

Microcredit/Microfinance:
Can it help end poverty?

What is microcredit?

The World Bank defines microcredit as the provision of small loans to poor people who lack access to the conventional banking system.



Muhammad Yunus



Microcredit is a form of credit that is provided to poor people who lack access to the conventional banking system.

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Solutions

- Focus on promoting savings rather than loans
- Identify regulations of microfinance institutions to ensure that they operate responsibly
- Promote or generate community owned financial institutions such as credit unions and building societies to promote local capital accumulation
- Support for microenterprises to compensate for lack of microfinance by strengthening skills that the poor may not have had the opportunity to acquire



Grameen Bank is a microfinance institution that provides small loans to poor people who lack access to the conventional banking system.

Grameen loan methodology

The methodology for Grameen loans is based on the principle of social collateral. It involves group lending where members of a group guarantee each other's loans.

Impact

The loan size tends to be smaller than other microfinance loans. The impact has been positive, particularly in terms of women's empowerment and income generation.

Microfinance and its Impact on Development

Harvard Case Solution & Analysis

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Grameen Bank, Which Pioneered Loans For the Poor, Has Hit a Repayment Snag



Market saturation

The assumption was that single members of the poor would have viable business ideas that they could profit from. In fact many businesses duplicated each other and quality eroded due to their own products. This caused for a drop in business.

The World Bank found that 50% of microenterprises failed within one year of being set up in Kenya and Nicaragua, while another study in Andhra Pradesh (India) had less than 1% of them were operating a year after their establishment. In many cases a business failure coincided with the need to pay back loans means that the loan recipients were made even poorer by their loans.

Problems

With the growth of neoliberalism the emphasis has been that the loan recipients must pay back the loans and also pay off credit of old loans. This has led to high interest rates averaging between 25-50%. In 2010, about 80 suicides in Andhra Pradesh, India were blamed on the pressure of having to pay back expensive loans.

Question: microfinance is said to have helped to lift poor people out of poverty. If they don't see the value in setting up income making business, they will not make money, but still see loans from the bank at high rates of interest. This can mean that rather than loan making them out of poverty, they could be in a worse position. It was found that in India, Bangladesh, China and the Balkans that people were taking loans of high interest in order to pay off their microfinance loans.

Does it help the poorest?

Proof

A study of 3 microfinance institutions in Bangladesh by Korten (Fighting Poverty with Microcredit, 1984) found that Grameen, BRAC, and FICV-11 were helping 10 million people out of poverty per year. Other studies suggested that members of microfinance programmes tended to have higher incomes than those not in such programmes.

A lot of the evidence tended to be anecdotal focusing on case studies of particular people who had benefited from a loan. But what about the rest of them?

Impact? What impact

A major study of 5000 households in Tanzania (see slides, 2011) 'A sobering assessment of Microfinance Impact'. Stanford Social Innovation Review found that microfinance had **no impact** on consumption, **one-fifth** on income, **no** on employment. By 2009 Korten's was arguing that '30 years into the microfinance movement we have little clear evidence that it improves the lives of clients in measurable ways'.

Claims for microcredit

Very strong claims have been made for microcredit, suggesting it can be a **lead tool** for lifting the poor out of poverty – that women can be empowered by such loans – it can create employment through promoting small businesses.

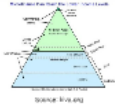
What is the proof?

Microcredit/Microfinance:
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What is microcredit?

For the last 50 years, it has been widely credited with helping to lift the world's poorest people out of poverty.

Microcredit is the provision of small-scale loans to the poor to help them start or expand a business or to help them improve their living conditions.



Solutions

- Focus on providing savings rather than loans
- Effective regulation of microfinance institutions to ensure that they operate responsibly
- Promotion of genuine community-owned financial institutions such as credit unions and building societies to promote financial inclusion
- Support for microenterprises to compensate for lack of knowledge/entrepreneurial skills that the poor may not have had the opportunity to acquire

Muhammad Yunus



The Grameen Bank received the Nobel Peace Prize in 2006 for its work in eradicating poverty through microfinance. Yunus is a pioneer in the field of microfinance, having founded the Grameen Bank in Bangladesh in 1976. He is also the author of the book 'Banking on the Poor'.



Grameen Bank is a Bangladesh-based microfinance bank, which is a pioneer in the field of microfinance. It was founded in 1976 by Muhammad Yunus. The bank provides small loans to the poor, particularly women, to help them start or expand a business. It is known for its 'Grameen model' of microfinance, which focuses on providing loans to the poor without requiring collateral.

Grameen loan methodology

The Grameen Bank's loan methodology is based on the principle of 'group lending'. Loans are provided to groups of five women, known as 'jambanis'. Each woman in the group acts as a guarantor for the others. This method is designed to reduce the risk of default and to provide a support network for the borrowers. The bank also provides training and technical assistance to its borrowers to help them succeed in their businesses.

Impact

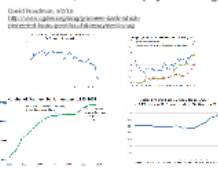
The Grameen Bank has had a significant impact on the lives of the poor in Bangladesh. It has provided millions of women with access to credit, which has enabled them to start or expand their businesses and improve their living standards. The bank has also provided training and technical assistance to its borrowers, which has helped them to become more successful in their businesses. The Grameen Bank's impact has been widely recognized, and it has received numerous awards and accolades.

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Market saturation

The assumption was that larger numbers of the poor would bank viable loans, which they could profit from. In fact, many have found it difficult to repay and gradually withdrawn demand for their products. This means that they are out of business.

The World Bank found that 50% of microenterprises failed within one year of being set up in Nigeria and Indonesia, while another study in India found that less than 20% of them were operating 3 weeks after their establishment. In many cases, businesses failed because they had no need to pay back loans, rather than the loan recipients were unable to pay for their loans.

Problems

With the growth of neoliberalism the emphasis has been that the loan recipients must pay back the loans and also pay off credit at full cost. This has led to high interest rates, averaging between 25-55%. In 2010, about 100 million in Andhra Pradesh, India were blamed on the pressures of having to pay back expensive loans.

Quite often, a small loan is used by poor people to finance a start-up business. If they use the loan to set up a home-making business, they will make money, but still have to pay back the loan at high interest rates. This can mean that rather than the loan helping them out of poverty, they get trapped in a cycle of debt. In many cases, businesses failed because they had no need to pay back loans, rather than the loan recipients were unable to pay for their loans.

Does it help the poorest?

Proof

A study of 3 Microfinance institutions in Bangladesh by Khondaker Tajul Karim found that the Grameen Bank, BRAC and IDJ-12 were doing significantly better than other microfinance institutions. Other studies suggested that members of microfinance programmes tended to have higher incomes than those not in such programmes.

A lot of the evidence tended to be anecdotal focusing on case studies of particular people who had benefited from a loan. But what about the rest of them?

Impact? What impact

A major study of 500 households in Morocco (see Strass, 2010). A sobering assessment of Microfinance impact. Standard Social Innovation Review found that microfinance had no impact on household income, but did have a positive impact on the number of businesses owned. By 2008 Khandaker was arguing that '50 years into the microfinance movement we have little solid evidence that (i) improves the lives of clients in responsible ways'.

Claims for microcredit

Very strong claims have been made for microcredit, suggesting it can be a lead tool for lifting the poor out of poverty – that women can be empowered by such loans – it can create employment through promoting small businesses.

What is the proof?

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What is microcredit?

For the last 30 years it has been touted as a key policy for lifting the poor in the developing countries out of poverty.

Microfinance is the provision of small loans to the poor to help them establish or expand an income generating small business so that they can escape from poverty.



Source: kiva.org

Muhammad Yunus



The microfinance movement began with Muhammad Yunus' work in Bangladesh in the late 1970s and spread to other developing countries.

Yunus believed that the poor could help themselves given a start . He said -
“When we want to help the poor, we usually offer them charity. Most often we use charity to avoid recognizing the problem and finding the solution for it. Charity becomes a way to shrug off our responsibility. But charity is no solution to poverty. Charity only perpetuates poverty by taking the initiative away from the poor. Charity allows us to go ahead with our own lives without worrying about the lives of the poor. Charity appeases our consciences.”

(Muhammad Yunus, *Banker to the Poor: Micro-Lending and the Battle Against World Poverty*)

"If we are looking for one single action which will enable the poor to overcome their poverty, I would focus on credit". (Dr Muhammad Yunus)



Grameen Bank

Twenty five years ago, Muhammed Yunus, a Bangladeshi economics teacher, was visiting a village when he met a woman who made bamboo stools. She couldn't afford to buy the bamboo to make the stools, so she had to borrow the money from the bamboo sellers and then pay them a large part of the profit from each one she sold. There was so little money left for her to keep that she couldn't afford to buy more bamboo, so she had to borrow more money. And so the cycle continued with no way out for her. She couldn't borrow money from friends or family because they were as poor as she was. She couldn't borrow from the bank because she had no collateral (property or land) to guarantee that she would pay back the loan.

Yunus went around the village and found forty-two people who were in the same situation - trapped in a cycle of poverty with no escape. When he added up the amount of money that they needed to break free of the cycle, it came to just twenty-seven dollars. As Yunus says "I felt ashamed of myself for being part of a society which could not provide even twenty-seven dollars to forty-two hardworking, skilled human beings."

He lent them the money and told them to pay it back whenever they could. He got all of it back, so he went to other villages and did the same thing. He always got his money back. The official banks didn't want to get involved in what he was doing, so Yunus started his own bank. The Grameen bank was born, and with it a new approach to lending money – 'micro-credit'.

Grameen loan methodology

The conventional banking system will only make loans on the basis of collateral. Grameen gives priority to those who have nothing, particularly the poorest women. The loans are small and repayments are made in small amounts spread over a year, with a built-in insurance scheme so that the family doesn't become responsible for the loan if something happens to the borrower. There is no legal contract between the bank and the borrower, and no danger of legal action if the repayments are not made – the relationship is based on trust and good faith.

Repayment rates are very high for two main reasons.

1. Borrowers know that they cannot borrow again if they don't repay the first loan.
2. They must join a group of other borrowers who all share some responsibility for other members' loans and are encouraged to make group decisions. So there is considerable peer pressure and support from the group to encourage them to pay it all back.

Another important difference from conventional banks is that Grameen has a social programme. The system encourages the borrowers to do practical things to improve their living conditions, health and level of education. These are known as the 'Sixteen Decisions' which include, for example, not continuing the dowry system, growing fresh vegetables, organising clean drinking water and good sanitation, education for children, and being ready to help each other whenever necessary. Conventional banks would not consider this to be any of their business.

Impact

The bank now lends over a billion dollars to more than two million borrowers, 96% of them women, and involving more than half of the villages in Bangladesh. The repayment rate is 99%. The rural economy of the country has improved greatly since the bank started. And the success has spread. This year it was estimated that there are now over 7,000 microcredit organizations in the world, lending to over 16 million of the poorest people.

Grameen's success in Bangladesh has also shown that the developing world has lessons to teach richer countries like the USA and Britain. Both countries have begun to encourage microcredit schemes based on the Grameen model, in an attempt to deal with their own levels of poverty.

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