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Is microcredit a blessing for the poor? A meta-analysis examining development outcomes and contextual considerations

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ABSTRACT

Increasing efforts aim at economic development and the reduction of poverty in developing countries through microcredit-enabled entrepreneurship. Following the award of the Nobel Peace Prize to Prof. Yunus, microcredit lending has risen to prominence and the volume of microcredit loans has increased substantially. However, theory on the outcomes of this financing form is controversial. Furthermore, the academic community lacks conclusive empirical evidence about the impact of such programs. Primary empirical studies report fragmented and to a large extent contradictory results. In this meta-analysis, we empirically synthesize a total of 545 quantitative empirical findings from 90 studies conducted to date. Our findings reveal a positive impact of microcredit on key development outcomes at the level of the client entrepreneurs. Additionally, we scrutinize how the development context influences the effectiveness of microcredit and find that microcredit generally has a greater impact in more challenging contexts. With our findings we contribute to research on the nexus of entrepreneurship and economic development, and offer recommendations for practitioners and academics working on this promising frontier.

1. Executive summary

Poverty remains one of the key global challenges. According to the World Bank (http://www.worldbank.org/en/topic/poverty/overview), 1.22 billion people lived in extreme poverty with an income of less than $1.25 a day in 2010. Furthermore, these people have little means for personal development (Chen and Ravallion, 2007). Their lack of access to financial resources has been proposed as a key obstacle blocking their development (Chen and Ravallion, 2007; Stiglitz, 1990; Yunus, 1998). Without access to financial resources poor individuals face difficulties to initiate, maintain and expand economic activities. Due to a lack of financial capital they have little chance of benefiting from positive effects of entrepreneurship even though these individuals might perceive promising business opportunities.

While some scholars proposed microcredit as a salient instrument to address credit constraints, enable entrepreneurial activity and broadly foster individual development, other scholars challenge the proposed benefits (Kent and Dacin, 2013; Morduch, 1999; Stewart et al., 2010). Furthermore, the controversy in the theoretical domain is reflected by conflicting findings about consequences of microcredit in the empirical domain (Hermes and Lensink, 2011; Khavul et al., 2012).

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To address the controversy, our meta-analysis synthesized the vast yet fragmented empirical research on outcomes of microcredit. Following Amartya Sen's prominent theorizing on capabilities and his conception of development as freedom (1999), we report the effect strengths of microcredit on various financial (venture survival, venture growth and venture profitability as well as the financial well-being of the individual) and non-financial (empowerment, education, health and nutrition) outcomes. Moreover, we scrutinize how the development context – namely characteristics at the country level – affect the strengths of the microcredit-outcome relationships. Some scholars have argued that microcredit is a substitute for traditional financing instruments (Ghatak, 1999; Stiglitz, 1990), hence suggesting that the performance effect should be greatest in less developed countries where institutions fail. In contrast, others have proposed synergistic relationships between increasing levels of social, economic and institutional development and the performance effects that additional development interventions such as microcredit can generate (De Soto, 2003; Sen, 1999).

Building on 545 empirical effect sizes from 90 individual studies, our meta-analysis uncovers various positive effects on human development outcomes including venture growth, venture profitability, financial well-being, health & nutrition, empowerment of women as well as education. However, the effect strengths are markedly different. Further, no effect was determined with regard to the survival of microcredit funded ventures. With respect to the development context, we find that the majority of moderating effects are negative, indicating support for the view that microcredit is most beneficial in weak institutional environments, for instance where access to health support or education is limited or political freedom and transparency are reduced (for specific contextual effects consult Table 2). Yet, we also find exceptions to this general pattern, including positive moderating effects of economic development on the relationships between microcredit and venture growth as well as financial well-being of clients. Moreover we find that in a context of greater political freedom, the effectiveness of microcredit for women's empowerment is increased.

We discuss our various findings and point to future research opportunities that can help determine how and under which circumstances microcredit financing can foster the economic and broader development of the poor at the base of the pyramid. Furthermore, we encourage researchers to make comparisons across different development interventions to gain a better understanding of the promise of microcredit financing vis-a-vis alternatives for fostering development.

> "If we are looking for one single action which will enable the poor to overcome their poverty, I would go for credit. […] If we can come up with a system which allows everybody access to credit while ensuring excellent repayment — I can give you a guarantee that poverty will not last long."
>
> [Yunus (1994)]

> "Micro-lenders make the people of this country their guinea pig. They are sucking blood from the poor in the name of poverty alleviation."Sheikh Hasina, Bangladesh Prime Minister (The Financial Times, 2010)

2. Introduction

Large parts of the world's population live in poverty and do not have access to financial resources (Chen and Ravallion, 2007). In consequence, these individuals face challenges to initiate, maintain or grow their venture activities and to participate in market transactions. Without the capability to actively engage in market transactions, they and their associated families might be forced into subsistence-based lives (Yunus, 1998). A lack of collateral, frequently non-existent credit histories and limited property rights of poor individuals coupled with high transaction costs of the minimal loan amounts demanded, thwart conventional banking organizations from providing credit to the poor and lead to an imperfect credit market (Ghatak, 1999; Stiglitz, 1990; Webb et al., 2013). Although these individuals and their families might perceive promising business opportunities, failure to obtain the necessary financial resources can prevent them from pursuing these opportunities and engaging in entrepreneurial activities. As a consequence, they have little chance of benefiting from the wealth-enhancing effects of entrepreneurship (Guiso et al., 2004; King and Levine, 1993; Schumpeter, 1934) and thus of escaping persistent poverty traps (Yunus, 1998). In this regard, it is important to note that entrepreneurship for individuals living in poverty in developing countries has important ramifications that transcend the generally studied entrepreneurship phenomenon in developed countries.

In the past decades, microcredit (MC hereafter) has become a popular instrument to address credit constraints and enable entrepreneurial activity (Yunus, 1998). MC schemes refer to "the issuance of small, unsecured loans to individuals or groups for the purpose of starting or expanding businesses" (Khavul, 2010: 58). According to data collected by the Microfinance Information Exchange, more than 3600 MC providers had reached over 205 million borrowers as of 2010 (Maes and Reed, 2012).

While MC has grown into a worldwide industry, scholars have raised doubts regarding the actual impact of MC for the client entrepreneurs (Hermes and Lensink, 2011; Morduch, 1999). They point to a lack of profit-generating potential of the financed ventures (Bradley et al., 2012; Hulme, 2000; Karnani, 2007); a lack of management skills of the entrepreneurs (Evers and Mehmet, 1994); and high interest rates (Webb et al., 2013). This raises the question of whether entrepreneurs are able to generate sufficient income to cover the costs of loans and assure loan repayment. Hence, controversy in the theoretical domain leaves the academic community in doubt about the effects of MC on development outcomes for the MC recipients (Kent and Dacin, 2013).

In order to address the controversy in the theoretical domain, a proliferating body of empirical studies has emerged, investigating the effects of MC on recipients. Surprisingly, while some studies present positive results of MC (Dunn and Arbuckle, 2001; Khandker, 2005; McKernan, 2002), several other studies have reported non-significant, or even negative impacts of MC on financial outcomes