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Enhancing the Effectiveness of Microcredit for Female Recipients in Mexico

Chloe I. Buckler Henry
Pepperdine University, marhenry23@gmail.com

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Introduction

As the world becomes more interconnected, debates persist surrounding the most effective ways to support economic growth and alleviate poverty globally. In the 1980s, Muhammad Yunus used a strategy known as microcredit to provide low-income individuals in Bangladesh with previously unattainable access to credit to alleviate poverty through the Grameen Bank (Nobel Media AB, 2020). Microcredit quickly gained international acclaim and popularity, culminating in Yunus receiving the Nobel Peace Prize in 2006 (Nobel Media AB, 2020). By 2015, over 125 million individuals worldwide were receiving microloans, and over eighty percent of recipients were women (Aizenman, 2016). Despite the widespread use of microcredit and numerous individual success stories, some research studies published in the 2000s began to note some limitations of microcredit programs (Aizenman, 2016). When considering how to address the microcredit industry's issues, studying the effectiveness of microcredit in Mexico for female borrowers as a case study proves insightful.

This paper examines the effect of the microcredit industry on female recipients in Mexico which illustrates some industry successes, and illuminates various issues within the current model. This paper will show that while female borrowers have seen increased social benefits, the microcredit industry also suffers from growing rates of indebtedness, low rates of financial literacy, high-interest rates, and microfinance institutions that can suffer from “mission drift.” In light of these various concerns, potential recommendations will be discussed that microfinance institutions in Mexico could adopt to better support female loan recipients and bolster poverty alleviation efforts.

Literature Review of Microcredit

The microfinance industry is largely composed of saving opportunities, insurance, and microcredit (Rodríguez-Acevedo, 2017). Microcredit, often referred to as microloans, is defined as small amounts of capital allocated “to an individual that has proven both to have the desire to invest his/her money in a productive task and for the task to be viable as a business itself” (Rodríguez-Acevedo, 2017). These microloans can range from as low as thirty dollars to a couple of hundred dollars and are based on the premise that “if given access to economic inputs” like capital, the poor can lift themselves out of poverty through business growth (Woller & Woodworth, 2001; Banerjee et. al, 2015, p.11). In addition to business activities, low-income individuals may utilize microloans for other purposes, including paying for emergency expenses and interest debt (Aizeman, 2016). Microcredit models can also vary in payment structure and in who the recipients are. While some microcredit lenders choose to work with groups to increase the repayment incentive through social pressure, others focus on specific demographics, including women, or work with individual entrepreneurs (Aizeman, 2016). Microfinance institutions, also known as MFIs, can also vary greatly in structure ranging from for-profit companies and governmental entities to nonprofit organizations (Karmkar, 6). These variations will significantly influence the issues and recommendations in the paper’s case study.

The microcredit industry was initially started to address low-income individuals’ lack of access to capital in developing countries. Historically, millions of individuals living below the poverty line have sustained themselves as entrepreneurs in informal economies composed of “street vendors, petty traders, small-shop owners, scrap collectors, small artisans, and ‘microbus’

drivers” (Woller & Woodworth, 2001, p. 267). Individuals participating in informal economies lack access to financial capital. Often, the poor cannot meet the criteria necessary to acquire a loan, including property ownership, proof of steady income, or other types of collateral (Aizeman, 2016; Innovations for Poverty Action, 2015). In the absence of capital, many low-income entrepreneurs face barriers to “expanding businesses, increasing their labor productivity, and moving up the income ladder” (Woller & Woodworth, 2001, p. 267). Furthermore, without options, many turn to loan sharks that may offer loans with high-interest rates (Glenwick, n.d.).

In light of this reality, in the 1980s, Mohammad Yunus started the Grameen Bank to provide small loans to individuals that previously lacked access to credit in Bangladesh following the repayment success he had seen in the 1970s from offering small loans to women (Nobel Media AB, 2020). Yunus envisioned microcredit as a way to both provide capital to low-income individuals and also as an “effective means of emerging from poverty” (Nobel Media AB, 2020). Around the same time, microlending began to spread in numerous areas globally and especially in Latin America (Aizeman, 2016). Thus, development strategies for the poor began to shift to center around pursuing “direct poverty alleviation by increasing the level of output per person and the total value of production for enterprises run by the poor” (Woller & Woodworth, 2001 p. 268). Microcredit quickly became a widely utilized model. According to the World Bank, by 1996 microcredit recipients totaled tens of millions of individuals with loan values in the billions of dollars (Woller & Woodworth, 2001, p. 267). By 2010 over seventy percent of developing nations had a microfinance program (Olsen, 2010).

Women & Microcredit Literature

Historically, many microfinance institutions have chosen to work specifically with women, and there is significant literature on the varied rationale behind this choice. One of the reasons women are often the preferred recipients is the theory that women repay loans at higher rates. Substantial literature has inquired as to why female repayment rates are higher. While some research has argued that these high rates occur because women choose safer businesses, other literature has found that gender inequality within society also provides a greater incentive for female clients to repay loans (Bittencourt-Marconatto, Cruz, Dantas, and Legoux, 2013). Results from a recent 2013 study on Microfinance in Latin America found female clients to have higher repayment rates and illustrates that repayment can also be affected by geographic settings (Bittencourt-Marconatto, 2013). Secondly, literature has also pointed to the notion that microcredit is a source of empowerment for females, encouraging MFIs to focus on female borrowers (Bittencourt-Marconatto, 2013). Finally, women are often chosen as preferred recipients because empowering women can impact poverty alleviation in the local region (Bittencourt-Marconatto, 2013).

Effectiveness of Microcredit

The literature surrounding the effectiveness of microloans is vast and varied. A recent study originally published by the American Economic Association highlights this reality while looking at randomized evaluations of multiple microfinance programs from numerous nations including Mexico, providing a comprehensive review of microcredit effectiveness (Banerjee et al, 2015; Innovations for Poverty Action, 2015). The study found that microcredit opportunities have some positive effects. Most notably, microcredit provided low-income individuals with “more freedom in optimizing the ways they make money, consume and invest” (Innovations for Poverty Action,

2015). Positive effects were also found in the areas of female decision-making power and risk management (Banerjee et al, 2015 p.14). Simultaneously, all but one study noted increased business activity, and some studies found that microcredit led to more business ownership, or an increase in sales (Innovations for Poverty Action, 2015). Microcredit can also help individuals in various areas outside of business practices since access to capital can “provide a cushion from unexpected economic shocks” (Innovations for Poverty Action, 2015, p.6).

However, studies on microcredit effectiveness have also found some limitations. Studies have shown that high-interest rates or a lack of financial literacy can hamper microcredit program effectiveness or increase debt (Rodríguez-Acevedo, 2017; Glenwick, 2020; Innovations for Poverty Action, 2015). Likewise, the comprehensive overview study of microcredit programs found limited results as well. For example, the comprehensive study reported that “none of the seven studies found that it had a significant impact on income for the average borrower” statistically speaking, and often profits decreased for smaller businesses (Innovations for Poverty Action, pg. 10).

Furthermore, studies have shown varied results when specifically looking at microcredit as a mechanism for poverty alleviation. Because of microcredit’s philosophy to support poverty alleviation efforts, “a wide stated goal within the microcredit movement is to reach ‘very poor clients’” (Woller & Woodworth, 2001, p.274). However, studies have shown that engaging the “very poor” client, or the “chronic poor” has proven difficult (Woller & Wollerand, 2001 p. 274; Montgomery & Weiss, 2005). In both group and individual-based microcredit models, the chronic poor are more likely to be excluded as they are “seen as a bad credit risk” (Montgomery & Weiss, 2005). Therefore, while microcredit programs can aid poverty alleviation efforts regionally, their ability to alleviate poverty for the chronic poor may be more limited or nuanced. With an understanding of the role of microcredit and the literature on the industry, attention will now be drawn to Mexico’s microcredit industry and its effect on female recipients.

Mexico’s Microfinance Industry & Issues

As of 2014, over six million microfinance recipients throughout Mexico received services from one of over 5,000 institutions (Women's World Banking, 2014 p. 3). The landscape for microcredit programs in Mexico is unique as loans are more readily available to the populace through various means. Many financial institutions throughout Mexico offer loans to the populace, including “retail banks, cooperatives, supplier credit and pawnshops” (Women's World Banking, 2014 p.3). In light of this, MFIs only represent nineteen percent of available credit nationwide (Women’s World Banking, 2014, p. 6). Partially as a product of the wide range of actors offering financial services to the Mexican public, “compared to its regional peers, Colombia and Peru, however, Mexico has the smallest loan portfolio” by billions of dollars (Women's World Banking, 2014, p.3). While a range of financial institutions offer capital to individuals in Mexico, microcredit programs in the nation tend to focus on offering opportunities to women, making it a premier nation to study the effect of microcredit for female recipients. In fact, as of 2014, women accounted for eighty percent of all microloan recipients in Mexico (Women's World Banking, 2014, p.5), illustrating that focusing on working with females can differentiate MFIs from other financial institutions nationally. In contrast to the wide array of financial providers nationally, “eighty percent of the [microfinance] market is served by just six institutions,” and one MFI, Banco Compartamos, accounts for thirty percent itself (Women's World Banking, 2014, p.3). While nearby nations focus on offering individual loans, the majority

of microloan programs throughout Mexico have a group lending model (Women's World Banking, 2014, p.3).

Strengths of Mexico's Microcredit Program

Overall, there have been benefits associated with microfinance programs in Mexico which primarily offer loans to women. In recent years a randomized evaluation study was conducted to learn about Banco Compartamos, the largest microfinance institution nationwide, and their work in Sonora with an exclusively female, group-based loan program, "Crédito Mujer" (Sweeney, n.d.). After twenty-six months comparing randomized treatment groups to comparison groups, the study found that female loan recipients had higher levels of trust in others and higher happiness levels, while overall business activity increased (Sweeney, n.d.). Other research on recipients of microloans in Mexico found that microloan recipients also "decreased spending on 'temptation goods'—such as alcohol, cigarettes, and gambling—to invest more in their businesses" (Innovations for Poverty Action, 2015, p.11). Additional studies have also found positive results as decision-making power increased for Mexican female microcredit recipients (Sweeney, n.d.). These studies point to significant social benefits for female loan recipients. In addition to social benefits, research suggests that Mexico's microcredit programs strengthen the economy by allowing more females to become wage earners. For example, one study focused on studying the effectiveness of the microcredit organization Banco Azteca in Mexico found that the organization's opening of two hundred branches in 2002 "led to an increase in the fraction of female wage-earners," (Bruhn & Love, 2009, p.14) emphasizing that microcredit programs have increased the number of female wage-earners throughout the nation. While there are benefits associated with Mexican microcredit programs, there are areas of concern for female recipients.

Issue 1: Low Financial Literacy & Institutional Distrust

Studies on microcredit programs in Mexico have found that microloan recipients have low financial literacy levels, and distrust in financial services is widespread (Women's World Banking, 2014, p. 8-10). When interviewing microloan recipients, the word "financial services," had a variety of negative connotations about "debt, high-interest rates, pressure, time limits, complications, stress, trouble and fear" (Women's World Banking, 2014, p.9). Because loan availability is widespread in Mexico, negative associations about financial services included "microfinance organizations, department store credit cards, savings groups, loan sharks, banks and pawn shops" (Women's World Banking, 2014, p.9). Not only can this distrust prevent individuals from seeking out microcredit programs, but a lack of financial literacy can also contribute to poor financial decisions. Moreover, in Mexico, only twenty-two percent of women have an account at "a formal financial institution" in comparison to thirty-three percent of men, highlighting women's lack of involvement with financial services, which could also point to financial distrust among women, among other factors (Russia Financial Literacy & Trust Fund: World Bank, 2013, p.83).

Issue 2: High Interest Rates & Over-indebtedness

Another issue that microcredit recipients face in Mexico are high-interest rates which can contribute to over-indebtedness. For example, Accion, one of the microfinance institutions working in Mexico, offers loans with up to a twenty percent interest rate especially for low-income individuals (Glenwick, n.d.). Banco Compartamos, another MFI that specifically works with female borrowers, has been known to charge around ninety percent (with 15 percent going

to a government tax) (Malkin, 2008). If female borrowers take multiple, high-interest loans from different lending institutions, interest payments can contribute to a vicious cycle of over-indebtedness and further deepen poverty levels. In recent years, over-indebtedness has risen in Mexico drastically. Survey results from FINCA, another global microfinance organization found that in their locations throughout Mexico, “about three out of four applicants had existing loans and 60 percent of individuals with two loans were behind in payment” (Women’s World Banking, 2014, p.9).

Issue Three: Mission Drift

In relation to poverty alleviation efforts through microcredit programs, the 2012 study on Banco Compartamos’ “Crédito Mujer” program found that profits and household income for female microloan recipients remained steady, matching the systematic review of multiple microloan programs discussed in the literature review (Sweeney, n.d.). In essence, even though business activity increased, individual businesses and households did not see a rise in income, meaning that effects on poverty alleviation efforts were limited in scope. Furthermore, the study also found that microcredit programs often “had a larger effect on households that already enjoyed relatively high business revenues, profits, and household decision-making” (Sweeney, n.d.). This reality could illustrate that microcredit opportunities are currently struggling to reach “chronically poor” female borrowers, as detailed in the literature review (Sweeney, n.d.).

In a similar vein, in recent years, Banco Compartamos, the nation’s largest MFI that works almost exclusively with women, has also been accused of “mission drift” by some who argue that the focus of the organization has begun to prioritize investor returns over poverty alleviation efforts (Malkin, 2008). When Banco Compartamos became publicly traded in 2007, a significant debate erupted concerning the MFI’s decision (Malkin, 2008). Though as the biggest MFI in Mexico, Banco Compartamos reaches many female entrepreneurs, some industry leaders, including Mohammad Yunus, feared that Banco Compartamos’ choice to focus on a more market-based approach by going public could shift the focus of the organization to look at “how well the investors and the microfinance institutions are doing, and not about ending poverty” (Malkin, 2008). In essence, some argue that this model focused on investor returns benefits the investors and the MFI itself, sometimes at the expense of female loan recipients and poverty alleviation goals (Malkin, 2008). Studies looking at Compartamos by the World Bank’s Consultative Group to Assist the Poor found that “23.6 percent of Compartamos’ interest income went to profits,” which is “more than triple the 15 percent average for Mexican commercial banks” (Malkin, 2008). When Banco Compartamos’ owners “sold 30 percent of their stock on the Mexican stock market in an initial public offering,” private investors “including the bank’s top executives pocketed \$150 million from the sale” out of \$458 million (Malkin, 2008). Thus, while the MFI did note that their success from going public has paved the way for other institutions to offer financial services to low-income individuals and allowed their own MFI to flourish, there is a question surrounding how the growing success of Banco Compartamos can benefit the female loan recipients as well (Malkin, 2008). In light of these various problems in Mexico’s microcredit landscape, some potential recommendations will be discussed that could be adopted by Mexican microfinance institutions to both strengthen program effectiveness for female loan recipients and enhance poverty alleviation efforts.

Recommendations to Enhance Mexico's Microcredit Industry

In light of some of the issues surrounding the current state of microcredit programs in Mexico, several steps could be taken to enhance support for female loan recipients. In the following section, potential recommendations for Mexican MFIs will be discussed in order to address over-indebtedness, low rates of financial literacy for female entrepreneurs, and mission drift.

Addressing Over-indebtedness

Concerning over-indebtedness, one strategy could be to have MFIs focus their efforts on expanding loans to individuals instead of only groups. Though group-based approaches to microloans can be beneficial in that they can help to incentivize greater degrees of loan repayment through social pressure, working with individual loan recipients can play a role in lowering over-indebtedness. Working with individuals instead of groups has been found to lower over-indebtedness rates since "careful, individual-focused evaluation processes provide more information about the client and her ability to repay a loan" (Women's World Banking, 2014, p.4). In essence, individual evaluations can help to ensure that individuals do not take out a loan that they cannot pay back and that they do not take out too many loans at one time. However, it should be noted that the benefits of reducing over-indebtedness through individual loans need to be weighed against the benefits that could potentially be lost for group-based microcredit models that usually keep default rates low through social pressure. Thus, if individual loans are used, it is imperative that individual microcredit evaluations consider an individual's ability to repay a loan, and that women continue to meet with a group in order to both provide support to the borrower and maintain group accountability. Adding additional loan officers could also prove beneficial. Having additional staff members at MFIs could help provide the necessary support to evaluate female borrowers' financial situation better and subsequently pressure clients to ensure timely payments (Bittencourt-Marconatto et al., 2013).

Simultaneously, to further prevent over-indebtedness, specifically for female recipients, further action can be taken to encourage higher repayment rates. For example, studies have shown that female recipient repayment rates in Latin America are higher in more urban environments than in rural environments (Bittencourt-Marconatto, Cruz, Dantas, and Legoux, 2013; Barboza & Trejos, 2009 p. 291). This could be in part because women working in urban areas have "better access to markets where they can sell their wares," which in turn, allows for faster repayment and more potential business growth opportunities (Barboza & Trejos, 2009, p.298). Performance for women has also seemed to rise in areas where there are greater levels of gender inequity making microcredit opportunities more valuable to women (Bittencourt-Marconatto et al, 2013). Therefore, to decrease over-indebtedness caused by individuals taking out too many loans, MFIs could also focus on working in urbanized areas and in areas where there is more gender inequality where loan repayment rates have proven to be higher for female borrowers.

Improving Poverty Alleviation Efforts

When considering how to alter Mexico's microcredit programs to better support poverty alleviation efforts for female borrowers, some potential actions could be taken. While there is no silver bullet to eradicate poverty, microcredit programs do have a place in aiding low-income individuals seeking to better their lives. Having a nuanced understanding about the role that microcredit opportunities have on local populations is important in order to both provide an adequate assessment of what microcredit opportunities offer, and to better capitalize on the

strengths of microcredit programs. For example, as illustrated by the study on the “Crédito Mujer” program, microcredit programs tended to have “a larger effect on households that already enjoyed relatively high business revenues, profits, and household decision-making,” illustrating that the “chronically poor,” or female borrowers further from surpassing the poverty line did not see the magnitude of results as those closer to breaking the poverty cycle (Sweeney, n.d.). While these results exemplify a need to improve efforts to reach “chronically poor” female borrowers, this does also point to the notion that microcredit opportunities are having more success in reaching female borrowers on the cusp of breaking the poverty cycle.

However, some actions could be taken to reach better “chronically poor” female borrowers, thereby increasing the scope and magnitude of poverty alleviation efforts throughout Mexico. For example, as noted previously, “chronically poor” individuals can often be excluded from group-model-based microcredit programs in part because they have a greater risk portfolio (Montgomery & Weiss, 2005). Therefore, in order to address this issue MFIs could work on increasing their capacity for individual lending to female borrowers with strict requirements on individual loan risk evaluations in order to provide more opportunities to the chronic poor, while also ensuring that individuals do not fall into over-indebtedness. Simultaneously, since many “chronically poor” individuals are turned away from loan opportunities because they are seen to be a “bad credit risk,” individual loans could also be helpful as individual loans would allow female borrowers to “build a risk-based credit history with the institution” (Women’s World Banking, 2014, p.4). Also, as noted previously, while investors of Banco Compartamos gained significantly after the MFI went public, the MFI could also divert more of their profits toward reinvestment opportunities for female loan recipients in order to further microcredit’s goal for poverty alleviation. Toward this end, Banco Compartamos could follow the example set by Pro Mujer, another MFI working in Mexico which uses profits to “reinvest in the service of the clients” by offering services including “breast cancer screenings, advice on dealing with domestic violence and financial education” (Malkin, 2008). Because Banco Compartamos is the largest MFI working in Mexico, even modest increased reinvestment could significantly benefit the female borrowers that they primarily work with.

Addressing Low Financial Literacy

Finally, there are numerous recommendations that Mexico could adopt to address the nation’s lackluster financial literacy rates among microcredit recipients. One way that low financial literacy scores could be addressed is through financial literacy training classes. For example, MFIs working with female borrowers could mandate financial literacy training as a part of the microcredit program. Topics that could be covered during the program include an overview of interest rates and how they operate, how to avoid over-indebtedness, payment schedules, and best practices to increase business growth and revenue. These sorts of financial literacy programs could lead individuals to make wiser financial decisions, cut down on over-indebtedness, increase self-sufficiency, and offset some of the financial risks associated with working with the chronically poor. Offering this sort of financial literacy training program could also be beneficial in Mexico’s market, where credit is readily available to the public through various sources and where there is significant distrust in financial services. Not only could focusing on financial literacy help the microfinance industry to differentiate itself from other institutions that offer access to capital like loan sharks and pawn shops, but it could also better equip female loan recipients to make wiser financial decisions with their money.

If creating financial literacy programs within MFIs proves too costly, microcredit enterprises throughout Mexico could also send their female loan recipients to utilize services offered by the federal government. In this sense, the microcredit sector could capitalize on the services already offered to the public, or seek to create partnerships with other organizations that offer these services already. One such program is currently offered by the Banco del Ahorro Nacional y Servicios Financieros (BANSEFI), which provides the public with “tools and information so that the target population can make better financial decisions, use their incomes more efficiently, and access to generic financial products” (Russia Financial Literacy & Trust Fund: World Bank, 2013, p.96). These programs have been shown to yield beneficial results for female borrowers. Studies surrounding BANSEFI's financial education program have found that women who attended the financial program saw an increase in savings following the training compared to the comparison group (Russia Financial Literacy & Trust Fund: World Bank, 2013, p.96). Therefore, financial literacy classes can reduce distrust surrounding financial institutions for women and help female entrepreneurs in Mexico increase their savings.

Conclusion

Prior to the creation of microfinance, many low-income individuals in developing nations lacked access to capital through traditional methods, driving many to seek out predatory alternative financial services. In order to address this lack of capital and support poverty alleviation efforts, the microfinance movement was created. Over time the microcredit industry has greatly expanded globally. Studying the effects the microcredit industry has on female borrowers in Mexico as a case study pinpoints the various successes of microloans as well as areas that need improvement. Current issues include high-interest rates, over-indebtedness, a lack of financial literacy, and “mission drift” within MFIs, which all hinder Mexican female loan recipients' ability to grow their businesses, repay loans, and break the poverty cycle. To address these realities, there are an array of potential recommendations that could be adopted by MFIs. Potential recommendations include mandating financial literacy programs, increasing the number of loan officers, expanding individual loan opportunities, and focusing efforts on urban areas where gender inequality is high since repayment rates are higher for women regionally in these areas. Not only could these potential recommendations enhance the Mexican microcredit industry, but they all also specifically target improving outcomes for female borrowers. It is hoped that this case study provides insight into the current realities of the Mexican microfinance industry and that microfinance institutions will adopt these recommendations to enhance their mission and better support female entrepreneurs.

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