

B11- Microcredit: A new means of financing for the poor

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1) What is involved ?

The activity of **microcredit** consists in general in **granting loans for small amounts** to impoverished families, to small entrepreneurs or artisans who cannot access conventional bank loans.

2) Who use this means and since when ?

This means is used by all of those who do not have access to conventional forms of credit or who simply want to borrow low amounts of money, primarily in the developing countries, but also recently in the other countries. **It appeared in 1976, at the initiative of Muhammad Yunus**, Nobel Peace Prize winner, Founder of the Grameen Bank, the "bank for the poor", in Bangladesh (see photo opposite) which since then has granted €7 billion to 8.3 million borrowers, of whom 97% are women.



This system was then deployed very, and above all too, rapidly as **there were probably already in 2010, according to the World Bank, more than 10,000 microfinance organisations** in the world, which have apparently lent about €30 billion to 130 million people... Some of these unfortunately in the end had no purpose other than getting rich at the expense of the poor, and sometimes even leading to hundreds of suicides of people who had become incapable of repaying as in India in 2010. In May 2011, after declaring that it was becoming essential for microfinance institutions to take their

distance from looking for maximum profit and to turn resolutely to the poor, Muhamad Yunus was forced to resign from the Grameen Bank for obscure but primarily political reasons.

Most of the organisations do however provide important services. When it is used correctly, microfinance is the best means to give the poor that little bit of extra help that will allow them to improve their situation.

3) Why ?

After a terrible famine in 1974 in Bangladesh, Muhammad Yunus saw that the artisan women in the nearest villages needed only 27 Dollars to be able to purchase their stock in advance in order to resume their activity and to no longer be subject to variations in price. But the banks were not offering loans for such low amounts and in any case they refused to lend to people considered to be insolvent. Muhammad Yunus then decided to loan the money himself to these artisan women who as such were able to develop their activity and reimburse their loan.

Microcredit therefore makes it possible to finance activities that could not be funded otherwise. It is based on **simple systems that are adapted to the local situations.** It is an engine for development from an economic standpoint as well as from a social or well-being standpoint, especially in the water and sanitation sector, although it is still used very often to assist people in difficult situations.

Kofi Annan (former United Nations Secretary-General) himself recognised that **microcredit has shown to be "an effective weapon against misery and hunger"** and in 2005 launched an international year of microcredit, within the framework of the Millennium Development Goals.

4) Who is primarily concerned ? Contexts in which this means seems the best suited



Microcredit is developed especially in the developing countries, where it makes it possible to enable microprojects and as such favour activity and the creating of wealth but is also practiced in developed countries and countries in transition as well.

Such organisations exist in **85 countries** (for example in France : ADIE, Planet Finance and the Centre international du crédit mutuel). The World Bank currently lists more than 10,000, which have lent about €30 billion to 130 million people !

According to the *Microcredit Summit Campaign* organisation, in 2009 there were **128 million families among the poorest who had recourse to microcredit** (only 7.6 million in 1977).

According to partial statistics compiled by the Grameen Bank and Adie from the 1,700 organisations who accepted to provide their balance sheet :

- the worldwide **average amount of loans** was **€410** (€12,000 in Western Europe),

Note : the average amount of all microcredits granted in the world, according to the World Bank, would be close to €230.

- 82% of the beneficiaries were women.

- the **reimbursement rate** in the North was **90%** and was **98 %** in the developing countries.

- the average **interest rate** was **8% in the North, and 25% in the South...**

- the number of credits granted in France by ADIE was 97,000 (which were used to create 74,000 companies)

Asia and the Pacific make up 83% of the accounts opened in the developing countries, which represents 17 accounts per 100 inhabitants. In Cambodia, 400,000 people are concerned. In Kenya 18,000 new accounts are opened every year.

It is however in Latin America where the system has had its greatest boom.

Bolivia is generally considered to be one of the most advanced and the most competitive countries in

microfinance.

In Venezuela, in 1997, a great social entrepreneur, **Salomon Raydan**, with his **Fundefir association** in 7 countries and on 3 continents, created a vast network of credit and savings groups able to finance themselves : autonomous groups of people supplying, without recourse to banks, a credit fund for which they set the rates themselves, usually low, and the conditions for repayment (98% of the loans are paid back).

But **some** microcredit **organisations** that were initially non-profit establishments then **transformed themselves into profit making institutions** and sometimes have even been listed on the stock market. This was the case for example in 2007 in **Mexico with "Banco Compartamos S.A"** and in 2009 in **India with "SKS Microfinance"** of which the capital is primarily held by American financier Georges Soros, and in which **17 customers committed suicide**. The latter acquires the funds at about 12% and lends them out at **24.5%**. Certain other Indian organisations are lending their funds at rates that can range up to 36% according to "Microfinance Institutions Network". Some isolated loan sharks are lending at even **much higher rates** in villages to people who can no longer repay...

As such, **victim of its success, the proliferation of microcredit organisations has unfortunately given rise in the last few years to dangerous abuse that risks compromising the reputation and the development of the system.**



In the area of water and sanitation, a microcredit system can help in meeting diverse types of needs such as in the examples below :

Setting up and maintaining community equipment

- initial contribution of communities in a hydraulics investment.
- purchasing equipment in order to replace, expand and rehabilitate a structure.
- financing unexpected major repairs.
- cash advances when there is a liquidity problem.
- constitution of a stock of spare parts or tools

Setting up individual equipment

- financing a connection (formula often used when creating social connections)
- building a water tank or a reservoir
- purchasing filters for treating water in the home.
- building latrines

5) What does this process involve ? How is it used ?

There are several types of microfinance institutions (MFI) which each use different methods of loans. **Three approaches** can however be distinguished : **banking, associative and individual.**

a) The banking approach

Principle :

In this approach, **microcredits come from banks or other institutions of the same nature.**

These are in particular :

- **cash** credits intended in principle for financing the needs of rural populations, for which monetary inflows follow a seasonal rhythm
- **investment** credit, for financing operating equipment, land improvements, building and extending micro-hydraulic programmes for villages or domestic energy
- **personal** credit, granted with the aim of improving the capacities and the conditions of life of populations.

Implementation :

Origin of the funds granted :

- deposits (40% to 90% of the loans come from the savings of populations)
- bank's own resources (shareholders' contributions)
- grants and loans from the government or institutional agencies
- Rediscounting transactions (interbank transactions at low rates that allow banks to refinance themselves and increase their lending capacity)
- income drawn from the bank's investments in other companies.
- Interest collected and profit margin.



Loan transactions

Borrowers must subscribe to certain principles according to the organisation that they are soliciting. Rather frequently, there is an **prior obligation of savings** (requirement to deposit at least a few percentage points of the monthly value of the loans solicited), the need also for borrowers to **not exceed a certain threshold of wealth** in order to be eligible for microcredit offers (for example, the Grameen Bank offers loans reserved for farmers operating on land less than 0.2 ha) and finally the **principle of collective responsibility** : the requestors form groups and they are together in the repayment of the loan, they thus ensure that that the other members are reliable ; in exchange, the interest rate for the loan is lower. Moreover, candidates can attend training sessions and explain how they are planning to pay back their loan.

System for recovering costs linked to the transactions

In order to reimburse the various costs (administrative and management costs, but also costs due to inflation or any depreciation and devaluations and finally costs stemming from payment default and other risks linked to repayment of the loans granted), the lending organism collects interest rates which are free or subsidised.

Guarantee system against risks

The guarantee is moral and material.

If the borrower is part of a group, the mutual knowledge of the members of the group is the moral guarantee and the collateral security is the material guarantee.

As such in the operation of the Grameen Bank for example only two members of the group receive loans. If the two candidates show proof of proper behaviour in repaying their debt within the allotted timeframe, the other members in the group can then in turn have access to credit.

If the borrower is not part of a group : small loans without any guarantee other than the fact that the property acquired thanks to the loan is the property of the bank as long as the loan has not been paid back, for example. The guarantee can also involve the borrower's future harvests.

Loan repayment

Their frequency can be weekly or monthly, **the total period is often less than one year**. Sanctions (implementation of the solidarity caution if a group, plus moral sanction) or incentives (in the form of incentives in the progressive decrease in the interest rates) can exist according to the organisations. The collection ratio is 80% to 98.6% according to the institution.

b) The associative approach

Principle

A community (of women, young entrepreneurs, of people with the same political or religious background, etc.) is formed and initiates microfinance activities, primarily loans and support structures for those who want to launch an activity. The association, cooperative or the working capital formed as such can

provide, according to the country's legislation, legal and tax protection. **This is not to be confused with NGOs, which are external organisations.**

This approach is complementary to the previous one due to the low density of banking credit networks and also because it constitutes the means for requestors to have contacts with the same socio-cultural, socio-economic or socio-professional status ; the conditions for the loans offered can therefore be better suited to the borrowers than those offered by banking institutions.



Community savings bank in Cambodia 

Implementation

Origin of the funds

These come from due from the members (in cash or in kind) but also from donations, grants or loans from governmental or institutional organisations.

Loan transactions

For members : They must **have settled a membership fee** or have purchased membership shares in the association. For certain associations, members must in addition **make periodic contributions** in order to be eligible for a loan ; this is to feed the funds that can be loaned out.

For example, access to a working capital loan for a farmer who would like to build a rainwater reservoir would require the acquisition beforehand of at least one share in the community (at a rate of a few dollars per share).

Loans can sometimes be granted to non-members, but at less advantageous conditions.

Recovering costs - Interest rate

The interest can be subjected to an auctioning process (they therefore depend on the state of demand). They can reach between 5 and 10% per month in associations with a partially commercial calling but are lower in associations with an entirely social calling such as Fundefir in Venezuela. They make it possible to cover the operating costs, sometimes remunerate members' deposits and to protect themselves against inflation. It is this rise in the rates practiced by some organisations and the accumulation of successive credits resulting in substantial over-indebtedness which has sometimes led to a full calling into question of the system.

Loan repayment

There is **much more flexibility compared to banking institutions** (the particulars can take into account the periods in which income arrives for their members - harvest season for farmers, for example). The timeframes and frequencies for repayment depend on the meeting frequencies of the members of the association and on the duration of the existence of the association if the latter is formed for a limited time.

Guarantee against risks

It is **less restricted** a priori than for banking institutions as it is primarily based on trust between the members and the evaluation of repayment capabilities of the borrowers by their peers. Deposit cheques can be required in certain cases. But it is above all the pressure from solidarity and the risk of social exclusion that bears down on bad payers that acts as a guarantee. Non-member need a sponsor, a member of the association, to guarantee the reliability of the requestor, he is then held responsible in the event of default on a payment. Beyond these threats of "social death", the trust and the mutual assistance within the associations remain the primary guarantee against the risks of a default on payment.

Example : The XETIC association (Lyons, France).

In September 2010, this NGO launched an **online microcredit website giving the possibility to private individuals to lend** money almost directly to African microentrepreneurs in order to support local development projects of which the authors, the content and the amount are mentioned on the website.

The principle for this is simple : the internet user who wants to grant a microcredit, alone or together with other people, first creates their profile and specifies the type of project that he would like to assist then chooses this project. He then sends the money via an online secure payment site. The corresponding amount is then sent by Xetic to its African partners (local microfinancing institutions) that have been mandated to set up the corresponding loan with the microentrepreneur involved and to monitor the microentrepreneur in the development of their project.

When the loan payment arrives, the internet user can chose either to be repaid, or reinvest the money in another project.



Launching of a small fishing activity

c) The individual approach

Principle

The credits are granted to populations by **people benefitting from their situation as a financial monopoly**.

These are usurers and other private individuals (professional lenders, itinerant bankers, land owners, merchants, notable people, etc.). Sometimes this is the only approach available for people located in areas that are not served by the banking network or who do not have enough credit to have access to it or incorporate associations.

It is recommended that the loan transactions be accompanied with the signing of written agreements, not just oral ones. **The interest rates are very high** : about 10% to 20% per week and sometimes per day...

6) Special difficulties and remedies and/or precautions to be taken, if any

The word 'credit' comes from the Latin 'credere' which means 'believe'. **Trust is therefore an essential condition for the proper operation of a microcredit system**. As shown in the collection statistics, this trust can be easier to generate from within a community where everyone knows everybody else and where a certain degree of social control already exists.

Such a system supposes that the populations have a certain capacity to repay and that the project meets their expectations. In other words, the conditions to access microcredit must be approachable and adapted to the local habits and customs.

The interest rate has to be a compromise between the need to recover the costs linked to the loan transactions, and the possibility of the populations to pay not only for the repayment of the capital, but also interest. In the case where deposits are made, the interest rate must be significantly attractive to draw savings. In practice is most often higher than the banks' prime rate in the country, but much less than the rates practiced by usurers that the poor had to solicit. In India, these rates could for example reach nearly 300% per year...

For information :

- this rate is between **10 and 20% per year** at the Grameen Bank (in general the interest rates are 16% for payment instalments spread out over one year, 10% for instalments over one month and are higher than 10% per day for instalments of a few days)

- it is **3.6% per month** at the Bank of Indonesia ; and less than 10% at the BAAC of Thailand. As such, **the shorter the loan is, the higher the rate in relation to the duration of the loan !** This is due to the fact that, in general, the shorter the loans are, the lower the amounts concerned are, although the fixed costs (fees for the dossier, personnel, training, etc.) remain almost unchanged. In order to partially offset this imbalance, the rates are therefore higher.

Inflation is high in many countries, which for borrowers decreases the value of their repayment, but for the fund involved, it reduces the value of its capital. In addition, the capital of the fund or of the association must be high enough in order to genuinely assist activities that are starting out.

Nevertheless, one should be vigilant as interest rates sometimes tend to go out of control and reach up to 25%, **which is difficult to justify in relation to the social objectives** of the system and results in increasing number of **situations of over-indebtedness which sometimes have dramatic consequences.**

Finally, in order to facilitate development, a microcredit should be granted rather for small development projects, from an economic standpoint or in terms of well-being, and should not turn into consumer credit or create a situation of over-indebtedness.

7) Main advantages and drawbacks



Opening of a fruit shop in India

a) The banking approach

Advantages :

- **financial system adapted** in particular to rural regions
- existence of financial potential in the rural populations
- **commodity** of passbook accounts
- **security** that these accounts procure.
- appropriate credit mechanisms

Disadvantages :

The system has to enjoy a stable economic and political environment.

- The frequent phenomena of depreciation, inflation and devaluation that certain countries in Africa and especially in Latin America are often confronted with
- The socio-political conflicts and especially government intervention in the banking system
- The absence of road infrastructures in rural regions
- **high costs** for establishing or building premises
- most of the institutions have to count on grants
- lack of qualified personnel or personnel specialising in issues concerning credit in rural zones
- The **guarantees** such as the land titles or real estate mortgages are **not within reach of small**

entrepreneurs and rural producers

- **The illiteracy** of local populations who therefore are poorly informed

b) The associative approach

Advantages :

- **highly accessible** for rural populations
- **no bureaucratic or administrative constraints** or constraints with regards to time
- direct and spontaneous contact amongst the members
- flexible credit arrangements
- **based on the solidarity networks that exist** in the communities
- beneficiaries of associative loans can receive material assistance and moral support from the group, and exchange experiences with certain members

Disadvantages :

- **interest rates higher than those at banks**
- associative credits finance by far **activities that concern the short term**
- expenses of a social nature such as weddings, funerals, births, education and health form a large part of this
- **relatively limited financial power**
- the financial management of associative movements suffers from a **lack of know-how** : lack of qualified personnel and noted absence of rigour and organisation in the manner in which financial transactions are carried out and especially concerning how the books are kept.

c) The individual approach

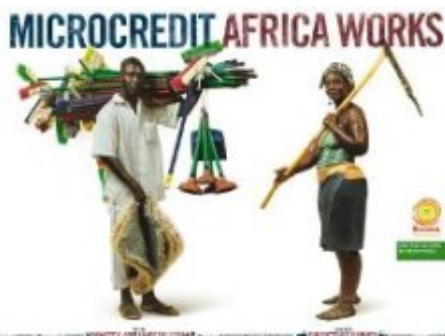
Advantage :

- high degree of proximity and easy to access

Disadvantages :

- **The most expensive credits by far**, with often usurious rates
- **Risks of scams**

8) Observations and recommendations



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Setting up a microcredit system makes it possible to organise and structure existing local savings which cannot be mobilised through other means, which as such prevents too much hoarding. Such a system also makes it possible to reinforce the sense of collective responsibility.

Microcredit allows for the financing of individual or collective projects. It enables the poorest to participate in projects by advancing a portion of the initial investment.

Finally, such systems must be levers for development but attention must be given so that they do not take the place of the responsibility of the civil authorities in the matter.

9) Achievement examples

- The setting up of a microcredit system can assist with the initial financing for the purchase of equipment. This was the case for example in **Ouagadougou in Burkina Faso** for the financing of private latrines by the households which, thanks to purchasing a share in the fund, had rights to microcredit.

- This was also the case with a project in Khon Kaen in **Thailand**, where households were able to obtain water tanks, by using the same system.

According to the national Thai programme, the purpose of this project was **to encourage the construction of water tanks** benefitting households in order to allow them to collect rainwater. Supported by grants from the government, a system of working capital loans was created in the village, in order to facilitate access to the working capital fund, but also to give each household the possibility of being able to build its tank. To do this, each candidate was required to acquire at least one share at 4 dollars a share, which conferred the right to a working capital credit for an amount greater than or equal to 150 dollars.

The fact that the borrowers first had to contribute financially in purchasing a share, before being able to take out a loan, is not only a way to increase the capital in the fund : it is also a way to reinforce the borrower's responsibility in light of his financial commitments.

The first group of loan beneficiaries finished repayment after fifteen months, paying 4 USD per month. If the principle of a monthly payment is complied with by all, the amounts that are reconstituted as such are loaned out again to another group, which was waiting during this period of time.

- **Several French solidarity NGOs also support microcredit** such as **CCHD** (Catholic Committee against Hunger and for Development) and the **Caritas France Foundation**.

As such, the **Caritas France Foundation acquired a holding at the end of 2011 in the capital of the first European Fund for Solidarity Financing for Africa (FEFSA)** for €125,000. Created by SIDI in France, this Fund pursues **two objectives : promoting microfinance on the African continent and supporting local organisations of producers**, who often suffer from hunger due a lack of capital, equipment and climate and political ups and downs.

Far from the excesses of certain microfinance funds, this Fund will loan money to farmers in local currency and at an average rate that is not high for a microfinance organisation of about 8%. It is planned in time to increase the capital of this Fund to €15 million.

10) Where to obtain further information



Creation of vegetable crops in Mali. Photo Enda

a) Websites

- **Grameen bank** ; bank for the poor

www.grameen-info.org/

- **PlaNNet Finance** ; Fight poverty through microfinance

www.planetfinancegroup.org/

- **Wikipedia** ; article on microcredit.

<http://fr.wikipedia.org/wiki/Microc...>

- **PSEAU** : IRC document on microcredit for water

<http://www.pseau.org/outils/ouvrage...>

- **IRC** (International Water and Sanitation Centre) ; micro finance and the water and sanitation sector in Africa

<http://www.washdoc.info/docsearch/t...>

b) Radio Programmes

- Site of the rural **RADIO** of **CTA** (Technical Centre for agricultural and rural Cooperation) which since 2000 has been carrying out its activities of information on the rural world in the ACP (Africa-Caribbean-Pacific) countries within the framework of the Cotonou Agreements with the E.U. **This site, located in Holland, provides documents and radio programme recordings** on various themes, including that of microfinance

Programmes are available, online, on <http://ruralradio.cta.int/fr/Microf...>

c) Videos

- **HURRAVIDEO** : 6-minute video "**Microcredit according to Muhammad Yunus**" founder of the **GRAMEEN BANK**. Interview segmented with You Tube images but **translated into French**, where he explains how he designed microcredit and how the Grameen Bank operates. Available, online, on :

<http://www.hurravideo.com/v/le-micr...>

- **YOU TUBE** : 3-minute video "**Women borrowers at the Grameen Bank in Bangladesh**" showing meetings of women who have obtained credits from the Grameen Bank and giving examples of what they have done with them

<http://www.youtube.com/watch?v=G162...>

- **XETIC** : A 3-minute video explaining how this recent non-profit microfinance organisation operates (Lyons, France) ; Available, online, on :

<http://fr.xetic.org/xetic-comment-a...>

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