International Journal of Scientific Research and Engineering Development-– Volume 2 Issue 4, July – Aug 2019
Available at www.ijsred.com

RESEARCH ARTICLE OPEN ACCESS

The impact of Microfinance Banks on Household income and Expenditure among Rural Communities in Oyo State

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Abstract:

The study evaluated the impact of microfinance banks on household income and expenditure among rural communities in Oyo State. Data were collected through questionnaires which were evenly distributed across the selected rural settlements to gather the opinions relating to the objective of the study using descriptive statistics and regression analysis to establish the relationship between microfinance banks and household income and expenditure. The results showed that emergence of microfinance banks in Oyo State impacts household level of income and expenditure because the size of loan obtained is negatively correlated to poverty index at 5% level of significant; which implies that an increase in size of loan obtained by an individual reduces the poverty level.

Keywords: **Microfinance, household, Income, Expenditure and Poverty**

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(1) Introduction

Microfinance institutions play a pivotal role in meeting the financial needs of both households and micro enterprises. Traditional or formal banking sector has failed to provide adequate credit services to the poor as a result of the fact that they are unable to meet up with the criteria for granting them credit facility.And microfinance institutions are being developed to fill this gap (CBN, 2012) widely open between the Deposit Money Banks and the average individuals in the society due to statutory standards set by the banks and inadequacy to meet up by the average individuals in the society. Hence, microfinance is a financial activity to provide small, collateral- free loans or financial services to the people who have low incomes, minimal assets and who are unable to acquire loans from commercial banks because of the demand of high collateral and tight conditions of security. Poverty is a diversified term but the most common type of poverty is income-based poverty (Nadia, 2012) where categories of income earners are stratified in accordance with their income level. Microfinance bank increases the incomes of poor borrowers by providing credit facilities for small businesses, livestock farming, trading, and artisanamong other. (Nadia, 2012).

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Microfinance bank credit is collateral-free with affordable bank interest rate and available on easy installments. Thus, after proper utilization of the credit, incomes of the borrowers increase which ultimately help them to come out of poverty trap. Consequently, microfinance is playing an extensive role in eradication of income-based poverty Nadia (2012). It is against this background that this study explores the role of microfinance banks in poverty alleviation among rural communities in Oyo State.The delivery of banking services in developing nations reaches less than 20% of the population (Rosenberg, 1995; Robinson, 2001). The rest of the population may not have access to a formal financial service provider because most formal financial service providers regard low income earners and households in rural areas as too poor financially to either save with or borrow from their institutions. Several categories of people such as rural inhabitants, poor people, and uneducated people are not served by formal financial institutions in developing countries (Adjei & Arun, 2009). In lieu of the envisaged impact that micro-finance bank could have on household income and expenditure, it is believed that the menace of poverty will be greatly ameliorated, so that myriad number of people leaving in abject poverty could be reduced drastically by the instrumentality of the capacity of micro-finance banks in discharging their presumed responsibility for betterment of the low income earners in Nigeria.

(2) Statemen Of Problem

Poverty is a global phenomenon affecting almost half of the world population. (Mou,2007). At present, about two-third of the Nigeria's population (about 100 million) are poor and the West Human Development Programme indicated that about 70.8 percent and 92.4 percent of Nigeria's population live below one and two United State of America Dollar respectively that is ₦360 a day (UNDP,2007).

Based on the data from the FOS, the state by state poverty incidence in Nigeria between 1980 and 1996, the data clearly indicated high and varying poverty levels among the states of the federation. The data further shows that poverty in Nigeria increased sharply both between 1980 and 1985 and between 1992 and 1996. Furthermore, by 1992 only 10 states have more than half of their population in poverty, but by 1996 all states including Oyo State. In Oyo State the incidence of poverty in 1980 was 7.8%, increased to 28.3% in 1985, 40.7% in 1992, increased to 58.7% in 1996 and the incidences of poverty is still on.

Before the 1970s, the Nigerian experience in Microfinance was limited to Self Help Groups, Rotating Saving and Credit Associations, Co-operative Unions, Community Saving Collectors and local money lenders. They were all informal and largely unregulated. Their strength was mainly micro-credit savings mechanisms and their strength was associated with good repayment records due to peer pressure and other cultural mechanisms. However, their weakness lay in low level access to capital and limited range due to informal non structured framework.

Between 1970 and 1990, there were general government initiatives in the form of Rural Banking Programme (RBP), Sectoral Allocation of Credit by Central Bank Agricultural Credit Guarantee Scheme (ACGS), Nigerian Agricultural and Co-operative Bank (NACB), the National Directorate of Employment (NDE). These efforts were largely incoherent and mainly targeted towards enhancing subsidized credit in Agriculture and a few other sectors of the economy. They were not sustainable as a result of poor repayment records and inefficient

administrative structures.

In the 1990s, the federal government embarked on other initiatives such as the People Banks, Community Banks, Nigeria Agricultural Insurance Corporation andNational Poverty Eradication Programmes and the Family Economic Advancement Programme.These were focused on rural and community small scale financing. They were all short lived and unsustainable as a result of poor government policies and corporate governance.

From 2000 to date, there have been other initiatives such as the merger of the People Banks (PB), Family Economic Advancement Programme(FEAP) and Nigerian Agricultural and Co-operative Bank(NACB) into the National Agricultural Co-operative and Rural Development (NACRDB). The National Economic Empowerment and Development Strategy (NEEDs) came and launch the Microfinance policy in 2005.These are more interactive initiatives resulting from wider consultations with stakeholders with the hope of better success than their predecessors. Regarding the alarming trendy state of poverty in the country, Nigeria, despite the effort being made to forestall the above, the menace is still felt.

(3) Objectives of the study

The study aims at evaluating the impact of microfinance banks on household income and expenditure among rural communities of the study area.

(4) Hypotheses of the Study

Ho: Microfinance banks have no impact on householdincome and expenditure inthe study area.

(5) Empirical Literature

Swain and Wallentin (2007) in a journal titled “empowering women through microfinance evidence from Indiasubmitted that microfinance programmes have been increasingly promoted in India because of their positive economic impact and the belief that they empower women. According to them, within the South Asian context, women empowerment is a process in which women challenge the existing norms and culture to effectively improve their wellbeing. The paper investigated the impact of microfinance in women empowerment using 2000 and 2003 Indian household survey data. The authors found that most microfinance institutions target women with the explicit goal of empowering them. Given the fact that a few studies have successfully investigated the impact of microfinance on women’s empowerment, the authors examined a few methods of measuring the impact used by other researchers including construction of an index/indicator of women empowerment. They concluded that measuring women empowerment by constructing indices is not an appropriate technique as it allows the use of arbitrary weights.

Brewer (2007) observed that lending to small firms is difficult because of the problems of information asymmetry. However, innovative ways to address the problems have the potential to increase credit availability to the firms. The two different innovations in small business financing are; increased usage of credit scoring technology and the introduction of microfinance lending institutions. Though these two approaches make use of different technologies, they provide a valuable

picture of how lending to small firms is evolving over time.

Berger and Frame (2007) provided an excellent analysis discussion of the usage of credit scoring technology by large banks in lending to small businesses. "The technology is changing the relationship between the small business borrower and his bank, relying more on easy veritable and quantifiable financial data rather than on information obtained through long term relationship". The credit scoring technology briefly consists of scores awarded to the prospective borrower with respect to various character traits as may be determined by the lender, such as age, type of work, and period of relationship with the bank among others, a bench mark score is determined and the decision made to lend or not to score compared to the bench mark score. The technique is not biased and non-emotional. It is highly recommended in microfinance credit operations as it will ensure less of credit failure and ensure higher rate of loan repayment.

Raham (1999) observed that microfinance borrowers have had to sell household assets or their own food supplies or have to leave their homes in search of wage labour in urban areas to repay their loans. There are other cases to the effect those delinquent borrowers of microfinance institutions are ostracized by joint liability groups and communities while they become destitute in their communities. One would observe that these are extreme cases. If a beneficiary of microfinance loan misapplies the proceeds of the loan, then he has himself to blame. That does not mean that the system has failed. This, of course, calls for care as to who should be admitted to microfinance services. Character of the borrower should be verified by microfinance operators. "Know your customers" guideline has a role to play as in the mainstream banking, even in microfinance practice.

Marr (2002) examined the impacts of microfinance on poverty reduction with the application to Peru. It is found that the Marr Group dynamics engendered by the Joint- liability microfinance programme had negative impacts on the well-being of participants. The results showed that tension was observed between financial and organization sustainability of the system to the extent that led to fracturing of the groups and the exclusion of the poor who should really benefit from the system. He further noticed that microfinance programmes that were established and organized in haste tend to exploit existing social hierarchical structures in other to achieve their financial sustainability, resulting in the erosion of social fabric of the communities they are expected to serve. These observations proved that in other for microfinance to serve the poor properly, all factors such as social fabric of the community, capabilities of borrowers and local conditions of host communities need to be weighed and balanced so as to achieve smooth operations that will benefit both the borrower and the lender.

Kiiru (2008) observed that microfinance has elicited different reactions from different stakeholders, but there seems to be a general agreement that it is useful in reducing poverty. Her opinion is that the context in which microfinance is of help to rural poor households is not well researched. She ventured to find out under what circumstances microfinance creates jobs and increase wage, employment and higher incomes in the rural areas. In the study, welfare effects of microfinance on the rural households and the patterns of entry, exit and growth of microenterprises, compared with the mainstream, theoretical and empirical work on rural development through entrepreneurship were observed. Apparently, the author came to the conclusion that all has not been too good from the study carried out in the microfinance, enterprises and rural poor relationship. She strongly recommended regulatory framework to enhance the lot of the stakeholders particularly

the rural low-income borrowers who seem to be at the receiving end.

Wome (2003) observed that excitement is building up about a set of unusual financial institutions prospering in distant corners of the world, especially Bolivia, Bangladesh and Indonesia. The hope is that much poverty can be alleviated and that economic and social structures can be transformed fundamentally by providing financial services to the low-income households.

Morduch (1999) also stated that these institutions united under the banner of microfinance, share a commitment to serving clients that have been excluded from formal banking sector.Wome (2003) observed that the aim of microfinance may have been misinterpreted by different people. While some see it as prospering the practitioner's others have seen it as a commitment to serve formal banking sector. The difference in expectations underlines the lack of clarity surrounding the term empowerment. What has become apparent over the last two decades is that microfinance has succeeded in bring out poor men and women all over the world, in Bolivia, Bangladesh and Indonesia as cited by this author from a state of abject poverty to a better economic status. This is achieved by giving them access to financial services from which the formal banking sector has excluded them. This is financial empowerment for better life.

Akintoye and Owoyori (2009) opined that micro- financing has been accepted as a major subsector in the finance sector in Nigerian economy. The authors are concerned with the performance of the microfinance banks in other that both the clients (the poor of the society) and the owners (shareholders) may attain the objectives of the banks. Ultimately, satisfactory performance of microfinance banks will lead to poverty alleviation and economic development. In a paper on microfinance and developing the Nigeria economy, Onwumere (2009) appraised Nigeria's current microfinance policy within the context of the country's aspiration to join the league of twenty largest economies of the world by year 2020. After reviewing the number of microfinance banks relative to the population of the country. The author concluded that more microfinance banks and branches would have to be put in place and more widely spread across the country in other to ensure that their services reach more clients. He further reasoned that the microfinance policy, till date remained the most wholesome approach ever adopted by the county to reach financially unserved segments of the economy and inject a process of poverty alleviation.

According to Kimotho (2000), there has been a high level of mushrooming of microfinance institutions (MFIs) in the world. He observed that microfinance practitioners and donors have continued to see it as the panacea or silver bullet and the sole answer to poverty reduction, with little regard to practitioners' management skills, professionalism, good governance, client's readiness, capacity and ability to undertake long term sustainable business activities. He opined that microfinance industry is still young compared to the universal banks and we should not readily conclude with certainty, its real contribution to poverty reduction, improvement in real purchasing power of the poor and the poor's asset accumulation. The author observed further that despite the growth of the sector over the last couple of years the overall outreach of MFIs remains relatively low. In effect, the entire microfinance activities in Nigeria contributed a meager 0.2 percent to the Gross Domestic Product (GDP) and account for only 0.9 percent of the total credit, compared with about 22 percent in South Africa.

According to Central Bank of Nigeria (2005), justification for the establishment of microfinance banks

includes the weak institution capacity that is the prolonged sub- optimal performance of many existing community banks. Secondly, the existence of a huge unserved market that is the size of the unserved market by existing financial institutions is large. The average banking density in Nigeria is one financial institutions outlet to 32,700 inhabitants. In the rural areas, it is 1:57,000 that are less than 2% of rural households have access to financial services.

(6) Population of study

The population under study refers to the beneficiaries of six microfinance banks from each of the Local Government areas of three Senatorial Districts of the study. These were villagers, artisans, petty traders, low income group and those that had benefited or would benefit from the activities of the chosen microfinance banks. The staff of these institutions is also included in the population.

(7) Sampling Method and Sample Size

The study employed multi-stage, purposive and random sampling methods to choose respondents from the beneficiaries of microfinance banks in the chosen Local Government areas. Six microfinance banks were chosen. First, two rural Local Governments areas were selected randomly from three Senatorial Districts of the study area (Oyo North, Oyo South and Oyo Central). Secondly, two rural communities were randomly selected from each of the chosen Local Governments of the Senatorial Districts of the study area, making twelve (12) rural communities/villages. Thirdly twenty (20) households were purposely selected from those chosen rural communities in the study area making a total sample size of 240 households, these households were mainly farmers, traders, teachers, artisans among others. Purposive because all the six Local Government areas are rural because poverty is more pronounced in the rural areas than in urban centres UNDP (2003).

(8) Method of Data Analysis and Models

The study employed the use of both descriptive and inferential statistics methods of analysis. Descriptive analysis such as cross tabulation, percentage and Inferential statistical tools employed for this study was Foster Greer-Thorbecke (FGT) model, regression analysis.

(9) Model Specification

Poverty Indices

Poverty indices are the measurement of head count (P_0), depth of poverty (P_1) and severity of poverty (P_2). The measure related to the different dimension of the incidences of poverty.

The three measures are based on a single formula but each index put different weight in the degree to which household or individuals falls below poverty line. This approach is based on the mathematical formula which explains poverty indices anchored upon existence of households' classification according to income or consumption expenditure.

To determine poverty profile indices, it becomes necessary to use the P-alpha measured analyzing poverty; its

mathematical formulation is derived thus;

$$P_x = \frac{1}{N}\sum_{i=}^{a}\frac{(Z-y_1)}{Z} \qquad \text{.............................(1)}$$

Where N = the total population in the group of interest

Z = poverty line

q = number of individuals below the poverty line

Y = Expenditure of income of the household in which the individuals' lives

X = the degree of concern of the depth of poverty, it takes on the value of O, 1, 2 for poverty incidence, poverty gap and poverty severity respectively. The indices are therefore derived as follows;

$$P_O = \frac{1}{N}\sum_{i-1}^{a}\left(\frac{(Z-y_1)^0}{Z}\right) \qquad \text{..............................}(ii)$$

$$P_1 = \frac{1}{N}\sum_{i-1}^{a}\frac{(Z-y_1)^1}{Z} \qquad \text{..................................}(iii)$$

$$P_2 = \frac{1}{N}\sum_{i=1}^{a}\frac{(Z-y_1)^2}{Z} \qquad \text{...................................}(iv)$$

Regression model is specified as;

$P_1=a_0+a_1x_1 +a_2x_2 +a_3x_3 +a_4x_4 +a_5x_5+e$

$P_2 =a_0+a_1x_1 +a_2x_2 +a_3x_3 +a_4x_4 +a_5x_5+e$

Where P_1 = Poverty index before loan = dependent

P_2 = Poverty index after loan = dependent

X_1 = Education

X_2 = Size of loan

X_3 = Household size

X_4 = Occupation

X_5 = Sex

The multiple regression equation is given by;

$y = a + b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4$

Where y = income,

a = constant,

b = regression coefficient,

x = microfinance banks variables.

In order to achieve objective two of the study, which is to examine the impact of microfinance banks onhousehold income and expenditure among rural communities in the study area, Foster-Greer-Thorbecke poverty model (1988) was used to measure poverty index. The model is specified as;

$$P_1 = \frac{1}{n}\sum_{i=1}^{H_1}\left(\frac{z - y_1}{z}\right)^{\propto}$$

and

$$P_2 = \frac{1}{n}\sum_{i=1}^{H_2}\left(\frac{z - y_2}{z}\right)^{\propto}$$

Where P is the poverty index, is a non-negative parameter which took the value 0,1 and 2 and P_0, P_1 and P_2 indicates the head count ratio, poverty gap and severity poverty gap respectively, n is the total number of respondents which is 240. H_1 is the number of the poor among the respondents before the collection of loan, H_2 is the number of the respondents after the collection of loan, y_1 and y_2 represent the income of the respondents before and after collection of the loan. Regression analysis was used to determine the variables that affect poverty level.

(9) Results and Discussion

Table 9.1: Income Distribution of the Respondents

Senatorial districts	Less than ₦10,000	₦10,000 - ₦40,000	₦40,000 - ₦100,000	Above ₦100,000	Total
Oyo Central	22.1	10.0	1.2	0.0	33.3
Oyo North	9.6	23.8	0.0	0.0	33.4
Oyo South	7.9	20.4	3.8	1.2	33.3
Total	**39.6**	**54.2**	**5.0**	**1.2**	**100**

Source: Field Survey (2014)

Table 9.1 presents the income distribution in Oyo Senatorial Districts. Across the districts, however, it was observed that while 23.8% of the majority of the people in Oyo North had their monthly income to be above ₦10,000 monthly, 20.4% and 10.0% were for both Oyo South and Oyo Central respectively. The overall monthly income in the districts however shows that the highest proportion of 54.2% earned above ₦10,000 monthly, 39.6% earned less

than ₦10,000, 5.0% earned above ₦40,000 while 1.2% earned above ₦100,000 per month respectively. This monthly income earned by the respondents shows the level of abject poverty in the study area.

Table 9.2: Expenditure Distribution of the Respondents

Senatorial districts	₦2,000 - ₦4,000	₦4,100 - ₦6,000	₦6,100 - ₦8,000	Total
Oyo Central	18.0	13.8	1.3	33.1
Oyo North	16.7	14.6	2.1	33.4
Oyo South	21.8	11.7	0.0	33.5
Total	**56.5**	**40.2**	**3.3**	**100**

Source: Field Survey (2014)

Table 9.2. shows the range of total expenditure in Oyo Senatorial Districts. Across the Districts, it was observed that while 21.8% of the majority of the respondents in Oyo South had their monthly expenditure between ₦2,000 - ₦4000, 18.0% in Oyo Central and 16.7% in Oyo North respectively had similar monthly expenditure. The overall monthly expenditure in the districts however shows that the highest (56.5%) proportion of the people spent between ₦2,000 - ₦4,000 per month, followed by 40.2% of the people who spent between ₦4,100 - ₦6,000 per month and 3.3% of the people who spent between ₦6,100 - ₦8,000. This showed the level of poverty among the rural communities in the study area.

The general reason for not approaching the microfinance banks was that the interest rate was high. The interests of the microfinance banks are very high, as this can be seen from table 4.3 below where 60.4% strongly agree that the interest rate by microfinance banks is high while 24.2% strongly disagree and 15.4% were undecided about the interest rate charged by the microfinance banks.

Table 9.3: Percentage of Poor Respondents before and after Collection of Loans

Poor Respondents	Head Count	Percentage %
Before	185	77.1
After	150	62.5

Source: Field Survey (2014)

Table 9.3. shows Foster-Greer-Thorbecke poverty model using the international poverty line of $1 per day for every person. This was translated to ₦58,680 per annum at the exchange rate of ₦163 per dollar in Nigerian

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naira (this was the exchange rate at present during this study), therefore any respondents whose income is below ₦58,680 is considered poor.

The result shows that the head count of respondents H_1 represent 77.1% for 185 respondents who were poor before collection of loan while H_2 represent the head count of the poor after collection of the loan which is 62.5% for 150 respondents, which showed a 14.6% reduction in people that are poor. This result is in consonance with UNDP (2004) publication which reported that about 70% of Nigerians live below the international poverty line of ₦160 per day. The result from this study agrees with earlier researchers like Yunus (2003), Mohammad and Mohammed (2007), Yeshiareg (2009), Yahaya (2010), Idowu and Salami (2011) and Oyeleye (2012). They reported that microfinance bank loan has positive impact in alleviating poverty and raised the standard of living of the people which is in consonant with this study.

Table 9.4: Regression Analysis to Determine Relationship between Characteristics of the Respondents, Size of Loan and Poverty Level before Loan.

P_1	Co-efficient	Std.error	Z	P > (Z)	95% Conf. Interval	X
Education	-1.621379	1.0343210	-1.31**	0.179	-3.2815474	0.6789982
Size of loan	-1.601379	0.5912401	-2.65**	0.006	-2.5641253	0.445182
Household size	-1.684914	0.4774387	-2.43**	0.125	-1.4565222	0.766742
Occupation	-1.572340	0.3760219	0.47	0.590	-0.8048941	1.415832
Sex	0.308610	0.5675476	0.53	0.690	-0.7047941	1.315834
Constant	1.80213	1.33726	1.49	0.175	-0.6034516	4.106612

Source: Author's computation (2014)

Number of Observation = 240

LR Chi 2(5) = 0.00040

Pseudo R^2 = 0.5272

**Significant at 5%

The adjusted R^2 is 0.5272 and this implied that 52.7% of the variation on the reduction of poverty is being explained by the model shown in table 9.4. above. The size of loan obtained is negatively correlated to poverty index at 5% level of significant; which implies that an increase in size of loan obtained by an individual reduces the poverty level. Also, the level of education and household size were negatively correlated, though not statistically significant, this implies that as the educational level increases poverty level decreases. Household size was also negatively correlated to poverty before the collection of loan.

(10) Conclusion

Based on the findings arrived at in the study, the following conclusions were drawn, the results showed that

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the bulk of respondents (98.9%), (97.9%) and (97.2%) respectively in Oyo South, Central and North Senatorial Districts reported improvements in their socio- economic lives as a result of their participation in microfinance bank poverty alleviation programmes.

The study showed that education, monthly income, large household size, expenditure is the major determinants of the incidence of poverty in the study area. It also showed that microfinance banks have positive impact on income of the respondents and improved the standard of living of the rural dwellers in the study area. The Foster-Greer-Thorbecke model showed a reduction of 13% (88% to 75%) in poverty level and the regression analysis showed that the higher the size of loan, the lower the poverty level. However, the effect is not well shown because of the high interest rate charged by the banks. The high interest rate "eat up" respondents' capital and also affects the profit from their investment.

It is therefore recommended that government at all level of governance should endeavour to assist microfinance banks to function effectively in their mode of operation, inasmuch they have been found relevant in alleviating poverty level of Nigerian citizens. Also, there should be public enlightenment as regards vital importance of microfinance banks on improving the economic state of individuals in the country and unwinding corroborating effort of Nigerian government in achieving the purpose-in-being being developing the microfinance banks.

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