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### Microfinance: is it really such a good thing?

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## Microfinance: is it really such a good thing?

### Abstract

Did you see Muhammad Yunus on Q&A on 3 April? Yunus was the founder of the Grameen Bank he and the Bank jointly won the Nobel Prize for Peace in 2006 for their work on microcredit. Maybe you have wondered why indigo foundation has not taken up microfinance? After all, it claims to be an incredibly powerful tool for the empowerment of women, which is one of our key focus areas. Like many things though, when you scratch the surface, microcredit is not all it is made out to be.

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# microfinance: is it really such a good thing?

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Did you see Muhammad Yunus on Q&A on 3 April? Yunus was the founder of the Grameen Bank he and the Bank jointly won the Nobel Prize for Peace in 2006 for their work on microcredit. Maybe you have wondered why indigo foundation has not taken up microfinance? After all, it claims to be an incredibly powerful tool for the empowerment of women, which is one of our key focus areas. Like many things though, when you scratch the surface, microcredit is not all it is made out to be.

Let's go back a little and look at what microcredit is and how it works. Microcredit is simply the provision of very small loans to the poor who have not been able to access traditional banking channels. Microfinance is now the more common term as it illustrates that many institutions now provide a range of services such as savings and insurance.

The estimates of the number of microfinance institutions (MFIs) across the world vary widely: there are at minimum over 1,000 institutions serving 130 million clients (Microfinance Barometer 2016). Some estimates say there are over 10,000 institutions – maybe well-over. As the industry has grown, it has become more commercialised and now NGOs are only responsible for servicing about 35 per cent of clients, with 60 per cent serviced by banks and finance firms and the rest by credit unions and rural banks (MacFarquhar, 2010). In the past decade, MFIs have started opening in developed countries.

## how microfinance works

Microcredit has a long history but providing it as a strategy for the empowering poor is often credited to Ela Bhatt in India in 1974 and Mohammad Yunus in Bangladesh in 1976. Both were responding to economic and institutional conditions limiting the productive potential of skilled artisans. Artisan and most poor people,



MUHAMMAD YUNUS

reserves for large expenses such as investment in an enterprise, medical expenses or investment in education. Often they do not save – sometimes because they cannot open traditional accounts requiring proof of identity and signatures or because there are no financial institutions in their area. Therefore, when they need credit, the poor use informal channels and this often means local money lenders, who generally charge exorbitant rates (Robinson, 2001).

Microcredit was designed to offer poor people an alternative source of small loans at more manageable interest rates than the money lenders. There are a range of models for providing microcredit. The most common model sees the formation of small groups of around five people, who initially make regular savings deposits into the scheme for a period of three to six months. This is the group collateral – the substitute for collateral normally required by financial institutions. Next, one or two members of the group can take out loans, the stated purpose of which must be creating or expanding a microenterprise. If loans are repaid, other group members become eligible. This system has produced very high repayment rates for most schemes.

## the limitations of microfinance

There are many dramatic claims regarding the benefits of microcredit, these are summarised

by Irish rock star Bono statement: 'Give a man a fish, he'll eat for a day. Give a woman microcredit, she, her husband, her children, and her extended family will eat for a lifetime' (quoted in Bateman, 2014). Proponents support this claim by pointing to the 97 per cent repayment rate of loans, which seems to show both that poor women are bankable and that MFIs can be self-sustaining. If the poor can lend their way out of poverty then this provides a pathway for the end of aid and a justification for not providing social transfers to the poorest.

But would it surprise you to learn that the 97 per cent repayment rate comes at a cost? Perhaps not when you consider two things:

- Globally rates of small business failures are very high, further the creation of thousands of new small business creates hyper-competition pushing prices down to unsustainable levels, it simply adds new supply in markets with limited demand (Bateman, 2014); and
- The interest rates on microfinance are very high – the global average is 37 per cent per annum but in Mexico it is 70 per cent and there are reports of institutions charging 125 per cent (MacFarquhar, 2010). This is because MFI running costs are high both due to the lending model and the high salaries of top officials (Bateman, 2014). Thus it seems that the industry that it is becoming little better than the local money-sharks they sought to replace.

The transformative agenda for women is also not all that it is cracked up to be:

- In many case, husbands actually control the loans but often expect their wives to repay them.
- Where women do set up small businesses this adds to their high workload. Their changed role in the family sometimes puts a strain on marriages and many instances of domestic violence linked to microfinance have been reported.
- In Bangladesh and other countries, the vast majority of field officers in microfinance organisations are men and

women generally are not involved in the planning, implementation or evaluation of these organisations (Fernando, 1997).

Microfinance loans are not always or, in fact, mostly used for starting up small business, something the industry has over time acknowledged. Often loans are used for household needs such as medical or educational expenses. Many poor people become reliant on a cycle of loans – taking out a new loan to repay the last one (Fernando, 1997).

While the group collateral system produces high levels of repayments, it also institutionalises a range of pressure tactics to ensure repayments are made. Indeed, Karim (2011) describes microfinance as an economy of shame. The shame economy works through the lending group, group leaders and MF officers, it gets poor women to police each other, notify managers of defaults or problems and evict probable defaulters from the group. The group actively shame defaulters and MFI officials demand that the borrowing group publicly shame the defaulter – in part because they often end up paying for it out of their own wages if the defaulter does not to pay. In Karim's (2011) study in Bangladesh, 75 per cent of the women she interviewed outlined low level verbal and physical abuse associated with loan recovery from group members, NGO workers and husbands. Other coercive behaviours to get loan repayments included:

- threatening to throw hot water on the face of a defaulter;
- confiscating housing items include cooking utensils until repayment is made meaning defaulters cannot feed their family;
- household goods being taken and sold to pay debts – one woman was forced to sell her house for US\$2.70;
- defaulters locked up in MFI offices overnight;
- taking court action against, and jailing of, defaulters, and;
- Karim discussed one case of suicide very closely linked to MF debt but in India there have been hundreds of cases.

Microfinance programs are not the panacea to global poverty as has been claimed. They do not eliminate the need for basic social and infrastructure services, end vulnerability to economic shocks, or even create many economic opportunities for the poor. The main impact of microfinance has been to dramatically increase individual indebtedness with many harmful consequences.

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