Measuring the impact of microfinance products and services on poverty alleviation: a review of literature

Esther Nyamoko Angwenyi[1*], Joshua Kwonyike[2] and Leonard Simiyu Mulongo[2]

[1] Research Scholar, Department of Development Studies, Moi University, Eldoret, Kenya

[2] Professor, Department of Development Studies, Moi University, Eldoret, Kenya

Correspondence Author: Esther Nyamoko Angwenyi

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Abstract

Aside from merely doing business, one of the core aims of microfinance is to provide alternative credit to the poor and disadvantaged groups. In this way, they help to equalize and expand economic means and opportunities for the poor and low-income people in developing societies. However, not much is known about the effectiveness of specific microfinances in poverty alleviation. Besides, it seems there exist no specific model for evaluating the effectiveness of microfinance services and products in alleviation and eradication of poverty. As such, this article attempts to define the parameters to be used for assessing the impact of microfinance products and services on poverty alleviation, especially in developing countries. The study drew findings from secondary research. It was drawn from existing literature on microfinance products and services, and the impact of microfinance. The reviewed publications included relevant journal articles, book chapters and some media reports on microfinance lending in developing countries. The literature was evaluated and findings drawn and interpreted. The review of literature showed that a positive impact of microfinance on household welfare and economic activity is possible despite the variation in the assessments' methodology, time and location. At the household welfare level, significant positive changes are identified on several outcomes including income, wealth, household expenditure and consumption, savings, food security, children schooling, non-land asset holdings, physical and mental health and empowerment. Nevertheless, the findings showed that the impact varies in significance and magnitude depending on a number of factors such as borrowers' gender, level of poverty, and level of education and experience, in addition to the time span of the assessment. The findings of the study shed more light on the conceptualization of poverty and how it correlates more broadly to microfinancing interventions.

Keywords: impact, microfinance products, services, poverty alleviation

Introduction

The microfinance industry and research is increasingly focusing on institutional sustainability (Hulme & Arun, 2011) [26]. Strategies to ensure the sustainability of microfinance institutions and to end their dependence on subsidies and external finance have preoccupied microfinance discourse. In ensuring the sustainability of microfinance institutions, financial sustainability has assumed increasing importance in the microfinance industry and literature. The idea of striving for financial sustainability is that it is institutions which do not depend on external support or subsidies that can grow and achieve wide outreach and have the maximum impact on service users (Robinson, 2020) [38]. Bateman and Chang (2012) [5] reject the implicit assumption in Robinson's argument that providing the poor with microfinance services will automatically result in the poverty reduction.

Emphasis on financial and institutional sustainability has compromised opportunities for ensuring that microfinance interventions have the maximum effect on poverty. When poverty reduction has been considered at all in microfinance research, loan repayment rates have been primarily employed as proxy for poverty reduction. Empirical evidence suggests that repayment rates may not be good indicators of poverty reduction (Marr & Tubaro, 2013) [32]. One challenge that threatens to nullify all discourse on the interplay of microfinancing and poverty reduction is that of defining poverty. While there are broad categories and several definitions of poverty, this article will focus on comprehensive definitions of poverty in terms of economic well-being, capabilities and social exclusion.

Economic well-being

Economic well-being is recognized as one of the most inclusive indicators of poverty. In this regard, poverty is associated with insufficient levels of income and consumption (Wagle, 2020) [44] and insufficient human development outcomes on health, education and assets. An alternative to using single indicators of poverty is using composite indices of wealth to capture the major aspects of poverty. The health status of household members can be a major indicator of well-being (Coudouel, Hentschel & Wodon, 2002) [11].

Analysis could focus on measuring outcomes such as the nutritional status of children or the frequency of distinct diseases such as malaria or diarrhoea (Smith & Ezzati, 2005) [43]. If data on such health indicators are difficult to collect, analysis could focus on measuring inputs such as the number of visits to health centres or children's immunization rates. Concerning education, the level of literacy could be used. In countries with very high literacy rates, the scores of school exams could be used as an outcome indicator. Another indicator could be the ratio of completed years of education to the years that should be completed (Coudouel *et al*., 2002) [11]. Schreiner (2014) [41] developed a simple standardized tool to measure poverty in its multidimensionality in Palestine. This tool is the simple poverty scorecards for Palestine. The national expenditure and consumption survey of 2011 was used to develop a scorecard of ten questions. The simple poverty scorecards are used to determine the statistical likelihood of microfinance borrowers and their households to live below or above several poverty lines including the national poverty lines.

The scorecards use indicators on household size, employment of household members, housing (main material of exterior walls) and ownership of durable goods (bookcases, computers, satellite dishes, televisions and video cassette recorders or digital versatile disc players, solar water heaters, landlines or cellular telephones). Such tool is designed to help MFIs determine the ratio of poor borrowers at different time intervals and track their movement in and out of poverty over time (Schreiner, 2014) [41].

Capability poverty

Sen (1999) [42] offers an alternative perspective on the definition of poverty. Poverty from the capability deprivation approach concentrates on deprivations in terms of rights and freedoms, unlike income, which is instrumental to the kind of life an individual is able to lead. People and societies differ in their capacities to convert financial and non-financial resources into achievements. For example, a disabled person needs extra resources such as a wheel chair and ramps in order to achieve what a normal person can achieve. Thus, it is very important to consider the capability of people to use resources such as income, goods and services at their disposal to make valuable achievements (Clark, 2004) [9]. Each answer in the questionnaire has a weighted score Sen (1999) [42] uses the terms “functionings” and “capabilities” to distinguish between being and doing. A functioning refers to what an individual can make using the commodities at his disposal. Achieving a functioning (such as being adequately nourished) using commodities depends on several personal and social factors such as age, gender, activity levels, body size, metabolic rates, and access to medical services. A capability refers to an individual’s ability to achieve a functioning, and reflects the individual’s freedom to choose a positive life style (Clark, 2004) [9].

As such, poverty is defined as one of the sources of “unfreedom”, where individuals are deprived of the freedom to access food to satisfy hunger, to access health care to receive treatment for curable diseases, and other rights to achieve their potentials that are inherent in their capabilities (Green Kirkpatrick & Murinde, 2006; Sen, 1999) [24, 42]. Sen (1999) [42] argues that freedom is at the heart of development, suggesting that the principal objective of development is to expand human capabilities rather than promoting economic growth. Income is not the only instrument in expanding capabilities (Sen, 1999) [42]. The effects of poor health and lack of nutrition can be much more persistent than can those of income. Health and nutrition not only affect well-being directly, but also have indirect and even more profound effects on the capabilities of individuals to derive income (Wagle, 2020) [44].

Social exclusion

Wagle (2020) [44] presents social exclusion as another important dimension of poverty. According to this dimension, poverty may still be persistent among individuals, even if they have adequate income, food, shelter and clothing, if they are excluded from economic, political, and cultural events (Wagle, 2020) [44]. Social exclusion broadens the definition of poverty beyond economic well-being and improved capabilities. In this respect, Saundres (2003) suggests that exclusion extends the concept of poverty beyond the lack of resources, cultural impacts on poverty. Social exclusion can be imposed through several forms of discrimination such as sexism and racial discrimination to deny certain individuals from access to economic activities. These activities include participation in the labour market, and access to assets such as credit and property (Peace, 2001) [36].

Exclusion from economic activities can also cause social isolation, driving individuals away from social networks (Wagle, 2020) [44]. Exclusion from political activities (such as elections) can disadvantage the poor, especially when those who participate in political activities have different needs and preferences. Few poor individuals tend to participate in political activities compared to better-off ones, and this results in implementing public policies and programs that may not respond to their needs and interests (Wagle, 2020) [44]. The role of social participation is important for increasing social capital through empowerment and for narrowing the inequalities gap. Individuals who are excluded from their social relations lose their links to mainstream society which negatively affect their social, psychological, political and economic experiences, ultimately driving the individual to remain or become poor (Peace, 2001; Wagle, 2020) [36, 44].

While income is instrumental for an individual to escape poverty, deciding whether an individual has an adequate income should take into consideration the existing difference in personal and social backgrounds among individuals. To identify meaningful indicators that capture poverty in its multidimensionality, a good starting point requires establishing a comprehensive analysis that especially those associated with Sen’s ideas of functioning and capability. Wagle (2020) [44] quotes the European Foundation’s (1995) definition of social exclusion as “the process through which individuals or groups are wholly or partially excluded from full participation in society in which they live” (p. 196). Social exclusion has economic, political and reflects access to financial resources and economic wellbeing by including income, wealth, education, state of health and nutrition, and type and extent of social participation (Wagle, 2020) [44].

All the national development plans inclusive of the vision 2030 strategy for Kenya’s industrialization recognize the importance of poverty alleviation (Government of Kenya, 1964, 1970, 1974, 1979, 1984, 1989, 1997, 2003, 2007) [13-23]. Equal emphasis is observed to have been focused on poverty alleviation in Kenya’s periodic session papers, which address economic development. Among these are Session Paper No. 10 of 1965 on African Socialism and application to planning in Kenya (GoK, 1965) [22]. Others are the District Focus for Rural Development Strategy (GoK, 1984) [17] and the *Economic Recovery Strategy for Wealth and Employment Creation* (GoK, 2003) [23].

The *Kenya Poverty and Inequality Assessment Report* (Government of Kenya, 2008) [28] gives a comprehensive poverty distribution in Kenya. This report indicates that in year 2005 47% of Kenya's population lives below the poverty line. This translated into 17 million people out of whom 14 million (82%) live in rural areas, in particular, the high potential agro-economic zone of Kenya's highlands. This report significantly notes that the officially estimated poverty rate in 1981 was 48% and suggested that over the long term, little inroads have been made in reducing poverty in Kenya.

The post-2015 millennium development goals under consideration have an ambitious but an attainable aim of attaining poverty alleviation by the year 2030 (O'Neil, Domingo & Valters, 2014) [35]. This is in harmony with Kenya Vision 2030 (GoK, 2007) [21]. The Overseas Poverty Institute Report (2014) strategy for poverty alleviation is to lessen poverty by stopping impoverishment, and sustaining poverty escapes. According to the Kenya Economic Report (2013), low income is one of the most important correlate of poverty that defines the poor even though it acknowledges that poverty is a multidimensional and complex phenomenon.

Microfinance has been globally recognized as an effective approach to poverty alleviation (Munguti, 2013) [34]. It is said to be a tool for providing a mechanism for poverty alleviation (Chowdhury, 2009; Hoda & Gupta, 2014; International Fund for Agricultural Development [IFAD], 2007) [8, 25, 27]. The microfinance revolution has changed attitudes towards helping the poor in many countries especially, the low-income households (Appah, John & Wisdom, 2012) [2]. Adams (2010) [1], an advocate of microfinance argues that microfinance is a powerful tool to alleviate extreme poverty. It is the aim of this research to provide a model for analysing the impact of microfinance on the poor with respect to delivery of products and services, outreach, target and inclusion of the poor.

Materials and methods

The study was based on secondary research. Data for the study was drawn from existing literature on microfinance lending to the poor. The keywords used in searching for the relevant literature included financial inclusion, the poor, developing countries, poverty eradication, among others. Various articles and publications were accessed online through the Margaret Thatcher Library of Moi University, Kenya. The reviewed publications included relevant journal articles, book chapters and some media reports on microfinance lending in developing countries. The literature was evaluated and findings drawn and interpreted.

Results and discussion

Microfinance products and services

Mader (2016) [31] defines microfinance as a movement that caters for the needs of low-income households by offering them access to affordable financial services to "finance income producing activities, build assets, stabilize consumption, and protect against risks." The terms 'microfinance' and 'microcredit' were initially used interchangeably to refer to very small loans extended to unemployed borrowers who lack traditional collateral (Microfinance Gateway, 2016). Over the past decades, however, MFIs have developed their products and services to meet the diverse financial needs of the poor around the world.

Today, the term 'microfinance' includes a range of financial and non-financial products and services. MFIs offer a variety of products and services, including enterprise loans for enterprise formation and development, consumption smoothing loans for those who suffer from income fluctuations, savings, transfer payments, micro-pensions, insurance and remittances (Brau & Woller, 2004; Littlefield, Morduch & Hashemi, 2003; Cull, Demirgüç-Kunt & Morduch, 2011) [7, 30, 12]. In addition, some MFIs integrate development services such as education and health care with financial services. Other MFIs provide various non-credit services as well to improve business performance and empower entrepreneurs by developing their skills through capacity building initiatives (Pitt & Khandker, 2002) [37]. Various lending methodologies are used by MFIs to extend loans to borrowers such as group lending, forced savings, and the gradual expansion of credit depending on borrower's credit repayment history (Microfinance Gateway, 2016).

This review of microfinance products and services would not be complete without a brief discussion of client targeting in terms of gender. Some MFIs focus on women empowerment. From their point of view, women are likely to be more financially constrained than men, with restricted access to credit and employment (Pitt & Khandker, 2002) [37]. Access to credit can empower women economically and enhance their confidence and self-esteem within the family (Kevane & Wydick, 2001) [29]. Other MFIs target women based on the belief that women use their loans in productive activities in order to improve household welfare while men tend to spend loans on consumption (Brau & Woller, 2004) [7]. So far, this section has introduced some of the most important aspects of microfinance. The next section presents in detail the different views on the role of microfinance in alleviating poverty.

Analysis of the impact of microfinance

Microfinance as a development intervention tool has been challenged. Literature on microfinance includes controversial claims and debates on its impact on the poor. There is no consensus among researchers on its impact (Banerjee, Duflo, Glennerster & Kinnan, 2015a) [3]. While some research finds that access to microfinance reduces poverty (Pitt & Khandker, 2002; Kevane & Wydick, 2001; Banerjee *et al.*, 2015b) [37, 29, 4], others argue that microfinance has little impact on poverty reduction (Morduch & Haley, 2001) [33]. Despite the voice of sceptics on the impact of microfinance, some studies were successful in showing positive results in various settings using different methodologies.

Impact assessments have shown how some MFIs work towards financial and social bottom-lines by displaying positive impacts of microfinance on various variables such as the well-being of poor households, female empowerment, self-employment profits, and psycho-social status (Brau & Woller, 2004; Banerjee *et al.*, 2015b) [7, 4]. On the far extreme, sceptics fear that microfinance has an overall negative impact that reduces incremental income and contributes to over-borrowing, leading to greater long-term effects of poverty (Banerjee *et al.*, 2015a; Chowdhury, 2009) [3, 8]. In his letter to the *Financial Times* in 2008, Milford Bateman is quoted saying: "In nearly 25 years of academic and consulting work in local economic development, my experience is that microfinance [programmes] most often spell the death of the local economy"

(Banerjee *et al.*, 2015a) [3].

Bateman argues that savings are critical for development and should be intermediated into 'growth and productivity enhancing projects' instead of mobilizing them to the informal sector through commercial microfinance programs that would direct the economy into a "non-industrial future and unending poverty" (Bateman, 2008) [6]. Critics also refer to other negative impacts of microfinance such as exploitation of women by not paying for their labour, increased workloads for women who have to work inside and outside the house, and child labour where children are forced leave school to work with their families (Rooyen, Stewart & Wet, 2012; Bateman & Chang, 2012) [39, 5].

Impact assessments of microfinance across the world

Among the most cited studies on the positive impact of microfinance is that of Pitt and Khandker (2002) [37]. Using data collected over the period 1991-1992, the study examined three group-based microcredit programs that work with the rural poor in Bangladesh. To account for potential biases resulting from unobserved characteristics at the individual, household and village levels, Pitt and Khandker used a quasi-experimental design. A comparison is held between the difference in impact between eligible treated and ineligible untreated individuals in treatment villages and the difference between eligible untreated and ineligible untreated individuals in control villages. Pitt and Khandker found that credit provided to both men and women significantly affects household expenditure, with the effect being greater when credit is provided to women. In addition, the study finds that credit provided to women significantly affects non-land asset holdings by women, labour supply, and schooling of boys and girls. The dependent variables used by Pitt and Khandker serve as good indicators for poverty in its multi-dimensional definition.

Another study by Kevane and Wydick (2001) [29] found a positive impact of an MFI's credit programme (FUNDAP) in Guatemala. The study relied on a 1994 survey to test whether providing credit to women in order to finance capital can result in a trade-off between economic growth and poverty reduction. The sample was composed of 260 entrepreneurs, where each entrepreneur belonged to a borrowing group consisting of three to six members. The sample also included a control group, which was composed of 82 non-borrowers with very similar characteristics to FUNDAP borrowers. The study found a significant difference between male-owned enterprises and female-owned enterprises in terms of employment generation, where women are less likely to witness employment growth since they spend more time at home during child bearing and child raising years to care for their children. Moreover, the study did not find a statistically significant difference between female and male-owned enterprises in terms of their ability to increase sales (Kevane & Wydick, 2001) [29]. Aside from the main research question, the results of Kevane and Wydick's study imply a positive role of microfinance in poverty reduction translated into employment generation and increases in sales.

Coleman (2006) [10] employed a survey to examine whether two village bank programs in Northeast Thailand target the "poorest of the poor" while controlling for potential biases arising from self-selection and program placement. The study compared the difference in outcome between existing and former borrowers and eligible non-participating individuals to the difference in outcome between new borrowers (whose loans were not released at the time of survey) and eligible non-participating individuals. The beneficiaries' level of poverty was identified using the value of land owned five years prior to the survey. Findings of the study showed a significant positive impact of microfinance on the better-off borrowers in terms of wealth (measured by non-land assets, productive assets, livestock and consumable durables), savings, sales, productive expenses, and labour time. The better-off borrowers were the richest village bank members who used their influential positions to borrow significantly from the village banks compared to rank and file members. These findings implied that a positive impact of microfinance on the poor may be achieved by enforcing eligibility criteria on measures of wealth to ensure that the poorest are those who benefit from microfinance and not those who are better off.

Coleman's (2006) [10] findings coincide with evidence from earlier studies on the impact of microfinance. For instance, Chowdhury (2009) [8] refers to studies undertaken by Hulme and Mosley (1996) which found that borrowers who are above the poverty lines can enjoy significant positive impacts of microfinance. These findings showed that credit is not the only factor for producing a positive impact. Other complementary factors are crucial for making credit more productive, and entrepreneurial skills are among the most important factors. In addition, basic education and experience are essential factors for understanding and managing simple business activities, yet most poor people do not have them (Chowdhury, 2009) [8].

In a more recent study, Banerjee *et al.* (2015b) [4] investigated whether a multidimensional graduation program aimed at the extreme poor can help them establish and sustain self-employment activities while producing lasting improvements on their well-being. Over the years 2007 to 2014, randomized trials in six countries, namely Ethiopia, Ghana, Honduras, India, Pakistan and Peru, were conducted. Over ten thousand households from eligible villages suffering from extreme poverty in the six countries were selected. After one year from starting the program, the results from all sites showed positive impacts of the programme on consumption, food security, assets, income and revenues, physical and mental health, political involvement and women empowerment.

The positive impact on consumption, food security and assets increased one year later (after three years from starting the intervention). The positive impact on income and revenues and mental health declined yet remained positively significant after one year from conducting the first end line survey while the impact on physical health and women empowerment declined and became even insignificant (Banerjee *et al.*, 2015b) [4]. Despite the variations in effect after one year from completing the programme, the results imply that it is possible to improve the economic status of the poor (particularly in consumption, food security and asset ownership) in a relatively short time.

Another three-year randomized study was conducted by Banerjee *et al.* (2015a) [3] to avoid potential biases resulting from self-selection and programme placement. The study found that microcredit can support some borrowers in expanding their businesses, yet it does not help them escape from poverty. The study does not find a significant difference in monthly per capita consumption (an indicator for overall welfare) or monthly non-durables expenditure. A significant positive impact on obtaining durables was reported, but it turned that these durables are financed partly by reducing temptation goods and partly by increasing labour supply. Business profits do not increase for most businesses, although the study finds a significant increase in the upper tail of profitability. The study does not find any significant effect on outcomes such as education, health and women empowerment in the short run (Banerjee *et al.*, 2015a) [3]. It is therefore very critical to assess whether social progress can be attributed to microfinance, noting that it has been seen in Asian countries long before microfinance emerged (Chowdhury, 2009) [8].

Conclusion

The review of literature shows that a positive impact of microfinance on household welfare and economic activity is possible despite the variation in the assessments' methodology, time and location. At the household welfare level, significant positive changes are identified on several outcomes including income, wealth, household expenditure and consumption, savings, food security, children schooling, non-land asset holdings, physical and mental health and empowerment. At the business level, positive impacts on employment, sales and business expansion are reported. However, the findings show that the impact varies in significance and magnitude depending on a number of factors such as borrowers' gender, level of poverty, and level of education and experience, in addition to the time span of the assessment.

Recommendations

Microfinance interventions will become more relevant for development if perceptions of service users as fare as the influence of microfinance to their welfare are taken into account in the design and implementation of microfinance interventions. A perusal of extant literature indicates that few studies have examined the effect of the various components of microfinance interventions on households and general wellbeing of service users. Furthermore, studies that try to systematically link the components of microfinance interventions to poverty outcomes (household effects) from the perspective of service users and taking contextual information into consideration are fewer in the microfinance literature. Contributing to the research gap just mentioned is perhaps the most important justification for further studies and innovation in microfinance studies. The findings of such studies should not only add to the literature on microfinance but have practical relevance in the microfinance industry. They should also enhance microfinance's relevance to poverty reduction.

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