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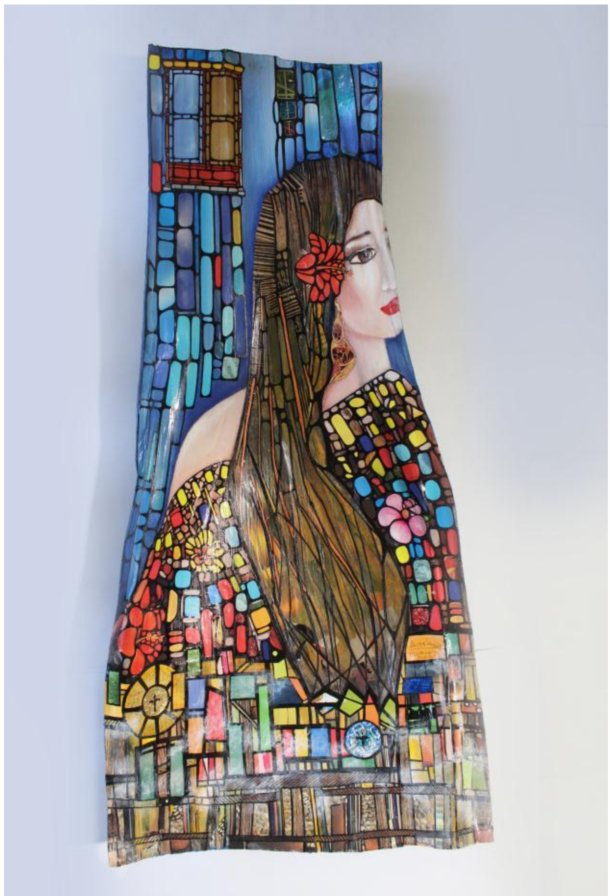

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A role of Malaysia microfinance institutions on poverty reduction and households' wellbeing

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Abstract

This paper is intended to propose a conceptual framework on the role of Malaysian microfinance institutions (MFIs) on poverty reduction and households' wellbeing. The aim of this paper is to discuss about the conceptual explanation of microfinance and poverty reduction via comparative qualitative method. As a result, paying high interest rates is not a central of concentration among the poor borrower because they borrow funds to become moneylenders, presumably successfully lending at rates higher than their MFI charges. In conclusion, development practitioners still know little about the possible efficiency of microfinance in reducing poverty.

Keywords: Microfinance, poverty, household' wellbeing.

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El papel de las instituciones microfinancieras de Malasia en la reducción de la pobreza y el bienestar de los hogares

Resumen

El objetivo de este documento es proponer un marco conceptual sobre el papel de las instituciones microfinancieras (IMF) de Malasia en la reducción de la pobreza y el bienestar de los hogares. El objetivo de este documento es discutir sobre la explicación conceptual de las microfinanzas y la reducción de la pobreza a través del método cualitativo comparativo. Como resultado, el pago de altas tasas de interés no es un centro de concentración entre el prestatario pobre porque piden prestados fondos para convertirse en prestamistas, presumiblemente con éxito a tasas más altas que sus cargos de IMF. En conclusión, los profesionales del desarrollo aún saben poco sobre la posible eficiencia de las microfinanzas para reducir la pobreza.

Palabras clave: microfinanciación, pobreza, bienestar del hogar.

1. INTRODUCTION

Microfinance programme has been marked as one of the development strategies that can enhance the economic performance of the poor. The vital role played by microfinance institutions in reducing poverty and improving the well-being of households has attracted policymakers' attention in the developing countries across the globe including Malaysia. Many scholars have recognized microfinance programme as one of the effective tools for combating poverty, creating jobs and improving the well-being of the poor. The basic principle behind the provision of microfinance services is to provide the platform to the poor to participate in the economic activities through forming their small businesses.

1.1 Basic Concept

Microfinance is the provision of financial facilities to poor and low-income households without access to formal financial institutions. According to Ackerly (1995), microfinance is defined as an effort to provide better access to small deposit and small loans for poor households neglected by banks. Microfinance is a tool provided for the poor to set up or enlarge business, invest in self-employment activities and increase household security especially for women in rural and urban areas (Rajasekhar, 2004). Generally, microfinance is part of economic development model intended to benefits low-income group of society.

Meanwhile, numerous scholars and experts differently describe poverty depending on its nature, place and volume. Cassar et al. (2007) state that poverty is a multifaceted concept and it is difficult to give a concise meaning to the term as different scholars will use different criteria to assign a meaning to it. A person is said to be poor when their consumption level falls below the poverty line of $1 per day. Narayan (2000) cited poverty as a lack of materials including shelter, assets and money and often been accompanied by hunger, pain, discomfort, social exclusion, powerlessness and low-esteem. The World Bank has revised the poverty line and increases the minimum global poverty line from $1.25 to $1.90; hence, people live on less than $1.90 a day are considered as extremely poor. It is noteworthy, almost 700 million people live on less than $1.90 a day in 2015 and more than 40 percent of the world's poor live in the Third World countries.

1.2 Microfinance as a Mechanism to Alleviating Poverty

The mechanism of microfinance has proven to empower the poor especially women by enabling them to expand their businesses as well as involvement in decision making, where previously was dominant by men. The importance of microfinance institution cannot be denied as the number of microfinance intuitions and their clients have witnessed a dramatical growth. Over the last three decades, the growth of microfinance institutions has been noticed in the developing countries especially in Asian countries. The involvement of the poor clients with microfinance programme had increased in number from 7.6 million in 1997 to 137.5 million in 2010, in which over than 113 million were women borrower. Microfinance programme in Malaysia has been implemented since 1986 as one of the poverty eradication strategies in the country (Amanah, 2016). AIM is a non-government organization with the social mission of targeting poor and low-income women to earn income from self-employed activities and expand their existing economic activities. By adjusting the characteristics of microcredit services to cope with the Malaysian context, the existence of AIM is based on the model of group-lending introduced by Grameen Bank, Bangladesh. Currently, AIM covers approximately 82 percent of Malaysian poor and low-income households.

The implementation of AIM programme is aimed at reducing poverty, while improving socioeconomic of deprived households through extending an economic loan to women with the purpose of start-up new microbusiness or extend existing businesses. Providing financial services to women who are excluded from formal financial services because of the lack of collateral is most often the goal of microfinance. The main reason for targeting women is due to their financial standing still comparatively lower than men. Other than that, the majority of women invest their income in household expenditure and their children health care and education which are in line with the objective of Malaysia government. Most importantly, many countries have proven that women are reliable microcredit borrowers, particularly in Malaysia where AIM recorded the highest rate of loan repayment in 2010.

Over than three decades of experience in contending poverty and enhancing household welfare especially in rural areas, AIM has been recognized as a reliable organization in achieving these microeconomic goals. It has been proven by the study of Gibbons and Kasim (1990) show that the monthly household income of AIM borrowers increased by 55 percent. Over the years of providing microcredit services to the poor by helping them to generate income via economic activities, today the microcredit schemes offered by AIM can be divided into two categories. The first is microcredit for economic activities, which are i-Mesra, i-Srikandi and i-Wibawa, and the second is for non-economic activities, which are i-Sejahtera, i-Bestari, i-Penyayang, and i-Emas. As of April 2016, AIM has disbursed about RM 15,097,046,687, covered 382,178 active borrowers across 156 branches nationwide. Today, AIM is the leading microcredit institution and considered as the pioneer in Malaysia.

2. The Impact of Microfinance on Poverty Alleviation and Households' Welbieng

2.1 Economic Outcomes of Microfinance

Numerous empirical studies on the role of microfinance in improving household income and poverty reduction in several developing countries such as Bangladesh, Thailand, Pakistan, Malawi, India and many other countries across the world has been found and cited. A number of empirical studies support the view that microfinance programmes led to a significant increase in household income among the participants (Awunyovitor et al., 2012). Hermes (2014) has contributed to this understanding by examining the relationship between microfinance and income inequality in developing countries and concluded that a reduction in the income gap between rich and poor is associated with the level of microfinance participation. By applying multinomial logistic on data, Ackerly (1995) revealed that the microfinance has increased the household income of respondents and concluded that microfinance is an effective tool for poverty reduction. The study was undertaken in two states of Malaysia and it involved 780 respondents from both rural and urban areas.

As far as the effect of microfinance on employment is concerned, Hossain (1998) has contributed to this understanding by pointing out that with the help of lending from microfinance, one-third of the participants were able to engage in self-employment activities, which previously they were unemployed. Of course, the involvement in self-employment activities among participant helps them to cope with crisis and reduce repayment problem as the programmes provide an opportunity to improve the number of sources of income. Cassar et al. (2007) state that the poor who had access to credit provided by Grameen bank in Bangladesh able to improve themselves in term of increase in the number of self-employment, which ultimately increases in rural wages. In a further study, Cassar et al. (2007) confirmed that improvement in income, production and employment particularly in a rural non-formal sector are positive outcome resulted from microfinance programmes.

Other scholars have considered various other effects of microfinance programmes. The study in this vein conducted by Cassar et al. (2007) found that total annual household expenditure increased by more than 20 takas for each additional 100 takas of credit to women in Bangladesh. His findings also state that poverty rates decline by more than 20 percentage points since 1991/92 until 1998/99 among participants. By using cross-sectional data from the two household survey in 1992/1993 and 1997/1998, Ackerly (1995) found that positive relationship between microfinance and an economic welfare of household in term of per capita expenditure, per capita food expenditure and per capita non-food expenditure. A few empirical studies on the impact of microfinance on poverty reduction in Vietnam revealed that it had a positive influence on household living standard. Ackerly (1995) stressed that after joining microfinance programme 17 percent of the participants are able to increase in assets, while 28 percent in average household income. Microfinance is considered a key tool in achieving MDGs, due to positive impacts on recipients' income, savings, expenditure, and the accumulation of assets (Awuah and Addaney, 2016).

By using a sample size of 60 microfinance clients, Dan (2006) examined the impact of microfinance on rural women in central Uganda. The result of the study shows the improvement in income and saving pattern among women's client. In addition, the study also suggests that microfinance help women socialize, having a good diet, able to cope with crises, and most importantly make saving to break the poverty trap. Rajasekhar (2004) reported the impact of the microfinance in terms of increased savings, increased credit accessibility and income generation. It has been supported by the other study conducted by Dupas and Robinson (2009) on clients of village bank in Kenya and reports that microfinance programmes are liable in increments of saving account for businesswomen by 40 percent, other than an increase in their consumption. However, there are several previous studies claimed that microfinance did not contribute a significant impact on income improvement and poverty reduction. Furthermore, insignificant evidence of the impact of a microfinance programme on household welfare has been found in Thailand. In addition, Diro and Regasa (2014) find no significant effect of microfinance on employment of borrower, even though the result shows a positive impact of microfinance on income, consumption and saving.

2.2 Social Outcomes of Microfinance

Recently, the issue regarding social outcomes of microfinance has caught the attention of the researcher by publishing articles addressing the impact of microfinance on the livelihood of the poor. By applying propensity score matching (PMS) using the same data as Cassar et al. (2007), it was found that there are positive impacts of microfinance on participant's expenditure, the supply of labor and male or female school enrolment. An example of studies by Emerson and Mcgough (2010) which examines the impact of microfinance on growth via investment in human capital highlighted that microfinance able to promote the growth of human capital as it would allow the poor household to spend more on the schooling of children. In fact, Emerson and McGough claim that the existence of a mechanism that may disrupt this positive impact will raise the opportunity costs of schooling, thus it will discouraging parents from sending children to the school.

The contribution of microfinance on the development of education is vital whereas school enrolment and the dropout rate among children shows a positive sign in the rural areas of Bangladesh. These positive impacts due to a significant role played by BRAC's non-formal education (NFE) in establishing awareness among its clients about the importance of education in human lives. A study of Nawaz (2010) emphasized that compared to short-term participants, long-term membership with the microfinance programmes experienced an improved education status of their children. However, the net effect of microfinance on education is still ambiguous. Critics such as Gonzalez (2010) claimed that an early and frequent repayment implemented by microfinance institutions would result in a reduction of schooling among participants' children. Their argument is based on the model built on household decision making in the presence of microfinance. The authors then postulate the existence of externalities in education to argue that even though the decision to reduce schooling may be beneficial for the borrowing households themselves, it might hurt overall economic growth.

The development of parents' social capital through microfinance has been hypothesized to influence child health. In a recent study, Ackerly (1995) confirmed that the mothers with a lower level of wealth and human capital fare who actively participating in community organization are causing the welfare of the children to improve better. The reason is, these informal networks help the mothers to circulate information about such things as nutrition and communicable diseases, thus thought to influence their child health.

With greater bargaining power, women are able to involve in decision making to allocated more the household resources toward expenditure that improve the health and well-being of children. Microfinance facilities were found to affect housing positively Chen and Snodgrass (2001) as the participants are able to access to better sanitation and clean water.

In addition, the study of Ackerly (1995) revealed that microfinance significantly impacts the living status of the people and concluded positive impact of microfinance on education, financial condition and health status. The study was done to examine the influence of microfinance on the living status of poor people in District Dera Ismail Khan, Pakistan by applying random sampling technique. A similar finding was found on the study of Alam et al. (2014) which analyze the role of microfinance on the socio-economic status of borrowers. To perform the study, the data was collected through a structured questionnaire from the borrower who got a loan from Punjab Rural Support Program scheme in district Gujranwala, Pakistan. The results revealed that microfinance contributes appositive impact on the living standard of farmers such as children education, health status and diet pattern.

Many authors such as Ackerly (1995) have looked into the specific role that social capital plays in MFI's in overcoming market failures that traditionally limit access to financial services for the poor. Ackerly (1995) famously defined social capital as features of social organization, such as trust, norms and networks that can improve the efficiency of society by facilitating coordinated actions. According to Cassar et al. (2007) network plays a vital role in protecting the failure of microfinance institutions by ensuring better repayment that helps microfinance to flourish for reducing poverty and creating social capital. In the same, by using two different locations which are Nyanga (South Africa) and Berd (Armenia), Cassar et al. (2007) claim that different aspects of social capital have a different impact on group performance.

2.3 Impact of Microfinance on Empowerment

Though microfinance and empowerment are intensively discussed in the academic literature, however, the connection is still unclear and need further empirical analysis. A number of studies show that better access to microfinance facilities has a positive impact on socioeconomic development. For instance, a study by Fidler and Webster (1996) states that women participants are able to expand business and improve their income as well as involve themselves in decision making. Nawaz (2010), argue that women empowerment, development of entrepreneurial activities among women and improvement in their living standard are part of microfinance contributions. According to Anderson and Eswaran (2005), access to microfinance loans enables women to have a greater autonomy and involvement in decision making as well as creating awareness and political and social inclusion (Armendáriz and Morduch, 2010).

The study on the impact of SHG-Based Islamic microfinance on living standard and women empowerment in Bangladesh has been carried out by Hassan & Saleem (2017) involving 700 women respondents. By using regression analysis, they found that women in Bangladesh are both socially and economically empowered through Islamic microfinance. As further stressed by Cheston and Kuhn (2002) microfinance generally revealed an evidence of positive impact on women empowerment, increase in respect and decision making as well as increased self-esteemed. A similar finding was reported by Ackerly (1995) that micro finance has contributed to the development of self-esteem and self-reliance of the poor. According to Bali (2007), women become more active in society and local politics as microfinance programmes encourage them to get involved in the community. Some authors have however warned about possible negative effects of microfinance on empowerment. The access to microfinance contributes a negative impact on gender empowerment. Even women were the one who a responsible to loan contracts, but the author claims that men tend to control over the utilization of loans. Yet, in most cases women had to use their own personal saving for the purpose of loan repayment due to primary responsibility lay with the women. It was supported by Hollis and Sweetman (1998) argued that women had a little control over the loans as decision making on loan utilization was dominated by men. The same thought was conveyed by Ackerly (1995) who agreed that with no control over loans, access to microfinance only because women being overworked and fatigued.

2.4 Access to Microfinance

Ackerly (1995) stated that, the existence of a microfinance institution enables the poor access to the financial market. Further, without being tied with physical assets as collateral, poor people can access microfinance at an affordable interest rate. It has been supported by Hollis and Sweetman (1998) which examined mid-19th-century Irish loan funds. The result of the study shows that the poor are able to get access to microfinance loans at competitive interest rates without subsidies. Ackerly (1995) argue that the interest rate charged by microfinance institutions is relatively low compared to their alternatives, where the working poor can afford these rates. As the intensity of access to financial services increases, it enables borrowers to smooth consumption, start or expand businesses, cope with risk, and increase or diversify household income and thereby reduce poverty and improve development outcomes. Rashid et al. (2011) revealed that lower interest rate, increased fund and accessible financial services parts of the positive impact of microfinance on poverty reduction. However, the study carried out by Gonzalez (2010) argued that the high transaction cost caused microfinance agencies to charge a higher interest rate to participants. He added that a normal interest rate charged by microfinance agencies are 20 percent to 70 percent, but it can touch as high as 90 percent depending on the nature of the activity(Haseeb, 2018).

From the demand side barrier, Ashraf (2014) in his study to understand the reason for low participation in MFIs among rural poor in Bangladesh found that fear of getting in to risk of loan's negative effect, individual preference of taking loan, and friends negative advice are significant influence for barriers of participation to MFIs. According to Conning (1999) sustainable MFIs that target poorer borrowers must charge higher-interest rates, have higher staff costs, and are less leveraged than those targeting less poor borrowers. He pointed the claim based on the theoretical model of the contract design problem facing MFIs that want to maximize impact, target the poor, and achieve financial self-sufficiency. However, there is evidence that paying-high interest rates is not a center of concentration among the poor borrower because they borrow funds to become moneylenders, presumably successfully lending at rates higher than their MFI charges.

3. CONCLUSION

Despite the fact that microfinance has been used for decades as a vital development instrument, but the role of microfinance on the poor wellbeing is still questionable and always repeated by development practitioners. This is because they still know little about the possible effects of microfinance in reducing poverty. Hence, the various efforts that have been done to explore more about the effectiveness of the program on the rural and urban poor. Generally, the objective of this paper is to provide clear evidence on the impact of microfinance on the poor wellbeing which contributes to the body knowledge of the literature. From the previous literature, the intervention of microfinance institutions is consists of three major functions of financial, nonfinancial and social intermediation services which have the significant impact on the poor wellbeing which demonstrated in the borrowers' household, economic, social, empowerment and their micro and small enterprises' performance. However, some literature asserts that the effect of microfinance depends on several factors such as population density, group-cohesion, and attitude to debt, enterprise development, financial literacy, financial service providers and its impact works differently from one context to other. In conclusion, this paper will provide valuable guidelines to the policy maker to improve the outreach and sustainability of microfinance institutions generally and the Malaysian microfinance institutions particularly.

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