Peace Prize was awarded to Muhammad Yunus and the Grameen Bank, marking microfinance's most prestigious accolade thus far.

However, the success of microfinance has been contradicted by intense criticism in the current literature, particularly regarding loan repayment, high interest rates, exploitation of women borrowers, ineffective microfinance provision to target groups, unchanging levels of poverty and failure to cater effectively to the target groups (Holt, 1994; Dignard and Havet, 1995; Christen, 1997; Mallick, 2002; Brau and Woller, 2004).

Based on our recent field-research on microfinance institutions (MFIs) in Bangladesh, this paper empirically examine the above criticisms and analyse the role of microcredit in promoting rural livelihoods in the country. The article is based on field-studies we have carried out in a village in central Bangladesh by applying participatory methodological techniques in two different phases; the most recent one in December 2007 and earlier in July 2005. Based on our literature review, section 2 presents a theoretical overview on the dynamics and drawbacks of microcredit practice in international development. Section 3 presents our case-study findings from the studied village in Bangladesh. The section also describes the research context and shed lights on methodologies. Finally, based on the findings, section 4 presents our main observations with concluding remarks.

2. Success or failure? Microcredit from a theoretical perspective

It has been stated above that despite many accolades, arguments lauding the success of microfinance initiatives have been countered by heavy criticism regarding exploitation of women, inability to effectively cater to target groups, unchanging poverty levels, high interest rates and loan repayment (Holt, 1994; Dignard and Havet, 1995; Christen, 1997;

Mallick, 2002; Brau and Woller, 2004). Chief among these issues is loan repayment. Before going to empirically examine the above criticisms and present our research findings in section 3, theoretically this section will shed light on these arguments.

2.1. Analysis of major criticisms

Very poor individuals are often described as high risk due to their lack of collateral and unstable sources of income and hence timely repayment of loans is often not anticipated. Holt (1994) and Christen (1997) cite loan repayment as one of the major challenges to microfinance, particularly in the Caribbean context, for example, given that a poor repayment culture has plagued numerous microfinance initiatives within the region (von Stauffenberg, 2000; Lashley, 2004). Dignard and Havet (1995) and ASA (1997) propose several causes of default in microcredit, which can be divided into four main categories. These are organisational, household/financial, group dynamics and other factors such as geographical location and environmental degradation. Christen (1997) observes that initially between 1970s and 1980s, the latter three categories were held responsible for high delinquency rates in credit programmes for the poor. However, he suggests that contemporary microfinance programmes have countered this view by demonstrating that the responsibility essentially relies upon factors within the control of the lending institution, that is, organisational factors such as staff inefficiency and skill as well as clear communication of repayment expectations. Despite the various factors influencing default in microcredit programmes, the current literature generally concedes that high repayment rates are a common feature of most microcredit programmes (Dignard and Havet, 1995; Brau and Woller, 2004).

However, Deheija *et al*. (2005: 6) observe that ‘high repayment rates are insufficient to drive the microfinance revolution’. Consequently, they identify high interest rates as necessary for generation of profitability, in order to ensure reduced reliance of microfinance institutions (MFIs) on external funding. This is confirmed by Mallick (2002) who observes that the interest rate on income-generating loans is 20 percent, which is notably higher than the eight to 10 percent rates offered by Bangladeshi commercial banks. In addition, studies by Deheija *et al*. (2005) emphasise that the poor are extremely sensitive to increases in interest rates which results in a reduced demand for financial services among this group. However, it is also acknowledged that, despite the detrimental effects of changes in interest rate, the actual rates themselves are substantially lower than those of the rural traditional money lender, which as confirmed by Hossain (2002) may range from 100 to 150 percent. This latter point is supported by Moll (2005) who expounds that the high rates are due to transaction costs incurred as a result of risk of lending to the poor, as well as information costs incurred in establishing the ability and the willingness of the borrower to repay. He concurs that despite the necessary additional cost, the rates are still competitive and therefore attractive to clients of MFIs. It is worth noting that in recent years many of the Bangladeshi MFIs (former NGOs) have been able to ensure their financial and operational sustainability and reduce their foreign-aid dependency with the relatively high interest rates they charge from their clients.

Failure to eliminate global poverty levels is another major criticism of microfinance. As stated by Morduch and Haley (2002), Moll (2005) and CGAP (2003b), microfinance is firmly associated with the Millennium Development Goals of poverty eradication. Mallick (2002: 162) questions the effectiveness of microfinance in this aspect and insists that poverty levels have not decreased in Bangladesh. Hossain (2002) refutes this claim by emphasising the fact that despite its various limitations like many other rural development models, the strength and success of microfinance cannot be ignored. This is confirmed by Yunus (2001) who reiterates that the Grameen borrower has experienced increased income with one third of the very poor escaping poverty. Newaz's (2001) empirical research confirms that microcredit truly empowers disadvantaged rural women. Therefore, Hossain (2002) suggests that rather than reduce the use of microfinance on the basis of the deficiencies outlined, these drawbacks of microfinance should instead be incorporated into its improvement. Although, as argued by Mallick (2002), poverty cannot be single-handedly alleviated by microfinance, it does play a large role in poverty reduction. In August 2005, an independent field research with the Grameen Bank borrowers in north-eastern Mymensingh district in Bangladesh we found that with Grameen microcredit, village women are making remarkable progress in their livelihoods. In a recent study on socio-economic impact of microfinance in South Africa, Hietalahti and Linden (2006) also reported that marginalised rural communities are greatly benefiting from microcredit. The Nobel Foundation (2006) advocates the use of microcredit in addition to all other initiatives, arguing that microcredit enhances their usefulness. As Potts (2002: 352) argues, 'it is unfortunate if a flexible and useful toolkit is completely discarded because some of the tools in the kit are difficult to use. What is needed is to use the appropriate tools at the right time and in the right places.'

3. Research context and field study findings from Bangladesh

3.1. Research context and methodologies

The main objective of this paper is to empirically examine the above theoretical claims on microcredit with regards to high interest rates, unchanging poverty levels and failure to cater effectively to the target groups in a Bangladeshi context. Exploitation of women and failure to cater effectively to target groups will also be discussed during the course of the case study.

The field research was conducted among the Grameen Bank borrowers in a local village in Madaripur sub-district in central Bangladesh. The study was carried out into two different phases – with the most recent one in December 2007 and an earlier component in July 2005. Participatory methodological techniques were used while conducting this study among the microcredit borrowers. Formal and informal interviews were also conducted with Grameen Bank's local branch officials and fieldworkers as a means of collecting information on their credit operations. At the time of our most recent field-visit in December 2007, the local Grameen Bank branch was found to have disbursed BDT 1500,000.00 among 255 borrowers (Shah, 2007). An excess of more than 100 Grameen Bank borrowers in the village participated in four different group discussions. Also included were borrowers of other MFIs (ASA, Proshika, Bangladesh Rural Advancement Committee [BRAC] and Islami Bank Bangladesh Ltd). In some occasions, male members of the family were discussed and interviewed separately in order that the female borrowers could share their opinion freely with the research team. Finally, relevant local government officials and elected authorities were interviewed and achieved data and relevant information were also verified with them. It should be noted the studied area is one of the more disadvantaged villages in the region and has been plagued by deficiencies in food, education and healthcare. However, standards of road communication in the village were found to be relatively better than other parts of the sub-district.

3.2. Highlights on main field-research findings

In our discussions with the Grameen Bank officials and field workers, it was revealed that the average interest rate for business loans is 10% with an additional 10% service charge, resulting in a total of 20% (Baiddya, 2007; Biswas, 2007). As previously outlined, it is this very 20% interest rate that has been discussed and presented by various academics, politicians, religious leaders via differing perspectives, thus generating heated debate in recent literature (Mallick, 2002) about the high actual interest rates. In some cases, it was found that even the borrowers themselves are unclear about the actual interest rates they are paying for their loan. The following box therefore presents a practical view of the operation of the interest rate and microcredit loan system:

Box 1: A glimpse into the microcredit loan system in Bangladesh

A.	Borrower 'A' receives a sum of BDT 5,000.00 as business loan from a MFI in Bangladesh.
B.	Borrower 'A' has to repay BDT 135.00 every week on an 'installment' basis to the MFI.
C.	Altogether borrower 'A' pays 46 'weekly installments' in 46 weeks' time and the entire sum of the loan is paid and the deal is closed (until borrower 'A' receives another loan from the MFI).
D.	All in all borrower 'A' receives BDT 5,000.00 as business loan for 46 weeks and repays a total of BDT 6,210.00 to the MFI.

Source: Developed by the authors with information from Grameen Bank officials and borrowers.

In a recent study by Knight (2007), it was observed that the interest rate is often dependent on the purpose of the loan. Interest rates have been lowered for particular initiatives such as education, agriculture and housing or mortgage, as well as those which encourage productivity and help the poor to obtain access to the basic necessities of life. This has been confirmed by our research which reveals that the Grameen Bank also provides interest-free housing loans, educational loans and scholarships for children of their clients. There are some circumstances, however, in which understandably, these rates would rise. For example, in provision of collateral-free loans to the poor, can one consider personal investments and funding for a wedding to be basic necessities? This highlights the importance of appropriateness of initiatives to the achievement of the objectives, of which poverty alleviation is the priority. Finally, one should consider that in a trade-off between a commercial bank which offers low interest rates and a 'client-owned' MFI with higher interest rates, the latter may prevail as the more preferred alternative in its opportunity for accommodating empowerment and autonomy of the poor. Therefore, despite various claims and criticisms about the interest rates, our research found that the borrowers are satisfied with the interest rates and the benefit and care they receive from Grameen Bank and other MFIs (Shah, 2007).

Yunus (The Nobel Foundation, 2006) maintains that the high repayment rate which was present in the initial stages of his microcredit pilot programme is still in force today at 99 percent. This is enforced by group lending which incorporates peer selection among the lending group (Ghatak, 1999 cited in Brau and Woller, 2004) while increasing social collateral and reducing risk and cost per borrower (Berenbach and Guzman, 1994). According to our study, despite all economic difficulties among the Grameen Bank borrowers, effective loan repayment is considered to be a matter of urgency among the clients. This does not indicate that they were pressured by the Bank, but reveals, rather, their consideration of loan repayment as a sign of their own responsibility. It is also important to note that at various times, business and other agricultural investments of the borrowers suffer with natural calamities (flood, cyclones, drought, etc) and other forms of uncertainty (political instability, general strike, market uncertainty, etc). For example, in December 2007, it was found that Grameen Bank and other MFIs temporarily stopped collecting the weekly installments from their borrowers (Shah, 2007). This is due to the fact that most of their borrowers in the studied village were seriously affected by a cyclone on 16 November 2007. This form of social responsibility by the local MFIs was deeply appreciated by their clients.

Our findings regarding the influence of microfinance on poverty levels are consistent with aforementioned studies in their observation that the level and nature of poverty in Bangladesh has been changing over the years. It should be noted while Bangladesh gained her independence from West Pakistan in 1971, the country struggled for a long period of time to reconstruct its war-affected infrastructure and economy. Despite the political unrest and natural calamities, the socio-economic progress the country has made since its independence cannot reasonably be overlooked. While conducting this study we have made a time-trend-analysis with the local clients of Grameen and other MFIs. It was surprising to observe that all of them feel that despite many existing problems, their current socio-economic condition is much better than previously. Certainly over the years various NGOs and MFIs have been found to make a significant contribution to uplift the socio-economic condition of the poor and disadvantaged communities.

3.3. Who is microfinance intending to reach?

These discussions on the role of microfinance in poverty eradication lead us to question whether microfinance effectively caters for its target groups. Brau and Woller (2004) outline two main issues in client targeting. These are gender targeting and poverty targeting. For example in the Caribbean context, Lashley (2004) highlights the severe absence of targeting of the rural, young and female, despite the fact that these three areas are the specific characteristics of poverty in the region.

Gender targeting involves offering loans to women as opposed to men. The use of microfinance in promoting financial and social empowerment of women has been a source of heavy debate throughout the current literature, with the Nobel Foundation (2006) outlining that 97 percent of the clients of Grameen Bank are female. Chowdhury (2001) draws attention to the longer life span of women and their greater focus on their families as the means by which emphasis on women can promote social development. Dignard and Havet (1995), however, highlight the difficulty encountered by women seeking loans, citing patronising attitudes by bank employees as a major deterrent. This is confirmed by Mallick (2002), who also argues that access to financial services, rather than increasing the status of women, serves to achieve the opposite by encouraging gender conflict, discrimination, and humiliation by male bank workers and domestic abuse by their spouses. He observes that the Grameen Banking system in particular, focuses on women as a means of social coercion where men often use corporate punishment in order to ensure compliance. In addition, he notes that extended bank meetings may delay or prevent women from meeting their usual household responsibilities such as preparation of dinner, sometimes resulting in physical abuse. However, Hossain (2002) questions the logic that a venture that causes an increase in income for the entire family would be directly responsible for such issues and that if so, the Grameen Bank should accept responsibility. He also highlights the possibility that even in the absence of the Grameen Bank, domestic abuse and gender conflict might still exist. In addition, Agarwal (1994 in Mallick, 2002) and Kabeer (1998 in Ahmad, 2001) describe a marked decrease in domestic violence subsequent to joining the Grameen Bank, as a result of increased respect. Finally, quantitative and qualitative evidence provided by Osmani (2007) and Amin *et al*. (1998 in Brau and Woller, 2004) shows that membership in microfinance programmes is directly proportional to empowerment by women.

Mallick (2002) further suggests that the role of women in microfinance is simply as an intermediary for loans to men, as a means of reducing the threat of physical violence by men when pressured by bank workers to make repayments. This, however, is countered by Newaz (2003) who advocates the effectiveness of microfinance in facilitating empowerment of women by creating prestige and rural social support systems for women, in terms of fulfilling societal, familial and practical responsibilities. Hossain (2002) also observes that the improved status of women over the last three decades has been illustrated by a significant increase in the number of female workers in banking, education, garment manufacturing and other service sectors as a result of microfinance initiatives. This observation suggests that with expansion of the microcredit field, the role of women in society has in fact become much less limited.

Another criticism of microfinance programmes is the apparent hesitation of banks to hire women as bank employees (Mallick, 2002). However, the soundness of this argument is weakened by the defence by Yunus and Jolin (1999) that female workers are more susceptible to attacks by villagers and others and may even encounter pressure by family to resign due to the frequently vulnerable nature of their job in walking unaccompanied through several villages. It is argued that these issues, rather than institutional gender discrimination associated with banks, which create difficulty in hiring and retaining female bank workers. Finally, one of the most effective and glaring illustrations of the true impact of microfinance on the livelihoods on today's poor women was in the joint acceptance of the Nobel Peace Prize 2006 by Muhammad Yunus and '*nine proud women from the villages of Bangladesh*' (The Nobel Foundation, 2006).

In discussions with the clients, research found no evidence that Grameen microcredit is involved in the exploitation of women borrowers. Rather among MFI clients, we observed harmony and good understanding between female and male members of the family and local community. Women were found to discuss freely the current challenges in their livelihoods and the benefit they receive by becoming MFI borrowers. It is visible that the 'emancipatory' approach practiced by the MFIs has really empowered the local women who would have easily been forgotten by other forms of developmental initiatives by the government or by the private sector. The fieldworkers with whom the borrowers really deal were also found to be very kind, friendly and sensitive to local needs and very insightful into the local culture. No evidence suggests that these fieldworkers were brutal with their clients in repayment practices. As a matter of fact, one of the interviewed Grameen fieldworkers (Biswas, 2007) mentioned 'we [fieldworkers] also come from a poor background and in the past our families also benefited from Grameen Bank. How can we be brutal with the people like ourselves?'

This discussion now focuses on poverty targeting, which has been equally debated throughout the literature and involves lending to the very poor and poor as opposed to the marginally poor and non-poor. Both Moll (2005) and Brau and Woller (2004) draw attention to the trade-off in MFIs between financial sustainability and the range of their client base, suggesting that the poorer clients are usually excluded in the process. In contrast, Yunus (2001) argues that many of the poor have crossed the poverty line as a direct result of their membership of the Grameen Bank. Nonetheless, if those in this category remain Grameen borrowers after escaping poverty, then the question remains as to whether it is really targeting all of the poor. This is echoed by Ahmad (2001) who suggests that the less poor benefit more from microfinance initiatives than do the poorest, if the latter do at all. Studies of Bolivian MFIs by Navajas *et al*. (2000) confirm that while the majority of the clients were near the poverty line, they did not represent the poorest of the population with Mallick (2002) arguing that even the well-off have received loans meant to help the poorest. However, increased emphasis on providing microfinance to those who really need it has recently been demonstrated by the Nobel Foundation (2006) which highlights that the target group of microfinance initiatives now extends even to beggars, who can now receive interest-free loans of approximately

US$12, with the amounts and the timing of repayments at their discretion. Thus, these initiatives have enabled 5000 beggars to discard this lifestyle.

Despite various shortcomings, most of the MFIs in our study have consistently been concentrating their efforts to provide welfare to the target groups. Our field research found that women, minorities and disadvantaged members of the community benefit most from the microcredit initiatives. It should be noted that MFIs are not developed to help the middle, upper-middle and higher classes of Bangladeshi society. All of the Grameen Bank borrowers that participated in our research came from the poorer segment of the society and it is appropriate for MFIs to keep their consistent focus on this group. Owing to the welfare efforts made by the NGOs and MFIs, today's Bangladeshi society is experiencing a degree of social transformation where the poorer segment of society now has a voice and is effectively participating in social development efforts.

Notably, our research discovered that Islami Bank Bangladesh Ltd., associated with a religious political party and a traditional critic of Grameen Bank, initiated their own microcredit operation in the studied village in 2007. Views from local government authorities also confirmed that MFIs are making valuable contribution to uplift the poor and disadvantaged communities (Mollah, 2007 & 2005; Rahman, 2007; Matin, 2005; Islam, 2005). Recently, the Ministry of Social Welfare and the Directorate of Youth Development of the Government of Bangladesh have incorporated microcredit practice and initiated their microfinance programmes among unemployed and persons with disabilities. However, these initiatives by the Government are in its initial stage and far limited compared to the microcredit operations by established MFIs in the country (Rahman, 2007). These steps are nonetheless encouraging, given the huge potential and demand for the implementation of socio-economic initiatives in such disadvantaged communities.

Finally, our research presents further evidence of what makes Grameen Bank different from other banks and MFIs who operate microcredit with the poor. Grameen microcredit monitoring approach offers a micro-insurance against a nominal yearly fee from its borrowers. In the event that the investment of the borrowers face proven loss (natural catastrophes, death, etc), the credit gets automatically written off. If a borrower or her/his partner dies, the husband/wife of the deceased partner gets a sum from the Bank as funeral expenditure (Shah, 2007). All these poverty focused welfare support systems show a sign of commitment by the Bank and definitely strengthen the bond and sense of moral and social responsibility between Grameen and her borrowers. The views expressed from within the circle of the poor borrowers have indicated a high relevance of microcredit to sustainable livelihoods within the village, which is a positive reflection of the effectiveness of the microcredit system.

4. Concluding observations

Poverty is not created by poor people. It has been created and sustained by the economic and social system that we have designed for ourselves; the institutions and concepts that make up that system; the policies that we pursue (The Nobel Foundation, 2006). Given that the work of Grameen Bank and other MFIs serves as a local response to global poverty, it is unsurprising that there exist inconsistencies between the works of various MFIs in various parts of the world. As a pioneer institution, the Grameen microcredit model has been generalised by academics and practitioners and received positive and negative feedback. Consequently, considering that remarks about the work of Grameen Bank usually influence the policy discourses of various international financial institutions and official donor agencies, it is both important and appropriate to present empirical observations and views from the target groups, in order to avoid such (mis-) generalisations.

This research found Grameen microfinance model to be an effective model of financing for the poor and disadvantaged. This study did not observe any particular challenges with regards to high interest rates, exploitation of women, loan repayment, unchanging poverty levels and failure to cater effectively to the target groups. Rather, our observations suggest that Grameen Bank is silently making a positive difference to poor and their livelihoods. At the same time, the microcredit model is helping various governmental and non-governmental actors to achieve their developmental objectives.

While microfinance methodologies are not faultless, an important consideration is that made by Yunus and Jolin (1999: 171), who remind critics of the following: ‘Micro-credit is not a miracle cure that can eliminate poverty in one fell swoop. But it can end poverty for many and reduce its severity for others. Combined with other innovative programs that unleash people’s potential, micro-credit is an essential tool in our search for a poverty-free world’, a sentiment to which the beneficiaries of microfinance in rural underprivileged and disadvantaged communities worldwide can surely attest.

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Appendix

Interviews

Baiddya, Ashim: Fieldworker, Grameen Bank, Panchkhola Branch, Madaripur. (2007). Personal interview. Madaripur, Bangladesh, 23 December.

Biswas, Pabitra: Fieldworker, Grameen Bank, Panchkhola Branch, Madaripur. (2007). Personal interview. Madaripur, Bangladesh, 23 December.

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Poverty Institute

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Executive Director
Professor Tony Addison

Research Director
Professor Michael Woolcock

Associate Director
Professor David Hulme

Contact:

Brooks World Poverty Institute
The University of Manchester
Humanities Bridgeford Street
Building
Oxford Road
Manchester
M13 9PL
United Kingdom

Email: bwpi@manchester.ac.uk

www.manchester.ac.uk/bwpi

The Brooks World Poverty Institute (BWPI) creates and shares knowledge to help end global poverty.

BWPI is multidisciplinary, researching poverty in both the rich and poor worlds.

Our aim is to better understand why people are poor, what keeps them trapped in poverty and how they can be helped - drawing upon the very best international practice in research and policy making.

The Brooks World Poverty Institute is chaired by Nobel Laureate, Professor Joseph E. Stiglitz.

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