

# MICRO LENDING MACRO GAINS

Lending to the poor—an idea shunned by commercial financial institutions not long ago, is now beginning to be seen as virtuous and even lucrative. Microlending is paying its way and demonstrating that finance and service to society can correlate.

“I’m walking a dusty road, in the heat of the afternoon sun, towards a small bamboo hut in a village in Bangladesh. My name is Nurul Islam and I’m a loan officer with the Grameen Bank. I am on one of my routine rounds here to assess a prospective borrower’s economic situation and her request for a loan from my bank. A small portion of the hut’s lot is planted in vegetables; a young boy tending them now hurries to the hut to alert his mother of my arrival. Her name is Asrina and she needs a loan to buy some saris so that she can peddle them door-to-door. Since she lives below the poverty line, none of the commercial banks are prepared to give her a loan. So she contacted the Grameen Bank after hearing about it from a neighbour. The neighbour started a small poultry business with our help.

“In accordance with the bank’s policy,” Nurul Islam continues, “I enrol her in our compulsory group training, during which every loan seeker is instructed in the principles,

rules, regulations, and procedures in the workings of our bank’s credit system. The training takes one hour seven days a week. During the training session, Asrina will meet other borrowers and form a support group of five people.”

“The group provides help in writing loan proposals and in understanding how the credit system can work for them. Once Asrina’s loan proposal has been approved by the group I check it over. The next step for her may be to meet with the manager of our local branch for final approval. But sometimes that’s skipped and the Taka stops with me. To ensure that the credit is

used for the purpose stated in the proposal, I will be monitoring her performance from time to time. She will be expected to repay her loan in 50 equal instalments.”

Like Asrina, there are millions of other borrowers who need funds, but have no collateral to offer. Grameen Bank, a microfinance organisation, works almost exclusively with this category of borrower. Founded by Nobel Peace Prize winner Muhammad Yunus, the bank launched its practice of making small loans to small people under the somewhat grand label of microcredit. And, oh, most of the bank’s customers are women.

## Interest rates

In contrast to the microcredit institutions, commercial banks earn their keep in a mix of ways. They charge interest on loans and earn revenues from service charges. Microfinance banks like Grameen do not operate this way. To defray their operating costs and to keep things simple they prefer to charge higher interest rates. These range from 20% to sometimes as high as 80%. Microfinanciers justify their rates by citing the cost of lending to a clientele that has no credit history and is largely illiterate. (More on this in one of the boxes accompanying this article.)



## BANKING FOR THE POOR

How and why plastic money became a killer application in finance.

There is a vast section of global population that faces financial exclusion—it has limited or no access to formal banking services. This segment, typically those below the poverty line or just at it have been left out of the formal banking purvey because of the belief that loans to this segment are unviable. Providing credit to this segment in the form of housing loans, insurance, pension, deposits etc constitutes micro finance. In its rudimentary form, micro finance activity was taken up by NGOs or a group of individuals working for social causes. Now even commercial banks have jumped on the bandwagon realising that this segment has a lot of potential due to the demand-supply gap and very high marginal return on capital.

Financial institutions have spotted the largely untapped potential at the bottom of the pyramid. Today around 30% of the worldwide population lives with less than \$2 a day and does not have access to basic financial services. It is estimated that only 4% of this population’s demand for microfinance services is being met. Though estimates vary widely, the potential global microfinance market is pegged at approximately \$300 billion.

The roots of Microfinance could possibly be traced to Friedrich Wilhelm Raiffeisen’s village banking movement in Germany in 1864. Timothy Guinnane, an economic historian at Yale, brought to light the success of this movement which reached two million rural farmers by 1901. While, there are records of such spurious initiatives, the idea of lending to the poor did not gain much ground till mid-1990s. In the 1950s, government-backed development projects and rural banks began introducing subsidised credit programs to priority/backward sectors but suffered massive erosion of capital due to subsidised rates and poor repayment. The microfinance movement began taking root in the 1970s, when a new wave of microfinance initiatives started gaining ground in developing countries like Bangladesh and Brazil. Through 1980s and 1990s microfinance initiatives started becoming organized and profit-oriented.

Microfinance is largely a developing countries’ phenomenon, for the obvious reason— a large proportion of poor seeking access to credit for improving their lives. Out of the different microfinance models that have emerged, the Grameen Bank model, developed in Bangladesh by Nobel Laureate Mohammed Yunus has been adopted in most countries. While village bank model is mainly prevalent in Latin America and Africa, rural credit unions have worked for Sri Lanka. The self-help group (SHG) model on the lines of village bank is prominent in India. Grameen Bank in Bangladesh, BancoSol in Bolivia, Acieda Bank in Indonesia, MiBanco in Peru, ICICI Bank (a commercial bank) in India are the top players in their countries. ■

Under the microfinance institute (MFI) system the business of banking is radically simplified. That saves all the red tape that accompanies loan requests travelling from one office up to the next through the corporate ladder - before being either okayed or rejected. The MFI way is a stripped-down version of conventional banking. As such, it appears to be custom-tailored for the clientele it serves. The high repayment rate, 98.4%, attests to that. At the end of 2006, Grameen had loan loss reserves of only \$40 million. Grameen even managed to recover over \$9 million that had been deemed written off.

## TYPES OF LOAN

The duration of MFI loans is short compared to that of a commercial bank. An MFI loan can run from a minimum of a few days (for simple cash flow transactions) to a maximum of two years. But Grameen has a Gold Membership Programme for borrowers who were able to maintain repayment schedules over a period of seven years. A Gold Member may request a loan running over a longer term.

Muhammad Abu Hanif is not a Gold Member but he was able to get a loan that served his purpose exactly. With his \$300 loan, he installed a lighting system in his sawyer’s workshop. That way he could work nights as well as days and make more money. He was able to increase his profits by Taka 500 (\$10) a week. Standing in for him, Dipan Chandra Barua, the head of Grameen Shakti, explains: “People can do with electricity

what they could never do with candles or kerosene.”

More recently Grameen entered the field of housing loans. Since durable shelter is one of the basic requirements that people have, and since Grameen’s clientele tends to use the home as its work place, the move made good sense. The interest rate for home loans is 8% and is paid back over a period of 10 years— you guessed it, in weekly instalments. Defaults on this line of enterprise are running at less than one-half of one per cent. And that, dear reader, is so clearly world record stuff that there should have been no need to write this.

Yet business loans remain No.1 in the field of microcredit. Take the Aga Khan Agency for Microfinance (AKAM). It provides loans to its borrowers ranging from \$10 up to \$3,000. These loans are used for income-generating activities such as farming, handicrafts, expansion of businesses, cottage industry, small shops, and modest restaurants.

Gonoshasthaya Kendra (Peoples Health Centre), an NGO that specialises in affordable healthcare, practices microfinance, but with a wrinkle. It lends livestock like cows and chicken instead of money to poor people. The livestock is used to produce consumer goods, like milk and eggs, which the borrowers can sell. The borrowed livestock can also be used for labour such as transporting goods and farming. In some cases the animals reproduce and the borrowers make a profit by selling the offspring. When

## Features of different forms of loans

	Micro loans	Bank Credit line	Short-term loans	Long-term loans
Duration	Few months to 2 years	1 year	1 to 5 years	5 to 30 years
Interest Rate	30%–70%	7.95 (Home Equity)	5%–9%	7%–10%
Amount Range	\$20–\$800	\$10,000–\$10,00,000	\$300–\$1,500	\$6,000–\$10,00,00,000
Loan qualifying criteria	Saving money	Business plan/ Personal financial history	Competency/ Financial record	Competency/ Financial record

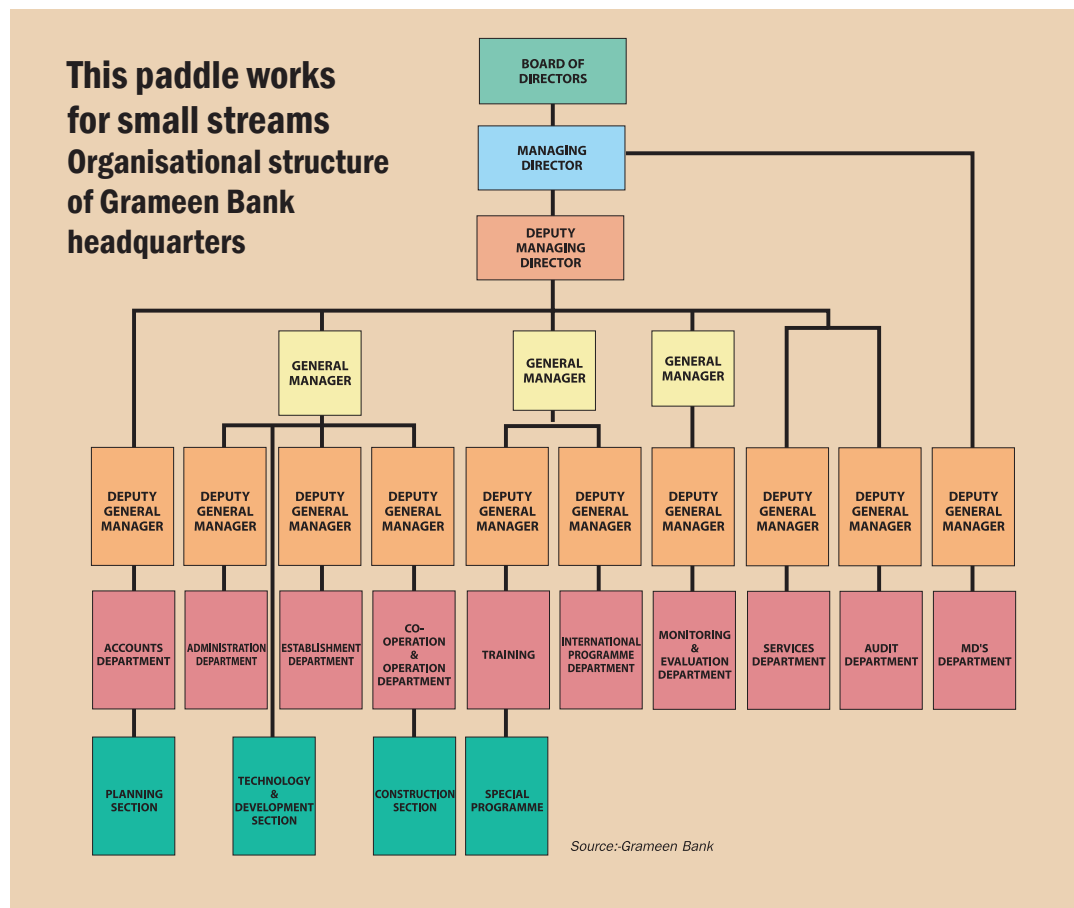
the period of the loan ends, the borrower returns the livestock.

## STAFF STRUCTURE

As of May 2006, Grameen Bank had 2,247 branches with a total staff of 18,795. Before the year 2000, the loan repayment rate was very low. After analysing the reasons for this, the company ordered up new and ambitious training programmes for its staff. Every one of its then 12,000 staff members received intensive training. Their aptitudes were then monitored via field-testing. Two years later, in 2002, the loan repayment rate stood at more than 98 percent.

Paperwork under Grameen II shrank very notably, at least when compared with that of the commercial banks. The field staff travels to the villages on bicycles, recruit new members, collect repayments, and monitor activity and morale in the member groups. They see to it that the groups reinforce in their membership the obligation to repay loans on time. The staff also helps loan seekers in coping with the formalities involved in living by Grameen II. Since Grameen sprawls over a large region and offers local service in its villages it is bank's outside staff that predominates. The ratio is one staffer from every 500 members. Relative to that, the personnel load at the branch headquarters is scant.

Grameen staff tends to view their occupation as something that transcends mere banking. GO has heard them call it a "job plus." All staff members receive



bonuses when their branch does well. When the contrary is the case they receive a warning. If no improvement results, the vultures begin to circle.

Microfinance has shown itself to be a good recipe for engaging the subclasses of society in the economy. Many who have become small entrepreneurs via MFI stand witness to its efficacy. And their message may yet reach out persuasively to hearts and minds all over the world. ■

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Top Microfinance banks					
Name	Country	Year	Assets (2006) (in millions)	Gross Loan Portfolio (in million)	No of active borrowers (in million)
Grameen Bank	Bangladesh	1983	\$819.8	\$482.1	\$6.9
ProCredit Bank Serbia	Serbia and Montenegro	2001	\$659.7	\$404.5	\$0.1
Banco Estado	Latin America & The Caribbean	1996	\$609.5	\$569.8	\$0.2
ProCredit Bank KOS	Kosovo	2000	\$632.6	\$289	\$0.1
ProCredit Bank BGR	Bulgaria	2001	\$455.4	\$320.8	\$0.1
BANTRA	Peru	1994	\$421.1	\$345.9	\$0.6
MiBanco	Peru	1992	\$388.4	\$320.4	\$0.2
ASA Bank	Bangladesh	1979	\$355.4	\$305.3	\$5.2
Compartamos	Mexico	1990	\$296.8	\$ 271.1	\$0.6
Banco Solidario	Ecuador	1995	\$341.1	\$243.6	\$0.1

Source: www.mixmarket.org