

Challenging the Industry: Poverty-Focused Microfinance in CEE and the NIS

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INTRODUCTION

Recently there has been a growing interest in poverty outreach of microfinance interventions among various industry stakeholders across the globe. Most of these considerations refer to poverty definitions in traditionally poor settings such as Asia and Africa. This is why it is not surprising that most microfinance practitioners in Central and Eastern Europe and the New Independent States (CEE and the NIS) region hesitate to get into discussions – so distinct from the reality in the regions themselves. This note presents an action-research framework aimed at exploring opportunities for microfinance institutions (MFIs) in CEE and the NIS to reach more poor people with high-quality microfinance services that will have a positive impact on their lives, therefore enhancing the role of sustainable microfinance in reducing poverty in the region².

It is important to emphasize that this is not a framework created so that all the MFIs in the region should focus on poverty alleviation. Rather, it is a framework for developing an alternative microfinance model to micro-credit (only) institutions financing micro enterprises of low income people. We acknowledge the rationale of the existing movement of

Box#1: Definitions Used

Microfinance refers to a range of services: the provision of small loans, savings facilities with a low minimum deposit, and other financial services such as insurance, leasing, money transfer, or bill payment designed appropriately for people who are on low incomes or financially excluded for other reasons (Rogaly et al. 1999). For the purpose of this initiative the term microfinance also encompasses business development and other non-financial services that expand poor people's participation in financial markets and increase the impact of the availability of financial services.

Poverty encompasses not only low household incomes and consumption but also other dimensions of human development, especially low fulfillment of basic needs such as nutrition, health, shelter, and education. In this framework the notion of poverty is broadened to include vulnerability and exposure to risks linked to the level and management of financial, physical, human and social household assets. The term is expanded also by social exclusion and deprivation – processes linked to powerlessness, lack of capabilities, limited access to labor and financial markets, disability to accumulate and maintain supportive social networks.

The Poor are all those living in households with a level of well-being (defined in a holistic way using the aspects listed above) which is below that necessary to live in a decent way considered by the standards of the majority in a given community. All the terms currently in use such as vulnerable non-poor, moderate poor, very poor, and destitute are put on purpose in one basket and termed as "the poor." The poor will be differentiated in sub-groups further in the process of action research.

Poverty-Focused Microfinance (PFM) does not necessarily intend to be a separate microfinance model. It is rather a way of thinking that emphasizes the underlying development rationale of the microfinance movement. It incorporates all efforts and practices to serve the poor with microfinance services. Therefore, PFM should be considered rather as an innovation vehicle contributing to the increased depth of microfinance interventions outreach and lasting impact on the poor.

Poverty-Focused MFIs (PF MFI) are all those organizations that are accountable for claims of depth of outreach and transparent in their efforts and practices to serve the poor. PF MFIs are strongly committed to their poverty-related missions and participate actively in pro-poor experimenting, innovating, sharing experience and replicating processes.

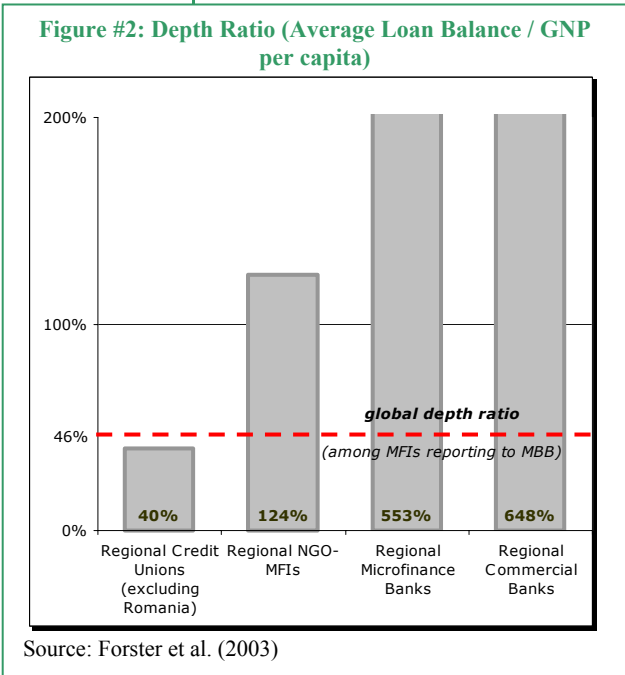
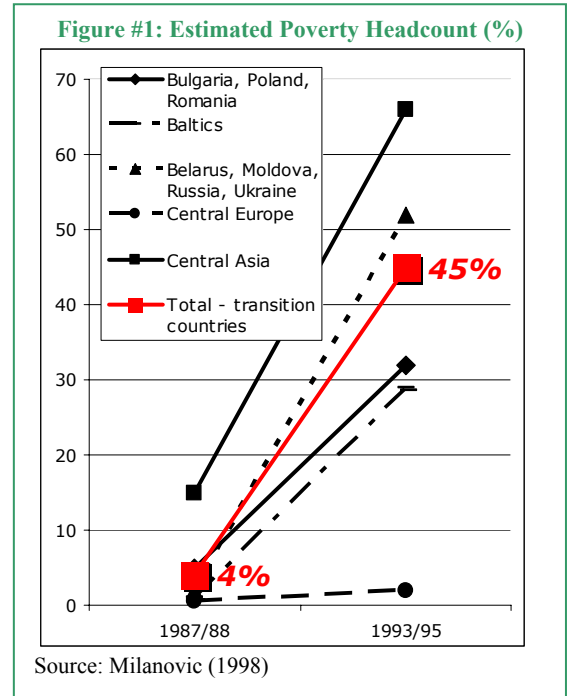
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² The author would like to thank Katarzyna Pawlak and Sean Kline for their comments on the first draft. Ideas included in this note are inspired by Imp-Act programme's "microfinance for the very poor" working group – www.imp-act.org.

MFI commercialization and the mission of most MFIs in the region to support micro-enterprise development. On the other hand we believe that there is a niche in CEE and the NIS to widen access to microfinance services to the poor, therefore helping them to escape poverty.

There are some strong indications for introducing a poverty-focused microfinance (PFM) agenda in the CEE and the NIS region:

- Poverty is increasing in most of the transitional countries across the region.** The total estimated number of poor in the 18 countries of the region has risen twelve-fold from nearly 14 million before the transition (1987-88) or about 4 percent of the population, to 168 million in 1993-95, or approximately 45 percent of the population (Milanovic 1998)³. Growing unemployment, the collapse of safety nets and poor public basic services has sharply decreased the quality of life of low-income people in many dimensions. Inevitably structural adjustments have been harmful to certain groups of society creating a very important wave of the “new poor,” becoming more and more vulnerable to increasing number of risks.
- As global experience shows, innovating microfinance systems and products can be of great benefit for the poor** (Sebstad and Cohen 2000; Daley-Harris 2002; Morduch et al. 2003). They make an important contribution to promoting opportunity, facilitating empowerment and enhancing security for the poor families. Furthermore, it is becoming clearer that poverty targeted schemes show a significantly greater depth of poverty outreach than non-targeted programs of the same institution (Van de Ruit 2001). Microfinance is only one component of poverty alleviation, however, it seems to be a very important one.



- Microfinance services can be delivered to the poor in a sustainable manner.** New evidence from the Micro-Banking Bulletin shows little correlation between the profitability of successful microfinance institutions and their average loan size, a rough proxy for poverty levels (MBB 2002). The poor can be considered as a new promising market segment for regional MFIs.
- The depth of outreach of microfinance interventions in CEE and the NIS is shallow compared to other parts of the world** (Nagarajan and Pytkowska 2002; Forster et al. 2003, Prism Research 2002). Apart from the non-poor, regional MFIs are reaching only the upper segments of the economically active poor. Evidently, among the poor there may be households that require other forms of assistance to develop their capacity prior to undertaking credit-based enterprises. The fact that such households exist clearly should not be taken as a reason for excluding all the poor from participation in microfinance services (Greeley 2002). In addition, the shallow depth of outreach might be due to the fact that **most regional MFIs deliver only enterprise credits**. This is a limitation to be released and especially concerns the issue of serving the poor. For example, services, such as savings and insurance prove to help them effectively to manage risks, smooth consumption and build their asset base (Sebstad and Cohen 2000; Wright 2000; Helms 2002; Greeley 2002).

³ Based on national poverty lines calculated using data from national household budget surveys. No data from ex-Yugoslavia countries.

ACTION RESEARCH FRAMEWORK

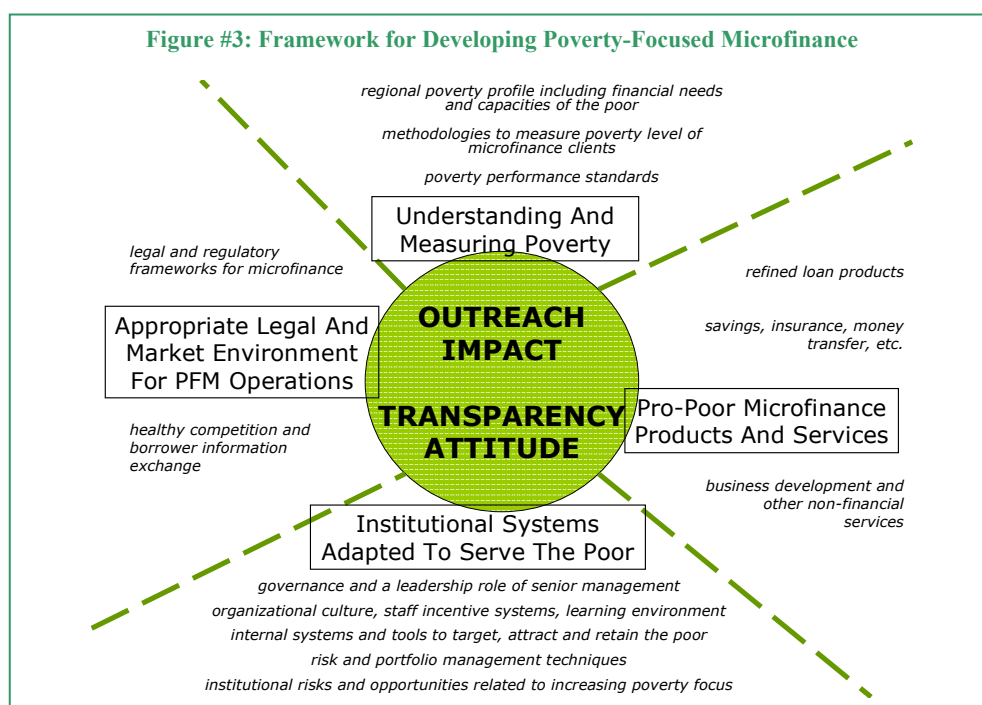
To that end, poverty exists in the region and needs to be addressed within a long-term development approach. There is growing evidence that sustainable PFM should be an important component of this action. **Nevertheless, one can not forget that the poverty concept in the CEE and the NIS region is remarkably different than in other traditionally poor settings all over the world.** The poor in transitional countries do possess key household assets of significant value, therefore, they will not be treated as vulnerable in Africa or Asia. Even if the main breadwinner of a family of four living on a formerly state-owned farm in rural northern Poland lost his job during the first years of the transition, his family still has reasonable housing conditions and a wide range of household assets. At the same time he is unable to send his children to the free, public primary school as his family cannot afford the transportation costs. A lack of stable sources of income, non-economic dimensions of a sudden status change among the “new poor” and weak management of household financial, physical, human and social assets are the main drivers at the micro-level of growing poverty in the transitional countries. Considering these main differences one should admit that global experience might not be sufficient in expanding microfinance outreach in CEE and the NIS. More regional research for innovation is needed.

In the next few years, MFC would like to work closely with practitioners in order to explore opportunities for MFIs to reach more poor people with high-quality financial services and therefore enhance the role of sustainable microfinance in the region as a poverty reduction tool. The main goals of this action research initiative are to:

- Reach more poor people and their families in CEE and the NIS with high-quality sustainable microfinance services;
- Ensure the impact of microfinance in reducing poverty by increasing opportunity, facilitating empowerment and enhancing security;
- Build transparency about PFM outreach and practices;
- Increase awareness and change attitudes of regional microfinance industry stakeholders, especially practitioners, with regard to rationale and design of PFM.

The development and promotion of poverty-focused microfinance (PFM) should be done in a comprehensive framework including three main areas:

- understanding and measuring poverty in CEE and the NIS,
- developing pro-poor microfinance products and services,
- adapting institutional systems to serve the poor,
- and creating an appropriate legal and market environment for PFM operations



There are many overlaps and synergies between these four main areas. The action research work should be undertaken simultaneously, taking into consideration all the aspects of PFM. Needless to say, focusing only on one area will hardly contribute to generating genuine and sustained improvements in deepening the outreach and ensuring the poverty impact of MFIs in the CEE and NIS region.

Understanding and Measuring Poverty in CEE and the NIS

Understanding and measuring poverty in the CEE and the NIS region is a crucial starting point for this initiative. Needless to say, more understanding will allow defining and identifying the “bankable” poor in the CEE and the NIS region. Consequently, common definitions of extremely poor, very poor, moderately poor, and vulnerable non-poor will contribute to overcoming the current conceptual vacuum. As a recent SEEP/MFC survey in CEE and the NIS shows there is still a lot to do to put poverty assessment into practice.

Box#2: Assessing the Poverty Level of Microfinance Clients in CEE and the NIS

Recently the SEEP Poverty Assessment Working Group and the MFC surveyed the current state-of-the-art method for assessing poverty of microfinance clients among CEE and the NIS practitioners. The most striking finding was that the majority of 41 MFIs who responded to the survey admitted that they did not have a holistic approach to poverty assessment. Furthermore, it is evident that virtually no institution uses poverty proxy indicators that can provide reliable information on poverty outreach of its interventions informing both the MFI management and external stakeholders.

Almost half of the MFIs attempt to measure the poverty level of their clients. As expected, those who provide a wider range of services are more involved in poverty assessment. Among those who provide exclusively credit for income-generating enterprise projects (most of the organizations in the mainstream microfinance movement) virtually no institution attempts to measure the poverty level of its clients. The smallest institutions are more often involved in poverty assessment.

Practitioners can rarely provide detailed classification of their current clients with regard to poverty level. Among the MFIs measuring poverty levels economic measures are most commonly used. Those MFIs that attempt to measure the poverty level of their clients expressed a strong need to develop methods based on non-economic measures. Consequently it might be said that practitioners need these poverty measures not only to report and compare quantitative data on their client poverty level but also to better understand how they can expand their outreach.

Source: SEEP/MFC poverty assessment survey among MFIs in CEE and the NIS, January 2003.

The following actions should be taken in consideration:

Drafting a regional poverty profile that includes financial needs and capacities of the poor

Given the fact that the poverty concept is remarkably unique in CEE and the NIS there is a need to draft a regional poverty profile (using the multi-dimensional approach). When the broad range of various groups of the poor are identified it will be necessary to link poverty to microfinance (not done when microfinance was replicated in the region in the 1990s). It is evident that poor people have a variety of needs for financial services (Rutherford 1999; Wright 2000). **How is this different in post-communism transitional settings?** One important thing is to distinguish “needs” and “wants”. The consumer demand to which normal business responds is geared to “wants” rather than “needs”. Responding only to poor people “wants” may not be sufficient to help them to move out of poverty. “Needs” should be in the center of all PFM development as their satisfaction promises to have a lasting impact on microfinance clients’ well-being (Dunford in Daley-Harris 2002). Other important, but very often forgotten aspect of serving the poor is to assess thoroughly their financial capacities in order to design services contributing to vulnerability reduction. In addition, the profile has to be completed by current use and the attitude toward financial services among the poor. **The holistic regional poverty profile, including financial needs and capacities of the poor, will give a firm background to developing poverty assessment methodologies and setting performance standards for PFM.**

Developing credible and useful methodologies to measure the poverty level of microfinance clients

Development of poverty measurement methodologies for PF MFIs supporting them in managing the poverty performance is a must. It is widely acknowledged that there are currently no poverty measurement methodologies that can be easily used by practitioners. Up to the moment only the indicators based on loan size are in use. It is becoming more and more evident that loan size is not an adequate basis for assessing the poverty reduction focus (Dunford 2002). There is also some evidence that poverty performance monitoring using loan size radically overstates poverty focus (Sebstad and Cohen 2002). It is evident the PFM needs poverty measures that are not such remote proxies.

The poverty measurement methodologies for PF MFIs in CEE and the NIS should be externally viable, internally useful, cost-effective, easy-to-use, and practitioner-oriented.

Both **relative and absolute measures** should be applied to assess the poverty level of microfinance clients.

Absolute measures can be useful for PF MFI for cross-regional and cross-country comparisons, in other words in development of poverty benchmarks for PF MFI regional appraisal. The poverty lines and relevant statistics should be reviewed in all countries in the region. Based on this, the absolute poverty of microfinance clients can be assessed using existing data (or building databases); this may follow ACCION poverty research framework (ACCION 2002). In this sense poverty measures should not be limited only to income poverty but attempt to cover different poverty dimensions and include vulnerability measures.

The poverty assessment methodologies should have a function of **international comparisons**. In order to provide viable cross-regional comparisons, the indicators should take into account some contextual dimensions. Apart from the local magnitude and profile of poverty it seems that local financial needs and capacities (including attitude toward credit) of poor people are crucial to better understand international comparisons.

Relative measures promise to be very useful for PF MFI itself to better understand local poverty and take relevant actions to fight it⁴. In other words, it is useful to get to know better the poor in the intervention area, and therefore target them effectively with appropriate products. In addition, the relative approach might also provide an opportunity for practitioners to compare different geographic regions of intervention as background for geographic targeting⁵.

The poverty measurement methodologies for PFM practitioners should be based on **indicators that are well adapted to the local context**. That way, the tools will be useful for practitioners for their day-to-day management and enhance their understanding how to manage deepening their outreach. The tools should also allow an **ongoing client poverty profiling** that should inform strategic management and self-assessment of PF MFI. Apart from some MIS poverty monitoring the methodologies should include some **basic qualitative methods** that will allow practitioners to understand better how to serve the poor. Thus, they will be not only empowered in reporting to external stakeholders but they will also be able to improve their performance in reaching the poor as well as to comply with new poverty performance standards. Furthermore, practitioner-oriented poverty measurement methodologies have to include some **simple tools** that will give a sufficient and cost-effective source of information **to understand and quantify needs and capacities of the poor as well as to target, attract and retain the poor**.

Last but not least, poverty assessment methodologies should have a function of **measuring impact** to judge if the PFM interventions respond to development needs of the poor.

Setting appropriate poverty performance standards

Poverty performance standards that will be built on newly developed poverty measures **are needed to hold MFIs accountable to claims of depth of outreach**. In addition, these standards should have a dual role: informing funding priorities of donors as well as allowing PF MFIs to manage successfully their poverty focus performance.

It is generally acknowledged that poverty standards should take into account poverty dimensions and levels contextually adapted. As it was noted before, the poverty standards should also be extended by one more layer: the needs and capacities of the poor. For example, international poverty benchmarks should reflect not only differences in national poverty lines but also differences in the needs and capacities of the local poor, e.g. taking into account an attitude toward credit, etc. All standards work should also try to link indicators to specific institutional missions of PF MFIs. Furthermore, taking into consideration poverty focus it might be important to review all the performance standards: institutional characteristics, productivity, efficiency, overall financial performance, portfolio quality, and outreach standards. The revised standards should be set on the basis of indicators currently in use by Microbanking Bulletin (MBB) and others.

Potentially, **setting the poverty outreach standards should push MFIs to innovate and experiment in new ways to comply with the standards** (as it happened for the financial MBB standards). Documenting the ways by which MFIs are successful in achieving such standards will be a milestone in PFM development. However, it might be that setting the standards alone would be harmful for the microfinance industry. Currently, most microfinance practitioners struggle to comply with financial standards. Even if there is no straightforward trade-off between profitability and poverty outreach, adding the next set of standards can exceed the management capacities of regional practitioners. Therefore, performance standards for PF MFIs should be set in a way that they will both inform MFI management how to deepen their outreach while not jeopardizing their current institutional goals.

⁴ As for the moment the only rigorous initiative to measure relative outreach in the region was that of Prizma (BiH) applying CGAP PAT (Prism 2002).

⁵ Greeley (2002) makes a good point that “relative poverty outreach should not be based on portfolio analysis alone but on portfolio analysis relative to the distribution of poverty in the operational area”.

Box#3: Prizma's Poverty Research

by Sean Kline, Prizma Board of Directors

With financial support from the Consultative Group to Assist the Poorest (CGAP) and the Ford Foundation funded Imp-Act Program, Prizma contracted a research firm to carry out a poverty assessment of its clients in 2002. This assessment was the first of its kind in Bosnia-Herzegovina and Central and Eastern Europe and the Newly Independent States (CEE & NIS) more generally and marked an important initiative given limited research thus far to understand the character and extent of poverty in the region.

Findings

CGAP's poverty assessment tool (PAT) was used to assess the poverty level of clients relative to non-clients in the same community while a national omnibus survey was used to assess poverty more generally across the Country. Among some of the key findings are the following:

Poverty is widespread across Bosnia-Herzegovina.

- Poverty is particularly prevalent among ethnic minorities in each community, returnees and refugees, women, the elderly (pensioners), people in rural areas, and in many communities of the Federation and most of the Serb Republic.
- The character of poverty in the Country is complex, encompassing "new poor," as well those with few assets and little or no education who are more typical of the millions of poor across the globe.
- While some regions have a greater concentration of poor people, given the ethnic and rural character of poverty in most communities, there are dramatic differences in poverty both between regions and within each region.
- Aspects of someone's shelter, which have proven critical indicators of poverty in the developing world, are only modestly correlated with poverty in many communities of Bosnia-Herzegovina, affirming that poverty and vulnerability is common among those with an important asset base but very limited and intermittent sources of income.

Broader Research Agenda

Findings from the poverty assessment are helping move Prizma along a continuum comprised of three critical objectives: (1) determining the relative and absolute poverty level of clients; (2) strengthening targeting of and service to poor and low-income clients; and (3) measuring change in the lives of these people over time. First, the poverty assessment indicated that 64% of new Prizma clients are among the 'moderate poor' and 'poorest' terciles in every community Prizma serves, affirming that the Institution is reaching its mission-defined target group.

Second, employing qualitative and quantitative methods, Prizma has sought to better understand who is poor in the post-war and transitional setting of Bosnia-Herzegovina. The poverty assessment highlighted areas of the country where poverty is most prevalent and, thus, areas and ways in which Prizma can strengthen its targeting. Such information has also helped the Institution refine its strategic position and re-engineer its performance management system—appraisal, reward, and communication—to more closely align employee interests and reward with greater depth of outreach, improved service quality, and the financial health of the Organization overall.

Third, working closely with the MFC and members of the 'Microfinance for the Very Poor' working group under Imp-Act, Prizma is now developing an impact monitoring system that will enable the Institution to report on poverty reach based on robust and meaningful indicators rather than on average outstanding balance as a percentage of GNP per capita—a tired industry convention that has proven an easy but wholly inadequate means of gauging an institution's depth of outreach, particularly in CEE & NIS.

Looking Ahead

Prizma's steps through 2003 include narrowing a strong pool of indicators drawn from qualitative participatory field research (PRA), the CGAP poverty assessment, and recent external research in Bosnia-Herzegovina, including a Living Standards Measurement Survey (LSMS), to a select few robust indicators. Prizma will then define ranges for these indicators, intended to enable the Institution to (a) assess the relative poverty status of clients; (b) link indicators to the Country's poverty line to determine clients' absolute poverty status in the national context; and (c) link indicators to \$1/day (purchasing power parity) measure, to determine clients' absolute poverty status comparable internationally. While such figures on their own will not reflect the complex and multidimensional nature of poverty—critical to any serious effort to address poverty and its root causes—they promise to enable Prizma to understand and demonstrate more clearly and on a regular basis the extent to which it is fulfilling its social mission.

Developing Pro-Poor Microfinance Products and Services

Global evidence shows that poor people have broad needs for financial services. That is why there must be a variety of products and services available to them. As evidenced above, countries in the CEE and the NIS region are remarkably different than developing countries in Asia and Africa. However, the majority of the MFIs in the region initially followed the practices and products used in these developing countries. It is evident that there is a need to experiment to link specific microfinance products and services to the new needs and capacities of the poor and adapt to existing socio-economic environment. This encompasses:

Fine tuning existing services to needs and capacities of the poor and adding new loan products in a sustainable way ensuring efficient risk management of multi-product portfolios

As more and more MFIs are aware that their “imported” products are not adapted to regional realities there is a growing number of product innovations in CEE and the NIS. These are limited by legal frameworks for loan products. It is crucial to draw from the existing wealth of loan product experiments and identify those that contribute to the biggest extent to deepening outreach. As products in this framework is considered in terms of all marketing P’s all documentation and development should encompass not only product design and prices but also process, positioning, place, promotion, people, and physical evidence.

Investigating how other financial services as savings, insurance, money transfer, etc. can be delivered under existing legal and regulatory frameworks

Savings and insurance services are obviously a missing part in the regional microfinance industry. Prior to any development in this field a detailed desk study on legal requirements for savings and insurance provision in all countries across the region is needed. In addition, detailed guidelines should be prepared assisting credit-only institutions in transformation into full intermediation entities. The Credit Union movement that is widely spread in CEE and the NIS can contribute to a better understanding of the provision of savings services to poor people.

Linking business development and other non-financial services to expand poor people’s participation in the financial market

Non-financial services are considered as possible additional tools to expand poor people’s participation in the financial market because it is assumed that there are synergies of joint delivery leading to bigger impact of both financial and non-financial services (Dunford in Daley-Harris 2002). It is high time to include non-financial provision of services in the regional microfinance industry development agenda.

The following classification of non-financial services can be useful for the purpose of this action research:

- Non-financial services that make possible a provision of financial services (e.g. business training before taking an enterprise loan);
- Non-financial services as development action that use financial services as a vehicle to be delivered effectively to the target group (e.g. credit with education).

Adapting Institutional Systems to Serve The Poor

What this framework aims to highlight is that designing financial services for the poor is not only about developing pro-poor products. Serving the poor also means creating an institutional system that works efficiently to serve the poor. If the pro-poor products were not embedded in the institutional system that puts poverty alleviation in the center, the best-adapted products would fail to reach the poor. The following core challenges arise when one considers the institutional side of reaching the poor:

Strengthening governance and the leadership role of senior management in increasing the poverty focus of MFIs

MFIs that are poverty focused and effective in both reaching the poor and remaining financially viable do so because they have a clear mission; the mission is considered primary, and the leadership of the organization is fully committed to fulfilling this mission⁶. This leadership role in strengthening mission and poverty-centered organizational culture can also be expanded by including poverty focus in the development of governance boards – still a fledgling process in the regional microfinance industry.

Building a pro-poor organizational culture that promotes social mission fulfillment, rewards reaching the poor and creates a learning environment

Further developments in this area should include: poverty-oriented HR management (recruiting, induction, training, motivation), staff incentive systems supporting social mission, optimizing client-staff-organization feedback loops and other learning processes.

Developing internal systems and tools to effectively target, attract and retain the poor

Further work in this area should include: adapting global targeting tools to regional context, cost-benefit analysis of different targeting methods; researching innovative ways of attracting and retaining (tracking drop-outs and enhancing loyalty of) the poor.

Reviewing risk and portfolio management techniques in order to set a firm basis to cross-sell more socially oriented products, non-financial services, etc.

Further developments in this area should include: identifying specific risks of serving the poor; redefining portfolio quality policies based on a combined measure of portfolio risk and the percentage of the portfolio that is made up of very poor people⁷; looking at the delinquency level that the PF MFI can tolerate for reaching and retaining larger numbers of poor and very poor clients.

⁶ Sean Kline, personal e-mail communication, February 14, 2003.

⁷ Sean Kline, personal e-mail communication, August 8, 2002.

Identifying all institutional risks and opportunities related to increasing the poverty focus of an MFI, allowing managers to make better-informed decisions

Increasing the poverty focus is a very important institutional change. Therefore, there is a need to identify risks and calculate the costs related to it. That way, all the MFIs willing to apply PFM best practices will be fully aware of the consequences.

Creating an Appropriate Legal and Market Environment for PFM Operations

Last but not least, the development of PFM as described above will not be possible without ongoing work to create a poverty-focused yet friendly legal environment and promote effective coordination on the microfinance market. This means:

Ensuring that PFM is feasible to be applied under new legal and regulatory frameworks for microfinance in CEE and the NIS

Further developments in this area should include: creating opportunities for development of deposit-taking institutions that may comply with some prudential norms, refine norms to adequately access the risk and return from activities, promote a risk-based supervision approach, encourage affiliations, mergers and partnerships between financial institutions, establish a consumer-protection code of conduct. In addition, it is important to integrate microfinance with other markets. Therefore, regulations on other markets should ease the participation of the poor.

Promoting healthy competition and a borrower-information exchange between all MFIs operating in the same area

There are clear advantages to active cooperation and healthy competition among MFIs to effectively serve the poor (Nagarajan and Pytkowska 2002). An effective exchange of information on borrowers will contribute to reducing multi-borrowing limiting risks of overindebtedness among the poor. A voluntarily-formed, member-based local network may be an effective forum to motivate cooperation and instill peer pressure to discipline MFIs. Needless to say, PF MFIs should comply with healthy market rules ensuring that microfinance remains a market-driven industry.

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