THE FATE OF MICROFINANCE INSTITUTIONS AS A DEVELOPMENT STRATEGY

By

CHLOE WALCZAK

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Approved by:

Kathleen Schwartzman

Dr. Kathleen Schwartzman
Department of Sociology

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Abstract

Microfinance is commonly used as a development strategy to help alleviate poverty across the globe. Microfinance has become more widespread and popular in the past decade, particularly in Latin America. This thesis outlines several variables of microfinance and how these variables affect the sustainability of microfinance institutions. The variables of microfinance analyzed in this thesis are: loan conditions, level of competition, type of microfinance institution, country, outreach, and gender. A meta-analysis study in the form of a literature review was performed in order to assess the relationship between each of these variables and the sustainability of microfinance institutions. The analysis concludes that the type of microfinance institution, specifically retail banks, is intimately linked to the sustainability of microfinance institutions in Latin America.

I. Introduction

Many development strategies have been implemented in developing countries to combat poverty and improve the livelihoods of the marginalized population. One development strategy that has increased in popularity and scale across the globe is microfinance. Microfinance is a relatively new development strategy, created by Muhammad Yunus in 1976 in Bangladesh. Yunus's goal was to provide financial services, specifically loans, to low-income clients in Bangladesh through developing a microfinance model. As microfinance became more popular and successful in Bangladesh, other individuals and NGOs across the world turned to this development strategy to alleviate poverty within their own countries.

The microfinance movement has changed the way development strategists view economic issues and solutions for developing nations. This movement has opened up a new market of microfinance institutions, MFIs, which are dedicated to administering and managing small loans for the working class in many developing nations. By 2011, it was estimated that there were microfinance institutions in over 100 countries are supplying small loans to over 92 million people across the globe (Microfinance Information Exchange 2012).

In recent years, one area of the world that has witnessed a flourish of microfinance institutions is Latin America. MFIs in Latin America range from non-governmental organizations to national banks that supply small loans to both urban and rural populations (Lapenu and Zeller 2002). While every MFI in Latin America's main objective is to supply small loans for local populations, each MFI has its own unique structure of administering these loans.

One of the Millennium Development Goals (MDGs) for 2015, is to decrease the percent of people living in poverty throughout the world by half. If achieved, this Millennium

Development Goal would help 100 million people out of poverty. In order to fulfill this goal, many have turned to microfinance as a solution to eradicate poverty in developing nations. However, as we are quickly approaching the year 2015, it is evident that many of the MDGs have not, and will not, be achieved. Specifically, the UN's objective to decrease worldwide poverty by half has fallen short (Fehr 1).

Although many people have viewed microfinance as a successful development strategy, some analysts are hesitant to endorse the microfinance movement. Many argue that the long-term benefits of microfinance to its clients are miniscule. Other analysts simply express that there is not enough evidence or conclusive research to demonstrate that the microfinance model is a truly sustainable development strategy.

This paper serves to address why MFIs are not living up to their expectations as successful solutions for poverty relief. Additionally, this paper serves to address not only the pitfalls of MFIs, but also assess the positive aspects that should be strengthened to make MFIs more efficient. This paper will accomplish this through assessing the variables of MFIs most frequently identified by researchers, which include: loan conditions, level of MFI competition, MFI type, country, outreach, and gender.

II. The Efficacy of Microfinance

Porfiria, a 26-year old Bolivian mother of three children, is an active microfinance loaner with the Kiva Organization. Porfiria makes a living by crafting and selling cholita hats in the city of El Alto, Bolivia. The father of Porfiria's children is no longer in the picture, so Porfiria is dependent on her hat sales to make ends meet for her family. Through her previous loan from Kiva, Porfiria successfully managed her money and utilized it to buy more supplies to craft her traditional hats. As a result, Porfiria's profit hit an all time high, allowing her to expand her business and income. Porfiria successfully paid back every penny of her first loan and is now requesting another loan to purchase a sewing machine that will allow her to maximize her production. Porfiria knows that if she can reach more customers, she will make more profit, which she will be able to provide her children with access to education, nutritional food, and an overall improved standard of living (Ginny 2013).

While some people in Latin America benefit from the microfinance development strategy, this is not true for all MFI borrowers. In recent years, studies have revealed that certain MFIs are scamming their borrowers and unfairly making profit off of the poor population that they serve. For example, the Mexican MFI entitled Compartamos has been known to charge up to a 195% annual interest rate on the loans its borrowers take out (Microfinance in Latin America).

Some MFIs such as CRECER in Bolivia strive to provide fair loans to the rural population but have negative impacts. CRECER has worked with the female population in the town of Luribay, Bolivia to provide them with group loans that can be used to assist them in their business pursuits. However, many women have taken on large loans that they cannot repay during the bi-weekly meetings they have with their fellow group loan members. These women have been forced to turn to family and friends as outlets for repayment on loans, making members indebted to other community members. While the microfinance loans have granted the women of Luribay financial independence and responsibility, they often default on their loans and cannot afford the repayment plans imposed on them.

CRECER's attempt to greatly improve the livelihoods of these women has backfired and exemplifies how microfinance loans can result in failed attempts of development strategies. These two stories mentioned reflect the range of MFI outcomes. To address this question, I first review the literature on MFIs and then analyze the research results, looking for indicators of success.

III. Methodology

Evaluation studies focus on a set of variables that appear crucial to the success and sustainability of MFIs. As mentioned, these include: loan conditions, level of MFI competition, MFI type, country, outreach, and gender. The literature reviewed is a compilation of data from several sources. The primary sources include organizations such as Mix Market, the World Bank, and USAID that possess available databases with access to statistics and facts about microfinance. Other organizations with databases that were reviewed are NGOs, such as ProMujer. In addition, case studies and articles presented by researchers and analysts contributed to the literature reviewed in this paper.

The literature reviewed in this paper span from 1997 to 2012. This paper focuses on current data of MFIs in Latin America in order to address the current obstacles and accomplishments of MFIs. The goals, challenges, and organization of MFIs in Latin America are changing on a frequent basis. Therefore, this paper evaluates recently published data and research in order to ensure a contemporary analysis of the sustainability of MFIs in Latin America.

This is a meta-analysis study of microfinance in Latin America. I analyze the results of individual research projects to understand the effectiveness or ineffectiveness of certain MFIs in Latin America. Merriam-Webster defines meta-analysis as “A quantitative statistical analysis of several separate but similar experiments or studies in order to test the pooled data for statistical significance” (Merriam-Webster 1976). Henceforth, the variables of MFIs discussed in this paper will be dissected through an evaluation of studies and statistics generated by MFI researchers.

The region of Latin America was selected for this meta-analysis study because the microfinance development movement has rapidly increased in Latin America over the past decade. As microfinance continues to expand in the region, we must critically analyze its long-term benefits and setbacks in order to evaluate whether or not microfinance is an effective development strategy in Latin America.

In order to have a conclusive analysis across the board for all MFIs in Latin America, a standard measurement of success must be establish. For the purpose of this analysis, success will be defined as the financial sustainability of MFIs. This unit of measurement was selected because it is one of the most common measurements assessed in data, articles, and research on MFIs. Additionally, many argue that financial sustainability of a MFI is positively correlated to the improvement of livelihoods of borrowers as well as the level of outreach of a MFI.

IV. Literature Review

a. Loan Conditions

MFIs lend to both individuals and groups. One element of microfinance that has been implemented in many MFIs is group lending. Group lending is a type of lending that allows a group of individuals to take out loans and use them for a common goal or project. Many of these groups consist of individuals in cooperatives or groups who want to establish a community business, such as coffee production or textile production. These individuals collaborate together to utilize loans for their business pursuits and are thereby all responsible for paying back the loan in a group effort with the profits they have made.

There are several models for group lending: joint liability, individual liability group lending, and village banking. Under joint liability, a group of people organize themselves to take out individual loans but share the responsibility of ensuring that every loan that each member of the group takes out is repaid. Individual liability group lending is similar to joint liability in the sense that each member of the group takes out his or her own loan. However, each member of the group is required to make repayments on his or her loans during regular community meetings (Khavul 61).

The third type of group lending, village banking, establishes a group of community members who take out a loan and then disperse the loan money amongst members. In village banking, certain individuals of the group take on a leadership role of ensuring regular repayments on the loan and that the loan is being allocated to members who are effectively using the capital from the loan. While there exists slight differences amongst the three models for group lending, they all share a common structure. In particular, all three types of group lending utilize peer pressure as a strategy to repay loans (Khavul 62).

Although group loans are the most popular amongst MFIs in Latin America, individual loans are another type of lending mechanism that MFIs provide. In individual lending, the individual is solely responsible for taking out the loan, using it for his or her own business, and paying back the loan in full with his or her own income. Individual lending allows for the conditions of loans to be adapted to the needs of the borrower (Burnett et al. 2).

The differences between individual lending and group lending are vast. For example, MFIs that provide group loans organize their institutions based on standardized loan processes, limited management, and minimum loan assessment. MFIs are structured in this manner because members of group loans are held responsible for managing and monitoring loans (Burnett et al. 1). Under the group lending model, MFIs rely on joint liability and social pressure as incentives for individuals to repay their share of the loans (Khavul 60). On the other hand, individual lending focuses more on the needs and desires of the individual as well as utilizing collateral and co-signers to hold borrowers accountable for paying back their loans (Burnett et al. 2)

MFIs have implemented individual loans into their institutions because they believe formal loans to individuals allow for a wider outreach to clients. MFIs have encouraged more individual lending in order to keep valued clients from straying away from their business by providing these customers with better loans that are tailored to their needs. Additionally, MFIs provide individual loans so that potential clients will be more inclined to take out loans from that bank (Burnett et al. 1).

However, individual lending does have its setbacks if it is not handled properly by MFIs. For example, individual loans must be analyzed through market research and customer analysis to guarantee that individual borrowers are benefitting from the loan (Burnett et al. 9). Additionally, individual lending should include planning, testing, and evaluation to comprehend the clients and ensure the quality of loans (Burnett et al. 77). Individual lending requires a much more hands on relationship between MFIs and individuals because MFIs are the primary actors in offering loans and holding clients accountable for repayment on their loans.

On the other hand, many scholars believe group lending is the most effective approach in providing loans to the poor. Scholars argue that group lending provides social ties amongst group members, causing clients to face pressure amongst their peers to repay loans in a timely manner. Additionally, peer monitoring provides a more effective performance amongst members because they are interconnected through loans and are all facing similar challenges. Group members have can communicate with other individuals who are receiving loans and can utilize each other as resources to maximize the sustainability and effectiveness of their loans (Luoto, Wydick, and McIntosh 463).

Due to borrowers strong reaction to peer pressure, repayments on loans are much quicker and more effective than in the individual lending model. MFIs that witness this faster return on loans usually lower the interest rate on loans and decrease access to more risky borrowers. As a result, MFIs are inclined to promote group loans to clients, therefore making group lending the most widespread model of microfinance in Latin America and the rest of the world (Luoto, Wydick, and McIntosh 464).

One example of the group lending model in Latin America can be seen from the MFI called FUNDAP. FUNDAP is based in Western Guatemala and provides group loans for its borrowers. FUNDAP focuses on the joint liability approach to managing its group loans, which means group members are jointly liable for the repayment of loans (Luoto, Wydick, and McIntosh 465). As previously mentioned, joint liability makes group members accountable for the repayments of all loans, not just their own loan, which increases peer pressure to repay these loans. In the case of FUNDAP, the repayment rate is extremely high at 97%, making FUNDAP a strong self-sufficient MFI. FUNDAP provides an example of how group lending is most effective with peer monitoring and can be utilized to benefit not only the borrowers but also the MFIs sustainability and profitability (471).

Moreover, group lending allows for wider outreach because it allows people who cannot provide collateral for individual loans to participate in group loaning (Ghatak 28). In general, MFIs do not require borrowers to provide collateral for group loans because peer pressure is a successful strategy for repayment on loans. While group lending is utilized in both urban and rural settings, researchers have noticed that group lending is most efficient in rural areas. Strong social ties community members have amongst one another, resulting in a more effective response to peer pressure and monitoring of group loans (46).

Group lending does have setbacks. MFIs must pay attention to the backgrounds and community structure of their clientele in order to make group loans truly effective. For instance, group members must have close social ties to one another or they will not respond to the peer pressure imposed on them to repay their loans. Social sanctions must be strong so that group members do not default on repaying their loans (Bhole and Ogden 348). MFIs should first assess the background of the group members who are seeking to receive a loan. If the group appears to have close social connections to one another, then the repayment rate on the loan is likely to be high. As previously mentioned, another factor to take into consideration when screening potential group borrowers is if they come from rural settings because social ties are generally stronger amongst this population compared to the urban population (349).

While there exists benefits and setbacks for both individual lending and group lending, there still remains the question of which of these two lending types is most beneficial in Latin America. Based on the analysis of articles and research presented on group and individual lending, the majority of scholars point to group lending as the most efficient and sustainable type of lending for MFIs in Latin America. Group lending provides borrowers with a stronger sense of credibility and responsibility for repaying their loans to MFIs. High rates of response to peer pressure amongst borrowers, especially borrowers of rural communities, create an increased repayment rate. Additionally, as Ghatak mentions in his research, group lending expands outreach. Unlike individual lending, group lending does not rely on using collateral as a way to ensure that borrowers will repay loans. Group lending grants the poor population access to take out loans without forcing them to give collateral that they cannot provide, thus expanding the level of outreach within MFIs. The pros and cons of group lending and individual lending in regards to MFIs' sustainability outlined by these authors are located summarized in Table 1.1.

TABLE 1.1

Author (s)	Group vs. Individual lending	Positive	Negative
Khavul	Group lending	Community members jointly responsible for repayments.	Dependent on peer pressure for repayment on loans.
Burnett et al.	Individual lending	Conditions of loans can be altered from person to person to fit their needs.	Need to have more development and organization of individual lending to ensure its success.
Luoto, McIntosh, & Wydick	Group lending	Strengthens social ties, increases repayment on loans, and increases profit of MFIs	Must take place in communities with strong response to peer pressure or some members will fall back on loans, leaving everyone else with the burden to repay their share of loan.
Ghatak	Group lending	Expands outreach	Most effective in rural areas and amongst tight-knit community members.
Bhole and Ogden	Group lending	Beneficial for MFIs because repayment rates are high and they allow community members to share financial responsibility.	MFIs need to have thorough concept of a community's organization and society to ensure successful implementation of group lending.

b. Level of MFI Competition

MFIs in Latin America are becoming more popular for both borrowers and lenders. Banks and private institutions have witnessed the high returns and profits made by MFIs in Latin America and have decided to enter into the market and establish new MFIs in Latin America. As more and more institutions are entering into the microfinance sector, competition is increasing. Competition in any economic sector can cause positive effects, such as increasing efficiency. On the other hand, competition can also create negative changes, such as limiting access to a small clientele size. It is critical to analyze the role of MFI competition in the sustainability of MFIs. This analysis is important to understand whether or not competition is a significant variable in determining the sustainability of MFIs.

Many argue that commercialization is necessary to ensure the best financial services to the poor (Christen and Drake 1). Others argue that implementing profit into microfinance causes MFIs to sway away from their commitment to the very poor (1). The introduction of competition into the microfinance world means the beginning of a market driven practice. Traditionally, creation of markets is associated with an array of benefits, such as a sustainability and efficiency. Therefore, the creation of competition is encouraged amongst economists so MFIs can have the absolute highest level of productivity within MFIs (2).

However, too much competition amongst MFIs can be negative, as can be seen in Bolivia. The increased competition in Bolivia has created an increase in indebted clients. Borrowers now have access to multiple MFIs and can take out numerous loans, but they often cannot repay all of these loans. As a result, the performance of MFIs has been marginalized. MFIs are finding it hard to become financially sustainable because the repayment rates are low, meaning that profit is low (Christen and Drake 2).

Competitions also leads to a decrease in outreach. In Latin America, large markets have failed to provide loans to the poor populations. As CGAP demonstrated in a review of microfinance in 2001, “90 percent of current microcredit clients in Latin America live in countries representing only 31 percent of potential demand” (CGAP 3). Only a small percentage of people who have a demand for microfinance loans are actually receiving access to these loans. CGAP argues that the barriers to entry in a competitive market make MFIs less inclined to expand their outreach while simultaneously making access to enter the market harder for MFIs who want to expand outreach (3).

Despite arguments against commercialization, the number of MFIs in Latin America has greatly increased in the past decade and continues to be on the rise. Banks and other organizations enter into microfinance market with hopes of gaining profit through lending loans to the local population. As long as the microfinance market continues to produce profit for MFIs, commercialization will continue to grow.

In relation to competition, retail banks are becoming more dominant in certain microfinance markets. One example can be seen in Paraguay, where retail banks are taking over NGOs as the most popular and numerous MFIs in the nation (Christen and Drake 9). NGOs have realized the need to adapt to these changes in the microfinance market. NGOs are responding to these market changes by transforming into competitive retail banks. Consequently, NGOs have to alter their goals in order to keep up with the competition amongst other MFIs surrounding them (12).

Christen and Drake argue neither in favor or opposition of competition. The researchers do argue that commercialization of microfinance may cause MFIs to become more efficient and organized by adapting a business model approach within their institutions (17). MFIs involved in a competitive market must adapt to become more sustainable and efficient. If these MFIs fail to do so, they will not survive.

In contrast to Christen and Drake, Luoto, McIntosh and Wydick argue competition is harmful to borrowers of MFIs. Competition is negative because it leads to elimination of access to loans for the poorest borrowers (2). On a similar note, Olsen states that increased competition causes MFIs to "scale up" their services in order to attract wealthier borrowers who will take out larger loans. MFIs who decide to scale up are turning away from targeting the poorest borrowers because this clientele requires more staff attention and services from MFIs (506). Additionally, the poorest borrowers take out smaller loans than wealthier borrowers because they cannot afford to pay back larger loans in a timely manner. MFIs investors receive a greater return on profit from borrowers taking out larger loans because the capital returned from interest rates will be greater (507). Consequently, MFIs are less inclined to provide loans to poorer borrowers because there do not exist any economic advantages for MFIs by expanding outreach.

The entrance of banks and private companies into the microfinance market has sparked not only greater competition, but has also created a shift in goals of MFIs. When MFIs were first implemented in Latin America, the majority of these institutions were sponsored by NGOs. These NGOs entered into the microfinance sector with the desire to provide fair loans to the poor population. NGOs did not seek profit for these loans, but due to small interest rates and an increase in the number of borrowers, NGOs witnessed some profit from the repayment of loans (Luoto, McIntosh, Wydick 2). Although the majority of these NGOs were using this profit towards strengthening microfinance projects, banks and other private institutions recognized this profit on loans to the poor as a moneymaking investment. As a result, in the past several years, banks and private institutions have entered into the microfinance market for profit-driven incentives (3).

Banks and private institutions acting as MFIs, have goals of financial sustainability, efficiency, and profit. While this can be seen as a negative shift in MFIs, Hermes, Lensink, and Meesters argue that increase competition and entry into the microfinance market can be beneficial (2). These scholars argue that competition can increase commercial funds, increase the amount of funding for loans, and allow MFIs more opportunities to achieve their goals. In the long run, competition can improve the sustainability and efficiency of MFIs through a decrease in interest rates and implementation of new financial services (4).

One example of the positive effects of competition on MFIs can be seen from Compartamos in Mexico. Compartamos was a commercial bank that established itself as a MFI lending to the poor rural population in Mexico (Hermes, Lensink, and Meesters 5). Compartamos first entered the microfinance market because of rising competition of MFIs in Mexico. While Compartamos does receive some profit from providing loans, Compartamos is also one of the few MFIs in Mexico that grants loans to the poor rural population. Compartamos is an example of the positive aspects of commercialization because competition amongst MFIs has allowed Compartamos to supply loans to an otherwise neglected population (5). However, the high interest rates of Compartamos' loans make it difficult for the rural poor to pay back loans and therefore diminish the benefits from microfinance loans that this population receives.

Hermes, Lensink, and Meesters also refer to a MFI in Bolivia, Caja Los Andes, to demonstate how competition can have negative consequences for borrowers. Previous to Caja Los Andes' entrance into the microfinance market, Bancosol, a national bank in Bolivia, was the primary MFI in providing loans to the poor Bolivian population. Due to an increase in demand for microfinance loans, Caja Los Andes decided to enter into the market. Caja Los Andes aimed at offering loans to wealthier borrowers (5). Although Bancosol did not necessarily want to change its target population of borrowers, the bank did not have a choice if it wanted to survive in the newly competitive microfinance market in Bolivia. As a result, Bancosol was forced to alter its lending conditions to fit the framework of Caja Los Andes (6).

The case of Bolivia demonstrates how competition can lead to less access to loans for the poor populations. Another scholar by the name of Brishti Guha demonstrates in his cross-sectional study of 28 Latin American countries that competition of MFIs in Latin America results in reduction of poverty outreach (2). Guha's study concludes that competition amongst MFIs reduces outreach to the most needy, the rural poor. Guha highlights Paraguayan MFIs, stating, "While the poorest clients would need loans of $300, Paraguayan microfinanciers were lending $1,200 and targeting the not so poor" (2). This example from Paraguay demonstrates how the poorest populations are not granted access to microfinance loans because competition has resulted in a marginalization of outreach.

Guha also sampled seventeen MFIs in Latin America to assess outreach. Only two of the seventeen MFIs targeted the very poorest borrowers (2). Guha argues that the effect of competition on outreach is dependent on the level of inequality in a nation. The more inequality a country has, the worse the effects of competition are on the outreach of MFIs (3). The majority of Latin American countries with large concentrations of MFIs have high Gini coefficients, meaning high levels of inequality. For instance, Paraguay and Bolivia have Gini coefficients of approximately 60 (6). Increased competition leads to decreased outreach in MFIs in Latin America.

Table 1.2 demonstrates that the literature reviewed concludes that competition amongst MFIs in Latin America results in an overall negative effect on the outreach of clients. While competition amongst MFIs can have positive effects, such as an increase in innovation, efficiency, and sustainability of MFIs, the high level of inequality in Latin America makes it impossible to create an environment of positive competition. As Olsen states, imperfect competition is rampant in Latin America. Imperfect competition does not only cause a lack of outreach but also creates inefficiency within institutions (507). MFIs in Latin American countries strive under non-competitive markets because they have more opportunities to establish sustainable and reasonable lending conditions without facing mission drift.

TABLE 1.2

Author(s)	Competitive vs. Non-competitive market	Positive	Negative
Christian and Drake	Neutral	Competition allows for expansion of financial services to poor and thereby increases a MFIs profit.	Borrowers can take out multiple loans from many MFIs but cannot repay all of the loans, creating a potentially smaller Return on Assets for MFIs.
CGAP	Non-competitive market	Non-competitive markets make MFIs more inclined to expand outreach.	
Guha	Non-competitive market	Competition leads to decreased outreach. The poorest population does not receive loans.	
Hermes, Lensink, and Meesters	Competitive markets	Competition increases funding, MFIs have better opportunity to achieve goals, increase sustainability, and improve efficiency of MFIs.	Mission drift and increased interest rates in loans by MFIs.

Luoto, McIntosh, and Wydick	Non-competitive markets	Non-competitive markets allow rural poor more access to loans.	MFIs may receive less profit from providing smaller loans to the rural poor.
Olsen	Non-competitive market	Competition causes MFIs to scale up their institutions to target the wealthier borrowers. Non-competitive markets create more outreach to poorer populations.	Competitive markets allow MFIs to increase profit by providing loans to wealthier borrowers who are more likely to repay loans than poorer borrowers, making return on assets and profit higher for MFIs.

c. MFI Type

Microfinance lending is provided by an array of different MFIs, both private and public. MFIs can range from commercial banks to credit unions to NGOs. This paper will address the two most common types of MFIs: NGOs and retail banks (Christen and Drake 3). Retail banks encompass state or national owned banks as well as private banks (7). A recently published study by CGAP demonstrates that retail banks provide the majority of loans for Latin American countries, marking 74% of capital of loans provided to borrowers (4).

Many NGOs, such as the Bolivian NGO entitled PRODEM, have sought to transform their organizations into financial institutions through receiving banking licenses. NGOs have made this transition so they can obtain legal rights to provide loans to the poor and act as self-sufficient MFIs. PRODEM was successful in transforming its NGO status into a non-profit MFI entitled BancolSol. The introduction of BancoSol in Bolivia over two decades ago has caused many other NGOs in Latin America to follow suit and become part of the financial sector while still maintaining their NGO based goals and practices (Christen and Drake 5).

Retail banks acting as MFIs have some advantages compared to NGOs. To begin with, retail banks have experience in managing and allocating loans to clients. Additionally, retail banks' networks and financial sectors within their institution supply them with a multitude of advantages. The overall organization and inner workings of retail banks makes the transition from a retail bank to a MFI fairly hassle free. The obstacles retail banks face when transforming into MFIs are limited compared to those faced by NGOs (Christen and Drake 6). Furthermore, retail banks have a previously established clientele, meaning that have greater access to existing clients as well as potential clients for loans (8). Retail banks have the ability to utilize these advantages and rise as dominant and more profitable MFIs in their local markets (7).

Banco do Nordeste in Brazil provides an example of a successful retail bank in Latin America that supplies microfinance loans to over 65,000 borrowers. Similarly, in Chile, Banestado MicroEmpresas grew faster than any other MFI in Chile between 1996 to 2000. Banestado MicroEmpresas' growth was primarily due to its implementation of its traditional practices as a retail bank, Banco del Estado, such as individual lending and credit scores (Christian and Drake 7). These two MFIs demonstrate how retail banks can rise as competitors in the microfinance sector.

Although retail banks serving as MFIs can be efficient, they also encounter difficulties with adjusting into the microfinance sector. Retail banks often find it difficult to adjust their traditional banking models into the microfinance model. This particular obstacle is due to the corporate mentality that retail banks possess, making it difficult for retail banks to adjust to the shift in culture and market to fit into the microfinance sector (Christen and Drake 8). Additionally, the microfinance market is not as regulated or incentive based as the retail banking market, adding to the obstacles retail banks face when entering in the microfinance sector (8).

Small retail banks are much more adaptable to the microfinance market than large retail banks. This is due to the flexibility of smaller banks to manage and monitor all aspects of their institutions. Similarly, newer banks have fewer problems adjusting into the microfinance market because they are constantly changing and are therefore quicker to respond and adjust to change (Christen and Drake 9).

Christen and Drake demonstrate that while the inspiration NGOs have provided to the microfinance market is beneficial, retail banks are the most successful institutions for managing and allocating microfinance loans. They highlight this argument by pointing to the structure and organization of retail banks as key factors in the success and sustainability of providing loans to clients. Retail banks have the beneficial experience of working with large sums of capital and using a variety of methods, such as interest rates and payment systems, to ensure a maximum return on loans from the borrowers (13). Therefore, the microfinance market in Latin America should be dominated by retail banks acting as MFIs. By doing so, outreach, sustainability, and profit from microfinance lending will all benefit greatly.

One profit-driven MFI that has been controversial in the eyes of microfinance supporters is Banco Compartamos. Banco Compartamos of Mexico, a MFI that provides loans to poor women, witnessed a steady expansion in loan borrowers. Compartamos skyrocketed from 6,000 clients to 800,000 clients between 2000 and 2007 ("Microfinance Meets the Market" Cull, Kunt and Morduch 168). At the time, Compartamos was imposing a 195 percent annual interest rate on the loans taken out by its clients, making the MFI worth $1.6 billion by 2007 (168). Compartamos is one of many MFIs that seeks to make profit through lending to the poor through increasing the number of borrowers and maintaining high interest rates. Consequently, profit-driven MFIs are controversial in the microfinance market and are looked down upon by many international development workers. However, some argue that Comparamos' profit-driven approach has created positive results because its profit has been used to expand its outreach to more clientele in rural and poor areas.

The example of Compartamos demonstrates how the microfinance market is split into two different types of MFIs: for profit institutions and nonprofit institutions. The co-existence of these two types of MFIs with conflicting goals brings up the question of which of these two types of institutions is more efficient and beneficial for lenders. As mentioned in *Microfinance Meets the Market*, for profit MFIs bring positive advancements in terms of outreach and sustainability. Additionally, MFIs receiving profit are able to become self-sufficient and are not dependent on donors or government funding to continue allocating loans. One statistic shows that 60% of borrowers take out loans from profit-making MFIs ("Microfinance Meets the Market" Cull, Kunt and Morduch 178).

Non-profits MFIs, often led by NGOs, are faced with a constant battle of whether or not to conform to the policies and procedures of profit-making institutions, such as retail banks. While profit-driven MFIs have annual interest rates of up to 94% on loans, NGOs on average place only a 25% annual interest rate on loans. While this is great for borrowers, non-profit MFIs receive little return on assets, making it difficult for them to be self-sufficient ("Microfinance Meets the Market" Cull, Kunt and Morduch 182). If non-profit MFIs cannot be self-sufficient without making profit from loans, then what is the solution?

The biggest controversy with profit-making MFIs is not that they are making some profit from providing loans to the poor, but rather the large amounts of profit they are making from these loans. As previously mentioned, Compartamos has a high return on assets due to its excessively high interest rates imposed on borrowers. Compartamos is one of the most profitable

MFIs in Latin America, and as a result, people are questioning the morals and values of this MFI. Moreover, the high profits Compartamos yields means its investors are likely to be businessmen who do not care about providing fair loans to borrowers but rather only want to reap the most profit from Compartamos' borrowers ("Microfinance Meets the Market" Cull, Kunt and Morduch 185). In the end, the authors of *Microfinance Meets the Market* argue that Compartamos demonstrates how MFIs can use the microfinance market to their advantage to become highly profitable institutions that care little about providing fair conditioned loans to its clientele (184).

While Compartamos represents the extreme side of profits that a MFI can receive, many MFIs are making marginal profit on returns that allow them the capital to establish themselves as self-sufficient institutions while expanding on their social missions and goals. The debate of whether non-profit MFIs or profit-making MFIs are best for the microfinance market roots itself in the assessment of what it means to be a "successful" MFI. Many development strategists argue that a successful MFI is one whose primary focus is on outreach, meaning the MFI's main goal is to reach out to the poor and actively engage in improving their livelihoods through providing them loans. Others argue that in order for a MFI to be successful, it must focus primarily on sustainability. This means that a MFI's main goal should be to ensure financial stability and efficiency of the institution (Gutiérrez-Nieto 104).

Although this paper focuses on the latter of the two definitions of sustainability, it is important to recognize that financial sustainability compromises other elements of MFIs. Figure 1 on page 110 (see below) of Gutiérrez-Nieto's *Social Efficiency in Microfinance Institutions* demonstrates how the majority of MFIs do not have a balance between these two types of successes, financial and social efficiency. If a MFI is financially stable, it generally does not pay attention to aspects of social efficiency, such as ensuring outreach to the poor and women, and vice versa for a MFI that is socially efficient (Gutiérrez-Nieto 110). NGOs are more effective in achieving goals of social efficiency where as retail banks acting as MFIs are more successful in ensuring financial sustainability and efficiency (112).

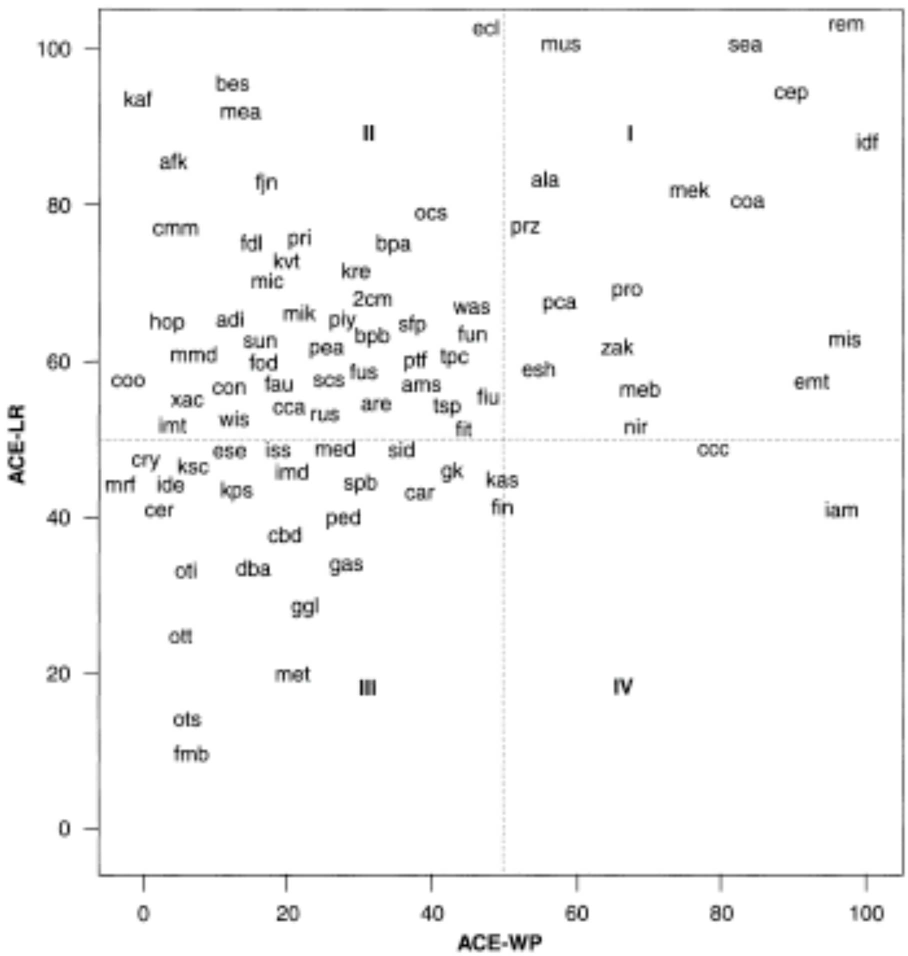


Figure 1 Social efficiency (ACE-WP) *versus* financial efficiency (ACE-LR).

Within Latin America, there are several hundred MFIs that serve approximately 2 million borrowers and make up a loan portfolio of $1.5 billion dollars (Jansson 1). The issue NGO-based MFIs face is that funding from donors and outside sources makes them dependent on multiple investors and binds them to the agreements and regulations formed between them and their donors. Additionally, while donor funding is extensive, donations cannot be relied on as a continuous funding source for the future because donors can back out or decide not to reinvest in MFIs in the future (2). Similarly, dependence on funding from other institutions can lead to a series of traps for MFIs (4). As a result, many MFIs are relying more on funding from the public rather than private donors. For example, in 2002, several MFIs across Latin America decided to expand their funding sources by issuing bonds to domestic investors. As Jansson highlights, “The bonds, whose tenors range from 2 to 3 years, will help these institutions match their assets and liabilities, introduce greater stability in their funding costs, and allow them to expand longer-term lending to their clients. A couple of years earlier, BancoSol in Bolivia successfully launched a $3 million bond program in three separate issues.” (10). The case of BancoSol demonstrates how MFIs are changing to become financially sustainable, often times by means of issuing bonds.

As previously mentioned, if someone believes a successful MFI is one with financial stability, efficiency, and profit, then that person is likely to favor a profit-making MFI. On the other hand, if someone views measuring success in regards to the social performance measurement of a MFI, then non-profit MFIs are the answer. This conclusion signifies that profit-making MFIs and non-profit MFIs vary greatly in terms of their goals and actions. More importantly, the way each type of MFI measures success alters the way that particular MFI manages and monitors loans as well as to which borrowers MFI provides its loans.

Table 1.3 below demonstrates the conclusions drawn from the literature. The table shows that retail banks are the most sustainable, which is the measurement of success used in this paper. Therefore, sustainability of a MFI is dependent on whether or not the MFI is a NGO or retail bank.

TABLE 1.3

Author(s)	NGOs vs. Retail Banks	Positive	Negative
Christian and Drake	Retail banks	Retail banks are already established as financial organizations with banking experience and easy assess to potential clients. They have a history of managing loans to clients. Limited risks compared to NGOs. Fewer obstacles means quicker ability to become sustainable and profitable.	Hard to transform the institutional goals and organization to adjust model to fit microfinance sector.
Cull, Kunt, Morduch	Retail banks	Retail banks expand outreach and sustainability of MFIs. They are not dependent on donors or other sources of funding.	Retail banks impose higher interest rates on loans, making repayment harder for borrowers.
Gutiérrez-Nieto	Retail banks	Retail banks are more financially sustainable than NGOs.	Outreach is low amongst retail banks.
Jannson	Retail banks	Retail banks have higher rates of sustainability.	Outreach is compromised.

d. Country

Microfinance operates primarily in developing that countries have an array of internal issues and challenges. Specifically, developing nations are prone to have inefficient and corrupt governments, disparities amongst social classes, and underdeveloped economies. The environment in which MFIs operate can often be problematic to providing microfinance loans to the local population. Many researchers have analyzed whether or not the internal conditions of a country affect the success and sustainability of MFIs.

Level of political and economic stability in a nation are factors in determining the development of microfinance (Crabb 97). The Latin American countries with the largest number of borrowers and MFIs are: Honduras, Mexico, Uruguay, Colombia Ecuador, and Bolivia. Several of these countries will be analyzed in this section in order to assess how their economic and political stability affect the sustainability of MFIs working in these countries.

One researcher Peter Crabb analyzed the correlation between the economic freedom of countries in which MFIs operate and the sustainability of these MFIs. Crabb's findings demonstrate that the majority of MFIs provide loans in countries that lack economic freedom and mobility (205). Consequently, MFIs seeking sustainability, instead of relying on donations and subsidies, find it difficult to achieve financial independence in countries with limited economic mobility. In addition, countries with restricted economies also possess governments that have control over the economic sector, including banking and resources (205). The power and management that the government has over the economy makes it even harder for MFIs to become financially sustainable because they have to conform to government regulations (205).

Crabb articulates that the inability of MFIs to achieve sustainability in these developing countries has become a huge obstacle because MFIs are now more focused on profit-driven goals, especially sustainability. Financial independence grants MFIs freedom to accomplish other goals without being bound to the conditions of the subsidies or donations they rely on. MFIs that work in nations with limited economic mobility find it difficult to obtain this independence. However, MFIs do not have any other option but to work around these governmental and economic challenges within the host countries in which they operate (207).

Crabb's research concludes that financial sustainability of a MFI is negatively effected by both government intervention and banking. He also argues, "Consistent with the literature, a country with low economic freedom, in terms of role that the government takes in the marketplace, will have trouble sustaining private business operations. A heavy government involvement in financial sector suggests MFIs will have difficulties lending to the poor" (216). Government involvement not only negative affects a MFI's sustainability but it also hinders the outreach of a MFI. MFIs are dependent on the country's economic and political policies and must abide by them. Unfortunately, in many cases this means that MFIs in Latin America cannot achieve financial sustainability due to heavy government involvement in their countries' eonomies (217).

Competition is another component of MFIs that is directly affected by the economic and political variables of the host country. Luoto, McIntosh, and Wydick highlight how credit information systems are utilized by MFIs in order to ensure transparency of their finances. The authors define credit information systems as, "Credit information systems act as information brokers that increase the transparency of credit markets". In developing countries, however, these credit information systems are underdeveloped and are still relatively new in economies across the world where MFIs exist (314).

While Latin America still faces problems of efficiency and expansion of credit information system, it is one of the regions in the world with the greatest extension of credit information systems. Luoto, McIntosh, and Wydick provide Bolivia as an example of how important credit information systems are to the microfinance sector. Before 1999, Bolivia placed a ban on credit bureaus. However, the growth of MFIs in Bolivia led to an expansion of Bolivians borrowing loans. Many Bolivians took out multiple loans finding themselves heavily indebted trying to repay these loans. The Bolivian government recognized this issue microfinance borrowers were facing and therefore decided to permit the existence of private credit bureaus, many of which concentrate on microfinance loans (315).

The case of Bolivia demonstrates the essential role of credit information systems in ensuring high repayment rates and, correspondingly, low default rates. Luoto, McIntosh, and Wydick explain this importance stating, "Their very existence creates an incentive effect that may deter negligent borrower behavior as information about borrower behavior is shared among lenders. Some borrowers who are on the margin of misusing borrowed capital may be dissuaded from doing so if they sufficiently value future access to loans" (317). It is evident how effective credit information systems can be, but the success and efficiency of these credit bureaus is highly contingent on the economic and political conditions of their host country. While Bolivia demonstrates a positive change in credit bureaus, this is not the case for all Latin American countries.

One obstacle MFIs face in this regard is that many credit transactions occur solely between the borrower and lender. In many of these cases, the borrower must accept the conditions of the loan that the lender has established, with little room for negotiation. Consequently, lenders are ruthless in terms of moral hazard, causing borrowers to succumb to unreasonable loan conditions. As a result, borrowers often cannot repay their loan, which negatively affects the MFIs that are lending the loans to them (Luoto, McIntosh, and Wydick 317).

The solution to these situations lies in the open sharing of positive data, which they define as information about the borrower's loan exposure and credit history. MFI lenders can refrain from providing loans to borrowers if they feel the borrower will not repay his or her loan, based on previous loan history. The borrower also benefits from the distribution of this data in the microfinance sector. If the borrower has a positive credit history but no tangible collateral to provide to a MFI, the borrower can show the lender its excellent credit history as a type of collateral. The MFI lender will be much more inclined to provide loans to a borrower with a strong credit history (Luoto, McIntosh, and Wydick 318).

Another example of successful implementation of credit information systems into the microfinance sector is CREDIREF, a credit bureau of Guatemala. CREDIREF works with many MFIs in Guatemala, including the six largest, and provides credit consultation to over 120,000 borrowers. CREDIREF takes on the same responsibilities as other credit bureaus, including providing credit data of borrowers to MFIs (Luoto, McIntosh, and Wydick 319). The creation of CREDIREF has significantly increased repayment rates of borrowers to the MFIs. CREDIREF is a prime example of how credit bureaus have the ability to be useful to MFIs in Latin America. However, not all credit information systems in Latin America have the same organization and implementation as CREDIREF. The conditions of credit bureaus often vary on a country-to-country, and even region-to-region, basis. MFIs must pay attention to existing credit bureaus before deciding to enter into the market in these areas. This is because much of the sustainability of MFIs is dependent on the efficiency of credit bureaus and the scope of data credit bureaus can provide to MFIs (332).

In correspondence to the arguments put forth by Luoto, McIntosh, and Wydick, Argandoña and Prior argue that credit bureaus and other banking tools are crucial to MFIs. They states, “The main factor that explains the low banking levels in LDCs, affecting mostly lower income segments, is the use of inefficient financial distribution models” (251). This quote demonstrates how the sustainability of MFIs is contingent on the efficiency of financial models. When a financial model is inefficient, MFIs suffer. The authors also express the need for MFIs to be held accountable and socially responsible for ensuring that the local population in their host country is receiving access to fair loans.

While Argandoña and Prior express the need for financial services to the poor populations in Latin America, they also explain that the majority of people in Latin American countries do not have access to financial institutions. Over 66% of the population in Latin America does not have access to financial services. To demonstrate specific countries’ statistics, 65% of the Peruvian population and 55% of the Colombian population do not have access to financial services (255). The lack of access to financial services is due to the fact that many Latin American countries have traditional and limited economies that do not provide access to the poor, nor take the poor population into consideration as part of their economies. Additionally, the poor population usually has jobs in the informal sector, which provides them with no financial services or benefits (255).

Moreover, many economies in Latin America do not have caps on interest rates and have high collateral rates (Argandoña and Prior 256). These economic factors make it hard for MFIs to provide fairs loans to the poor population with reasonable conditions that they can meet. MFIs must follow the restrictive regulations and rules the government implements on financial institutions, therefore causing a conflict for MFIs. However, this is not the case for all countries in Latin America. For example, MFIs in Peru and Ecuador do not have to face as harsh of regulations as MFIs in Colombia (256).

The case study of Argandoña and Prior explains how the economic crises of the 1990s have affected Colombia, Peru, and Ecuador and how this effects MFIs operating in these countries (256). While one might at first think these economic crises have had an overall negative impact on these countries, there is a silver lining. The chaotic and plundering conditions of the economies during this time caused the government to intervene and save banks from becoming bankrupt. The economic crises have created a shift in the economies of Peru, Colombia, and Ecuador. Governments of these nations want to avoid another financial crisis and have therefore been able to increase economic growth through targeting income inequality and inflation (257).

As a result, the governments of these three countries have had a positive reaction to microfinance. Access to loans has now been open to the rural poor, who had very limited access to loans from banks prior to the spread of MFIs. In addition, the largest banks in these countries have seen the success of MFIs and have therefore transformed their institutions into MFIs. A couple of these banks include Banco de Crédito and Bancolombia. Even more, the governments of these countries have openly accepted microfinance as a part of their economies. In certain cases, governments have sponsored banks operating as MFIs, such as Opportunity Banking in Colombia (Argandoña and Prior 258).

Peru, Ecuador, and Colombia demonstrate examples of governments that have welcomed microfinance into their economies. The governments of these three countries have allowed for less strict regulations on financial services that MFIs provide so that MFIs can continue to serve the poor population of their nations. Many governments are actively participating and investing in MFIs. However, these governments still regulate the economies and MFIs still face obstacles when operating in Peru, Ecuador, and Colombia. The biggest problem that the microfinance sector faces in these countries is that there are not enough MFIs in these countries to supply loans to every potential borrower who possesses a demand for a microfinance loan (Argandoña and Prior 262).

The main reason why the demand remains higher than the supply is due to the high prices and uneven distribution of financial services in Peru, Colombia, and Ecuador. As previously stated, MFIs suffer under regulations that governments impose on institutions. MFIs cannot continue to supply loans if the costs to enter the market and manage business are too high (Argandoña and Prior 262). The most profitable MFIs in these countries are large banks that are financial sustainable. While Peru, Colombia, and Ecuador represent countries in Latin America that have a positive response to MFIs due to their economic growth and sustainability, many MFIs still find it difficult to operate in these countries. The solution for MFIs is either to remove themselves from the microfinance sector in these nations or to expand into profitable and sustainable banks, such as Banco de Crédito and Bancolombia (262).

Table 1.4 demonstrates the findings from the literature reviewed in this section. While every author has his or her own reasons as to why a country's economic and political stability are contingent on the sustainability of MFIs, all of the authors conclude that a nation's stability effect the sustainability of MFIs.

TABLE 1.4

Author(s)	Economic and Political Conditions of Country	Positive	Negative
Crabb	Need for economic freedom and mobility in countries.	MFIs are more likely to be sustainable if the economies they operate in have minimal government intervention and regulation. MFIs face fewer obstacles when there are not as many economic restrictions, allowing them to achieve sustainability quicker.	MFIs are subjected to the economic regulations of the countries in which they operate. MFIs are bounded by the governmental and economic restrictions. Regulations can be imposed at any time.
Luoto, McIntosh, and Wydick	Credit information systems, which can operate only if governments permit them, are crucial for sustainability.	Credit information systems allow MFIs to view borrowers credit history and decide if they want to provide loans to borrowers based on their previous repayment history. Credit information systems weed out potentially riskier borrowers which in turn creates a higher repayment on loans and therefore a greater chance of sustainability for MFIs.	If a country does not allow for credit information systems to operate in economies, than MFIs face consequences of low repayment rates and low return on assets, making sustainability difficult. MFIs are very dependent on the government's restriction or allowance of credit information systems.
Argandoña and Prior	MFIs function best with economic freedom and a hands off approach from the country's government.	Countries that allow for implementation of banking tools, like credit bureaus, assist MFIs in becoming financially sustainable.	The majority of the population in countries in Latin America does not have access to financial services because the local governments have not implemented programs to assist people to become financial independent.

e. Outreach

Many argue that microfinance fails at providing loans to the very poor, which are the populations that benefit the most from microfinance. Woller argues in his article that the reason why outreach is so limited amongst MFIs is because MFIs are product oriented rather than market oriented (1). This means that MFIs are more focused on providing the best product to their clients rather than ensuring that all scopes of the population have access to the product. Woller argues that MFIs need to shift their model, explaining, "Success (in terms of both deep outreach and institutional sustainability) will come to those organizations that best determine the perceptions, needs, and wants of the very poor and satisfies them through the design, communication, pricing, and delivery of appropriate and competitively viable offerings" (1). In this quote, it is evident that Woller stresses the need for MFIs to refocus their goals on outreach to the poor. By doing this, MFIs will become successful while also providing loans to the poor population. Woller therefore argues that MFIs can achieve profit-driven goals and socially-driven goals at the same time (2).

One reason why MFIs are no longer as focused on outreach as they were in the past is due to an increase in competition within the microfinance market. Kai demonstrates in his research that new MFIs entering into the market are more profit-driven then socially motivated. These profit-driven MFIs do not turn to increased outreach to improve their success and profit. These types of MFIs know that expanding their outreach of clients to the rural poor will not increase their profit, therefore making outreach for these MFIs useless. As more and more profit-driven MFIs are entering the market, socially driven MFIs must adjust their client scope to fit that of profit-driven MFIs. This has caused outreach to decrease, as the majority of MFIs are no longer focused on provide loans to the poorest borrowers (1).

Simanowitz demonstrates in his review of microfinance that outreach is hardly ever used to assess the success of a MFI. He also argues that despite microfinance's initial goals to provide loans to the poor population, MFIs today rarely consider outreach as a primary focus of their insititutions. Simanowitz explains the need to put outreach back on the agenda for MFIs and articulates that poverty assessment tools should be implemented in the assessment of MFIs. These assessment tools will allow MFIs to demonstrate to their donors and other funding sources that their donations are being utilized for improving the livelihoods of the very poor. This will make donors inclined to provide future contributions to MFIs (2). Furthermore, poverty assessment tools can be used to compare the successes of MFIs in terms of outreach and analyze why certain MFIs are failing to expand outreach. Poverty assessment tools allow for greater transparency of MFIs to donors, other MFIs, and analysts (6).

Simanowitz points out that outreach is crucial to the success and sustainability of MFIs. He correlates outreach to donors' participation in MFIs, arguing that increasing outreach to the poorest population will result in more donations to a particular MFI. This is based on the contingency that MFIs who expand outreach must also utilize poverty assessment tools to demonstrate to donors the successes of their lending to benefit the livelihoods of the poor. Smanowitz's overall argument is that outreach is crucial to the success of MFIs but outreach must be measured with poverty assessment tools in order for MFIs to have continual donor investment.

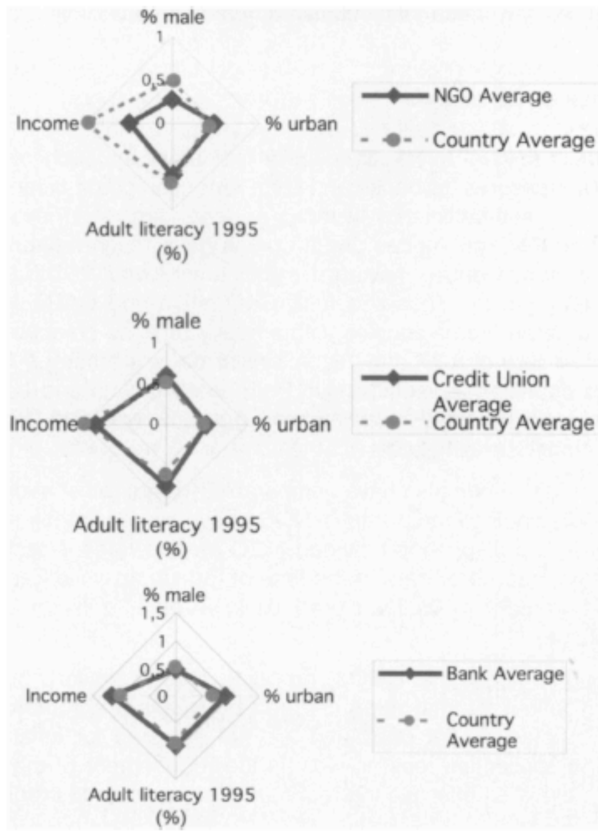
Another aspect of MFIs that is highly encouraged by many NGOs to help expand outreach is village banks. Village banks are essentially banks that are established within a community and are managed, as well as owned, by community members. NGOs such as CARE and Save The Children support the implementation of village banks because they believe village banks are the most direct way to provide loans to the poor population. Village banks focus on expanding outreach while simultaneously reducing poverty on a smaller more focalized level. Village banks can be an excellent method for outreach as well as leadership within communities but also require high start up costs, demonstrating that expanding outreach is not a cheap investment (Johannsen and Zeller 231).

As Johannsen and Zeller explain, unstable MFIs that reach out to the poorest borrowers end up being much more inefficient than stable MFIs that only provide loans to borrowers who are above the poverty line. The authors explain why this true, stating that more stable MFIs that don't necessarily target the poor population create unintentional positive effects for the poor. Johannsen and Zeller explain these effects as "creating employment for those below the poverty line. Furthermore, this MFI may require only small subsidies by the government or donors that can be phased out after a few years." (228). These spillovers are highlighted to demonstrate that outreach should not be the only factor considered when analyzing a MFI's success (228).

While Johannsen and Zeller articulate the spillover effects on outreach, Christen and Drake argue that increasing outreach to a more expansive borrower population is beneficial to MFIs who want to increase profit. Christen and Drake argue the expansion of loans to more people reduces transaction costs for MFIs. This means that expanding outreach to the rural poor population will in the long run make MFIs more profitable because their transaction costs will as a result from simply increasing the number of transactions.

One measurement of outreach in MFIs utilized by researchers is the Development of Outreach Index (DOI). The DOI includes certain variables of clients such a gender, poverty level, and geographic location (70). Paxton uses the DOI in relation to sustainability in order to assess the trade-offs between the two variables on the success of specific MFIs in Latin America and Africa (71). Paxton compares the outreach of NGOs to banks and credit unions, which can be seen in Figure 1. The figure demonstrates that the breadth of outreach is much larger within NGOs than it is for banks and credit unions. Paxton highlights this finding by explaining that NGOs are generally more socially-motivated, therefore targeting more of the poor female populations (75).

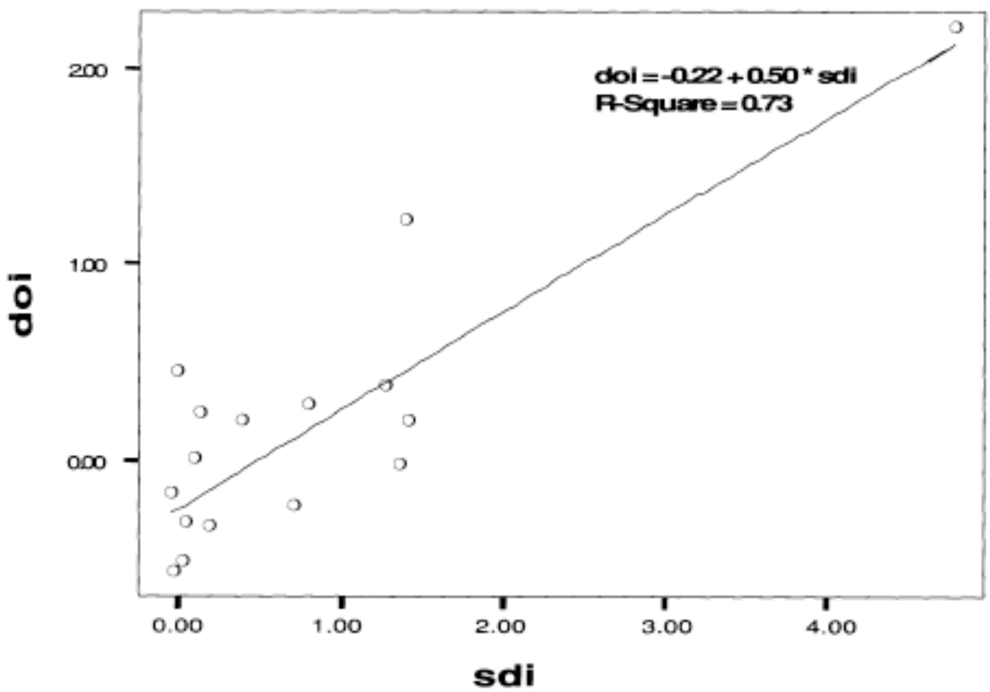
Figure1
Depth of Outreach Diamonds



In relation to sustainability, Paxton demonstrates that MFIs with a high level of outreach also have a low level of sustainability. In this sense, sustainability is measured in terms of the MFI’s ability to sustain itself without dependency on outside subsidies or donations (78). Paxton argues that because broader outreach is seen primarily in NGOs, reliance on outside funding is also more common because NGOs are non-profit organizations. NGOs are dependent on subsidies and donations to function as MFIs and are therefore not sustainable in terms of

Paxton's definition of sustainability. Figure two demonstrates the correlation between outreach and sustainability. The correlation amongst these two variables within MFIs was found to be .89, in Latin America, whereas the correlation in Africa was only .40. This statistic demonstrates how in Latin America the depth of outreach is strongly correlated to the type of MFI.

Figure 2
Relationship between SDI and DOI



Paxton's research validates the theory that NGOs in Latin America are the primary MFIs that focus on targeting the poorest borrowers (81). While many NGOs lack sustainability, sustainability and outreach are not mutually exclusive. Paxton therefore argues that NGOs should maintain their high levels of outreach while simultaneously expanding their financial security (82). While the solution is not simple, Paxton urges NGOs to seek out new forms of finance, such as slightly increasing interest rates in order to have a high return on assets.

Correspondingly to the findings of Paxton's research, Meyer and Zeller highlight the correlation of outreach to sustainability, stating that the tradeoff of a broad level of outreach is financial sustainability of a MFI. The more outside financial support a MFI receives, such a subsidies or donations, the greater the outreach the MFI can achieve (2). The correlation between levels of outreach and dependency on outside funding by MFIs demonstrates the need for state involvement in microfinance. Since evidence shows that outreach can only be achieved with support from outside funding, the state should invest capital in microfinance to help MFIs achieve outreach to the poor population (2).

The Bolivian MFI entitled Bancosol is an example of a sustainable MFI. Consequently, the outreach of Bancosol is limited. BancoSol primarily targets the poor urban population. While these people are impoverished, the MFI does not extend its outreach to the rural poor who are greatly in need. The outreach of BancoSol is therefore compromised in order to achieve sustainability (CGAP 1997).

Another analysis of outreach by Cull, Kunt, and Morduch demonstrated the correlation of outreach compared to the level of supervision of a MFI. These researchers found that these two variables of MFIs are negatively correlated, signifying that the breadth of outreach is compromised when there exists a high level of supervision within a MFI. When a MFI invests its capital in supervision, it has to make a tradeoff between supervision and another component of the institution. MFIs with high levels of supervision decide to contract their level of outreach. MFIs are willing to incur the low opportunity cost of decreasing outreach in order to increase their levels of supervision, demonstrating that outreach is not a top priority for the majority of MFIs ("Does Regulatory Supervision Curtail Microfinance Profitability and Outreach?" Cull, Kunt, and Morduch 19).

Although level of outreach is not an important factor for many MFIs, many argue the benefits of outreach are much greater than the consequences. For instance, some researchers argue a positive correlation between outreach and profit but there is not enough evidence to prove this correlation in all MFIs. Additionally, MFIs are hesitant to expand outreach because they do not think they can maximize profit from providing loans to the poor.

Table 1.5 examines the conclusions made by each of the authors in regards to the dependency of sustainability of a MFI on the scope of its outreach. The majority of authors conclude that sustainability of a MFI correlates to limited outreach of that MFI. While there does not exist enough evidence to prove that outreach corresponds to sustainability or financial success of a MFI, the research analyzed demonstrates that outreach greatly benefits the poorest borrowers who prosper most from microfinance loans.

TABLE 1.5

Author(s)	Levels of Outreach	Positive	Negative
Woller	High Level of Outreach	High levels of outreach allow for MFIs to increase their number of clients, which creates an environment for financial sustainability.	MFIs must focus their efforts on expanding outreach to the poor and women, which may at first result in miniscule profit. MFIs have to be patient and willing to potentially wait longer to become sustainable until their repayment rates increase.
Kai	Limited Outreach	MFIs are becoming more profit-driven, and expansion of outreach to the poor has the potential to limit MFIs' profits. Sustainability has become a more important goal than outreach.	MFIs that focus on outreach must alter their models to fit that of their competitors, which usually means no longer focusing on outreach and rather concentrating on financial factors, like sustainability.
Simanowitz	Limited Outreach	Success of MFIs is more commonly determined by the	If MFIs do expand outreach, donors may become more inclined

		sustainability of MFIs. There is no definite correlation between increase outreach and sustainability. MFIs will achieve sustainability if they focus on financial goals instead of social goals.	to donate to the MFIs that are focusing on the poor population.
Johannsen and Zeller	Limited Outreach	Stable MFIs that provide loans to a limited population of borrowers have more financial sustainability than unstable MFIs that expand outreach to the poor.	Expansion of outreach has certain positive spillover effects for the financial sustainability of a MFI.
Christian and Drake	High Level of Outreach	Expansion of outreach creates more profit for a MFI. Expansion of outreach creates lower transaction costs, which means the MFIs have greater returns on assets, and therefore more financial sustainability.	MFIs that expand outreach must be patient because the short-term benefits are not necessarily seen but the long run benefits are bountiful.
Paxton	Limited Outreach	MFIs with high levels of outreach have low levels of sustainability. MFIs that have low levels of outreach have high levels of sustainability.	
Meyer and Zeller	Limited Outreach	There is a tradeoff between sustainability and outreach. The more sustainable a MFI, the less outreach of that MFI.	

Cull, Kunt, and Morduch	Limited Outreach	MFIs that focus on profit-driven goals are more sustainable than MFIs that focus on expansion of outreach. MFIs that focus on outreach receive their funding from donations and subsidies, which prevents them from becoming financially sustainable.	

f. Gender

Eighty percent of the world's microfinance lenders are women. When microfinance was first implemented in the 1970s, loans were primarily granted to male farmers (Aghion and Morduch 142). So, why has there been a drastic shift from primarily providing loans to men to now providing loans to women? Financial and social reasons are the main causes for this change in the targeted population of microfinance loans. Women have significantly higher repayment rates on loans than men because women are traditionally more conservative with their money. Additionally, women have a higher response to peer pressure from group-lending strategies because women form closer social ties and kinship with other community members then men (Aghion 143). Aghion and Morduch argue that women across the world are more impoverished then men, meaning their health, nutrition, and safety are all compromised (143). MFIs feel a social obligation to improving the livelihoods of the most marginalized populations, which are women and children. Therefore, in past two decades MFIs have altered their goals and client outreach to primarily women.

One example of a MFI that focuses not only on providing loans to women but also on providing health advocacy programs to women is the MFI entitled Pro Mujer. Pro Mujer's mission is to provide health care and financial support to women in Latin America through implementation of a microfinance model. Pro Mujer believes women are crucial in the development of Latin America stating, "Women are at the heart of families and communities. Investing in women has a return that spans generations. Women reinvest 90% of their income into their families…when women unlock their potential, families become healthier, better fed, and more educated. Income grows and savings increase" (Promujer.org). Pro Mujer's mission statement and Theory of Change demonstrate how many MFIs are founded on the basis of serving women because they believe they are catalysts for change.

As Karmakar states in his article *Emerging Trends in Microfinance,* microfinance has " empowered women by enhancing their contribution to household income, increasing the value of their assets and generally by giving them better control over decisions that affect their lives. In certain areas, microfinance has reduced child mortality, improved maternal health and the ability of the poor to combat disease through better nutrition, housing and health - especially among women and children" (23). The benefits of microfinance for women have sparked an interest in health organizations to collaborate with female microfinance participants. For example, the CRECER Organization in Bolivia has shown significant results in their health education programs to women. CRECER has reported that their clients leave the program with skills of rehydration therapy, breast-feeding, and an overall better knowledge of preventative measures to take to improve the health of themselves and their families (Hashemi, Littlefield, and Murduch 3).

Critiques of microfinance argue that despite relentless incentives, MFIs can never fully achieve positive long-term impact for their borrowers. While providing loans to women can see some benefits, targeting women as the primary recipients can also be detrimental. Traditional societies in Latin America have a hierarchical family structure. The male figure acts as the head of the household and has the final say in the family matters. When microfinance loans grant to women in Latin America, their husbands and other men in the community often frown upon these women. The new responsibilities and independence women receive allow them to take on the roles that men traditionally have in the household (Maclean 501). As a result, microfinance loans provided to women can be controversial amongst husbands and community members.

While there is no easy solution to working around these social norms in Latin America, it is important for MFIs in Latin America to acknowledge these social barriers before providing microfinance loans to women. MFIs should pay attention to these social relationships and constraints of female borrowers and look for solutions. One solution is to provide these loans solely based on a group lending basis. Through group lending, women in the community bond together and unite if any conflicts come up with community members, specifically men, who are hesitant towards microfinance loans (Maclean 502). Group lending provides women with intra-community support, but also grants women access to relationships and networking outside their community (503).

Another common community structure in Latin America can be seen from the town of Luribay in Bolivia. Luribay is a small agriculture-based community outside of La Paz. The men of the town usually work in the fields during the day while the women are left in charge of the household. Even more common now, men of Luribay commute to La Paz for work or even move to other cities to seek work and send money back home. Because of the men's absence from the house for long periods of time, women in the community are seen as the head of the household and are responsible for kinship ties amongst other community members. Despite the independence and responsibilities these women have, they are still dependent on the income and authority of their husbands (Maclean 507).

One MFI by the name of CRECER, has begun providing loans to the women of Luribay so they can become less dependent on their husbands and expand their own personal pursuits. The loans granted to the women are given on a group-lending basis. The group meets bi-monthly and has a high repayment rate on loans (508). However, some women of the group have been unable to pay their share of the loans on their own and have been forced to borrow money from friends or family in the community to repay the loan to CRECER. While this is not the case for all women who are part of the group lending, it is the case for the majority of borrowers are indebted to community members. Not only has tension between the community members grown because of loans, but microfinance loans have also created a cycle of debt amongst group lenders (511).Although CRECER's goal is to provide loans with fair repayment conditions, many of these borrowers in Luribay do not have any previous experience handling money and therefore find it difficult to repay the loans.

Even though women are indebted to their family and friends, they still benefit from the independence they receive by taking out loans from CRECER. Additionally, microfinance loans give women financial responsibility. While the example of Luribay demonstrates how financial responsibility can be a burden on borrowers, this responsibility gives women the experience they need to become self-sufficient. A solution for diminishing the cycle of debt of borrowers is to create financial workshops for borrowers of microfinance loans. If CRECER invests in these types of workshops, they will not only benefit the borrowers, but the workshops will also increase the profit of CRECER. Repayments of loans will be higher if women are better informed on how to manage their loans (Maclean 511).

Even though there exist possible consequences of providing loans to women, women are still the best population to target as recipients of microfinance loans. Women who receive microfinance loans are much more likely to allocate and mange the capital of the loans in more efficient ways than men. For example, women are more inclined to spend their income on educational and health benefits for their children. The traditional role of women in Latin America is to raise their children and provide the best living conditions for them. Therefore, it is no surprise that when women are recipients of these microfinance loans, they willingly invest their capital towards the health and wellbeing of their children and family (Hashemi, Littlefield, and Murduch 11).

Through granting women the responsibility and freedom to manage their loans, microfinance also assists women to become more independent and confident in their lives. This confidence motivates women to speak out more against community issues and women's roles, therefore sparking a movement of positive change in their communities (Hashemi, Littlefield, and Murduch 1) One example of the effect microfinance has on promoting children's education can be seen in Honduras. Save The Children completed a survey from female participants of microfinance and almost every single participant said that their involvement in microfinance granted them enough income to send their children to school. Participants also said that if they were not part of these microfinance programs, they would not have sufficient income for their children to attend year after year (2).

Coffee Kids, a NGO in Nicaragua, provides another example of how microfinance can be successful for women and their children. Coffee Kids was established in rural areas of Nicaragua with the goal of starting a exclusively female microfinance program concentrated on coffee production. The response of the women who participate with Coffee Kids has been very positive, and the program has expanded to even more women in rural Nicaraguan communities. Women are able to save more money, allowing for them to send their children to attend school. The attendance rate of children whose mothers are members of Coffee Kids is much higher than other children in the community whose families do not collaborate with Coffee Kids. This example, and others alike, have drawn a "consensus of the international development community that strengthening women's empowerment is an effective way to promote children's educational achievement" (UNDP, 2002).

Two New York Times reporters by the names of Nicholas D. Kristof and Shryl WuDunn, have dedicated much of their time and research to analyzing poverty in developing nations. They argue that women are the solution to poverty reduction, demonstrating "the poorest families in the world spend approximately 10 times as much (20 percent of their incomes on average) on a combination of alcohol, prostitution, candy, sugary drinks and lavish feasts as they do on educating their children (2 percent). If poor families spent only as much on educating their children as they do on beer and prostitutes, there would be a breakthrough in the prospects of poor countries" (7). These statistics show how women allocate and save their money more efficiently than men.

The shift in money invested on education would greatly benefit girls because their education is sacrificed so that their parents can pay for their brothers to attend school (Kristof and WuDunn 7). When girls are granted the opportunity to attend school, they are in turn granted the opportunity to receive an education and degree that will give them access to the formal job sector in their country. As a result, the entry of more women into the job force will stimulate the country's economic growth (8).

Not only would girls advance the most from the increased capital their families are receiving from microfinance loans, but microfinance loans would also be most effective if placed in the hands of women. Kristof and WuDunn, like numerous other advocated of microfinance loans being issued to females, highlighting studies that have shown nutrition, education, and overall health of children is significantly improved when women are the recipients of loans (7).

Table 1.6 highlights the conclusions from the literature reviewed. Although only a couple of authors discuss the correlation between sustainability of MFIs and the gender of borrowers, the overarching theme amongst all literature reviewed is that microfinance is most effective when the loans are placed in the hands of women. Health organizations, development programs, and leaders share the same consensus that women are the catalysts for change in the developing world. Women are a key solution to eradicating poverty in the developing world, which explains why MFIs in Latin America are focusing their efforts on the female population.

Author(s)	Gender of Borrowers	Positive	Negative
Aghion and Morduch	Female	Women have higher repayment rates on loans than men. MFIs seek more return on assets when women are the recipients of loans.	
Pro Mujer	Female	Women who are in charge of their families' earnings through microfinance loans are more inclined to spend income on their children and health services.	Does not discuss the gender of borrowers in relation to sustainability of MFIs.
Karmakar	Female	Women use loans for health programs, education, and nutritional benefits for their children and family members.	Does not discuss the gender of borrowers in relation to sustainability of MFIs.

Hashemi, Littlefield, and Murduch	Female	Studies demonstrate that women spend their money in more efficient ways then men, such as providing their children with access to education.	Does not discuss the gender of borrowers in relation to sustainability of MFIs.
Maclean	Female	Females are give financial responsibility, which allows them to become more independent and gain valuable financial skills that they would not otherwise have. Females are better recipients of loans than males, but they still face certain setbacks.	Females may be limited on their accessibility to their loan money because husbands may interfere and demand control of their family's capital. A case study from Bolivia demonstrates that women may face financial burdens from taking out loans and have difficulties making repayments on loans. MFIs may be susceptible to loan default.
Kristof and WuDunn	Female	Microfinance loans allow more girls to attend school, therefore providing a larger market of skilled workers for a country's economy.	

V. Conclusion

A review of the literature reveals different explanations of MFI sustainability. Several conclusions can be drawn about the importance of each of the variables addressed. Table 2 below provides a numerical summary of the findings reported from the literature reviewed. Each variable has a tally for the number of literary works reviewed that either concluded each variable to have a positive and negative effect on MFIs. It is important to note that some of the literature reviewed did not discuss the relation between female borrowers and sustainability of MFIs. Therefore, this paper cannot draw any conclusions about the effect of the gender of borrowers on sustainability of a MFI.

TABLE 2. Summary of MFI Study Findings

Variables	Positive	Negative
Individual Loans	1	4
Group Loans	4	1
Non-Competitive Market	4	2
Competitive Market	2	4
NGOs	0	4
Retail Banks	4	0
Instability of Country	0	3
Stability of Country	3	0
Limited Outreach	5	2
Expanded Outreach	2	5
Female Borrowers	6	0
Male Borrowers	0	6

In regards to loan conditions, researchers argue that group lending is much more efficient than individual lending. Group lending focuses on using peer pressure to ensure that borrowers will repay their loans to MFIs. The research analyzed shows this method creates a higher repayment on loans, allowing for MFIs to increase their profitability while simultaneously increasing their sustainability. Additionally, group lending creates an expansion of outreach. Group lending grants the poor population access to take out loans without forcing them to give collateral that they cannot provide, thus expanding the level of outreach within MFIs.

Competition between MFIs is controversial amongst researchers as to whether or not it aids in the sustainability of MFIs. Potential positive effects of competition include: creation of an environment of innovation, efficiency, and expansion of outreach amongst MFIs. The most salient theme in the research is that competition in Latin America occurs in an imperfect economy and thereby creates inefficiency within institutions. However, competition does not correlate as strongly to the sustainability of MFIs as other variables discussed in this paper.

The type of MFIs has a strong correlation to the sustainability of MFIs. Profit-making MFIs, generally banks, have higher levels of sustainability than NGOs that take the form of MFIs, taking the form of NGOs. MFIs rely on donors and subsidies to operate, therefore making their financial model one of dependency. The majority of funding for banks operating as MFIs comes from within these institutions, meaning the profit they make from the loans they provide. While many of bank-based MFIs do not start off as one hundred percent sustainable, it is much easier for these types of MFIs to achieve sustainability. The organizational structure of bank-based MFIs is formed from their original banking strategies, which is primarily operated on a profit-driven model. Banks functioning as MFIs have a greater chance of obtaining financial sustainability than NGOs operating as MFIs. Therefore, sustainability of MFIs is dependent on their structure and type.

Another variable of MFIs addressed in relation to sustainability is the economic and political conditions of the host country in which the MFI operates. The research reviewed shows a correlation between the political and economic stability of a nation and the ability of a MFI to become financially sustainable. While certain governments of countries like Peru and Ecuador welcome MFIs, MFIs still struggles with economic restrictions and regulations within these nations. These regulations harm MFIs in their pursuits of financial sustainability because they must abide by the host country's governmental policies. However, large banks, such as Banco de Crédito in Peru, succeed in becoming financial sustainable. Therefore, the sustainability of these MFIs is more contingent on the type of MFIs rather than on the country in which MFIs operate.

The final two variables analyzed were outreach and gender. These two variables were selected because they are widely discussed in MFI research. However, because these two variables relate more to the social aspect of MFIs, they do not have a strong correlation to the financial sustainability of MFIs. The research that analyzed outreach and gender concluded that expanding outreach and providing loans to women are valuable variables for MFIs actively seeking to improve the livelihoods of the rural poor in Latin American countries. Additionally, when MFIs expand their outreach to the poor and women, the number of borrowers increases and allows for a greater potential profit on returns. However, there is a level of uncertainty in terms making profit from the rural population, which is why the majority of MFIs limit their scope of outreach.

Further research should be performed to analyze whether or not outreach and gender play a significant role in promoting or harming the sustainability of a MFI. It is crucial to find a balance between profit-driven goals, such as sustainability, and socially motivated goals, such as improving the livelihoods of marginalized populations. Current research focuses on analyzing one type of goal at time, rather than evaluating the two together. Similarly, many MFIs do not have a balance between these two types of goals, making them inefficient to combat poverty.

The strongest correlation between a variable of MFIs and the sustainability of MFIs was found in the type of MFI. While banks demonstrate a high level of sustainability, NGOs exhibit a low level of sustainability for their MFIs. Although sustainability is necessary element for MFIs to continue operating in the microfinance market, it should not be the only measurement of success and efficiency of a MFI. MFIs should also evaluate whether or not their institutions are effectively combating poverty through providing loans to their borrowers.

Political leaders, activists, and development workers are all turning to microfinance as a solution to achieve the Millennium Development Goal to reduce the level of poverty by half by the year 2015. It is evident that this goal will not be met in the next two years but microfinance does have the potential to help eradicate poverty. In order to accomplish this goal, there must be a shift in the organization and goals of MFIs. As this paper has discussed, sustainability amongst banks is much higher than NGOs acting as MFIs. While NGOs concentrate more on providing loans access to the poor and to women. Both these populations benefit the greatest from these loans because the profit they make is used wisely for nutrition, education, and overall public health improvement. Therefore, MFIs must find a balance between profit-driven goals and socially motivated goals in order to maintain sustainability while simultaneously improving livelihoods of their poorest borrowers. If this equilibrium can be created, microfinance will strive as a development strategy to effectively eradicate poverty not only in Latin America but across the world.

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