

MASTERS OF BUSINESS ADMINISTRATION

A CASE STUDY ON SOCIAL PERFORMANCE OF AMANAH
UKHTAR MALAYSIA: 'REACHING THE BOTTOM BILLION'

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ABSTRAK

Mikrokredit ialah program pemberian pinjaman kepada golongan miskin agar mereka dapat menggunakan pinjaman tersebut untuk menjana pendapatan dan meningkatkan taraf hidup. Keupayaan institusi-institusi yang melaksanakan program ini untuk bertahan bergantung kepada keupayaan mereka untuk menjana pendapatan sendiri atau meminjam dari institusi-institusi kewangan komersial untuk menampung kos operasi dan seterusnya membuat keuntungan. Oleh itu, akhir-akhir ini, program mikrokredit ini mula dikomersialkan dan institusi-institusi pelaksana mikrokredit berbentuk badan bukan kerajaan seperti Amanah Ikhtiar Malaysia juga ingin turut serta menjadi sebuah institusi kewangan mikro.

Fokus penilaian ke atas kejayaan sesuatu institusi mikro kewangan hanyalah disandarkan kepada petunjuk-petunjuk kewangan sahaja. Keberkesanan sama ada institusi mikro kewangan masih berpegang kepada tujuan asal penubuhan untuk meningkatkan taraf hidup rakyat miskin makin terpinggir. Justeru itu, timbul kesedaran di kalangan penyumbang dana untuk menitikberatkan penilaian dari aspek sosial agar institusi kewangan mikro tidak tersasar dari misi asal penubuhan. Untuk tujuan itu, beberapa mekanisme telah dicipta untuk menilai keberkesanan institusi mikro kredit dalam menjalankan misi sosialnya. Namun begitu, sehingga kini tidak ada satu mekanisme penilaian standard yang boleh diguna pakai oleh kesemua institusi kewangan mikro. Tujuan tesis ini adalah untuk menilai sejauh mana Amanah Ikhtiar Malaysia berpegang kepada misi sosialnya untuk memberi pinjaman dan meningkatkan taraf hidup golongan miskin dengan menggunakan kaedah penilaian

sosial yang dirangka oleh CERISE berdasarkan kepada 4 dimensi iaitu jangkauan, adaptasi produk dan perkhidmatan, meningkatkan aspek sosial dan politikal ke atas peminjam dan tanggungjawab sosial AIM. Hasil kajian ini secara dasar mendapati AIM masih berpegang kepada misi sosialnya.

Daripada sesi perbincangan bersama pegawai-pegawai AIM dan hasil pembacaan jurnal-jurnal, cabaran yang dihadapi oleh AIM telah dikategorikan kepada 3 isu utama iaitu isu kepimpinan, isu polisi pinjaman dan caj pengurusan. Dengan menggunakan keputusan penilaian CERISE berserta cabaran yang telah dikenalpasti, analisa SWOT dilakukan untuk mengetahui kelebihan, kekurangan, peluang dan ancaman AIM. Maklumat-maklumat yang dianalisa tersebut digunakan untuk memberi cadangan kepada AIM untuk meningkatkan prestasi sosialnya. Ia juga digunakan untuk memberi cadangan kepada Kerajaan untuk mewujudkan polisi membasmi kemiskinan yang kondusif.

ABSTRACT

Microcredit programme is developed to provide financing access to the poor so that they can increase their income and improve their living conditions. The survival of microfinance institutions depends on their ability to be financially sustainable that is the ability to generate their own funds either internally or commercially to cover operational costs and generate profit. As many microfinance institutions (MFIs) around the world are progressing towards commercialization, non-governmental organisations like Amanah Ikhtiar Malaysia (AIM) is also planning to follow suit. Initially, achievement of microfinance institutions are directed towards financial indicators. This has raised concerns that microfinance programmes are drifting away from their social mission to serve the poor. Thus, donors requires MFIs to conduct social performance assessments to ensures that MFIs are not drifting away from their social mission. As a result, several social performance assessment tools are developed to gauge whether microfinance institutions are adhering to their social mission. The purpose of this thesis is to evaluate AIM's social performance, the challenges it faces in achieving its social mission and to propose recommendations to improve its social performance.

CERISE Social Performance Indicators is used to evaluate Amanah Ikhtiar social performance based on four dimension: outreach to the poor, adaptation of services and products to target clients, improving clients' social and political capitals and social responsibility. Overall result showed that AIM has not neglected its social mission to serve the poor. Based on interviews and information gathered from various

journals, challenges AIM encountered in achieving its social missions are identified in three areas. They are on leadership issues, policy on lending and administrative charges. Using both the CERISE scores on social performance and challenges faced by AIM, a SWOT analysis is performed to identify the organization strengths, weaknesses, opportunities and threats.

AIM has advantage in its capital channel system that facilitate the poor to apply micro loans. Its participatory and decentralised management provide a win-win situation for AIM and also its participants in terms of reducing operational cost and empowering participants. Nevertheless, it has several weaknesses in delivering its services due to the slow loan disbursement. Still dependent on Government for funds also limit AIM's capability to involve in community investment activities. There are a few opportunities that can be grabbed by AIM especially when it becomes a microfinance institution. Apart from that, AIM has the potential to be a pioneer of Islamic microfinance since its operations are geared towards complying the Islamic Syariah. Due to its role in alleviating poverty, AIM received immense funding from the Government, thus it is expose to political intervention. By being a microfinance institution, poses yet another threat to AIM. The threat of drifting away from its social mission.

These information are used in this thesis to provide recommendations to AIM on how it can improve its social performance and how the government can play its role to create a pro-poor policy environment.

CHAPTER 1

INTRODUCTION

1.0 Background Of The Study

Microfinance provides the poor access to financial services like credit and savings. Before microcredit revolution, the poor are not considered as a viable market by the conventional banks (CGAP website, 2009). Due to this, the poor obtained credit mainly through local money lenders at very high interest rates and they saved through informal relationships like rotating savings (CGAP website, 2009). The poor are deemed as not a viable market by the conventional bank due to several factors (Sengupta and Aubuchon, 2008). Firstly, they lack the resources to invest their borrowings in the most productive uses (Sengupta and Aubuchon, 2008). Thus, the money gained is used for consumption and not for investment purposes to generate income (Bhaduri, 1977 and Aleem, 1990 as quoted by Sengupta and Aubuchon 2008). Secondly, with no credit histories, it is difficult for the conventional banks to assess the creditworthiness of the poor even if they have the intention to invest the money borrowed (Sengupta and Aubuchon, 2008). Finally the poor could not provide collateral on their loans, reduces the bank's resources to sell the assets in case of defaults (Sengupta and Aubuchon, 2008).

However, such claims are debunked by the success of Grameen Bank. It all started when Professor Muhammad Yunus returned to Bangladesh in 1972 to teach economics in the University of Chittagong after completing his PhD in the United States (Sengupta and Aubuchon, 2008). Bangladesh had just gained its independence and two

years of flooding caused the country to be dependent for food aid (Hulme, 2008). More than 80 percent of people in Bangladesh were living in poverty by 1974 (Yunus, 2003 as quoted by Sengupta and Aubuchon 2008). Professor Muhammad Yunus approached the local banks to loan money to the poor but his request was denied due to the inability of the poor to provide collateral (Third World Traveler website). Therefore he lent his own money to the poor and they managed to repay his loan. Professor Yunus then started giving out loans to the poor starting from initially several villages until finally reaching five districts (Third World Traveler website). Nevertheless, his efforts could not convince the local banks to provide credit to the poor, so he thought that the only way for the poor to get access to credit is by setting up his own bank (Third World Traveler website). After obtaining a special charter from the Government of Bangladesh, Grameen Bank was established in 1983 as a formal and independent financial institution (Sengupta and Aubuchon, 2008). As at April 2009, the cumulative amount disbursed by Grameen bank stood at US \$7,971.49 million and the cumulative amount repaid totaled US \$7,071.71 million (Grameen Bank website, 2009).

The success of Grameen Bank triggered microfinance institutions (MFIs) in other countries to duplicate the Grameen Bank model (Sengupta and Aubuchon, 2008). In Malaysia, the Grameen Bank model was emulated by Amanah Ikhtiar Malaysia (AIM) and it is the largest replication of Grameen Bank in Asia. Grameen Bank proved that poor households could benefit from greater access to credit, thus microcredit can be a tool for poverty alleviation and MFIs do not necessarily incur extreme losses from lending to the poor (Sengupta and Aubuchon, 2008). As noted by Professor

Muhammad Yunus, the founder of Grameen Bank :

" To me poor people are like bonsai trees. When you plant the best seed of the tallest tree in a flower pot, you get a replica of the tallest tree, only inches tall. There is nothing wrong with the seed you planted, only the soil base is too inadequate. Poor people are bonsai people. There is nothing wrong with their seeds. Simply society never gave them base to grow. All it needs to get the poor out of poverty is for us to create an enabling environment for them. Once the poor can unleash their energy and creativity, poverty will disappear very quickly."

(Professor Muhammad Yunus, 2006)

The effort to eradicate poverty in Malaysia was initiated before the microfinance revolution. It started with the New Economic Policy in the 1970s which focused on eradicating poverty and restructuring society (Mohamed Zaini, 2002). Besides the New Economic Policy, there are several other programmes like the Integrated Agricultural Development Programme, land and regional development, land consolidation and rehabilitation programme to eradicate poverty (Mohamed Zaini, 2002). However, all these programmes did not reach the goal to curb poverty (Mohamed Zaini, 2002).

As mentioned above, after the viability and success of Grameen Bank in reducing poverty in the rural areas of Bangladesh, the idea for the establishment of AIM to tackle poverty in Malaysia emerged. In 1986, Professor David S. Gibbons and Professor Sukor Kasim from the Center for Policy Research, Universiti Sains Malaysia undertook an action research program which they named Projek Ikhtiar as a trial project

to examine the suitability and viability of the Grameen Bank approach in Malaysia (AIM website, 2009). It involved only 373 poor households in the North West of Selangor. The project's capital loan was obtained from the Islamic Economic Development Foundation Malaysia (YPEIM), the State Government of Selangor and the Asian Pacific Development Center (AIM website, 2009). Project Ikhtiar was a success and it proved that microfinance can be used as a tool to eradicate poverty especially to the indigent residents in the rural areas. In order to fulfill this objective, AIM was officially established in 1987 and registered as a private trust under the Trustee Corporation Act 258 (revised in 1981) (AIM website, 2009).

Subsequently in 1988, a research was conducted on AIM participants to study the implications on Amanah Ikhtiar's loans. The study showed women participants were more successful compared to their male counterparts (AIM website, 2009). The women participants recorded 95 percent repayment rate compared to only 75 percent by the men (AIM website, 2009). Impact studies also showed that the increase in income amongst women were more significant than the men (AIM website, 2009). The huge success of the Ikhtiar pilot project gave confidence to AIM founders to expand the Ikhtiar project to other states in Malaysia (AIM website, 2009).

AIM is one of the implementation agencies chosen by the Government to minimise the level of poverty and the number of poor households in the country. Since its establishment in 1987, AIM has grown with a network of 48 branches in Peninsula Malaysia and 21 branches in Sabah and Sarawak (Economic Report 2008/2009). It has outreached 190,900 participants as at the end of June 2008 and disbursed loans totaling

RM2.6 billion (Economic Report 2008/2009).

1.1 Problem Statement

The mission of microfinance institutions to alleviate poverty is similar and consistent with the first goal of the United Nations Millennium Development Goals. (Model United Nations at the University of Illinois website, 2008). The first objective of the Millennium Development Goals is to eradicate extreme poverty and hunger by focusing on three targets:

- (i) To halve between 1990 and 2015 the proportion of people whose income is less than US\$1 a day;
- (ii) To achieve full and productive employment and decent work for all, including women and young people; and
- (iii) To halve between 1990 and 2015 the proportion of people who suffer from hunger.

(United Nations website, 2008)

Due to the similarity of purpose, the United Nations supports microfinance institutions as part of its development strategy to alleviate poverty (Model United Nations at the University of Illinois website, 2008). The similarity is in line with the first of the dual mission of microfinance institutions “to provide financial services to large numbers of low-income persons to improve their welfare” (Markowski 2002, p.11 as quoted by Wrenn 2005). The second mission is a commercial mission which is defined

as “to provide those financial services in a financially viable manner” (Markowski 2002, p.117 as quoted by Wrenn 2005).

In order to achieve financial viability, "micro finance institutions must cover all administrative costs plus the cost of capital, loan losses and a provision for increasing equity. If they failed to do so, they may only operate for a limited time, reach a limited number of clients and will tend to be driven by donor or government goals and not client needs" (CGAP Donor Brief No.6, 2002). Since microfinance institutions are moving towards financial sustainability, the success of microfinance institutions were determined using financial performance indicators such as loan portfolio quality, cost recovery and profitability (Social Performance Progress Brief, 2006).

Due to the emphasis given on financial performance of microfinance institutions, the challenge to measure and manage social performance has been ignored previously (Social Performance Progress Brief, 2006). Unlike commercial banks, microfinance institutions carry social mission to alleviate poverty, thus assessing its success only by financial indicators is not sufficient (Social Performance Progress Brief, 2006). It is important to know whether microfinance clients are experiencing the same growth as the positive result of financial indicators depicts (Social Performance Progress Brief, 2006).

AIM is the most prevalent form of microfinance provider organization in Malaysia and represent a new generation of microfinance institution that focuses on financial sustainability and rapid expansion. Impact studies have shown that there were positive effects to AIM's participants especially in terms of increase in income that surpassed the poverty level income. A summary of impact studies carried out are as

follows:

Table 1.1
Summary of Previous Impact Assessments Studies

	Implementers	Research Duration	Changes in Income		Amount Increased	Increase in %
			Before	After		
1.	AIM (Impact One)	1988	RM142	RM220	RM78	54.9
2.	AIM (Impact Two)	1990	RM142	RM460	RM318	223.9
3.	SERU JPM	1990-1991	RM198	RM465	RM259	130.8
4.	AIM (Impact Three)	1991-1993	RM223	RM532	RM309	138.6
5.	USM (Impact Four)	1994-1995	RM201	RM760	RM559	278.1
6.	AIM (Impact Five)	2004-2005	RM321	RM1904	RM1,583	493.1

(source: Amanah Ikhtiar Malaysia)

Impact studies only measure the changes in welfare and quality of life among clients and non clients due to the activities of AIM (Zeller, Lapenu and Greeley, 2003). On the other hand, social performance measures how well AIM has translated its social goals into practice (Zeller, Lapenu and Greeley, 2003). Social performance studies the intent and design of a microfinance institutions (what does the MFI seek to achieve), activities (how services are targeted to clients through the MFI organisational structure), output (what are the services delivered), outcome (result of the service provided) and impact (long term sustainable changes as a result of the outcome) (IFAD, 2006). It does not only focus on the final impact (IFAD, 2006).

In order to achieve the Millennium Development Goals, microfinance institutions' chief focus is on the objective to reduce poverty. It is crucial to monitor whether MFIs are executing their social mission. Therefore, the purpose of this study is

to evaluate AIM's social performance, the challenges it faces in achieving its social mission and to propose recommendations to improve its social performance.

1.2 Case Issues

The issues examined in this case is to determine the social performance of AIM by looking at how well it translates its social goals into practice. In order to structure the case write up, information will be gathered on how AIM has converted its social mission based on four dimensions developed by Comité d' Echanges, de Reflexion et d'Information sur les Systèmes d'Epargne-crédit (CERISE) Social Performance Indicators (Zeller, Lapenu and Greeley, 2003). The four dimensions are:

- (i) the outreach to the poor and excluded;
- (ii) adaptation of services and products to target clients;
- (iii) improving clients' social and political capitals; and
- (iv) social responsibility of Amanah Ikhtiar

(Zeller, Lapenu and Greeley, 2003)

While these questions will guide the data collection:

- (i) what are the strategies adopted by AIM to fulfill its social mission?;
- (ii) has AIM achieved its social strategic objectives based on CERISE Social Performance Indicators? and
- (iii) what are the challenges and problems faced by AIM in attaining its social objectives?

1.3 Organisation of the Thesis

Chapter 2	:	Microfinance
Chapter 3	:	Methodology
Chapter 4	:	AIM History
Chapter 5	:	AIM and Social Performance
Chapter 6	:	Analysis
Chapter 7	:	Recommendations and Conclusion

CHAPTER 2

MICROFINANCE: HISTORY AND OVERVIEW

2.0 Definition Of Microfinance

There are various definitions of microfinance. It is defined as "loans, savings, insurance, transfer services and other financial products targeted at low income clients" (International Year of Microcredit 2005 website, 2009). Microfinance is also defined as "the provision of financial services to low-income poor and very poor self-employed" (Omero 1999,p.8 as quoted by Wrenn 2005). These financial services "generally include savings and credit but can also include other financial services such as insurance and payment services" (Ledgerwood 1999 as quoted by Wrenn 2005). "The attempt to improve access to small deposit and small loans for poor households neglected by the commercial banks" is also defined as microfinance (Schreiner and Colombet, 2001, p.339 as quoted by Wrenn 2005).

Since the word microcredit and microfinance are used interchangeably, the difference between microcredit and microfinance need to be highlighted. Microcredit provides credit to the poor, but microfinance involves additional non-credit financial services such as savings, insurance, pensions and payment services (International Year of Microcredit 2005 website, 2009). Thus microcredit is a component of microfinance (Okiocredit, 2005 as quoted by Wrenn 2005).

2.1 Key Characteristic Of Microfinance

There are at least seven characteristics of microfinance (Karlan and Goldberg, 2006). They are:-

- (i) Microfinance involved small transactions or micro in nature;
- (ii) The loans are for entrepreneurial activities or income generating activities and not for consumption purposes;
- (iii) The loans are collateral free;
- (iv) Group lending is the most common model of microcredit;
- (v) The focus of microcredit programmes is towards the poor;
- (vi) Microcredit focus is on women because women are very discipline when repaying; and
- (vii) Loans are offered at market rates. Microcredit interest rates are high because " the costs of making a small loan will always be higher in percentage terms rather the cost of a larger loan" (CGAP Occasional Paper No 9, 2004). Interest charges need to cover "the cost of funds, the cost of risk (loan loss), and administrative cost (identifying and screening clients, processing loan applications, disbursing loans, collecting repayments and following up on non-repayment)"(CGAP Occasional Paper No 9, 2004).

2.2 History of Microfinance

The history of microfinance can be traced in the 1800s (Global Envision website, 2008). Savings and credit groups were operated in numerous countries with different names such as 'susus' in Ghana, 'chit funds' in India and 'arisan' in Indonesia (Global Envision website, 2008). In 1800, savings and credits institutions were established in Europe to cater for the need of the poor. The savings and credit institutions are known as People's Bank, Credit Unions and Savings and Credit Co-operatives (Global Envision website, 2008).

Friedrich Wilhelm Raiffeisen created the concept of credit unions with the hope to assist and cater for the needs of the poor for credit (Global Envision website, 2008). He did not want the poor to rely on moneylenders for credit. The concept of credit union then spread to various countries (Global Envision website, 2008). Models of credit unions were adopted in countries in Latin America in the early 1900s with the objective to modernize the agricultural sectors (Global Envision website, 2008). The existence of credit unions in Latin America was also aimed to commercialise the rural sectors through mobilising idle savings and to increase investments by providing credits thus reducing oppressive feudal relations that were forced through indebtedness (Global Envision website, 2008).

Focus on agricultural credit to small farmers to increase productivity and income resulted the government and donors to focus on agricultural credit in the 1950s and the 1970s (Global Envision website, 2008). Credit was provided to farmers through state owned development finance institutions or farmers co-operatives at below market

interest rates (Global Envision website, 2008). However due to subsidised lending rates, the goals to increase productivity and income were not realised and resulted in the failure of the rural development banks (Global Envision website, 2008)

2.3 Grameen Bank

The world poorest face barriers in obtaining basic financial services due to their inability to provide collateral, without having any credit record, do not possess any educational background and have no formal employment record (Ruben, 2007). As men were only guarantor for loans, the access for financial services could not be obtained by women who were also part of the world poorest. These people have no other alternatives besides opting for credit from local money lenders (Ruben, 2007).

Professor Muhammad Yunus observed the same situation exist in Bangladesh. However he believed that the poor possess the ability to develop themselves, if given the opportunities to do so (Sengupta and Aubuchon, 2008). This resulted with the establishment of Grameen Bank in 1976. Grameen means rural or village in Bangla language (Sengupta and Aubuchon, 2008). Grameen Bank targets the poor with the aim of lending exclusively to women. In fact 95 percent of Grameen Bank clients are women (Sengupta and Aubuchon, 2008).

Why women? Professor Muhammad Yunus has strong confidence that lending to women has larger significance than lending to men (Sengupta and Aubuchon, 2008). His belief was supported by numerous research findings. One of which stated that "loans to women resulted in a greater impact on per capita household expenditure on both food

and non food items than loan to men" (Khandker 2005 as quoted by Sengupta and Aubuchon, 2008). It was further reiterated that "a pro female bias works well for microfinance institutions because women are believed to be more risk averse in choosing investment project" (Sengupta and Aubuchon, 2008). They are also regarded as "more fearful of social sanctions and less mobile thus making it easier for the women to be monitored by the microfinance institutions" (Sengupta and Aubuchon, 2008). These traits possessed by women enable them to repay their loan and ensuring high repayment rates to the microfinance institutions (Sengupta and Aubuchon, 2008). Besides focusing on women, other features of Grameen Bank microcredit programme are as follows:-

- (i) Loans without collateral;
- (ii) Grameen Bank approach the poor, has flexible credit delivery system, promotes weekly repayments and promotes social capital;
- (iii) Potential of borrowers are accounted in developing the terms and conditions of loans;
- (iv) Creating a problem solving culture by putting trust in the ability of its staff and clients in facing adversity;
- (v) Offering loans and saving products and regards savings as important part of its programmes. Amongst the loans offered are housing loan and education loan.

(H.I. Latifee, 2008)

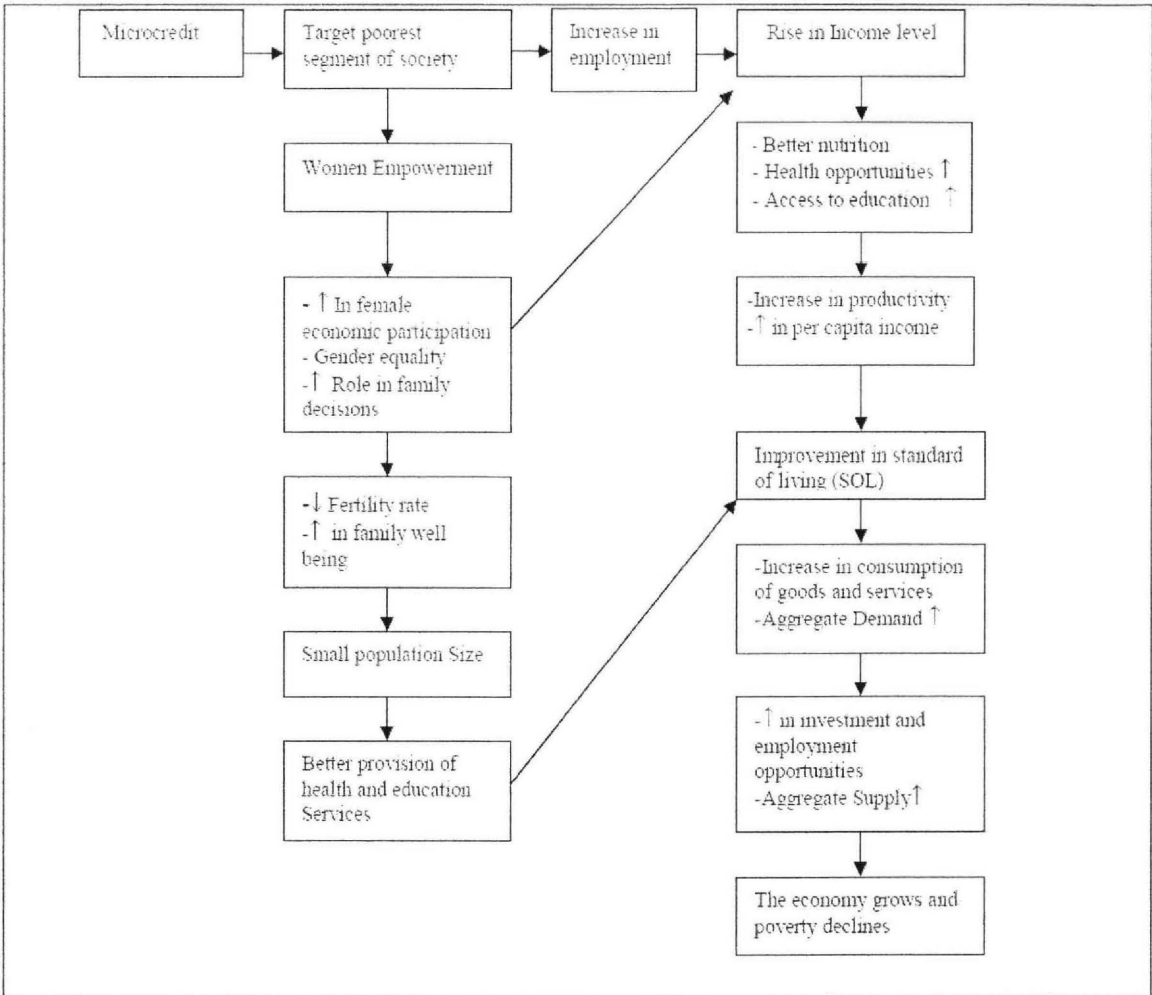
Initially in 1974, Grameen Bank started with 42 families and in 2007, it has 6.9 million borrowers and 97 percent of them were women. Services provided by Grameen Bank covers 75,359 villages with 2,343 branches and 2,120 of the branches are computerized (economag. de website, 2009). As of January 2008, the cumulative loan disbursed by Grameen Bank amounted to US\$6.009 billion with US\$5.344 billion were repaid (Grameen Bank 1/2008a as quoted in economag. de website, 2009).

The unique features of group lending model contributed to Grameen's success (Sengupta and Aubuchon, 2008). In the innovative group lending model, groups of five prospective borrowers were formed. Initially only two in the group of five will be given credit (Grameen Bank website, 2009). The rest of the groups members are eligible for loans only after the first two members repay their loans (Grameen Bank website, 2009). This mechanism impose pressure to the members and promote sense of collective responsibility (Grameen Bank website, 2009). With collective responsibilities, any burden or problems faced by individual borrowers will be lightened by the help of other group members (Grameen Bank website, 2009).

2.4 Microcredit Role in Poverty Alleviation

The role microcredit plays in poverty alleviation can be best illustrated with the figure below:

Figure 2.1
Transmission of mechanism of microcredit flowchart



(source: The State of Pakistan Economy First Quarterly Report 2004-2005)

Microcredit programmes target the poor especially women by providing them access to credit to invest in income generating activities. By focusing on women microcredit stimulates women participation in the economy, promotes gender equality

and increase women role in their family circles. The flow chart illustrates that as a result of increase in income through women empowerment, poor households can afford to buy and consume nutrition foods. Microcredit programmes offers education loan and stresses the importance of education to avoid children of the poor families from inheriting poverty from their parents. With increase in income, poor families can afford to send their children to schools and can have better access to health care facilities. All these contribute to increase in standard of living and increase in consumptions of goods and services. At the end of the day, microcredit alleviate poverty and contribute to the economic growth of a country. The success of Grameen Bank is an example of how credit to the poor can be used as an effective tool for poverty alleviation (Sengupta and Aubuchon, 2008). Being awarded the Noble Prize in 2006, Grameen Bank success has inspired the establishment of Grameen Bank replications around the world, one of which is AIM.

2.5 Issues in Microfinance

Despite of its success, there are numerous issues and challenges facing the microfinance institutions (MFIs) today. The issues and challenges are:-

(i) Interest Rates and Interest Rate Ceilings

Microcredit loans have higher interest rate than normal loans. The interest rates are high because "the cost of making small loans is higher in percentage terms than the cost of making a larger loan" (CGAP Donor Brief No. 6, 2002). For example, if the

actual cost per loan is \$15, the percentage cost is only 0.15 percent for a \$10,000 loan but 15 percent for a RM100 loan (CGAP Donor Brief No. 6, 2002). One of the reason for the the higher rates is due to the nature of microcredit loan itself that does not require collateral (CGAP Donor Brief No. 6, 2002). Moreover, it caters for those who have no credit history and often live in remote areas (CGAP Donor Brief No. 6, 2002). Microfinance institutions target the poor and render their services by approaching the poor unlike other financial institutions. Therefore the cost of loans are high due to the need to find borrowers and to monitor repayments (CGAP Donor Brief No. 6, 2002).

Although there are arguments that the microfinance rates are too high for the poor, the high rates did not hinder the poor from obtaining microfinance loan as they regard "access to credit as more important than the actual cost of loan" (CGAP Occasional Paper No 9, 2004). The high repayments rates also exhibits that the poor are able to repay their microcredit loans (CGAP Occasional Paper No 9, 2004).

Due to the concern of high interest rates, Government in some countries decided to impose interest rates ceilings on microfinance institutions so that microcredit loans can be offered at lower rate (CGAP Occasional Paper No 9, 2004). However, with the lower rate, government have to subsidised the remaining operating cost to the lenders (CGAP Occasional Paper No 9, 2004). For example if cost of loans is 15 percent, imposition of interest rate ceiling by the Government restrict microfinance institutions to charge only 4 percent to borrowers. The remaining cost have to be subsidised by Government.

Several problems are observed in subsidised lending programs (CGAP Occasional Paper No 9, 2004). Firstly, cheap funds due to low interest rates lead to increase demands (CGAP Occasional Paper No 9, 2004). Those who are not so in need of microfinance loans will apply due to the attractively low interest rate. As a result, it diverts loans from the poor to the not so poor who want to apply for microcredit loans due to low interest rate (CGAP Occasional Paper No 9, 2004). Secondly, borrowers regard government subsidies as gifts and are not willing to repay the subsidised loans. Finally, with the low interest rate, microfinance institutions could not cover their operating costs and always need government support to survive (CGAP Occasional Paper No 9, 2004).

Governments intention to impose interest rate ceilings for the purpose of encouraging participation of commercial lenders mostly have failed (Michael Hamp, 2005). Due to the failure, emphasis are given on performance of microfinance institutions and their ability to provide services in a sustainable manner (Michael Hamp, 2005).

(ii) Sustainability

In order for microfinance institutions to be self sustainable, they have to depict operational self sufficiency and financial self sufficiency (CGAP 1997 as quoted by Khan, 2008). Operational self sufficiency is defined as the need for microfinance institutions to cover all the administrative costs and operational costs, while financial self sufficiency requires the micro finance institutions to meet financial requirements to

obtain funds for their operations internally as well as from other commercial sources (CGAP 1997 as quoted by Khan, 2008). Therefore, microfinance institutions have to operate without depending on donor or government funds (Khan, 2008).

The need to be sustainable and the requirement to be financially self sufficient resulted in the occurrence of two differing school of thoughts in microfinance. The differences in these two school of thoughts are described as microfinance schism (Murdoch 2000 as quoted by Bhatt and Tang, 2001). The first school of thought is the welfarist approach that encourages donor dependency (subsidised credit) (Murdoch 2000 as quoted by Bhatt and Tang, 2001). The second school of thought is the institutionalist approach that believes in self sufficiency of the microfinance institutions (Murdoch 2000 as quoted by Bhatt and Tang, 2001). The institutionalist believes in maximizing outreach to the poor and ensuring their long term survival and sustainability by commercialising operations to ensure profitability (Robin 2001,2002 as quoted by Khan, 2008).

(iii) Commercial Banks as Microfinance Delivery Vehicles

The participations of commercial banks in the microfinance industry is becoming a trend. Due to the emphasis on financial sustainability, there are views to upscale microfinance institutions such as non-governmental institutions into commercial banking operations which emphasize on financial self sufficiency (Bhatt and Tang, 2001). The trend toward commercialisation raise concern of mission drift. A concern that microfinance institutions are drifting away from their social mission to the poor and

poorest to become very profit oriented (Bhatt & Tang 2001).

(iv) Performance Assessments

Since microfinance institutions are moving towards financial sustainability, the success of microfinance institutions were gauge with financial performance indicators such as loan portfolio quality, recovery cost and profitability (Social Performance Progress Brief, 2006). Emphasis are given only on financial transparency (Cordaid, 2007). Unlike commercial banks, microfinance institutions carry social mission to alleviate poverty, thus assessing its success only by financial indicators is not sufficient. It is important to know whether microfinance clients are experiencing the same growth in terms of releasing themselves from poverty despite the favorable financial performance indicators (Cordaid, 2007).

In order to achieve its social mission, microfinance institutions need a tool to document and monitor their social achievements. However, the assessment of social performance is often neglected by many MFIs. Therefore, it is important for micro finance institutions to highlight double bottom line performance - financial and also social achievements in its assessment (Tulchin).

2.6 A Successful Microcredit Scheme

The success or failure of microcredit scheme depends on two basic principle, client discipline and institutional discipline (CGAP Focus Note 20). Client discipline is defined as the act of responsibility of the poor on their decisions and repaying on time

(CGAP Focus Note 20). On the other hand, institutional discipline refers to practice that lead to sustainability of the micro finance institutions such as:-

- i. imposing interest rate charges that can absorb all costs;
- ii. timely repayment from clients and constantly monitoring repayments on the part of MFIs;
- iii. introducing products and delivery techniques that meet clients needs;
- iv. building in house management information systems (MIS) to access information in a timely manner. MIS can also serves as guidance for staff and management in carrying their tasks;
- v. acknowledging field staff efforts by providing performance incentives;
- vi. provide space for decentralization to permit adaptability and growth; and
- vii. planning ahead for capacity, growth and sustainability.

(CGAP Focus Note 20)

Both client and institutional discipline provide as "a litmus test" to gauge the success of microfinance institutions. If its is difficult to implement client or institutional discipline, the microcredit programme is likely to be unsuccessful (CGAP Focus Note 20).

2.7 Microfinance Institutions In Malaysia

There are various models of microcredit institutions in Malaysia. Here are some of the models that exist in Malaysia (S.K Yow, 2006):

(i) Microcredit schemes of Non-governmental Organizations

Non-governmental microcredit programme was implemented in September 1987 by the establishment of AIM. It is modeled from Grameen Bank and it promotes group-based microcredit program which put priority on personal relationships, trust, group participation and joint liability.

(S.K Yow, 2006)

(ii) Microcredit schemes of Financial Institutions

In order to cater for financial needs of small medium enterprises and to boost domestic investment, financial institutions are encouraged to involve in microcredit programmes (S.K Yow, 2006). With the announcement of RM 1 billion for microcredit in the stimulus Package of New Strategies in 2003, RM500 million was disbursed to Bank Pertanian Malaysia (now known as Agro Bank), RM300 million was disbursed to Bank Simpanan Malaysia (National Savings Bank) and RM200 million to AIM (New Strategies Towards Stimulating Economic Growth, 2003). The aim of this five year scheme is to provide easy access of funds to the small borrowers through relaxation of loan conditions so that they would not resort to obtain fund through illegal money lenders (S.K Yow, 2006). Interest rate on loans was set at only 4 percent and the loans do not require any collateral (New Strategies Towards Stimulating Economic Growth, 2003). The imposition of interest rate ceilings of 4 percent caused both Bank Pertanian Malaysia and Bank Simpanan Nasional to incur high operational cost. After the scheme ended, both banks continued with their own microcredit

programmes that enable them to set their own interest rate charges.

(iii) Microcredit Schemes of Cooperative Societies

Cooperative societies can be divided into urban credit cooperatives and rural credit cooperatives. It is initially set up with the objective to offer means for members to save, to invest and to participate in economic enterprises. The urban credit cooperatives activities revolves around mobilizing savings, providing consumer credit and providing investment channel for members. Meanwhile, the rural cooperative societies focus on agricultural development. However, rural cooperative rarely exhibits success stories because only few participate in it.

(S.K Yow, 2006)

(iv) Microcredit Schemes of Quasi-Governmental and State Based Agencies

In order to alleviate poverty, to encourage entrepreneurship and to enhance income generating activities, Government have partnered with quasi-governmental agencies like Permodalan Nasional Berhad, Majlis Amanah Rakyat and Perbadanan Nasional to facilitate entry for small traders, hawkers and small-scale entrepreneurs into micro business. Partnership with state based agencies was also were carried out by the Government. One such partnership is the Projek Usahamaju in Sabah which is now known as Yayasan Usaha Maju.

(S.K Yow, 2006)