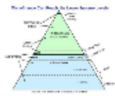
Microcredit/Microfinance:

Can it help end poverty?

What is microcredit?



Source: fdms.org

Muhammad Yunus

Grameen Bank

Grameen loan methodology

Impact

Solutions

Focus on promoting 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 local capital accumulation

Support for microenterprises to compensate for lack of managerial/accounting/other skills that the poor may not have had the opportunity to acquire

Microfinance and its Impact on Development Harvard Case Solution & Analysis

TheCaseSolutions.com

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

David Roodman, 9/2/10
http://www.cgdev.org/blog/grameen-bank-which-pioneered-loans-poor-has-hit-repayment-snag

Market saturation

The assumption was that large numbers of the poor would have viable business ideas that they could profit from. In fact many businesses duplicated each other and quickly exhausted demand for their products. This means that they go out of business.

The World Bank found that 50% of microenterprises failed within one year of being set up in Bosnia and Herzegovina, whilst another study in Andhra Pradesh found that less than 3% of them were operating 3 years after their establishment. In many cases a business failure combined with the need to pay back loans meant that the loan recipients were made even poorer by their loan.

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 80 suicides in Andhra Pradesh, India were blamed on the pressures of having to pay back expensive loans.

Does it help the poorest?

Quite often microfinance is used by poor people to meet consumption needs. If they don't use the loan to set up an income making business, they will not make money, but still have to pay back the loan at high rates of interest. This can mean that rather than the loan raising them out of poverty, they get further into debt traps. It was found that in India, Bangladesh, Peru and the Balkans that people were taking loans off loan sharks in order to pay off their microfinance loans.

Proof

A study of 3 Microfinance institutions in Bangladesh by Khandker (Fighting Poverty with Microcredit, 1998) found that Grameen, BRAC and RD-12 were lifting up to 5% of participants 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 Morocco (see Shaia, 2010, 'A sobering assessment of Microfinances impact', Stanford Social Innovation Review) found that microfinance had no impact on consumption, new business creation, or women's empowerment. By 2009 Karnikher was arguing that "30 years into the microfinance movement we have little solid evidence that (it) improves the lives of clients in measurable ways".

Claims for microcredit

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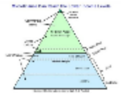

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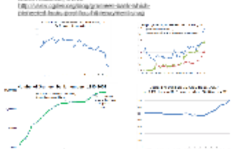

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For the last 30 years it has been touted as a key policy for lifting the poor in the develoing countries out of poverty.

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 form 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)

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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