Can Microloans Lift Women Out Of Poverty?

November 1, 2016 (revised)

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You’ve probably heard the stories. A desperately poor woman in a poor country gets a tiny loan—a couple hundred dollars. It's the **break** she’s always needed. With that money she can finally buy the materials to start a small business. She turns a profit. Her income rises. Now she has money to expand her business even further, buy her children more nutritious food, pay their school fees. Over time, she lifts her whole family out of poverty.

That’s the vision often associated with microloans in the popular imagination, but is it the reality? Research indicates that increasing access to microloans is not an effective strategy for helping more women start businesses, at least not many. However, microloans can help poor people in many other ways.

**The Backstory**

Until about 40 years ago, the world’s poorest had virtually no access to credit from large-scale lenders. Very poor people had difficulty satisfying traditional methods that lenders used to check on borrowers. They often didn’t own enough **property** or other forms of **collateral** to receive a loan. Furthermore, they didn’t have a formal credit history, a steady source of income, or education that banks liked to see.

In the 1970s, however, the idea of microfinance emerged. Probably the most famous is Muhammad Yunus, an economics professor in Bangladesh who founded the Grameen Bank. In countries in Central and South America as well similar approaches were being tried.

**The Big Idea**

Microfinance loans usually use creative methods to reduce the cost of the loan and the risk of **default**. For instance, many lenders discovered that by lending to a small group instead of a single person, they would spread the risk and use social pressure from group members to ensure each person repaid their share of the loan. Another method was to require frequent repayments—for instance, once a week—over a very short period of time.

Furthermore, as David Roodman noted in his excellent book on microfinance, many microlenders also decided to focus on women and sometimes loan only to women. This was partly due to the spread of feminism in the 1970s and ‘80s and the growing attention it brought to the particular difficulties poor women face in getting economic opportunities.

The overall model has proved not just self-sustaining but profitable for lenders, so many for-profit businesses have entered the microfinance world. The microloan industry is huge, with some 125 million people worldwide—of which 80 percent are women receiving a total of about $100 billion in microloans from the major microfinance lenders. The size of these loans varies widely, too, with an average of about $200 in South Asia to nearly $3,000 in Eastern Europe and Central Asia. The robustness and longevity of the industry shows that microloans are clearly serving a need.

The key question is this: *What* is that need? Is it mainly providing money so a poor person can start a small business? Or might there be other, better uses?

**Does It Work?**

At first, microfinance generated a wave of excitement over its promise, so much so that in 2006 Mohammad Yunus was awarded the Nobel Peace Prize. However, doubts continued, and in the early 2000s, a series of economic studies examined the results of microfinance loans. Dean Karlan of Yale University explained that stories of individual borrowers were basically meaningless because they failed to show whether a successful borrower had succeeded as a result of the microloan or for some other reason. Karlan and various other researchers then began a series of carefully designed studies, which was a new area of research.

Since that time, in about a dozen studies trials of microloan programs in multiple countries, a randomly selected group of people who had been offered the loans to an otherwise identical group that had not. The studies looked at programs serving mostly women in countries that included India, Mexico, Mongolia and the Philippines.

**The results, however, were disappointing:** although in most of the studies, borrowers used the loan to expand their business, but the expansion was quite small. Moreover, in *no* studies did the average microloan borrower significantly increase his/her income relative to the control group.

How can we explain that? Abhijit Banerjee, an economist at MIT, said that in theory these findings suggest that extremely poor people are just bad at business. However, a better explanation is that poor people can substantially increasetheir income if they’re given a cash grant or a free asset—for example, some livestock—to use in a business. Thus, Banerjee argues that microloans are less suited for starting a business than helping a small business by, for example, making building improvements or paying down existing debt.

In short, microloans have not proven to be a magical solution to poverty, but they have helped many people.

Original version retrieved March 24, 2019, from https://www.npr.org/sections/goatsandsoda/
2016/11/01/500093608/you-asked-we-answer-can-tiny-loans-lift-women-out-of-poverty

Adapted July, 2021.