Microfinance: What’s Next?
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Living in the southern highlands of Peru in the district of Ocongate, Leonarda was a farmer’s daughter with a dream, to provide for her 6 children and send them to University. Through Kiva, a microfinance[[1]](#footnote-1) institution, Leonarda was able to obtain enough capital to buy seeds, manure and seeds for reselling to retailers. Fortunately, Leonarda’s dream came true when 8 people contributed to the microfinance institution that provided her loan of $375. Leonarda fully repaid the loan and is currently using her second $375 loan to buy agricultural inputs that will expand her business and ultimately improve the productivity of the zone’s cultivated lands.[[2]](#footnote-2)

This is the power of microfinancing. Microfinancing provides the poor with financial services, which include micro-credit (loans), savings, money transfer services (the movement of money from one account to another[[3]](#footnote-3)), and micro-insurance (products that are specifically designed for low income clients and whose annualized premium for Life, Health and Property Insurance are below 2%, 4% and 1% of the Purchasing Price Parity GNI $ per capita respectively[[4]](#footnote-4)). These financial services are being reliably provided to the poor in lieu of loan sharks who prey on the impoverished in order to make a profit. These microfinancing services are provided by microfinance institutions or MFIs whose goal is to enable people to step out of poverty and into a better standard of living through entrepreneurial means.[[5]](#footnote-5)

The Grameen Bank (meaning village bank) was started in 1976 as an experiment on rural credit programs which had a specific target group, the extreme poor. The target group was those in Bangladesh who owned less than 0.5 acres of land (these people are considered landless)[[6]](#footnote-6). The experiment was a success and Grameen became an independent bank in 1983.[[7]](#footnote-7) The Grameen Bank, and more specifically, Muhammad Yunus is credited with the creation of the concept of microfinance (sometimes referred to as Grameencredit). Microfinance has several criteria which include the following:

“a) It promotes credit as a human right.

b) Its mission is to help the poor families to help themselves to overcome poverty. It is targeted to the poor, particularly poor women.

c) Most distinctive feature of Grameencredit is that it is not based on any collateral, or legally enforceable contracts. It is based on "trust", not on legal procedures and systems.

 d) It is offered for creating self-employment for income-generating activities and housing for the poor, as opposed to consumption.

 e) It was initiated as a challenge to the conventional banking which rejected the poor by classifying them to be "not creditworthy". As a result it rejected the basic methodology of the conventional banking and created its own methodology.

f) It provides service at the door-step of the poor based on the principle that the people should not go to the bank, bank should go to the people.

g) In order to obtain loans a borrower must join a group of borrowers.

 h) Loans can be received in a continuous sequence. New loans become available to a borrower if her previous loan is repaid.

i) All loans are to be paid back in installments (weekly, or bi-weekly).

 j) Simultaneously more than one loan can be received by a borrower.

 k) It comes with both obligatory and voluntary savings programs for the borrowers.

l) Generally these loans are given through non-profit organizations or through institutions owned primarily by the borrowers… Reaching the poor is its non-negotiable mission. Reaching sustainability is a directional goal. It must reach sustainability as soon as possible, so that it can expand its outreach without fund constraints.

m) Grameencredit gives high priority on building social capital. It is promoted through formation of groups and centers, developing leadership quality through annual election of group and centre leaders, and electing board members … It gives special emphasis on the formation of human capital [through efforts to expand technology use] and concern for protecting environment. It also monitors children's education, provides scholarships and student loans for higher education.”[[8]](#footnote-8)

The Grameen bank has been an obvious success in Bangladesh. Because of the Grameen Bank, the economic situation for Grameen members in villages has improved quite dramatically. The World Bank did a study in the early 1990s and found that five percent of clients successfully stepped out of poverty because of microfinance. The households that had the opportunity to step out of poverty were also able to sustain their gains long term; there was a 21 percent increase in wages in the program villages.

Another study of the Grameen Bank showed that the incomes of Grameen members were 43 percent higher than the incomes of control groups in non-program villages. In the villages that the Grameen programs were established, the Grameen members’ incomes were 23 percent higher than those in the same village who were not members of the Grameen Bank programs.

The U.N. agrees with the success of the Grameen Bank and has put microfinancing on the map as a promising strategy to help the United Nations meet their Millennium Development Goals.[[9]](#footnote-9) The Millennium Development Goals (MGDs) were established in September of 2000. These goals include the following: values and principles; peace, security, and disarmament; development and poverty eradication; protecting our common environment; human rights, democracy, and good governance; protecting the vulnerable; meeting the special needs of Africa; and strengthening the United Nations.[[10]](#footnote-10)

The U.N. has some lofty goals to meet by 2015 specifically in the realm of development and poverty eradication. They want to halve the number of people in the world who live on less than a dollar a day, suffer from hunger, and who do not have access to clean drinking water; ensure that children everywhere will complete primary school; promote gender equality and the empowerment of women; implement strategies that give young people a chance at a decent job; and to ensure the benefits of new technologies are available to all.[[11]](#footnote-11)

According to CGAP, microfinance can help the U.N. achieve their goals. The Consultative Group to Assist the Poor says, “Access to financial services underpins the ability of the poor to achieve the MGDs on their own terms in a sustainable way.”[[12]](#footnote-12) Small loans provide opportunities for the impoverished to start companies using the skills and capital they already have or obtain extra money in case of sudden needs, like an emergency room visit or a failed crop.

There are several points that make microcredit unique. The first is the self-sustainability of microfinancing,[[13]](#footnote-13) not only to the people to which they lend but also for the MFIs that provide financial service opportunities for the poor. Through small loans, the poor are able to open small businesses using skills they already have. Businesses can include street vending; selling of goods like jewelry or weaved baskets; or services like repair shops and cleaning.

As profits begin to roll in for these small businesses, borrowers are able to pay off their loans and even apply to receive larger loans as they build their credit. Their ability to make payments not only allows the impoverished to have a hand up out of poverty but allows them to build credit which is essential in the modern world. Many MFIs who participate in microfinancing are able to remain self-sustained. Because borrowers are able and diligent about repaying their loans, MFIs are getting back of their costs, fees, and interest on those loans. This enables MFIs to make a profit and become self-sustained. In time, MFIs no longer need subsidies from donors in order to provide financial services and can provide their services solely on the profits earned from the borrowers.[[14]](#footnote-14) As of October 2011, the Grameen Bank has had 89.28% of their loans repaid.[[15]](#footnote-15)

 As seen in point c (above) of the Grameen model, the most unique aspect of microcredit is that it requires no collateral for its loans. This makes microfinance a feasible way to raise the standard of living in impoverished areas and to start to breakdown the walls of poverty. This strategy is made possible using the concept of group lending in lieu of collateral. The borrower must have a group of people willing to say that the borrower will be financially responsible and can be trusted to use the loan properly. This is an excerpt from *Small Loans, Big Dreams* by Alex Counts showing what this process can look like.

“[Krishna said,] ‘Are there any loan proposals today?’

Four women stood up…Then came Rasheda from the fifth group, who had recovered from typhoid in July and wanted a loan for a tube well.

‘Sir,’ Rasheda said, ‘I need a tube well. Please sanction a three thousand taka loan.’

Krishna looked up from the form on which he had noted the tree loan proposals that he had [already] accepted. He studied Rasheda, and surveyed the women her row. ‘Rasheda, how can we trust you?....Group number five chairman, stand up…Do you support this loan proposal?’

‘Yes, sir’

‘Will it be used correctly, or will she sell it?’

‘She will use it correctly, sir,’ the woman [chairman] replied firmly but respectfully.

‘Supi, stand up.’ The former center chief rose. ‘What about you—do you support it? Will you take personal responsibility with your group chairman to make sure the loan is used properly?’

‘Yes, sir,’ she said, looking Krishna in the eye as she spoke the words.

‘Okay, sit down, all of you,’ he said. ‘Rasheda, stand up.’ He went through all the formalities of asking her all the information he needed for the draft loan proposal—her husband’s name, the amount and the use. Then he called the four women applying for loans, and the center chief to come up and sign the proposal. When that was complete, he asked the women to practice a ritual that they hadn’t done for some time—chanting slogans at the end of their meeting…

Shandha was the only one who remembered how to lead them in the slogans. With everyone standing, she called out, ‘Unity, hard work, and discipline.’

‘Unity, hard work, and discipline,’ the other women echoed.

‘That is our creed,’ Shandha yelled.

‘That is our creed,’ they repeated three times.”[[16]](#footnote-16)

As seen in this passage, MFIs use not only the borrowers but the community to determine the reliability of the customer. This method holds borrowers accountable to their community members, which builds tighter community bonds. The community method also creates an incentive for the borrower to make the monthly payments in order to maintain a sense of pride for themselves and their supporters. This method works exceptionally well in impoverished areas because of the rural culture that often emphasizes the community over self.

As mentioned earlier, often, MFIs will allow borrowers to “start small” and build their credit. “[Short term loans] help to minimize initial risk for the bank and enable borrowers to use the money to carefully grow their businesses and increase their incomes. Borrowers who repay their loans on time are eligible for increasingly larger loans in a stepped lending process.”[[17]](#footnote-17) This creates easily sustainable incomes and credit that allow borrowers to start to take a hold of their circumstances and truly change them.

Although many people support microfinancing, there are others that say microfinance doesn’t actually solve the problem of poverty and that the public puts too much stock into its capability. Doubters believe the fact that MFIs want to be financially sustainable and move away from being subsidized will harm those who are borrowers. Due to the drive to be financially self-sustainable, MFIs will focus on loan accounts, which bring in more money, rather than savings accounts. A change in focus may lead to a change in the demographic of the borrowers MFIs lend to in order to boost returns on loans. This blurring of the lines between the poorest of the poor and the relatively poor can lead the issue of the definition of poverty. MFIs may justify providing loans to people who are not in as much need in order to generate profits. With this, the original intentions of reaching the poorest of the poor through microfinancing are lost. As Muhammad Yunus once said while reacting to the commercialization of microfinancing, “When we started the concept of microcredit, we didn’t go there to make money. If you want to commercialize this activity, then choose another term to describe yourself. Don’t call yourself a microcredit player.”[[18]](#footnote-18) Many people also have the misconception that microfinance is the final solution to solving the issues of poverty. Microfinance is an incredible opportunity for the impoverished to improve their lives but is only one aspect of a multifaceted solution that people need in order to step out of poverty.[[19]](#footnote-19)

All of these issues may seem discouraging but these shortcomings can be circumvented. Since microfinancing is a fairly new endeavor, a regulation system is still developing. With the implementation of more regulation and a more clear definition of poverty, MFIs will reach the poor as originally intended. The CGAP also recognizes that,

“No single intervention can defeat poverty. Poor people need employment, schooling and health care. Some of the poorest require immediate income transfers or relief to survive. Access to financial services forms a fundamental basis on which many of the other essential interventions depend. Moreover, improvements in health care, nutritional advice and education can be sustained only when households have increased earnings and greater control over financial resources. Financial services thus reduce poverty and its effects in multiple concrete ways. And the beauty of microfinance is that, as programs approach financial sustainability, they can reach far beyond the limits of scare donor resources,”[[20]](#footnote-20)

If all MFIs have the mindset of continuous reevaluation, it will encourage these institutions to create new programs and ideas to help their borrowers through innovation.

 Although microfinance is increasing in popularity around the world, it is still a fairly young program that is in the early stages of development. Surprisingly, many people are unaware of microfinancing and the strides it is making in alleviating poverty. A survey conducted at Illinois State University in the Fall of 2011 revealed very interesting data regarding participation in poverty-ending pursuits and knowledge of microfinancing. Only 15.% of students said they actively participate in solving the issues of poverty. Participation included donations, mission trips and raising awareness. In addition, only 24.2% of students had heard of microfinancing, and of those 24%, only 43%, when asked, could provide an accurate definition. There seems to be a lack of knowledge about microfinancing but this lack of knowledge is not exclusive to those outside of the microfinancing realm.

 A quick look at the websites of popular microfinance institutions, The Grameen Bank, Kiva and Accion, reveals this issue. There is statistical information about how many loans have been given and repaid but no long term studies on the success of businesses started using microfinance loans. In the United States, the statistics about small firms reveals that “seven out of 10 new employer firms survive at least 2 years, half at least 5 years, a third at least 10 years, and a quarter stay in business 15 years or more” according to the SBA Office of Advocacy (U.S. Small Business Administration)[[21]](#footnote-21) The differences between the United States and developing countries is sure to make these statistics even more staggering. Research needs to be done on business owners who actually use microfinance loans to start small businesses. This research can help new business owners navigate the hardships of starting a small business which can foster the success of entrepreneurial endeavors. The unfortunate lack of specific information from microfinance institutions regarding small business successes contributes to the doubt of its effectiveness and questioning of its current focus. Further research has found that microfinance loans are often used to pay for emergency medical care, food for the week or other unexpected expenses.[[22]](#footnote-22) If borrowers are not using microfinancing to start small businesses, strategies and incentives for entrepreneurship must be changed. It could also be possible that the use of microfinancing as emergency funds is the natural evolution of microfinancing. In this case, the focus of MFIs should be modified in order to adjust with the changing needs of the poor.

 As stated earlier, microfinancing is not the answer to ending poverty but just a step. Next steps must be taken which include improvements with health care education and opportunity. Katie Wolf, an undergraduate at Illinois State, agrees and believes as an education major that in order to get people out of poverty, education is essential.[[23]](#footnote-23) Education can come in many forms, skill-based education, life-based education and academic-based education.

 Skill-based education is loosely defined as educating people in a skill that can be used specifically in small entrepreneurial endeavors such as jewelry making, pottery spinning, basket weaving or sewing techniques. These skills are easily turned into specialty skills which are marketable within small villages and can also be used within households. Skill-based education can quickly become self-sustainable as previously trained workers take on apprentices.

 Life-based education is defined as educating people in way that will enable them to thrive and overcome health issues that plague the poor. These health issues include HIV/AIDS education, contraceptive and sex education, malaria prevention and water sanitation. The poor die of preventable diseases every day. “Some **21,000 children die every day** around the world… The silent killers are poverty, hunger, easily preventable diseases and illnesses, and other related causes.”[[24]](#footnote-24) Education of how to prevent health related issues can extend life expectancy and improve quality of life.

 Academic-based education can give people who otherwise would not have the chance to receive an education. “A unique study [by] researchers from the International Institute for Applied Systems Analysis (IIASA) and the Vienna Institute of Demography (VID)…provides unambiguous evidence of consistently positive, statistically significant effects of education on a country’s economic development. Rigorous analysis of the data provides policymakers with proof that education is the necessary (although not always sufficient) precondition for long-term economic growth.”[[25]](#footnote-25)

One microfinance institution believes in the power of education so much that providing higher education is their focus. Vittana is founded on the belief that education can change lives. Vittana believes that education is the most powerful tool in the world to fight poverty and transform lives. Education for the students that Vittana supports means opportunity. Many success stories can be read on the Vittana website which points to the power that education has in changing not only one person’s life but the lives of all those in contact with them.[[26]](#footnote-26)

 English proficiency is also an important aspect of academic-based education. The ITS Tutorial School in Hong Kong focuses specifically on English proficiency. ITS recognizes the need for people to correspond in a global world where products are bought and sold and services are provided globally. Language skills can make or break business efforts. “In a recent survey of more than 25,000 employees of global corporations, the percentage of respondents who said that English was either ‘critical’ or ‘important’ to be successful in their current positions increased…91% of respondents said that English was either ‘critical’ or ‘important’ but only 9% said their proficiency was sufficient to do their current jobs.”[[27]](#footnote-27) English education around the world can enable small business owners to not only sell globally but to cut out the middle man and keep more of the profit for themselves.

 Clearly, continuing research and realizing how microfinance loans are being used is extremely important. Loan programs maybe not be enough and should be supplemented with supporting programs, especially those focused on education, that will allow the poor to not only step out of their current situations but also have a chance at creating a better life for themselves, their family and those in their community. Microfinance can be effective; its success is a matter of creating efficiency that is matched with collaboration with the poor, continuous research and development and an emphasis on the value of humanity. This focus will enable microfinance to reach more people like Leonarda. Microfinance has the power to enable their borrowers to thrive and change their circumstances while maintaining their dignity and encouraging the poor to help themselves.

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