

Rethinking Poverty Reduction by Microfinance Institutions: A case study of Rural Subsistence Farmers in Uganda

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Introduction

To achieve meaningful poverty reduction strategy, access to financial services is vital for the development of the private and informal sectors of the national economy; and in the development discourse, microfinance is considered a vital tool especially for sectors that hardly meet the requirements of mainstream financial services. In Uganda, which is not different from what is happening in the rest of Africa, financial services are largely underdeveloped, lacking in depth, highly inefficient, concentrated in the urban areas and dominated by a few, often foreign-owned commercial banks. In effect microfinance finance institutions (MFIs) became to be viewed as the most obvious vehicles for delivering financial services to the poor. As a consequence, interest in microfinance has soared in the recent decade and the instrument is now seen as one of the most promising tools to tackle poverty in the developing world.

Essentially, MFIs lend to customers who have low incomes and, at least anecdotally, have helped many of those trapped in the most extreme form of poverty better their lives by loaning them amounts of money that many others would consider a paltry sum. They also provide borrowers with access to education, credit, basic savings accounts and insurance. In particular, credit, savings and insurance services in the rural areas are generally non-existent, and of those that do, many work imperfectly (Morduch, 1995). On the other hand, given the agricultural dependence of the rural economies, the role of microfinance Institutions that meet the peculiar requirements of the rural population cannot be over-emphasized. For example, agricultural production exhibits a great deal of correlation across farms such that bad weather may leave an entire village or group of villages clamouring for an insurance pay out (Ray, 1998).

The importance of microfinance services can be best understood by examining their potential contribution to the development of the agricultural sector. Agriculture forms a significant part of the lives of the rural households, who in the case of Uganda constitute about 85% of the population (Republic of Uganda, 2015). Many of the agricultural activities are spread over time (Ray 1998), for example, adoption of a new technique or a new crop requires investment in the current period with payoffs in the future. In addition, productive activities require inputs in advance of harvest and sales.

In Uganda, the optimism over the role and the movement of microfinance as a poverty reduction intervention is increasingly becoming stronger than ever before. The country is generally seen as one with the most vibrant and successful microfinance industry in Africa; a number of MFIs in the country have experienced strong growth and are now reaching a considerable number of clients (Foundation for Sustainable Development Report, 2012). However, while the practices of microfinance services for the poor have grown immensely especially in developing countries, the reality on the ground provides conflicting evidence and shows that rather than improving the conditions of the poor, most of the so-called beneficiaries are left in debts and some end up losing their assets in the process.

It is notable also that the most existing literature on MFIs focused on the outreach of their services, with little attempt to explore why these communities remain in poverty. The current paper tries to fill this gap in the literature and to show whether providing financial services to groups that traditionally could not access them helps these people or only puts them further in debt is still up for debate. The presentation is framed with the rural poor subsistence farmer, who is often a female as the central element. It

recognizes the emerging awareness that financial needs of the poor are many and are provided by multiple market players beyond the scope of any single institutional form. As such, this presentation aims to focus on poverty reduction by microfinance Institutions with the view to assessing how it can foster rural poor subsistence farmers to pull out of their poverty situation.

To address this, the following issues will be covered. First, key concepts and terms will be highlighted because these can be interpreted differently by academic scholars. In addition, I will also discuss the concepts of microfinance, microfinance institutions and Uganda's microfinance industry in order to provide a country's context to guide the discussion. Second, Uganda's effort at poverty reduction is discussed, highlighting the Entandikwa Credit Scheme (ECS) and Bonna Bagaggawale (Prosperity for All). Third, the key issues regarding literature review and theoretical framework will be covered; i.e. Social capital and Cumulative Interdependence theories are discussed, demonstrating how these theories are conceptualized. The paper concludes with suggestions and recommendations which incidentally forms the main part of this presentation.

1.0 Concept of Microfinance Institutions

Microfinance is a broad term that describes banking and financial services provided by poverty-focused financial institutions (often referred to as microfinance institutions or "MFIs") to poor populations that are not being served by mainstream financial organizations. Microfinance institutions are legally registered entities which work to develop products and deliver methods to meet the diverse financial needs of low-income people. MFIs take many forms and include savings and loan cooperatives, local or international NGOs, village banks and programs set-up by international institutions. Commercial banks support microfinance operations directly (by providing financing or equity investment to existing MFIs) and indirectly (by creating branches or a range of microfinance products and services). Since its inception in the 1970s, microfinance has been based on the principal that the working poor, particularly women, need alternatives to what had previously been the only source of borrowed funds, namely informal lenders who charge excessive interest.

MFIs primarily provide small loans to their clients (although some MFIs also offer additional services, including micro-deposit and micro-insurance products). Unlike commercial banks, MFIs use methodologies such as group lending and liability, pre-loan savings requirements, and they gradually increase in loan sizes to evaluate clients' credit worthiness. Creditworthiness standard is based on the performance of a group of borrowers by initially extending a loan to an individual and then lending money to additional members of the group if that individual proves to be a reliable borrower. In effect, MFIs create incentives for each individual within the group to repay their loans, as the failure to do so will jeopardize the ability of the rest of the group to obtain credit. Others lend directly to individuals without tying credit to group performance. In a nutshell, Microfinance is the provision of tiny loans to the poor to help them establish or expand an income-generating activity, and thereby escape from poverty.

1.1 Microfinance Industry of Uganda

The microfinance sector of Uganda is often heralded as the most vibrant and successful in Africa. The strong state of the microfinance industry has been attributed to several factors, including the government's enabling environment, macro-economic stability, the weakness of the formal financial sector, sound donor commitment, strong capacity builders, stakeholder co-ordination and the healthy competition. It is however a relatively new industry in Uganda even though access to finance has been identified as a key development strategy since the 1960s. The first true microfinance institutions (MFIs) did not appear until the early 1990s.

Microfinance first appeared in Uganda in the 1980s as a socially motivated bid by the non-governmental organization (NGO) sector to alleviate poverty and increase access to financial services for the rural poor. A number of NGOs and aid bodies developed microfinance departments and a few specialized MFIs started operations offering microcredit collateralized by compulsory savings. In the early 1990s some of the NGO microfinance projects split off to become standalone MFIs. These organizations grew quickly in size and number, helping to counteract the gap left by the closure of several large banks in the 1990s. The late 1990s and early 2000s witnessed a plethora of fully sponsored training and technical assistance for MFIs, and the adoption of sustainability and profitability alongside the original social mission of the MFIs. Microfinance in Uganda is now no longer seen as just a social service but also a long term commercially viable enterprise. This dual mission has prompted MFIs to increase their outreach and client numbers have grown accordingly.

A combination of both formal and semi-formal institutions provide microfinance services in Uganda, including commercial banks, credit institutions, microfinance deposit-taking institutions (MDIs), savings and credit cooperative organizations (SACCOs), non-government organizations (NGOs) and money lenders.

1.2 Concept of Poverty

The definition of what is meant by poverty and how it is measured and who constitute the poor are fiercely contested issues. In the poverty debate, stands the question whether poverty is largely about material needs or whether or it is about a much broader set of needs that permit well-being. According to Sida, poverty has a multiple and complex causes. The poor are not just deprived of basic resources. They lack access to information that is vital to their lives and livelihoods, information about market prices for the goods they produce, about health, about the structure and services of public institutions, and about their rights. They lack political visibility and voice in the institutions and power relations that shape their lives. They lack access to knowledge, education and skills development that could improve their livelihoods. They often lack access to markets and institutions, both governmental and societal that could provide them with needed resources and services. They lack access to and information about income-earning opportunities" (see, SIDA: November 2005:14: ICTs for Poverty Alleviation). In a nut shell poverty can be seen as a situation in which individual is an unable because of economic, social, political and psychological incapacitation, to provide himself and his family the barest basic necessities of life.

2.0 Uganda's Efforts at Poverty Reduction

Poverty reduction has been and continues to be the focus of the Uganda government's development strategy. A number of anti-poverty programme/policies have been implemented over the past two decades, but the key ones include among others; Bonna Bagaggawale (Prosperity for all), Entandikwa Credit Scheme and of recent promotion of formation of SACCOs.

2.1 Entandikwa Credit Scheme (ECS)

The Entandikwa Credit Scheme (ECS) was initiated and funded by the Government of Uganda in 1995 to facilitate small-scale entrepreneurs to undertake productive economic/commercial venture. The scheme was designed to reduce poverty and thereby improve the socio-economic well being of the poor population both in the rural and urban areas. The scheme targeted that section of the population that could not obtain credit through the traditional commercial lending. The long term objective of the scheme was to achieve poverty reduction through creation of a revolving fund to support income generation and employment creation among the rural and urban poor, rural artisans, women, youth and the disabled in Uganda.

Unfortunately, it ran into serious difficulties, largely of political and administrative nature. Politically the local councilors feared to recover the loans for fear of being politically unpopular and therefore running a big risk of re-election. The Entandikwa cheap credit leaked to the relatively richer rural households and the subsidy dependence of these institutions required regular injection of government and donor funds. Mpuga (2004:2) cites (Republic of Uganda, 2000b) that these government-provided credit schemes have been plagued with a culture of default and the presence of political interest, which limited their efficacy even if, as in the case of the Entandikwa the credit scheme were otherwise well intended.

2.2 BonnaBagaggawale (Prosperity for all (PFA))

In 2005 Government placed renewed emphasis on poverty reduction under the BonnaBagaggawale (prosperity for all programme [PFA]). The pillars of PFA are production, value addition, marketing and microfinance. The Rural Financial Services Strategy (RFSS) One of the major pillars of PFA, the RFSS guides the delivery of financial services in rural areas. Emphasis is placed on savings, credit and investment to improve production and processing for value addition. There are now over 2,800 Savings and Credit Cooperative Organizations (SACCOs) throughout the country. Lending is channeled through the SACCO network to smallholder farmers through farmer groups at below-market interest rates.

However, revelations are to the effect that some poor households are reluctant to apply for credit from SACCOs because they lack confidence in their ability to repay the loans and fear of losing their property after defaulting on loans. For example, Kyomuhendo & Mwiine (2012), observed that categories of individuals preferred to live in poverty for fear of being shamed and ridiculed in the case of failure to pay back the borrowed funds. The shaming incidences that were most experienced included confiscation of property including personal effects, prosecution, incarceration and penalties such as being compelled to pay back the loan at higher than the stipulated interest rate. SACCOs were widely associated with poverty, hopelessness and shame.

In the above context, SACCOs and other microfinance institutions, despite being a core pillars of the well-intended PFA, anti-poverty programmes were cast in negative light by the targeted beneficiaries who boldly described them as schemes for fleecing the vulnerable, helpless and ignorant rural poor.

3. 0 Literature Review and Theoretical Issues

3.1 Empirical Evidence of the Impact of Microfinance and Poverty Reduction

Empirical evidences and surveys give mixed results on the performance of MFIs. In some cases debacle stories have been reported, yet there have been success stories. In other cases the reasons for failures or successes have not been well documented. In terms of impact evaluations and specifically the role of microfinance in the process of poverty reduction, the recent work of Bateman (2011), has been extremely helpful in conceptualizing the debate. These authors were interested in what earlier impact evaluations revealed, pushing forward the idea that individual microfinance programmes have most often been judged on the basis of impact evaluations. They established that though most early impact evaluations were positive, they were very thin in terms of robust evidence, pointing out that very often, the 'evidence' consisted of anecdotes from successful MFI clients, while less successful clients were ignored.

Within this genre, the work of Khandker (1998) a widely cited study is very helpful in assessing the impact of MFIs. Khandker (1998) examined three major MFIs in Bangladesh namely; BRAC, Grameen Bank and RD-12. He established that up 5% of the participants were able to lift their families out of poverty every year by borrowing from one of these MFIs. This work is complemented and expanded by Littlefield et al. (2003) and Goldberg (2005). Summarizing the literature available at the time (Littlefield et al., 2003), cited evaluation findings of higher incomes among microfinance programme participants than among non-participants. Similarly, Goldberg (2005) found that most impact evaluation studies reported a positive impact on poverty and income.

In contrast to the above, researchers using randomized control trials (RCT), in 2007, reported that microfinance had little or no impact (Bateman et. al., 2011). According to Straus (2010), Esther Duflo and colleagues analyzed 5,000 households in Morocco over two years. Their findings found the effect of microfinance on consumption to be negative and insignificant, with no impact on new business creation, education or women's empowerment.

Others [Karlan and Zinman (2009) and Banerjee et al., (2009)] found almost no impact from a number of large-scale microfinance programmes. On the other hand, Roodman and Morduch (2009) using a different approach reworking on the original data of Pitt and Khandker they came to a new conclusion; there was little to confirm that micro finance was having any real role in poverty reduction. They concluded that: 'strikingly, 30 years into the microfinance movement, there was little solid evidence that microfinance improves the lives of clients in a measurable ways'. As a matter of fact, in 2010, the six leading microfinance advocacy bodies confirmed that it is difficult for studies to demonstrate the impact of microfinance quantitatively for methodological reasons (Implicitly conceding the lack of robust quantitative evidence), and fell back on anecdotal evidence, citing carefully selected anecdotes and uplifting case studies from individuals (ACCION International et al., 2010).

Uganda Bureau of Statistics 2011/12 National Panel Survey report released in 2013 puts the national poverty levels at 32.2 while in the eastern region poverty surpass the national average at 33.1 per cent. Poverty situation in this region (Busoga) of the country is manifested in various forms such as inaccessibility to education and inadequate education facilities (Strategic plan 2015). The average dropout rate of 30% is attributed to poverty in various parts of the region and the high dropout rate is exacerbated by child labour in the sugar cane plantations. Poverty in the area was worsened by an outbreak of a jigger infestation in 2013 that left an unspecified number of locals effectively out of action, unable to fend for a living. The impact of microfinance and/or microcredit schemes on poverty reduction is still largely unknown. Therefore, the key question is whether providing financial services to groups that traditionally could not access them, helps these people out of poverty or only puts them further in debt is still up for debate.

3.2 Theoretical framework

There are many approaches to fighting poverty and various studies on poverty reduction have adopted different theoretical underpinnings in order to find a workable solution to their subject matter. The theories that support this study include;

3.3 Social Capital Theory

The notion of social capital which is mainly used by the poor without collateral in microfinance lending is a key aspect of the current debate on poverty reduction. Ismawan (2000) articulated that 'the effort to alleviate poverty traditionally has used and was based on natural capital, physical or produced capital and human capital'. He goes on to say that together they constitute the wealth of nations and form the basis of economic prosperity. His criticism is that the three types of capital determine only partially the effort to keep poverty at a minimal level but forgets to recognize the way in which the poor interact and organize themselves to generate growth and development. The missing link is social capital.

Rakodi (2002:) explains it (social capital) in terms of "the rules, norms, obligations, reciprocity and trust embedded in social relations, social structures, and society's institutional arrangements, which enable its members to achieve their individual and community objectives. For social interaction to be termed "capital", it must be persistent, giving rise to stocks (for example, of trust or knowledge) on which people can draw, even if the social interaction itself is not permanent. The collective resources are built up through interaction with other people outside the families. It includes trust as the main component, co-operative behaviour, helpful networks, and willingness to give and take and to participate in issues of common concern.

There is of course a link between individuals and their communities, the growing realization is that individuals are shaped by their community, and communities are as a consequence shaped by their individual members. Bradshaw (2006) argues that it is 'The strength of the growing interest in social capital by social scientists following Putnam (2000) points to this interdependence where individuals through association memberships create communities characterized by more trust and reciprocity, and in these communities with more social capital thousands of small activities are possible that contribute to reversing the spiral of decent into poverty. It is no wonder that communities with strong social capital

(or similarly entrepreneurial communities described by Flora and Flora) have been shown to be more resilient to adversity and thus protect their residents from the spiral into poverty that less civic communities experience when facing similar challenges’.

Baas (1998) Portrayed Social capital as the social cohesion, common identification with forms of governance, cultural expression and social behaviour that makes society is more cohesive and more than a sum of individuals- in short, to social order that promotes a conducive environment for development and solidarity. He argues that social capital plays an important role in encouraging solidarity in overcoming market failures through collective action and common pooling of resources. However, in spite of perceived importance of social capital, serious questions need to be asked about what sorts of norms, networks and associations are to be promoted, in whose interests, and how they can best contribute to empowerment, particularly for the poorest women.

Social capital is used as security in the group credit lending methodology. It is considered by many as the best way to reach the poorest who qualify for microfinance, and evidence indicates that group credit procedures are indeed easier to target at clients taking very small loans. Another potential advantage why social capital has become popular to the rural poor is that the association or trust is neither bought nor sold but freely shared. Social capital is also seen as simultaneously contributing to financial sustainability, poverty targeting and women’s empowerment. The assumption underlying the paradigm is that social capital is inherently positive and beneficial and can be used by programmes without external intervention to build or increase it. However group credit has come under criticism in that the group may share joint liability in the event of one group member’s inability to repay is supposed to be covered by others in the group.

3.4 Cumulative and Cyclical Interdependencies

This work adopts the theoretical model of cumulative and cyclical interdependencies as its framework because the theory looks at individuals and their community as caught in a spiral of opportunity and problems, hence individual and community resources are mutually dependent. This theory originated from the works of Myrdal (1957) who coined it as “interlocking, circular, interdependence within a process of cumulative causation”. Myrdal argued that personal and community wellbeing are closely linked in a cascade of negative consequences, and that closure of a factory or other crises can lead to a cascade of personal and community problems including migration of people from a community. Thus, the interdependence of factors creating poverty actually accelerates once a cycle of decline starts.

For example, at the community level, a lack of employment opportunities leads to out migration, closing retail stores and declining local tax revenue which lead to deterioration of schools and lead to poorly trained workers, resulting in firms not being able to utilize technology fully, which in turn leads back to a greater lack of employment. This cycle also repeats itself at the individual level. The lack of employment leads to lack of consumption and spending due to inadequate incomes, and to inadequate savings, which means that individuals can not invest in training, and individuals also lacks the ability to invest in businesses, or to start their own businesses, which leads to lack of expansion, erosion of market and disinvestment, all of which feedback to inadequate opportunities. It is conceivable that Health problems and the inability to afford preventive medicine, a good diet, and healthy living environments become reasons the poor fall further behind.

As a theory of poverty, the cyclical theory shows how multiple problems cumulate, and it allows speculation that if one of the linkages in the spiral was broken, the cycle would not continue. The problem is that the linkages are hard to break because each is reinforced by other parts of the spiraling system. A key piece of this approach to helping people in their poverty reduction struggles; is that there is no way access to financial services alone can help communities pull out of poverty without addressing other factors that contribute to poverty. It is suffice to note that poverty is an extremely complex and multi-dimensional phenomenon, thus, interventions aimed at reducing poverty should equally be complex. Therefore, to help the poor out of poverty, the intervention like the cyclical theory itself, should combine strategies and the following are recommended:

3.5 Conclusion and Recommendation

Much as elimination of structural barriers to help the rural poor in form of microfinance, which brings basic banking tools to the worlds' most needy has generated substantial numbers of success. Similarly, perceived failures have also been noticed in some cases as depicted in the literature reviewed. Thus, while addressing the poverty problem through microfinance Institutions is vital and critical; it is likely that it will not solely be enough for the poor households to escape from the poverty quagmire.

It is apparent that stimulating economic growth, making markets work better for the poor and building their capacity is the key out of their poverty situation. There is therefore, the need to change the whole context of lives of the poor and economic activities which do not produce enough surpluses to lift their standard of living.

Low productivity characterize the rural poor, thus more focus is needed on other interventions that may better promote productivity/growth and poverty reduction, such as increasing social capital among communities of the poor. Strong interpersonal ties as in villages or organized groups of poor people build supportive communities with shared assistance. Research supports that building social capital based on 'affinity groups' where people share common interests from their ethnicity, religion, family history, living area, or other sources of friendship stimulates productivity/growth (Putman, 2000). Thus, fighting poverty calls for pro-poor growth and pro-growth calls for sound economic policies to stimulate investment and jobs for the poor. It calls for a good institutional framework for delivering public goods and services not only efficiently but also fairly.

By providing small loans to the world's poor people, MFIs to a large extent have improved access to capital and financial services to the poor. However, it is worth noting that, microfinance is not a panacea to the problem of poverty though improved access to capital and other financial services are significant to the poor.

The implication from the above is to understand that capital in form of microfinance is just one factor which requires other factors such as access to markets, information, training of any kind, business development skills, business networks and entrepreneurial skills among others. Therefore, it is important to note that access to capital and other financial services alone is insufficient in ensuring

increased productivity/growth, particularly when people engaged in such activities lack basic knowledge and skills related to business management among others.

That apart, while microfinance programs as an intervention tool was designed to enhance production especially in agricultural sector, since the sector employs the vast majority of the poor especially in Africa. Raising productivity through increased agricultural investment by the use of MFIs services may not come about: For instance, post-harvest losses in rural communities is very high in most rural communities in Uganda since most households use rudimentally storage facilities. Uganda's experience is not different from what is happening in the rest of Africa.

Worse still, rural subsistence farmers' investment demand may be weak for reasons other than access to credit. Even where demand is enhanced by access to credit, there are several reasons why improvements may fail. For example, poorly developed inputs distribution systems may fail to supply enough complementary inputs or may result in unaffordable input prices. Thus, investment may be unprofitable, or investment returns may be risky.

Additionally, although microfinance institutions have enhanced access to financial services by rural households in aggregate, poorly developed infrastructures in rural areas may result in exorbitant administrative charges and poor delivery of such services in rural areas.

There are many other obstacles to the expansion of MFIs programs to rural subsistence farmers that may be important. For instance, there are limited funds in the MFIs; an expansion of microfinance rural funding might imply; a general decrease in lending.

Agricultural loans to rural subsistence farmers are often too small implying very high costs to MFIs. Finally, risks in agricultural lending are inherently high because of the risks associated with the climate and the health of household labour. Thus it becomes difficult for MFIs to accommodate these very many subsistence farmers.

Having said that, instead of undermining the importance of MFIs in regard to poverty reduction. The foregoing reasoning simply suggests that MFIs are necessary but not sufficient for poverty reduction especially in rural communities. Many other factors appear to be more urgent problems facing the poor such as health and infrastructure among others. Thus, unless these conditions are altered, poverty reduction will not be achieved.

Conclusively therefore, poverty reduction strategies should be premised on the proper identification why the condition of poverty exists, if performance is to be achieved. Thus, proper segregation of the conditions that exists, needs to be well articulated for any poverty reduction to be realized.

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