

International Executive Master in Development Studies (IMAS)
2010-2011

Title of the dissertation to obtain the Master of Advanced Studies (MAS):

Overindebtedness in microfinance.

**Case-study of the clientele of Financiera CREAR
in Los Olivos, Lima Norte, Peru**

Author: Cosmin Olteanu

Supervisor: Jean-Michel Servet

Date: Geneva, 18th of March 2011

Acknowledgements

This thesis would not have been possible without the help and support of numerous persons whom I keep a warm memory of. I want to thank Dr. Felipe Portocarrero who made my adventure in Peru possible and accompanied my discovery of the fascinating Peruvian microfinance sector. As every academic work has an origin, it is to Jean-Michel Servet that I have to thank for what I achieved. He was the one that trusted me and guided my first steps in the research process. With infinite kindness he supported me during the sometimes difficult process, always giving me useful advice and encouragements.

A special thank is for all those who accepted to talk to me and share their opinions, namely Luis Guerra, Ramón Flores, Jorge Bustamante, Marcos Corrales, Cesar Gordillo and Luz Valdez. I am particularly thankful to the clients who allowed me to enter their homes and discussed with me very personal and delicate issues. The support of my host institution, Financiera CREAR S.A., was invaluable, and I am grateful to all the managers and employees who welcomed me and went to great lengths to support me during my field study. This research was done during a sabbatical year from my job, and I have to thank Dr. Bernd Zattler and Dan Balke for their support and understanding.

Finally and above all I want to thank my wife Yasmin for always being there when I needed her. Her insightful remarks and thoughtful advice made this paper what it is now.

It goes without saying that any errors or mistakes in this work are entirely my responsibility.

Abstract

Originally celebrated as a poverty alleviation tool which is financially sustainable, microfinance is experiencing worrying developments, such as deterioration of loan portfolios, growing commercialization and increasing public criticism due to exaggerated profits. Overindebtedness is one of the most worrying trends, as it has negative effects on the loan beneficiaries and in the same time it threatens the very existence of the sector. This field research analyses from an empirical perspective the causes and effects of overindebtedness in the specific case of the clientele of Financiera CREAR Arequipa S.A. in Lima Norte, Peru. It was found that overindebtedness is generated by a mix of causes related to the increased competition between microfinance institutions and to the specific behaviours of clients confronted with an abundant credit offer. This produces a series of effects at institutional and client levels, which can be described as institutional cannibalization, client forced-feeding, desperate borrowing and loan bicycling.

Key words: microfinance, overindebtedness, cross indebtedness, commercialization, Peru

Célébrée à l'origine comme un outil de lutte contre la pauvreté qui est financièrement viable, la microfinance connaît des évolutions inquiétantes, comme la détérioration des portefeuilles de prêts, la commercialisation croissante et l'augmentation de la critique publique en raison de profits exagérés. Le surendettement est l'une des tendances les plus inquiétantes, car celui a des effets négatifs sur les bénéficiaires de prêts et dans le même temps menace l'existence même du secteur. Cette recherche de champ analyse d'un point de vue empirique les causes et les effets du surendettement dans le cas spécifique de la clientèle de la Financiera CREAR Arequipa S.A. à Lima Norte, Pérou. Il a été constaté que le surendettement est généré par une combinaison de causes liées à la concurrence accrue entre les institutions de microfinance et les comportements spécifiques des clients confrontés à une offre de crédit abondante. Il en résulte une série d'effets au niveau institutionnel et du client, qui peuvent être décrites comme cannibalisation institutionnelle, alimentation forcée du client, emprunt désespéré et faire la bicyclette de prêts.

Mots clés: microfinance, surendettement, endettement croisé, commercialisation, Pérou

Celebrada originalmente como una herramienta de reducción de la pobreza que es financieramente sostenible, la microfinanza se encuentra en un contexto preocupante, caracterizado por el deterioro de las carteras de préstamos, la creciente comercialización y la crítica de la opinión pública en relación a sus utilidades exageradas. El sobreendeudamiento es una de las tendencias más alarmantes, ya que tiene efectos negativos sobre los beneficiarios de préstamos y al mismo tiempo amenaza la existencia misma del sector. Este estudio de campo analiza desde una perspectiva empírica las causas y los efectos del sobreendeudamiento en el caso específico de los clientes de la Financiera CREAR Arequipa S.A. en Lima Norte, Perú. Se encontró que el sobreendeudamiento esta generado por una combinación de causas relacionadas con la alta competencia entre las instituciones de microfinanzas y con los comportamientos específicos de los clientes frente a una abundante oferta de crédito. Esto produce una serie de efectos a nivel institucional y del cliente, que pueden ser descritos como canibalización institucional, alimentación forzada de cliente, prestar desesperadamente y hacer ruleta de préstamos.

Palabras clave: microfinanzas, sobreendeudamiento, endeudamiento cruzado, comercialización, Perú

Chapters

Chapter I: Introduction

Chapter II: Microfinance, from village to Wall Street

Chapter III: Microfinance at a crossroads

Chapter IV: Overindebtedness, a growing concern

Chapter V: The context of the study and the research method

Chapter VI: Data presentation and analysis

List of figures, tables, text boxes and photos

Figure 1: The wealth pyramid	18
Figure 2: The spectrum of Financial Services Providers.....	26
Figure 3: The critical triangle of microfinance	36
Figure 4: The causes of overindebtedness according to Schicks	49
Figure 5: Location of Los Olivos in Lima and in Peru.....	61
Figure 6: Financing structure of CREAR as of September 2010	63
Figure 7: The chain of overindebtedness.....	83
Table 1: Comparison between individual lending and group lending methodologies	24
Table 2: The “microfinance schism”	31
Table 3: Levels of cross indebtedness around the world.....	54
Table 4: Levels of cross indebtedness in Peru	54
Table 5: Overindebtedness early warning sign index	55
Table 6: The Peruvian microfinance institutions at a glance	59
Table 7: CREAR at a glance.....	63
Text box 1: Advent of microcredit in Peru	12
Text box 2: Microfinance at a crossroads	16
Text box 3: The entrepreneurial spirit of the poor	20
Text box 4: BANEX Nicaragua.....	45
Photo 1: CREAR Agency in Los Olivos.....	62
Photo 2: CREAR mission, vision and values	64
Photo 3: The Wall Street of Los Olivos.....	71

List of Acronyms

ACP	Acción Comunitaria del Perú
ASOMIF	Asociación de Instituciones de Microfinanzas del Perú
BID	Banco Interamericano de Desarrollo
BRI	Bank Rakyat Indonesia
CAC	Cooperativa de Ahorro y Crédito
CAF	Corporación Andina de Fomento
CARE	Cooperative for American Relief to Everywhere
CGAP	Consultative Group to Assist the Poor
CMAC	Caja Municipal de Ahorro y Crédito
COFIDE	Corporación Financiera de Desarrollo
COPEME	Consorcio de Organizaciones Privadas de Promoción al Desarrollo de la Micro y Pequeña Empresa
CRAC	Caja Rural de Ahorro y Crédito
EDPYME	Entidad de Desarrollo para la Pequeña y Micro Empresa
FEPCMAC	Federación Peruana de Cajas Municipales de Ahorro y Crédito
FFH	Freedom from Hunger Foundation
FINCA	Foundation for International Community Assistance
GDP	Gross Domestic Product
IADB	Inter-American Development Bank
IPO	Initial Public Offer
LAC	Latin America and The Caribbean
MF	Microfinance
MFI	Microfinance Institution
MIV	Microfinance Investment Vehicle
NGO	Non-Governmental Organisation
PEN	Peruvian Nuevo Sol
PRODEM	Fundación para Promoción y el Desarrollo de la Microempresa
PROMUC	Consorcio de Promoción de la Mujer y la Comunidad
ROE	Return on Equity
ROSCA	Rotating Savings and Credit Association
S&L	Savings and Loans Association
SBS	Superintendencia de Banca, Seguros y AFP
UN	United Nations
USD	United States Dollar
SKS	Swayam Krishi Sangam

CHAPTER I: INTRODUCTION

1.1. Problem background

Microfinance occupies an important place in the development landscape of the last decade and a half. The United Nations declared 2005 as the International Year of Microcredit, and microfinance is seen as an important strategy to achieve the Millennium Development Goal of halving poverty by 2015¹. Microfinance finds itself in the middle of ideological and political battles. Being part of the development context this is hardly surprising if we take into account the irreconcilable tensions between the “‘economic’ and ‘altruistic’ concerns that have always been the two axes of development discourse and practices”². According to the supporters of the industry, microfinance reduces poverty and stimulates gender empowerment. Its opponents argue that microfinance has no social impact and does not alleviate poverty, and in some cases it even increases the levels of vulnerability and exclusion of its beneficiaries. Nowadays, the “microfinance schism”³ is getting deeper and the positive effects of microfinance are increasingly refuted. Not even Muhammad Yunus, the founder of Grameen Bank, together with which he was awarded the 2006 Nobel peace prize “for their efforts to create economic and social development from below”⁴ was spared from being put against the wall. Starting with the end of 2010 a series of extremely critical articles appeared, sparked by a documentary aired by the National Norwegian Television called "Fanget i Mikrogjeld" (Caught in Micro debt), according to which Yunus transferred 100 million USD between different entities of the Grameen group in order to avoid taxes⁵. On 8th of March 2011 the

¹ UNCDF, "Microfinance and the Millennium Development Goals. A reader's guide to the Millennium Project Reports and other UN documents", 2005, p. 5

² Gilbert RIST, *The History of Development. From Western Origins to Global Faith*, 3rd edition, Zed Books, London, 2008, p. 212

³ As Morduch calls it in Jonathan MORDUCH, "The Microfinance Schism", *World Development* Vol. 28, No. 4, 2000, pp. 617-629

⁴ The Norwegian Nobel Committee, Press Release, Oslo, 13 October 2006

⁵ <http://www.muhammadyunus.org/In-the-Media/> and <http://www.spiegel.de/international/business/0,1518,734650,00.html> (retrieved 12 January 2011)

Bangladeshi High Court upheld his removal as managing director of Grameen Bank requested by the Central Bank on the grounds of his advanced age.⁶

One of the biggest threats brought by microfinance is the overindebtedness of its beneficiaries. As overindebtedness “means social exclusion and increases vulnerability”⁷, it is in sharp contradiction with the main goal of microfinance, which is to decrease the vulnerability and exclusion of the target group. Although several crises occurred (Bolivia 1999; Morocco, Bosnia Herzegovina, Pakistan and Nicaragua 2008 and Andhra Pradesh 2010) “in the microfinance literature, academic work on the causes of over-indebtedness is hardly existent”⁸. Still, according to the Microfinance Banana Skins 2009 Report⁹, overindebtedness is the number one risk threatening the microfinance industry¹⁰. The gravity of this issue in the Peruvian context is recognised by various national and international microfinance actors. The very high levels of competition and concentration in urban areas, combined with the constant increase in loan delinquency and cross indebtedness is analysed in the July 2010 report of Consorcio de Organizaciones Privadas de Promoción al Desarrollo de la Micro y Pequeña Empresa (COPEME)¹¹. The December 2010 study¹² of the Centre for Microfinance at the Swiss Banking Institute of the University of Zurich, commissioned by responsAbility Social Investments AG, Triodos Investment Management BV and Council of Microfinance Equity Funds places Peru at the top of the countries facing a risk of overindebtedness¹³.

⁶ Amy KAZMIN, Daniel DOMBEY, “Bangladesh High Court upholds Yunus exit”, Financial Times, 8 March 2011

⁷ Oliver J. HAAS, “Overindebtedness in Germany” Working Paper No. 44, Social Finance Program, International Labour Organization, Geneva, 2006, p. 1

⁸ Jessica SCHICKS, “Microfinance Over-Indebtedness: Understanding its drivers and challenging the common myths”, Centre Emile Bernheim, Solvay Brussels School, Brussels, 2010, p. 1

⁹ David LASCELLES, Sam MENDELSON, *Microfinance Banana Skins 2009. Confronting crisis and change*, CSFI, New York, 2009

¹⁰ “One of the biggest concerns is the high level of indebtedness that already exists among microfinance borrowers in many markets. Damian von Stauffenberg of MicroRate in the US said that ‘overindebtedness is rising and could come back to haunt the microcredit industry’. Sanjay Sinha, managing director of M-CRIL in India, said that ‘the over-indebtedness of clients is emerging as a key problem in the microfinance sector. This could lead to portfolio quality problems in the medium term’. Similar responses came from most parts of the globe”, David LASCELLES, Sam MENDELSON, *Microfinance Banana Skins 2009. Confronting crisis and change*, CSFI, New York, 2009, p. 15

¹¹ COPEME, “Microfinanzas en el Perú. Reporte Julio 2010”, Lima, July 2010, pp. 53 sq.

¹² Vivien KAPPEL, Annette KRAUSS, Laura LONTZEK, “Over-Indebtedness and Microfinance. Constructing an Early Warning Index”, Center for Microfinance, University of Zurich, Zurich, 2010

¹³ *Id.*, p. 41

1.2. Problem statement

The microfinance sector in Lima is characterised by very high levels of commercialization and competition, and microfinance institutions (MFIs) are in a continuous race for customers. The clients on the other hand find themselves flooded with credit offer and do not always make rational choices. The external environment can also contribute to overindebtedness through adverse shocks. Taking the abovementioned issues in consideration, I decided to conduct a field study titled *Overindebtedness in microfinance. Case-study of the clientele of Financiera CREAR in Los Olivos, Lima Norte, Peru*. The goal of my thesis is to study the causes of overindebtedness in the specific case of the microfinance clients of Financiera CREAR in Los Olivos, in the north of the capital city. The main objective of my thesis formally is *to identify and analyse the causes for the overindebtedness of microfinance clients in the case of the clientele of Financiera CREAR in Los Olivos*. The elements of the research are structured according to the framework proposed by Schicks¹⁴, which distinguishes three main categories of causes for overindebtedness: related to the behaviour of the microfinance institutions, related to the behaviour of the clients and external adverse influences¹⁵. Hence, my thesis will study overindebtedness from a three-layered perspective, analysing the problem at the level of microfinance industry professionals, of representatives of the host institution and of the clients. Consequently, two secondary questions accompany the main objective: 1) *what are the causes for overindebtedness that are linked to the functioning of the microfinance industry?* and 2) *what behaviours of the household are conducive to overindebtedness?*

1.3. Reasons for selecting the case and its relevance

The fact that I carried out my field study in Lima with the support of Financiera CREAR SA was rather a matter of coincidence than of personal choice. Being in a sabbatical year from my job and having no previous experience in Latin America I wanted to study the microfinance context in one country

¹⁴ Jessica SCHICKS, "Microfinance Over-Indebtedness: Understanding its drivers and challenging the common myths", Centre Emile Bernheim, Solvay Brussels School, Brussels, 2010

¹⁵ *Id.*, p. 15

of the region. My employer facilitated the contact with Dr. Felipe Portocarrero from the International Finance Corporation office in Peru who suggested that I conduct my study in the CREAR agency in Los Olivos and supported my contact with the institution and the development of my study.

With hindsight, the choice of the location of my study and of the host institution was justified for several reasons. First, the area of Los Olivos is representative for the Peruvian microfinance sector as it is characterised by very high competition and increased presence of commercial microfinance institutions. It is also characterised by a very high number of microentrepreneurs and poor people, both representing the target group of microfinance. The choice of the CREAR agency was also made for its representative character, as it is the oldest agency in Lima, and it has the biggest loan portfolio. Also, the agency confronts more and more with the problem of overindebtedness of its clients.

1.4. Structure of the thesis

This research deals with the issue of overindebtedness in microfinance in the concrete context of the clientele of Financiera CREAR in Lima Norte, Peru. It is the result of a four-month field and desk study carried out during the second phase of the International Executive Master in Development Studies programme of the Graduate Institute. This work is structured in six chapters. Following the introductory chapter, the theoretical framework is presented in chapters 2, 3 and 4, followed by the description of the context of the study and of the research method in chapter 5 and concluding with the data presentation and analysis in chapter 6.

Consequently, chapter two describes the evolution of microfinance during the last five decades, giving also an insight on the characteristics of microfinance institutions and their clients. The chapter ends with a comparison between the two paradigms of microfinance: the poverty alleviation approach and the financial systems approach. The next chapter presents two main dilemmas faced by microfinance: on one hand the trade-off between impact, outreach and financial sustainability, and on the other hand the mission drift. Chapter four describes the most current threat to microfinance – overindebtedness. It begins with a short analysis of overindebtedness crises across

the world and continues with a review of literature on overindebtedness. The presentation of the main factors causing overindebtedness (i.e. lender behaviour, borrower behaviour and external adverse shocks) follows, and a number of quantitative data on overindebtedness end this chapter and the theoretical framework. Chapter five begins with a presentation of the current state of microfinance in Latin America and in Peru. The host institution is presented subsequently, followed by the presentation of the research method and of the process of data collection and analysis. Chapter six presents the findings of the research and the interpretation of the results.

CHAPTER II: MICROFINANCE, FROM VILLAGE TO WALL STREET¹⁶

2.1. Introduction to microfinance

Microfinance gained a central role in the development landscape in the last two decades. Although usually defined as “all types of financial services that are provided to low-income people”¹⁷ and seen as a tool to fight poverty, a more accurate description of this intervention is that of “a tool against financial exclusion”¹⁸. Thus, a more appropriate term to designate the activities which are usually circumscribed by the name of microfinance would be “financial inclusion”¹⁹, clarification which would also avoid dangerous confusions, as according to Jean-Michel Servet “this clarification is essential [...]. To equate microfinance with the fight against poverty is extremely dangerous. Not only is microfinance, unfortunately, poorly equipped to really fight against poverty, but even more so, this confusion of objectives leads many stakeholders (not only microfinance organisations, but also commercial banks and investors) to adopt practices not very compatible with effective action in the fight against poverty”²⁰.

Many institutions define themselves as providing microfinance services and there is a multitude of definitions of microfinance²¹. This work will use the definition proposed by Jean-Michel Servet in his

¹⁶ Title of a paper written by Tor JANSSON, "Microfinance: From Village to Wall Street", Inter-American Development Bank, Washington, 2001

¹⁷ Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, p. 126

¹⁸ Jean-Michel SERVET, Isabelle GUÉRIN, Marc ROESCH, "Microfinance, Financial Inclusion and Social Responsibility" in *Finance for a better world. The shift towards sustainability*, Henri-Claude de Bettignies and François Lépineux (eds.), Palgrave Macmillan, London, 2009, pp. 7 - 29

¹⁹ *Ibidem*

²⁰ *Ibidem*

²¹ According to Jean-Michel Servet: “Les expressions désignant ou qualifiant les divers services réunis ici sous l’appellation microfinance et les modalités d’intervention de ses nombreux dispositifs sont multiples. Elles se recouvrent imparfaitement en mettant l’accent sur tel ou tel aspect du phénomène. On parle de microcrédit et de crédit solidaire, de finance décentralisée ou services financiers décentralisés (SFD), de finance-semi formelle, de finance intermédiaire, de services financiers de proximité, avec le double sens de la proximité (c’est-à-dire spatiale mais aussi mentale et culturelle), tout comme de finance solidaire, qui en anglais est souvent traduit par ‘social finance’”, Jean-Michel SERVET, *Banquiers aux Pieds Nus. La Microfinance*, Odile Jacob, Paris, 2006, pp. 224 - 225

book *Banquiers aux pieds nus*²². According to this definition, in order to determine the microfinance character of an intervention, one has to evaluate three aspects: the amount of operations, the relationship between the institution and its target group and the characteristics of the target group²³. A microfinance institution is defined by the small, sometimes minute amount of its operations - although the institution can reach considerable size, the amount of each loan given to its clients or of the savings deposited by them is very small²⁴. A microfinance institution is also characterised by the proximity to its target group, both in spatial terms but also in social terms. The overwhelming majority of microfinance offices are located in the village where the clients live or in the market where they have their business. Perhaps one of the most interesting features of a microfinance institution is the close connection with its target group at mental and social level²⁵. The target group identifies with the institution, and trust is the main building material of their relationship. Last, the target group is characterised by two features: relative poverty and high levels of exclusion. Although the poverty element is of extreme importance, it has to be said that microfinance clients do not represent the poorest layers of the population, and not all the microfinance clients are poor. A closer examination of the common features of microfinance clients reveals that they all are characterised by a central feature, i.e. high level of exclusion from the traditional financial system²⁶.

According to supporters of the industry, microfinance is a poverty-reduction tool which promotes the financial inclusion of the poor²⁷. However, this is strongly disputed²⁸, given the lack of irrefutable

²² Jean-Michel SERVET, *Banquiers aux Pieds Nus. La Microfinance*, Odile Jacob, Paris, 2006

²³ *Id.*, p. 224

²⁴ For example, MiBanco in Peru had a total loan outstanding of 1.186 million USD as of June 2010, but this corresponded to 376,000 loans. In Mexico, Banco Compartamos had a loan portfolio of 488 million USD as of December 2009, but with 1,488,897 loans outstanding it meant that the average amount of each loan was a little more than 300 USD. Source: COPEME, "Microfinanzas en el Perú. Información a Junio 2010", Lima, September 2010, p. 13 and Renso MARTÍNEZ, María Cecilia RONDÓN *et al.*, "2010 Microfinance Americas: The Top 100", 2010, p. 7. It should be noted here that a small loan amount does not necessarily imply a low monthly payment: as most microfinance loans are given on short terms (less than a year), the pressure of instalment repayment on the household budget can be considerable. Therefore, in order to make certain comparisons one should also take into account the amount the household has to pay month by month.

²⁵ Jean-Michel SERVET, *Banquiers aux Pieds Nus. La Microfinance*, Odile Jacob, Paris, 2006, p. 225

²⁶ *Id.*, pp. 61 *sq.*, 225 - 228

²⁷ Brigit HELMS, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006; Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001; Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999

²⁸ Heather MONTGOMERY, John WEISS, "Great Expectations. Microfinance and Poverty Reduction in Asia and Latin America", ADB Institute, Research Paper Series, No. 63, 2005; David ROODMAN, Jonathan MORDUCH,

proofs and impact studies which attest the positive effects of poverty alleviation and financial inclusion of microfinance²⁹. According to Jean-Michel Servet, “concerning the supposed effectiveness of microcredit in fighting poverty, we find ourselves in front of beliefs rather than proofs”³⁰. If we observe the clientele of microfinance institutions, in the overwhelming majority of cases this does not represent the poorest layers of the population. An interesting picture reveals if we look at the change in the denomination of CGAP. Created in 1996 as the “Consultative Group to Assist the Poorest” it was World Bank’s response to the critics concerning the effectiveness of its reform policies, and envisaged microfinance as a poverty-reduction tool. Nonetheless, after some time the “poorest” in the name changed to “poor”, together with a change of focus towards “low income and unbanked populations”³¹.

Microfinance and especially microcredit can work against their main mission of financial inclusion, increasing the levels of inequality. As Jean-Michel Servet emphasises “some forms of microcredit can increase the average income of a part of the population, but in the same time are increasing the differences between the beneficiaries and therefore the vulnerability of the majority”³². In the second edition of their book, *The Economics of Microfinance*, Beatriz Armendáriz and Jonathan Morduch are debunking several myths about microfinance. One of them concerns the alleged social impact of microfinance, and its poverty reduction and gender empowerment capacity. By reviewing the available impact studies, Armendáriz and Morduch conclude that there is no clear evidence as to the positive effect of microfinance. As the authors put it, “microfinance is neither a panacea nor a magic bullet, and it cannot be expected to work everywhere or for everyone”³³.

"The Impact of Microcredit on the Poor in Bangladesh: Revisiting the Evidence", Center for Global Development, Working Paper 174, 2009.

²⁹ See Heather MONTGOMERY, John WEISS, “Great Expectations. Microfinance and Poverty Reduction in Asia and Latin America”, ADB Institute, Research Paper Series, No. 63, 2005 for a thorough list of microfinance impact studies in Asia and Latin America and their conclusions

³⁰ Jean-Michel SERVET, "Quelques limites du microcrédit comme levier du développement", *Informations et commentaires*, no. 143, Lyon, 2008, p. 19. See also Richard ROSENBERG, "Does microcredit really help poor people?", CGAP Focus Note No. 59, Washington, 2010

³¹ Susan JOHNSON, "Microfinance is dead! Long live microfinance. Critical reflections on two decades of microfinance policy and practice", Centre for Development Studies, University of Bath, 2009, p. 3

³² Jean-Michel SERVET, "Responsabilidad social y responsabilidad con la sociedad en microfinanzas", Programa ANR Sud RUME 2008-2011, Documento de trabajo Servet/2008.05.01/01, p. 7

³³ Beatriz ARMENDARIZ, Jonathan MORDUCH, *The Economics of Microfinance*, Second Edition, MIT Press, Cambridge, 2010, p. 5

2.1.1. The history of microfinance

Microfinance as a concept emerged in parallel in Latin America and Asia during the 1970s. The pioneers of the industry wanted “to supply formal financial services to poor people shunned by banks because their savings were tiny, their loan demand was small, and they lacked loan collateral”³⁴. Although the concept and intentions were similar and the activities occurred in the same period, given the political, economic and socio-cultural particularities of the two regions one can discern quite some differences between the approaches to microfinance in Asia and Latin America. This can be clearly exemplified by taking a closer look at two institutions which have stayed at the forefront of microfinance for the last four decades: Grameen Bank in Bangladesh and BancoSol in Bolivia. Grameen Bank (which in Bengali means “Bank of the village”) traces its origins in the Bangladesh of the mid 1970s, a country devastated by the Bangladeshi Liberation War of 1971 and by the 1974 famine. Muhammad Yunus, at the time Professor at the University of Chittagong, began a research project providing small loans to groups of women in the village³⁵.

In Bolivia, a collapsing regime and a state marked by coups and counter-coups led to economic turmoil and chronic unemployment. After a hyperinflationist episode in the 1980s and in the middle of an economic downturn which would last six years, the government of Víctor Paz Estensoro launched a shock programme aimed at curbing inflation and restoring economic order. In this context the *Fundación para Promoción y el Desarrollo de la Microempresa* (PRODEM) was created as a ground-breaking Non-Governmental Organisation (NGO) in 1986 with the support of Acción Internacional³⁶. Its mission was to address the “bottleneck”³⁷ of microenterprise development – no access to credit due to lack of collateral and dependence on moneylenders. Six years later, the institution would become BancoSol, Bolivia’s first microfinance bank.³⁸ As Rutherford puts it, “by

³⁴ Manfred ZELLER, Richard L. MEYER, *The Triangle of Microfinance: Financial Sustainability, Outreach, and Impact*, Johns Hopkins University Press, Washington, 2002, p. 1

³⁵ Stuart RUTHERFORD, “Microfinance’s evolving ideals: how they were formed and why they’re changing” paper presented at ADBI Conference, Microfinance in Asia: poverty impact and outreach to the poor, Dec. 5, 2003, Tokyo, p. 4

³⁶ BANCOSOL, “BancoSol: del microcrédito a las microfinanzas”, BancoSol, La Paz, Bolivia, p. 13

³⁷ *Ibidem*

³⁸ *Id.*, pp. 8 - 13

comparison with Bangladesh, the Bolivian intervention was typically urban rather than rural [...]. It targeted the 'economically active poor' – people with established businesses that needed capital to grow...”³⁹.

Historical phases of microfinance

1950 – 1970 Subsidized credit programmes

After the end of the Second World War donors and governments started experimenting with small farmer credit projects. While not officially called microcredit programmes, “key assumptions about the status, potential, and behaviour of small farmers were virtually identical to the assumptions involved in many recent credit programs for microentrepreneurs”⁴⁰. Most of these programmes were implemented through state-owned banks or development agencies in Latin America, Africa and Asia. Their most important characteristic was the subsidized nature, meaning that loans were given at below-market interest rates. This did not allow the rural development banks to cover their costs and gave the loans the image of governmental hand-outs⁴¹. Poor loan appraisal standards, high costs and massive defaults led to the generalised collapse of all these programmes. Given the appealing nature of subsidies and the programmes’ integration into state-owned structures, most “fell victim to predatory behaviour by politicians or their clients”⁴². After four decades and tens of billions of dollars invested, the overwhelming majority of the programmes failed lamentably, and new ways of promoting microcredit emerged⁴³.

1970s Birth of microcredit

The 1970s marked the advent of microcredit, through initiatives which emerged in parallel in Asia and Latin America, where tiny loans were given to poor entrepreneurs, mostly women. The model

³⁹ Stuart RUTHERFORD “Microfinance’s evolving ideals: how they were formed and why they’re changing” paper presented at ADBI Conference, Microfinance in Asia: poverty impact and outreach to the poor, Dec. 5, 2003, Tokyo, p. 5

⁴⁰ J. D. Von PISCHKE, Dale W. ADAMS, "Microenterprise Credit Programs: Déjà Vu", Economics and Sociology Occasional Paper No. 1828, 1991, p. 3

⁴¹ Brigit HELMS, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006, p. 4

⁴² J. D. Von PISCHKE, Dale W. ADAMS, "Microenterprise Credit Programs: Déjà Vu", Economics and Sociology Occasional Paper No. 1828, 1991, p. 17

⁴³ Gary M. WOLLER, Christopher DUNFORD *et al.*, "Where to microfinance?", *International Journal of Economic Development*, Vol. 1, No. 1, 1999, p. 11

was based on group lending, a methodology which used peer pressure in order to ensure loan repayment. Grameen Bank in Bangladesh, ACCION Internacional in Latin America and the Self-Employed Women's Association (SEWA) Women's Cooperative Bank in India were at the forefront of these efforts, as were a multitude of NGOs⁴⁴. A special role in this process belonged to these NGOs, which through innovations and ingenuity achieved the operational breakthroughs that would later be the foundation of successful microfinance institutions. These organisations were driven by a social mission and had a poverty alleviation approach⁴⁵. In Peru, Acción Comunitaria del Perú (ACP) was initiated as an NGO and was active in social projects such as housing construction and community education⁴⁶. The NGO was planned to start functioning on the 3rd of October 1968, but the opening was postponed three months because of the military coup through which General Juan Velasco replaced the government of Fernando Belaunde.⁴⁷ After 30 years of development work, in May 1998 ACP transformed in Mibanco, Peru's first microfinance bank. Today, Mibanco is the third biggest microfinance institution in Latin America.⁴⁸

Text box 1: Advent of microcredit in Peru⁴⁹

"The discovery of small enterprise as a powerful lever for reducing poverty began in the early 1970s. A big push to the idea was given by country studies of 'the employment problem' carried out by the International Labour Organization (ILO), especially a study of what began to be called the 'informal sector' in Kenya which documented the entrepreneurship and creativity of the owners of market stalls, workshops, and small service establishments in an African city. The ILO began to multiply its work on employment, creating PREALC (Programa Regional de Empleo para América Latina y el Caribe / Regional Employment Programme for Latin America and the Caribbean). PREALC helped create a climate of opinion that stimulated a search for credit and training projects to develop small enterprise in Peru, and even contributed directly to the creation of the Instituto de Desarrollo del Sector Informal (Idesi), one of Peru's first important microfinance institutions. The new focus on small enterprise was also encouraged by the resurgence of conservative politics that occurred at the turn of the decade, led by Margaret Thatcher, Ronald Reagan and Helmut Kohl. For government officials charged with the design of anti-poverty policies, the message was, top-down is out, bottom-up is the way to go."

⁴⁴ Brigit HELMS, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006, p. 3

⁴⁵ Lucy CONGER, Patricia INGA *et al.*, *The mustard tree. A history of Microfinance in Peru*, Universidad de San Martín de Porres, Lima, 2009, p. 18. The poverty alleviation approach is described in detail in subchapter 2.2

⁴⁶ Anita CAMPION, Elizabeth DUNN, "The Transformation of Acción Comunitaria del Perú (ACP) to Mibanco", 2001, p.1

⁴⁷ Lucy CONGER, Patricia INGA *et al.*, *The mustard tree. A history of Microfinance in Peru*, Universidad de San Martín de Porres, Lima, 2009, p. 51

⁴⁸ Renso MARTÍNEZ, María Cecilia RONDÓN *et al.*, "2010 Microfinance Americas: The Top 100", 2010, p. 7

⁴⁹ Lucy CONGER, Patricia INGA *et al.*, *The mustard tree. A history of Microfinance in Peru*, Universidad de San Martín de Porres, Lima, 2009, p. 20

1980s Financial sustainability

The 1980s was the era when successful microcredit programmes “demonstrated that microcredit provided at interest rates that enable full cost recovery could be delivered with high repayment”⁵⁰.

This decade marked the transformation of NGO programmes into financially sustainable microfinance institutions of impressive size. It was the turning point in microfinance, when financial sustainability and profit making became the most sought-after characteristic of a successful institution. This movement was based on three arguments: first, it became clear that poor can pay high interest rates with extraordinary discipline.⁵¹ These high interest rates were crucial in order to cover the high operational costs associated to disbursing and managing a huge number of tiny loans. The prospect of having *access* to a regular and reliable source of financing was more important for the microentrepreneur than the *cost* of this source. Second, it was argued that subsidies were incentives for low performance and discouraged innovation and efficiency. Third, it became visible that in the long run subsidies would lag behind the extraordinary development of microfinance institutions; therefore the only way of providing microfinance services to an ever increasing number of poor was to operate on a cost-recovery basis⁵². Full-fledged microfinance institutions offering microcredits and savings products reached millions of poor, while operating on a commercial basis.⁵³

In Peru the year 1980 marked the end of the military government but also the beginning of one of the most difficult decades of the country’s history. The economy was practically paralysed, and was facing a high external debt and an ever-growing inflation. On this background, the Andean region was subject to the atrocities of the two guerrilla groups, Sendero Luminoso and Túpac Amaru Revolutionary Movement. At the beginning of the decade, “the financial system had almost nothing to offer the large majority of very poor families in Peru. Formal banks were inaccessible, credit unions and S&Ls [Savings and Loans Association] had failed, and small enterprise credit programmes

⁵⁰ Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, p. 52

⁵¹ “The top microlenders boast repayment rates of 98 percent and higher, achieved without requiring that loans be secured with collateral.” From Robert CULL, Asli DEMIRGÜÇ-KUNT *et al.*, “Microfinance Meets the Market”, Policy Research Working Paper 4630, The World Bank, Washington, 2008, p. 4

⁵² Robert CULL, Asli DEMIRGÜÇ-KUNT *et al.*, “Microfinance Meets the Market”, Policy Research Working Paper 4630, The World Bank, Washington, 2008, p. 5

⁵³ “By the end of the decade BRI had also shown that its microbanking system could service more than 6 million savings accounts and could operate its entire microbanking system without subsidy” Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, p. 54

did not reach the very poor”⁵⁴. In May 1980 a landmark decree was issued, setting the stone of what would become one of the many institutions forming the Cajas Municipal⁵⁵ network: Caja Municipal de Piura was founded in 1982, followed by other 11 Cajas Municipales in the ten years that followed.⁵⁶

1990s Developing the industry in a neoliberal context

The 1990s were characterised by several trends: increased commercialization, integration in the financial markets and accelerated growth in a neoliberal context. Existing players were growing, while focusing on profitability and sustainability. New institutions appeared and existing commercial banks began experimenting with microfinance programmes, all attracted by the excellent repayment behaviour and financial viability of the business. Microfinance institutions were focusing on attracting savings from their target group, thus ensuring the much needed funds for their growth⁵⁷. At the end of 1996 (Bank Rakyat Indonesia) BRI’s microbanking division was managing 16.1 million deposit accounts amounting to 3 billion USD⁵⁸. Microfinance was becoming an industry, with support from donors and international institutions which were promoting a commercial approach as a sustainable way to fight poverty. The decade also marked another ground-breaking achievement of microfinance – its integration in the financial markets, with the listing of BancoSol on the Bolivian stock exchange in September 1997⁵⁹.

The commercialization of microfinance and its integration in the financial markets initiated in the middle of the 1990s a strong debate between those who were advocating the *financial systems approach* and the supporters of the *poverty lending approach*.⁶⁰ The first group argued that the main mission of microfinance is the financial inclusion of the highest number of poor possible, and this can

⁵⁴ Lucy CONGER, Patricia INGA *et al.*, *The mustard tree. A history of Microfinance in Peru*, Universidad de San Martin de Porres, Lima, 2009, pp. 42, 45

⁵⁵ See Table 6: **The Peruvian microfinance institutions at a glance** for a detailed description of the institutions composing the Peruvian microfinance sector

⁵⁶ FEPCMAC, <http://www.fpcmac.org.pe/?s=institucional&p=resena-historica> (retrieved 13 December 2010)

⁵⁷ Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, pp. 54 ff

⁵⁸ *Id.* p. 63

⁵⁹ *Id.* p. 67

⁶⁰ See Elisabeth RHYNE, “The Yin and Yang of Microfinance: Reaching the Poor and Sustainability”, 1998, *MicroBanking Bulletin* 2, pp. 6 – 8; Brigit HELMS, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006; Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001

only be achieved by financially sustainable microfinance institutions. Therefore, full costs have to be supported by the beneficiaries, and institutions should function on a profitability basis, offering services to the “middle poor”⁶¹. On the other hand, the supporters of the poverty lending approach argued that credit should primarily be a poverty-fighting tool, targeted at the poorest of the poor. Microcredit should be accompanied by training and teaching programmes in health, hygiene, literacy and family planning.⁶² As Rhyne puts it, “those in the poverty camp feel strongly that it is important to reach the poorest possible people. Many in the sustainability camp are more interested in opening access to the full spectrum of the poor who lack access to financial services; although most do include the poorest in that spectrum.”⁶³

The 1990s were also the heyday of the Washington Consensus, when the “stabilize, privatize, and liberalize” mantra was the underlining theme of a wave of reforms in Latin America and Africa.⁶⁴ Microfinance was following the same trend, as „in the 1980s and 90s the Washington-based institutions [...] came on the scene to try to neoliberalise microfinance, to turn it into a commercial offer [...] that was absolutely paramount”⁶⁵. Jean-Michel Servet describes the neoliberal context as being characterised by deregulation, privatization, structural adjustment plans and the calling into question of the social benefits and workers’ rights⁶⁶. This was done against the background of increased levels of monetarization and speculative financial transactions.⁶⁷

⁶¹ Elisabeth RHYNE, “The Yin and Yang of Microfinance: Reaching the Poor and Sustainability”, 1998, *MicroBanking Bulletin* 2, pp. 6 - 8

⁶² Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, p. 22

⁶³ Elisabeth RHYNE, “The Yin and Yang of Microfinance: Reaching the Poor and Sustainability”, 1998, *MicroBanking Bulletin* 2, p. 7

⁶⁴ Dani RODRIK, “Goodbye Washington Consensus, Hello Washington Confusion? A Review of the World Bank’s Economic Growth in the 1990s: Learning from a Decade of Reform”, *Journal of Economic Literature*, Vol. XLIV, December 2006, p. 973

⁶⁵ Speech by Milford Bateman “Microfinance in the time of neoliberalism”, Overseas Development Institute, London, 5th July 2010, <http://www.odi.org.uk/events/report.asp?id=2447&title=microfinance-time-neoliberalism#audio-video>

⁶⁶ “acquis sociaux” in original

⁶⁷ “Cette extension *a priori* de la finance s’est produite dans un contexte néolibéral: celui des dérégulations, des privatisations, des plans d’ajustement structurel et de la remise en cause d’«acquis sociaux»; ou indirectement par délocalisation des biens et services produits ainsi à bas coûts. Sa propagation s’est faite dans la cadre général de l’intensification de la financiarisation des sociétés et de l’essor de nouvelles modalités de celle-ci: une monétarisation accrue, une intermédiation financière croissante des transactions, une couverture par assurance privée et par capitalisation des risques et de la protection sociale, et au sommet de cette pyramide le bouillonnement de masses financières considérables disponibles pour les mouvements spéculatifs.”, Jean-Michel SERVET, *Banquiers aux Pieds Nus. La Microfinance*, Odile Jacob, Paris, 2006, p. 13

In Peru the microfinance sector was struggling to survive, in a harsh economic and social context. Inflation in 1990 was at 7,560 per cent the highest in the world, the GDP per capita was at the same level as in 1960, and Sendero Luminoso was attacking now the capital city. Still, it was a decade of far-reaching reforms – several non-performing banks and financial institutions were liquidated, the Superintendence of Banks' role was strengthened and the state development bank, Corporación Financiera de Desarrollo (COFIDE), was transformed in a second-tier lender which would play a crucial role in supporting the microfinance sector in the following years. The Caja system was solid, Mibanco was born and commercial banks were more and more active in microfinance.⁶⁸

2000s microfinance at a crossroads

The debate on the effectiveness and the *raison d'être* of microfinance got even more heated in the last decade. The end of the 1990s and the beginning of the 2000s marked the “post Washington-Consensus” era, hailed by Joseph Stiglitz.

Looking back at the achievements of the neoliberal policies, Stiglitz argues beyond doubt that the Washington Consensus was a failure, especially in Latin America, where inequality levels rose and poverty remained a big problem⁶⁹. In the same time, a deeper understanding of poverty as a multidimensional phenomenon emerged from the World Bank itself. It became clear that poverty was not only a question of low or lacking incomes, but a combination of social, territorial, natural and national factors. This implies that poverty-alleviating policies had to be based on a holistic approach to the phenomenon, rather than focusing only on

Text box 2: Microfinance at a crossroads

“Today, the word *microfinance* doesn't even capture the scope and scale of what is happening in the world of finance for the poor. What was once a neat and tidy, well-delineated little sub-culture, now encompasses a dizzying range of delivery organizations and services, all increasingly interwoven with the rest of the financial sector. All around us, we are witnessing experimentation, and a surge of new entrants to the field. The result is an explosion of diversity: diversity of delivery channels, of services, of funding sources and, of course, clients.”

Elizabeth Littlefield, CGAP CEO and World Bank Director - remarks made at the International Year of Microcredit and Georgetown University Conference on Microfinance, Washington DC, April 19. 2005.

⁶⁸ Lucy CONGER, Patricia INGA *et al.*, *The mustard tree. A history of Microfinance in Peru*, Universidad de San Martín de Porres, Lima, 2009, pp. 61 sq.

⁶⁹ Joseph E. STIGLITZ, "The post *Washington Consensus* Consensus", Sao Paolo, August 22, 2005

economic growth⁷⁰. Still, these advances had little influence, if any, on the state of microfinance at the turn of the millennium. The debate between *institutionalists* who were supporting the financial systems approach and the *welfarists* supporting the poverty lending approach continued stronger, the industry grew to new heights, various microfinance crises appeared throughout the world and commercialization and integration into the financial markets was complete. Since the UN declared 2005 as the “International Year of Microcredit”, the industry experienced major and at times controversial developments. In 2006 Muhammad Yunus and the institution he created 30 years before were awarded the Nobel Peace Prize “for their efforts to create economic and social development from below”⁷¹. In 2007 Compartamos, a Mexican microfinance institution, launched an (Initial Public Offer) IPO to sell 30% of its shares. The offer was oversubscribed 13 times, bringing 450 million USD to the owners. In July 2010, (Swayam Krishi Sangam) SKS, the biggest microfinance institution in India was floated on the stock exchange⁷², bringing the value of the company to 1.5 billion USD. Yunus sanctioned this, stating that “this is pushing microfinance in the loansharking direction. [...] offering an IPO, you are sending a message to the people buying the IPO there is an exciting chance of making money out of poor people”⁷³.

2.1.2. Who are the microfinance clients ?

As previously stated, microfinance clients are poor people who are excluded from the formal financial system. As this definition is too general, it is worth taking a closer look at the characteristics of these clients, underlining four of them: their relative poverty level, their entrepreneurial spirit, the household-business unit and the fungible nature of their resources.

We shall begin by saying who the microfinance clients **are not**. Although it is generally said that microfinance is providing financial services to the poor, an important distinction has to be made

⁷⁰ Deepa NARAYAN (dir.), *Voices of the Poor. Can anyone hear us?* Oxford University Press, New York, 2000

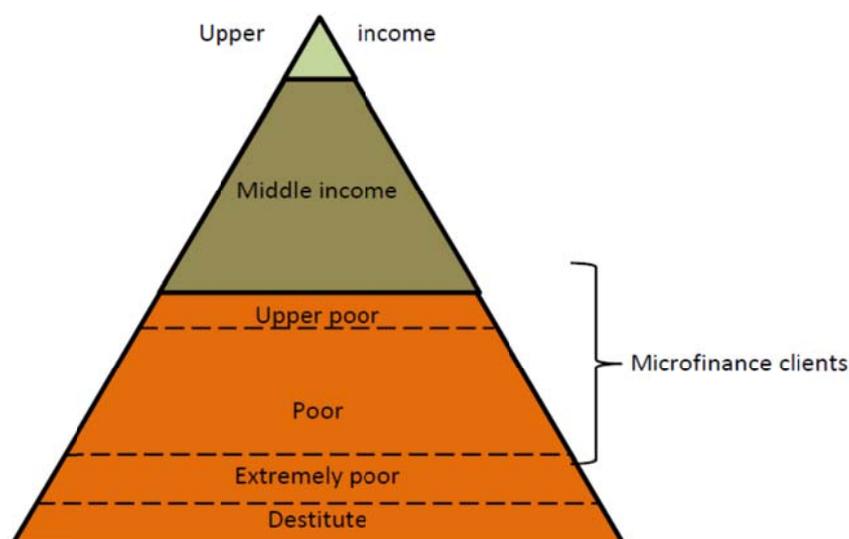
⁷¹ The Norwegian Nobel Committee, Press Release, The Nobel Peace Prize for 2006, http://nobelprize.org/nobel_prizes/peace/laureates/2006/press.html (retrieved 15 December 2010)

⁷² Greg CHEN, Stephen RASMUSSEN *et al.*, "Indian Microfinance Goes Public. The SKS Initial Public Offering", CGAP Focus Note No. 65, Washington D.C., 2010

⁷³ The Associated Press, "Microfinance IPO, mission conflict", <http://www.pressherald.com/business/microfinance-ipo-mission-conflict-2010-07-29.html> (retrieved 10 December 2010)

between the *extremely poor* and the *economically active poor*⁷⁴. Regarding the very concept of poverty, it has to be said that given its multidimensional⁷⁵ and relative⁷⁶ nature, it is extremely difficult to define and measure. In general two methods are used to measure poverty: the poverty line method and the unsatisfied basic needs method. Although presenting certain limitations⁷⁷, poverty lines are used internationally as they are easily quantifiable and allow comparisons. We can have a more clear idea if we look at the wealth pyramid below, in order to understand how its bottom of is structured.

Figure 1: The wealth pyramid ⁷⁸



Those at the bottom of the pyramid (the destitute and the extremely poor) are in a desperate situation, and their most urgent needs are food, shelter and medicine.⁷⁹ These people are

⁷⁴ Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, p. 17

⁷⁵ Deepa NARAYAN *et al.*, *Voices of the Poor. Can anyone hear us?*, World Bank, Oxford University Press, New York, 2000

⁷⁶ Jean Michel SERVET, Amadou DIOP, Isabelle HILLENKAMP, "Poverty versus Inequality", in Bernd BALKENHOL (ed.), *Microfinance and public policy. Outreach, performance and efficiency*, International Labour Organization, Palgrave Macmillan, Hampshire, 2007, pp. 27 - 46

⁷⁷ See Jean Michel SERVET, Amadou DIOP, Isabelle HILLENKAMP, "Poverty versus Inequality", in Bernd BALKENHOL (ed.), *Microfinance and public policy. Outreach, performance and efficiency*, International Labour Organization, Palgrave Macmillan, Hampshire, 2007 for a comprehensive analysis on poverty, how it is measured and its relation with microfinance

⁷⁸ Adapted from Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, p.21 and C.K. PRAHALAD, Stuart L. HALL, "The Fortune at the Bottom of the Pyramid", *strategy+business* no. 26, Booz Allen Hamilton, 2002, p. 4

unemployed or have an insignificant income which cannot cover basic nutritional needs, they live in areas gravely depleted of resources or they are too young, too old or too ill to carry on any activity. They are excluded from the economic life because of their ethnicity, their gender or for political reasons or they are refugees from wars, conflicts or natural catastrophes.⁸⁰ Credit is not the right poverty alleviation tool for them, and providing loans to them is highly risky, as these loans will be used to cover emergency needs such as food or medication⁸¹. As a result, the loans will serve neither the lenders, nor the borrowers, as people in extreme poverty lack the possibilities to use the money effectively and will not be able to repay them. Consequently the probability to end up in a debt trap is high⁸². On the other hand, microcredit can be a useful tool to assist the economically active poor, as they have the preconditions to effectively use loans in a lucrative manner⁸³. Due to the general vulnerability of the people at the bottom of the pyramid, the distinctions between the various categories of poor are not clear cut and they change with time⁸⁴. In the context of this research, an important relationship has to be established between poverty, exclusion and vulnerability, as “the fundamental cause of not just insufficient income, but also little or no access to education, health care, decent housing and so on is often discrimination and processes of marginalization”⁸⁵. In this respect, using exclusively monetary indicators to measure poverty provides an unilateral view, as social phenomena such as exclusion, marginalization and discrimination are not taken into account. From this perspective, it can be argued that “exclusion begets poverty”⁸⁶ which in turn increases the vulnerability of the poor. Thus, a more accurate definition of microfinance is that of “a tool against

⁷⁹ Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, p. 20

⁸⁰ *Id.* p. 18. There is a direct link between extreme poverty and the precarious nature of the households and their incomes. While at times a household can be above the line of extreme poverty, an external shock (illness, loss of assets, death of a cow that provides milk, etc.) can cause it to fall back to extreme poverty.

⁸¹ According to Marguerite ROBINSON “the poorest of the poor should not be the responsibility of the financial sector. The food, employment, and other basic requirements needed to overcome desperate poverty are appropriately financed by government and donor subsidies and grants. These tools are properly the responsibility of ministries of health, labor, social welfare, and others, as well as of donor agencies and private charities”, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, p. 20

⁸² Brigit HELMS, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006, p. 30

⁸³ Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, p.20

⁸⁴ *Id.*, p. 19

⁸⁵ Jean Michel SERVET, Amadou DIOP, Isabelle HILLENKAMP, “Poverty versus Inequality”, in Bernd BALKENHOL (ed.), *Microfinance and public policy. Outreach, performance and efficiency*, International Labour Organization, Palgrave Macmillan, Hampshire, 2007, p. 32

⁸⁶ *Id.*, p. 32

financial exclusion”⁸⁷ as proposed in subchapter 2.1 rather than the provision of financial services to poor people.

Another important feature of microfinance clients is their **entrepreneurial spirit**. They are men and women in urban and rural areas, who are self-employed and managing one or more small businesses, using their determination and ingenuity in a multitude of activities, ranging from trade to production to services.

Text box 3: The entrepreneurial spirit of the poor⁸⁸

Rosa was born into a Quechua speaking household in a provincial area and she was orphaned at an early age. In 1964 she migrated to the capital city with her husband and two young children. After renting for a time, they participated in a land invasion on the urban periphery of Lima where they lived in a house with dirt floors and walls made out of straw mats. In 1982 Rosa received her first microloan from *Accion Comunitaria*, which she used to buy inventory for starting a small market stall, a business which she continues to operate today. Her business offers staple food products (*abarrotos*) and currently operates out of a store in the family home during afternoons and evenings, and out of the market stall across the street during morning hours. Three of Rosa’s six children have professions, the oldest son is a lawyer, a middle son is an Air Force pilot, and the daughter is a social worker. Two of the remaining three children have separate microenterprises. The oldest has a print shop and paper goods store, which is located across the street from the family home. Located within the store is a small beauty salon, which he contracts out to local beauticians. The middle son has an appliance repair business, which is located in the adjacent house. Rosa was planning the launching of her youngest son (eighteen years old) in his own computer graphics business. At the time of the interview, she was on her ninety-first credit.

They can be running a small market stall or selling goods on the street; they can be baking cookies, tailoring, small farming, producing furniture or they can be offering services such as transport, communication or even money transfer. They are poor, but due to the fact that they have some sort

⁸⁷ See footnote 18

⁸⁸ Adapted by the author from Elizabeth DUNN, “Diversification in the household economic portfolio”, *Assessing the Impact of Microenterprise Services (AIMS)*, Management Systems International, Washington, 1997, pp. 15 – 16. Similar examples of determination and entrepreneurial spirit were encountered by the author during the field study. Just to quote two of them: Mrs. Margarita Borda started a sewing business in the difficult decade of the 90’s terrorism. Due to the constant threats at the time, she opened a clandestine workshop in her home. Later, she bought a sewing machine and she started offering sewing services in the textile market of Gamarra. Now she owns her own shop producing children clothes which are sold locally and exported to France. Mrs. Rosa Mamani started selling spices in Lima 21 years ago. In the 90’s she moved to a more central area, but her business was evicted with other small shops due to an order of the mayor, as the terrain was public. Later she bought her own market stall next to her house. Apart from the spice stall, she was also selling snacks and hamburgers she made at home.

of economic activity which is providing a stable source of income they are not the *poorest of the poor*⁸⁹. The third feature of the microfinance clients is the **close connection between the household and the business**, to such an extent that in the majority of cases we speak about “enterprises operated by [...] households”⁹⁰. Because the family is the *de facto* owner of the business⁹¹, and the business activity is located in most of the cases in the family’s home⁹², there is an intimate relationship between the business and the family. There is no clear difference between the financial flows of one and the other, so money is flowing from the business to the family and vice versa. This observation leads us to the fourth characteristic of the microfinance clients, which is the **fungible nature of their resources**. *Portfolios of the poor*, a seminal book co-authored by Jonathan Morduch⁹³ studies in detail how the poor manage their finances through the analysis of 250 *financial diaries* of households in India, Bangladesh and South Africa. The authors found that poor people juggle with a multitude of financial instruments and financial relations with other family members, with moneylenders, with formal, semiformal or informal providers in order to face the uncertainties and shocks of daily life⁹⁴. The budget of poor households is fungible – it can be adjusted, divided and restructured in various ways⁹⁵. This is also true in the case of microloans – research revealed that only 50% of the borrowers use the microcredit they take for the business purpose declared, while the other half spends it on home improvement, school tuition, medical treatment or wedding expenses⁹⁶. While this may seem an arbitrary measure, the decision is taken by the household based on the importance it assigns to other non-business related needs.⁹⁷

⁸⁹ Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, p. 2

⁹⁰ *Id.*, p. 3

⁹¹ Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, p. 11

⁹² Brigit HELMS, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006

⁹³ Baryl COLLINS, Jonathan MORDUCH *et al.*, *Portfolios of the Poor. How the World's poor Live on \$2 a Day*, Princeton University Press, New Jersey, 2009

⁹⁴ *Id.*, p. 14

⁹⁵ *Id.*, p. 30

⁹⁶ Don JOHNSTON, Jonathan MORDUCH, *Microcredit vs. Microsaving. Evidence from Indonesia*, New York, 2007

⁹⁷ “A fundamental but easily overlooked lesson from the diaries is that the demand for microcredit extends well beyond the need for just microenterprise credit. The poor households in the study seek loans for a multitude of uses besides business investment: to cope with emergencies, acquire household assets, pay schooling and health fees, and, in general, to better manage complicated lives. [...] microcredit is often diverted from its intended uses (of running businesses) to other uses ranked more important by households. This lesson has not yet been well recognized by promoters of microcredit and microfinance.” Baryl COLLINS, Jonathan MORDUCH *et al.*, *Portfolios of the Poor. How the World's poor Live on \$2 a Day*, Princeton University Press, New Jersey, 2009, p. 25

2.1.3. What are the main methodologies of microfinance?

As we have seen, microfinance has become more and more complex over the last decades. This was also accompanied by a change in the methodologies used by the various microfinance institutions. As already stated in subchapter 2.1.1, the pioneering microfinance programmes used the “solidarity group lending”⁹⁸ technology, “in which every member of a group guaranteed the repayment of all members”⁹⁹. Apart from group lending, Cull, Demirgüç-Kunt *et al.*¹⁰⁰ differentiate two more lending methodologies – village banking and individual lending. We will analyse their characteristics in the following paragraphs.

Group Lending

According to Wright, the main features of the group lending model are peer pressure and peer support, group guarantee and joint liability.¹⁰¹ The roots of group lending can be traced back to the 19th century Europe, when Friedrich Wilhelm Raiffeisen developed in 1849 the first rural credit union¹⁰² based on the idea of “financial cooperation”¹⁰³. The peer pressure acts as a loan default deterrent – in case the borrower does not pay his loan he will be stigmatized by the other members of the group. This is further enforced by the proximity of the group’s members¹⁰⁴. Although the loans are made to the individual members, the whole group guarantees loan repayments and is held

⁹⁸ Brigit HELMS, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006, p. 4

⁹⁹ *Id.*, p. 4

¹⁰⁰ Robert CULL, Asli DEMIRGÜÇ-KUNT *et al.*, “Financial Performance and Outreach: A Global Analysis of Leading Microbanks”, Policy Research Working Paper 3827, World Bank, Washington, 2006, pp. 4 - 5

¹⁰¹ Graham WRIGHT, *Microfinance systems. Designing quality financial services for the poor*, Zed Books Ltd., London, 2000, p. 52

¹⁰² The institution was called *Heddesdorfer Darlehnskassenverein*, which could be translated as *Cooperative lending bank of Heddesdorf*. According to Prinz (2002), the main features of the cooperative were: a) the members were recruited exclusively from the local parish; b) all the members of the community were entitled to benefit from its services, even the poorest; c) no entrance fee was charged and no dividends were paid; d) the members had unlimited liability in case of bankruptcy; e) loans had flexible terms and a very short period of notice, usually one day; f) the cooperative was also providing additional services to its members, such as buying raw-materials or machinery; g) the profits were collected in an „undividable fund“. Michael PRINZ, “German Rural Cooperatives, Friedrich-Wilhelm Raiffeisen and the Organization of Trust. 1850 – 1914”, Paper delivered to the XIII IEHA Congress Buenos Aires, Session 57, 2002, p.10

¹⁰³ “Coopérativisme financier” in original, Jean-Michel SERVET, *Banquiers aux Pieds Nus. La Microfinance*, Odile Jacob, Paris, 2006, p. 207

¹⁰⁴ Aliya KHAWARI, “Microfinance. Does it hold its Promises? A survey of recent literature”, HWWA Discussion Paper No.276, Hamburg, 2004, p. 21

responsible in case problems appear¹⁰⁵. The joint liability acts as a social contract which ensures the repayment of loans due to the fact that it diminishes the moral risk associated to any single borrower and reduces adverse selection of borrowers through the use of the local information.¹⁰⁶

Village Bank

The village banks are associations of credit and savings which are managed by rural communities. The village bank methodology is a way of providing access to financial systems in remote or difficult to reach areas, while in the same time building a community self-help group and helping the members save money.¹⁰⁷ The model originated in a 1985 experiment carried out by the Foundation for International Community Assistance (FINCA) in Costa Rica. A group of villagers (usually women) is formed, made up of 30 to 50 members, who enjoy high autonomy with respect to the loan decisions and the group management¹⁰⁸. A loan from a sponsoring organisation makes up the initial capital which is saved in an *external account*. Group members have to save up to 20% of the amount they request as a loan (which starts at approximately 50 USD for the first one), and the interest is used to cover the costs. The member's savings are kept in an *internal account*, where the depositors have access according to their necessities. Due to their group nature, the village banks make full use of the local information and peer pressure, but without forming small groups characteristic to the group-lending methodology.¹⁰⁹

¹⁰⁵ Beatriz ARMENDÁRIZ, Jonathan MORDUCH, "Microfinance beyond group lending", *Economics of Transition*, Volume 8 (2) 2000, p. 402

¹⁰⁶ Robert CULL, Asli DEMIRGÜÇ-KUNT *et al.*, "Financial Performance and Outreach: A Global Analysis of Leading Microbanks", Policy Research Working Paper 3827, World Bank, Washington, 2006, pp. 4 - 5

¹⁰⁷ Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, p. 85

¹⁰⁸ In Peru, the "village banking methodology began to expand after the creation of the FINCA Perú programme in Ayacucho in 1993, which followed several pilot projects in the region beginning in 1990. [...] The main entities specialising in Village Banking are members of the Consortium for Promotion of Women and the Community (Consortio de Promoción de la Mujer y la Comunidad, PROMUC). PROMUC currently has 13 associates, seven of whom have joined since 2006 [...] Another group of microfinance entities consists of organisations that are unregulated, but which have extensive experience in microfinance activities. The microfinance initiative of COPEME, the consortium of private organisations for development of small businesses and microenterprise, includes 17 specialised microfinance NGOs in its information system [...]; 10 of these organisations operate with village bank technology, mainly serving women", Sara PAIT, "The microfinance sector in Peru. Opportunities, challenges and empowerment with gender mainstreaming", 2009, pp. 22 sq.

¹⁰⁹ Jonathan MORDUCH, "The Microfinance Promise", *Journal of Economic Literature*, Volume 37, Nashville, 1999, p. 1579

Individual lending

The individual lending methodology is based on a bilateral relationship between the lender and the borrower. The loan decision is taken by the microfinance institution based on financial information, analysis of the business and of the client, collateral and the character of the borrower. As individual lending requires frequent visits to the client, it is most successful in urban areas with a high concentration of clients. In general, the average amount of the loans given according to the individual lending methodology is higher than the average amount of the loans given using the group-lending methodology.¹¹⁰

Table 1: Comparison between individual lending and group lending methodologies¹¹¹

Individual lending		Group lending
Screening		
<ul style="list-style-type: none"> • Reputation, character reference, credit history • Credit scoring 	Character Check	<ul style="list-style-type: none"> • Self-selection of group members (inside information) • Group formation process
<ul style="list-style-type: none"> • Evaluation of assets • History of business • Financial statements • Business planning 	Capital Assessment	<ul style="list-style-type: none"> • Emphasis on human capital • Examination of experience and skill
<ul style="list-style-type: none"> • Rigorous financial analysis • Cash flow of business (and household) • Loan amount determined individually 	Repayment capacity	<ul style="list-style-type: none"> • Joint analysis • Rough estimate of cash flow • Standardized loan amount set per cycle
Monitoring		
<ul style="list-style-type: none"> • Loan officer responsible • Close daily tracking of portfolio 	Loan Follow-up/ Arrears Monitoring	<ul style="list-style-type: none"> • Group members have first responsibility • Loan officer oversees portfolio
Enforcement		
<ul style="list-style-type: none"> • Pledge of assets/collateral • Guarantor/co-signer 		<ul style="list-style-type: none"> • Group guarantee • Compulsory savings

¹¹⁰ Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, p. 68

¹¹¹ From Hans DELLIEN *et al.*, *Product Diversification in Microfinance: Introducing Individual Lending*, Women's World Banking, New York, 2005, pp. 2 - 3

2.1.4. What are the types of microfinance institutions?

Microfinance institutions have as main mission the provision of financial services to a growing number of people which are excluded from the traditional financial system.¹¹² The range of services offered by microfinance institutions is extremely diverse, covering everything from individual or solidarity loans for business or family needs, savings products, micro insurance for goods or persons, money transfer or pensions¹¹³. The same diversity characterises the microfinance institutions. Microfinance institution is an “umbrella term”¹¹⁴ which includes state-owned programmes and banks, member-owned savings and loan institutions, small rural or community banks, NGOs, commercial banks specialised in microfinance or financial cooperatives.¹¹⁵ In order to distinguish between various types of institutions, two criteria can be used, which are relevant to this work. One criterion groups institutions according to their degree of regulation and formality¹¹⁶, and the other one groups institutions according to their level of financial sustainability¹¹⁷.

According to their degree of regulation, one can discern three main groups of microfinance institutions: regulated, semi-regulated and non-regulated. Regulated institutions operate within the national legal framework and are subject to strict procedures and supervision, while semi-regulated institutions are authorised by the authorities to function but do not have to comply with the banking regulations. In some cases these institutions choose to auto-regulate themselves under an umbrella organisation¹¹⁸. Non-regulated institutions operate without any legal framework and with no supervision from the state.¹¹⁹ It has to be underlined that in this context the non-regulated character of a microfinance institution does not mean that the latter is not functioning according to clear rules, even if those are not written.

¹¹² Jean-Michel SERVET, *Banquiers aux Pieds Nus. La Microfinance*, Odile Jacob, Paris, 2006, p. 9

¹¹³ *Id.*, pp. 248 sq. See also for a more detailed description of other types of microfinance interventions, such as guarantee funds and risk-capital.

¹¹⁴ Raimar DIECKMANN, “Microfinance: An emerging investment opportunity. Uniting social investment and financial returns”, Deutsche Bank Research, Frankfurt am Main, 2007, p. 3

¹¹⁵ Brigit HELMS, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006, pp. 5, 36

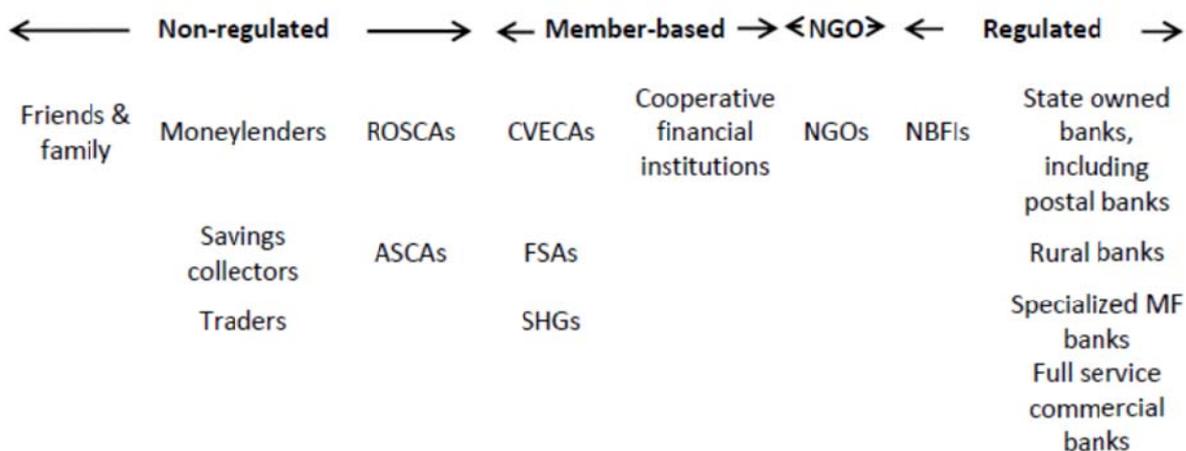
¹¹⁶ Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, pp. 12, 97 sq. and Brigit HELMS, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006, pp. 35 sq

¹¹⁷ Brigit HELMS, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006, pp. 6 sq.

¹¹⁸ Such is the case of COPEME in Peru, which reunites the most prominent NGOs with microfinance programs and also provides the framework for their self-regulation.

¹¹⁹ Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, pp.12, 97

Figure 2: The spectrum of Financial Services Providers¹²⁰



Note: ROSCA = rotating savings and credit association; ASCA = accumulating credit and savings association; CVECA = caisse villageoise d'épargne et de crédit autogérée ; FSA = financial service association; SHG = self-help group; NBFi = nonbank financial institution.

According to the level of financial sustainability, two main categories of institutions can be discerned: institutions which are able to cover costs through the income obtained from interest and fees, and institutions which are unable to cover their costs.¹²¹ The majority of microfinance programmes belong to the latter category, meaning they are unable to cover their costs and depend on grants and subsidies from donors or governments.¹²² This categorization is also reflected in the types of services offered by these institutions and their target group: whereas commercial microloans bearing cost-covering interest rates are offered to “many lower-middle-income households and for most of the economically active poor, including some below the official poverty line”¹²³, poverty-alleviation programmes, which are funded by subsidies and grants, are offered to “those below the poverty line and [...] the extremely poor”¹²⁴. The first approach is also called

¹²⁰ From Brigit HELMS, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006, p. 36. Adapted by the author.

¹²¹ Marguerite Robinson presents three types of microfinance institutions, according to their level of sustainability, the first two being financially non-sustainable: “Institutions in which revenues from interest and fees do not cover operating costs. Institutions in which revenues cover operating costs but do not cover the commercial costs of loanable funds. Fully self-sufficient institutions that cover all costs and risks and generate a profit.” Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, pp. 56 sq.

¹²² *Id.*, p. 56

¹²³ *Id.*, p. 21

¹²⁴ *Ibidem*

“minimalist”¹²⁵, while the latter is called “integrated”¹²⁶. The microfinance institutions which follow the latter approach are offering their clients microfinance services as well as social services¹²⁷, such as education and training¹²⁸. Due to the fact that the delivery of social services is not financially sustainable and requires on-going subsidies, microfinance institutions choosing the integrated approach fall in the category of financially non-sustainable institutions¹²⁹. Research¹³⁰ showed that NGOs were the most active in providing integrated services. Other institutions who are providing integrated services are Grameen Bank, which provides its member with health and nutrition training and consciousness raising workshops¹³¹; FINCA Costa Rica, Freedom from Hunger Foundation (FFH) and CARE which offer education services and training in agriculture and nutrition related subjects¹³² and the state-owned Bank Rakyat Indonesia which operates the Unit Desa network of village banks¹³³. Due to the fact that the provision of integrated services is not financially sustainable and the institutions are constantly dependent on donor funding¹³⁴, this model is strongly criticised¹³⁵.

¹²⁵ Nitin BHATT, Shui-Yan TANG, “Delivering Microfinance in Developing Countries. Controversies and Policy Perspectives”, *Policy Studies Journal*, Vol. 29, No. 2, 2001, p. 323

¹²⁶ Shari BERENBACH, Diego GUZMAN, “The Solidarity Group Experience Worldwide”, in Maria OTERO, Elisabeth RHYNE (eds.), *The New World of Microenterprise Finance. Building Healthy Financial Institutions for the Poor*, Kumarian Press, Connecticut, 1994, p. 137. See also Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, p.65, for a parallel between the minimalist approach and the integrated approach.

¹²⁷ “Social services, or nonfinancial services that focus on improving the well-being of microentrepreneurs. They include health, nutrition, education, and literacy training. Social services are likely to require ongoing subsidies, which are often provided by the state or through donors supporting NGOs.” Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, p.65

¹²⁸ A similar concept is that of *microfinance plus* which advocates accompanying the financial services offered by microfinance institutions with non-financial services such as business training, health and literacy training. See Robert LENSINK, Roy MERSLAND, “Microfinance plus”, Working paper, 2009 and Nitin BHATT, Shui-Yan TANG, “Delivering Microfinance in Developing Countries. Controversies and Policy Perspectives”, *Policy Studies Journal*, Vol. 29, No. 2, 2001

¹²⁹ Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, p. 82

¹³⁰ Robert LENSINK, Roy MERSLAND, “Microfinance plus”, Working paper, 2009 and Julia PAXTON, “A Worldwide Inventory of Microfinance Institutions”, World Bank, Sustainable Banking with the Poor Project, Washington, D.C., 1996

¹³¹ Shahidur R. KHANDKER, “Grameen Bank. Impact, Costs, and Program Sustainability”, *Asian Development Review*, vol. 14, no. 1, 1996, p. 66

¹³² Sharon L. HOLT, “The village banking methodology. Performance and prospects” in Maria OTERO, Elisabeth RHYNE (eds.), *The New World of Microenterprise Finance. Building Healthy Financial Institutions for the Poor*, Kumarian Press, Connecticut, 1994, p. 160

¹³³ Jacob YARON, Benjamin MCDONALD *et al.*, *Rural Finance. Issues, Design, and Best Practices, Environmentally and Socially Sustainable Development Studies and Monographs Series 14*, Washington, D.C., World Bank, 1997

¹³⁴ “It also became obvious that the ‘integrated’ method of developing microenterprises, which combined traditional methods of making loans with intensive entrepreneur training and technical assistance, had limited impact on the beneficiaries, was costly, and could be sustained or expanded only through grant funding.” From

Based on this reasons, the advocates of financial sustainability suggested that in order to become financially sustainable, institutions should “concentrate only on financial services”¹³⁶.

2.2. The two paradigms of microfinance

The underlying condition delimiting minimalist from integrated microfinance institutions presented above is their degree of financial sustainability, as “nonfinancial services are rarely financially sustainable”¹³⁷. Therefore, the debate¹³⁸ between the minimalist and the integrated approach is nothing but one aspect of the industry-wide debate between *welfarists* and *institutionalists*, as “each position differs in their views on how microfinance services should be delivered (NGO versus commercial banks), on the technology that should be used (financial services or ‘minimalist’ approach versus an ‘integrated’ service approach), and on how their performance should be assessed”¹³⁹.

Albert Kimanthi MUTUA, “The Juhudi Credit Scheme. From a Traditional Integrated Method to a Financial Systems Approach”, in Maria OTERO, Elisabeth RHYNE (eds.), *The New World of Microenterprise Finance. Building Healthy Financial Institutions for the Poor*, Kumarian Press, Connecticut, 1994, p. 268

¹³⁵ “While there are a few exceptions (the Bangladesh Rural Advancement Committee, or BRAC, is a notable example), institutions providing both social services and microfinance have typically shown themselves to be inept at financial management. Lacking a focus on financial viability, they have often been unwilling or unable to manage loan delinquency, and generally have not achieved financial self-sufficiency.” Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, p. 73

¹³⁶ Maria OTERO, Elisabeth RHYNE (eds.), *The New World of Microenterprise Finance. Building Healthy Financial Institutions for the Poor*, Kumarian Press, Connecticut, 1994, p. 99

¹³⁷ Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, p. 66

¹³⁸ Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, p. 65; Nitin BHATT, Shui-Yan TANG, “Delivering Microfinance in Developing Countries. Controversies and Policy Perspectives”, *Policy Studies Journal*, Vol. 29, No. 2, 2001, p. 323; Francisco OLIVARES-POLANCO, “Commercializing microfinance and deepening outreach? Empirical evidence from Latin America”, *Journal of Microfinance*, issue 7, 2005, p.3; Shari BERENBACH, Diego GUZMAN, “The Solidarity Group Experience Worldwide”, in Maria OTERO, Elisabeth RHYNE (eds.), *The New World of Microenterprise Finance. Building Healthy Financial Institutions for the Poor*, Kumarian Press, Connecticut, 1994, p. 138

¹³⁹ According to Francisco OLIVARES-POLANCO, “Commercializing microfinance and deepening outreach? Empirical evidence from Latin America”, *Journal of Microfinance*, issue 7, 2005, p. 3

The poverty alleviation approach

Welfarists view microfinance as a “means to alleviate directly the worst effects of deep poverty”¹⁴⁰, and are consequently committed to serve the “very poor”¹⁴¹. The emphasis is placed on depth of outreach (meaning how deep on the poverty scale the microfinance institution penetrates), and operations are usually accompanied by subsidies.¹⁴² The poverty alleviation approach advocates a holistic approach to poverty, by offering training programmes in health, education and family planning, combined with cheap credit which is typically donor-funded.¹⁴³ Another important feature of the poverty alleviation approach is how the performance of an institution is measured. According to the welfarists, an intervention should be evaluated according to whether or not it is successful in reaching its poverty alleviation objectives.¹⁴⁴

The financial systems approach

As stated above, the financial systems approach to microfinance emerged in the beginning of the 1990s, driven by the industry-wide push for financial sustainability¹⁴⁵. For the supporters of this approach, the access to financial services is more important than the direct *impact* of individual loans¹⁴⁶. The only way to provide access to a growing number of beneficiaries is by increased “breadth of outreach”¹⁴⁷ of microfinance institutions. Thus, from the financial systems perspective, microfinance institutions have two goals: *outreach*, serving a growing part of the population which was traditionally underserved by financial institutions and *financial sustainability*, being able to generate enough income to cover the costs incurred¹⁴⁸. Institutions following the financial systems

¹⁴⁰ Gary M. WOLLER, Christopher DUNFORD *et al.* "Where to microfinance?", *International Journal of Economic Development*, Vol. 1, No. 1, 1999, p. 32

¹⁴¹ *Id.*, p. 37

¹⁴² *Id.*, pp. 2, 31

¹⁴³ Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, pp. 22, 56 sq.

¹⁴⁴ Francisco OLIVARES-POLANCO, "Commercializing microfinance and deepening outreach? Empirical evidence from Latin America", *Journal of Microfinance*, issue 7, 2005, pp. 47 sq.

¹⁴⁵ Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, p.2

¹⁴⁶ Maria OTERO, Elisabeth RHYNE (eds.), *The New World of Microenterprise Finance. Building Healthy Financial Institutions for the Poor*, Kumarian Press, Connecticut, 1994, pp. 12, 106

¹⁴⁷ Gary M. WOLLER, Christopher DUNFORD *et al.*, "Where to microfinance?", *International Journal of Economic Development*, Vol. 1, No. 1, 1999, p. 31

¹⁴⁸ Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, p. 34

approach are mitigating the for-profit objective with the social objective through the so-called “double bottom-line approach”¹⁴⁹. According to Rhyne, the paramount objective of microfinance is outreach, sustainability playing the role of facilitator: “there is in fact only one objective—outreach. [Institutional] sustainability is but the means to achieve it”¹⁵⁰.

2.3. The debate between *welfarists* and *institutionalists*

The debate¹⁵¹ between welfarists and institutionalists, which Jonathan Morduch refers to as the “microfinance schism”¹⁵² originated in the 1990s, sparked by the trend towards commercialization, defined as “the movement of microfinance out of the heavily donor-dependent arena of subsidized operations into one in which microfinance institutions ‘manage on a business basis’ as part of the regulated financial system”¹⁵³. The principles of commercialization, i.e. financial performance and sustainability, were embraced by a large array of microfinance institutions, be it NGOs that transformed into regulated financial institutions, for-profit entities, traditional financial institutions or other specialised entities offering microfinance services.¹⁵⁴ Although on opposing positions, the advocates of the two approaches share the same concern: “that the alternative approach threatens

¹⁴⁹ Robert CHRISTEN, Richard ROSENBERG, *CGAP Occasional Paper no. 8: Financial Institutions with a Double Bottom Line: Implications for the Future of Microfinance*, Washington, 2004, p. 2

¹⁵⁰ Elisabeth RHYNE, “The Yin and Yang of Microfinance: Reaching the Poor and Sustainability”, 1998, *MicroBanking Bulletin* 2, p. 7

¹⁵¹ See Elisabeth RHYNE, “The Yin and Yang of Microfinance: Reaching the Poor and Sustainability”, 1998, *MicroBanking Bulletin* 2; Niels HERMES, Robert LENSINK *et al.*, “Outreach and Efficiency of Microfinance Institutions”, Centre for International Banking, Insurance and Finance, University of Groningen, Holland, 2008; Jonathan MORDUCH, “The Microfinance Schism”, *World Development* Vol. 28, No. 4, pp. 617-629, 2000; Francisco OLIVARES-POLANCO, “Commercializing microfinance and deepening outreach? Empirical evidence from Latin America”, *Journal of Microfinance*, issue 7, 2005; Jay K. ROSENGARD, “Banking on Social Entrepreneurship. The Commercialization of Microfinance”, *Mondes en Développement*, Vol. 32-2004/2, n°126, 2004; Mark SCHREINER, “Aspects of Outreach. A Framework for the Discussion of the Social Benefits of Microfinance”, *Journal of International Development*, Volume 14, Issue 5, 2002

¹⁵² Jonathan MORDUCH, “The Microfinance Schism”, *World Development* Vol. 28, No. 4, pp. 617-629, 2000

¹⁵³ Deborah DRAKE, Elisabeth RHYNE, *The commercialization of microfinance. Balancing business and development*, Kumarian Press, Connecticut, 2002, p. 4

¹⁵⁴ *Ibidem*

the fulfilment of the movement’s broadly shared goal—poverty reduction”¹⁵⁵. The two approaches differ in a number of aspects, as the following table shows:

Table 2: The “microfinance schism”¹⁵⁶

	The poverty lending approach	The financial systems approach
Development philosophy	<ul style="list-style-type: none"> • Welfarist • Government influenced 	<ul style="list-style-type: none"> • Institutionalist • Market led
Underlying paradigm	<ul style="list-style-type: none"> • Interventionist – geared towards poverty alleviation and community development 	<ul style="list-style-type: none"> • Neo-liberal – geared towards market growth
Definition of sustainability and indicator of institutional performance	<ul style="list-style-type: none"> • Improved social welfare and establishment of local-level participatory institutions • Depth of outreach (profundity of penetration down the poverty scale); 	<ul style="list-style-type: none"> • Financial self-sufficiency (cost recovery and profit) • Breadth of outreach (highest number of clients reached)
Approach towards the target group	<ul style="list-style-type: none"> • Targets the extreme poor • Integrated approach – provides credit, social intermediation†, enterprise development services and social services • Solidarity group lending 	<ul style="list-style-type: none"> • Targets the economically active poor • Minimalist approach – provides only credit • Individual lending
Institutional model	<ul style="list-style-type: none"> • NGO • Rural operations • Limited scale of outreach • Donor and government funded operations 	<ul style="list-style-type: none"> • Commercial bank • Urban operations • Large scale outreach • Limited use of subsidies • Savings mobilisation¹⁵⁷ and

¹⁵⁵ Gary M. WOLLER, Christopher DUNFORD *et al.*, "Where to microfinance?", *International Journal of Economic Development*, Vol. 1, No. 1, 1999, p. 35

¹⁵⁶ From Gary M. WOLLER, Christopher DUNFORD *et al.*, "Where to microfinance?", *International Journal of Economic Development*, Vol. 1, No. 1, 1999; Jonathan LASHLEY, "Microfinance in the Eastern Caribbean: Demand and Delivery Options", Paper presented at the St Vincent and the Grenadines Country Conference, May 22-24, 2003; Linda MAYOUX, "Micro-finance and the empowerment of women: a review of the key issues", Social Finance Working Paper No. 23, ILO, Geneva, 2000; Francisco OLIVARES-POLANCO, "Commercializing microfinance and deepening outreach? Empirical evidence from Latin America", *Journal of Microfinance*, issue 7, 2005; Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999; Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001; Robert CULL, Asli DEMIRGÜÇ-KUNT *et al.*, "Microfinance Meets the Market", Policy Research Working Paper 4630, The World Bank, Washington, 2008. Compiled by the author

	<ul style="list-style-type: none"> • Limited savings mobilization • Low interest on loans 	<ul style="list-style-type: none"> • high leverage • Higher interest on loans • Access to finance is more important than its price
--	---	---

†According to Bennet¹⁵⁸, *social intermediation* is defined as “the process of creating social capital as a support to sustainable financial intermediation with poor and disadvantaged groups or individuals”. Other authors define it as “a process in which investments are made in the development of both human resources and institutional capital, with the aim of increasing the self-reliance of marginalized groups, preparing them to engage in formal financial intermediation”¹⁵⁹, or more concise as “financial intermediation with a capacity-building component, aimed at those sectors of society that lack access to credit and savings facilities”¹⁶⁰.

The arguments of the institutionalists

According to Ledgerwood, the financial systems approach is based on five beliefs. First, subsidised credit undermines development. Past experiences have shown that subsidised credit programmes suffer from several problems: diversion of the funds towards the wealthier or the powerful, low rates of repayment and continuous dependence on external financial help¹⁶¹. Second, institutions can cover their costs through interest rates charged, as the poor can pay the high interest rates¹⁶² needed to achieve self-sustainability. Third, financial self-sustainability ensures not only the

¹⁵⁷ The dichotomy of the two approaches can be clearly illustrated by the different roles and functions of savings. Whereas in the poverty lending approach savings fulfils the roles of reducing the vulnerability of the target group and increasing the level of financial literacy, in the financial systems approach savings is seen as a source of cheap funds and acts mainly as a financial lever.

¹⁵⁸ Lynn BENNETT, “A Systems Approach to Social and Financial Intermediation with the Poor”, Paper presented at the Banking with the Poor Network/World Bank Asia Regional Conference on Sustainable Banking with the Poor, Bangkok, November 3–7, 1997 in Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, p. 63

¹⁵⁹ Elaine EDGCOMB, Laura BARTON, “Social Intermediation and Microfinance Programs. A Literature Review”, SEEP Network, 1998, p. vii

¹⁶⁰ *Ibidem*

¹⁶¹ Brigit HELMS, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006, p.77; Maria OTERO, Elisabeth RHYNE (eds.), *The New World of Microenterprise Finance. Building Healthy Financial Institutions for the Poor*, Kumarian Press, Connecticut, 1994, p. 29

¹⁶² “Some people treat this question as if it comes down to a value judgment: which do you care more about - poor people or profits (...or financial systems...or neoliberal ideology). To avoid any such confusion, let’s assume that the only objective we care about is maximizing benefit to poor people. From this perspective, the argument for high interest rates is straightforward. In most countries, donor funding is a limited quantity that will never be capable of reaching more than a tiny fraction of those poor households who could benefit from quality financial services.” Richard ROSENBERG, “Microcredit Interest Rates”, CGAP Occasional Paper no. 1, 1996, p. 11

permanence of the institution, but also makes the institution more efficient and focused. Fourth, large scale is needed in order to reach sustainability, due to the fact that the average loan size is very small. And last, because the impact of microloans on alleviating poverty or on the growth of the microenterprise is extremely difficult to demonstrate, outreach and repayment rates are used as proxies for impact.¹⁶³

The arguments of the welfarists

On the other hand, the welfarists fear that the increasing commercialization of microfinance will lead to a number of worrying evolutions. First, the need to satisfy investors' demands will make that increasing focus will be placed on profits, and this will ultimately end by displacing the social mission of microfinance. Second, it is feared that the search for profitability will turn away the industry from the "spiritual foundation"¹⁶⁴ on which it was built¹⁶⁵. Third, given that donors will allocate funds only to financially successful programmes, smaller or less efficient programmes which can have greater impact will be condemned to disappearance. Last, commercially successful institutions who have reached both sustainability and scale dictate how the business should be managed and establish *best practices*, and this can lead to a standardized approach imposed to all institutions, in the detriment of innovation and experimentation.¹⁶⁶

¹⁶³ Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, pp. 2-3

¹⁶⁴ Gary M. WOLLER, Christopher DUNFORD *et al.*, "Where to microfinance?", *International Journal of Economic Development*, Vol. 1, No. 1, 1999, p. 38

¹⁶⁵ "Spiritual principles linked to sound financial principles must be a central tenant of the microfinance movement so that this noble effort to eradicate poverty does not become simply business as usual, with money at the bottom line. Again, the issue is not only whether we reach the numerical goal, but how that will determine the outcomes." Barbara J. RODEY, "The Spiritual Dimensions of Microfinance. Towards a Just Civilization and Sustainable Economy", European Baha'i Business Forum, Paris, 1997, p.12

¹⁶⁶ Gary M. WOLLER, Christopher DUNFORD *et al.*, "Where to microfinance?", *International Journal of Economic Development*, Vol. 1, No. 1, 1999, p. 38

CHAPTER III: MICROFINANCE AT A CROSSROADS

3.1. The critical triangle of microfinance

The “microfinance revolution”¹⁶⁷ brought microfinance in the mainstream financial system. This movement was accompanied by growing difficulties to balance out the social goals with the financial aspects of a growing business, insofar as the two approaches to microfinance began to move in different directions¹⁶⁸. The challenges posed to microfinance by this schism are summarised in the preface of the 2009 Microfinance Banana Skins report: “in my opinion [...] microfinance is at a crossroads, and [...] it might do the industry a power of good if it was able to call a ‘time-out’ to reassess its role. In the popular press, microfinance is still very much the developmental flavour of the month – and even the most battle-hardened aid veteran has to acknowledge its appeal as an alternative to the conventional ‘top down’ model for wasting taxpayers’ money. But [...] microfinance currently faces serious challenges – challenges that have been exacerbated by the global crisis. Should microfinance institutions shift from their essential social role to a (perhaps) more sustainable profit-seeking model? Can they go on relying (as they have done) on subventions of one sort or another from Western investors? Should they develop into more or less full service financial institutions, and become part of the formal financial sector? These kinds of questions pose real challenges to the microfinance industry, and I very much hope that this [...] survey prompts practitioners, investors, donors and regulators to have a good, long think about where they are going.”¹⁶⁹

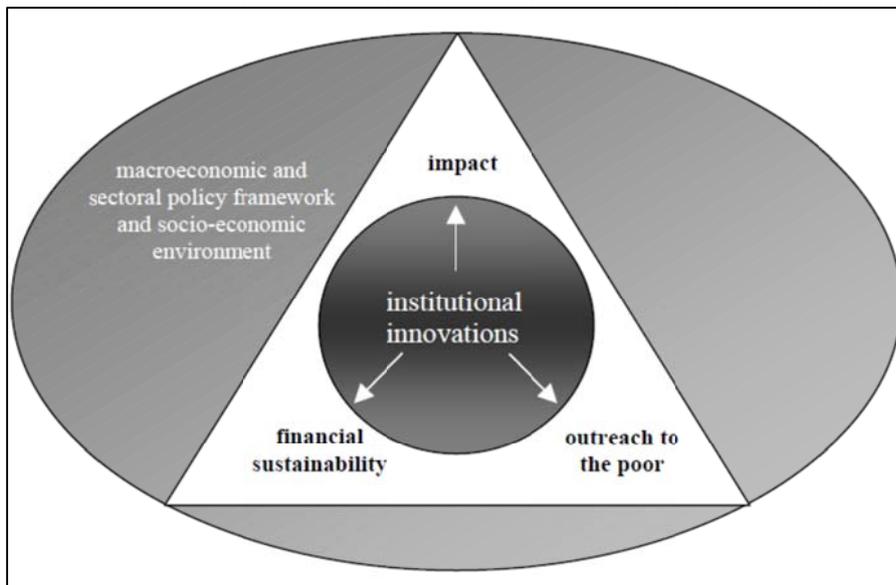
¹⁶⁷ Defined as “the large-scale provision of small loans and deposit services to low-income people by secure, conveniently located, competing commercial financial institutions”, Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, p. xxx

¹⁶⁸ “Overall, the poverty lending approach poses a deep dilemma for governments, microfinance institutions, donors, and others. This is because microfinance has reached a fork in the road. The microfinance revolution, based largely on the financial systems approach, and the poverty lending agenda, based largely on eradicating poverty through credit, have begun to move in different directions”, *Id.*, p. 27

¹⁶⁹ David LASCELLES, Sam MENDELSON, *Microfinance Banana Skins 2009. Confronting crisis and change*, CSFI, New York, 2009, p. 1

The debate between the *welfarists* and the *institutionalists* presented in the previous chapter is but one aspect of the dilemmas faced by microfinance. A conceptual framework reflecting the three objectives of microfinance, i.e. *outreach to the poor*, *financial sustainability* and *impact* is offered by the critical triangle of microfinance proposed by Zeller and Meyer¹⁷⁰.

Figure 3: The critical triangle of microfinance¹⁷¹



Most microfinance institutions attempt to fulfil the three objectives, but due to the trade-off between them, one has precedence over the others¹⁷². For example, a microfinance institution can increase the impact of its loans by offering complementary services to the borrowers, such as business training, financial education or literacy, but the supply of such services will increase the operation costs which will have a negative effect on the financial sustainability of the institution¹⁷³. The triangle presented below comprises an inner and an outer circle. The inner circle represents the innovations that the institution can do in order to improve the fulfilment of each of the three objectives. These innovations can take the form of improved information systems which reduce costs and improve the *financial sustainability*, of targeted and low-cost complimentary services

¹⁷⁰ Manfred ZELLER, Richard L. MEYER, *The Triangle of Microfinance: Financial Sustainability, Outreach, and Impact*, Johns Hopkins University Press, Washington, 2002, pp. 5 sq.

¹⁷¹ Manfred ZELLER, Richard L. MEYER, *The Triangle of Microfinance: Financial Sustainability, Outreach, and Impact*, Johns Hopkins University Press, Washington, 2002, p. 6

¹⁷² *Ibidem*

¹⁷³ M. SHARMA, G. BUCHENRIEDER, *Impact of microfinance on food security and poverty alleviation: A review and synthesis of empirical evidence*, in Manfred ZELLER, Richard L. MEYER, *The Triangle of Microfinance: Financial Sustainability, Outreach, and Impact*, Johns Hopkins University Press, Washington, 2002, p. 223

which increase the *impact* or of more effective screening and lending mechanisms that are targeting the right kind of clientele, increasing the institution's *outreach to the poor*.¹⁷⁴ The outer circle represents the external environment comprising the factors that influence the performance of microfinance institutions in a direct or indirect fashion.¹⁷⁵

The constant positioning and repositioning of microfinance institutions within this framework can be illustrated by looking at some examples from the Peruvian microfinance sector. In order to enter new markets and diversify the products and services offered, ACP which was created as an NGO in 1969 transformed into Mibanco in May 1998. CREAR Arequipa was created as ONG Hábitat Arequipa Siglo XXI in 1992 and in 1998 it transformed into Entidad de Desarrollo para la Pequeña y Micro Empresa (EDPYME). Ten years later the institution transformed into financial company (Financiera), together with the entry of new shareholders and the authorisation to collect deposits from the public. Edyficar was incorporated as EDPYME in 1997 by the NGO CARE. In March 2008 the national banking supervision SBS approved the transformation into Financiera together with the increase of number of services offered to the public from 10 to 40, including the possibility of collecting savings from the general public. In 2009 Edyficar was bought by Banco de Crédito del Perú (BCP) becoming a part of the biggest banking conglomerate in the country, and thus allowing BCP to go downmarket and reach the traditionally poorer clientele of Edyficar.

3.2. The mission drift in microfinance

As seen in the previous chapter, the tendency of microfinance in the last two decades was towards increasing levels of financial sustainability, advocated by the supporters of the financial systems approach. Profitability became the “key objective”¹⁷⁶ of microfinance, a trend circumscribed by the industry-wide movement towards increased commercialization¹⁷⁷. The commercialization brought

¹⁷⁴ Aliya KHAWARI, "Microfinance. Does it hold its Promises? A survey of recent literature", HWWA Discussion Paper No.276, Hamburg, 2004, p. 9

¹⁷⁵ *Ibidem*

¹⁷⁶ Brigit HELMS, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006, p. 47

¹⁷⁷ According to Christen, the movement towards the commercialization of microfinance is characterised by three trends: aiming for profitability, higher levels of competition and increased regulation. Robert Peck

several benefits, most notably better services for the clients, possibility for smaller institutions to mobilize savings and wider outreach of microfinance institutions¹⁷⁸. But commercialization also brought several threats, and among those, mission drift¹⁷⁹ is perceived as the most prominent “peril”¹⁸⁰ to microfinance. Mission drift is intimately linked to the process of commercialization¹⁸¹, and designates the tilting of the institutional balance towards maximising financial returns while sacrificing the mission of helping the poor.¹⁸² Drifting microfinance institutions are crowding out the poorer layers of the target group and start serving wealthier and better-off clients¹⁸³. This is done because of two reasons: on one hand reaching the poorest clients is very cost-intensive and on the other hand bigger loans are more profitable¹⁸⁴. The characteristics of the target group make microfinance a cost-intensive activity¹⁸⁵. Usually microfinance clients live either in sparsely populated areas, or in areas with poor transport infrastructure, thus the transport costs needed to reach the clients are high. Providing services to illiterate people requires special procedures which are time-intensive, thus increasing further the operational costs. Moreover, institutions in countries with female seclusion must take special measures in order to reach this specific target group.¹⁸⁶ As the number of microloans a microfinance institution has to monitor is very high, the personnel,

CHRISTEN, “Commercialization and Mission Drift. The Transformation of Microfinance in Latin America”, CGAP Occasional Paper No. 5, 2001, p. 2

¹⁷⁸ Gary WOLLER, “The Promise and Peril of Microfinance Commercialization”, *Small Enterprise Development* vol. 13, no. 4, 2002, pp. 12-21

¹⁷⁹ “We’ve seen a major mission drift in microfinance, from being a social agency first,’ says Arnab Mukherji, a researcher at the Indian Institute of Management in Bangalore, to being ‘primarily a lending agency that wants to maximize its profit.’”, *The Wall Street Journal*, 13 August 2009, “A Global Surge in Tiny Loans Spurs Credit Bubble in a Slum”, article by Gokhale KETAKI

¹⁸⁰ Gary WOLLER, “The Promise and Peril of Microfinance Commercialization”, *Small Enterprise Development* vol. 13, no. 4, 2002, pp. 12-21

¹⁸¹ The Webster dictionary gives as a third definition for commercialization: “to debase in quality for more profit”. Merriam-Webster’s Collegiate Dictionary, 11th Edition, online version

¹⁸² Deborah DRAKE, Elisabeth RHYNE, *The commercialization of microfinance. Balancing business and development*, Kumarian Press, Connecticut, 2002, pp. 3 - 4

¹⁸³ Gary WOLLER, Warner WOODWORTH, “Microcredit as a Grass-Roots Policy for International Development”, *Policy Studies Journal*, Volume 29, Issue 2, 2001, p. 274

¹⁸⁴ While this is absolutely true in the case of the traditional banking sector, it has to be mentioned that there are several microfinance institutions (Compartamos, SKS) who register a very low average loan amount per borrower, while enjoying a very high profitability, mainly due to very strict contract enforcement and loan collection measures.

¹⁸⁵ Francisco OLIVARES-POLANCO, “Commercializing microfinance and deepening outreach? Empirical evidence from Latin America”, *Journal of Microfinance*, issue 7, 2005, p. 59

¹⁸⁶ Robert Peck CHRISTEN, Elisabeth RHYNE *et al.*, “Maximizing the Outreach of Microenterprise Finance. An Analysis of Successful Microfinance Programs”, USAID Program and Operations Assessment Report No. 10, USAID, 1995, p. 14

transportation, communication and office network costs are consequently high¹⁸⁷. As “greater loan size usually means more profitability”¹⁸⁸, by disbursing higher loan amounts, microfinance institutions are reducing the operational costs per currency unit lent, thus increasing the profitability of their business. Institutions that follow this path are characterised by a “shift in the composition of new clients, or a reorientation from poorer to wealthier clients among existing clients”¹⁸⁹. Thus, the wealthier individuals are favoured, while the poorer clients are “crowded out”¹⁹⁰, which translates into a deterioration of the institution’s *depth of outreach*¹⁹¹.

Mission drift is perceived as bringing along several dangers. First, it is believed that having profit as a main objective will act as a disincentive for providing complementary services to the target group, as these services can never be provided on a cost-covering basis¹⁹². In other words, microfinance institutions will cease to provide *social services*¹⁹³ to their target group. Second, institutions will focus on the easy-to-reach clientele from the urban agglomerations and economical centres, rather than on the rural clients from remote or difficult to reach areas.¹⁹⁴ Usually rural clients have smaller businesses, are less homogenous and less able to demonstrate their creditworthiness, thus perceived riskier in comparison to urban, better off clients¹⁹⁵. Third, given that “in general, the solidarity group and village banking programs have smaller average loan sizes than individual loan programs”¹⁹⁶ it is feared that microfinance institutions will move out of the traditional group lending area towards the more profitable individual lending area¹⁹⁷. As the target group which is generally

¹⁸⁷ Jonathan CONNING, “Outreach, sustainability and leverage in monitored and peer-monitored lending”, *Journal of Development Economics*, Vol. 60, 1999, pp. 68, 75

¹⁸⁸ Mark SCHREINER, “Seven Aspects of Loan Size”, *Journal of Microfinance*, Vol. 3, No. 2, 2001, p. 42

¹⁸⁹ Robert CULL, Asli DEMIRGÜÇ-KUNT *et al.*, “Financial Performance and Outreach: A Global Analysis of Leading Microbanks”, Policy Research Working Paper 3827, World Bank, Washington, 2006, p. 23

¹⁹⁰ B. ARMENDÁRIZ, A. SZAFARZ, “On mission drift in microfinance institutions”, Solvay Brussels School of Economics and Management, Centre Emile Bernheim, CEB Working Paper N° 09/015, Brussels, 2009, p. 2

¹⁹¹ Roy MERSLAND, Øystein R. STRØM, “Microfinance mission drift?”, Paper presented at the European Financial Management Symposium 2009, p. 3

¹⁹² Nitin BHATT, Shui-Yan TANG, “Delivering Microfinance in Developing Countries. Controversies and Policy Perspectives”, *Policy Studies Journal*, Vol. 29, No. 2, 2001, p. 322

¹⁹³ For a definition of social services, see footnote 127 above

¹⁹⁴ R. CHAO-BÉROFF, “Developing Financial Services in Disadvantaged Regions. Self-managed Village Savings and Loan Associations in the Dogon Region of Mali”, in Schneider H. (Ed.), *Microfinance for the poor?*, IFAD/OECD, 1997, p. 105

¹⁹⁵ Mark SCHREINER, “Aspects of Outreach. A Framework for Discussion of the Social Benefits of Microfinance”, Center for Social Development, George Warren Brown School of Social Work, St. Louis, 1999, p. 8

¹⁹⁶ Robert Peck CHRISTEN, Elisabeth RHYNE *et al.*, “Maximizing the Outreach of Microenterprise Finance. An Analysis of Successful Microfinance Programs”, USAID Program and Operations Assessment Report No. 10, USAID, 1995, p. 25

¹⁹⁷ Heather MONTGOMERY, John WEISS, “Great Expectations. Microfinance and Poverty Reduction in Asia and Latin America”, ADB Institute, Research Paper Series, No. 63, 2005, p. 4

associated to group lending is composed of women and rural population, mission drift will increase the level of financial exclusion of the aforementioned populations.¹⁹⁸ A good marker of mission drift is the average loan amount, due to the fact that it can indicate the *depth of outreach* of a microfinance institution, as “smaller amounts [...] usually mean greater depth”¹⁹⁹. Several authors²⁰⁰ propose the usage of average loan size as a proxy for the depth of outreach, as it is believed that it shows the capacity of a microfinance institution to target the poorer layers of the clientele. The argument is that smaller loan amounts indicate poorer clients and also act as deterrents for non-poor clients who usually need higher loans.²⁰¹ Nevertheless, the reliability of this tool is disputed, as it is believed that smaller loan amounts do not necessarily imply that the clientele served is poor. According to Hatch and Frederick²⁰², if there are no alternatives for financing, non-poor clients will take the smaller loans offered by a microfinance institution. Also, given that the majority of institutions offer the same amount to *all* new clients, the average loan amount cannot be used as a tool to differentiate the different levels of poverty.²⁰³

3.3. Studies on mission drift

There are a number of studies on mission drift²⁰⁴, which have mixed results. Cull, Demirgüç-Kunt *et al.*²⁰⁵ studied the data of 124 microfinance institutions in 49 countries, and although they did not

¹⁹⁸ Roy MERSLAND, Øystein R. STRØM, “Microfinance mission drift?”, Paper presented at the European Financial Management Symposium, 2009, p. 20

¹⁹⁹ Mark SCHREINER, “Aspects of Outreach. A Framework for Discussion of the Social Benefits of Microfinance”, Center for Social Development, George Warren Brown School of Social Work, St. Louis, 1999, p. 8

²⁰⁰ Robert CULL, Asli DEMIRGÜÇ-KUNT *et al.*, “Financial Performance and Outreach: A Global Analysis of Leading Microbanks”, Policy Research Working Paper 3827, World Bank, Washington, 2006; Roy MERSLAND, Øystein R. STRØM, “Microfinance mission drift?”, Paper presented at the European Financial Management Symposium, 2009

²⁰¹ John K. HATCH, Laura FREDERICK, “Poverty Assessment by Microfinance Institutions. A Review of Current Practice”, Microfinance Best Practices/USAID, 1998, p. 11

²⁰² *Ibidem*

²⁰³ *Id.*, pp. 11-12

²⁰⁴ Mark SCHREINER, “Seven Aspects of Loan Size”, *Journal of Microfinance*, Vol. 3, No. 2, 2001, pp. 27-47; Mark SCHREINER, “Aspects of Outreach. A Framework for the Discussion of the Social Benefits of Microfinance”, *Journal of International Development*, Vol. 14, Issue 5, 2002, pp. 591–603; Robert CULL, Asli DEMIRGÜÇ-KUNT *et al.*, “Financial Performance and Outreach: A Global Analysis of Leading Microbanks”, Policy Research Working Paper 3827, World Bank, Washington, 2006; Robert CULL, Asli DEMIRGÜÇ-KUNT *et al.*, “Microfinance Meets the Market”, Policy Research Working Paper 4630, The World Bank, Washington, 2008; Robert LENSINK, Roy MERSLAND, “Microfinance plus”, Working paper, 2009; B. ARMENDÁRIZ, A.

find clear evidence of mission drift, the results of the study suggests that “as institutions mature and grow, they might focus increasingly on clients that can absorb larger loans”²⁰⁶. Olivares-Polanco²⁰⁷ analysed the information of 28 Latin American microfinance institutions in order to empirically test if commercialization leads to mission drift. He found that competition plays an important role as a trigger of mission drift: higher competition reflects in higher loan amounts, which suggests that microfinance institutions operating in a highly competitive environment are targeting the bigger and more profitable clients.²⁰⁸ He also found evidence which confirms the existence of the trade-off between profitability and depth of outreach.²⁰⁹ The study of Hermes, Lensink *et al.*²¹⁰ examined the trade-off between outreach and efficiency in a context of increased competition and commercialization. The authors found that microfinance institutions with a deeper outreach (with lower loan amounts or with female borrowers) are less efficient. Although “commercialization may induce a stronger emphasis on efficiency”²¹¹, the authors do not see this as worrying, as more efficient institutions may cause a higher poverty reduction at macro level and given the variety of investors’ interests, “commercialization does not necessarily mean more focus on efficiency”²¹².

In an analysis²¹³ of the 1999-2000 Bolivian microfinance crisis, Elisabeth Rhyne examines the effects of increased commercialization on the Bolivian microfinance sector. While the author notes that the average loan balance of BancoSol more than doubled from 1995 to 2000²¹⁴, she does not find clear evidence of mission drift. Rhyne also points to the positive effects of commercialization: better

SZAFARZ, “On mission drift in microfinance institutions”, Solvay Brussels School of Economics and Management, Centre Emile Bernheim, CEB Working Paper N° 09/015, Brussels, 2009; MERSLAND Roy, STRØM Øystein R., “Microfinance mission drift?”, Paper presented at the European Financial Management Symposium 2009; RHYNE Elisabeth, “Commercialization and Crisis in Bolivian Microfinance”, Microfinance Best Practices/USAID, 2001

²⁰⁵ Robert CULL, Asli DEMIRGÜÇ-KUNT *et al.*, “Financial Performance and Outreach: A Global Analysis of Leading Microbanks”, Policy Research Working Paper 3827, World Bank, Washington, 2006

²⁰⁶ *Id.*, p. 29

²⁰⁷ Francisco OLIVARES-POLANCO, “Commercializing microfinance and deepening outreach? Empirical evidence from Latin America”, *Journal of Microfinance*, issue 7, 2005, pp. 47-69

²⁰⁸ *Id.*, p. 68

²⁰⁹ *Ibidem*

²¹⁰ Niels HERMES, Robert LENSINK *et al.*, “Outreach and Efficiency of Microfinance Institutions”, Centre for International Banking, Insurance and Finance, University of Groningen, Holland, 2008

²¹¹ *Id.*, p. 18

²¹² *Id.*, p. 19

²¹³ Elisabeth RHYNE, “Commercialization and Crisis in Bolivian Microfinance”, Microfinance Best Practices/USAID, 2001

²¹⁴ “In 1992 BancoSol’s average loan balance was US\$250. By 1995 this figure had doubled, and by the end of 2000 it was US\$1.276” *Id.*, p. 20

service quality, improved methodology, introduction of new services and in general a broader and better access of the entire population to microfinance services.²¹⁵

But the author also underlines the negative effects of the commercialization which caused the transformation of a number of NGOs into regulated financial institutions.²¹⁶ This, together with the entry of foreign banks in the field and the rise of consumer credit led to fierce competition, which altered “the balance of power between lender and borrower”²¹⁷. Clients began taking multiple loans, postponed payments or began “bicycling”²¹⁸ loans (using a new loan to repay an old one). This was favoured by the fact that microfinance institutions pressured by increasing competition started to “push beyond prudent limits”²¹⁹ and relaxed their lending methodologies. Unfortunately, these developments appeared in the same time as the country was experiencing the worst crisis after more than a decade and a half of progress. The result was chronic overindebtedness, which lead to social unrest, high rates of delinquency and the closing of two financial institutions.

²¹⁵ Elisabeth RHYNE, “Commercialization and Crisis in Bolivian Microfinance”, Microfinance Best Practices/USAID, 2001, pp. 19, 25

²¹⁶ *Id.*, p. 25

²¹⁷ *Id.*, p. 17

²¹⁸ *Id.*, p. 11

²¹⁹ *Id.*, p. 20

CHAPTER IV: OVERINDEBTEDNESS, A GROWING CONCERN

Overindebtedness is a growing concern in the microfinance industry. The most recent microfinance crisis is unfolding in the south-eastern Indian state of Andhra Pradesh, where the presence of several big microfinance programmes²²⁰ led to increasing household debt levels and multiple borrowing²²¹, which in turn caused a wave of suicides among borrowers²²². But this is only the last in a series of microfinance crises which appeared in various other settings. We will concentrate in the following pages on these.

4.1. Presentation of microfinance crises across the world

The beginning of 2008 was marked by rising levels of stress in all the 12 microfinance institutions in **Morocco**, caused by increasing loan delinquency and multiple lending²²³. The cause of the crisis was unsustainable growth. The Moroccan microcredit sector experienced one of the most spectacular growths ever seen in the microfinance landscape. In the four years period between 2003 and 2007 the combined loan portfolio of all microfinance institutions in the country multiplied 11-fold and client outreach multiplied four times.²²⁴ But in May 2009, the most prominent Moroccan MFI, Zakoura, registered a ratio of loans overdue of more than 30 percent, and the government organised its acquisition by the Fondation des Banques Populaires.²²⁵ In the Moroccan case, the microfinance crisis was triggered by a combination of two factors of equal importance. First, in order to better

²²⁰ The government-backed SHG programme of the Society to Eliminate Rural Poverty and other five of India's biggest MFIs

²²¹ CGAP, "Andhra Pradesh 2010. Global Implications of the Crisis in Indian Microfinance", CGAP Focus Note no. 67, Washington, 2010, p. 3

²²² Amy KAZMI, "Debt trap leads to despair for rural poor", Financial Times, 29 October 2010

²²³ Xavier REILLE, "The Rise, Fall, and Recovery of the Microfinance Sector in Morocco", CGAP Brief, Washington, D.C., 2009, p. 2

²²⁴ *Id.*, p. 1

²²⁵ *Id.*, p. 3

face the competition and continue growing, the biggest institutions shifted their lending methodologies - individual lending instead of group lending or monthly payments instead of weekly ones²²⁶. This allowed them to disburse higher loan amounts and also to reduce the relative weight of loans in default. Second, due to the increase in offer, clients began taking multiple loans causing increased cross indebtedness, and at the peak of the crisis 40 percent of the beneficiaries had two or more loans outstanding.²²⁷ This problem was particularly severe in urban, densely populated areas.

In Eastern Europe, the microfinance sector in **Bosnia and Herzegovina** started showing problems in late 2008, following the financial crisis in Europe. All the major microfinance institutions in the country experienced increasing levels of loan delinquency and write-off ratios.²²⁸ The case of Bosnia and Herzegovina is of particular interest in the Eastern European context, as at the time it was the country where the majority of microfinance related investments were concentrated²²⁹ and the market was experiencing a high level of saturation²³⁰.

In **Pakistan** a microfinance crisis was sparked in late 2008 by the refusal of borrowers from the central part of Punjab province living in semi-urban areas of the provincial capital of Lahore to repay their loans²³¹. Although problems were initially concentrated with one institution, they spread to four other microfinance institutions which experienced growing loan delinquency in the next months²³².

²²⁶ Xavier REILLE, "The Rise, Fall, and Recovery of the Microfinance Sector in Morocco", CGAP Brief, Washington, D.C., 2009., p. 2

²²⁷ *Ibidem*

²²⁸ Greg CHEN, Stephen RASMUSSEN *et al.*, "Growth and Vulnerabilities in Microfinance", CGAP Focus Note No. 61, Washington D.C., 2010

²²⁹ European Fund for Southeast Europe (EFSE) is a microfinance fund initiated by KfW. As of September 2010, EFSE invested more than 130 million EUR in Bosnia and Herzegovina, which represents 23% of its total portfolio. Source: http://www.efse.lu/uploads/embedding_list_upload_4d00786fef8c1/investment_portfolio-g3-2010_final.pdf (retrieved 10 January 2011). Bosnia and Herzegovina together with nine other countries (Bulgaria, Romania, Serbia, Russia, Ukraine, Azerbaijan, Morocco, Ecuador and Peru) accounted for fifty-one percent of development financial institutions' outstanding portfolio for microfinance as of December 2008. Source: Greg CHEN, Stephen RASMUSSEN *et al.*, "Growth and Vulnerabilities in Microfinance", CGAP Focus Note No. 61, Washington D.C., 2010, p. 3

²³⁰ Xavier REILLE, "The dark side of competition. Credit risk and market penetration", CGAP Microfinance Blog, 2010

²³¹ CHEN Greg, RASMUSSEN Stephen *et al.*, "Indian Microfinance Goes Public. The SKS Initial Public Offering", CGAP Focus Note No. 65, Washington D.C., 2010, p. 5

²³² *Ibidem*

In **Nicaragua**, the microfinance crisis affected all the major microfinance institutions in the country. The crisis started unrolling in 2008 in the northern region of the country, where a group of borrowers with strong political connections and endorsed by President Daniel Ortega²³³ called themselves the *no pago* (no pay) movement and decided to stop repaying their microloans. Nicaragua has the biggest number of microfinance institutions in whole Central America, and the microfinance market here is estimated at 450,000 clients and 400 million USD portfolio²³⁴. The market for microfinance was growing at a

Text box 4: BANEX Nicaragua

BANEX NICARAGUA

At the IDB's annual FOROMIC conference in El Salvador in 2007 investment funds were competing to get face time with Nicaraguan MFIs. The market had grown substantially since 2004 and Findesa/Banex had a loan portfolio of US\$125 million, up from US\$33 million at the end of 2004. How much sense did it make to lend to so many small MFIs in one country with 5 million people, 600,000 informal sector workers and 300,000 credit clients? Later that year in Managua, the CFO of Findesa when asked what the institutions' main competitive advantage was, answered "we are very good at raising money from foreign investors." Debt financing was clearly flowing to Nicaragua, with high profile, fast growing institutions like Findesa bringing in the bulk of the money; yet how would these MFIs' loan portfolios grow? Mostly, by trying to compete for each other's clients, ultimately adding to the clients' debt burdens. Implicit in this strategy is a loosening of credit methodology. Banex's delinquent portfolio reached 40 percent in December 2009, compared to 9.0 percent in the formal financial sector. In the period between 2008 to 2009 MFI performance plunged, unregulated MFIs lost 15 percent of the portfolio and on September 2010 Banex was liquidated.

From: <http://financialaccess.org/node/3547> (retrieved 10 December 2010)

very fast pace – Findesa, the country's leading microfinance institution tripled its loan portfolio from 2004 to 2007. The increasing competition and the high levels of growth resulted in overlending, and as of 2009 forty percent of all borrowers were managing two or more loans in parallel.

The four microfinance crises presented above share a set of common features. First of all unnatural growth levels were made possible by the **uninterrupted flow of funds** directed towards microfinance institutions, funds which did not come in any of the cases from depositors. In Morocco the overwhelmingly majority of funds came from commercial banks which were financing 85% of

²³³ <http://www.elnuevodiario.com.ni/nacionales/37308>

²³⁴ Elyssa PACHICO, "No Pago Confronts Microfinance in Nicaragua", North American Congress on Latin America, 2009 <https://nacla.org/node/6180> (retrieved 4 January 2011)

microfinance assets at the end of 2008.²³⁵ In Pakistan the tendency was similar, with “loans from a national apex fund and domestic commercial banks largely [replacing] earlier donor support”²³⁶. In Nicaragua international and regional microfinance funds invested 150 million USD in the top five microfinance institutions as of the end of 2008²³⁷. The situation in Bosnia and Herzegovina was no different, as shown above. The liquidity pressure on the institutions increased competition among them to unhealthy levels and concentrated the offer of microcredits in highly dense areas. This in turn changed the balance of power between the microfinance lenders and their clients who “moved from having no choices of formal credit to having several choices within a few years, rapidly increasing their ability to borrow more”²³⁸, a phenomenon which was also present in Bolivia at the end of the 1990s²³⁹. The final effect on the clients was their inability to comply with the payment obligations due to overindebtedness.²⁴⁰

4.2. Review of literature on overindebtedness

Although “over-indebtedness is currently one of the most serious risks of microfinance, endangering both social impact and industry stability”²⁴¹, the literature regarding this issue is rather limited²⁴². There is no consensus in the literature regarding a definition of overindebtedness, partially because

²³⁵ Greg CHEN, Stephen RASMUSSEN *et al.*, “Growth and Vulnerabilities in Microfinance”, CGAP Focus Note No. 61, Washington D.C., 2010, p. 3

²³⁶ *Ibidem*

²³⁷ Blue Orchard had 46 million USD invested, The Central American Bank for Economic Integration (CABEI) 33 million USD, ProCredit Holding 28 million USD, Financiera Nicaraguense de Inversiones (a government agency created with funds from KfW) 27 million USD and responsAbility 15 million USD. Source: http://blogs.cgdev.org/open_book/2010/08/death-of-a-microfinance-institution.php, (retrieved 10 January 2011)

²³⁸ Greg CHEN, Stephen RASMUSSEN *et al.*, “Growth and Vulnerabilities in Microfinance”, CGAP Focus Note No. 61, Washington D.C., 2010, p. 8.

²³⁹ “The fundamental fact of increased competition in microfinance is that it alters the balance of power between lender and borrower. A Fossil loan officer stated the problem succinctly, ‘Before, the institution selected the clients. Now the client selects the institution’”, from Elisabeth RHYNE, “Commercialization and Crisis in Bolivian Microfinance”, Microfinance Best Practices/USAID, 2001, p. 17

²⁴⁰ *Ibidem*

²⁴¹ Jessica SCHICKS, “Microfinance Over-Indebtedness: Understanding its drivers and challenging the common myths”, Centre Emile Bernheim, Solvay Brussels School, Brussels, 2010, p. 1

²⁴² See footnote 257 below, which enumerates a series of studies on overindebtedness in microfinance within the RUME project

of its multi-dimensional nature and of the mix of objective and subjective factors involved in the phenomenon itself²⁴³.

Regarding overindebtedness in general, in the British context the issue was studied from the perspective of consumer and mortgage credit. The 2007 Report "Tackling Over-indebtedness"²⁴⁴ acknowledges the complex nature of the phenomenon, and accounts for the objective dimensions of the phenomenon – the ratio between debt and earnings, as well as for the subjective dimensions – the perception of the individuals on their situation and on the debt burden²⁴⁵. The report proposes a framework to measure the level of overindebtedness of a household based on three indicators: arrears on outstanding payments (whether for loans or household bills), debt burden (both perceived and as a percentage of the household income) and number of parallel loans.²⁴⁶ In Germany, overindebtedness is defined as a household's incapacity to fulfil its payment obligations over a longer period, even despite the reduction of the standard of living.²⁴⁷ The multifaceted nature of the phenomenon is also taken into account, and overindebtedness is seen as a process of "gradual social exclusion"²⁴⁸ which increases vulnerability and leads to poverty²⁴⁹. The vulnerable layers of the population (poor, unemployed, or undergoing lifetime events which increase their vulnerability) are the most affected by the phenomenon.²⁵⁰ The definition proposed by Betti *et al.* (2001)²⁵¹ stresses the subjective component of overindebtedness. According to the author, "a person is over-indebted if he or she considers that he or she has difficulties in repaying debts, whether consumer debt or a mortgage"²⁵². The European Commission proposes²⁵³ a common operational European definition of overindebtedness, based on six common elements of existing definitions, i.e.: use of the household as the relevant unit for measuring overindebtedness; the equal importance given to all payment obligations of the household (be it credit instalments, utility and

²⁴³ Jessica SCHICKS, "Microfinance Over-Indebtedness: Understanding its drivers and challenging the common myths", Centre Emile Bernheim, Solvay Brussels School, Brussels, 2010, pp. 2 *sq.*

²⁴⁴ UK Department for Business, Enterprise and Regulatory Reform, *Tackling over-indebtedness. Annual Report 2007*, London, 2007

²⁴⁵ *Id.*, p. 4

²⁴⁶ *Id.*, p. 25

²⁴⁷ Oliver J. HAAS, "Overindebtedness in Germany" Working Paper No. 44, Social Finance Program, International Labour Organization, Geneva, 2006, p. 4

²⁴⁸ *Id.*, p. 6

²⁴⁹ *Id.*, pp. 1, 5

²⁵⁰ *Id.*, p. 7

²⁵¹ Gianni BETTI *et al.*, "Study of the problem of Consumer Indebtedness. Statistical Aspects", Report Submitted to Commission of the European Communities, Brussels, 2001

²⁵² *Id.*, p. 2

²⁵³ European Commission, *Towards a Common Operational European Definition of Over-indebtedness*, Brussels, 2008

telephone bills or rent payments); the incapacity to meet the aforementioned payments; the structural character of the problem, meaning that financial problems are persistent and on-going; the assumption that standard of living should not be reduced in order to meet contractual payments; and the illiquidity, meaning that the problem cannot be resolved through recourse to financial and non-financial assets.²⁵⁴

4.3. Overindebtedness in microfinance

Although as stated before the literature on overindebtedness in microfinance is rather limited, there are several researchers who studied this subject in the last years, some of them reunited under the umbrella of the RUME Project²⁵⁵. Notably, overindebtedness in microfinance was the object of an international workshop which was coordinated by Isabelle Guérin and titled "From debt to overindebtedness. Processes, practices and meanings"²⁵⁶. Isabelle Guérin and Marc Roesch investigated the overindebtedness of the Indian households in a series of articles²⁵⁷ and Georges Gloukoviezoff investigated in his doctoral thesis²⁵⁸ the links between financial exclusion and overindebtedness in the French context.

²⁵⁴ European Commission, *Towards a Common Operational European Definition of Over-indebtedness*, Brussels, 2008, p. 37

²⁵⁵ RUME stands for *Rural microfinance and employment* and is a project financed by Agence Nationale de la Recherche (ANR) and Institut de Recherche pour le Développement (IRD) <http://www.rume-rural-microfinance.org>

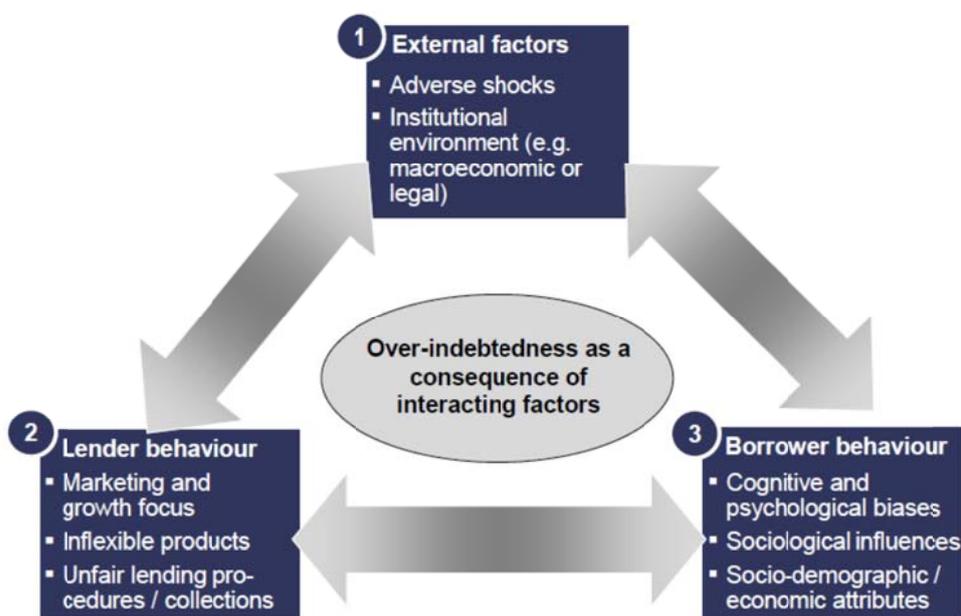
²⁵⁶ Paris, 7-8 December 2009. Workshop organised by RUME, Développement et Sociétés UMR 201 and CIESAS. <http://www.rume-rural-microfinance.org/spip.php?article106>

²⁵⁷ Isabelle GUERIN, Marc ROESCH *et al.*, " Crise, microfinance et surendettement. Une étude de cas en Inde du Sud ", in P. PHELINAS, M. SELIM (eds.), *La crise vue d'ailleurs*, L'Harmattan, Paris, 2010, pp. 241-269. Also Isabelle GUÉRIN, Marc ROESCH *et al.*, "Microfinance, endettement et surendettement. Une étude de cas en Inde du Sud", *Revue Tiers Monde* No. 197, 2009, pp. 131 – 146

²⁵⁸ GLOUKOVIEZOFF Georges, *De l'exclusion à l'inclusion bancaire des particuliers en France. Entre nécessité sociale et contrainte de rentabilité*, Thèse de doctorat en sciences économiques, Faculté de sciences économiques et de gestion, Université Lumière Lyon 2, 2008. See also his book *L'exclusion bancaire le lien social à l'épreuve de la rentabilité*, PUF, Paris, 2010, 368 p.

One of the most comprehensive works on the issue of overindebtedness in microfinance is that of Jessica Schicks²⁵⁹, who proposes a “sacrifice-based definition”²⁶⁰ of the phenomenon, according to which the continuous difficulty to meet repayment deadlines and the repeated high sacrifices made in order to meet loan obligations are signs of overindebtedness²⁶¹. In the same time, the author reviews the heterogeneous factors influencing the phenomenon and uses a multidisciplinary approach to study its various causes and their interrelations.²⁶² By analysing overindebtedness from an economic, psychological and sociological perspective, the author defines it as a result of interacting influences coming from lenders, borrowers and from the exterior.²⁶³

Figure 4: The causes of overindebtedness according to Schicks²⁶⁴



We will analyse subsequently each of the three sets of causes:

²⁵⁹ Jessica SCHICKS, "Microfinance Over-Indebtedness: Understanding its drivers and challenging the common myths", Centre Emile Bernheim, Solvay Brussels School, Brussels, 2010

²⁶⁰ Jessica SCHICKS, "Microfinance Over-Indebtedness: Understanding its drivers and challenging the common myths", Centre Emile Bernheim, Solvay Brussels School, Brussels, 2010, p. 6

²⁶¹ *Ibidem*

²⁶² Jessica SCHICKS, "Microfinance Over-Indebtedness: Understanding its drivers and challenging the common myths", Centre Emile Bernheim, Solvay Brussels School, Brussels, 2010, p. 15

²⁶³ *Ibidem*

²⁶⁴ *Ibidem*

External factors

This set of factors is outside of the control of either the borrower or the lender. A negative external shock can transform a reasonable debt level into an unmanageable debt, and cause the overindebtedness of the microfinance client. According to Bouquet²⁶⁵, economic shocks affect the households in two ways: either by reducing the incomes from their business activity (due to price fluctuations, loss of an asset or death of a productive member of the family), or by increasing the expenses (illness, unexpected expenses)²⁶⁶. In the same time the behaviour of lenders or borrowers is affected by the influence of the institutional environment, which manifests itself in the form of unstable economic situation, volatility of the labour market and of increased competition in the financial sector.²⁶⁷ The influence of competition deserves special attention in the framework of this paper. It is generally agreed that competition has a positive effect on the performance of microfinance institutions²⁶⁸. Still, numerous authors²⁶⁹ pointed out the negative effects competition can have when it is reaching extreme dimensions. Hellmann, Murdock and Stiglitz²⁷⁰ describe the chain of events triggered by increased commercialization and competition as follows: “Financial market liberalization increases competition; competition erodes profits; lower profits imply lower franchise values (i.e., the capitalized value of expected future profits); and lower franchise values

²⁶⁵ Emmanuelle BOUQUET *et al.* “Trajectoires de crédit et vulnérabilité des ménages ruraux. Le cas des Cecam de Madagascar”, *Revue Autrepart*, No. 44, 2007, pp. 157–172

²⁶⁶ *Id.*, p. 159

²⁶⁷ Luisa ANDERLONI, Daniela VANDONE, “Households Over-indebtedness in the Economic Literature”, Working Paper n. 2008-46, Milano, 2008, p. 20

²⁶⁸ Robert CULL, Asli DEMIRGÜÇ-KUNT *et al.*, “Microfinance Meets the Market”, Policy Research Working Paper 4630, The World Bank, Washington, 2008; Beatriz ARMENDÁRIZ, Jonathan MORDUCH, *The Economics of Microfinance*, Second Edition, MIT Press, Cambridge, 2010; Joanna LEDGERWOOD, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999; Marguerite ROBINSON, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001; Marguerite ROBINSON, *The microfinance revolution. Volume 2: Lessons from Indonesia*, The World Bank, Open Society Institute, Washington, 2002; HELMS Brigit, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006

²⁶⁹ Elisabeth RHYNE, “Commercialization and Crisis in Bolivian Microfinance”, Microfinance Best Practices/USAID, 2001; Greg CHEN, Stephen RASMUSSEN *et al.*, “Growth and Vulnerabilities in Microfinance”, CGAP Focus Note No. 61, Washington D.C., 2010; Xavier REILLE, “The dark side of competition. Credit risk and market penetration”, CGAP Microfinance Blog, 2010; Gary WOLLER, “The Promise and Peril of Microfinance Commercialization”, *Small Enterprise Development*, Vol. 13, no. 4, 2002; Robert Peck CHRISTEN, “Commercialization and Mission Drift. The Transformation of Microfinance in Latin America”, CGAP Occasional Paper No. 5, 2001; Ulrike VOGELGESANG, “Microfinance in Times of Crisis. The effects of Competition, Rising Indebtedness and Economic Crisis on Repayment Behaviour”, *World Development*, Vol. 31, No. 12, 2003, pp. 2085–2114

²⁷⁰ Thomas HELLMANN, Kevin MURDOCK, Joseph STIGLITZ, “Liberalization, Moral Hazard in Banking, and Prudential Regulation: Are Capital Requirements Enough?”, *The American Economic Review*, Vol. 90, No. 1, 2000, pp. 147-165

lower incentives for making good loans, increasing the moral-hazard problem. With sufficient competition banks will find it desirable to gamble²⁷¹. There is a direct relation between competition and overindebtedness, as “competition does influence the behaviour of both borrowers and lenders in ways that may lead to overindebtedness”²⁷². Devaney²⁷³ argues that a market with increased competition attracts new lenders, among them unscrupulous ones who use minimal loan-assessment tools to determine the credit worthiness of the clients²⁷⁴. This creates a climate where “there is pressure on everyone to over-lend for short-term survival”²⁷⁵. Finally, Vogelgesang²⁷⁶ makes an important connection between the economic environment and a market characterised by high competition. First, the author argues that high levels of competition and supply will lead to growing overindebtedness and multiple lending²⁷⁷. Furthermore, the author finds that in the situation of a growing economy, increased supply and competition generates better repayment, whereas in years of economic crisis it triggers the deterioration of repayment rates.²⁷⁸

Lender behaviour

Schicks analyses the institutional practices which are conducive to overindebtedness. The author distinguishes three types of lender behaviour which increase the risk of overindebtedness: an excessive and aggressive institutional orientation towards growth, the provision of loan products unsuited to the borrower’s situation and faulty lending procedures²⁷⁹. We will subsequently detail on each of the abovementioned behaviours.

An **excessive focus on growth** determines microfinance institutions to force their clients to take new loans on an uninterrupted manner, in order to maintain their loan portfolios²⁸⁰. A common practice

²⁷¹ *Id.*, p. 148

²⁷² Adrian GONZALEZ, *Microfinance, Incentives to Repay, and Overindebtedness: Evidence from a Household Survey in Bolivia*, Doctoral thesis, Ohio State University, Ohio, 2008, p. 37

²⁷³ Patricia Lee DEVANEY, *Bringing Pro-Consumer Ideals to the Client. A Consumer Protection Guide for Financial Institutions Serving the Poor*, ACCIÓN Publication, Monograph Series No. 14, Washington D.C., 2006

²⁷⁴ *Id.*, p. 18

²⁷⁵ *Ibidem*

²⁷⁶ Ulrike VOGELGESANG, "Microfinance in Times of Crisis. The effects of Competition, Rising Indebtedness and Economic Crisis on Repayment Behaviour", *World Development* Vol. 31, No. 12, 2003, pp. 2085–2114

²⁷⁷ *Id.*, pp. 2103, 2105

²⁷⁸ *Id.*, p. 2107

²⁷⁹ Jessica SCHICKS, "Microfinance Over-Indebtedness: Understanding its drivers and challenging the common myths", Centre Emile Bernheim, Solvay Brussels School, Brussels, 2010, pp. 9 *sq.*

²⁸⁰ *Ibidem*

of microfinance institutions who have a strong focus on growth is to adjust the bonus system of the loan officers accordingly. Brix and McKee²⁸¹ argue that bonus schemes based on volumes motivate loan officers to oversell and overindebt their clients²⁸². An intensive growth strategy forces institutions to use aggressive marketing practices in order to determine the client to access the loans. Thus, microfinance institutions “can frame offers of credit to exploit the psychological biases of borrowers”²⁸³ in the form of special or limited-time offers²⁸⁴. From a psychological point of view, the perception of affordability of a good or service is positively affected by the possibility to buy it on credit²⁸⁵, and easily accessible credit can incite borrowers to access multiple debts. If the features of the loan (amount, maturity, payment schedule) are not adapted to the specific situation of each borrower (such as the degree of cash flow stability, business seasonality or time constraints) this can lead to overindebtedness.²⁸⁶ Lenders increase the overindebtedness risk of their clients through the use of inappropriate lending procedures. Most of the microfinance institutions use the so-called “graduation principle”²⁸⁷ in their lending operations, meaning that they increase the size of repeated loans for recurrent customers according to their repayment history. As the activity of a client may not follow the same path, the automatic increase of loan size may lead to overindebtedness²⁸⁸.

Borrower behaviour

There are instances when a situation of overindebtedness is due to the faulty behaviour of the client. Looking from a psychological, sociological and economic perspective, Schicks differentiates three types of destructive behaviours due to cognitive and psychological biases, sociological influences and socio-economic characteristics of the borrowers. Although the classic economic

²⁸¹ Laura BRIX, Katharine MCKEE, “Consumer Protection Regulation in Low-Access Environments. Opportunities to Promote Responsible Finance”, CGAP Focus Note No. 60, Washington D.C., 2010

²⁸² Laura BRIX, Katharine MCKEE, “Consumer Protection Regulation in Low-Access Environments. Opportunities to Promote Responsible Finance”, CGAP Focus Note No. 60, Washington D.C., 2010, pp. 14, 16

²⁸³ David PORTEOUS, “Policy Focus Note 2. Consumer Protection in Credit Markets”, Financial Access Initiative, 2009, p. 7

²⁸⁴ Laura BRIX, Katharine MCKEE, “Consumer Protection Regulation in Low-Access Environments. Opportunities to Promote Responsible Finance”, CGAP Focus Note No. 60, Washington D.C., 2010, p. 4

²⁸⁵ A. NOTANI, “Perceptions of Affordability. Their Role in Predicting Purchase Intent and Purchase”, *Journal of Economic Psychology*, Volume 18, Issue 5, 1997, pp. 525-546

²⁸⁶ Jessica SCHICKS, “Microfinance Over-Indebtedness: Understanding its drivers and challenging the common myths”, Centre Emile Bernheim, Solvay Brussels School, Brussels, 2010, p. 10

²⁸⁷ Sylvia WISNIWSKI, “Microsavings Compared to Other Sources of Funds”, Consultative Group to Assist the Poorest, Working Group on Savings Mobilization, 1999, p. 10

²⁸⁸ Laura BRIX, Katharine MCKEE, “Consumer Protection Regulation in Low-Access Environments. Opportunities to Promote Responsible Finance”, CGAP Focus Note No. 60, Washington D.C., 2010, p. 16

theory describes the decision maker as rational, studies in behavioural economics have shown that this is not the case²⁸⁹, and in most of the cases the individuals tend to overestimate their payment capacity and underestimate the future costs²⁹⁰. Research²⁹¹ has also found a connection between the level of financial literacy and overindebtedness, insofar as lower levels of financial literacy were connected with more expensive loans and overindebtedness²⁹². Social influences also play a role in the borrower's decisions, as due to social pressure and rising inequalities poorer households are forced to exert to higher levels of debt in order to keep up with richer households.²⁹³ Several studies²⁹⁴ highlighted that borrowers with certain socio-demographic characteristics (such low education, many young children or ill health) are more likely to become overindebted.

4.4. Some quantitative data on overindebtedness

Given the recent rise of overindebtedness crises around the world, recent attempts were made to measure the phenomenon in a quantitative manner. Although cross indebtedness does not necessarily mean overindebtedness, the volume of exclusive and shared clients can serve as a proxy for the tendency towards increasing levels of indebtedness. The following table shows the

²⁸⁹ "Empirical analyses show that household debt demand seems less rational but more driven by emotional factors, such as overconfidence, impulsivity in consumption attitudes, social comparison and myopia, that is the inability to perceive the long run consequences of today's debt decisions. Such behavioural factors may induce individuals to make 'non rational' borrowing choices and this may lead them to hold a level of debt that is unsustainable in relation to their earnings. In turn, such a situation may cause overindebtedness", Luisa ANDERLONI, Daniela VANDONE, "Risk of overindebtedness and behavioural factors", Working Paper n. 2010-25, Milano, 2010, p. 2

²⁹⁰ *Id.*, p. 3

²⁹¹ Annamaria LUSARDI, Peter TUFANO, "Debt literacy, financial experiences, and overindebtedness", CERP, Working paper 83/09, 2009

²⁹² *Id.*, p. 24

²⁹³ Markus CHRISTEN, Ruskin MORGAN, "Keeping Up With the Joneses: Analyzing the Effect of Income Inequality on Consumer Borrowing", *Quantitative Marketing and Economics*, Volume 3, Number 2, pp. 145-173

²⁹⁴ Sarah BRIDGES, Richard DISNEY, "Use of Credit and Arrears on Debt among Low-Income Families in the United Kingdom", *Fiscal Studies*, 2004, vol. 25, issue 1, 2004, pp. 1-25; Ulrike VOGELGESANG, "Microfinance in Times of Crisis. The effects of Competition, Rising Indebtedness and Economic Crisis on Repayment Behaviour", *World Development*, Vol. 31, No. 12, 2003, pp. 2085-2114; Adrian GONZALEZ, *Microfinance, Incentives to Repay, and Overindebtedness: Evidence from a Household Survey in Bolivia*, Doctoral thesis, Ohio State University, Ohio, 2008; Luisa ANDERLONI, Daniela VANDONE, "Households Over-indebtedness in the Economic Literature", Working Paper no. 2008-46, Milano, 2008

percentage of borrowers who have loans with more than one microfinance institution in four countries.

Table 3: Levels of cross indebtedness around the world²⁹⁵

	% active borrowers with loans from >1 MFI	Sources
Nicaragua	40 (2009)	Interview with director of Nicaraguan MFI
Morocco	40 (2007) 39 (2008) 29 (2009)	Central bank and credit information sharing among the five largest MFIs
BiH	40 (2009)	MFI clients survey, MiBOSPO
Pakistan	21 (2009) Nationwide 30 (2009) Districts with repayment crisis	Pakistan Microfinance Network

In Peru the situation is similar. Due to the high level of transparency of the microfinance market more and better data is available, which provides a more detailed picture. The main advantage is that not only the number of exclusive and shared loans can be measured, but also the amount of these loans, thus providing a real picture of the magnitude of the phenomenon, as shown in the next table.

Table 4: Levels of cross indebtedness in Peru²⁹⁶

Type of institution	Total loan outstanding ('000 PEN)	% exclusive outstanding amount	% shared outstanding amount
MiBanco	3,086,793	32.0	68.0
Financieras	3,518,191	27.6	72.4
Cajas Municipales	6,477,490	33.3	66.7
Cajas Rurales	1,357,332	34.5	65.5
Edpymes	878,697	31.1	68.9
ONGs	224,125	49.4	50.6
Cooperatives	739,388	32.0	68.0
Total	16,282,016	32.0	68.0

²⁹⁵ From Greg CHEN, Stephen RASMUSSEN *et al.*, "Growth and Vulnerabilities in Microfinance", CGAP Focus Note No. 61, Washington D.C., 2010, p. 7

²⁹⁶ From COPEME, "Microfinanzas en el Perú. Reporte Abril 2010", Lima, April 2010, p. 59. Data as of December 2009

As it can be seen from the above table, 68% of the total loan portfolio of the microfinance industry is shared between two or more microfinance institutions. This is one of the reasons why Peru was placed among the countries with a high level of overindebtedness risk in the December 2010 study²⁹⁷ of the Centre for Microfinance at the Swiss Banking Institute of the University of Zurich, commissioned by responsAbility Social Investments AG, Triodos Investment Management BV and Council of Microfinance Equity Funds. According to this study, the countries with the highest risk of overindebtedness are Bosnia and Herzegovina, Cambodia and Peru, as shown in the table below:

Table 5: Overindebtedness early warning sign index²⁹⁸

Lowest level	–
Relatively low level	Bolivia, Ecuador, El Salvador, Georgia
Medium level	Armenia, Paraguay, Tajikistan
Medium to high level	Colombia, Ghana, Kosovo
Relatively high level	Bosnia and Herzegovina, Cambodia, Peru
Highest level	–

²⁹⁷ Vivien KAPPEL, Annette KRAUSS, Laura LONTZEK, “Over-Indebtedness and Microfinance. Constructing an Early Warning Index”, Center for Microfinance, University of Zurich, Zurich, 2010

²⁹⁸ *Id.*, p. 41

CHAPTER V: THE CONTEXT OF THE STUDY AND THE RESEARCH METHOD

5.1. The current state of microfinance in Latin America and Peru

The microfinance industry in Latin America is the most developed in the world²⁹⁹, and is characterised by high competition, commercialization and integration in the financial markets³⁰⁰. According to the MIX Market, the online information exchange platform of the microfinance industry, in 2009 the loan portfolio of all reporting microfinance institutions from the Latin America and The Caribbean (LAC) region amounted to more than 19 billion USD and the institutions were offering services to 14 million borrowers and 17 million depositors.³⁰¹ Although several countries in the region (Argentina, Brazil, Mexico, Uruguay and Venezuela) have weak regulatory structures and underdeveloped markets³⁰², in the majority of Latin American countries microfinance is characterised by increased **competition** due to high levels of market penetration³⁰³. In several countries (Peru, Bolivia, Nicaragua) the system is saturated, without any prospects for potential new entrants.³⁰⁴ With regards to **commercialization**, nowhere in the world did this process unfold more rapidly than in Latin America, where commercial financial institutions cover the major part of the market.³⁰⁵ According to a 2008 Inter-American Development Bank (IADB) study, 70 per cent of the total microloan portfolio is managed by regulated institutions, who also account for half of the total clients.³⁰⁶

²⁹⁹ Economist Intelligence Unit, "Global microscope on the microfinance business environment 2010", London, 2010

³⁰⁰ Robert Peck CHRISTEN, "Commercialization and Mission Drift. The Transformation of Microfinance in Latin America", CGAP Occasional Paper No. 5, 2001

³⁰¹ <http://www.mixmarket.org/mfi/region/Latin%20America%20and%20The%20Caribbean>

³⁰² Economist Intelligence Unit, "Global microscope on the microfinance business environment 2010", London, 2010

³⁰³ J.P. Morgan, "Impact Investments. An Emerging Asset Class", J.P. Morgan Global Research, November 2010, p. 90

³⁰⁴ *Id.*

³⁰⁵ Robert Peck CHRISTEN, "Commercialization and Mission Drift. The Transformation of Microfinance in Latin America", CGAP Occasional Paper No. 5, 2001, p. 1

³⁰⁶ Sergio NAVAJAS *et al.*, "Microfinance in Latin America and the Caribbean. 2008 Data Update", Inter-American Development Bank, Washington, D.C., 2008, p. 3

Today, microfinance in Latin America is an integral part of the international **financial markets**, and the investments made here by Microfinance Investment Vehicles (MIVs)³⁰⁷ accounted in 2009 for almost 1.6 billion USD.³⁰⁸ The 2010 Economist Intelligence Unit study places Latin America and the Caribbean first in the worldwide ranking of the microfinance industry, with Peru being first in the region³⁰⁹.

Microfinance in Peru has a long history, thoroughly described by Lucy Conger, Patricia Inga *et al.* in their 2009 book *The mustard tree. A history of Microfinance in Peru*. The Peruvian microfinance sector was marked by several breakthroughs: the first cooperative was created in 1942 by the workers in the port of Callao³¹⁰, the internationally renowned system of Cajas Municipales was initiated in the 1980's, MiBanco started its operations in 1998 following the transformation of Acción Comunitaria del Perú and in 2007 the first international syndicated loan for a microfinance institution in Latin America was issued to Mibanco³¹¹. In the last decade the microfinance sector followed the trend of the country's economy³¹², and in 2010 Peru was named global leader in microfinance for the second year in a row³¹³. The microfinance market in Peru is characterised by very good levels of financial performance and increased competition. Concerning the **very good levels of financial performance**, as of July 2010, MiBanco, the only specialised microfinance bank in Peru, was the most efficient institution in the entire banking system³¹⁴; the other microfinance institutions also recorded very high profitability levels, reaching returns on equity as high as 42%³¹⁵.

³⁰⁷ "Microfinance Investment Vehicles (MIVs) are independent investment entities with more than 50% of their non-cash assets invested in microfinance. They include: Public Placement Funds, Private Placement Funds, Cooperative Companies / Non-Governmental Organizations, Collateralized Debt Obligations (CDOs)", CGAP, "2010 MIV Survey Report. Market Data & Peer Group Analysis", CGAP/Symbiotics, 2010, p. 6

³⁰⁸ According to the "State of Microfinance Investment. The MicroRate 2010 MIV Survey", Latin America and the Caribbean accounted for the highest proportion of assets hold by MIVs (37%), followed by Eastern Europe and Central Asia (35%)

³⁰⁹ Economist Intelligence Unit, "Global microscope on the microfinance business environment 2010", London, 2010, pp. 9 - 11

³¹⁰ Richard WEBB, "La Aventura de las Finanzas en el Perú", http://www.institutodelperu.org.pe/descargas/la_aventura_de_las_finanzas_en_el_peru.pdf (retrieved 10 January 2011)

³¹¹ <http://www.webwire.com/ViewPressRel.asp?ald=55136> (retrieved 10 January 2011)

³¹² Lucy CONGER, Patricia INGA *et al.*, *The mustard tree. A history of Microfinance in Peru*, Universidad de San Martín de Porres, Lima, 2009, p. 113

³¹³ Economist Intelligence Unit, "Global microscope on the microfinance business environment 2010", London, 2010

³¹⁴ According to the July 2010 "Boletín Estadístico de Banca Múltiple" issued by the SBS, MiBanco had a ROE of 36.97%, whereas the average ROE for the whole Peruvian banking system was 23.93%

³¹⁵ As of July 2010 the ROE of Financiera Crediscotia was 42.10%, of Financiera CREAR 39.53% and of Caja Municipal Arequipa 22.32%. (source "Boletín Estadístico SBS")

It is worth noting that the top-performing institutions started as NGOs (MiBanco as ACP, Financiera CREAR as ONG Hábitat Arequipa Siglo XXI). The **competition** is especially fierce, and as of March 2010 there were 71 active MFIs operating 1,349 agencies all over the country³¹⁶. Against this background the microfinance sector is evolving in an extremely dynamic manner, and the last year witnessed numerous acquisitions, mergers, transformations and entry of new operators, all in a context of institutional transformation and migration towards the more regulated and formalised end of the market.³¹⁷ The institutional landscape is extremely diverse, with different types of institutions varying from non-regulated NGOs to full-fledged banking institutions.

Table 6: The Peruvian microfinance institutions at a glance

Type of institution	Characteristics	Examples
Commercial banks	Full regulated financial institutions. They offer all range of banking services to microentrepreneurs. Mibanco, founded in 1998, is focusing exclusively on microfinance, and is one of the biggest microfinance institutions (MFI) on the continent	Banco de Crédito del Perú, Scotiabank, Mibanco
Financieras	Regulated institutions, which are allowed to offer savings accounts and the majority of financial services to microentrepreneurs	Confianza, CREAR, Edyficar
Caja Municipal de Ahorro y Crédito (CMAC)	Regulated financial institutions owned by the municipal governments and managed by an independent management board. They can offer the majority of financial services.	CMAC Arequipa, CMAC Piura, CMAC Trujillo
Caja Rural de Ahorro y Crédito (CRAC)	Regulated institutions authorised to receive deposits from the population, had initially a focus on agriculture, but now provide services to small and medium enterprises.	CRAC Nuestra Gente, CRAC Señor de Luren, CRAC Profinanzas
Entidad de Desarrollo para la Pequeña y Micro Empresa (EDPYME)	A non-bank regulated institution which is not allowed to receive deposits. The majority of EDPYMES were initiated as NGOs and transformed into regulated institutions starting with 1996.	EDPYME Efectiva, EDPYME Raíz, EDPYME Proempresa
Cooperativa de Ahorro y Crédito	A cooperative financial institution owned by its members, it is a not-for-profit entity. It is allowed	CAC Los Andes Cotarusi Aymaraes, CAC Señor

http://www.sbs.gob.pe/0/modulos/JER/JER_Interna.aspx?ARE=0&PFL=0&JER=148, retrieved 15 December 2010)

³¹⁶ COPEME, "Microfinanzas en el Perú. Reporte Julio 2010", Lima, July 2010, p. 37

³¹⁷ COPEME, "Microfinanzas en el Perú. Información a Junio 2010", Lima, September 2010, p. 9

(CAC)	to take deposits and give loans to its members. It is supervised by the Peruvian federation of cooperatives FENACREP.	De Los Milagros De Atacocha
Non-Governmental Organisations (NGO)	Various programmes offering microfinance loans. The most prominent NGOs with microfinance programmes are members of COPEME, which also provides the framework for their self-regulation.	Asociacion Arariwa, Fondesurco, ProMujer Peru

A big number of microfinance institutions are concentrated in Lima, given the high numbers of entrepreneurs in the capital city and the prosperous economic activity here. Lima's microfinance sector serves more than one million clients and accounts for 30% of the entire national microfinance industry³¹⁸. One of the most active areas is the north of the capital, the so-called Lima Norte, the most populous³¹⁹ conurbation in Lima, concentrating in the same time the highest number of microentrepreneurs and poor people, both representing the target group of microfinance. No exact figure exists, but there are almost 200.000 microentrepreneurs in Lima Norte³²⁰. In the same time it is one of the poorest districts, with more than 400.000 of its population unable to satisfy their basic needs³²¹. The district of Los Olivos is extremely attractive for microfinance institutions, which are highly concentrated here – for example, in the same street where the CREAR agency where the field study took place is located, 15 other microfinance institutions offer their services on the length of two blocks³²², which makes it that the area is sometimes called *the Wall Street of Los Olivos*. The location of the district of Los Olivos in Lima is shown in the figure below:

³¹⁸ COPEME, "Microfinanzas en el Perú. Reporte Julio 2010", Lima, July 2010, p. 99

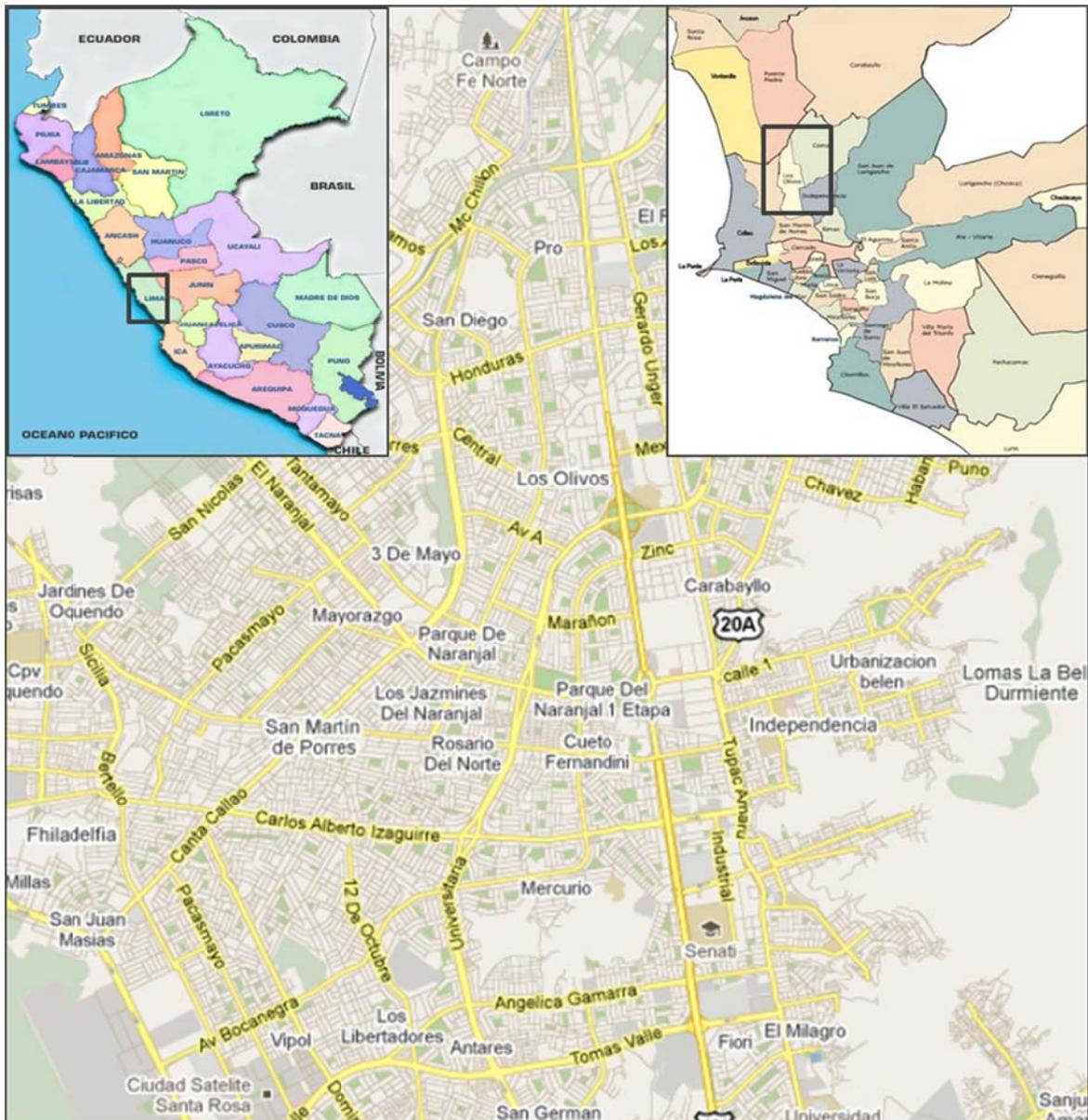
³¹⁹ 2,280,000 inhabitants. <http://www.losolivosperu.com/vercontenido.asp?idc=201011910367805840> (retrieved 15 December 2010)

³²⁰ http://www.ucss.edu.pe/osel/investigacion/pdf/01_lima_norte.xls, "Convenio MTPE - PROPOLI - UCSS. OSEL Lima Norte. Encuesta Especializada en Niveles de empleo 2007" and <http://www.ucss.edu.pe/osel/institucional/pdf/009-2010.pdf> (Retrieved 15 December 2010)

³²¹ "La estimación es de 99,788 hogares con necesidades básicas Insatisfechas (NBI), es decir un promedio de 399,112 pobladores de Lima Norte" http://www.alter.org.pe/portal/publicaciones/PP_balance.pdf (Retrieved 15 December 2010)

³²² CAC Finatel, Mibanco, CMAC Trujillo, CRAC CrediChavin, Banco Azteca, CRAC Nuestra Gente, Banco de la Nación, Banco Interamericano de Finanzas, Banco de Crédito, Caja Metropolitana, Financiera Edyficar, BBVA Banco Continental, EDPYME Nueva Vision, Interbank and Inversiones La Cruz.

Figure 5: Location of Los Olivos in Lima and in Peru



5.2. Presentation of the host institution

Financiera Créditos Arequipa S.A. (CREAR) is a microfinance institution with more than 18 years of experience whose roots can be traced back to 1992, when it originated as ONG HÁBITAT AREQUIPA SIGLO XXI in Arequipa, the second biggest city in Peru known for its dynamism and entrepreneurial spirit. The initiators of the NGO, a group of local entrepreneurs lead by Percy Tapia, had as main objective to facilitate access to decent housing for the low income layers of the population, mainly Andean migrants. The NGO soon realised the potential of microenterprise as an engine for development, and started promoting the development of small businesses situated in the marginal areas of the city. In 1998, after seven years of activity, the NGO transformed into EDPYME CRÉDITOS AREQUIPA (CREAR), a microfinance institution regulated and supervised by the superintendence of banks. While being at the time the smallest institution in the Peruvian financial system, EDPYME CREAR reached financial sustainability after only nine months of operations, and proved to be one of the most dynamic MFIs in Peru. This dynamism also reflected in its regional expansion, with CREAR becoming the first financial institution from the province to open an agency in the competitive environment of the capital city – the agency in Los Olivos was opened in the beginning of the 2000's, offering its services to the small entrepreneurs of Lima Norte.

Photo 1: CREAR Agency in Los Olivos



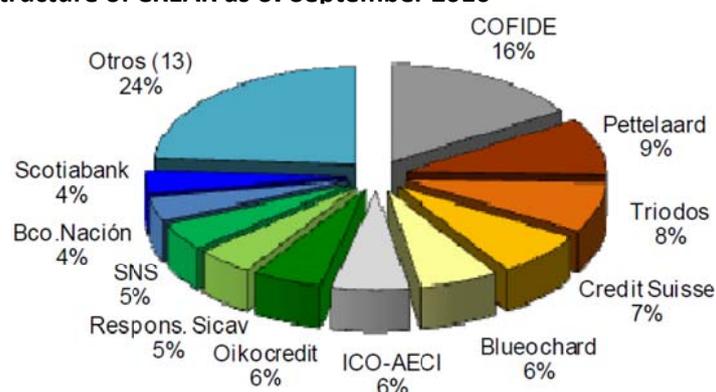
The year 2006 marked an important moment in the development of the institution, with the entry of reputable international shareholders in the capital structure: the Andean Development Corporation, the Multilateral Investment Fund of BID and the ASN-NOVIB Fund. As a result, SBS granted the authorization for the transformation of CREAR from EDPYME into Financiera in August 2008. The positive evolution of the institution continued, and in September 2010 CREAR was granted the authorisation to receive deposits from the public, an activity which will start in 2011 with the implementation of term deposits. As of December 2010, CREAR has a strong presence in Lima and Arequipa, with a total of 24 agencies and 870 employees. The majority of the agencies in Lima are located in Lima Norte (see the map on page 61), an extremely dynamic region with a high presence of microentrepreneurs, mainly Andean migrants. CREAR is a well-established financial institution, which has achieved impressive results in the last years, both operationally as well as financially.

Table 7: CREAR at a glance

	August '08	August '09	August '10
Number of agencies	12	21	24
Loan portfolio ('000 PEN)	161,514	250,434	345,799
Annualised growth	48.67%	55.05%	38.08%
Number of clients	45,894	70,103	90,660
Number of loans	60,897	90,641	117,269
ROE	31.34%	21.80%	40.56%

This, together with the strong shareholder base of the institution makes it one of the most reputable microfinance institutions in the Peruvian microfinance context. On the financing side, CREAR has relationships with a range of national and international funds which are supporting the expansion of the institution.

Figure 6: Financing structure of CREAR as of September 2010



It is worth noting here the commitment of the shareholders, who decided to capitalize all the profits obtained in 2009 in order to strengthen the capital base of the institution. The human resources are trained in-house and the middle management is recruited internally, which allowed the creation and maintenance of a strong corporate culture. The mission, vision and values are an important part of this culture, and they are displayed in every agency of CREAR.

Photo 2: CREAR mission, vision and values³²³



The institution is offering 10 loan products³²⁴ for several specific needs of the microentrepreneurs and low income population. The absolute majority of the loans is represented by business loans, which are destined to trade and services.

³²³ Mission: *Somos la fuerza de apoyo financiero que genera progreso*; Vision: *Ser el modelo empresarial que ofrezca servicios financieros para emprendedores*; Values: *Transparencia, compromiso, confiar, integridad*; Objective: *Crecer con calidad Total*.

³²⁴ Microenterprise loans: FACIL, YAPA, PYME, WARMI (targeted at women customers), VUELVE, JALE, CASH. Housing and renovation loans: CONSTRUYE. Consumption loans: EFECTIVO.

5.3. Presentation of the research process

5.3.1. Research methods and instruments used

The study is mainly circumscribed in a *qualitative methodology* and also makes use of quantitative research techniques. Thus, the methodological approach is that of *mixed methods research*³²⁵ as described by Bryman³²⁶, which has the advantage of enhancing the strengths of the two approaches and in the same time compensate for their weaknesses³²⁷. For the realisation of the investigation two qualitative investigation techniques were used, i.e. semi-structured interviews and observation, which were accompanied by the revision of secondary sources of information. The method of research was the *case study*³²⁸, as it allows for the in-depth understanding of a phenomenon “in its natural setting, recognizing its complexity and its context”³²⁹. The main analytical approach used is triangulation, understood both as an approach to the measurement processes which provides greater reliability and confidence to the findings (as originally defined by Webb³³⁰ and more broadly by Denzin³³¹), but also as an approach to the mixed methods research, consisting in using the findings from the quantitative research to cross-check the findings from the qualitative research and vice versa, as proposed by Hammersley³³².

³²⁵ Alan BRYMAN, *Social Research Methods*, Third Edition, Oxford University Press, Oxford, 2008, pp. 603 - 625

³²⁶ *Id.*

³²⁷ Keith F. PUNCH, *Introduction to Social Research. Quantitative and qualitative approaches*, Second Edition, SAGE Publications, London, 2005, p. 240

³²⁸ Defined by Gerring as “an in-depth study of a single unit (a relatively bounded phenomenon) where the scholar’s aim is to elucidate features of a larger class of similar phenomena.” John GERRING, “What Is a Case Study and What Is It Good for?”, *The American Political Science Review*, Vol. 98, No. 2, 2004, p. 341

³²⁹ Keith F. PUNCH, *Introduction to Social Research. Quantitative and qualitative approaches*, Second Edition, SAGE Publications, London, 2005, p. 144

³³⁰ Eugene J. WEBB, Donald T. CAMPBELL *et al.*, *Unobtrusive Measures. Nonreactive Measures in the Social Sciences*, Rand McNally, Chicago, 1966

³³¹ Norman K. DENZIN, *The research act in sociology. A theoretical introduction to sociological methods*, Butterworths, London, 1970. The author defines triangulation as an approach through which “researchers combine in one investigation multiple observers, theoretical perspectives, sources of data, and methodologies”, p. 310

³³² Martyn HAMMERSLEY, *The relationship between qualitative and quantitative research: paradigm loyalty versus methodological eclecticism*, in John T. E. RICHARDSON (ed.), *Handbook of Qualitative Research Methods for Psychology and the Social Sciences*, BPS Blackwell, Oxford, 1996, p. 167

The main investigation technique was the semi-structured interview, as it allows an in-depth analysis of the perspective of the actors involved while providing flexibility. The interviews were carried with three categories of persons, representing the three layers of the analysis structure. The first group was represented by professionals from the microfinance industry working in a rating agency and in two microfinance fund managers. The second group was represented by employees of the host institution. The third group was represented by clients of CREAR in situation of overindebtedness. It is worth noting that the interviews were also conducted in the abovementioned sequence in order to give the possibility of going from the general to the specific. The other technique used was observation. In this respect I visited several agencies of CREAR observing the activities of all the departments in an agency. The majority of my time was spend in the agency of Los Olivos, where I observed the activity of client advisors, sale force, loan officers, credit coordinators and agency manager. I took part in all the activities at agency levels: group credit committees, meetings, training sessions, arrears committees, promotional activities, supervision visits, etc. I also observed the competition in the Los Olivos area by doing mystery shopping in several other microfinance institutions. Regarding the analysis of secondary sources of information I used mainly data about the microfinance industry and statistical and demographical data about the area of Los Olivos, together with internal documents and statistics of CREAR.

5.3.2. Data collection and analysis

The field study took place during four months, from October 2010 to January 2011. One of the most challenging activities was the data collection, due to several reasons. Having arrived in Peru six months before the beginning of the field study without any previous experience in the country or the region, I had to adapt and integrate quickly in order to conduct my research. The language was also a challenge, as I did not speak Spanish before arriving, and all the interviews were conducted in Spanish.

As stated before, the field work started with the interviews of microfinance industry professionals, which allowed me to get a clear picture of the Peruvian microfinance industry, and its specific characteristics in Lima. These interviews gave me the basis for the continuation of my research, and the next set of interviews was conducted with employees of the host institution: the regional

manager of the agencies in Lima Norte, the agency manager of the CREAR agency in Los Olivos and the credit coordinator from the same agency. This stage allowed me to put in the context of Los Olivos the general information accumulated before. Last, I conducted interviews with clients of CREAR who were facing overindebtedness, in order to study the causes and effects of the phenomenon at the level of individual households. As these interviews demanded from the part of the interviewed person to discuss sensible private issues with a stranger, they posed particular challenges. In order to gain the confidence of the client, one or several days prior to the interview I went to the client business accompanied by the responsible loan officer who was introducing me to the client. With this occasion I was presenting myself, the topic of my studies and I was informing the client about what we will discuss and for how long, and finally I was establishing a meeting for the actual interview. On the agreed date I was going to the client's business or home alone, without being accompanied by the loan officer. As in all the cases the relation between the client and the institution was not optimal due to the impossibility to repay the loan, I was thoroughly explaining each person that I carry my study for academic reasons exclusively. After all the interviews were conducted and transcribed, the data from each of them was synthesized in an index card, according to the categories of analysis. Following, three matrices were created, one for each group of persons interviewed, summarising the findings from all the interviews. Finally, the results were analysed and the information gathered through observation and analysis of secondary sources was used to triangulate the findings.

5.3.3. Analysis biases

Given the fact that this study is demarcated in a qualitative approach, its results can and should not be generalised. The research tries to empirically describe a situation (overindebtedness of microfinance clients), its causes (why is this happening) and to study the causes and effects of this phenomenon at the level of the individual households. Thus, I am aware that the study is characterised by a number of biases:

- First, it has to be said that the sample of clients interviewed is not representative for the clientele of CREAR. CREAR has more than 90.000 clients, therefore the 9 clients which were interviewed represent an insignificant part of the institution's portfolio.

- Also, I interviewed only clients which were already in a situation of overindebtedness, thus assuming from the beginning of the investigation the occurrence of this phenomenon in the analysed sample. As the aim of my research was not to identify the extent to which overindebtedness was present in the portfolio of the institution, but to study the causes and effects of overindebtedness in the case of the microfinance clients, this was an intentional choice.
- The fact that during the field study I spend the entire time in the agency or with the loan officers poses the problem of the distance to the object of my study. As the employees of CREAR were extremely helpful and were supporting me fully during the entire time of my field study, this may have created some biases in my analysis. Nonetheless, as the object of the study is not CREAR but the dynamics which cause households to be overindebted, I tried to mitigate this bias by conducting all the interviews with the clients alone, without the presence of an employee of CREAR.

CHAPTER VI: DATA PRESENTATION AND ANALYSIS

6.1. Data presentation

As the field research was structured on three levels, i.e. microfinance industry, host institution and client level, the data will be presented following the same structure. Due to the fact that this is a qualitative case study, the discourse of the participants to the research is of crucial importance, and therefore I chose to quote the original statements of the interviewed persons in Spanish. In the case of the interviewed clients their names were changed in order to maintain the confidentiality of the interviews.

Industry level data

According to the majority of the persons interviewed, overindebtedness is the major risk facing the Peruvian microfinance sector. The seriousness of the risks posed by overindebtedness was also acknowledged by other voices at microfinance industry level, both nationally as well as internationally: in the July 2010 report, COPEME makes a detailed analysis of the causes of overindebtedness and its effects on the microfinance institutions in Peru³³³. The December 2010 study³³⁴ of the Centre for Microfinance at the Swiss Banking Institute of the University of Zurich, commissioned by responsAbility Social Investments AG, Triodos Investment Management BV and Council of Microfinance Equity Funds places Peru at the top of the countries facing a risk of overindebtedness. While overindebtedness was seen as the most important risk facing the industry, the industry professionals interviewed indicated a series of other specific risks to the Peruvian microfinance sector, which are by themselves conducive to overindebtedness:

³³³ COPEME, "Microfinanzas en el Perú. Reporte Julio 2010", Lima, July 2010, pp. 53 sq.

³³⁴ Vivien KAPPEL, Annette KRAUSS, Laura LONTZEK, "Over-Indebtedness and Microfinance. Constructing an Early Warning Index", Center for Microfinance, University of Zurich, Zurich, 2010

Commercialization is seen as an important factor favouring overindebtedness by the majority of the persons interviewed. The pressure to reach high level of profitability has negative effects on the entire sector:

La agresividad con que trabajan algunas instituciones, de hecho hay un círculo, digamos de alguna manera pernicioso en el sector que es que el sector está demasiado enfocado en, se está comercializando demasiado... (Interview with Ramón Flores, Senior Investment Analyst, 25 October 2010)

Hay instituciones que solo están haciendo microcrédito, tienen una visión muy “for profit”, ósea solamente están haciendo las microfinanzas por ganar plata, que es parte de la sustentabilidad, pero digamos que en origen estas instituciones tienen una doble misión, [...]se han ido olvidando de esta misión social (Interview with Jorge Bustamante, Senior Analyst, 26 October 2010)

According to all microfinance industry professionals interviewed, the Peruvian microfinance sector is characterised by very high levels of competition. This competition leads to **market saturation** due to the presence of a very high number of microfinance institutions in urban areas:

Hay una gran competencia entre las instituciones y [...] por ejemplo, donde tú vas a estar en Los Olivos, tienes en un kilómetro cuadrado por lo menos 25 instituciones microfinancieras, entonces eso es obviamente un gran riesgo, porque el microempresario difícilmente va decir que no va tomar el dinero (Ramón Flores)

Las zonas urbanas va seguir siendo una selva... (Jorge Bustamante)

The market saturation was visible in the street where the CREAR Agency where my study took place (Alfredo Mendiola), where 15 other microfinance institutions were present, all offering the complete range of microfinance loans:³³⁵

³³⁵ CAC Finantel, Mibanco, CMAC Trujillo, CRAC CrediChavin, Banco Azteca, CRAC Nuestra Gente, Banco de la Nación, Banco Interamericano de Finanzas, Banco de Crédito, Caja Metropolitana, Financiera Edyficar, BBVA Banco Continental, EDPYME Nueva Vision, Interbank, Inversiones La Cruz and Financiera CREAR

Photo 3: The Wall Street of Los Olivos³³⁶



Another feature of the Peruvian microfinance industry which is favouring overindebtedness is the pressure created by the readily available funding of the sector. This **over-liquidity** creates in turn a pressure for the microfinance institutions to place the money in the market. Ramón Flores depicts this phenomenon, which according to him happened in the past in Peru and is now getting more and more under control:

...el principal destino de inversión de [...] la mayoría de fondos ha pasado a serlo Perú por ejemplo ahora, entonces muchos fondos ya están bastante expuestos en Perú, con lo cual la cantidad de fondos que pueden colocar en Perú a futuro también está un poco restringido. [...] eso ha cambiado, recientemente, ahora ha cambiado en los últimos, el último año, pero hasta hace un año atrás si era como tú decías, allá, ese es un poco la discusión, es digamos de alguna manera había mucha disponibilidad de dinero y había la

³³⁶ In the picture can be seen from left to right: Banco Interamericano de Finanzas, Banco de Crédito, Caja Metropolitana, Financiera Edyficar, Banco Azteca, Inversiones La Cruz

mucha oferta de dinero [...] yo básicamente lo describiría como que había dinero disponible para el que lo pidiera (Ramón Flores)

The other important risk to the industry was the **mission drift** of the sector, due to the increasing commercialization pressure.

El segundo riesgo que yo veo es un riesgo de identidad del sector, que el sector no tiene muy claro qué es lo que es, qué es lo que es microcrédito y de alguna manera he muchas instituciones que se llaman de microfinanza y no necesariamente son microfinancieras porque se dedican parte de la cartera de microfinanzas pero no de manera exclusiva, y por ende no actúan ni tienen su misión lo que nosotros entenderíamos como microfinanzas (Ramón Flores)

Cross indebtedness was seen by the majority of the persons interviewed as a risk in itself as well as a cause of overindebtedness. Although according to some experts “multiple borrowing is not necessarily a problem as long as debt service of borrowers is not affected”³³⁷, the persons interviewed at industry level perceived cross indebtedness as a risky phenomenon, which favours overindebtedness.

Los niveles de exclusividad han bajado de 60%, 50% a niveles de 40% más o menos [...] y eso lo hemos podido observar cuando hemos visto que alguna institución financiera por ejemplo considera que un cliente puede pagar, digamos o puede endeudarse solamente hasta 3,000 dólares y viene una institución más grande y le da un crédito a 10,000 dólares. (Ramón Flores)

The readily available credit offer comes on a background of **increased consumption** on the part of the population.

El consumo, hablándolo macroeconómicamente del peruano ha subido y está creo por encima de lo que debiera [...] Hay definitivamente un incremento de consumo, y parte de ese consumo está yendo a ser financiado por la banca, y una parte de ese consumo seguramente está siendo financiado por la microfinanzas [...] No sé, pero, lo que creo que

³³⁷ Vivien KAPPEL, Annette KRAUSS, Laura LONTZEK, “Over-Indebtedness and Microfinance. Constructing an Early Warning Index”, Center for Microfinance, University of Zurich, Zurich, 2010, p. 11. This opinion is also expressed by Elisabeth Rhyne in a recent article Elisabeth RHYNE, “How much debt is too much? Microlenders want to know”, http://www.huffingtonpost.com/elisabeth-rhyne/how-much-debt-is-too-much_b_578776.html (Retrieved 10 January 2011)

este incremento de consumo general de los peruanos está siendo financiado en una parte por el microcrédito, y obviamente eso tiene riesgos mayores (Interview with Luis Guerra, Senior Equity Officer, 29 October 2010)

Estamos hablando de los centros urbanos de las zonas más alejadas, pero todos podemos usar tarjeta de crédito, o la mayoría digamos, pero digamos que el centro más que la tarjeta es el hecho que hubo un poco más de liquidez, ósea había plata (Jorge Bustamante)

Two extremely interesting findings can be observed in the analysis of the microfinance industry level. The first one is related to the issue of **interest rates**, which are often cited as a main cause for the overindebtedness of the clients. The average microfinance interest rate in Peru is around 36%³³⁸, but interest rates can go up as high as 100%. Still, according to all the interviewed experts the level of interest rates in Peru was not seen as posing any problems. The other interesting finding is related to the issue of the **loan destination**: while during the interviews with microfinance professionals this issue never appeared, according to all the persons from CREAR level, the fact that clients are not using the loans for the (declared) business-related purposes and therefore not investing in the business constitutes the main cause of overindebtedness.

Institution level data

The analysis at the host institution level allowed me to know the situation in the field and to gather valuable information through observation and interviews. As this level of analysis followed the analysis at industry level, it gave me the opportunity to distinguish the differences between the two views and opinions on the microfinance sector. As stated before, the greatest contrast between the two levels is related to the importance given to the usage of the loan (which in the absolute majority of the cases is business-related, at least officially). Whereas according to the industry professionals this does not have an important influence on overindebtedness, according to the interviewed persons from CREAR, the non-respect of the loan destination is the main cause of overindebtedness.

¿En tu opinión cuándo comienza un cliente a ser sobre-endeudado?

Para mí el sobre-endeudamiento es cuando el crédito que ha recibido el cliente no está

³³⁸ Lucy CONGER, Patricia INGA *et al.*, *The mustard tree. A history of Microfinance in Peru*, Universidad de San Martín de Porres, Lima, 2009, p. 22

reflejado en el negocio ni en ningún otro lado (Interview with Luz Valdez, Credit Coordinator, 16 November 2010)

¿Si deberías citar una descripción del sobre-endeudamiento, cuál sería esto, cómo definirías tú el sobre-endeudamiento?

Yo diría el otorgamiento de dinero sin destino seguro. Sin destino seguro, porque si tuviera destino seguro tuviera un repago, generaría un renta (Interview with Cesar Gordillo, Agency Manager, 16 November 2010)

When the loan is not used according to the declared investment plan or is not invested in the business at all, the result is an increasing debt burden which is not accompanied by an increase in the business activity, finally leading to the incapacity to repay. The **no questions asked** policy seems to be a generalised practice in the industry. This practice seems to be generated by the phenomena encountered at the industry level, such as over-liquidity, increased competition, commercialization and increased market saturation.

... porque los otros bancos ni le preguntan, porque ellos mismos dicen, hay otros bancos a mí no me preguntan ni siquiera me ofrecen cuánto, que si yo tengo 20,000; 30,000 soles aprobado y ahí estaba la plata, en realidad no tienen responsabilidad, no hay responsabilidad que si el cliente va pagar bien, si se le está sobre-endeudando, qué destino va tener esa plata, no hay responsabilidad del funcionario de que simplemente le da el dinero (Luz Valdez)

La oferta crediticia excesiva, la responsabilidad de muchas empresas en regalar la plata sin pedir nada, sin evaluación, ha malogrado a muchos clientes que son buenos, los ha malogrado, los ha infectado (Interview with Marcos Corrales, Regional Manager, 16 November 2010)

The quasi inexistence of monitoring aimed at checking if the loan was invested as planned can be explained by the very high growth targets, which demand from the institutions a sustained rhythm of loan disbursements. This in turn forces the employees of microfinance institutions to concentrate on loan disbursements, assigning less time to monitoring. As shown above, when the clients take several loans which are not invested in the business, the debt burden increases while the benefits generated by their activity remain the same or even decrease. Thus, the client is more vulnerable in case of even a small downturn in the business or in the case of an external negative shock.

Tienen mucha razón en que el destino del crédito que a veces se le ha dado al cliente no ha utilizado el dinero, se lo ha dado a algún familiar, ha hecho un nuevo negocio, el destino del crédito importante, varios créditos creo que por el destino del crédito como decían se ha caído. [...] los otros bancos ni le preguntan, porque ellos mismos dicen, hay otro bancos a mí no me preguntan ni siquiera me ofrecen cuánto, que si yo tengo 20.000 30.000 soles aprobado y ahí estaba la plata (Luz Valdez)

Se está trabajando solamente otorgamientos de créditos y metas y no se hace seguimiento (Marcos Corrales)

The persons interviewed at host institution level alike the industry professionals have the same perception about the Peruvian microfinance market as being characterised by overindebtedness and extreme credit offer. The only difference is that the employees of CREAR are confronted every day with cases of overindebted clients, which gives them a more vivid picture of the causes and effects of overindebtedness. According to agency manager of Los Olivos:

Netamente es el sobre-endeudamiento que es horrible, el sobre-endeudamiento es catastrófico, al cliente de un momento a otro lo hace, de rey lo vuelve a mendigo, [...] lo mata, lo mata al cliente (Cesar Gordillo)

All the employees of CREAR interviewed described to large extent the practice of microfinance institutions to push the clients to take loans, a practice that can be described as **forced feeding**. According to the credit coordinator of the Los Olivos Agency:

El cliente pagaba 3,000 soles puntuales, [...] la cuota es 315 soles. ¿Qué hacía [Banco X]? Le daba por ejemplo 10,000 soles a tres años, va poderme pagar porque como me ha pagado 3,000 a un año que es la cuota 315 soles, le doy 10,000 a tres años, que la cuota es 315, pero no necesariamente el cliente te va pagar ese crédito, uno que ni siquiera sabe en qué lo invirtió, se lo dan nada más por dar, ni siquiera se aseguran del destino del crédito...

This behaviour from the part of the microfinance institutions can be explained by looking at the environment of extreme competition which characterises the area where the study took place. According to all the persons interviewed at CREAR level, the microfinance institutions are in a continuous race for placing more and more money on the market. Aside from increasing the systemic risk, this also influences the behaviour of the clients, by artificially creating needs. According to the agency manager, this in turn becomes a problem for the client:

Hay [...] sobre-oferta de dinero y no todos saben administrar bien sus deudas, conlleva a que se les cree una necesidad que a veces en vez de crearles una necesidad, les crea un problema (Cesar Gordillo)

The client acts opportunistically and benefits from the increased supply of microloans, but in the end the effect is overindebtedness and payment incapacity, which in turn damages the client's reputation in the financial system and makes it impossible to access future loans. Like this, clients end up being excluded from the financial system. According to the regional Manager of CREAR:

La competencia viene le da cualquier monto, lo convence en recibir cualquier monto, lo recibe y lo hace malo. Un cliente bueno lo hacen malo... (Cesar Gordillo)

The practices seen above do not circumscribe to what is generally understood as cautious lending practices. According to the employees of CREAR, the lax loan assessment standards on one hand and the lack of loan monitoring on the other hand are endangering the sector. Given the increasing pressure to disburse loans, microfinance institutions are having the tendency to simplify the decision process to the maximum. This is paradoxically made possible by the high level of transparency of the Peruvian microfinance market. Being one of the most advanced countries for microfinance, Peru also has one of the most advanced credit bureaus, where the majority of financial institutions (including microfinance institutions) report to. Because the access to these credit bureaus is open to each participant who can access full information on any client, some microfinance institutions are using this readily available information as a credit assessment tool, subsequently offering new loans to clients without a formal analysis:

Crean accesos demasiados fáciles, el tema de los requisitos obviamente los flexibiliza al máximo, ya no pide casi nadie documentación [...] pocos requisitos, evaluación muy ligera, ya no preguntan nada, solamente llenan formularios y les entregan el crédito. Hay empresas que no miden [...] que quieren es solamente llegar a las metas, después cómo cobran no les interesa (Marcos Corrales)

Hay entidades que se fían en la evaluación de una buena entidad, ósea una buena entidad le ha dado...ya, hay que darle (Cesar Gordillo)

Hay otros clientes que sí, le llegan tremendas cartas de todos los bancos, 30,000 soles, 40,000 soles, 50,000 soles [...] Sí, te mandan los bancos, te mandan, tienes tu crédito aprobado de 30,000 soles, 40,000 soles, ven a cobrar sólo con tu DNI (Luz Valdez)

This behaviour of the microfinance institutions together with the vast offer of microloans shifts the balance of power between the borrower and the lender³³⁹. This puts pressure on institutions to ask less and less information from the clients and to reduce to a minimum the loan assessment process, thus increasing the risk of default.

Al cliente también les resulta, por el tema de la competencia, les resulta también un poco molesto volver a tirar papeles (Cesar Gordillo)

El tema de los requisitos obviamente los flexibiliza al máximo, ya no pide casi nadie documentación, [...] empieza a tener malos hábitos crediticios, la cultura empieza a deteriorarse sobre al respecto de los requisitos, [...] ya no preguntan nada, solamente llenan formularios y les entregan el crédito (Marcos Corrales)

According to the persons interviewed at the host institution level, in this context of increased offer and easily available loans the clients act opportunistically and without foresight. Thus, a big part of the blame for overindebtedness can be put on the client's shoulders.

Cual es en tu opinión, la culpa del cliente en ese proceso?

Ser irresponsable porque fácilmente, te dicen ya, tienes aprobado 2,000 soles y ni siquiera sabe en qué lo va invertir, y viene corriendo a cobrarlo, ósea sin quizás darse cuenta si está en la posibilidad de verdad de poder pagar, ósea no le interesa, porque [...] hay otros clientes que sí, le llegan tremendas cartas de todos los bancos, 30,000 soles, 40,000 soles, 50,000 soles (Luz Valdez)

Nonetheless, as we will see below, the motivations of the interviewed clients to take several loans and not invest them in their activities is not at all arbitrary or not thought through.

Client level

The interviews with the microfinance professionals and the employees of the host institution gave me the possibility to gain a detailed vision of the analysed case and to construct a series of hypotheses, which I then tested during the last phase of my research, i.e. interviews with the clients of CREAR. The most important hypothesis was that, according to the interviewed persons from

³³⁹ See pages 40 sq.

CREAR, the client's decision to take multiple loans and not invest them in the business activity is arbitrary and denotes an opportunistic behaviour. Nevertheless, during the interviews I had with CREAR's clients which were overindebted I discovered that in fact their decision was not at all the result of hazard or insufficient caution, but rather the clients took new loans forced by the particular situations they were in. I call this **desperate borrowing**, as it denotes the situation in which a client forced by an external shock (health problems of family members, theft, loss of an important business partner) takes a loan knowing that it will not be invested in the business and sometimes knowing that he or she will not be able to pay it back. In the majority of the cases encountered, clients took loans because they were facing an emergency related to the health of a family member. In a lesser number of cases the cause for desperate borrowing was related to the business, and clients were taking loans in order to recover after a shock.

Mi hija [...] hace ya un año que se me ha caído, pero le molestaba, y por eso le hice operar. De ahí agarré, llegó un momento que me quedé sin dinero, no sabía qué hacer, entonces fui acá a un ente que se llama la Caja Municipal X, y opere a mi hija, me quedé sin plata, buscaba de donde sacar dinero [...] y me fui acá a un esto, y lleve mis papeles a la Caja Municipal X, les dije que si podía, una señorita le dije: sabe que he tenido problemas, quisiera saber si me puede atender o si no, la señorita me dijo que sí, lo único que le podemos dar es 500 soles, nada más, de ahí saque de otro, me dieron otros 500, como tres, cuatro bancos me dieron así...(Interview with Rosa Mamani , 22 November 2010, 45 years, 6 loans)

Mi madre lo tenía en fase terminal de cáncer y prácticamente el dinero que fue para negocio lo destiné en salud de mi madre por cuestiones de salud, de problemas familiares me hice de unos préstamos, trabajé con Banco Y, de ahí trabajé con Caja X, y con Financiera Z. Para que no tuve problemas, pero ahora, últimamente sí tuve problemas porque me hice un préstamo de 7,000 soles en una Financiera X y en la otra de Financiera Y que me hice de 10,000 soles... (Interview with Pablo Romero, 19 November 2010, 49 years, 4 loans)

The experiences of the clients also show in vivid colours what was discovered at institutional level – forced feeding of the clients by the microfinance institutions through very aggressive marketing practices, extremely light loan assessment and very flexible requirements. Another widespread practice is to offer clients with good repayment history new loans with no previous analysis and with no defined destination.

Banco X me dijeron así: señora se ha ganado, usted es la señora Borda, sí, se ha ganado un premio, entonces, ¿qué premio me he ganado? Usted se ha ganado el premio de 30,000 soles me dijeron que me he ganado, a ver, voy a ir, voy a llamar, deme sus datos [...], y yo llegué al banco y ya en ella el administrador recién empezaba y me dijo sí, has ganado estas con el Fulano Tal, que te ha llamado, ya, ¿cómo debo hacer? Venga por acá, me hicieron sentar, firme acá, firme todo, todo, no leía, solamente firmaba, [...] y luego cuando vino el mes siguiente [...] me dijeron ¿señora Borda cómo está? Bueno le llamamos del Banco X, yo le digo, ah sí, de qué se trata, me dijo señora le estamos haciendo recordar que hoy día se vence la primera letra del pago. ¿De qué pago? Del pago de 30,000 soles que sacó, ah qué bien que supieron hacerla, entonces si a usted le dicen que se ha ganado esa plata, [...] entonces yo le dije, y cómo puedo pagar, tú me has dicho que es un premio... (Interview with Margarita Borda, 18 November 2010, 53 years, 4 loans)

In the majority of cases another phenomenon revealed – **loan bicycling**, or the practice of taking new loans in order to repay older loans. This is done with the aim of maintaining a good relationship with one microfinance institution, which is perceived as being the most important. Obviously, this means that the other lenders are left aside, and the loans taken from them are not repaid.

Ese dinero, con eso se pagaba el banco, ahora yo me tengo que prestar, sacar por otro lado, eso es lo que pasa. (Interview with Claudia Rivero, 22 November 2010, 41 years, 7 loans)

A [los bancos] no les interesa, ósea tu problema, lo que les interesa es que pagues y punto, y no le interesa de dónde saques, la gracia que tú pagues, entonces tenía que ir a sacar de un sitio, para cubrir a ellos y pagar otros intereses por otro lado, y qué haces, que se te haga quizás una ruleta rusa, que estés sacando de allá, de allá, para que cumplas con uno, para que quedes bien con uno, pero quedas mal con los demás. (Interview with Daniel Rosales, 20 November 2010, 45 years, 5 loans)

Given the increased debt burden on the household finances, savings are reduced as an increasing part of the household budget is destined for loan repayments. In the majority of the analysed cases, clients are incapable of putting aside even a small amount of money on a regular basis. This creates a vicious circle, because due to their incapacity to save households are vulnerable to external shocks. If such shock occurs, the money needed for hospitalisation or for other urgent needs comes not from an emergency fund of the household but from microfinance loans. By taking microfinance

loans to cover emergency needs, the clients further indebt themselves and become even more vulnerable.

¿Y usted ahorra por caso de emergencia, tiene la capacidad de ahorrar un poco?

No, no se puede, como te digo está programado así al milímetro, fríamente calculado, con un pequeño desbalance que ha sido mi enfermedad, [...]

¿Y antes ahorrabas, tenía está costumbre?

Claro, teníamos costumbre, teníamos cuenta en el banco, todo eso, pero hay un momento que no se puede, ah, hay un percance y como tengo crédito en cualquier financiera puedo sacar ponte, 1,000 soles o 500 soles trato de cubrir con eso, cualquier percance, de salud, que se yo, yo sé que si voy a Banco Y me dan 500 soles, así nomás voy y firma y sacó; voy a Banco Z también me dan 500 soles ... (Interview with Daniel Rosales, 20 November 2010, 45 years, 5 loans)

Overindebtedness has a range of negative effects on the clients and their family members. Two main effects were identified: high personal sacrifices made in order to cope with the difficult financial situation, and high level of psychological stress which affects all the household members.

A veces tengo que pasar un montón de dificultades o tal vez le digo vergüenza por, para darles a mis hijas [...], pero solamente por tratar de pagar al Banco, ósea todo ese problema que tengo, que le digo no creo que nadie pasaría lo que yo, sinceramente he pasado (Interview with Lucia Quispe, 17 November 2010, 35 years, 3 loans)

Porque yo nunca me he atrasado, jamás, jamás en mi vida me he atrasado porque yo me siento mal [...] me agarró la depresión, después que me sentí eso, no tienes ánimos de trabajar, no tienes esas ansias de trabajar, o salir adelante...

¿Cuáles fueron los efectos de este estrés sobre su familia y su hogar?

El estrés fue que mi familia primerito yo vi cuando ya mis hijos estén sin hacer nada, cuando se enfermaron, eso es desesperante porque tú no sabes cómo darles para que ellos estén bien, con tal que tú los veas así, porque ellos son bien tranquilos, mis dos hijos están tranquilos, ya está bien, yo cuando ya me sentí mal, yo dije, ya no, yo necesitaba una operación urgente, pero tenía que prestarme, yo dije, de dónde voy a sacar (Interview with Sonia Gonzales, 19 November 2010, 46 years, 2 loans)

As my field study took place while the Indian overindebtedness crisis was unfolding with full force, in this context it has to be noted that none of the interviewed clients mentioned unfair or illegal recovery practices of microfinance institutions, and all of them had a clear image of how much they owed to the MFIs. Another interesting finding is related to the issues of interest rates and of moneylenders which are often cited as contributing to overindebtedness, but which in my research did not appear as having a noticeable weight.

6.2. Correlation with the main objective and possible answers to the principal and secondary investigation questions

The main objective of my research was to identify and analyse the causes for the overindebtedness of microfinance clients in the case of the clientele of Financiera CREAR. It was found that overindebtedness is the result of a mix of heterogeneous causes related to the functioning of the microfinance industry, of its institutions and to the specific behaviours of the clients.

The integration of the microfinance industry in the traditional financial sector generated a widespread tendency towards commercialization and an increased competition between institutions. The Peruvian microfinance industry became very attractive, registering record levels of profitability, and the majority of financial institutions saw increasing business opportunities in this development. Thus, aggressive growth targets, liquidity pressure and a high concentration of microfinance institutions in urban areas resulted in a constant race for customers which transformed the urban area in a jungle, where microfinance institutions are **cannibalising** each other. The constant race for improved financial performance is forcing the institutions to concentrate on profit targets, inclining the balance towards the financial end of the scale, and thus endangering the double-bottom line which characterises the industry.

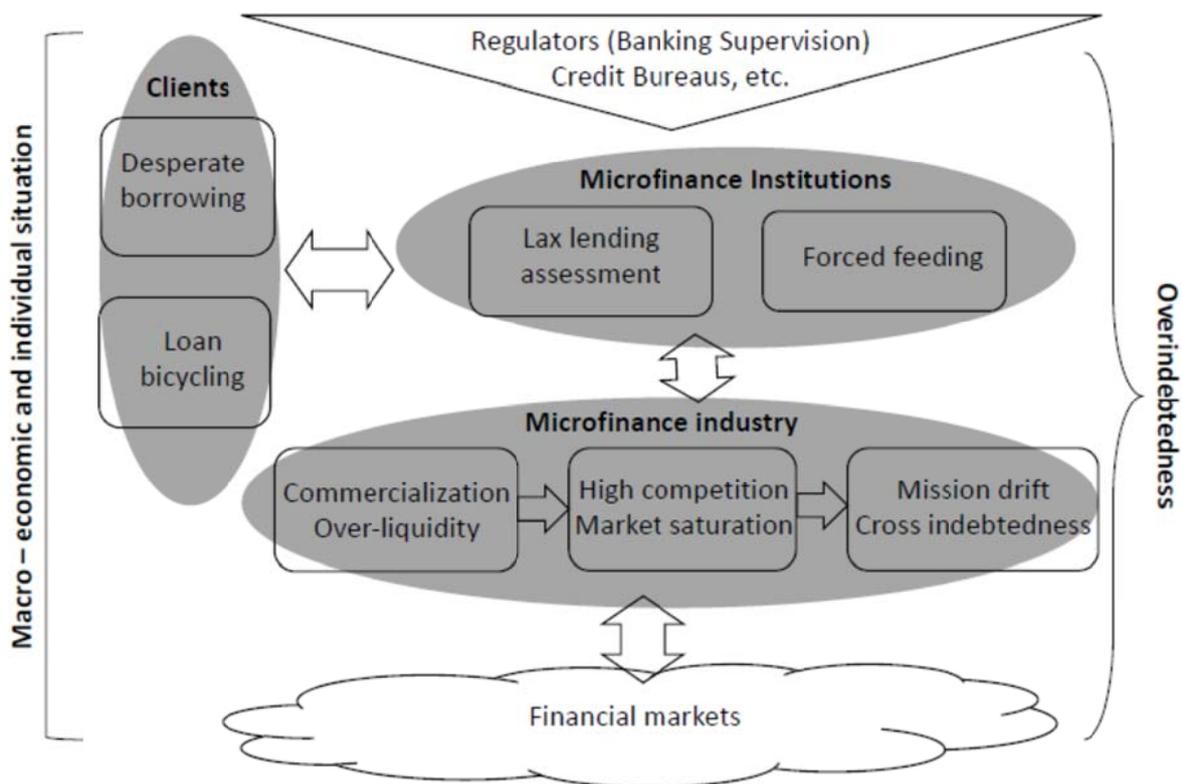
Microfinance institutions are functioning under two major constraints: on the one hand they have to reach ambitious growth targets and on the other hand they are faced with a harsh competition. The Peruvian microfinance industry expanded rapidly in the last years, reaching saturation levels in urban areas, and in such a situation the only possible way to grow is to pump money in the existing clientele. This forces the microfinance institutions to reduce their requirements to a minimum and simplify their risk assessment processes to unsustainable levels. In the same time, microfinance institutions are flooding the clients with credits, using various practices to determine the clients to take new and larger loans, a process which can be described as **forced-feeding**.

The clients took advantage of the readily available offer and overindebted themselves not by hazard, but because they used microloans as an “emergency cash box” to cover urgent expenses related to the household or the business. In the majority of the analysed cases, these urgent needs were generated by the health problems of a family member which forced the clients to take microfinance loans, a phenomenon I call **desperate borrowing**. In a lesser number of cases, clients were practicing **loan bicycling** by taking new loans in order to repay older loans. In such cases, clients intend to

maintain a good repayment history with one institution which is perceived as being the most important, while loans taken from institutions which are perceived as less important are not repaid.

The complex relations between the phenomena described above can be synthesized in a methodological chain of causes and effects, similar to the one proposed by Jean-Michel Servet in his book *Le grand renversement*³⁴⁰ (which exemplifies the generalised process of financialization). The following graphic illustrates how the sector-wide developments within the microfinance industry are influencing the functioning of microfinance institutions. In the same time it shows the relations between the latter and their clients, highlighting the main causes which ultimately lead to overindebtedness. Finally, the larger financial system and the regulating entities are brought to the picture.

Figure 7: The chain of overindebtedness



³⁴⁰ Jean-Michel SERVET, *Le grand renversement. De la crise au renouveau solidaire*, Desclée de Brouwer, Paris, 2010, pp. 75 sq.

6.3. Conclusion

Overindebtedness finally leads to vulnerability, as more loans increase the debt levels; increasing debt levels decrease the borrower's capacity to save; savings acts as a buffer, and in its absence the borrower's business and family are more vulnerable to outside shocks, and thus forced to resort to new loans. This is the vicious circle of debt, which has disastrous effects on the client, the household and the business.

When microfinance causes the overindebtedness of its beneficiaries, it is increasing the vulnerability and exclusion of the target group instead of decreasing it. Consequently, the threat of overindebtedness is three fold: first, it poses a risk to the reputation of the entire microfinance sector, which appears to the public as yet another face of the global system responsible for the financial crisis which emerged in 2007. Second, it endangers institutions which were successful examples of sustainability and social performance. Last, it has miserable effects on the borrowers, who are caught in a debt trap and are experiencing an ever-increasing psychological and social stress.

From this perspective, at the end of this research several reflections are to be made. The first one is that the microfinance actors, be it institutions, shareholders, investors or regulators, should analyse the current state of the industry and publicly debate on a set of pressing issues: what is the distinction today between microfinance and traditional banking business or consumer lending? What are the expected outcomes of microfinance in social and financial terms? What are the reasonable growth and profitability targets of a microfinance institution in Peru? This will allow the industry to rethink and re-invent itself, giving it the possibility to maintain its financial inclusion feature.

Second, the microfinance market cannot grow on medium term as it has grown in the last ten years. In order to expand, new markets have to be covered, such as rural and remote areas. Of course, this means less efficiency and profitability, but only by providing access to credit to new layers of unserved population can the industry grow while keeping its promise of financial inclusion.

Last, the experience in Peru showed that the role of the bank supervision and of regulatory bodies in a context of increased competition and market saturation is crucial, as they are the only ones able to put a break to the tendency of risky over-lending.

Bibliography

- ANDERLONI Luisa, VANDONE Daniela, "Households Over-indebtedness in the Economic Literature", Working Paper no. 2008-46, Milano, 2008, 68 p.,
http://www.economia.unimi.it/uploads/wp/Deas2008_46wp.pdf (retrieved 4 January 2011)
- ANDERLONI Luisa, VANDONE Daniela, "Risk of overindebtedness and behavioural factors", Working Paper no. 2010-25, Milano, 2010, 19 p.,
http://www.economia.unimi.it/uploads/wp/DEAS2010_25wp.pdf (retrieved 10 December 2010)
- The Associated Press, "Microfinance IPO, mission conflict",
http://www.pressherald.com/business/microfinance-ipo-mission-conflict_2010-07-29.html
(retrieved 10 December 2010)
- ARMENDÁRIZ Beatriz, MORDUCH Jonathan, "Microfinance beyond group lending", *Economics of Transition*, Vol. 8, no. 2, 2000, pp. 401 – 420,
http://www.microfinancegateway.org/gm/document-1.9.24985/18230_Microfinance_Beyond_Group_Lending.pdf (retrieved 17 December 2010)
- ARMENDÁRIZ Beatriz, MORDUCH Jonathan, *The Economics of Microfinance*, Second Edition, MIT Press, Cambridge, 2010, 468 p.
- ARMENDÁRIZ B., SZAFARZ A., "On mission drift in microfinance institutions", Solvay Brussels School of Economics and Management, Centre Emile Bernheim, CEB Working Paper N° 09/015, Brussels, 2009, 30 p.,
https://dipot.ulb.ac.be:8443/dspace/bitstream/2013/53972/1/RePEc_sol_wpaper_09-015.pdf
(retrieved 29 December 2010)
- BANCOSOL, "BancoSol: del microcrédito a las microfinanzas", BancoSol, La Paz, Bolivia, 27 p.,
<http://www.bancosol.com.bo/archivos/otros/historiamicro.s.pdf> (retrieved 10 December 2010)
- BENNETT Lynn, "A Systems Approach to Social and Financial Intermediation with the Poor", Paper presented at the Banking with the Poor Network/World Bank Asia Regional Conference on Sustainable Banking with the Poor, Bangkok, November 3–7, 1997 in LEDGERWOOD Joanna, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, 304 p.
- BERENBACH Shari, GUZMAN Diego, "The Solidarity Group Experience Worldwide", in OTERO Maria, RHYNE Elisabeth (eds.), *The New World of Microenterprise Finance. Building Healthy Financial Institutions for the Poor*, Kumarian Press, Connecticut, 1994, pp. 119 - 140
- BETTI Gianni *et al.*, "Study of the problem of Consumer Indebtedness. Statistical Aspects", Report Submitted to Commission of the European Communities, Brussels, 2001, 119 p.
http://ec.europa.eu/consumers/cons_int/fina_serv/cons_directive/fina_serv06_en.pdf
(retrieved 4 January 2011)
- BHATT Nitin, TANG Shui-Yan, "Delivering Microfinance in Developing Countries. Controversies and Policy Perspectives", *Policy Studies Journal*, Vol. 29, No. 2, 2001, pp. 319-333,
<http://onlinelibrary.wiley.com/doi/10.1111/j.1541-0072.2001.tb02095.x/pdf> (retrieved 20 December 2010)
- BOUQUET Emmanuelle *et al.* "Trajectoires de crédit et vulnérabilité des ménages ruraux. Le cas des Cecam de Madagascar", *Revue Autrepart*, No. 44, 2007, pp. 157–172,
http://www.cairn.info/load_pdf.php?ID_ARTICLE=AUTR_044_0157 (retrieved 4 January 2011)
- BRIDGES Sarah, DISNEY Richard, "Use of Credit and Arrears on Debt among Low-Income Families in the United Kingdom", *Fiscal Studies*, 2004, Vol. 25, Issue 1, 2004, pp. 1-25

- BRIX Laura, McKee Katharine, "Consumer Protection Regulation in Low-Access Environments. Opportunities to Promote Responsible Finance", CGAP Focus Note No. 60, Washington D.C., 2010, 32 p., <http://www.cgap.org/gm/document-1.9.42343/FN60.pdf> (retrieved 5 January 2011)
- BRYMAN Alan, *Social Research Methods*, Third Edition, Oxford University Press, Oxford, 2008, 748 p.
- CAMPION Anita, DUNN Elizabeth, "The Transformation of Acción Comunitaria del Perú (ACP) to Mibanco", 2001, 40 p., http://www.microlinks.org/ev_en.php?ID=7505_201&ID2=DO_TOPIC (retrieved 10 December 2010)
- CASEY Greg, "Nobel Laureate Muhammad Yunus Speaks Out Against For-Profit Microfinance", Asia-Pacific Microcredit Summit, 2008, <http://www.microcapital.org> (retrieved 10 December 2010)
- CGAP, "Andhra Pradesh 2010. Global Implications of the Crisis in Indian Microfinance", CGAP Focus Note No. 67, Washington, 2010, 8 p., www.cgap.org/gm/document-1.9.48945/FN67.pdf (retrieved 5 January 2010)
- CGAP, "2010 MIV Survey Report. Market Data & Peer Group Analysis", CGAP/Symbiotics, 2010, 42 p., http://www.cgap.org/gm/document-1.9.47373/CGAP_2010_MIV_Survey_Report.pdf (retrieved 23 December 2010)
- CHAO-BÉROFF, R., "Developing Financial Services in Disadvantaged Regions. Self-managed Village Savings and Loan Associations in the Dogon Region of Mali", in H. Schneider (ed.), *Microfinance for the poor?*, IFAD/OECD, 1997, pp. 87-108
- CHEN Greg, RASMUSSEN Stephen *et al.*, "Growth and Vulnerabilities in Microfinance", CGAP Focus Note No. 61, Washington D.C., 2010, 16 p., <http://www.cgap.org/gm/document-1.9.42393/FN61.pdf> (retrieved 4 January 2011)
- CHEN Greg, RASMUSSEN Stephen *et al.*, "Indian Microfinance Goes Public. The SKS Initial Public Offering", CGAP Focus Note No. 65, Washington D.C., 2010, 16 p., http://www.cgap.org/gm/document-1.9.47613/FN65_Rev.pdf (retrieved 4 January 2011)
- CHRISTEN Robert Peck, "Commercialization and Mission Drift. The Transformation of Microfinance in Latin America", CGAP Occasional Paper No. 5, 2001, 24 p. <http://www.unCDF.org/mfdl/readings/CGAPocc5.pdf> (retrieved 23 December 2010)
- CHRISTEN Markus, MORGAN Ruskin, "Keeping Up With the Joneses: Analyzing the Effect of Income Inequality on Consumer Borrowing", *Quantitative Marketing and Economics*, Vol. 3, No. 2, 2005, pp. 145-173
- CHRISTEN Robert Peck, RHYNE Elisabeth *et al.*, "Maximizing the Outreach of Microenterprise Finance. An Analysis of Successful Microfinance Programs", USAID Program and Operations Assessment Report No. 10, USAID, 1995, 67 p., http://www.microlinks.org/file_download.php/PNABS519.pdf?URL_ID=7264&filename=11201324431PNABS519.pdf&filetype=application%2Fpdf&filesize=139447&name=PNABS519.pdf&location=user-S/ (retrieved 29 December 2010)
- CHRISTEN Robert Peck, ROSENBERG Richard *et al.*, "CGAP Occasional Paper no. 8. Financial Institutions with a 'Double Bottom Line': Implications for the Future of Microfinance", Washington, 2004, 20 p., <http://www.cgap.org/gm/document-1.9.2701/OP8.pdf> (retrieved 10 December 2010)
- COLLINS Daryl, MORDUCH Jonathan *et al.*, *Portfolios of the Poor: How the World's Poor Live on \$2 a Day*, Princeton University Press, New Jersey, 2009, 283 p.
- CONGER Lucy, INGA Patricia *et al.*, *The mustard tree. A history of Microfinance in Peru*, Universidad de San Martín de Porres, Lima, 2009, 176 p.
- CONNING Jonathan, "Outreach, sustainability and leverage in monitored and peer-monitored lending", *Journal of Development Economics*, Vol. 60, 1999, pp. 51-77, <http://urban.hunter.cuny.edu/~conning/papers/JDEcopy.pdf> (retrieved 29 December 2010)
- COPEME, "Memoria 2008 – 2009", Lima, 2010, 60 p., <http://www.copeme.org.pe/images/stories/copeme/memoria/memoriacopeme2008-2009.pdf> (retrieved 10 December 2010)

- COPEME, "Microfinanzas en el Perú. Información a Junio 2010", Lima, September 2010, 97 p.
- COPEME, "Microfinanzas en el Perú. Reporte Abril 2010", Lima, April 2010, 114 p.
- COPEME, "Microfinanzas en el Perú. Reporte Julio 2010", Lima, July 2010, 122 p.
- CULL Robert, DEMIRGÜÇ-KUNT Asli *et al.*, "Financial Performance and Outreach: A Global Analysis of Leading Microbanks", Policy Research Working Paper 3827, World Bank, Washington, 2006, 51 p., http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2006/01/24/000016406_20060124163013/Rendered/PDF/wps3827.pdf (retrieved 17 December 2010)
- CULL Robert, DEMIRGÜÇ-KUNT Asli *et al.*, "Microfinance Meets the Market", Policy Research Working Paper 4630, The World Bank, Washington, 2008, 40 p., <http://dri.fas.nyu.edu/docs/IO/13017/Microfinancemeetsthemarket.pdf> (retrieved 10 December 2010)
- DELLIEN Hans *et al.*, *Product Diversification in Microfinance: Introducing Individual Lending*, Women's World Banking, New York, 2005, 80 p., http://www.swwb.org/files/pubs/en/product_diversification_in_microfinance_introducing_individual_lending_e.pdf (retrieved 17 December 2010)
- DENZIN Norman K., *The research act in sociology. A theoretical introduction to sociological methods*, Butterworths, London, 1970, 368 p.
- DEVANEY Patricia Lee, *Bringing Pro-Consumer Ideals to the Client. A Consumer Protection Guide for Financial Institutions Serving the Poor*, ACCIÓN Publication, Monograph Series No. 14, Washington D.C., 2006, 50 p. http://resources.centerforfinancialinclusion.org/publications/Bringing_P_207.asp (retrieved 5 January 2011)
- DIECKMANN Raimar, "Microfinance: an emerging Investment opportunity. Uniting social investment and financial returns", Deutsche Bank Research, Frankfurt am Main, 2007, 20 p., <http://www.microfinancegateway.org/gm/document-1.9.25062/41.pdf> (retrieved 20 December 2010)
- DISNEY Richard, BRIDGES Sarah *et al.*, "Drivers of Overindebtedness", Centre for Policy Evaluation, The University of Nottingham, 2008, 87 p., <http://www.bis.gov.uk/files/file49248.pdf> (retrieved 10 December 2010)
- DRAKE Deborah, RHYNE Elisabeth, *The commercialization of microfinance. Balancing business and development*, Kumarian Press, Connecticut, 2002, 320p.
- DUNFORD Chris, "What's wrong with loan size?", Published by Freedom from Hunger, 2002, 7 p., http://collab2.cgap.org//gm/document-1.9.26357/3223_3223.pdf (retrieved 29 December 2010)
- DUNN Elizabeth, "Diversification in the household economic portfolio", Assessing the Impact of Microenterprise Services (AIMS), Management Systems International, Washington, 1997, 29 p.
- EUROPEAN COMMISSION, *Towards a Common Operational European Definition of Over-indebtedness*, Brussels, 2008, 131 p. <http://ec.europa.eu/social/BlobServlet?docId=763&langId=en> (retrieved 4 January 2011)
- THE ECONOMIST, "Froth at the bottom of the pyramid. Is microfinance going the same way as subprime mortgages?", 25th of August 2009
- Economist Intelligence Unit, "2008 Microscope on the Microfinance Business Environment in Latin America and the Caribbean", London, 2008, 68 p., http://graphics.eiu.com/marketing/microfinance/English_Microscope%202008.pdf (retrieved 10 December 2010)
- Economist Intelligence Unit, "Global microscope on the microfinance business environment", London, 2009, 68 p., http://graphics.eiu.com/upload/eb/Microfinance_ENG_WEB_Sept%202009.pdf (retrieved 10 December 2010)

- Economist Intelligence Unit, "Global microscope on the microfinance business environment 2010", London, 2010, 74 p.,
http://graphics.eiu.com/upload/eb/EIU_Global_Microscope_2010_Eng_WEB.pdf (retrieved 10 December 2010)
- EDGCOMB Elaine, BARTON Laura, "Social Intermediation and Microfinance Programs. A Literature Review", SEEP Network, 1998, 60 p.,
http://www.microlinks.org/file_download.php/social.pdf?URL_ID=7495&filename=11202841011social.pdf&filetype=application%2Fpdf&filesize=385444&name=social.pdf&location=user-S/ (retrieved 29 December 2010)
- FERNANDO Nimal A., "Mibanco, Peru: profitable microfinance outreach, with lessons for Asia", Asian Development Bank, 2003, 28p.,
<http://www.adb.org/documents/papers/mibanco/mibanco.pdf> (retrieved 10 December 2010)
- GEHRKE Matthew, MARTÍNEZ Renso *et al.*, "Championship League 2008. MIX Latin America & Caribbean 100", 2008, 13 p.,
<http://www.themix.org/sites/default/files/2008%20LAC%20Championship%20League%20EN G.pdf> (retrieved 10 December 2010)
- GERRING John, "What Is a Case Study and What Is It Good for?", *The American Political Science Review*, Vol. 98, No. 2, 2004, pp. 341 - 354
- GLOUKOVIEZOFF Georges, *De l'exclusion à l'inclusion bancaire des particuliers en France. Entre nécessité sociale et contrainte de rentabilité*, Thèse de doctorat en sciences économiques, Faculté de sciences économiques et de gestion, Université Lumière Lyon 2, 2008, 586 p.,
<http://gloukoviezoff.files.wordpress.com/2009/01/these-version-finale.pdf> (retrieved 10 January 2011)
- GLOUKOVIEZOFF Georges, "The link between financial exclusion and over-indebtedness. Working paper", 10 p., <http://www.fininc.eu/gallery/documents/working-papers/working-paper-financial-exclusion-over-indebtedness-final.pdf> (retrieved 10 December 2010)
- GOKHALE Ketaki, "A global surge in tiny loans spurs credit bubble in a slum", *The Wall Street Journal*, 13 August 2009
- GONZALEZ Adrian, *Microfinance, Incentives to Repay, and Overindebtedness: Evidence from a Household Survey in Bolivia*, Doctoral thesis, Ohio State University, Ohio, 2008, 178 p.,
<http://etd.ohiolink.edu/send-pdf.cgi/Gonzalez%20Adrian.pdf?osu1211556326> (retrieved 4 January 2011)
- GUÉRIN Isabelle, ROESCH Marc *et al.*, "Microfinance, endettement et surendettement. Une étude de cas en Inde du Sud", *Revue Tiers Monde* No. 197, 2009, pp. 131 – 146
- GUÉRIN Isabelle, ROESCH Marc *et al.*, "Crise, microfinance et surendettement. Une étude de cas en Inde du Sud", in Phélinas P. and Sélim M. (eds.), *La crise vue d'ailleurs*, L'Harmattan, Paris, 2010, pp. 241-269
- HAAS Oliver J., "Overindebtedness in Germany" Working Paper No. 44, Social Finance Program, International Labour Organization, Geneva, 2006, 19 p.,
http://www.ilo.org/wcmsp5/groups/public/---ed_emp/documents/publication/wcms_117963.pdf (retrieved 4 January 2011)
- HAMMERSLEY Martyn, *The relationship between qualitative and quantitative research: paradigm loyalty versus methodological eclecticism*, in RICHARDSON John T. E. (ed.), *Handbook of Qualitative Research Methods for Psychology and the Social Sciences*, BPS Blackwell, Oxford, 1996, pp. 159–174
- HATCH John K., FREDERICK Laura, "Poverty Assessment by Microfinance Institutions. A Review of Current Practice", *Microfinance Best Practices/USAID*, 1998, 63 p.,
http://www.microfinancegateway.org/gm/document-1.9.28864/1241_01241.pdf (retrieved 29 December 2010)

- HÉLIÈS Ophélie, "Surendettement : le chemin vers l'extrême pauvreté", BIM n° - 13 janvier 2007, 2007, 6 p., <http://microfinancement.cirad.fr/fr/news/bim/Bim-2007/BIM-07-03-13.pdf> (retrieved 10 December 2010)
- HELLMANN Thomas, MURDOCK Kevin, STIGLITZ Joseph, *Liberalization, Moral Hazard in Banking, and Prudential Regulation: Are Capital Requirements Enough?*, *The American Economic Review*, Vol. 90, No. 1, 2000, pp. 147-165, <http://individual.utoronto.ca/zheli/G31.pdf> (retrieved 10 December 2010)
- HELMS Brigitte, *Access for all. Building inclusive financial systems*, CGAP, Washington, 2006, 170 p., http://www.cgap.org/gm/document-1.9.2715/Book_AccessforAll.pdf (retrieved 10 December 2010)
- HERMES Niels, LENSINK Robert *et al.*, "Outreach and Efficiency of Microfinance Institutions", Centre for International Banking, Insurance and Finance, University of Groningen, Holland, 2008, 29 p. <http://som.eldoc.ub.rug.nl/FILES/reports/2008/08002/08002.pdf> (retrieved 23 December 2010)
- HOLT Sharon L., "The village banking methodology. Performance and prospects" in OTERO Maria, RHYNE Elisabeth (eds.), *The New World of Microenterprise Finance. Building Healthy Financial Institutions for the Poor*, Kumarian Press, Connecticut, 1994, pp. 156 - 184
- HUDON M., "Should Access to Credit be a Right?", Working Paper N° 07/008, Centre Emile Bernheim, Solvay Brussels School, Brussels, 2007, 24 p., https://dipot.ulb.ac.be:8443/dspace/bitstream/2013/53925/1/RePEc_sol_wpaper_07-008.pdf (retrieved 10 December 2010)
- J.P. Morgan, "Impact Investments. An Emerging Asset Class", J.P. Morgan Global Research, November 2010, 96 p. http://www.jpmorgan.com/cm/cs?pagename=JPM/DirectDoc&urlname=impact_investments_nov2010.pdf (retrieved 23 December 2010)
- JANSSON Tor, "Microfinance: From Village to Wall Street", Inter-American Development Bank, Washington, 2001, 26 p., <http://www.microcapital.org/downloads/resourcepapers/IADB-VillagetoWallStreet.pdf> (retrieved 10 December 2010)
- JICK Todd D., "Mixing Qualitative and Quantitative Methods: Triangulation in Action", *Administrative Science Quarterly*, Vol. 24, No. 4, Qualitative Methodology, 1979, pp. 602-611
- JOHNSON Susan, "Microfinance is dead! Long live microfinance. Critical reflections on two decades of microfinance policy and practice", Centre for Development Studies, University of Bath, 2009, 11 p., http://www.bath.ac.uk/soc-pol/people/profiles/susan_johnson/Johnson_-_reflections.pdf (retrieved 10 December 2010)
- JOHNSTON Don, MORDUCH Jonathan, *Microcredit vs. Microsaving. Evidence from Indonesia*, New York, 2007, 23p., http://siteresources.worldbank.org/INTFR/Resources/Microcredit_versus_Microsaving_Evidence_from_Indonesia.pdf (retrieved 10 December 2010)
- KAPPEL Vivien, KRAUSS Annette, LONTZEK Laura, "Over-Indebtedness and Microfinance. Constructing an Early Warning Index", Center for Microfinance, University of Zurich, Zurich, 2010, 52 p., <http://www.microfinancegateway.org/gm/document-1.1.9421/overindebttness%20and%20microfinance.pdf> (Retrieved 15 January 2011)
- KAZMIN Amy, "Debt trap leads to despair for rural poor", *Financial Times*, 29 October 2010, <http://www.ft.com/cms/s/0/33dfa528-e378-11df-8ad3-00144feabdc0.html#axzz1ACFOVg5U> (retrieved 10 December 2010)
- KAZMIN Amy, DOMBEY Daniel, "Bangladesh High Court upholds Yunus exit", *Financial Times*, 8 March 2011, <http://www.ft.com/cms/s/0/a5e90038-4944-11e0-b051-00144feab49a.html?ftcamp=rss#axzz1G2glfdPe> (retrieved 8 March 2011)
- KHANDKER Shahidur R., "Grameen Bank. Impact, Costs, and Program Sustainability", *Asian Development Review*, Vol. 14, No. 1, 1996, pp. 65-85, <http://www.adb.org/documents/periodicals/adr/pdf/ADR-Vol14-1-khandker.pdf> (retrieved 20 December 2010)

- KHAWARI A., "Microfinance. Does it hold its Promises? A survey of recent literature", HWWA Discussion Paper No.276, Hamburg, 2004, 43 p.,
<http://ageconsearch.umn.edu/bitstream/26394/1/dp040276.pdf> (retrieved 10 December 2010)
- KRISHNA Anirudh, "Escaping poverty and becoming poor: who gains, who loses, and why?", *World Development* Vol. 32, No. 1, 2004, pp. 121–136,
http://siteresources.worldbank.org/INTPGI/Resources/Pro-Poor-Growth/Krishna_Rajasthan_poverty.pdf (retrieved 10 December 2010)
- LASCELLES David, *Microfinance Banana Skins 2008. Risk in a booming industry*, CSFI, New York, 2008, 52 p., <http://www.citigroup.com/citi/microfinance/data/news080303b.pdf> (retrieved 10 December 2010)
- LASCELLES David, "A different world. A follow-up to Microfinance Banana Skins 2009 'Confronting crisis and change'", CSFI, New York, 2010, 9p.,
<http://www.microfinancegateway.org/gm/document-1.1.4708/05.pdf> (retrieved 10 December 2010)
- LASCELLES David, MENDELSON Sam, *Microfinance Banana Skins 2009. Confronting crisis and change*, CSFI, New York, 2009, 42 p., <http://microrate.com/wp-content/uploads/2009/07/microfinance-banana-skins-2009-2.pdf> (retrieved 10 December 2010)
- LASHLEY Jonathan, "Microfinance in the Eastern Caribbean: Demand and Delivery Options", Paper presented at the St Vincent and the Grenadines Country Conference, May 22-24, 2003, 12 p.
<http://www.cavehill.uwi.edu/BNCCde/svg/conference/papers/lashley.html> (retrieved 22 December 2010)
- LEDGERWOOD Joanna, *Microfinance handbook. An institutional and financial perspective*, The World Bank, Washington, 1999, 304 p.
- LENSINK Robert, MERSLAND Roy, "Microfinance plus", Working paper, 2009, 31 p.,
<http://p31.itcilo.org/entdev/synergies/en/impact-assesments/microfinance-plus.lensink-r-and-mersland-r.2009> (retrieved 20 December 2010)
- LUSARDI Annamaria, TUFANO Peter, "Debt literacy, financial experiences, and overindebtedness", CERP, Working paper 83/09, 2009, 44 p.,
<http://siteresources.worldbank.org/INTFR/Resources/LusardiandTufano122208.pdf> (retrieved 10 December 2010)
- MAGNONI Barbara, "Bubble bubble Banex trouble", Financial Access Initiative, 2010,
<http://financialaccess.org/node/3547> (retrieved 10 December 2010)
- MARTÍNEZ Renso, RONDÓN María Cecilia *et al.*, "2010 Microfinance Americas: The Top 100", 2010, 18p., <http://www.themix.org/sites/default/files/2010%20Microfinance%20Americas%20-%20The%20Top%20100%20-%20EN.pdf> (retrieved 10 December 2010)
- MARULANDA Beatriz, FAJURY Lizbeth *et al.*, *Lo bueno de lo malo en microfinanzas: lecciones aprendidas de experiencias fallidas en America Latina*, Washington, 2010, 126 p.,
<http://www.microfinanzas.org/uploads/media/35404961.pdf> (retrieved 10 December 2010)
- MATTHÄUS-MAIER Ingrid, VON PISCHKE J. D. (dir.), *Microfinance investment funds. Leveraging private capital for economic growth and poverty reduction*, KfW Entwicklungsbank, Springer-Verlag, Berlin, 2007, 291 p.
- MAYOUX Linda, "Micro-finance and the empowerment of women: a review of the key issues", Social Finance Working Paper No. 23, ILO, Geneva, 2000, 31 p.,
http://www.ilo.org/wcmsp5/groups/public/---ed_emp/documents/publication/wcms_117993.pdf (retrieved 22 December 2010)
- MERSLAND Roy, STRØM Øystein R., "Microfinance mission drift?", Paper presented at the European Financial Management Symposium 2009, 30 p.,
<http://efmaefm.org/OEFMSYMPIUM/Nantes%202009/paper/bankdrift.pdf> (retrieved 29 December 2010)

- MicroRate, "State of Microfinance Investment. The MicroRate 2010 MIV Survey", MicroRate, 2010, 12 p., <http://microrate.com/wp-content/uploads/2010/07/The-MicroRate-2010-MIV-Survey-Report.pdf> (retrieved 23 December 2010)
- MIX, "The Microbanking Bulletin No.19", Washington, 2009, 112 p., <http://www.themix.org/sites/default/files/MBB%2019%20-%20December%202009.pdf> (retrieved 10 December 2010)
- Microfinance Information Exchange, "2009 MIX Global 100: Ranking of Microfinance Institutions", 2010, 15 p., <http://www.themix.org/sites/default/files/2009%20MIX%20Global%20100%20Composite.pdf> (retrieved 10 December 2010)
- MIX, "The Microbanking Bulletin No.20", Washington, 2010, 27 p., <http://www.themix.org/sites/default/files/MBB%2020%20-%20September%202010.pdf> (retrieved 10 December 2010)
- MONTGOMERY Heather, WEISS John, "Great Expectations. Microfinance and Poverty Reduction in Asia and Latin America", ADB Institute, Research Paper Series, No. 63, 2005, 34 p. <http://www.adbi.org/files/2005.02.rp63.microfinance.poverty.latinasia.pdf> (retrieved 26 December 2010)
- MORDUCH Jonathan, "The Microfinance Promise", *Journal of Economic Literature*, Vol. 37, Nashville, 1999, pp. 1569-1614, http://www.nyu.edu/projects/morduch/documents/microfinance/Microfinance_Promise.pdf (retrieved 10 December 2010)
- MORDUCH Jonathan, "The Microfinance Schism", *World Development* Vol. 28, No. 4, pp. 617-629, 2000, <http://faculty.insead.edu/kapstein/emdc/ARCHIVES/Reading/Restricted/Microfinance/Morduch%20WDev.pdf> (retrieved 10 December 2010)
- MORDUCH Jonathan, "Debunking the microfinance bubble", Financial Access Initiative, 2009, <http://financialaccess.org/node/2225> (retrieved 10 December 2010)
- MUHAMMAD Anu, "Grameen and Microcredit: A Tale of Corporate Success", *Economic & Political Weekly*, Vol. XLIV No. 35, Mumbai, August 29, 2009, pp. 35-42, http://academia.edu.documents.s3.amazonaws.com/602916/Anu_EPW.pdf (retrieved 10 December 2010)
- MUTUA Albert Kimanthi, "The Juhudi Credit Scheme. From a Traditional Integrated Method to a Financial Systems Approach", in OTERO Maria, RHYNE Elisabeth (eds.), *The New World of Microenterprise Finance. Building Healthy Financial Institutions for the Poor*, Kumarian Press, Connecticut, 1994, pp. 268 – 276
- NARAYAN Deepa *et al.*, *Voices of the Poor. Can anyone hear us?*, World Bank, Oxford University Press, New York, 2000, 343 p., http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2000/05/06/000094946_00042605311270/Rendered/PDF/multi0page.pdf (retrieved 10 December 2010)
- NAVAJAS Sergio *et al.*, "Microfinance in Latin America and the Caribbean. How Large Is the Market?", Inter-American Development Bank, Washington, D.C., 1996, 53 p. <http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1718100> (retrieved 23 December 2010)
- NAVAJAS Sergio *et al.*, "Microfinance in Latin America and the Caribbean. 2008 Data Update", Inter-American Development Bank, Washington, D.C., 2008, 6 p. <http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=1384010> (retrieved 23 December 2010)
- The Norwegian Nobel Committee, "Press Release: The Nobel Peace Prize for 2006", http://nobelprize.org/nobel_prizes/peace/laureates/2006/press.html (retrieved 15 December 2010)

- NOTANI A., "Perceptions of Affordability. Their Role in Predicting Purchase Intent and Purchase", *Journal of Economic Psychology*, Vol. 18, Issue 5, 1997, pp. 525-546
- OLIVARES-POLANCO Francisco, "Commercializing microfinance and deepening outreach? Empirical evidence from Latin America", *Journal of Microfinance*, issue 7, 2005, pp. 47-69, <http://www.microfinancegateway.org/gm/document-1.9.24763/21.pdf> (retrieved 21 December 2010)
- OTERO Maria, RHYNE Elisabeth (eds.), *The New World of Microenterprise Finance. Building Healthy Financial Institutions for the Poor*, Kumarian Press, Connecticut, 1994, 302 p., http://pdf.usaid.gov/pdf_docs/PNABR718.pdf (retrieved 20 December 2010)
- PACHICO Elyssa, "No Pago Confronts Microfinance in Nicaragua", North American Congress on Latin America, 2009, <https://nacla.org/node/6180> (retrieved 4 January 2011)
- PAIT Sara, "The microfinance sector in Peru. Opportunities, challenges and empowerment with gender mainstreaming", 2009, 27 p., www.microfinancegateway.org (retrieved 10 December 2010)
- PAXTON Julia, "A Worldwide Inventory of Microfinance Institutions", World Bank, Sustainable Banking with the Poor Project, Washington, D.C., 1996, 57 p., http://www.microfinancegateway.org/gm/document-1.9.27230/28364_file_10.pdf (retrieved 20 December 2010)
- PORTEOUS David, "Policy Focus Note 2. Consumer Protection in Credit Markets", Financial Access Initiative, 2009, 18 p., <http://www.microfinancegateway.org/gm/document-1.9.41468/15.pdf> (retrieved 5 January 2011)
- PORTOCARRERO Felipe Maisch, *Microcrédito en el Perú. Quiénes piden, quiénes dan*, Consorcio de Investigación Económica y Social, Lima, 2002, 107 p.
- PORTOCARRERO Felipe Maisch, BYRNE Labarthe Guillermo, *Estructura de Mercado y Competencia en el Microcrédito*, Consorcio de Investigación Económica y Social, Lima, 2003, 66 p.
- PRAHALAD C.K., HART Stuart L., "The Fortune at the Bottom of the Pyramid", *strategy+business* no. 26, Booz Allen Hamilton, 2002, 14 p., <http://www.cs.berkeley.edu/~brewer/ict4b/Fortune-BoP.pdf> (retrieved 18 December 2010)
- PRINZ Michael, "German Rural Cooperatives, Friedrich-Wilhelm Raiffeisen and the Organization of Trust. 1850 – 1914", Paper delivered to the XIII IEHA Congress Buenos Aires, Session 57, 2002, 28 p., <http://eh.net/XIIICongress/Papers/Prinz.pdf> (retrieved 17 December 2010)
- PUNCH Keith F., *Introduction to Social Research. Quantitative and qualitative approaches*, Second Edition, SAGE Publications, London, 2005, 320 p.
- REILLE Xavier, "The Rise, Fall, and Recovery of the Microfinance Sector in Morocco", CGAP Brief, Washington, D.C., 2009, 4 p., http://www.cgap.org/gm/document-1.9.41164/BR_Microfinance_Sector_Morocco.pdf (retrieved 4 January 2011)
- REILLE Xavier, "The dark side of competition. Credit risk and market penetration", CGAP Microfinance Blog, 2010, <http://microfinance.cgap.org/2010/02/25/the-dark-side-of-competition-credit-risk-and-market-penetration/> (retrieved 4 January 2011)
- RHYNE, Elisabeth, "The Yin and Yang of Microfinance: Reaching the Poor and Sustainability", 1998, *MicroBanking Bulletin* 2, pp.6 – 8, <http://www.uncdf.org/mfdl/readings/Rhyme-yingyang.pdf> (retrieved 15 December 2010)
- RHYNE Elisabeth, "Commercialization and Crisis in Bolivian Microfinance", Microfinance Best Practices/USAID, 2001, 33 p., http://www.microlinks.org/file_download.php/commercialization_and_crisis.pdf?URL_ID=7438&filename=11202924201commercialization_and_crisis.pdf&filetype=application%2Fpdf&file_size=341557&name=commercialization_and_crisis.pdf&location=user-S/ (retrieved 29 December 2010)
- RHYNE Elisabeth, "How much debt is too much? Microlenders want to know", http://www.huffingtonpost.com/elisabeth-rhyme/how-much-debt-is-too-much_b_578776.html (Retrieved 10 January 2011)

- RIST Gilbert, *The History of Development. From Western Origins to Global Faith*, 3rd edition, Zed Books, London, 2008, 288 p.
- ROBINSON Marguerite, *The microfinance revolution. Sustainable finance for the poor*, The World Bank, Open Society Institute, Washington, 2001, 306 p.
- ROBINSON Marguerite, *The microfinance revolution. Volume 2: Lessons from Indonesia*, The World Bank, Open Society Institute, Washington, 2002, 468 p.
- RODEY Barbara J., "The Spiritual Dimensions of Microfinance. Towards a Just Civilization and Sustainable Economy", European Baha'i Business Forum, Paris, 1997, 29p.
- RODRIK Dani, "Goodbye Washington Consensus, Hello Washington Confusion? A Review of the World Bank's Economic Growth in the 1990s: Learning from a Decade of Reform", *Journal of Economic Literature*, Vol. XLIV, December 2006, pp. 973–987, http://dgroups.org/file2.axd/560eb968-07a6-44f4-8063-66a586e56bf8/dec06_rodrik.pdf (retrieved 15 December 2010)
- ROESCH Marc, HELIES Ophelie, "La microfinance: outil de gestion du risque ou de mise en danger par sur-endettement ? Le cas de l'Inde du Sud", *Revue Autrepart* no. 44, 2007, pp. 109 – 130
- ROODMAN David, MORDUCH Jonathan, "The Impact of Microcredit on the Poor in Bangladesh: Revisiting the Evidence", Center for Global Development, Working Paper 174, 2009, 50 p., http://www.microfinancegateway.org/gm/document-1.9.35109/Roodman_Morduch_Bangladesh.pdf (retrieved 10 December 2010)
- ROSENBERG Richard, "Microcredit Interest Rates", CGAP Occasional Paper No. 1, 1996, 12p. <http://www.unCDF.org/mfdl/readings/CGAPocc1.pdf> (retrieved 23 December 2010)
- ROSENBERG Richard, "Does microcredit really help poor people?", CGAP Focus Note No. 59, Washington, 2010, 8 p., <http://www.cgap.org/gm/document-1.9.41443/FN59.pdf> (retrieved 10 December 2010)
- ROSENGARD Jay K., "Banking on Social Entrepreneurship. The Commercialization of Microfinance", *Mondes en Développement*, Vol. 32-2004/2, No.126, 2004, pp. 25 – 36 <http://www.microfinancegateway.org/gm/document-1.9.24285/08.pdf> (retrieved 23 December 2010)
- RUTHERFORD, S., "Microfinance's evolving ideals: how they were formed and why they're changing" paper presented at ADBI Conference, Microfinance in Asia: poverty impact and outreach to the poor, Dec. 5, 2003, Tokyo, 8p., <http://www.adbi.org/files/2003.12.05.cmats.rutherford.paper.pdf> (retrieved 10 December 2010)
- SCHICKS Jessica, "Microfinance Over-Indebtedness: Understanding its drivers and challenging the common myths", Centre Emile Bernheim, Solvay Brussels School, Brussels, 2010, 35p., <https://dipot.ulb.ac.be:8443/dspace/bitstream/2013/64675/3/wp10048.pdf> (retrieved 10 December 2010)
- SCHREINER Mark, "Aspects of Outreach. A Framework for Discussion of the Social Benefits of Microfinance", Center for Social Development, George Warren Brown School of Social Work, St. Louis, 1999, 29 p., <http://www.gdrc.org/icm/ppp/aspects.pdf> (retrieved 29 December 2010)
- SCHREINER Mark, "Seven Aspects of Loan Size", *Journal of Microfinance*, Vol. 3, No. 2, 2001, pp. 27-47, <http://contentdm.lib.byu.edu/cdm4/document.php?CISOROOT=/Microfinance&CISOPTR=115&REC=5> (retrieved 29 December 2010)
- SCHREINER Mark, "Aspects of Outreach. A Framework for the Discussion of the Social Benefits of Microfinance", *Journal of International Development*, Vol. 14, Issue 5, 2002, pp. 591–603, <http://www.gdrc.org/icm/ppp/aspects.pdf> (retrieved 23 December 2010)
- SERVET Jean-Michel, *Banquiers aux Pieds Nus. La Microfinance*, Odile Jacob, Paris, 2006, 511 p.

- SERVET Jean-Michel, DIOP Amadou, HILLENKAMP Isabelle, "Poverty versus Inequality", in BALKENHOL Bernd (ed.), *Microfinance and public policy. Outreach, performance and efficiency*, International Labour Organization, Palgrave Macmillan, Hampshire, 2007, pp. 27 - 46
- SERVET Jean-Michel, "Quelques limites du microcrédit comme levier du développement", *Informations et commentaires* no. 143, Lyon, 2008, pp. 19-25
- SERVET Jean-Michel, "Responsabilidad social y responsabilidad con la sociedad en microfinanzas", Programa ANR Sud RUME 2008-2011, Documento de trabajo Servet/2008.05.01/01, 30 p.
- SERVET Jean-Michel, "Responsabilité sociale versus performances sociales en microfinance", *Revue Tiers Monde* no. 197, 2009, pp. 55-70
- SERVET Jean-Michel, *Le grand renversement. De la crise au nouveau solidaire*, Desclée de Brouwer, Paris, 2010, 270 p.
- SERVET Jean-Michel, GUÉRIN Isabelle, ROESCH Marc, "Microfinance, Financial Inclusion and Social Responsibility" in *Finance for a better world. The shift towards sustainability*, Henri-Claude de Bettignies and François Lépineux (eds.), Palgrave Macmillan, London, 2009, pp. 7 - 29
- SHARMA M., BUCHENRIEDER G., *Impact of microfinance on food security and poverty alleviation : A review and synthesis of empirical evidence*, in ZELLER Manfred, MEYER Richard L., *The Triangle of Microfinance: Financial Sustainability, Outreach, and Impact*, Johns Hopkins University Press, Washington, 2002, pp. 221-240
- SHARMA Manoj, WRIGHT Graham, "Microfinance. Time to Get to Back to Basics?", MicroSave India Focus Note 41, 2010, 2 p., http://www.microsave.org/briefing_notes/india-focus-note-41-microfinance-time-to-get-to-back-to-basics (retrieved 10 December 2010)
- SHYLENDRA H. S., "Microfinance institutions in Andhra Pradesh. Crisis and diagnosis", *Economic and Political Weekly*, 2006, pp. 1959 – 1963, <http://www.apmas.org/pdf%5Cn.pdf> (retrieved 10 December 2010)
- STIGLITZ Joseph E., "The post *Washington Consensus* Consensus", Sao Paolo, August 22, 2005, 36 p., http://www2.gsb.columbia.edu/faculty/jstiglitz/download/speeches/IFIs/Post_Washington_Consensus_Consensus.ppt (retrieved 15 December 2010)
- UK Department for Business, Enterprise and Regulatory Reform, *Tackling over-indebtedness. Annual Report 2007*, London, 2007, 93 p., <http://www.berr.gov.uk/files/file42700.pdf> (retrieved 10 December 2010)
- UNCDF, "Microfinance and the Millennium Development Goals. A reader's guide to the Millennium Project Reports and other UN documents", 2005, www.yearofmicrocredit.org/docs/mdgdoc_MN.pdf (retrieved 7 January 2011)
- VOGELGESANG Ulrike, "Microfinance in Times of Crisis. The effects of Competition, Rising Indebtedness and Economic Crisis on Repayment Behaviour", *World Development*, Vol. 31, No. 12, 2003, pp. 2085–2114, <http://ifmr.ac.in/pdf/internships/Default%20Analysis%2001.pdf> (retrieved 10 December 2010)
- VON PISCHKE J.D., ADAMS Dale W., "Microenterprise Credit Programs: Déjà Vu", *Economics and Sociology Occasional Paper No. 1828*, 1991, 22p., http://pdf.usaid.gov/pdf_docs/PNABK705.pdf (retrieved 10 December 2010)
- WEBB Eugene J., CAMPBELL Donald T. et al., *Unobtrusive Measures. Nonreactive Measures in the Social Sciences*, Rand McNally, Chicago, 1966, 240 p.
- WISNIWSKI Sylvia, "Microsavings Compared to Other Sources of Funds", Consultative Group to Assist the Poorest, Working Group on Savings Mobilization, 1999, 21 p., http://www.ruralfinance.org/servlet/BinaryDownloaderServlet/36510_Document.pdf?filename=1147350668836_microsavings_sources_funds_GTZ.pdf&refID=36510 (retrieved 5 January 2011)
- WOLLER Gary, "The Promise and Peril of Microfinance Commercialization", *Small Enterprise Development*, Vol. 13, no. 4, 2002, pp. 12-21

- WOLLER Gary, WOODWORTH Warner, "Microcredit as a Grass-Roots Policy for International Development", *Policy Studies Journal*, Vol. 29, Issue 2, 2001, pp. 267–282
- WOLLER Gary, DUNFORD Christopher *et al.*, "Where to microfinance?", *International Journal of Economic Development*, Vol. 1, No. 1, 1999, pp. 29-64,
http://www.microfinance.com/English/Papers/Where_to_Microfinance.pdf (retrieved 21 December 2010)
- WRIGHT Graham, *Microfinance systems. Designing quality financial services for the poor*, Zed Books Ltd., London, 2000, 283 p.
- YARON Jacob, MCDONALD Benjamin *et al.*, *Rural Finance. Issues, Design, and Best Practices, Environmentally and Socially Sustainable Development Studies and Monographs Series 14*, Washington, D.C., World Bank, 1997, 154 p. http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1999/04/09/000009265_3971113151006/Rendered/PDF/multi0page.pdf (retrieved 20 December 2010)
- ZELLER Manfred, MEYER Richard L., *The Triangle of Microfinance: Financial Sustainability, Outreach, and Impact*, Johns Hopkins University Press, Washington, 2002, 399 p.

Appendix A: Semi-structured interviews guides

Semi-structured interview guide

Microfinance industry professionals

Introduction	Personal presentation, presentation of the IMAS and of the topic of my thesis.
Presentation	<ol style="list-style-type: none"> 1. Can you tell me a bit about yourself, your professional trajectory and your personal background? 2. Can you tell me in some words what is your actual position and what do you do in this position? 3. If you had to describe the Peruvian microfinance sector in one sentence, how would you do this?
Peruvian microfinance context - risks - deterioration of portfolio quality - cross indebtedness - growing competition - over-liquidity - client education	<ol style="list-style-type: none"> 4. What are in your opinion the main risks facing microfinance in Peru? 5. In the last period there has been a continuous deterioration of the portfolio quality, tendency which started last year and continued strongly throughout 2010. In your opinion, what are the causes of this deterioration? 6. According to the COPEME reports more than 50% of microfinance clients have loans in 2 or more microfinance institutions (cross-indebtedness). What is your opinion on this respect? 7. In Lima we can notice a very high competition in the microfinance market, with areas where 20 institutions are present within 3 blocks. What are the positive and negative aspects of such a high competition? 8. Who will loose and who will gain in this game of competition? 9. Many voices say that because donors and investors have embraced the Peruvian microfinance market, liquidity levels are high. Do you share this opinion and if yes how does this influence the Peruvian microfinance market and institutions? 10. What is your opinion on the level of financial education of Peruvian microfinance client?

<p>- institutional practices</p> <p>- interest rates</p>	<p>11. Would you say that there are specific institutional practices that are favouring overindebtedness (e.g. consolidation of debt, refinancing of doubtful loans, aggressive marketing practices)?</p> <p>12. How do you perceive the interest rates of Peruvian MFIs?</p>
<p>Overindebtedness</p>	<p>13. In your opinion, is there overindebtedness in the Peruvian microfinancemarket, and if yes, what are its causes?</p> <p>14. Some analysts say that the increasing PAR levels are signs of overindebtedness. What is your opinion on this?</p> <p>15. According to COPEME, cross indebtedness is a major cause of overindebtedness. What is your opinion on this theory?</p> <p>16. How does your institution deal with the issue of overindebtedness?</p> <p>17. What should other (institutions similar to yours) do in order to address the issue of overindebtedness in the Peruvian microfinance context?</p> <p>18. What should the other actors (regulators, funders, rating agencies) do in this respect?</p> <p>19. How should MFIs (microfinance institutions) address this issue?</p>
<p>Peruvian microfinancecontext</p>	<p>20. How do you see the evolution of the Peruvian microfinance sector next year?</p>
<p>Conclusion</p>	<p>21. Are there some other things that you would wish to mention or that you feel are relevant to our discussion?</p>
<p>Thank you!</p>	

Semi-structured interview guide

Host institution - Financiera CREAR

Introduction	Thanks, personal presentation, presentation of the IMAS and of the topic of my thesis.
Presentation	<ol style="list-style-type: none"> 1. Can you tell me a bit about yourself, where you come from and what is your professional trajectory? 2. Can you tell me in some words, since when are you with CREAR, what is your actual position and what do you do in this position? 3. If you look at the other microfinance institutions on this street, what does come to your mind first?
General / institutional context - growing competition - credit assessment - credit assessment - cross indebtedness - deterioration of portfolio quality - clients' opinion	<ol style="list-style-type: none"> 4. In Lima there is very high competition in the microfinance market, especially in the areas where CREAR Agencies are (Los Olivos, ATE). How does this high competition affect the credit operations of CREAR? 5. What are the competitive advantages of CREAR in this context? How did CREAR adjust its internal processes and regulations as a result of this situation? 6. What would you say that are the differences between the credit assessment of CREAR compared to other institutions in terms of accuracy, strictness, etc.? 7. According to COPEME reports, 50% of all MES clients have loans with 2 or more MFIs (which is also the case of the clientele of CREAR). What is your opinion on this respect? 8. In the last period there has been a continuous deterioration of the portfolio quality of microfinance institutions (which is also the case of CREAR). In your opinion, what are the causes of this deterioration? 9. What reasons do clients invoke when they are in arrears?

<p>Overindebtedness</p> <ul style="list-style-type: none"> - definition -institutional practices - situation and cause - evaluation - monitoring - position - mitigation 	<p>10. How would you define overindebtedness? According to you, when does a client start to be overindebted?</p> <p>11. Would you say that there are specific practices of other microfinance institutions which are favouring the overindebtedness of clients (e.g. consolidation and augmentation of debt, refinancing of doubtful loans, aggressive marketing practices)?</p> <p>12. What is the situation of the clientele of CREAR in regard to overindebtedness? What is the main cause of OI in the case of CREAR's clients?</p> <p>13. How do CREAR's Loan Officers evaluate the risk of overindebtedness of a potential client?</p> <p>14. After disbursement, during the entire life of a loan, how is the risk of OI monitored?</p> <p>15. In your position within CREAR, what are your tasks regarding the mitigation of the OI risk of CREAR's clients?</p> <p>16. What are the main tools used at your Agency/CREAR level in order to mitigate the risk of OI (vintage analysis, reports, monitoring of outstanding loans, etc)?</p>
<ul style="list-style-type: none"> - human resources - client education 	<p>17. What is CREARS's personnel retention rate? What measures do you take in order to ensure that staff does not "migrate" to other institutions?</p> <p>18. In your opinion what is the level of financial education of (CREAR's) clients?</p>
<p>Conclusion</p>	<p>19. Are there some other things that you would wish to mention or that you feel are relevant to our discussion?</p> <p>20. Can I quote you by name, or shall I use anonymous information?</p>
<p>Thank you!</p>	

Semi-structured interview guide

Client

Introduction	Thanks, personal presentation, presentation of the topic of the interview.
Presentation	<ol style="list-style-type: none"> 1. Can you tell me a bit about yourself, where you come from and what is your activity? 2. Can you tell me a bit about your family? 3. Can you tell me since when do you work with CREAR?
<ul style="list-style-type: none"> - cross indebtedness - cross indebtedness - total debt - debt burden - debt burden - sacrifices - sacrifices - effects - causes - factors 	<ol style="list-style-type: none"> 4. Can I ask you if you have loans with other banks or Financieras? 5. Can I ask you how many loans do you have in total at the moment? 6. Can you tell me what is the total amount you owe for these loans? 7. Can you tell me how much do you have to pay monthly for these loans? 8. How much does this amount represent in relation to your present monthly income? 9. Can you tell me what efforts and sacrifices do you have to make in order to repay these loans? 10. How would you describe these efforts and sacrifices: normal, moderate, big, extraordinary? 11. What are the effects of the fact that you (are not able to repay the loans) / (have to make sacrifices in order to repay the loans) on you and on your family? 12. In your opinion, why do you think that you came to this situation? 13. If you would be able to change something or to do something different in order not to be in this situation, what would you do?
Family situation	
<ul style="list-style-type: none"> - finances - responsible - saving 	<ol style="list-style-type: none"> 14. How are the finances managed in your family? 15. Who is responsible for the administration of the family budget? 16. Do you generally save money; did you use to save money for emergencies?
Conclusion	17. Are there some other things that you would wish to mention or that you feel are relevant to our discussion?
Thank you!	

Appendix B: Data matrix

Industry level

Variables	Sub variables	Ramón Flores (Senior Investment Analyst - PlaNIS)	Jorge Bustamante (Senior Analyst – Planet Rating)	Lucho Guerra (Senior Equity Officer – Triple Jump)
Competition		+	+	+
Perceived market characteristics/risks	Overindebtedness	+	+	0
	Market saturation	+	+	-
	Mission drift	+	0	+
	Decreasing margins	+	0	+
	Cross indebtedness	+	+	0
Over-liquidity		+	+	0
Commercialization – increased profit targets		+	+	0
Client education		0	0	0
Aggressive institutional practices		+	0	0
Interest rates		0	0	0
Loan officers’ incentives		+	-	-
Institutions do not check the loan destination		+	-	-
High personnel rotation		+	+	-
Institutional target pressure		-	+	-
Lack of saving culture		-	+	-
High personal consumption		-	+	+

Legend

+ : is present and has a great influence / occurrence

- : is present and has little or no influence / occurrence

0 : is not a problem / was not mentioned

Institutional level

Variables	Sub variables	Credit Coordinator	Agency Manager	Regional Coordinator
Increased competition		+	+	+
Perceived market characteristics/risks	Overindebtedness	+	+	+
	Extreme offer	+	+	+
	Decreasing margins	-	-	+
Lax loan assessment standards		+	+	+
Forced feeding		+	+	+
Aggressive competition practices		+	+	+
Causes of overindebtedness	Non business-related investment	+	+	+
	Lack of monitoring	+	+	+
Low client education level		+	+	0
Client vulnerability to external shocks		+	-	-
Increased consumer spending		+	-	-
Client opportunistic behaviour		+	+	-
“Easy money”		+	+	+
Targets pressure		+	-	+

Legend

+ : is present and has a great influence / occurrence

- : is present and has little or no influence / occurrence

0 : is not a problem / was not mentioned

Client level

Variables	Sub variables	Lucia Quispe	Margarita Borda	Sonia Gonzales	Pablo Romero	Daniel Rosales	Rosa Mamani	Claudia Rivero	Juana Toledo	Bruno Toche
Desperate borrowing due to:	Health problems	0	0	+	+	0	+	0	+	+
	External shock (theft, etc)	+	0	0	0	+	0	+	0	0
Loan bombardment		+	+	+	+	+	+	-	+	+
Loan bicycling		0	0	+	+	+	+	+	-	+
Effects on the family	Spouse help	0	-	0	+	0	-	-	-	0
	High sacrifices	+	0	+	+	0	+	-	-	+
Lack of saving		+	0	+	+	+	+	-	0	+

Legend

+ : is present and has a great influence / occurrence

- : is present and has little or no influence / occurrence

0 : is not a problem / was not mentioned

Table of contents

Acknowledgements.....	III
Abstract.....	IV
Chapters.....	V
List of figures, tables, text boxes and photos	VI
List of Acronyms.....	VII
CHAPTER I: INTRODUCTION.....	1
1.1. Problem background.....	1
1.2. Problem statement	3
1.3. Reasons for selecting the case and its relevance.....	3
1.4. Structure of the thesis.....	4
CHAPTER II: MICROFINANCE, FROM VILLAGE TO WALL STREET	7
2.1. Introduction to microfinance	7
2.1.1. The history of microfinance	10
2.1.2. Who is the microfinance client?	17
2.1.3. What are the main methodologies of microfinance?.....	22
2.1.4. What are the types of microfinance institutions?	25
2.2. The two paradigms of microfinance	28
2.3. The debate between <i>welfarists</i> and <i>institutionalists</i>	30
CHAPTER III: MICROFINANCE AT A CROSSROADS.....	35
3.1. The critical triangle of microfinance	35
3.2. The mission drift in microfinance.....	37
3.3. Studies on mission drift.....	40
CHAPTER IV: OVERINDEBTEDNESS, A GROWING CONCERN.....	43
4.1. Presentation of microfinance crises across the world.....	43

4.2. Review of literature on overindebtedness.....	46
4.3. Overindebtedness in microfinance	48
4.4. Some quantitative data on overindebtedness.....	53
CHAPTER V: THE CONTEXT OF THE STUDY AND THE RESEARCH METHOD	57
5.1. The current state of microfinance in Latin America and Peru	57
5.2. Presentation of the host institution.....	62
5.3. Presentation of the research process	65
5.3.1. Research methods and instruments used	65
5.3.2. Data collection and analysis.....	66
5.3.3. Analysis biases.....	67
CHAPTER VI: DATA PRESENTATION AND ANALYSIS.....	69
6.1. Data presentation	69
6.2. Correlation with the main objective and possible answers to the principal and secondary investigation questions.....	82
6.3. Conclusion.....	84
Bibliography	85
Appendix A: Semi-structured interviews guides.....	96
Appendix B: Data matrix	101