

CHAPTER II

LITERATURE REVIEW

2.1 Introduction

This chapter provides an overview of microfinance and MFIs in Burma, the contentious debate about the relationship between sustainability and outreach, and two different approaches to microfinance. It then discusses the three most prominent and successful MFIs in the world: the Grameen Bank in Bangladesh; BancoSol in Bolivia; and Bank Rakyat Indonesia (BRI). The chapter then elaborates key factors for sustainability and outreach, and concludes with a discussion of the main challenges to sustainability and outreach.

2.2 Microfinance

Microcredit and microfinance are slightly different from one another although practitioners and scholars tend to use them synonymously. Microcredit refers to the provision of small loans to the poor who lack collateral and are therefore not considered creditworthy by formal commercial banks (Armendariz and Morduch, 2005: 14). Microfinance, on the other hand, includes the provision of small loans, savings services, insurance, and other banking services (Armendariz and Morduch, 2005: 14; Robinson, 2001: 9).

MFIs use social collateral or capital, rather than the material collateral, to guarantee loans. Social capital consists of trust, reciprocity, information, and norms. Horizontal social capital exists among agents of the same status and power, while vertical social capital exists among unequal agents with hierarchical relations (Dowla, 2006: 116). The role of vertical and horizontal social capital is crucial in attaining high repayment rates as members are either pressured by their peers or bank staff to regularly repay their loans.

Some scholars, such as Marguerite Robinson, argue that commercial MFIs sustain themselves financially and become self-sufficient by providing loans to “economically active” poor and by achieving greater outreach. By contrast, non-profit poverty-alleviating MFIs are dependent on funds and in this sense are not sustainable (Robinson, 2001). In other words, she argues that reaching the very poor entails high risks and costs to the sustainability of MFIs.

Muhammad Yunus, the founder of the Grameen Bank, however, criticizes the profit-based MFIs because such schemes operate like conventional banks by providing loans with very high interest rates to the more wealthy of the poor (Yunus, 2007: 69). Yunus asserts, “Make all the profit you want from your middle-class customers ... but don’t apply the same thinking to the poor. If you lend to the poor, do it without concern for profit” (Yunus, 2007: 69).

Researchers, including Robinson, however, argue that the very poor do not have the entrepreneurial skills to make effective use of loans and thus provision of loans to the very poor entails high risks for both the borrowers and the MFI. Robinson adds that very poor people also lack basic infrastructure and access to markets that are necessary in order to make effective use of loans and to repay the principal and interest. Therefore, MFIs, both commercial and not-for-profit, face obstacles of low repayment rates due to outreach to the very poor (Robinson, 2001: 20). Moreover, Robinson argues, it is not the responsibility of MFIs to alleviate such poverty and reach the very poor, but rather such responsibility falls upon the government, donor agencies, and private charities.

2.3 Welfarist and Institutional Approaches to Microfinance

Two main normative approaches for assessing MFI’s performance are the welfarist and the institutionalist approaches⁷ (Bhatt and Shui-Yan, 2001; Schicks,

⁷ Welfarist and institutionalist approaches are also referred to poverty and sustainability approaches respectively (Edward and Olsen, 2006: 31; Schreiner, 2002: 591).

2007; Olivares-Polanco, 2005: 48; Woller and Woodworth, 2001). The welfarist approach focuses on alleviation of poverty and reaching the poorest of the poor, and thereby maximizes MFI's welfare impact (Schreiner, 2002: 591; Bhatt and Shui-Yan, 2001). Schreiner argues that the welfarist approach puts "a very high weight on the poorest and little or no weight on anyone else" (Schreiner 2002: 597). By contrast, the institutionalist approach focuses on providing financial services to "large number of poor people on a sustainable basis," thereby broadening the number of borrowers (Bhatt and Shui-Yan, 2001). The institutionalist approach is "more willing to make trade-offs between the poorest and the less-poor" (Schreiner, 2002: 597). Christen argues that sustainable MFIs' "initial mission was not reaching the poorest of the poor" but rather "to generate employment in the urban microenterprise sector" (qtd. in Olivares-Polanco, 2005: 55).

Schicks distinguishes MFIs as either sustainable MFIs, such as BancoSol from Bolivia, or "charitable" MFIs, such as the Grameen Bank in Bangladesh (Schicks, 2007). Sustainable MFIs' main goals are to provide "profitable high quality financial services to low-income people in need of financial services, whereas charitable MFIs main goals are to provide financial services to the poor in order to alleviate poverty.

Although this distinction about the different approaches and types of MFI may be useful in theory, in reality MFIs often do not work in such clear-cut ways. As Schicks notes, such differentiation is "artificial" and represents "an abstraction from a large continuum of institutional types in reality" (Schicks, 2007: 560). Some MFIs, including MRBCCU, adopts both welfarist and institutionalist approaches as their mission is to reduce poverty and yet they lack access to subsidies and so they must become sustainable. Many researchers and practitioners urge for the need of both types of MFIs as they carry out different social missions and reach different target groups (Bhatt and Shui-Yan, 2001; Schicks, 2007: 565).

2.4 Trade-offs between Sustainability and Outreach?

Debate persists about the relationship between sustainability and outreach to the very poor. Most experts agree that there is a relationship between sustainability and outreach, but disagree about its nature. Some argue that a trade-off exists between sustainability and outreach to the poor, while others argue that a complementary relationship exists, and still others argue that sustainability is a means to achieve outreach to the poor (Meyer, 2002: 4; Rhyne, 1998: 7; Tucker, 2001: 108; Otero, 1999: 14).

2.4.1 Proponents of trade-off between Sustainability and Outreach

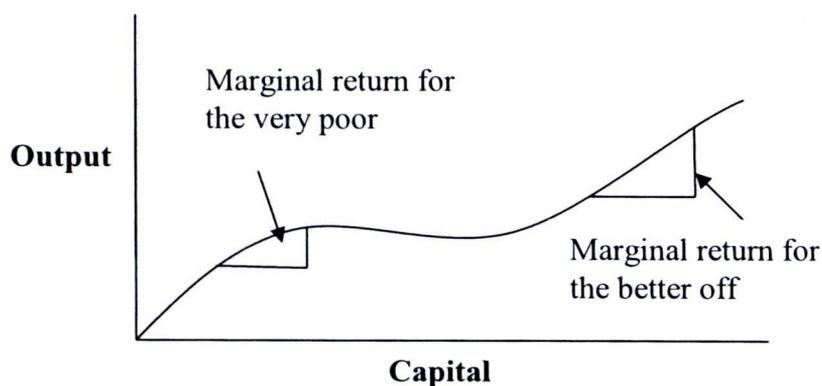
A variety of factors are attributed to the inverse relationship between sustainability and outreach to the very poor. Some scholars argue that sustainable MFIs cannot reach the very poor because small loans for them are costly and because the very poor are risky and lack entrepreneurial skills (Maes and Basu, 2002: 72; Paxton, Graham, and Thraen, 2000; Robinson, 2002: 20; Tucker, 2001: 111). They argue that the poor tend to use loans to smooth their consumption due to their low and irregular income, and are therefore unable to use their loans for “promotional” activities (McGuire and Conroy, 2000: 99; Montgomery and Weiss, 2005: 6). The poor also voluntarily exclude themselves from borrowing (Maes and Basu, 2002: 72). In addition, they argue that very poor are more likely to be excluded as peer members in a solidarity group⁸. Bank staff may also exclude the very poor because they are worried about default (Montgomery and Weiss, 2005: 6).

The same school of thought argues that the very poor may not be able to afford the high interest rates charged by the MFIs as marginal returns on small loans are lower than those received by better-off borrowers as shown in figure 2.1 (Montgomery and Weiss, 2005: 6; Armendariz and Morduch, 2005: 19). Therefore,

⁸ This grouping is a well-known loan methodology applied in Grameen style MFIs in order to create peer social pressure. Three to five members form a group and guarantee one another's loans.

they are more likely to get into financial difficulties when they borrow money (Montgomery and Weiss, 2005: 6).

Figure 2.1 Marginal Returns on the Very Poor and the Better-off borrowers



Source: Armendariz and Morduch, 2005: 19

Note: Output is the outcome or result of the capital investment. Capital is the money the borrower uses for investment.

Von Pischke (1996) argues that all types of MFIs “face a trade-off between outreach and sustainability within a medium-term horizon such as three to five years [after establishment]”. Pischke calls such a trade-off “common sense” because he believes “not everyone is creditworthy” or “capable of repaying a lender” (Pischke, 1996: 227). He adds, “At some point the outreach shoe begins to pinch the sustainability foot; later it cripples it” (Von Pischke, 1996: 228).

David Hulme (2007) disregards the “rhetoric” that microfinance is for the very poor and that MFIs can be sustainable by reaching the poor. He is blunt about the trade-off between sustainability and outreach to the very poor. Hulme asserts, “MFIs virtually never work for the poorest ... and many MFIs have high proportions of clients who are non-poor ... Those who present microfinance as a magic bullet to reduce poverty ... [are] simple-minded” (Hulme, 2007: 20-21).

Hulme argues, “MFIs have created a myth that poor always manage to repay their loans because of their ability to exploit business opportunities. This is nonsense ... we should call microcredit ‘microdebt’” (Hulme, 2007: 19). Hulme argues that many MFI dropouts felt threatened by their peers, staff, and the police, and believed that they were in danger of having their possessions confiscated or being the victims of physical violence (Hulme, 2007: 20). In addition, indebted borrowers suffer from “the internalization of guilt (or shame) to an extreme of irrationality” (Ditcher, 2007: 15). Such guilt or shame “becomes externalized as anger, resentment and even violence towards others” (Ditcher, 2007: 15). Thus, indebted persons end up feeling “unequal in stature, unempowered, diminished, and could even undergo a loss of identity. One possible result of this is suicide” (Ditcher, 2007: 14).

These scholars, however, attempt to represent absolute reality and truth about what works and what does not work with the very poor, leaving the very poor behind the curtain. These studies fail to bring the direct words or expressions of the very poor borrowers or non-borrowers, but merely mention the very poor as voiceless people and objects of study.

2.4.2 Disputants of the Trade off between Sustainability and Outreach

The disputants argue that greater outreach to the poor helps create financial sustainability. Sustainability also enables the MFIs to reach large numbers of poor in the long run and yield high repayment rates. In addition, borrowers have incentives to repay loans because they expect to receive future services from the sustainable MFIs (Mersland and Strom; 2010: 35; Navajas et al, 2000: 335; Rhyne, 1999: 7; Tucker, 2001: 108). Contrary to Hulme and Ditcher, Khandker claims, “microcredit programs

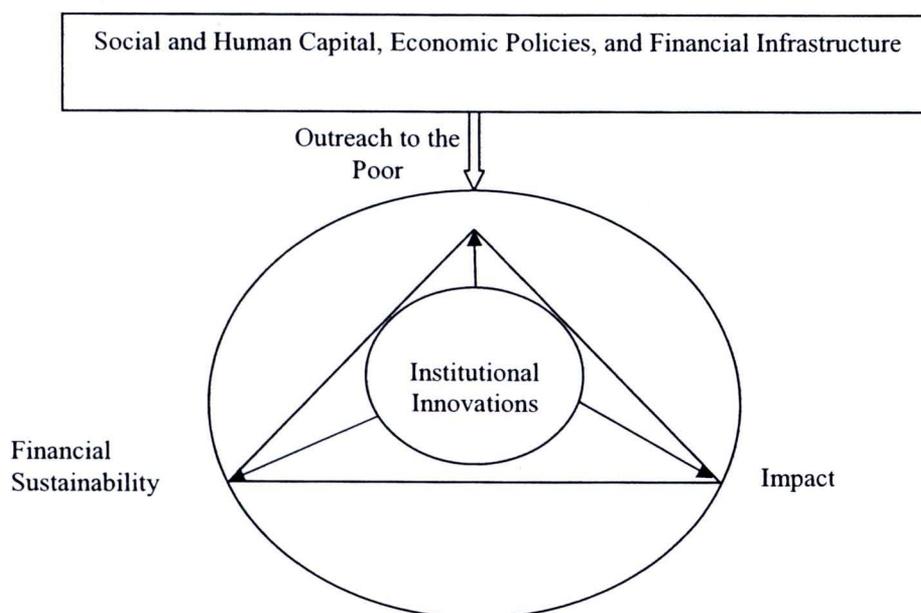
have been able to reach the poor and enhance productivity and human capital by generating self-employment opportunities” (Khandker, 1998: 146).

Elisabeth Rhyne argues that outreach to the poor is the end goal of MFIs, while sustainability is the means to achieve it (Rhyne, 1999: 7; Otero, 1999: 14). Consequently, Rhyne argues that commercialized sustainable MFIs are better at serving the poorest because such institutions tend to be more efficient and to seek new markets for their services to gain higher profits (qtd. in Mersland and Strom, 2010: 28).

2.5 A Critical Microfinance Triangle

Manfred Zeller and Richard Meyer (2002) developed a “critical microfinance triangle” in order to analyze the performance of MFIs (qtd. in Meyer, 2002: 2). The three critical components of the triangle are financial sustainability, outreach to the poor, and impact (see figure 2.2).

Figure 2.2 A Critical Microfinance Triangle



The outside of the triangle is the environment that affects the performance of the MFI (Meyer, 2002: 2). The environment refers to the economic policies of the country, the social and human capital, and the quality of the financial infrastructure. The inner circle represents the MFI's innovations in “technology, policies, organization, and management that affect how well each objective is met” (Meyer, 2002: 2).

The MFI's sustainability has two dimensions: operational sustainability and financial sustainability (Sengupta and Aubuchon, 2008: 22). Microfinance Information Exchange (MIX) defines sustainability as “an organization's ability to cover costs” which can be measured along a continuum ranging from not sustainable to financially sustainable (Microfinance Information Exchange, 2010).

When MFIs operate without subsidies they tend to charge high interest rates and tend to offer loans to the marginally poor rather than the very poor in order to

reduce risks and maximize repayment rates (Sengupta and Aubuchon, 2008: 21). This creates ‘a dichotomy between financial independence and poverty alleviation’.

Measuring impact on borrowers is “the most difficult and controversial aspect of performance evaluation” due to the methodological problems and high costs of doing research (Meyer, 2002: 5). Meyer claims that “the most important evidence of impact should be whether or not MFI clients continue to use the services” (Meyer, 2002: 5). The underlying assumption is that if borrowers continue to use the services, the benefits of borrowing outweigh the costs. Accordingly, Meyer argues that measuring impacts should center on the impacts on MFIs’ services to the poor, not the impacts on clients. Because it overlooks what happens with borrowers and their loans, and neglects the impacts of loans on borrowers in terms of mental well-being and self-esteem, it puts borrowers in a black-box.

2.6 Key Factors for Repayment Rate

The two most successful microfinance institutions, Grameen Bank and Bank Rakyat Indonesia (BRI), use three key common principles in their loan methodologies (McGuire et al, 1998: 9). First, they create convenient office locations and simple application procedures for borrowers so that borrowers feel that the benefits are higher than the costs. Second, they use decentralized approvals and have the borrowers handle the loan processes. Third, they use self-selected grouping and progressive lending, compulsory savings, incentives for borrowers who repay regularly, and ‘intensive motivation and supervision of borrowers’ (McGuire et al, 1998: 9).

Joint liability through group solidarity helps each borrower of the group guarantee one another’s repayments of their loans. Joint liability encourages members to form a group with people they trust, thereby providing screening for the MFI, which lacks a history of the creditworthiness of potential borrowers.

Progressive lending helps borrowers repay their loans by offering “small initial loans, with the promise of future credit for timely repayment” (Sengupta and Aubuchon, 2008: 20). In addition, penalties can be used for late repayment by using threats to cut off future loans, or to cut off interest rates on compulsory savings (Morduch, 1999: 1582).

Frequent weekly repayments may also help maintain high repayment rates and help borrowers with their saving difficulties, including “seasonality of income, family members dropping by to borrow funds, or discretionary spending” (Sengupta and Aubuchon, 2008: 20).

Another mechanism for ensuring repayment is through nontraditional collateral with “notional value” to the borrower. A bank may not be able to sell such collateral without a high transaction cost, but it “would be even more difficult and costly for the family to do without [it]” (Sengupta and Aubuchon, 2008: 21).

2.7 Key Factors for Default

The World Bank highlights three factors that contribute to overdue loans: borrowers’ failure to use the loans for productive purposes; the ‘failure of investments undertaken’; and poor ‘repayment ethics’ (Padmanabhan, 1988: 67). Causes of defaults can be measured at several levels: the borrower level, the MFI level, and the economy level. (Padmanabhan, 1988: 68-69).

Factors that contribute to default at the borrower level are:

- bad loans to unwilling borrowers who become inefficient producers and defaulters;
- use of loans in ‘non-essential consumption’;
- failure in investment undertaken due to natural disasters;
- borrowers’ use of various financial services which get priority in repayment;

- use of loans for contingencies, such as death and sickness;
- lack of incentive for repayment;
- low level of real interest rate; and
- borrowers who are “politically powerful” committing strategic default.

The causes of default at the MFI level include:

- poor quality of loan officers and their capacity to determine effective borrowers due to the lack of incentives for staff good performance;
- ‘absence of supporting services’ or failure to advise borrowers;
- inappropriate repayment schedules;
- lack of sanctions against defaulters;
- lack of frequent contact with borrowers;
- lack of education or advice for borrowers;
- absence of sound book-keeping; and
- declining loan portfolios that reduce borrowers’ trust about the sustainability of the MFI and expectations about future loans (Padmanabhan, 1988: 68-69).

Marr argues that the root cause of default rates is information asymmetries (Marr, 2002: 20). Asymmetric information between MFIs and borrowers occurs as MFIs do not know what causes the borrowers’ default. Because of information asymmetries, MFIs are “unable to observe whether default is due to a negative economic shock or strategic default by the borrower” (Tedeschi, 2006: 88). Stiglitz and Weiss (1981) elaborate that lenders or banks have “imperfect information” as they have difficulties in identifying borrowers who are creditworthy and more likely to repay loans (Stiglitz and Weiss, 1981: 393). They write, “the bank is not able to directly control all the actions of borrowers” (Stiglitz and Weiss, 1981: 394).

2.8 Challenges to Achieving Sustainability

At the institutional level, MFIs with lack of *accountability and transparency* face hurdles in achieving sustainability. MFIs need to design “a system of

accountability that works for both program officials and borrowers ... and must therefore ensure a socially conscious and transparent system” (Khandker, 1998: 154).

The *macro-economic and political environment* of a country affects the sustainability of MFIs. For instance, Turnell notes that Burma’s weak financial sector and high inflation impede sustainability of MFIs (Turnell, 2009). In addition, *a lack of good governance and lack of freedom to set interest rates* also impede the success of sustainability (Conroy, 2003: 154-155).

“Easy” donor money, *subsidies*, or a “perpetual source of support”, creates *moral hazard* for both staff and borrowers even though it may enable the MFI to reach the very poor by charging lower interest rates (Navajas et al, 2000: 336; Seibel and Torres, 1999: 126). Morduch, Rutherford, and Ruthven (2009) give as an example of moral hazard how “being insured for one’s health may also change one’s behavior” (Morduch, Rutherford, and Ruthven, 2009: 88). In the case of MFIs, when both staff and borrowers know that they will receive grants or subsidies from donors they have fewer motivations to work hard for high repayment. In addition, subsidies also become a substitute for local savings, as staff may not work hard to mobilize savings so as to build a sustainable MFI (Seibel and Torres, 1999: 126).

2.8.1 Educational Loans

The types of financial contracts and services made available to borrowers are significant to the sustainability of MFIs because different types of loans enable the institution to meet the varying demands of its borrowers. For instance, the Grameen Bank offers student educational loans with zero percent interest during the period of study and 5 percent after the degree (Yunus, 2007: 65). Yunus claims, “We are creating a completely new generation that will be well equipped to take their families way out of the reach of poverty” (Yunus, 2007: 60).

One of the sixteen social goals of the Grameen Bank is, to “educate our children and ensure that they can earn to pay for their education” (Yunus, 2007: 59). Accordingly, the Grameen Bank encourages both borrowers and staff to send their children to schools by giving over 30,000 scholarships every year to the children of the borrowers. It also set up the Grameen Education and Scholarship Management Program that invites donors to contribute a minimum of \$750 for scholarships (Yunus, 2007: 91). Yunus claims that some of the borrowers’ children become “doctors, engineers, college teachers, and other professionals” (Yunus, 2007: 60). Providing such educational loans to borrowers can, thus, help maximize both the welfare of the borrowers’ families and the sustainability of the MFIs.

2.9 Three Empirical Case Studies

This section elaborates the sustainability and outreach of the well-known MFIs: the Grameen Bank from Bangladesh, BancoSol from Bolivia, and Bank Rakyat Indonesia (BRI) (Morduch, 1999: 1573-1578; Schicks, 2007: 553-557).

2.9.1 Sustainability and Outreach of the Grameen Bank

Many practitioners and researchers agree that the Grameen Bank has had great success in reaching the very poor and has thereby fulfilled its social mission in terms of depth of outreach (Morduch, 1999: 1575, Schicks, 2007: 558).

However, many, including Morduch and Robinson, argue that the Grameen Bank’s remarkable outreach is only possible through subsidized loans (Morduch, 1999: 1575; Robinson, 2001: 95). Robinson (2001) argues that unlike BRI and BancoSol, the Grameen Bank does not emphasize “full cost recovery and commercial funding, hallmarks of the microfinance revolution” (Robinson, 2001: 95).

Like most MFIs, the Grameen Bank received financial support until 1996. It received “\$175 million in subsidies, including both direct donations and “soft”

donations such as soft loans, implicit subsidies through equity holdings, and delayed loan loss provision” (Sengupta and Aubuchon, 2008: 22). Japan’s Overseas Economic Cooperation Fund loaned Grameen Bank \$30 million at 1 percent interest rate for 30 years (McGuire, 1998: 96). Bangladesh Bank also gave the Grameen Bank \$145 million between 1993 and 1994 at 6 percent interest rate. Since 1994, Grameen Bank has also issued bonds backed by the government. In addition, nationalized commercial banks bought \$360 million of bonds from the Grameen Bank, as they can be used for statutory liquidity requirements.

Whilst subsidization may have been the case before, nowadays Grameen Bank’s new branches rely only on savings from borrowers and non-borrowers to run their banking business sustainably from “day 1” (Yunus, 2007: 65). Yunus asserts that within twelve months, most new branches achieve sustainability by mobilizing deposits for loans (Yunus, 2007: 72). Yunus claims, “Grameen is especially proud of its self-reliance ... Grameen does not anticipate any need to solicit donor money or even take new loans from internal or external sources in the future” (Yunus, 1999: 235). Borrowers currently own 93 percent of Grameen Bank, with the remainder owned by the government (Yunus, 1999: 235).

2.9.2 Loan Methodologies of the Grameen Bank

The quality of loan methodology is important to attain high repayment rates and reach the poor. As MFIs generally do not require collateral, methodologies such as joint liability through solidarity group lending, progressive and dynamic loans, and compulsory savings are utilized to ensure repayment and provide peer pressure (Yunus, 1999: 63).

Potential Grameen Bank members are required to attend a one-week training to learn about the bank’s policies and then pass an exam about the bank’s lending policies. According to Yunus, the exam is a way of screening those who really need the loan and who are serious about making money with the small loans.

The Grameen Bank uses a progressive lending method in that two members of the five grouping receive the first loan. If the two members pay back their loans regularly for the first six weeks, then the next two members will receive loans. If they pay back their loans, the last member will receive a loan. The first loan is normally about \$25 over a one-year period at an interest rate of 16 percent. Two percent of the loan is repaid weekly.

The Bank use close monitoring by both bank workers and peers to ensure repayment rate. Bank workers meet with borrowers weekly to make sure they use their loans wisely. Most borrowers are women based on the rationale that women face extreme poverty and that they are likely to use loans more efficiently than men (Yunus, 1999: 72).

The Grameen Bank requires the borrowers give 0.5 percent of every loan to an “emergency fund” in case of default, death, or other emergency issues (Morduch, 1999: 1585). In addition, borrowers have to deposit 5 percent of the loan in the group fund for a “group tax” the purpose of which is to increase savings. Yunus describes this practice as *mushti chaal* - “a handful of rice” that a mother sets aside for contingencies (Counts, 2008: 61). The members can borrow up to half of the fund without interest rates for a fixed term (Morduch, 1999: 1585). Before 1995, borrowers were not able to withdraw their group tax upon leaving. Now, they can withdraw their “forced savings” if they repay all their loans.

As shown in table 2.1, in recent years, the Grameen Bank has changed some of its techniques, calling the changes Grameen II “in order to serve its customers and their needs most effectively” (Yunus, 2007: 63). The Grameen II techniques are more flexible in terms of loan duration, repayment schedules, and installment size, and are more active in mobilizing savings from both borrowers and non-borrowers.

Table 2.1 From Grameen I to Grameen II: A More Flexible, Responsive System

Grameen I	Grameen II	Reason for Change
No provision to save for pension.	Borrower deposits a fixed monthly amount in Grameen pension scheme.	To help borrowers build a nest egg for retirement
Fixed, one-size-fits-all savings program	Varied savings plans to fit members' individual needs	To encourage saving for special needs and long-term economic benefit
No initiative to collect savings from nonmembers	Active campaigns to collect savings from nonmembers	To enable the bank to self-fund future loans
Mostly one-year loans with fixed installment amounts.	Loan duration and installment size may vary.	To allow borrowers to tailor loan products to individual needs and changing circumstances
Common loan ceiling	Individual loan ceilings are based on savings and others.	To reward and incentivize good borrowing and repayment
Family responsible for loan of deceased borrower	Special savings fund ensures that outstanding loans are paid off after death.	To alleviate borrowers' fears of leaving debt behind after death
Borrower becomes defaulter if loan is not repaid in 52 weeks.	Borrower becomes defaulter if repayment schedule is not met within six months.	To create an early warning signal of potential borrower problems
Funds for new bank branches borrowed from head office at 12 percent interest.	New branches are self-funding from day 1, using savings from borrowers and non-borrowers.	To ensure that branches become self-sufficient quickly

Source: Yunus, 2007: 64

The Grameen Bank applies incentive systems to improve staff performance. The Bank uses a five-star evaluation system for staff and branches (Yunus, 2007: 13). If a staff member achieves 100 percent repayment rate for his unit, which consists of 600 borrowers, he will get a green star. A second blue star is for the employee who generates profits for his unit. A third violet star is awarded when savings are greater than outstanding loans. A fourth brown star is awarded when all borrowers' children go to school. A final red star is awarded when all borrowers escape from poverty (Yunus, 2007: 14).

2.9.3 Sustainability and Outreach of BancoSol

BancoSol from Bolivia was established as an NGO project in 1987 and became a bank in 1992. The bank does not receive any subsidies and has earned returns on equity (ROE) since 1998. It achieves sustainability and breadth of outreach, but falls short in the depth of its outreach thereby resulting in a trade-off relationship between sustainability and outreach (Morduch, 1999: 1576; Schreiner, 2002).

The mission of BancoSol is not to reach the very poor but to provide good banking services to urban dwellers, “the richest of the poor” or “poorest of the richest”, yet who are in need of microfinance (Morduch, 1999: 1576; Navajas et al, 2000: 342; Schicks, 2007: 558). This approach finds support among some scholars who argue that the most important mission of MFIs should not be whether they reach the poorest of the poor, but “whether they reached the poorest of those who demanded loans and who were creditworthy” (Navajas et al, 2000: 342).

Despite the trade-off between sustainability and outreach, BancoSol is able to cover five aspects of outreach: worth, cost, breadth, long length, and scope while often unsustainable MFIs fail to cover these five aspects of outreach and cover only depth in reaching the poor (Schreiner, 2002: 597-598).

2.9.4 Loan Methodologies of BancoSol

BancoSol uses “solidarity groups” of three to seven members and disburses loans to all members simultaneously (Morduch, 1999: 1576). BancoSol emphasizes solidarity groups to achieve high repayment (Morduch, 1999: 1586). Unlike the Grameen Bank, BancoSol charges high interest rates to cover its operational and financial costs. Its annual interest rate on loans was between 12% and 22% in 2007 (MIX, 2010). The average loan size is \$1,700. The repayment schedules are flexible with both weekly and monthly options. Loan durations are also flexible, ranging from one month to two years (Morduch, 1999: 1576).

2.9.5 Sustainability and Outreach of Bank Rakyat Indonesia (BRI)

BRI is a state-owned bank. BRI stopped accepting subsidies since 1988 and has since been financially self-sustainable (Yaron, 1997: 122). Like BancoSol, BRI does not regard itself as providing social services, but rather providing financial services to earn a profit (Morduch, 1999: 1578). BRI requires full collateral from every borrower, and thereby excludes the very poor.

2.9.6 Loan Methodologies of BRI

The bank targets rural low and middle-income households (Yaron, 1997: 132). Unlike the Grameen Bank and BancoSol, BRI lends to individuals (Morduch, 1999: 1577). As mentioned above, BRI uses full collateral that may or may not be expensive but significant and essential to family members (Sengupta and Aubuchon, 2008: 21). Usually, collateral is land (Yaron, 1997: 135). Although BRI requires collateral, it emphasizes dynamic incentives to achieve high repayment (Morduch, 1999: 1586).

The repayment schedules of BRI are monthly or quarterly (Yaron, 1997: 135). Loan duration varies from one to three years. The monthly interest rate on loans is 1.5 percent.

The bank applies penalties for late repayment as the borrowers lose 0.5 percent per month interest rates benefits from the original loan amount that the bank provides (Yaron, 1997: 135). In addition, unreliable borrowers are denied future loans. As a last resort, the bank will repossess the collateral of defaulters (Yaron, 1997: 136).

Incentives for staff are used to increase the bank's performance. Good performance of the staff is assessed by 'unit profits, loan portfolio quality, and savings mobilization' (Yaron, 1997: 124). Staff can enjoy 10 percent of a unit's profits and bonuses per year (Yaron, 1997: 124).

2.10 Microfinance in Burma

MFIs in Burma are led by intergovernmental organizations (IGOs), international non-governmental organizations (INGOs), and local Burmese civil society. However, there are almost no literature studies on MFIs in Burma (see section 1.1.2).

One of the obstacles that MFIs in Burma face is a lack of legal status. The Burma's Money Lenders Act (1945) restricts high interest rates by stipulating that the total interest rate on a loan should never exceed the recovery of the principal sum. This makes MFIs vulnerable, as their activities are technically illegal (Turnell, 2009: 337). In addition, the sustainability of microfinance schemes established in Burma's Irrawaddy Delta has been hampered by natural disasters. For instance, Cyclone Nargis in 2008 affected five MFIs led by the UNDP in Labutta in the Irrawaddy (United Nations Development Programme, 2008). Others argue that subsidized MFIs like the UNDP projects in the Irrawaddy Delta face difficulties in achieving

sustainability due to moral hazard in which both borrowers and bank staff act irresponsibly and take unnecessary risks because they receive and expect assistance or subsidies (Robinson, 2001; Seibel and Torres, 1999).

2.11 Conclusion

Literature studies on sustainability and outreach show that practitioners and researchers have polemical arguments about the nature of the relationship, and argue about which approach is the best. Despite the increasing extensive studies on microfinance throughout the world, the industry still needs to establish standardized measurements and procedures to assess the successes and pitfalls of microfinance, so that a more accurate and comprehensive conclusion about the status of microfinance can be drawn and therefore improved.

Polarization over the challenges and benefits of microfinance do help critically examine and understand microfinance better. Yet, due to incomplete data and therefore conflicting analysis, practitioners, researchers, and donors become like blind men touching different parts of an elephant and describing it incorrectly from their own perspective instead of linking their observations together to realize the complete picture.

Literature studies on microfinance in Burma are almost nonexistent. Therefore, in the case of Burma, it becomes even harder to build a general picture of the benefits and challenges of microfinance for both institutions and borrowers. Furthermore, no research has been undertaken on locally-led MFIs in Burma, despite their apparent growth throughout the country.

Reflecting on the studies undertaken to date, they largely fail to regard the borrowers themselves as active and alive beings whose voices are recognized as significant. Instead, existing studies generally treat the borrowers as study objects.

They conduct sophisticated economic research methodologies that allow for various economic calculations thus generating analysis, conclusions and recommendations by the researchers. It seems that rather than let the borrowers speak out directly for themselves, these studies seek to portray and represent the very poor borrowers without ever listening to their actual voices. This thesis, therefore, seeks to shed light on how borrowers actually perceive the benefits and impacts of their loans. Most MFI literature focuses on economic indicators, such as loan repayment rates, income generating activities and income levels, but then often ignores the borrowers' emotional wellbeing. Such studies conceal the part where borrowers suffer and struggle to repay their loans in cases where, due to mismanagement or misfortune, the loans have failed to support activities that allow for the loan to be readily paid back. The reported "success stories" of MFI high repayment rates do not necessarily tell the full story of the feelings and struggles of borrowers who make such things happen.

This thesis is also about a locally-led MFI that does not receive any outside subsidies and has been created through a bottom-up approach. This thesis attempts to present the borrowers as beings and active participants who are out there alive, not behind the curtain, and who are capable of expressing their feelings and perceptions on the benefits or costs from their MFI loans directly, rather than the author predicting and speculating over what benefits they received.