Microfinance

Harnessing enterprise to fight poverty

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Globalisation Institute
London

First published in 2006
Published in the UK by GI Research Ltd
A not-for-profit company limited by guarantee

Typeset in Monotype Garamond and ITC Officina Sans
Cover photograph by Sven Torfinn/Panos

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The views expressed in this report are those of the author alone and is published as a contribution towards public debate.

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Foreword by Mike Cook CMG, Former British High Commissioner to Uganda

Development assistance is delivered in macro packages. At the Gleneagles Summit last year, G8 leaders agreed to increase aid by US$ 50 billion a year by 2010, and to cancel an equivalent sum of debts owed by poor countries. Britain's own annual aid budget now stands at US$11.1billion with a commitment to increase it further, to reach the UN target of 0.7% of GDP by 2013.

Much of this British aid is disbursed in multi-million pound tranches, as direct budget support, to allow the recipient countries to fight disease and provide health care, supply safe water, promote good governance and stimulate economic growth and thereby help their citizens escape poverty.

How the British aid cocktail is mixed in each country is decided between British Ministers and officials and their counterparts. The paradox is that while the commendable objective is to attain the Millennium Development Goals and lift millions out of poverty, the poor themselves are rarely asked for their own views and priorities.

Of course all should have access to education, healthcare, clean water and the other benefits aid is intended to fund. But as I know from extensive touring of the country during my three years as British High Commissioner to Uganda, people frequently had far more modest demands which if met would nevertheless make a profound and immediate improvement to their daily lives and ease their poverty.

Demands such as a bag of fertiliser to increase crop yields beyond subsistence levels so that the surplus could be sold in the local market and generate an income for the family; a bicycle to help carry the surplus to the market; a manual sewing machine to allow a widow to make school uniforms for village children and thereby earn enough to feed and clothe and educate her own children; or just a couple hens to produce eggs for sale.

These are demands from people who, though desperately poor, want to escape from dependence on aid and to become self-reliant. Millions of pounds of donor funds pumped in as budgetary support cannot help them to do this in the short term. But microfinance schemes such as those described in this paper prepared by the Globalisation Institute, and such as I have seen at work on the ground, can and do help achieve this transformation.

There is a further dividend. People with an economic stake in their community and country are far more likely to require good governance and accountability from their political leaders, improvements which are desperately needed in much of the developing world, especially in Africa.

This is an excellent and timely paper, which I hope will generate a wider understanding of and support for microfinance institutions and schemes and will encourage governments and the private sector to commit more resources to them.

Michael Cook CMG

1. An introduction to Microfinance

Tom Clougherty

Umberto Castillo and his family were forced to flee their subsistence farm in Northern Colombia at gunpoint. Explaining their flight he said: "Maria and I have seven children, all younger than thirteen. The guerrillas were building up for war and wanted our eldest sons, who were only nine and eleven, to join them. They threatened us; they said we would be killed if we didn't let them take our sons." This was no idle threat – the Colombian government estimates that there are over seven thousand child combatants in the ranks of the guerrillas and paramilitary groups. To save his family Umberto packed everything he could and began the long journey to Bogotá, where they would join the many thousands of displaced Colombians already clustered in Soacha, a shanty town on the outskirts of the capital.

Despite this harrowing experience, the Castillo family were able to get back to their feet. Umberto received an eighty-pound loan from Oportunidad LatinoAmerica Colombia (OLC), a local microfinance institution, which he invested in the raw materials to start an "envueltos" business with his wife. Envueltos are made of a corn, butter and flour paste, which is packed into the leaves of the corn. Umberto began to sell them on the street for five pence a piece, making a two-and-a-half pence profit on each one. Now he can afford to send three of his children to school, but Umberto dreams that one day they will all receive an education.

– *Opportunity International* UK.

What is Microfinance?

It is not altogether easy to define microfinance, since no proper definition of the term exists. As *The Economist* has written, it "could mean anything from what a village priest provides when handing out alms to what state banks and credit unions offer to their least affluent clients."[1] But for our purposes the best way to define microfinance is as follows. It is the provision of financial services (whether loans, deposit accounts, insurance or otherwise) to poor and low-income individuals and households. What primarily distinguishes microfinance from the traditional provision of financial services, aside from the small sums of money involved, is the absence of collateral as security for a loan. Instead money is advanced on the basis of reputation. Since much of the developing world does not have a formalised system of property rights the poor are frequently unable to provide collateral, cutting them off from traditional financial services. This is why microfinance is so important – without it the only source of credit is the local moneylenders who may charge extortionate rates of interest and beat up clients who do not pay on time. And as Hernando de Soto illustrated in his ground breaking book, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, commercial credit is a central component of the successful market economy.

The oldest microfinance institution in the Americas is said to be the pawnshop on Mexico City's central square, the Monte de Piedad. It was established under an edict of the Spanish Crown in 1775 to assist

[1] "What do you know?" *The Economist*, 3 November 2005.

people suffering financial hardship. But, in its modern sense, microfinance was really made famous by the Grameen Bank of Bangladesh, and their model remains central to microfinance today. In the Grameen system money is advanced to small groups (usually of five women), with each member of the group agreeing to be financially responsible for the others. Failure to meet the shared liability would stop the whole group from accessing further loans. But as the loans are repaid people are allowed to borrow more. Group members are required to monitor each other at regular meetings, and thus social pressure to meet financial commitments is created – filling the role of collateral in traditional financial services and avoiding the twin problems of moral hazard (an unwillingness to pay) and adverse selection (bad payers who drive up the cost of credit for everyone else). Muhammad Yunus, founder of the Grameen Bank and winner of the 2006 Nobel Peace Prize, sums up the success of 'Grameencredit' with the following words:

> Grameen believes that charity is not an answer to poverty. It only helps poverty to continue. It creates dependency and takes away the individual's initiative to break through the wall of poverty. Unleashing of energy and creativity in each human being is the answer to poverty.
>
> Grameen brought credit to the poor, women, the illiterate, the people who pleaded that they did not know how to invest money and earn an income. Grameen created a methodology and an institution around the financial needs of the poor, and created access to credit on reasonable terms enabling the poor to build on their existing skill to earn a better income in each cycle of loans.[2]

The facts seem to back him up. Studies have shown that during an eight-year period, among the poorest in Bangladesh with no credit service available to them, only 4% pulled themselves above the poverty line. But among those receiving credit from the Grameen Bank the figure rose to nearly 50%.[3] Another report, concerning borrowers on the Indonesian island of Lombok, is even more striking. Microfinance clients of Bank Rakyat increased their income by an average 112%. 90% of them climbed out of poverty.[4]

Yunus also highlights one of the great advantages of microfinance as opposed to more traditional forms of development aid – it is based on the philosophy of the hand-up rather than the handout. Microfinance is not a top-down solution to poverty, it is a bottom-up approach that aims to empower the poor, harnessing their individual aspirations and abilities and creating an environment in which they can realize the true benefits of the market economy. No one claims that microfinance is a panacea – but it does represent a significant step in the right direction.

The Changing face of Microfinance

Unlike traditional banks, the establishment of microfinance institutions was motivated not by profit, but rather by charity. For the most part the charitable attitude persists today. Organisations like Grameen, as well as Opportunity International and FINCA, concentrate entirely on providing credit to the poor and therefore offer lenient repayment plans and interest rates designed simply to cover operating costs. The emphasis is on sustainability, bringing in enough funds to keep providing microcredit. Even when interest rates do not cover running costs, there is little shortage of available

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[2] Muhammed Yunus, *What is Microfinance*, <www.grameer-info.org/bank/WhatisMicrocredit.htm>

[3] "Data Snapshots on Microfinance," *The Virtual Library on Microcredit*, <http://www.gdrc.org/icm/data/d-snapshot.html>

[4] Elizabeth Littlefield, "Is Microfinance an Effective Strategy to Reach the Millennium Development Goals," *CGAP*, <http://www.cgap.org/portal/site/CGAP/menuitem.da0167f15fefd30167808010591010a0/>

donor money. According to CGAP (Consultative Group to Assist the Poor) the big development agencies put $1 billion into microfinance in 2004 alone.

But there is change in the air. Firstly, a lot of microfinance institutions have moved away from the traditional Grameen group-lending model, which was not without limitations. The main problem was that the businesses of the members grew at different rates. Naturally, the more successful ones wanted more capital but felt constrained by their group partners. On the other hand, the businesses that grew more slowly often found themselves guaranteeing the big debts of the larger members. Another problem was highlighted by Robert Guest in *The Shackled Continent*. He tells the story of Mr Zimba, a Malawian farmer. Mr Zimba had plenty of land but could not afford enough seed or fertiliser to make good use of it. He tried to join a local microlending scheme, but was told all the groups were full – in truth the local elite simply did not think he "made the grade".[5] C.P. Zeitinger, founder of ProCredit, does not believe in group lending. He thinks that it only works in rural settings where the group members are genuinely close and that, in any case, people should be judged on their own merits without being made responsible for the failure of others.[6]

The other change is more fundamental, concerning the essential nature of the microfinance institutions. UNDP (the United Nations Development Programme) estimates the global demand for microfinance at between 400 and 500 million households, of which only 30 million currently have access. And according to Unitus at least 90% of eligible self-employed lack access to microcredit programmes. It is clear therefore that demand outstrips supply – and that donor money is not realistically going to make up the shortfall. As a result an increasing number of microfinance institutions have concluded that the best way to develop and serve their market is to become profitable and operate more like the traditional financial institutions of the developed world, offering a wider range of services and becoming more efficient.

It may strike some as unlikely a profit could be made from microfinance, but the figures suggest otherwise. Research from CGAP has shown that there is money to be made in microfinance – 63 of the world's top microfinance institutions had an average rate of return, having adjusted for inflation and taken out subsidies, of 2.5% of total assets. This does not compare unfavourably with returns in the commercial banking sector, a fact that has not gone unnoticed by the big banks. Many of them are becoming increasingly involved in microfinance. It is certainly true that this move tends to be driven by the banks' corporate-responsibility or community-development departments but some financial institutions, like CitiBank for example, are genuinely motivated by profit.

"Bottom of the pyramid" strategies,[7] the idea that the poor represent an enormous, albeit diffuse, market worth trillions of dollars - and that companies can profitably sell to this market so long as they meet the consumers' needs, are growing in popularity among leading companies in a range of industries. This can only be of benefit to the developing world. Large banking corporations can move money around the world with ease and have access to enormous pools of capital, as well as an abundance of technical and commercial expertise. If they can show that microfinance can be profitable then, to quote *The Economist*, "it will be able to attract all the investment the rich can provide to fund all the opportunities poor people can handle."

Of course, it's not just big banks pointing the way forward. The aforementioned ProCredit is a good

[5] Robert Guest, *The Shackled Continent* (London: Pan Books, 2005), 80.
[6] 'From charity to business', *The Economist*, 3 November 2005.
[7] Named after *"The Fortune at the Bottom of the Pyramid"* by C.K. Prahalad.

example of a commercially successful microfinance-devoted institution: by introducing a consistent and rigorous banking system in its branches around the world it has experienced remarkable growth. By the end of 2005 it had 7,500 employees and $2 billion in assets and was given an investment-grade rating by Fitch, a leading rating agency. ProCredit was initially backed by various development agencies (like the World Bank's International Finance Corporation) and when it moves into a new country it typically accepts subsidies in the first few years, when there are high start-up costs and little revenue. But ProCredit hopes to become entirely independent of development agencies in the near future. It is arguable that this is the best way for international development organisations to put money into microfinance: contributing to the start-up costs and fostering the establishment of truly self-sustaining microfinance institutions.

Criticisms of Microfinance

Despite its manifest advantages over traditional forms of aid, microfinance is not without its detractors. There are a number of criticisms levelled at microfinance and chief among them is that microfinance is just a "band-aid", that it simply covers up the real problems without actually addressing them. Stephen Daley and Frederic Sautet made this criticism persuasively in their paper *Microfinance in Action: The Philippine Experience* – "one must not lose sight of the fact that microfinance has become a viable option only because the institutional environment in many developing countries is unworkable. Microfinance is a band aid – a necessary band aid at times, but a band aid nevertheless."[8]

They go on to identify four fundamental institutional problems in the Philippines: discriminatory laws, excessive regulation, endemic corruption and the lack of formalised property rights. These problems are not confined to the Philippines; they can be seen throughout the developing world. Indeed, they are probably the main reason why Africa remains so poor. Therefore it is worthwhile dealing with this "band aid" critique in detail because it is both initially compelling and, in the end, fatally flawed.

The first three institutional problems identified by Daley and Sautet can be dealt with under one umbrella: "bad governance." Many, if not most, governments in the least-developed world are bad. Bad because they are corrupt, bad because they pass discriminatory laws, bad because they regulate excessively (and so create more opportunities to rent-seek). The African novelist Chinua Achebe said of his homeland – "The trouble with Nigeria is squarely and simply a failure of leadership". Robert Guest wrote that if you substitute 'Nigeria' for 'Africa' you have a pretty good idea what holds the continent back. Visit much of Africa and you will find yourself agreeing with him.

No one disputes that poor governance is a fundamental cause of poverty in the developing world, but it is not immediately clear what the solution is – after all, what can we do to make African governments better? A new era of liberal imperialism seems unlikely, and is hardly a realistic solution anyway. The other obvious option is making aid conditional, or even not giving it at all. But neither of these courses has much to commend it. Conditionality is a well-documented failure – the developing world is full of leaders who can talk the talk and persuade donors that they will carry out a particular reform. However, if the reforms do happen (and frequently they don't) they are rarely carried out with much conviction. For a government to implement a programme of reform effectively they must feel they have ownership of it – which seems rather unlikely when they have been bribed into it with aid money.

Only giving money to governments that meet certain standards, and then giving it in the form of direct

[8] Stephen Daley and Frederic Sautet, *Microfinance in Action: The Philippine Experience*, <http://www.mercatus.org/Publications/pubID.2207,cfilter.0/pub_detail.asp>

budget support is a better idea. It incentivises and rewards good government, in theory creating a virtuous upward spiral. But this approach is still prone to manipulation by corrupt leaders and would also create the peculiarity of gradually giving a greater share of aid money to those countries that least need it – while the unfortunate citizens of the world's worst regimes receive no help at all. Cutting off aid altogether would have one positive effect – it would make governments dependent on their citizens for an income and would, in theory, promote more democratic and responsible government. However, theory and practice are rarely the same thing: corrupt governments are endlessly creative when it comes to finding new ways to turn a fast dollar, and cutting off aid may lead to even greater tyranny and oppression. And the poorest would suffer most.

So – while bad governance is a fundamental cause of poverty in the developing world it is not at all obvious what we can do about it. Therefore to criticise microfinance on the grounds that it does not address the problem hardly seems fair. Indeed, it is at least arguable that successful microfinance programmes will have some effect on government. We have already seen that microfinance seems to make people richer. The richer a person gets the more seriously his government will take him and his concerns. It is very easy for corrupt leaders to simply ignore the great mass of poor people they rule over, but as their citizens get wealthier they become more vulnerable to them. Microfinance, like any scheme which empowers people and allows them to help themselves, should not be ruled out as a way of encouraging better governance.

The other problem that Daley and Sautet identified was the lack of formalised property rights. This is an institutional problem that should not be overlooked. Hernando de Soto estimated that the total value of Africans' informally owned urban dwellings was $580 billion, the value of informally owned rural land $390 billion. Put this together and you get nearly a trillion dollars – roughly three times Africa's annual gross domestic product and more than one hundred times its foreign direct investment in 1998.[9] Mr de Soto put the global figure for this "dead capital" at nine trillion dollars – "in the midst of their own poorest neighbourhoods and shanty towns there are trillions of dollars, all ready to be put to use if only the mystery of how assets are transformed into live capital can be unravelled." [10] Of course the way assets are turned into capital, in a system of formal property rights, is by using them as collateral to raise loans – the very thing that microfinance allows people to avoid.

Formal property rights have other benefits besides making assets fungible, they also make it possible to do business with strangers. If you are part of a formal property system then you have addresses, bank records and identifiable assets. If you renege on your commitments then the bailiffs know where to find you and what to seize. In a country without formal property rights there are no such assurances, and so people tend to transact only with people they know, and only with things they can see. Such a cumbersome system makes trade – the best way of creating wealth – all the more difficult.

Because of all this microfinance critics say: "microfinance is just a band aid – we should impose formal property rights from the top down and make a real difference." It's tempting to accept this as common sense, but further examination proves it to be misguided. Formalising property rights from the top down is incredibly difficult and seldom successful. The secure property rights we enjoy in the developed world took hundreds of years to come about – until the last century most countries had multiple and contradictory sets of property rules – and it is simply not feasible to thrust them upon the world's least developed countries. Furthermore, the cost of suddenly formalising property rights would be enormous – meaning that it may not be economically efficient to do so, especially given the low

9 Guest, *The Shackled Continent*, 76.

10 Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000), 35-7.

individual value of the property in question.

So again microfinance emerges from the band aid critique virtually unscathed. If formalising property rights will be extremely difficult and extremely expensive then isn't it better to work within the existing institutional framework and make whatever difference we can? No one is denying the desirability of formal property laws but perhaps microfinance is the best way to deal with their absence. It is also arguable that microfinance, by helping people to grow wealthier and amass more property, will accelerate the organic development of formal property rights – if people have more things, and those things are worth more, then it becomes increasingly likely that their ownership will gradually be recognised and eventually formalised. Microfinance is thus a catalyst for spontaneous order.

This Report

The next chapter seeks to give microfinance a human face. Microfinance institutions from around the world have contributed stories, about both individuals and communities, and the successes they have achieved thanks to microfinance. Chapter three examines the difficulties of implementing the Bangladeshi model of microfinance in Africa, and looks at how people are working to fit microfinance into the African context. Particular attention is paid to the village banking model and the opportunities it presents. Our final chapter addresses the future of microfinance, examining things like microleasing and new and innovative forms of agricultural finance.

2. Microfinance in Action

Often in public policy it is useful to be able to replicate what has been done on a small scale or in another country. When it comes to microfinance British policymakers can turn to a world of examples to see where microfinance has had an important and benevolent effect. Of course when compared with the global demand that exists microfinance still operates on a relatively small scale, but the examples in this chapter, which were sent to us by microfinance institutions around the world, show it working in practice. The stories tell of individual and community successes, achievements that would not have been possible without access to microfinance. We include them in this publication to show readers the human side of microfinance because, after all, microfinance is not about grand plans or miraculous solutions to poverty – it is about recognising the potential of the world's poorest people, and then giving them the help they need to raise themselves and their families out of poverty.

Collecting for the future – Urban microfinance in Bangladesh

The urban slum areas of Saidpur in Northern Bangladesh are home to some of Bangladesh's poorest people. These areas are densely populated and lack clean water and electricity. Most people live in overcrowded shacks and squatter settlements. Increasingly, these areas are home to "floating populations" of homeless people who sleep on the streets at night.

Imran was one such person. An elderly man with no family, no way of earning a living and very few possessions, Imran had been homeless for most of his life. He felt ashamed to be a burden on his already impoverished community. Although trapped in a cycle of poverty, Imran had an idea of how he could get himself out. He just needed the means to do so.

Concern Worldwide knows from experience that microfinance can unleash the human dynamism and creativity which so many of the poor possess. This is why we have been supporting Community Based Organisations (CBOs) in one of the world's poorest countries to set up group savings schemes and allow the poorest people in their communities to access cheap credit to start up small businesses, and so get out of poverty.

Imran's idea was to support himself through the sale of firewood. Most of the people in the urban slum community in which he lived need wood for cooking, and to boil water for washing and drinking. However, they have to walk for some distance to get this firewood. This takes up time which adults could use for productive work, or children for attending school. Imran felt that if he could collect the firewood and sell it to families at a reasonable price, he would not only be supporting himself, but providing a service to the community at the same time.

To do this, he needed credit to rent a stall, and to buy the necessary equipment. In the past he would not have been able to get credit as he had nothing to use as collateral. The interest rates of the moneylenders would have been too high and too much of a risk. However, members of the community identified Imran as someone most in need of support, and so a Community Based Organisation working in the area, and supported by Concern, offered him the chance to join one of their group savings schemes.

Because of the nature of the group saving scheme, Imran could take out a loan without any assets. By collecting and selling wood, and using his stall as his new accommodation, Imran soon paid off his loan and was in a position to begin saving for his future. Not only is he now self-sufficient, but through his savings he is helping other members of the group to access credit and get out of poverty. Imran has always been proud of his community, and now he feels part of a wider family who respect and value him.

Imran is just one of more than 45,000 people supported by Concern's microfinance program in Bangladesh. This program was developed in recognition that grassroots organisations are able to significantly reduce poverty and empower the extreme poor. With rapid urbanisation in Bangladesh increasing demands for city housing and basic urban services, it is estimated that there will be 18 million urban poor in Bangladesh by 2015. We are currently working to link Community Based Organisations to the formal financial system in Bangladesh, so that in future these organisations may have access to technical support, can grow in a sustainable way and help many more of the extreme poor such as Imran.

> *This case study comes from Tom Arnold, Chief Executive Officer of* ***Concern Worldwide****. Concern was founded during the disastrous famine in Biafra in 1968, and its ultimate objective is to enable the poor to achieve major improvements in their everyday lives that are sustainable without the need for ongoing charitable support. As such, microfinance forms an important part of their economic development strategy. See www.concern.net for more details.*

Women Liberated by Microfinance

Jamii Bora Trust – Nairobi, Kenya

Susan Wangui grew up in a poor, rural area of Kenya. She attended school through fourth grade but was forced to leave when her parents could no longer afford the fees. When she became pregnant aged 17, her parents threw her out of the family home. In the hope of finding work she moved to Nairobi, the Kenyan capital, with her infant son. She married and had another child, a daughter. Unfortunately Susan was unable to find work and, like so many women in her position, was forced to turn to prostitution. Her husband left her when she became HIV positive.

Things began to look up for Susan when neighbours told her about Jamii Bora, a local microfinance provider. She completed their business training and then, with the credit she received from Jamii Bora, started a business mending and selling clothes. She has now received three loans, increasing from an initial $75 to $110, which have enabled her to quit prostitution and move her family out of the crime and disease-ridden slums and into a safer house. She sometimes struggles with the higher rent and has to skip meals, but she feels the security for her children is worth it. Unlike their house in the slum, Susan's new home has a floor, clean water, a roof and a locking door.

With each increasing loan, Susan is able to buy more raw materials in bulk at a lower cost and thus increase her business's profitability. She is convinced she would not be alive without Jamii Bora's medical insurance and access to HIV medication. She can't imagine what would become of her children as there is no one else to care for them. She strives to earn enough money to complete her children's education so they can someday provide for themselves.

SKS – Hyderabad, India

Ittamma Polkurthi and her family were forced from their home in rural India because the government was building a new dam. They were paid little in the way of compensation and were only able to afford one empty acre of land. Worse still, they had been evicted from their home during the harvest, leaving them with no means to feed the family or build shelter. As a result, Ittamma and her husband, her in-laws and two oldest children were forced to sell themselves into bonded labor, meaning they worked for nothing more than a miniscule amount. Although illegal, this cruel practice occurs all too frequently.

Ittamma took out her first $45 loan four years ago and used it to cultivate their land. She was able to harvest some crops, earning just enough to repay her loan. With subsequent loans, she bought banana plants and started a banana plantation on their acre. She harvested and sold her bananas, earning $1,100. With these profits, she rebuilt her house, leased two additional acres, planted more bananas and even bought a buffalo for her family and to sell the surplus milk. She has also hired several employees to help with the banana plantation. Most importantly, she paid off the bonded labour debts and freed her family.

Using loans totaling just over $400, this family of eight went from destitute poverty to being productive landowners with a profitable and expanding business and employees. They were freed from the entrapment of bonded labour and became integral and respected members of the community in just four years.

> *SKS and the Jamii Bora Trust are both members of* ***Unitus****. Unitus is a non-profit organisation whose mission is to fight global poverty by increasing access to microfinance. They use proven strategies from the venture capital, investment banking and strategy consulting industries to accelerate the growth of high-potential microfinance institutions worldwide, providing both capital investment and capacity-building consultancy. See www.unitus.com for more details.*

The Case of Tadesse Yilma – Microfinance in Ethiopia

(N.B. 1USD = 8.66 Ethiopian Birr)

Tadesse Yilma is 40 years old. He lives in Akaki (a suburb of Addis Abeba) with his wife and four children.

Ten years ago, Tadesse was employed in a small restaurant, earning just 150 Birr per month. He saved half of his salary each month in Iquib, a local savings scheme. Eventually, Tadesse decided to invest his savings by establishing a business. Having surveyed the local market he realized that he could earn more if he produced and sold household furniture. However, he had no technical skill to implement his idea. Therefore he approached a skilled friend, who was also working a low-paid job. Tadesse proposed that they work together and his friend agreed.

Tadesse allocated the 2000.00birr he collected from Iquib to buy a second hand welding machine, a hammer and a saw. He rented one room in a small mud house. Since Tadesse did not have any capital he asked to receive payment for the furniture in advance. His workshop was soon producing beds, chairs, doors and windows, and supplying them to local citizens. Fortunately Tadesse was enthusiastic

to acquire new skills and when his partner passed away he managed to continue running the workshop by himself. However, Tadesse's income was too meagre to cover all his living costs and lead a comfortable life. Beyond the household expenses, he was obliged to support his relatives, paying for rent, night school and contributing to Iddir (a traditional burial association).

Abero Adeg Iddir is a kinship based Iddir established in 1987 with 10 members. It now has 64 members, 20% of whom are women. The initial purpose of Iddir was to cover burial expenses, but in 1997 Abro Adeg Iddir registered with ACORD for financial support to establish a savings and credit scheme. The community-based organization (CBO) received a financial grant of 21,000.00 from ACORD and soon started to lend money to members who had capital shortages so that they could run businesses. As a member of this Iddir, Tadesse seized the opportunity and took a loan of 1500 birr to improve his business, while continuing to save 40 birr each month in the saving and credit scheme.

Tadesse had always dreamed of becoming a successful businessman so he decided to open a small shop where his wife could work and so increase their household income. Unfortunately the loan ceiling was too low for him to expand his business and make the most of his entrepreneurial skill. Based on his complaint the loan ceiling was subsequently raised to 4000 birr for committed members like Tadesse. He immediately took the 4000 birr loan and opened a shop in the centre of the local market where his wife began to sell ready made clothes, shoes, suitcases, cosmetics and so on. Soon the business became lucrative. Now Tadesse's wife, Yegize, works in the shop permanently along with two of Tadesse's brothers. Tadesse himself continues to produce household furniture and now employs two additional workers. When business demands it he can afford to employ extra technicians on temporary basis. In 2004 Tadesse began construction of a new home. This year he and his family moved into the moderately sized villa, which is worth approximately 300,000.00 Birr. His three children are studying at one of the best schools in his region.

Tadesse believes he owes his success to the credit access created by ACORD and his CBO – the total capital of which has reached 162.0000 Birr. Tadesse also appreciates the importance of the training provided by ACORD in entrepreneurship, business development and record keeping, which he feels allowed him to make the best use of his credit access. He continues to believe very strongly in savings and saves 510.00 birr per week in his Iquib. In 2003 the Forum for Social Studies selected Tadesse as a role model for microfinance intervention, and he went on to share his business experience with many other aspiring businessmen. Tadesse does not consider himself unique - he knows many men and women who, thanks to microfinance, have created employment for themselves and their families.

> *Tadesse's story was provided by Kassech Abegaz of* ACORD Ethiopia. *ACORD (Agency for Co-operation and Research in Development) was established in 1976 as a consortium of Northern international agencies, but it is building its future as a genuinely African-led alliance of groups and individuals addressing not only the consequences of poverty, but also the conditions that cause it. Their website can be found at www.accord.org.uk.*

Tales from Uganda and the Philippines

Jennifer Mwesigye

Not long ago, Jennifer Mwesigye and her husband William struggled to support their family. Jennifer worked hard as a seamstress but they were just getting by. When she heard about Opportunity

International's group-lending programme, Jennifer joined a Trust Bank group in her town of Sanga, Uganda. She used her first loan of £98 to buy a sewing machine, and with this investment her business began to grow. Increased profits allowed Jennifer to hire employees, and her business expanded even further.

Soon, she started noticing business opportunities in her community. A need for transportation became an opening to start a *bodo boda* business - a motorcycle taxi service around her town. Now she employs four drivers. After buying some property near her home, Jennifer built apartments to rent for local families. As her businesses grew, Jennifer purchased farmland outside the town and her employees help her raise more than 50 head of cattle.

Jennifer serves as treasurer of her Trust Bank and is a pillar of her community. Elected to the town council, she changed local statutes to make it easier for women to own property and start businesses. Jennifer's expanding businesses allow her and her husband to support their seven children, as well as four AIDS orphans. Jennifer also provides income for her employees to support their own families. In all, her businesses support 57 people. Jennifer's life and influence represent the ripples of opportunity seen in Opportunity International clients around the world – where expanding small businesses provide employment and hope to ever increasing numbers of people.

Farolito

Opportunity partners are increasingly providing life insurance and other kinds of insurance cover for their clients and their families. Sadly 'case studies' only arise when disaster strikes, such as the story of Farolito, a client in the Philippines.

Farolito was a construction worker who dreamed of starting his own business because he wanted to earn more to support his family's immediate and future needs. His dream became possible when he was encouraged by his friends and relatives to join the Trust Bank programme with Opportunity partner Taytay Sa Kauswagan Inc. (TSKI). In June 2005 he received his first loan of £30. He used this as capital to start a pig-raising business.

As a member of the Trust Bank programme, Farolito's family was covered by TSKI's life insurance scheme and he paid £3 as a premium. A couple of weeks after he joined the programme, Farolito's wife fell ill with pneumonia and died, leaving him the sole guardian of their ten-month-old son. Farolito received £540 from the micro-insurance payout. He was able to provide a dignified funeral for his beloved wife and to pay off their debts. Farolito is saving the remaining amount of £160 for his son's future education.

Although nothing can compensate him for his loss, Farolito is thankful that he had insurance as it lessened his financial burdens and saved him further stress at a very difficult time. He hopes to continue as a client of Opportunity and to build up his pig-raising business to provide for himself and his son.

These case studies were provided by ***Opportunity International*** *UK. Opportunity seeks to offer poor entrepreneurs in developing countries the tools they need to break out of poverty and support themselves. They provide training, support and microcredit, as well as other financial services. For more information visit their website at www.opportunity.org.uk.*

Local Solutions to Local Problems: Microfinance and Post-tsunami reconstruction

Seruthur is a coastal village in the district of Tamil Nadu in India, one of the worst affected by the tsunami. It houses the families of around 600 fishermen and suffered massive loss of life. The tsunami destroyed virtually all the houses and the entire fleet of fishing boats in less than 20 minutes.

On June 6th 2005, PlaNet Finance and its local partner, the NGO CRED (Centre for Rural Education and Development) officially launched a project with the goal of restarting income generating activities in the village.

The project is part of a long-term development programme and incorporates a simple principle that communities should have a strong involvement in their own reconstruction. In order to benefit from the programme's services, beneficiaries undertake to enter into a savings and credit mechanism, the proceeds of which are reinvested for the benefit of the community as a whole. The village previously lacked access to any kind of financial services through banks or NGOs and the community not only depended on local moneylenders, getting endlessly exploited, but also lacked financial discipline and financial management.

The capacity building programme comprises of three main components:

- Restart of income generating activities,
- Financial discipline training for the community,
- Regular access to financial services for the population.

PlaNet Finance gave 5 complete sets of FRP (Fiber Reinforced Plastic) boats, marine engines and fishing nets to 20 fishermen after they accepted repayment of 50% of the cost over the next 2 years, agreeing to a minimum repayment of approximately £1.50 (15% average daily income) every day that they go fishing. This achieved an immediate impact and the fishermen began to repay their micro credits twice as fast as agreed.

These on-going repayments are reinvested into the community itself: part is used to provide interest free loans to women in the village in order to help them buy ice boxes, weighing balances and aluminum containers to sell fish at a better price; another part is used to finance training in financial discipline. Thirty groups of women have already gathered more than 7,000 rupees (approximately £82) thanks to weekly savings and they have received their first micro credit.

The reconstruction project of the Seruthur community is based on restarting economic activity. In the stream of donations that followed the tsunami in December 2004, it became important to prove the relevance of microfinance as a sustainable reconstruction tool. This project was built with and for the local population and can be used as a model for the development of similar projects, on a larger scale, in all the regions hit by the natural disaster. PlaNet Finance India is developing a similar program in Arcotuthurai, a village forgotten by the international aid effort because of its remoteness and its difficult access.

Written by Cornell Jackson (UK Chief of Mission) and Mike Moser of ***PlaNet Finance****. PlaNet Finance is operates in more than 60 countries and aims to alleviate poverty by contributing to the development of the microfinance sector. It supports Microfinance Institutions and accelerates their growth by providing a platform for cooperation, capacity building and provision of financial services. Private donors such as ING and OSEO have contributed to their post-tsunami reconstruction work. For more see www.planetfinance.org.*

3. Adapting microfinance to the African context

Alex Singleton

The journey from Nairobi to arrive in Nunguni took two and a half hours in a battered Nissan. The town was full of traders selling Coca-Cola, second hand Nike clothing ("mutumbu" in Swahili) and Celtel mobile top-up cards out of their shabby buildings. A few metres off the main road, we arrived at the local microfinance institution, a concrete building with a hand-painted sign saying "Nunguni Financial Services Association", otherwise known as "the village bank".

The bank manager, a smartly dressed man in his early 20s, works in an unpainted office. There is no computer and I can see no telephone. Behind him are the bank's 'vaults' – two Chubb safes, bigger than one might find in a UK office supplies catalogue – but not much bigger. On one of the walls there is some shelving containing paper records of people's accounts.

He is employed directly by K-Rep Development Agency, a Kenyan microfinance co-ordinating body, and the village pays K-rep a management fee. He is well paid and in a discussion about "mutumbu" he informs me that second-hand clothing is not something he wears. His job is to ensure that the village bank does not get looted. The bank itself employs two security staff, one accounts clerk, two loans officers and a cashier.

He shows me the two cheque books possessed by the bank. Like traditional British Building Societies, customers can get cheques by turning up at the counter and asking them to make one out. They have cheque books from two different major city banks and I ask why. He leans forward earnestly and whispers: "This is Africa. You learn not to put all your eggs in one basket."

A cheque costs customers 100 shillings per cheque (74p in Sterling) which might sound expensive to Brits used to 'free' banking but the good thing is that it provides access to a service that was once effectively unavailable.

Customers can also cash cheques, including overseas ones. In the old days, they would have had to persuade one of the big businesspeople in their region to take the cheque (signing it over to them on the back), who would have deducted a very large commission. The village bank has massively cut the cost of receiving cheques.

I am walked through into a meeting room to meet the board. It consists of eight people elected by the members of the village bank – the customers – who govern the affairs of the bank and decide policy. They are keen to expand and offer an increasing range of services. Next year, the bank will get its first computer, using software and a computer being provided by K-rep, which is currently being tested.

The bank manager and I get in the back of the battered Nissan and take a five minute drive to where one of the lending groups is meeting, known as a Kikundu Cha Mkopo (KCM) in Swahili which translates as a Group for Loans. In fact, when I arrive, three of lending groups have come together in larger group known as a Muungano. Eleven women and six men are sat outside being taught how to manage money and do their personal accounts by a loans officer from the bank. The reason for the larger groups is that the bank has been expanding and it is no longer feasible for a loans officer to attend every group meeting. Each of the members of this Muungano has with him or herself what looks like a mirror image of a British building society passbook. They also have an accounting book

where they keep their own records of their personal finances.

In fact, teaching economic prudence is a key part of what the village bank tries to do. Members of the bank have to be trained as part of a group for loans for two months before they can borrow. Because the world of banking is a new thing, the village bank recognises that it is important to provide financial training, helping their customers treat loans responsibly and improve their domestic economics.

A first loan from the bank would typically require repayment within a six month period and be for a maximum of 15,000 shillings. The bank's largest loan at the time I visited was 70,000 shillings and it went to a businessman who operated as a bookseller and printer of stationery.

While many of the loans are pretty traditional microcredit loans, they offer a range of different loan products including a special agricultural loan for farmers who use irrigation (they don't give agricultural loans to farmers relying on rain because it is too risky). They also offer emergency loans for people in particular short-term difficulties. These are repayable after two months. And they give education loans, known as "masomo" loans in Swahili. It is a savings account where you can borrow twice what you have saved and has a lower borrowing interest rate, helping people pay for school fees.

The bank manager then explained to me why most of the people at the lending group were women rather than men. He said that women are more likely to pay back debts. They have a feeling of respect towards money. Men, he said, do not want to expose themselves in a group and they have more difficulty, because of the types of jobs they do, getting away during the day to attend such a group. Women customers, conversely, are often market vendors, small businesspeople, teachers and sometimes farmers which gives them time to attend a group during the day time. Men, he said, tend to be interested only in very big loans, which are risky for the bank to issue.

It is worth bearing in mind that though microcredit is a significant part of what the microfinance bank does, three quarters of the bank's customers are net depositors rather than borrowers.

Why the village banking system works

The success of microfinance in Bangladesh, in particular through the Grameen Bank, is something that people have rightly wanted to copy elsewhere. It would be a mistake however for the international development community to take the approach of cloning what works in one country and to try and create an identical copy in another. There are cultural, historical and legal differences between developing countries that must be taken into account. It is essential, therefore, that we see "seekers" experiment on a small scale with what works, rather than encourage "planners" in developed countries to attempt to impose a one-size-fits-all plan on new markets. Part of the success of microfinance is that it has been allowed to develop from the bottom upwards, rather than the top down. Indeed, though microfinance access is very limited in Kenya, it is worth bearing in mind that there are already 500 different microfinance institutions.

There is a widespread feeling among those involved in the African microfinance industry, including outside the village banking model, that village banks are particularly suited to African circumstances and resonate well with African culture. There is a belief that the village banking model is alone in Africa for its ability to really "dig deep" into rural poverty. Part of this is undoubtedly because access to microfinance is limited, such that if you aim to cover a very large geographical area, you are going to simply cherry pick the "elite poor". Conversely, if you limit yourself to a small area, you will dig deeper

in order to expand.

There are those who say that microfinance is merely a sticking plaster (as discussed in an earlier chapter) that does not create the real "institutions of a free society". Critics argue that it does not address the root causes of poverty and that it only exists because of poorly-functioning institutional environment. Indeed, microfinance is not everything, but what I saw of the village banking model in practice had the words "this is a real and valuable institution" written all over it.

Indeed, the increasing access to banking products is a vital part of the package of institutions that societies need in order to grow and prosper. The reliance on banking products on a day to day basis in the developed world is massive, and increasing access to them in the developing world has an important role to play in increasing growth and wellbeing. Village banks offer an excellent way of selling such products. Because they are constituted so that the customers are the shareholders and elect the board, there is a useful local dimension to the decision-making, helping local needs to be met.

Attempts to impose formal property rights on African nations would be extremely difficult. Attempts to do this elsewhere on the planet have not worked very well. Formalised property rights have been created successfully when they have developed naturally, as William Easterly says, "as piecemeal solutions to deal with particular problems as they arose"[11]. Policymakers should therefore look to policies that encourage processes that lead to formalised property rights. When microfinance enables someone to buy fertiliser to increase crop yields, it makes land economically more valuable, making the transaction costs of formalisation of property rights more cost-effective and creating an upward pressure from below for stronger property rights protection by people who understand the complex web of local informal property rights that have developed over centuries.

By encouraging the creation of sustainable village banks, we both encourage the creation of an important local institution, which is able to adapt to local needs and preferences, and also create an environment in which demand for formal property rights is likely to increase.

[11] William Easterly, *The White Man's Burden*, New York: Penguin, 2006, p.93

4. Innovation in microfinance

Tom Clougherty

Much of the current innovation in microfinance around the world is in the area of agricultural microfinance. The reason for this is one of simple supply and demand. On the one hand farming has become far more capital intensive over the last thirty years: the use and cost of inputs, such as fertilizers, pesticides, electricity, fuel and irrigation, has increased dramatically. Such purchased inputs now make up more than 87% of a farmer's initial outlay, whereas they accounted for just 39% in 1970-71.[12] This means that farmers require much greater access to credit.

On the other hand, microfinance institutions have traditionally shied away from agricultural microfinance for a number of reasons. The first such reason is the poverty focus of most microfinance institutions (MFIs). Since most MFIs were set up as charitable organizations with limited resources there was a tendency to focus their services on the poorest and most needy. In rural areas this meant that those who owned land, like farmers, were excluded. The Grameen Bank, for example, did not offer microfinance to households with more than half an acre of land. The very nature of agriculture has also meant that farmers were not ideal as clients for microfinance.

Seasonality meant that all the farmers wanted their loans at more or less the same time, placing great capital demands on the MFIs, and also led to repayment difficulties – the normal system of weekly or monthly repayments did not work well for farmers who would have no money to repay their loans until after the harvest. In addition to this, operating in agriculture was a very uncertain business for MFIs due to the high risk of poor weather or pest attacks. When these occur they tend to affect all the farmers in a given area, which is bad news for MFIs because they tend to operate regionally. Thus there was an increasingly high demand for agricultural microfinance that MFIs found themselves unable to meet – particularly problematic given that agriculture is generally the dominant livelihood in the developing world and especially in Africa.

However, the microfinance industry has been adapting to these challenges and developing new strategies and products to overcome them. For instance, the repayments issue has been dealt with through a system of "balloon payments." This means that the interest on the loan and a small amount of the principal is paid on a regular basis, with the remaining balance subsequently repaid as a larger lump sum – the balloon payment. This means that farmers can delay repayment until they have completed the harvest and sold their produce. MFIs have also diversified their operations: offering microleasing and microinsurance, as well as post-harvest investment schemes, alongside the traditional microcredit. These new products warrant further explanation.

Microleasing

In a way, microleasing is the logical next step after microcredit. Once the microloans have helped the borrower's business grow, it is likely that they will want to get new equipment to further their enterprise and make their businesses more profitable. The problem with purchasing equipment is that it can be rather expensive, which of course means greater risk for the MFIs and greater liability for the borrowers. This in turn makes the group-lending model more difficult to operate – other group members will probably be unwilling to guarantee such a large debt. As we have seen, the social pressure

[12] Vijay Mahajan and NV Ramana, *Agricultural Finance by Microfinance Institutions: Problems and the Way Forward*, 1.

of the group is used in microfinance to replace collateral. If the group system cannot be used because the debt is too large this presents a problem. The way microfinance institutions have got around this issue is through the development of microleasing schemes.

Microleasing is a medium to long-term financial scheme that is generally used to finance the purchase of machinery or equipment, but which may also be used to buy or rent land for farming. What happens under a microleasing scheme is this: the MFI purchases a piece of machinery, which the client has chosen. The client then gets to use the machinery for an agreed period of time. In exchange for the use of the equipment the client pays fixed installments to the MFI, who retain ownership of property throughout. Once all the installments have been paid and the lease has come to an end, the client generally has the option to buy the equipment for a reduced price. If not then the MFI takes it back and, perhaps, leases it to someone else.

There are several benefits to operating a scheme such as this. Firstly, it allows clients with limited assets to acquire new production techniques through the use of equipment they would otherwise not have access to. It thus avoids the negative cycle where people need new equipment and techniques to become more profitable, but are unable to adopt those techniques and equipment without first making more money. Secondly, the problem of providing a guarantee is eliminated because at all times the MFI retains ownership of the equipment in question. If a clients defaults on his installment payments the MFI can simply take back their property. This means that there is very little risk in operating a microleasing scheme for MFIs. These schemes also cost less to administer than traditional microcredit, since there is no need to organize group meetings and so on – in fact the only thing that the MFIs really need to do is send someone to collect the payments. Less risk and lower costs translate into a better deal for clients: they get lower interest rates and longer repayment periods. Frequently the repayments can also be staggered in order to fit in with the client's business or farming activities.

Warehouse receipts

One major problem facing farmers in the developing world is the fluctuation of prices. When the crop is good the market is flooded with produce and it is impossible to get a good price. This means that small-scale farmers are usually forced by immediate cash needs to sell their goods straight after the harvest when prices are at their lowest. Prices are of course much higher during the lean season but, since they do not have the capacity (financial or otherwise) to hold onto their produce, most poor farmers are unable to take advantage of this. The problem is particularly acute in Sub-Saharan Africa where, despite large post-harvest price fluctuations and the enormous benefits storage would have, the spread of warehouse receipts and inventory credit has been very slow. This is mostly a result of inadequate storage facilities and the heavy-handed state intervention which has tried unsuccessfully to control the market and prevented commercial solutions from evolving. Even where there are suitable and trustworthy storage facilities the poor farmers (who most need them) tend to be excluded because their low produce volumes cannot justify the high administrative expense.

Fortunately this is a problem that microfinance institutions are now trying to address, helping the poor to take advantage of seasonal price swings. The Ghana Inventory Credit Project is a good example – in 1989 it pioneered the use of inventory credit and warehouse receipt systems for small-scale farmers in Ghana. The system works as follows. Farmers form groups of twenty to fifty members to store their produce. Upon arrival in the warehouse their produce is graded according to things like moisture and non-content materials. Then the farmers receive a receipt showing the quality and quantity of produce received. Money is then advanced to the group – initially between seventy and eighty per cent of the

market price – and shared according to each member's contribution.[13]

This system means that farmers can get some money straight away, in order to cover their immediate cash demands, while storing their produce and waiting to get a better price. If they do subsequently sell the produce for a good price then they can pay back the MFI that has been storing their goods. If for some reason they do not then the MFI holds their produce as collateral and can sell it to recoup their losses. Of course a knock-on effect of schemes like this is that over time they reduce the inter-seasonal price variations, because both supply and demand stay more constant, meaning that even those farmers who have no choice but to sell their produce immediately benefit.

Microinsurance

In many rural communities in the developing world the simple provision of microcredit is a very incomplete service. In particular a demand exists for insurance products that allow farmers to manage the various risks to their business and livelihood. Since the major threat to farmers in the developing world tends to come from the weather, it is against this that they generally wish to take out insurance. In collaboration with the World Bank and Lombard Insurance Co. BASIX, an Indian microfinance institution, has operated such a scheme.[14] It was based on the rainfall and crop yield data available in the district for the last thirty years. From this data BASIX was able to establish a relationship between the amount of rainfall and the output for castor and groundnut crops, as well as predetermining expected levels of rainfall. Insurance payouts were determined by the extent to which actual rainfall deviated from this predetermined level.

In 2003-4 BASIX sold approximately 230 individual policies for an insurance coverage of 3.2 million Indian rupees. The total of the premiums paid amounted to INR 96,000. Claims were subsequently settled to 154 farmers for a total of INR 42,000 – this covered excesses and shortages of rainfall. The project was repeated in 2004-5 with a much larger sample of over 18,000 farmers.[15] The same year BASIX insured its own crop loan portfolio (worth 17 million rupees) with Lombard Insurance Co. for a premium of INR 750,000. The insurance covered the portfolio of three branches of BASIX, which had diversified rainfall patterns. Since the weather was good that year no claims were made.

The great thing about insurance of this sort, whether at the level of the farmer or the microfinance institution, is that it transfers credit risks to insurance risks. Insurance risks are diversifiable across areas with various agro-climates – easy in places like India or Africa – and this means that the overall level of risk is reduced. As Vijay Mahajan and NV Ramana of BASIX have written, "the way forward for MFIs… has to be to offer a joint product, a crop loan and weather insurance, the risk of the latter being borne by an insurance company which is in a position to diversify the risk across a number of regions."[16]

This is another example of microfinance institutions identifying a gap in their market and using commercially inspired solutions to tackle it. In doing so they have shown that agriculture need not be such a high risk livelihood for the farmers engaged in it, or such a high-risk investment for the MFIs providing finance for it. Indeed, microinsurance seems to be an area with real growth potential within the microfinance industry and, of course, this is not limited to agricultural microinsurance. In recent

[13] The World Bank Group, *Agricultural Investment Sourcebook*, <http://www-esd.worldbank.org/ais/index.cfm?Page=mdisp&m=07&p=9>
[14] Mahajan and Ramana, *Agricultural Finance*, 7.
[15] *Ibid*
[16] *Ibid,* 11.

years we have also seen the emergence of health insurance as part of an MFI's services.

The K-Rep Development Agency's health care financing project is an excellent example of this happening. K-Rep set out to develop "an innovative, private sector driven, commercially viable and replicable health financing scheme to reach low-income people."[17] In many respects they have succeeded, albeit on a modest initial scale. Having conducted extensive market research three "Afya Card" products were offered, with the components and prices worked out by actuaries involved in the project. The three products were: Afya 1 – an in-patient only cover; Afya 2 – comprehensive in and out patient cover; and Afya Maisha – an in-patient only cover targeted at corporate clients.

K-Rep realized that clients on low-incomes would not be able to afford to pay their insurance premiums in one go, so they also developed the "Afya Loan" scheme. This meant that K-Rep and their partners would loan families money to cover 10 months of their annual health insurance premium, provided that they paid the equivalent of one month's premium as a down payment at the beginning of the loan. The rest of the loan would then be repaid on the monthly or weekly basis. Around 40% of those taking out health insurance through K-Rep did do using an Afya Loan. The overall membership of the health insurance scheme has grown steadily since the project began, showing that "health care products tailored for low-income groups do indeed have a huge market in Kenya."[18] This seems to be borne out by the fact that AAR (a partner on the project) has subsequently replicated the scheme in Uganda and Tanzania.

Conclusions

This chapter has only provided a brief snapshot of the innovations that are currently occurring the microfinance industry worldwide, but it clearly demonstrates that microfinance is not a "one-size fits all" business. Ultimately this is the great strength of microfinance: it is always adapting and evolving and finding new ways to overcome the challenges it faces. It identifies the world's poorest people not as cases for pity and charity, but rather as consumers and potential clients – and it is always striving to provide the services they need. This is why microfinance is so much more successful than traditional forms of aid. It is a bottom-up solution to poverty. It is not developed by planners in some distant centre, but instead by a multitude of agencies and professionals, each of them searching for solutions to their problems and the problems of their clients. As stated in the first chapter of this report, microfinance is not a panacea. It is neither an instant nor a complete solution to global poverty and deprivation. Nevertheless, it has helped a vast number of people already and, if the innovation seen in this chapter is anything to go by, it will help many more in the future.

[17] K-Rep Development Agency, *2005 Annual Report & Financial Statements*, 10.
[18] *Ibid,* 11.

5. Conclusion

Alex Singleton and Tom Clougherty

By helping people to help themselves, microfinance has had a significant effect in promoting enterprise and reducing poverty. But despite its growing reputation, and the recognition it recently received when Muhammad Yunus, the founder of Grameen Bank, won the Nobel Peace Prize, microfinance still operates on far too small a scale. It must be expanded, especially in Africa.

However, policymakers should be wary of simply throwing money at microfinance or of thinking that what works in one place (for example, in Asia) can easily be transplanted somewhere else (like Africa). We must recognise that the strength of microfinance lies in its innovative and bottom-up nature.

Therefore a more thoughtful approach to microfinance is required. In particular, we believe it is important that the microfinance institutions should aim to be self-financing and sustainable, and should endeavour to make a profit in order to do so. To raise the capital required to meet the needs of a much wider market, microfinance institutions should diversify their operations, offering a broader range of financial services to their clients – whether these be microleasing, microinsurance or just simple savings accounts.

None of this is to say that there isn't more that can be done to promote and support microfinance. We believe that governments and international donors should look to support the establishment of new and sustainable microfinance institutions. This may be accomplished through the provision of start-up capital, given that development aid is on the increase, or indeed through technical assistance and the sharing of expertise.

We also recognise that the formalisation of property rights, the Hernando de Soto agenda, is of great importance. However, we believe that the cost of doing this in the world's poorest areas may be prohibitive. It may be more rational, for the time being, to encourage the use of reputation and not property as the major element of raising capital. Microfinance has demonstrated its ability to lift people out of poverty and as this happens the pressure from below to formalise property rights increases and the cost of doing so becomes more realistic. It is therefore important that microfinance and property rights are seen as belonging to the same integrated approach to fighting poverty – empowering the poor and helping them to realise their potential.

We believe that DFID should have a team focussing on microfinance, and assessing what works on the ground, with a head reporting directly to the Secretary of State on a monthly basis. In addition, to get microfinance higher up the agenda, it would be extremely useful for the Secretary of State for International Development to host an annual summit on microfinance in London, drawing together the leading figures in the world of microfinance and the major international banks, to encourage greater private funding of microfinance and to promote the exchange of expertise and best practice.

Above all, DFID needs to take microfinance more seriously. The Globalisation Institute repeatedly criticised DFID during 2005 for its apparent lack of interest in the UN's International Year of

Microfinance. DFID did eventually issue a briefing on *DFID & the Private Sector,*[19] which was supportive of microfinance, but its approach to the issue remains little more than a token gesture. For example, too few of DFID's Programme Partnership Agreements (PPAs) even refer to microfinance and none are with organisations focussed on the subject. Indeed, microfinance institutions complain that they are left out of these agreements, with DFID preferring to support "big name" development charities instead.

Both the government and the opposition are committed to increasing DFID's budget to 0.7% of GDP. The Department has commendably decided that it is not going to increase its personnel. We believe that a greater proportion of the DFID's increasing resources should be devoted to the support and promotion of microfinance, particularly in Africa – where microfinance is yet to make the difference it is capable of.

Professor Muhammad Yunus and thousands of other creators of microfinance institutions globally have shown the power of micro solutions to poverty – solutions that help poor people lift themselves up the economic ladder. Such solutions may not sound as dramatic as the "big push" solutions currently favoured by the Department for International Development but, out on the ground, they are making the difference between poverty and prosperity.

[19] *DFID & the Private Sector: Working with the private sector to eliminate poverty* <http://www.dfid.gov.uk/pubs/files/dfid-private-sector.pdf>