

Measuring Mission Drift in Emerging Economies: An Evidence from Pakistan Microfinance Network

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ABSTRACT

This study aims to determine if mission drift is taking place in Pakistan. For this purpose, the study has examined depth of outreach (A measure of mission drift) by various financial measures, sustainability, credit methodology, female borrowers, leverage, age of institutions, profit status and regulations of institutions. The results revealed that, credit methodology and age of the institution negatively affects depth of outreach while leverage, female borrowers and profit status have positive impact on depth of outreach. Further, the results indicate that leverage financing provide an opportunity for institution to expand their operation across the country, despite bearing high cost on small loan size. Besides, sustainability has negative insignificant affect on depth of outreach while regulations have positive insignificant impact on depth of outreach. The findings of the research suggest that in Pakistan, depth of outreach can be successful if institutions lend smaller loans even if they finance their projects with debt.

KEYWORDS: Depth of Outreach, Sustainability, Leverage, Female borrowers, Market Mix, Pakistan.

INTRODUCTION

Microfinance programs are in operation to help financially poor people and to enable them to live a sustainable life. Such programs were initially run by government and NGOs to help the poor in both urban and rural areas of Pakistan but due to commercialization of microfinance institutions has raised debate about poverty reduction mission of microfinance. Microfinance represent small loan provided to low income individuals. Microfinance is the financial service for the poor to alleviate poverty and bring financial development in a country (Sinha,2008). Microcredit enables poor people to start their own business to generate revenues, which help them to start their own businesses (Onumah, 1995). Poverty prevails in various forms, low income, lack of basic resources, education and so on. Microcredit is the development process provides an opportunity to local entrepreneur and poor people of society to avail financial service and to start their own business to contribute to the economy (Akanji,2001).

Microfinance provider bears high cost of small loan size and little collateral and high risk. Microfinance has currently received considerable attention in the developing world. Microfinance with its entrepreneurial roots contributes tremendously to poverty mitigation and growth. Poverty and economic growth happen to be the two debatable issues in the developed as well as in the developing economies as poverty is a key challenge faced by these economies to attain economic growth and development (Armendariz and Morduch, 2010; Morduch, 2000). Mustafa (1996) reported that micro lender recipient earn economic values such as, increase in income, increase in spending, increase expenditure on foods and increase in overall expenditure i.e. house expenditures, from a broader prospective microfinance also include, insurance and saving. With financial service, microfinance institutions also provide a non-financial service, which includes counseling, training and education etc. The prime objective of both services is to enable the poor people to increase their access to sustainable life.

Credit is one important aspect to enable the poor people to start a business but the lack of solid business infrastructure can cause its efficiency. On the other hand, commercial banks mainly do group lending and focus on profitability. While microfinance institutions focused on poor peoples and do individual lending. Thus, commercial banks at larger contest avoid poor peoples of the society. Cull et al (2007) reported that profitable institution prefer

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individual landings. However, lending large number of small loans increases administrative cost. Thus, to increase depth of outreach, institutions incur higher administrative costs, which cause lesser returns on group lending instead of individual landings. To eradicate poverty investments are required in both human and physical capital to boost the productivity and provide employment opportunity to the poor. Poor borrower demand smaller loan and pay their installments frequently, which increase poor borrower ability to repay its outstanding amounts (Conning, 1999; Morduch 2000). Like conventional banks to reduce poverty and contribute to people well being, the role of microfinance intuitions is significant to examine in developing world. Individual loans represent large proportion of microfinance institutions, because the aim of MFIs is to reach the depth or poorer while also to increase the breadth. It cause issue of suitability, the word sustainability represents financial performance of institutions.

Historically, it is presumed that microfinance institutions have been established with the social mission of poverty alleviation. As the institutions become mature, their social objective of poverty alleviation shifts to economic objective, they change their focus from poor to rich people of the society, and mission drift occurs (Christen, 2001). For sustainability in the capital market, MFIs appear to have scarified their original mission of reaching to the poor. In addition, with the emergence of other institutions like ‘for profit microfinance institutions’ ‘profit’ has become their main objective. However, it is said that Nonprofit /NGO (Non Government Organizations) usually extend smaller loans because poverty reduction is their prime objective (since it is assumed in microfinance world that poor are not interested in bigger loans).

The concept of commercialization has caused the debate about mission of poverty reduction. Commercialized microfinance institutions focus on profitability and serve wealthy people not the poor ones. Christen, (2001) examined that regulated MFIs are highly commercialized and find out a great difference of loan size and categorized them by, profitability, regulations and competition. Two schools of taught emerged: ‘Institutionalists’ who favor commercialized institutions and argue that to meet large demand of microfinance service, commercialization is necessary; the ‘welfarist’ who argue that commercialization cause mission drift, means that commercialized institution shift from serving the poor to earning profit (Olivares, 2005). A mission drift can be affected by institutions’ strategy, maturity and group loans not by profitability and regulations (Christen, 2001; Armendariz and Morduch, 2010; Mersland and Strom, 2010). This debate is inconclusive however, ‘institutionalists’ are dominant in the equity market. Many microfinance institutions, operating in different countries have shifted to commercialized status. The first commercialize institution reported is Bank Rakyat Indonesia (Bateman, 2010). Commercialized microfinance institutions charged market interest rates and operate with dual mission of making profit and serving poor.

Microfinance for Poverty in Pakistan:

Pakistan is a developing country facing poverty issue since independence. Pakistan was rated world 146 poor country out of 187 countries in The World. Pakistan microfinance network was established in 1998 to provide social setup to emerging MFIs. In 2000, with support of World Bank Pakistan poverty alleviation fund was established. This organization provides about 60 percent financing service to MFIs, who are the member of MFN. According to World Bank 2013, 60 percent of total population lives below the poverty line. Until 2001, no uniform measures have been taken in Pakistan to measure poverty, when planning commission of Pakistan declared poverty line however, for adult to use estimated 2150 calories in the urban area and 2450 in the rural area. The per capita income was declared as Rs. 673.54 at that time. This amount was consistent for attainment of 2350 calories. The per capita income was reported in 2013 (Rs. 1174). In 2013, the Human Development Report show that 49% of population is living in multidimensional poverty and the country stands 123 in term of gender inequality while in Bangladesh it is 58%. The report further says that intensity of deprivation is 53% in Pakistan compare to 50% in Bangladesh.

The extensive study of Naveed and Ali (2012) examined poverty in Pakistan by using multidimensional poverty approach at district level. The findings show that in Pakistan one-third of all households fall below the poverty line and 21 % are severely poor. The report showed that 30 to 39 % are vulnerable and 50% and high is severely poor. The study found unequal, intra provincial; inter provincial and rural-urban poverty distribution in Pakistan. The clustering of poverty within each province was found strong; Baluchistan MPI was reported almost three times higher than Punjab. The MPI score shows that health and education deprivation was about 50%. Lack of assessment in passion and non-enrolment of children in school were found very high.

To take initiative for poverty reduction in the country government started various developmental programs to reduce poverty and bring development in all part of the country, especially in two provinces. i.e. Khyber Pukhtunkhwa and Baluchistan where people has been suffered a lot due to numerous actions taken by government to bring peace in these provinces. Khyber Pukhtunkhwa is the 3rd pulpous province facing serious law in order situation since last decades. In 2009, the flood causes serious damages to poor people. 1.5 million people migrate to

safe places in various parts of the country. In 2010, the military operation against Taliban fueled the miseries for the poor people in this already destructed province. About four million people migrated from Khyber Pukhtunkhwa to other provinces to save their lives. Their houses have been damaged and heir businesses were destroyed. This military operation was ended in three months but their destructive impact can still be visible in the area. Government and other institution like NGO's required to work together to attain the desire growth level in these affected areas. In Pakistan, thirty one institutions are currently providing micro finance services to the poor people. Among them, eight are banks, five are specialized microfinance institutions and the remaining are NGOs (Non-governmental organizations).

These intuitions have imminent importance for Pakistani people, where income level of average family is about \$2 per day (Economic Survey 2011-2012). Development, therefore, is slow in the developing countries. The central goal of development is to eradicate poverty and affect life of the people positively. In this regard, World Bank and IMF have been working continuously by providing subsidized funds to finance projects targeted at the improvement of poor people's life across the world. Sen, (1999) explained that to escape poverty, poor people need freedom and employment opportunities. To deal with poverty and to affect development anywhere in the world, a political system that promotes and facilitates organizations that exert their efforts to achieve developmental goals is highly critical and bears extreme relevance. Pakistan is a developing country. Many governmental and non-governmental organizations are working in both urban and rural areas of the country to assist poor people to contribute in the development of the country. To objective about mission of poverty eradication the important arguments is that household need credit, not cheap credit. For that sustainable financial programs are good weapon to fight poverty, other issue involved subsidize credit programs are good but are inefficient and importantly end up in the hand of nonpoor.

Variables, Measurement and Expected Signs

Dependant Variables- Depth of Outreach

In this study, Depth of outreach was measured by two methods, Average outstanding loan and average outstanding loan per capita gross national product. Average outstanding loan represents the amount received by each borrower with respect to total loan portfolio. Smaller the loan sizes higher the outreach or more lending to poor of the society. Average outstanding loan is used as a proxy for measuring the depth of outreach and calculated by average outstanding loan portfolio divided by number of borrowers (Olivares ,2005). Average outstanding loan per capita gross national product measures the country per dollar earning allocations to poor clients and is measured through average outstanding loan as a percentage of per capita gross national product. Schreiner (2002) criticized average outstanding loan and average outstanding loan per capita gross national product, stated that it ignores other aspect of loan size importantly, maturity. According to him, relatively newly established organizations have bigger loan sizes to decrease the cost, average loan size ignore this aspect of cost. Other macro-economic variables also create problems for MFIs in the development process (Boyd et al., 2001) find out that higher inflation rate in economy reduce profitability. In other words economic stability has direct impact on MFIs performance and development. (Olu, 2009) found a positive association of microfinance institution and extension of GDP in Nigeria. He also reported that these institutions have no significant impact on interest rates.

Independent variables- Sustainability:

Sustainability represents financial performance of institutions. It is often argued that poor people need continues access to loans, thus sustainable microfinance institutions are in better position to generate profit. Sustainability and depth of outreach are contrary in relation because it is said that serving the poor is costly, thus microfinance institutions may not sustain growth in long run if these are not subsidized through government or donor funding. Therefore, in order to be sustainable, the microfinance institutions should lend bigger loans. Return on asset ratio was used by many researchers as measure of sustainability (Mersland and Storm , 2008. Bassem, 2008). Sustainability is measured through return on asset ratio and calculated by earning before taxes as a percentage of total assets. We expect a negative relationship of sustainability with average outstanding loan and per capita gross national product.

Lending methodology:

Christen (2001) examined that variation in loan size determine mission drift. In addition, mission drift can be affected by institutions strategy, maturity and group loans not by profitability and regulations. Lending methodology represents individual and group lending, but in this study we used only individual lending, which is measured through percentage of individual loans. Individual loans represent large proportion of microfinance institutions, because the aim of MFIs is to reach the depth or poor while also to increase the breadth. The study of

(Cull *et al.*,2007) suggest that individual lending institutions are more profitable, but the poor borrower and women borrower are less in average outstanding loan portfolio. Therefore, we expect a positive sign of lending methodology with average outstanding loan and per capita gross national product.

Women Borrowers:

Most of the studies on gender find out that women are considered poor and most vulnerable in the society. Therefore, women should be given priority to access loans, so they can lift themselves up out of poverty.(Cull *et al.*,2007:Bhatt and Tang, 2001) reported that women are considered to be poor than men and institutions serving individuals have low ratio of women borrower. In Pakistan, women did not have access to basic facility like health and education. In Pakistan literacy rate is 57.4 percent of which male literacy was 69.2 percent and 45.2 percent of women. In this study we consider institutions lending small loans targeting women borrowers and measured through number of female borrowers as a percent of total number of borrowers. As women are consider poor and loan size should be smaller thus, we expect a negative relationship of women borrowers with average outstanding loan and average outstanding loan per capita gross national product.

Leverage:

Leverage was measured through debt to equity ratio. This ratio can be measured by either book value or market value of debt and equity. Book value of debt provides opportunity of tax-shield benefit therefore; book value of debt was used. Miller and Modigliani (1958) examined that there is no optimal capital structure or debt-equity mix exist to create firm value, because every structure is based on certain assumptions(no taxes, perfect capital market etc).Firms can create value for their assets by employing either debt or equity. Therefore, we expect a positive relationship of leverage with average outstanding loan and per capita gross national product.

Institution age:

Age of the institutions plays a vital role while reaching to the depth. (Christen, 2001) suggest that mission drift is like a natural evolution for NGOs, when institutions matures their outstanding loan balances increase and they transferred to regulated institutions. (Christen, 2001), further added that to know whether institution achieve the outreach or not. Make a comparison with other institution. A common argument is longer the age of institutions, larger the loan size or increase in incremental landings. We expect a positive relation of institution age with depth of outreach; the rational is when institution become older their capability to reach the depth increases.

Nature of Institution:

Christen (2001) suggest that regulated MFIs are highly commercialized and find out a great difference of loan size in regulated and non-regulated institutions. To measure the nature of institution, regulated institutions are assign "1" and non-regulated "0". There are only three institutions are non-regulated and represent NGOs out of sixteen institutions analyzed in this study. We expect that regulated institution have positive association with average outstanding loan and per capita gross national product.

Profit Status of Institution:

The deeper outreach is rooted in organization's commitment and good governance. Micro lending was mainly targeted to the poor of a society with prime aim to eradicate poverty. But, there are institutions established as 'for profit microfinance institutions' and thus, one of their main objectives is 'profit'. It is said that non-profit status or NGOs (Non Government Organizations) usually lends smaller loan, because poverty reduction is their prime objective (Since it is assumed in microfinance world that poor are not interested in bigger loans). In this paper profit, status financial institutions were measured through "1" and NGOs are taken as non-profit status institutions measured through "0". We expect that profit status institution has positive relationship with average outstanding loan and per capita gross national product.

Materials and Methods:

The current study was carried to check the magnitude of changes in sustainability, credit methodology, female borrowers, leverage, age of institutions, profit status and regulations of institutions on depth of outreach. To examine the relationship empirically we took a sample of 22 MFIs from total of 31 for period of (2008-2012). Data were collected from Market Mix. Data were in penal form therefore, ordinary least square method was used for analysis. In both models internal heterogeneity of institutions was ruled out by keeping time factor as constant.

Model specifications:

Model 1

$$Y_{1it} = \beta_0 + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \beta_4 X_{4it} + \beta_5 X_{5it} + \beta_6 D_{1it} + \beta_7 D_{2it} + \varepsilon_{it} \dots \dots \dots (01)$$

β_0 = stand for the intercept term

β_i = stand for slope coefficients where $i = 1, \dots, 7$.

Y_{1it} = stands for Average outstanding loan of i^{th} institution for the t^{th} time period

X_{1it} = stands for sustainability of i^{th} Institution for the t^{th} time period

X_{2it} = stand for credit methodology of i^{th} Institution for the t^{th} time period

X_{3it} = stand for female borrower of i^{th} Institution for the t^{th} time period.

X_{4it} = stand for Leverage of i^{th} Institution for the t^{th} time period

X_{5it} = stand for age of i^{th} Institution for the t^{th} time period

D_{1it} = stand for Profit and non - profit status of i^{th} Institution for the t^{th} time period
(where $D_1 = 1$ for profit status Institution and $D_1 = 0$ for non profit status Institution).

D_{2it} = stand for Regulated and Non - Regulated i^{th} Institution for the t^{th} time period
where $D_2 = 1$ for Regulated Institution and $D_2 = 0$ for Non - Regulated Institution).

ε_{it} = is the error term the i^{th} Institution for the t^{th} time period.

Model 2:

RESULTS AND DISCUSSION

$$Y_{2it} = \beta_0 + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \beta_4 X_{4it} + \beta_5 X_{5it} + \beta_6 D_{1it} + \beta_7 D_{2it} + \varepsilon_{it} \dots \dots \dots (02)$$

β_0 = stand for the intercept term

β_i = stand for slope coefficients where $i = 1, \dots, 7$.

Y_{2it} = stands for Average outstanding loan of i^{th} Institution for the t^{th} time period

X_{1it} = stands for sustainability of i^{th} Institution for the t^{th} time period

X_{2it} = stand for credit methodology of i^{th} Institution for the t^{th} time period

X_{3it} = stand for female borrower of i^{th} Institution for the t^{th} time period.

X_{4it} = stand for Leverage of i^{th} Institution for the t^{th} time period

X_{5it} = stand for age of i^{th} Institution for the t^{th} time period

D_{1it} = stand for Profit and non - profit status of i^{th} Institution for the t^{th} time period
(where $D_1 = 1$ for profit status Institution and $D_1 = 0$ for non profit status Institution).

D_{2it} = stand for Regulated and Non - Regulated i^{th} Institution for the t^{th} time period
where $D_2 = 1$ for Regulated Institution and $D_2 = 0$ for Non - Regulated Institution).

ε_{it} = is the error term the i^{th} Institution for the t^{th} time period.

In the first model, average outstanding loan was used as dependent variable. The results suggest that five independent variables, credit methodology, female borrower, leverage, age of institution and profitability significantly affect the loan size. Sustainability and regulation does not affect the loan size.

Table 1: Model 1 Coefficients of the regression model on Average outstanding loan on selected independent variables

Independent variables	Coefficients
Sustainability (Return on asset ratio)	-12.07627 (-0.392336)
Credit methodology (% of individual loan)	-36.40419*** (-3.581526)
Female borrowers (% female borrowers)	151.1669*** (8.817570)
Leverage (debt to equity ratio)	1.795592*** (3.431517)
Age of institution (years)	-4.625342** (-2.517620)
Profit and Non-profit status (NGO-Financial institution)	44.16207*** (4.252653)
Nature of Institution (Regulated or Non-regulated)	5.836754 (0.564781)
Constant	19.22393 (0.977564)
R-squared	0.615096
Adjusted R-squared	0.579702
Prob (F-statistic)	0.000000

MFIs 22

Note: Number in parentheses is t-values and for F-test probability is given

***p (.001)

**p (.01)

*p (.05)

The results show that one time increase in individual loan size leads to 36 time decreases in dependent variable average outstanding loan. (Olivares Polanco, 2005) also used average loan size as proxy for measuring the level of poverty. He found that larger loan size leads to depth of outreach.(Cull et al, 2007) reported that individual lending institutions are more profitable then group lending institutions.The result contradicts our expectation. One time increase in female borrowers shows 151 times increase in the dependent variable. Further, Cull et al (2007) examined that institutions involved in individual lending are serving relatively rich clients hence mission drift occur. The result confirmed our expectation. The leverage coefficient affects is about 1.79 which shows that one time increase (decrease) in leverage bring 1.79 time increase (decrease) in average outstanding loan confirmed Miller and Modigliani (1958) finding, that firms can increase its assets value either by using debt or equity. Age of institution indicating that shorter the life of institutions more the loan they lend. In current study one time increase in institution life decrease, four times loan size. The result contradicts our expectation. In the two dummy's, D2show no significant impact on loan size, it means that in Pakistan regulated and non-regulated institutions does not affects loan size. D1 stands for profit and non-profit institutions, in which those firms run with a motive of profitability, have positive impact on average outstanding loan then non-profit firms. The results confirmed our expectation.

Table 2: Model 2 Coefficients of the regression model on Average outstanding loan on selected independent variables

Independent variables	Coefficients
Sustainability (Return on asset ratio)	-0.029395 (-0.645951)
Credit methodology (% of individual loan)	-0.040511*** (-2.695816)
Female borrowers (% female borrowers)	0.180768*** (7.132071)
Leverage (debt to equity ratio)	0.002102*** (2.716863)
Age of institution (years)	-0.012746*** (-4.692840)
Profit and Non-profit status (NGO-Financial institution)	0.053777*** (3.502781)
Nature of Institution (Regulated or Non-regulated)	0.006325 (0.413951)
Constant	0.054956 (1.890245)
R-squared	0.547072
Adjusted R-squares	0.505424
Prob (F-statistic)	0.000000
MFIs	22

Note: Number in parentheses is t-values and for F-test probability is given

****p* (.001)

***p* (.01)

**p* (.05)

Table 2 shows the second model results, The R-squared of model is low but good because here we are dealing with cross sectional data and adjusted R-squared value is desirable. The model two results are consistent, but show less sensitivity compares to model one. The probability of F-statistic says that overall model is highly significant and variable included in the model are relevant. Most of the independent variables on the basis of t-statistic relates significantly to the dependent variable of the model. While other independent variable sustainability and dummy variable regulated and non-regulated, which was introduced to capture the qualitative effects were found insignificantly.

Conclusion

The discussion concludes that, if MFIs want to achieve depth in Pakistan, they should give up profitability, means trade-off between depth of outreach and sustainability exist. Sustainability negatively affects depth of outreach, i.e. coefficient value indicating that increase in sustainability decrease depth of outreach confirmed our expectation and finding of (Schreiner, 2002). As lending small loans to large number of people is expensive thus, institutions using group lending are less profitable. It has found that institutions lending to the individuals are more profitable and their depth of outreach is less. The positive significant impact of leverage on depth of outreach, means debt financing increases MFIs access to poor despite bearing high cost and negative sustainability. In current study gender includes women borrowers, the coefficient value shows that women borrowing are highly sensitive to depth of outreach, indicating that a small change (an increase) in average outstanding loan brings considerable big change in women borrowers well being. The negative coefficient value of institution's age confirming that younger the institution smaller the loan size they lend, the result confirmed the findings of (Olivares , 2005). In Pakistan, profit status of institution has positive impact on outreach, indicating that institution with a profit motive can better serve the poor instead of being working as a non-profit institution. The coefficients value of regulation confirms that in Pakistan, rules and regulation have no affects on depth of outreach. MFIs performance in term of individual serving is satisfactory because people are benefitted from these institutions but the explanatory variables suggest that overall performance is not satisfactory and the overall impact on poverty reduction were found low. It is recommended that

government and non government microfinance providers should improve their accessibility to the poor across the country. This will help to lower down the poverty and will bring positive changes in the lives of the poor.

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