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„Can Micro-Credit Change the World?“

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Ting-lan Yang

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1. Introduction

1.1 Can 'Micro-Credit' Change the World?

In the last few years there have been tremendous interests in organizations that lend Micro-Credits to poor people and the impoverished communities of the Third-World. The success of these Micro-Credit Institutions has gained high recognitions and many international awards (including the Nobel Peace Prize). Many believe that financial institutions in the First-World can learn a lot from these Third-World countries.

This thesis explores the concepts of Micro-Credit and the impact it is having on the everyday lives of people around the world. It asks the key question "Does Micro-Credit Reduce Poverty?", if so then Micro-Credit has the power to change the world!

The Thesis starts off by explaining the fundamentals of Micro-Credit; including its concepts and methodologies. It then introduces Professor Muhammad Yunus, who is widely recognized as a leading pioneer in this field. It describes how he founded the Grameen Bank and goes into detail about the Micro-Credit model that he created. It then analyzes some key questions, with the main focus on the factors that make Micro-Credit Institutions succeed or fail. Finally, it answers the key question: "Does Micro-Credit Reduce Poverty?".

1.2 Why is Micro-Credit so important?

For poor people in impoverished communities, it is extremely hard to gain access to commercial financial services; since most of them have nothing to offer in the way of collateral. Without the support of a proper financial institution, these people in developing countries are exposed to local money-lenders who often abuse their power and charge an exorbitant high interest

rate. Thus the income that is left for the clients is minimal and has to serve as subsistence for the whole family. This is a real challenge and their lives become a daily struggle with no way out of this disaster situation.

The situation worsens when a Global Financial Crisis occurs; as unskilled laborers and casual workers are most likely to be the first to lose their jobs. There is no safety net and without alternative work they will struggle to exist. Professor Muhammad Yunus, who was awarded with the Nobel Prize in Peace in 2006, illustrated this in simple way when he was interviewed in October 2008 by a well-known German newspaper. He said: *"If a billionaire loses half a billion, then he will still have half a billion left, but if an unskilled laborer of a Third-World country loses his job, then he loses everything"*¹.

1.3 Why is Professor Yunus so important?

Muhammad Yunus is Professor at the University of Chittagong, in Bangladesh. He established a lending institution, known as the 'Grameen Bank', to serve the rural poor with Micro-Credits without any collateral. He did this to help people in these poor communities from the debt trap by borrowing money from local money-lenders.

The first Grameen Bank is based in Jobra, Bangladesh and achieved great success from the beginning of its inception. As of June 2010, the Grameen Bank has 8.28 million clients, 97 percent among them are women. It holds 2,564 branches and provides services in 81,362 villages which cover more than 97 percent of the total villages in Bangladesh².

This positive development on society through the Grameen Bank was soon understood by other countries which resulted in adoption of the Grameen

¹ Cf. Frankfurter Allgemeine. Article from October 9, 2008. <http://www.faz.net/-00mp99> [Accessed on July 26, 2010]

² Cf. The Grameen Bank Homepage http://www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=175 [Accessed on July 27, 2010]

Bank idea in 90 countries so far, including a handful of industrialized and developed countries like the USA or Norway.

Micro-Credit has gained recognition as an effective way to bring very poor families low-cost financial services as well as an instrument for socioeconomic development. The notion of Micro-Credit is appreciated so much that the UN General Assembly designated 2005 as the International Year of Micro-Credit, and in 2006, both the Grameen Bank and its founder Professor Muhammad Yunus were awarded the Nobel Peace Prize for pioneering Micro-Credit, for the scale of their outreach and for their impact on poverty alleviation³.

³ Cf. The Grameen Foundation Australia Homepage
<http://www.grameen.org.au/about.htm> [Accessed on July 28, 2010]

2. What is Micro-Credit?

2.1 The difference between Micro-Finance and Micro-Credit

Micro-Finance and Micro-Credit are sometimes referred to as the same thing, but there is a very clear difference between these two terms.

Micro-Finance is defined as the practice of providing basic financial services, such as credit, savings, insurance and transfer services (remittance) to poor communities and low-income clients.

Micro-Credit is a fundamental part of Micro-Finance. It relates to the financial services that are offered to clients in the form of loans. Micro-Credit is based on providing a range of very small loans, known as Micro-Loans. These Micro-Loans are normally offered to low salaried or unsalaried clients who have little or no collateral. They are provided by a bank or other institution with the purpose of boosting entrepreneurship.

Hence there is a structured relationship between Micro-Finance and Micro-Credit. They are influenced by the same external factors and market forces. Micro-Credit forms a major part of Micro-Finance and its growth or decline will impact directly on Micro-Finance.

2.2 History of Micro-Credit

The concept of Micro-Credit is not new; it has been around for a very long time since people started to borrow small amount of capital.

One of the earlier Micro-Credit organizations providing small loans to poor rural communities with no collateral, was the Irish Loan Fund System, emerged in the 1720s, using peer monitoring to enforce the repayment in weekly

installments of initially interest-free loans from donated resources. The Fund reached its prime-age a century after, which was triggered by two events⁴:

- A special law was introduced in 1823, that turned the charities into financial intermediaries by allowing them to charge interest on loans, enabling them at the same time to collect interest-bearing deposits; and
- The establishment of a Loan Fund Board in 1836 for their regulation and supervision. Around 1840s it became a widespread institution of about 300 funds all over Ireland and eventually covered 20 percent of all Irish households at their peak.

The downfall of these Funds began slowly when they started providing deposit rates that were three times higher than conventional banks. They soon became a strong competitor, to these established banks. This caused the conventional banks to fight back and they use all their conceivable means to stop the growth of the Loan Funds. The end of the Loan Funds came in 1843 when the banks got the Irish Government to impose a ceiling on interest rates. Consequently the Loan Funds lost their competitive advantage and became less attractive during the second half of the 19th century. By the start of the 20th century Loan Funds were few and far between and they finally disappeared altogether in the 1950s⁵.

The development of Micro-Credit also took place in other European countries. Various types of larger and more formal savings and credit institutions began to initiate, organized primarily among the rural and urban poor. These institutions were known as People's Banks, Credit Unions, and Savings and Credit Co-operatives⁶.

⁴ Cf. Seibel H., (2003), Small Enterprise Development – An International Journal of Microfinance and Business Development, Vol. 14, no. 2, *History matters in microfinance*, page 2.

⁵ Cf. Seibel H., (2003), Small Enterprise Development – An International Journal of Microfinance and Business Development, Vol. 14, no. 2, *History matters in microfinance*, page 2.

⁶ Cf. CGAP Microfinance Gateway Homepage, <http://www.microfinancegateway.org/gm/document-1.9.45764/the%20history%20of%20microfinance.pdf> [Accessed August 1, 2010]

The concept of the Credit Union was developed in Germany by Friedrich Wilhelm Raiffeisen and Schulze-Delitzsch in 1864. Their aim was to assist the rural population in becoming independent from their money-lenders and thus to improve their welfare. From 1870 the union, today known as Raiffeisenbank, began to expand rapidly over a large sector of the Rhine Province and other regions of Germany. By the year 1901 the bank had reached two million rural farmers⁷.

Timothy Guinnane, an economical historian at Yale University conducted research into Friedrich Wilhelm Raiffeisen's Village Bank movement and his findings regarding the growth of the Village Bank shows that Micro-Credit was able to pass two important tests⁸:

- The ability to provide financial service to poor people
- The payback moral's of these low income clients.

The development of Micro-Credit over in North America began in the early 1900s in Quebec. The 'Caisse Populaire', was established in 1900 by Alphone and Dorimène Desjardins. The founders strongly supported the poor and offered themselves as guarantors with all their private assets which showed that they had been very sure about the concept of Micro-Credit⁹.

Following the introduction of Micro-Credit in North America, pioneer banks started offering forms of Micro-Credit to the rural poor in Central and South America in the early 1900s. The goal of these institutions was defined in terms of modernizing the agricultural sector. They focused on two main objectives¹⁰:

⁷ Cf. CGAP Microfinance Gateway Homepage, <http://www.microfinancegateway.org/gm/document-1.9.45764/the%20history%20of%20microfinance.pdf> [Accessed August 1, 2010]

⁸ Microfinance and Microcredit – Principles of Microfinance Homepage <http://www.microfinanceinfo.com/history-of-microfinance/> [Accessed on August 9, 2010]

⁹ Cf. Microfinance and Microcredit – Principles of Microfinance Homepage <http://www.microfinanceinfo.com/history-of-microfinance/> [Accessed on August 9, 2010]

¹⁰ Cf. CGAP Microfinance Gateway Homepage, <http://www.microfinancegateway.org/gm/document-1.9.45764/the%20history%20of%20microfinance.pdf> [Accessed August 1, 2010]

- Increasing the commercialization of rural communities, by offering credit which mobilized savings that would have remained idle.
- Reducing the oppressive feudal relations that had been previously enforced through a regime of indebtedness.

In most cases these banks were not owned by the poor themselves but rather by government agencies or private banks. Over the years, these institutions became inefficient and at times abusive¹¹.

In the 1970s Bangladesh, Brazil and several other countries implemented experimental programs that provided tiny loans to groups of poor women and served as start-up aid for their Micro-Businesses¹². The experiment in Bangladesh became a major impetus behind the Micro-Finance movement and ultimately laid the first foundation of today's Micro-Credit and Micro-Finance.

Since the 1970's numerous financial institutions and banks have been created to pioneer a range of Micro-Finance programs. The most significant among them are¹³:

1) The Grameen Bank:

The Grameen Bank was founded in 1983 by Professor Muhammad Yunus and now serves about 7.97 million poor people in Bangladesh. The success of the Grameen Bank has also stimulated the formation of several other giant Micro-Finance Institutions such as ASA, BRAC and Proshika.

¹¹ Cf. CGAP Microfinance Gateway Homepage, <http://www.microfinancegateway.org/gm/document-1.9.45764/the%20history%20of%20microfinance.pdf> [Accessed on August 16, 2010]

¹² Cf. CGAP Microfinance Gateway Homepage, <http://www.microfinancegateway.org/gm/document-1.9.45764/the%20history%20of%20microfinance.pdf> [Accessed on August 16, 2010]

¹³ cf. CGAP Microfinance Gateway Homepage, <http://www.microfinancegateway.org/gm/document-1.9.45764/the%20history%20of%20microfinance.pdf> [Accessed on August 16, 2010]

2) ACCION International:

This institution was established by the law student, Joseph Blatchford, to help the poor people residing in the rural and urban areas of the Latin America countries. ACCION today is one of the most important Micro-Finance institutions in the world with a network of lending partners that spans Latin America, North America and Africa.

3) SEWA Bank:

In 1972, the Self Employed Women's Association (SEWA) was registered as a trade union in Gujarat (India), with the main objective of "strengthening its members' bargaining power to improve income, employment and access to social security." In 1973, to address their lack of access to financial services, the members of SEWA decided to found "a bank of their own". Four thousand women contributed share capital to establish the Mahila SEWA Co-operative Bank. Since then it has been providing banking services to poor, illiterate, self-employed women and has become a viable financial venture and now has more than 60,000 active clients¹⁴.

Various different styles of Micro-Credit programs have been developed and enhanced by different institutions over the years. In the process, these organizations gained valuable experience and many have come to the conclusion that poor people, especially women, have excellent repayment rates. Moreover the poor were willing and able to pay interest rates that allowed Micro-Finance Institutions to cover their costs. These two important features – high repayment and cost-recovery interest rates have allowed some Micro-Finance Institutions to achieve long-term sustainability and reached large numbers of clients.

¹⁴ SEWA Bank Homepage, <http://www.sewabank.com/financialdata.htm>
[Accessed on August 16, 2010]

From the 1990's the Micro-Finance industry had been thriving and prospering in many countries around the world, Micro-Finance still is considered by different institutions and non-governmental organizations as an effective instrument for poverty alleviation¹⁵.

Since 1997 Micro-Credit Summits have been held annually in different countries around the world. The first summit which was held in Washington D.C. in February 1997, gathered more than 2,900 people from 137 countries. At this summit they introduced a nine-year campaign to reach 100 million of the world's poorest families, with credit for self-employment or other financial and business services. The goal was very nearly reached by 2005.

At the Micro-Credit Summit in November of 2006 the campaign was re-launched with two goals¹⁶:

- To work to ensure that 175 million of the world's poorest families, especially the women of those families, are receiving credit for self-employment or other financial and business services by the end of 2015.
- To work to ensure that 100 million of the world's poorest families move from below USD-\$ 1 a day adjusted for Purchasing Power Parity (PPP) to above USD-\$ 1 a day adjusted for PPP, by the end of 2015.

The year 2005 was proclaimed as the International Year of Micro-Credit by the United Nations General Assembly. The United Nations Capital Development Fund (UNCDF) together with the United Nations Department of Economic and Social Affairs (UNDESA) were responsible for the coordination of the International year of Micro-Credit. The aim of this special year was to raise public awareness of the importance of Micro-Credit and Micro-Finance

¹⁵ Cf. CGAP Microfinance Gateway Homepage, <http://www.microfinancegateway.org/gm/document-1.9.45764/the%20history%20of%20microfinance.pdf> [Accessed on August 16, 2010]

¹⁶ cf. The Microcredit Summit Campaign Homepage, [http://www.MicroCreditsummit.org/about/about the Micro-Credit summit campaign/](http://www.MicroCreditsummit.org/about/about%20the%20Micro-Credit%20summit%20campaign/) [Accessed on August 15, 2010]

in the alleviation of poverty, to share good practices and to further enhance financial sector developments that support sustainable pro-poor financial services in all countries.

The International Year of Micro-Credit united Member States, United Nations Agencies and Micro-Finance Partners in their shared interest to build sustainable and inclusive financial sectors, and achieve the Millennium Development Goals (MDGs)¹⁷.

The performance of the 2005 International Year of Micro-Credit and its achievements were very impressive. The UNCDF has reported that more than 100 different countries responded to the call and initiating a wide array of initiatives ranging from the serious work of regulatory change to celebrating Micro-Entrepreneurs. These actions represent a significant step forward creating real change at a national level in the long term¹⁸.

The 2005 International Year of Micro-Credit also addressed the major information gaps that had presented a formidable obstacle to the development of Micro-Finance industry in countries around the world. In this year a massive Data Project's engaged the World Bank, the International Monetary Fund. It was a groundbreaking effort that addresses the lack of data on Micro-Finance which previously stymied efforts to focus the attention of decision-makers on this critical issue¹⁹.

The 2005 International Year of Micro-Credit introduced the Global Micro-Entrepreneurship Awards Program which celebrates the hard work and incredible achievements of Micro-Entrepreneurs in 30 different countries around the world. These awards give important recognition to these Micro-Entrepreneurs and bring their dedication to national and international attention²⁰.

¹⁷ Cf. International Year of Microcredit 2005 Homepage,
http://www.yearofMicroCredit.org/pages/whyayear/whyayear_learnaboutyear.asp#objectives
[Accessed on August 16, 2010]

¹⁸ Cf. UNCDF, Newsletter (2005), Issue 18, page2.

¹⁹ Cf. UNCDF, Newsletter (2005), Issue 18, page2.

²⁰ Cf. UNCDF, Newsletter (2005), Issue 18, page2.

The biggest success of the 2005 International Year of Micro-Credit was: the International Forum on Building Inclusive Financial Sectors, which was held at the United Nations Headquarters in New York in November 2006²¹.

This engagement of such a diverse and high-level array of actors, from the formal financial and private sectors, was clear evidence in itself that times are changing for Micro-Finance.

2005 was undoubtedly a critical year for Micro-Finance; from endorsements by the G8 and the United Nations World Summit to the increasingly active participation of major global financial institutions, all the signs indicate that Micro-Finance is poised to graduate from insular niche, to take its rightful place as a serious element of formal financial sectors around the world over²².

The prospects for the Micro-Finance industry are very strong as the gap between demand and supply remains big. The table below illustrates the growth of Micro-Finance Institutions including the numbers of clients reached within a decade.

Table 1: Growth of Micro-Finance coverage as reported to the Micro-Credit Summit Campaign, 1997 – 2007

End of year	Total number of institutions	Total number of clients reached (millions)	Number of “poorest” clients reported (millions)
1997	655	16.5	9.0
1998	705	18.7	10.7
1999	964	21.8	13.0
2000	1,477	38.2	21.6
2001	2,033	57.3	29.5
2002	2,334	67.8	41.6
2003	2,577	81.3	55.0
2004	2,814	99.7	72.7
2005	3,056	135.2	96.2
2006	3,244	138.7	96.2
2007	3,352	154.8	106.6

Source: Cf. Armendáriz, Morduch 2010, page 4.

²¹ Cf. UNCDF, Newsletter (2005), Issue 18, page2.

²² UNCDF; Newsletter (2005), Issue 18; page2.

Table 1 shows the result of a survey conducted by the Micro-Credit Summit Campaign. By the end of 2007, the campaign had reports of 154.8 million Micro-Finance clients served worldwide by over 3,350 Micro-Finance Institutions. Of these clients, 106.6 million were reported as being in the bottom half of those living below their nation's poverty line or were living in households earning under \$ 1 per day per person (defined as “the poorest”; Daley-Harris 2009). Between 1997 and 2007, the numbers have grown on average by about 30 percent per year²³.

The rapid growth of Micro-Finance reached its peak in 2008 when the world economy was hit by the Global Financial Crisis. The sector of Micro-Finance was no exception, like all the other financial industry sectors, it was also affected by the impact of credit crunch, inflation, currency dislocations, and global recession. But the Global Financial Crisis hit Micro-Finance in variety of different ways, depending on the location, the funding structure, the financial state, and the economic health of its clients²⁴.

In March 2009, the Consultative Group to Assist the Poor²⁵ (CGAP) launched a survey to monitor the impact of the Global Financial Crisis. The survey responses of over 300 Micro-Finance Institution managers across the world revealed that Micro-Finance Institutions and their clients have being hurt by the food crisis and Global Financial Crisis²⁶. But the sector has proved to be fundamentally robust and when the Global Financial Crisis is over it should emerge even stronger than before.

The Global Financial Crisis has highlighted the role of local sources of funding for Micro-Finance. When international funding became scarce, local deposits

²³ Armendáriz, B., Morduch, J. (2010) *Economics of Microfinance*, 2nd Edition, The MIT Press.

²⁴ Cf. CGAP Virtual Conference: Microfinance and the Financial Crisis, November 18-20, 2008

²⁵ The Consultative Group to Assist the Poor (CGAP) is a consortium of over 30 development agencies and private foundations who share a common mission to alleviate poverty. It was founded in 1995 and houses at the World Bank; with an annual budget of USD-\$ 10 million, the consortium acts as a resource center for the whole industry, incubating ideas, launching new products, and setting standards and legal frameworks.

[Cf. http://www.cfr.org/publication/7774/defending_microfinance.html -Accessed on August 15, 2010]

²⁶ Cf. CGAP's 2009 Opinion Survey: *The Impact of the Financial Crisis on Microfinance Institutions and Their Clients*

played an important role in supporting Micro-Finance Institutions' lending²⁷. Like so many other crises, this one also brings opportunity; some Micro-Finance markets had become overheated in recent years, with sensational growth rates and crumbling risk-return tradeoffs. Slower growth, scarcer credit, more conservative policies, better products, and the consolidation of weaker institutions into stronger ones may be very beneficial in the long run. At the very least, the crisis has clearly illustrated the value of adopting a deposit-led approach to building sound and permanent domestic financial systems that can serve the poor with both credit and savings services²⁸.

2.3 Future of Micro-Credit

The evolution of Micro-Credit – from interest free loans funded by donation, to experimental borrowing, over to a globally recognized important financial tool – Micro-Credit, has become a fundamental element of Micro-Finance, and is now integrated into the financial system in numerous countries around the world. Today, Micro-Finance serves as a powerful and efficient instrument in poverty alleviation.

The important questions now are:

- What are the challenges and opportunities that Micro-Credit will face in the 21st century?
- Will Micro-Credit Institutions be able to adapt and evolve to continue meeting the needs of their clients?

At the Micro-Finance Conference in June 2009, Mr. Vikram Akula, founder of SKS Micro-Finance and a nominee in 'The Times' magazine's top 100 people

²⁷ Cf. CGAP Homepage, <http://www.cgap.org/p/site/c/template.rc/1.11.89556/1.26.9911/> [Accessed on August 18, 2010]

²⁸ Littlefield E., Kneiding Ch., CGAP Focus Note (2009), No. 52, page 7.

of the year in 2006,highlighted the problems of today. Micro-Finance Institutions have only reached 150 million people out of over 3 billion poor in the world – this is less than 5 percent. He explained this huge evident gap issue to the following three primary reasons²⁹:

- a) Lack of access to financial capital.
- b) Lack of capacity to build scalable models.
- c) Prohibitive costs of widespread operation.

Mr. Vikram Akula also presented some ideas, which he believes would be essential to overcome the challenges³⁰:

- Create profit models to access commercial capital –it is necessary to attract commercial capital to the industry and make it appealing and profitable for conventional venture investors in order to offset the first primary reason.
- Learn from scalable business models that have been successful (e.g. Starbucks, McDonalds, Coca-Cola, etc.) – concerning the second primary reason, Mr. Vikram Akula recommended Micro-Finance Institutions to learn from global firms who have successfully scaled their business models to reach those in remote villages or at least become recognizable to them. Micro-Finance Institutions also need to standardize the processes to make them easily replicable anywhere in the world.

²⁹ Cf. Social Earth – promoting social entrepreneurship, businesses, and ideas Homepage, <http://www.socialearth.org/microfinance-20-conference-day-1-vikram-akula-on-the-wins-opportunities-future-of-microfinance> [Accessed on August 23, 2010]

³⁰ Cf. Social Earth – promoting social entrepreneurship, businesses, and ideas Homepage, <http://www.socialearth.org/microfinance-20-conference-day-1-vikram-akula-on-the-wins-opportunities-future-of-microfinance> [Accessed on August 23, 2010]

- Use technology to automate manual processes to dramatically lower transaction cost – to address the issue of prohibitive costs of widespread operation, mentioned above as the third primary reason, automation must be introduced. Instead of using pen and paper to record millions of loan entries, a simple database can be created to automate the entire process.

The Micro-Finance Conference in 2009 highlighted the potential to greatly increase the Micro-Credit around the world. Mr. Latiffee (Managing Director of the Grameen Bank) stated that the Micro-Credit sector is now in a position to overcome the difficulties and hurdles it faced in the past. Mr. Latiffee believes that there will be a massive growth in Micro-Credit during the next decade³¹.

Another important issue which has been neglected over the years and definitely needs to be addressed in the future is transparency. In 1995, there was very little transparency and it was difficult to get a correct sense of how a Micro-Finance Institution was doing. Today, 1,700 Micro-Finance Institutions, over 100 investors and almost 200 partners report to the Micro-Finance Information Exchange (MIX). Audited financial statements and rating reports are online. During the Global Financial Crisis, some networks requested and received weekly or even daily updates from their creditors³². The target is trying to get all Micro-Finance Institutions and their investors, as well as their partners to report to the Micro-Finance Information Exchange. Until now, only the half of the total Micro-Finance Institutions reported to the Micro-Credit Summit Campaign (also see table 1) has been captured by the MIX.

In the future new players will enter into the market and create alliances with what before may have been considered unlikely partners, who together will continue to reinvent Micro-Finance. The new players – conventional banks, non-financial retailers, technology companies – will assume an increasingly important role. Institutions and NGOs will have to modernize themselves and

³¹ Latiffee H., Micro-Credit Summit Paper (2008), page 9.

³² Cf. CGAP Homepage, <http://microfinance.cgap.org/2010/05/17/microfinance-in-2010/>
[Accessed on August 25, 2010]

approach places where commercial players might not go, to deepen coverage, and increase social impact. All parties that are involved in Micro-Finance will have to expand their minds and visions³³.

³³ Cf. Rhyne E., Otero M., Micro-Credit Summit Paper (2006), page 59.

3. Prof. Yunus, Bangladesh and The Grameen Bank

3.1 Who is Professor Muhammad Yunus?

Professor Muhammad Yunus was born on June 28, 1940 in the seaport city of Chittagong in Bangladesh which was formerly part of British India. He grew up in a very large family and was the third of nine children. His father was a successful jeweler and encouraged him to seek higher education. His mother always helped poor people that knocked on their door and she inspired him to make the alleviation of poverty his mission in life³⁴.

Professor Yunus began his studies at Dhaka University in Bangladesh, later he received a Fullbright scholarship and continued his studies at Vanderbilt University in Tennessee in the United States. In 1969 he obtained his Ph.D. in economics from Vanderbilt and served three years as Assistant Professor of Economics at Middle Tennessee University before he returned to his home country³⁵.

Professor Yunus returned to Bangladesh in 1972, to rebuild and reconstruct a resilient new nation as the country was massively destroyed during the Liberation War of Bangladesh in 1971³⁶. The first difficulty Professor Yunus encountered however was the terrible famine during the year 1974 until 1975 which resulted from several natural disasters and the turbulence on the foreign exchange market after the oil crisis in 1973. Professor Yunus found a way to achieve higher crop by improving the irrigation system to fight against the famine. His construction proved to be a great success hence the yield of crop could be significantly increased. Despite all the effort he was not able to

³⁴ Cf. The Grameen Bank Homepage,
http://www.grameen-info.org/index.php?option=com_content&task=view&id=329&Itemid=363
[Accessed July 29, 2010]

³⁵ Cf. The Grameen Bank Homepage,
http://www.grameen-info.org/index.php?option=com_content&task=view&id=329&Itemid=363
[Accessed July 29, 2010]

³⁶ Cf. Yunus M., (2006), *Für eine Welt ohne Armut*, page 72.

reach all disadvantaged people in that village as not everyone held a farmland³⁷.

In 1974 Professor Muhammad Yunus took his students on a field trip to a poor village. They interviewed a woman who made bamboo stools and learned that she had to borrow the equivalent of 50 cents to buy raw bamboo for each stool made. After repaying the middleman, sometimes at rates as high as 10 percent a week, she was left with one cent of profit margin. If she had been able to borrow at more advantageous rates, she would have been able to amass an economic cushion and she would have risen above the subsistence level³⁸. But like many other women in the village, she was excluded from conventional financial services as she could not provide any collateral; hence she was dependent from the local money-lender. The only way to escape from poverty was to interrupt the business relationship with the money-lenders. For this reason Professor Yunus paid 27 US-Dollar from his own pocket to 42 basket makers and learned that such a small amount of loan could make an enormous difference to a poor person's life³⁹. It served as initial capital for the formation of their business thus led to a higher income and eventually helped them work their way out of poverty. To reach more victims of high rates from money-lenders, Professor Yunus began to talk with mainstream banks and tried to encourage them to lend money to the poor. But the result of these talks was disappointing; the response that Professor Yunus received from the banks was always the same, the poor were not considered as creditworthy since they did not have credit history or were able to provide any collateral. As this approach didn't work, Professor Yunus changed his strategy and finally achieved his first success; he offered himself as guarantor for the poor. The outcome of his endeavor was unbelievable; the poor indeed paid back their loan on time. Highly impressed by this result Professor Yunus was able to convince Krishi Bank's director to join him in a project which would borrow money to the poor without requiring any collateral. Krishi Bank, an

³⁷ Cf. Yunus M., (2006), *Für eine Welt ohne Armut*, page 92.

³⁸ The Grameen Bank Homepage,
http://www.grameen-info.org/index.php?option=com_content&task=view&id=329&Itemid=363
[Accessed on August 1, 2010]

³⁹ Cf. Yunus M., (2008), *Die Armut besiegen*, page 57.

agricultural bank, was one of the biggest financial institutions in Bangladesh. Together with Professor Yunus and the Krishi Bank setup a new subsidiary in the town of Jobra and named this little project 'Experimental Grameen Branch of the Agriculture Bank' which represented an important milestone in the Micro-Finance⁴⁰.

Excellent operating figures and the loan default rate which was almost to zero, confirmed the theory of Professor Yunus'; and encouraged him to expand the project. On October 2, 1983, the project was converted into a fully-fledged bank named the Grameen Bank (which means the Village Bank), specializing in granting small loans to low income people⁴¹. Driven by his strong beliefs and desires to eradicate poverty, his objective was to help poor people escape suffering by providing suitable loans on terms they could manage. He also wanted to teach them a few sound financial principles so they could help themselves⁴².

The concepts pioneered by the Grameen Bank have advanced to the forefront of a growing world movement aimed at using Micro-Credit to eradicating poverty. Replicas of the Grameen Bank model now operate in over 100 countries around the world. This Third-World concept is also being applied to so called First-World countries including the US, Canada, France, the Netherlands and Norway⁴³.

From 1993 to 1995, Professor Yunus was a member of the International Advisory Group for the Fourth World Conference on Women, a post to which he was appointed by the UN Secretary General. He was served on the Global Commission of Women's Health, the Advisory Council for Sustainable

⁴⁰ Cf. Yunus M., (2008), *Die Armut besiegen*, page 58.

⁴¹ Cf. Yunus M., (2008), *Die Armut besiegen*, page 60.

⁴² Cf. Nobelprize.org – The Official Web Site of the Nobel Prize,
http://nobelprize.org/nobel_prizes/peace/laureates/2006/yunus-bio.html
[Accessed on October 13, 2010]

⁴³ Cf. Nobelprize.org – The Official Web Site of the Nobel Prize,
http://nobelprize.org/nobel_prizes/peace/laureates/2006/yunus-bio.html
[Accessed on October 13, 2010]

Economic Development and the UN Expert Group on Women and Finance. Furthermore, he is a member of the board of the United Nations Foundation.

Professor Yunus has been the recipient of numerous international awards for his ideas and endeavors, this list of prestigious awards includes⁴⁴:

- The Independence Day Award (1987), Bangladesh's highest award.
- The Mohamed Shabdeen Award for Science (1993), Sri Lanka.
- The Humanitarian Award (1993), CARE, USA.
- The World Food Prize (1994), World Food Prize Foundation, USA.
- The King Hussein Humanitarian Leadership Award (2000) King Hussein Foundation, Jordan.
- The Volvo Environment Prize (2003), Volvo Environment Prize Foundation, Sweden
- The Nikkei Asia Prize for Regional Growth (2004), Nihon Keizai Shimbun, Japan.
- The Franklin D. Roosevelt Freedom Award (2006), Roosevelt Institute of the Netherlands.
- The Seoul Peace Prize (2006), Seoul Peace Prize Cultural Foundation, Seoul, South Korea.
- The Nobel Peace Prize (2006), The Nobel Foundation, Norway.
- The Medal of Freedom (2009), USA's highest civilian honor.

The highlight of his achievements so far came in October 2006, when Professor Muhammad Yunus and the Grameen Bank were jointly awarded the Nobel Peace Prize for their efforts to create economic and social development. The Norwegian Nobel Committee stated⁴⁵:

"Muhammad Yunus has shown himself to be a leader who has managed to translate visions into practical action for the benefit of millions of people, not

⁴⁴ Nobelprize.org – The Official Web Site of the Nobel Prize,
http://nobelprize.org/nobel_prizes/peace/laureates/2006/yunus-bio.html
[Accessed on July 30, 2010]

⁴⁵ Nobelprize.org – The Official Web Site of the Nobel Prize,
http://nobelprize.org/nobel_prizes/peace/laureates/2006/press.html [Accessed on July 30, 2010]

only in Bangladesh, but also in many other countries. Loans to poor people without any financial security had appeared to be an impossible idea. From modest beginning three decades ago, Yunus has, first and foremost through the Grameen Bank, developed Micro-Credit into an even more important instrument in the struggle against poverty. The Grameen Bank has been a source of ideas and models for the many institutions in the field of Micro-Credit that have sprung up around the world’.

“Every single individual on earth has both the potential and the right to live a decent life. Across cultures and civilizations, Yunus and the Grameen Bank have shown that even the poorest of the poor can work to bring about their own development.

Micro-credit has proved to be an important liberating force in societies where women in particular have to struggle against repressive social and economic conditions. Economic growth and political democracy can not achieve their full potential unless the female half of humanity participates on an equal footing with the male.

Yunus's long-term vision is to eliminate poverty in the world. That vision can not be realized by means of micro-credit alone. But Muhammad Yunus and the Grameen Bank have shown that, in the continuing efforts to achieve it, micro-credit must play a major part.”

By 2006 the Grameen Bank had helped more than six million clients, the vast majority of them women.

Professor Yunus became the first Bangladeshi to receive the Nobel Prize and devoted much of his award to starting up a new food company and a hospital⁴⁶. He was given a number of other prestigious awards, including the Presidential Medal of Freedom by President Barack Obama in 2009.

⁴⁶ cf. Mid America Bengali Association Homepage, <http://www.mabaonline.net/yunus.shtml>
[Accessed on July 31, 2010]

3.2 Poverty in Bangladesh

Bangladesh is situated in South Asia between the Himalayas and the Bay of Bengal and bordered by India and Myanmar.

Bangladesh was established in 1971 following the 'War of Liberation'. But after independence, Bangladesh suffered over 20 years of turmoil caused by famines, natural disasters, political unrest and military coups. This turmoil has caused widespread poverty and put Bangladesh in the top 50 poorest countries in the world⁴⁷.

Over the last decade the situation in Bangladesh has slowly started to improve. The economy of Bangladesh is now growing at an average of 5 percent per annum⁴⁸. The moderate growth rate is caused by various obstacles such as inefficient state-owned enterprises, growing labor force that has outpaced jobs, inefficient use of energy resources, inefficient power supplies and slow implementation of economic reforms. The World Bank believes that the most significant obstacles to growth of Bangladesh's economy are poor governance and weak public institutions⁴⁹.

Bangladesh has not been able to eliminate extreme poverty despite considerable international assistance. Table 2 and Figure 2 show the percentage of Bangladesh's population that is living below the poverty line. Bangladesh's per capita income in 2009 was US-\$ 1,500 compared to the world average of US-\$ 15,354⁵⁰. According to the CIA World Factbook, in 2008, 36.3 percent of Bangladesh's population was living below the poverty line. But this represents a decrease by 19.33 percentages compared to the estimations of 2004 and shows signs that the poverty levels are being reduced.

⁴⁷ Cf. Wikipedia Homepage, http://en.wikipedia.org/wiki/Bangladesh#cite_note-CIA2007-44
[Accessed on October 16, 2010]

⁴⁸ Cf. Central Intelligence Agency Homepage,
<https://www.cia.gov/library/publications/the-world-factbook/geos/bg.html>
[Accessed on October 18, 2010]

⁴⁹ Cf. Wikipedia Homepage, http://en.wikipedia.org/wiki/Bangladesh#cite_note-CIA2007-44
[Accessed on October 18, 2010]

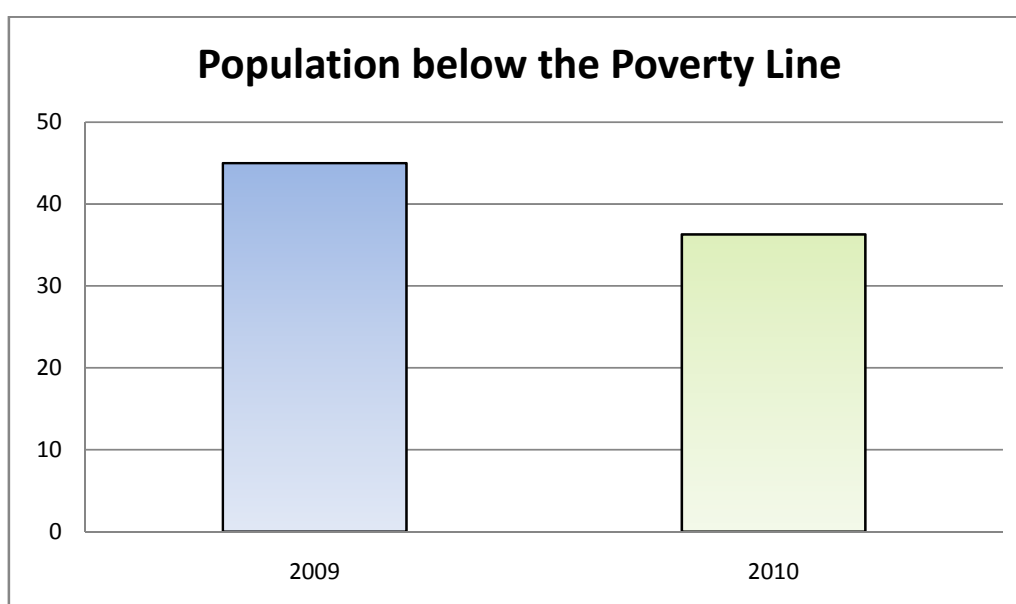
⁵⁰ Cf. Central Intelligence Agency Homepage
<https://www.cia.gov/library/publications/the-world-factbook/geos/bg.html>
[Accessed on October 18, 2010]

Table 2: Bangladesh's Population below the Poverty

Year	Population below the Poverty Line	Rank	Percentage Change	Date of Information
2009	45	36		2004 est.
2010	36.3	48	-19.33 %	2008 est.

Source: CIA World Factbook, last update February 19, 2010

Figure 1: Bangladesh's Population below the Poverty Line



Source: CIA World Factbook, last update February 19, 2010

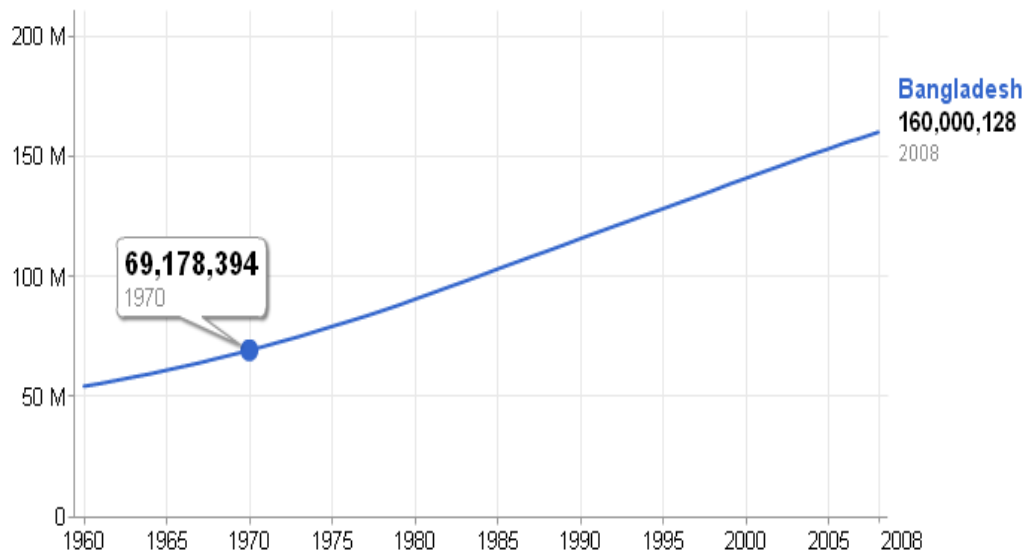
Figure 2 shows the development of Bangladesh's population from 1960 to 2008. The population of Bangladesh has increased dramatically from approximately 69 million in 1970 to over 160 million in 2008. This population explosion over 90 million in 38 years is an increase of 131 percent. Bangladesh is the seventh most populous country and is one of the most densely populated countries in the world with a high poverty rate. Despite the massive population, Bangladesh is quite a small country. It is only 147,570 km² which is less than twice the size of Austria.

Today Bangladesh still faces numerous major issues, such as political corruption, economical problems, serious overpopulation, widespread poverty, and an increasing danger of hydrologic shocks caused by ecological vulnerability due to climate change. As show by the recent flooding in Bangladesh in June 2010, the country is still very vulnerable to natural disaster⁵¹.

Figure 2: Bangladesh's Population Growth from 1960 – 2008

Population

Midyear estimates of the resident population.



Data source: [World Bank, World Development Indicators](http://data.worldbank.org/WDI) - Last updated October 2, 2010

⁵¹ Cf. BBC News Homepage, <http://www.bbc.co.uk/news/10315737> [Accessed on October 21, 2010]

3.3 The Grameen Bank

a) Owners of the Grameen Bank

The Grameen Bank is known as 'the Bank for the Poor' and is owned by its clients, mostly women, who hold at present 95 percent of the total equity. The remaining 5 percent is owned by the government.

b) Proportion of Grameen Bank Loans to Women

The proportion of loans made to women is extremely high. 97 percent of the clients from the Grameen Bank are women. This is not that surprising as Micro-Credits are more likely to be given out to women than their counterparts. Experiences have shown that women are a much better credit risk than men with high repayment rates. They contribute a major fraction of their income for the well being of the family. Hence the whole family, in particular children, will benefit from the loan. Studies have proven that new incomes generated from Micro-Enterprises are often first invested in children's education. Households of Micro-Finance clients appear to have better health practices and nutrition than other households.

c) Number of Grameen Bank Branches and Members

According to the annual report 2009, the last year has been another excellent year for the Grameen Bank. The organization showed a steady growth, even during the Global Financial Crisis from 2007 until 2009; the bank reported an increase in growth of 7 percent in 2007, 3 percent in 2008 and 4 percent in 2009. At its peak the bank grew by 40 percent per year. This is illustrated in Figure 3.

The number of branches as well as the profit increased. The expansion of 23 new branches brought 300,413 new members across the country, thus raised the total number of members to 7.97 million. As of August 2010, the Grameen Bank has 8.28 million clients. The total amount of branches accounts for

2,562 which covers 99 percent of country's nearly 84,000 villages located in all 64 districts of Bangladesh⁵².

d) The Grameen Bank's Revenue and Expenditure

In 2009 the Grameen Bank generated a total revenue of Bangladesh Taka (BDT) 14.50 billion (USD-\$ 209.80 million). The total expenditure amounted to BDT 14.13 billion (USD-\$ 204.42 million), the interest payment on deposit represented the largest component with 7.07 billion (USD-\$ 102.29 million); followed by salary and allowance expenses as well as pension benefits of BDT 3.82 billion (USD-\$ 55.33 million)⁵³.

During the fiscal year 2009 the bank made a profit of BDT 372 million (USD 5.38 million) and declared to pay out a 30 percent cash dividends to its shareholders who are in fact the Grameen Bank's client⁵⁴.

e) Interest Rates

The Grameen Bank is providing different interest rates depending on the target group⁵⁵:

- 20 percent for income generating loans (these are usually Micro-Credit for Micro-Entrepreneurs)
- 8 percent for housing loans
- 5 percent for student loans
- 0 percent (interest-free) loans for Struggling Members (beggars).

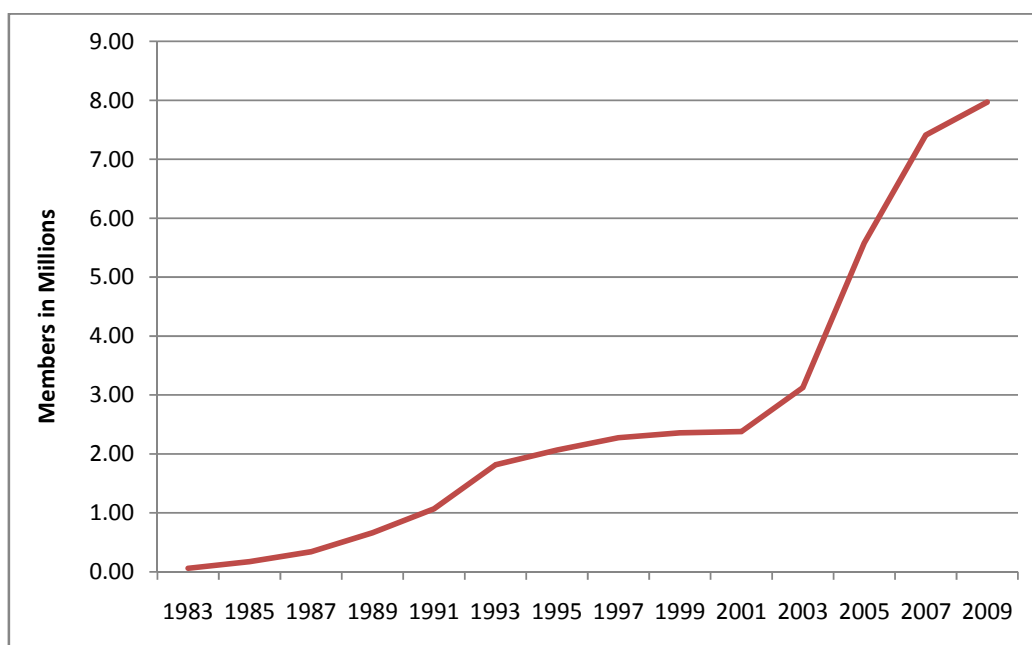
⁵² Cf. The Grameen Bank Homepage,
http://www.grameen-info.org/index.php?option=com_content&task=view&id=755&Itemid=729
[Accessed on September 2, 2010. Last update of homepage on August 22, 2010]

⁵³ The Grameen Bank Homepage,
http://www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=175
[Accessed on September 2, 20201. Last update of homepage on August 22, 2010]

⁵⁴ Cf. The Grameen Bank Homepage,
http://www.grameen-info.org/index.php?option=com_content&task=view&id=758&Itemid=732
[Accessed on September 2, 2010. Last update of homepage on August 22, 2010]

⁵⁵ The Grameen Bank Homepage;
http://www.grameen-info.org/index.php?option=com_content&task=view&id=758&Itemid=732
[Accessed on September 2, 2010. Last update of homepage on August 22, 2010]

Figure 3: Growth of the Grameen Bank Membership, 1983 – 2009



Source: The Grameen Bank Historical Data Series, available at www.grameeninfo.org.

f) Disbursement and Deposit

By the end of the year 2009, the cumulative disbursement of the bank reached BDT 498.31 billion equivalent to USD-\$ 8.74 billion. The cumulative amount of saving deposit at the bank by its clients also reached a new high of about BDT 44.82 billion (USD-\$ 648.68 million) at year end⁵⁶.

By the end of July 2010, the total amount of loan disbursed by the Grameen Bank since inception is BDT 553.78 billion (USD-\$ 9.54 billion). Out of this, BDT 491.78 billion (USD-\$ 8.50 billion) has been repaid. Current amount of outstanding loans stands at BDT 62.01 billion (USD-\$ 893.97 million). During the past 12 months (from August 2009 to July 2010) the Grameen Bank disbursed BDT 88.50 billion (USD-\$ 1,279.04 million). Monthly average loan

⁵⁶ The Grameen Bank Homepage, http://www.grameen-info.org/index.php?option=com_content&task=view&id=758&Itemid=732 [Accessed on September 2, 2010. Last update of homepage on August 22, 2010]

disbursement over the past 12 months was BDT 7.37 billion (USD-\$ 106.59 million)⁵⁷.

Projected disbursement for year 2010 is BDT 97.00 billion (USD-\$ 1,403 million). End of the year outstanding loan is projected to be at BDT 70.00 billion (USD-\$ 1,103 million)⁵⁸.

The total deposit in the Grameen Bank at the end of July 2010 amounted to BDT 92.63 billion (USD-\$ 1,335.50 million). Member deposit constituted 53 percent of the total deposits. Balance of member deposits has increased at a monthly average rate of 2.41 percent during the last 12 months⁵⁹.

Figure 4 compares the disbursement carried out each year with the deposits made by the clients from 1983 until 2009. It shows clearly that these two parameters have been developed consistently over the years. In 2008 first time in the Grameen Bank's history the total amount of deposits exceeded the amount of disbursement made during that year. This phenomenon is explained by the Global Financial Crisis as during that time fewer loans were given out.

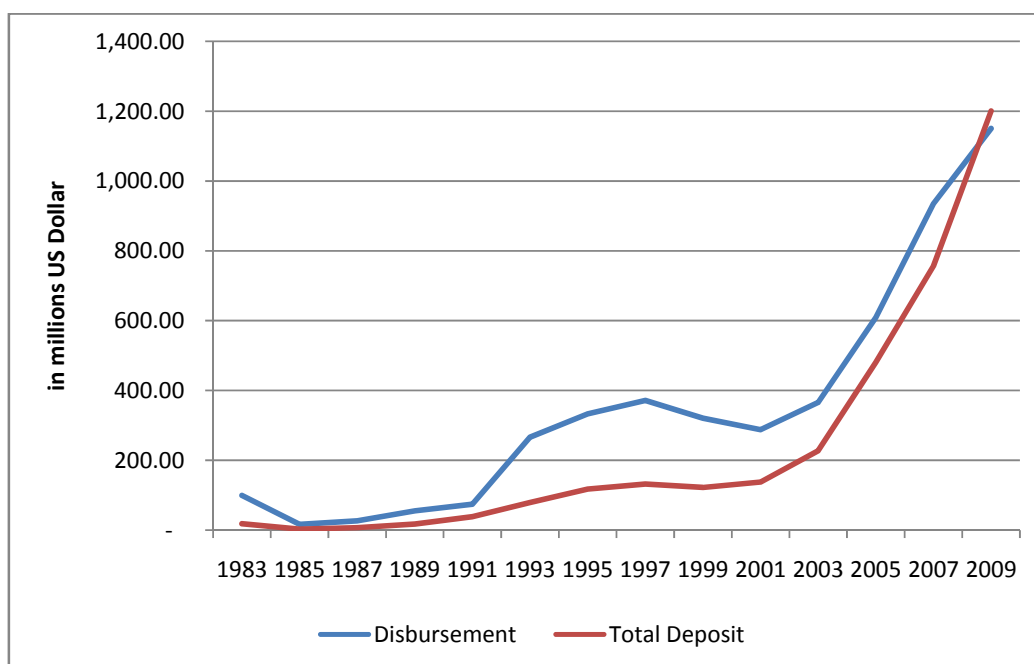
The disbursement curve experienced two significant increases, the first in 1993 by 94 percent, and the second in 2005 by 41 percent. The deposits line however, records its most notable increase in 1989 by 70 percent and 51 percent in 2004. During the Global Financial Crisis, from 2007 until 2009, the Grameen Bank reported an average growth rate of 18 percent in disbursement and 24 percent in deposits respectively.

⁵⁷ The Grameen Bank Homepage,
http://www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=175
[Accessed on September 2, 2010. Last update of homepage on August 22, 2010]

⁵⁸ The Grameen Bank Homepage,
http://www.grameen.com/index.php?option=com_content&task=view&id=26&Itemid=175
[Accessed on September 2, 2010. Last update of homepage on August 22, 2010]

⁵⁹ Cf. The Grameen Bank Homepage,
http://www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=175
[Accessed on September 2, 2010. Last update of homepage on August 22, 2010]

Figure 4: Development of Disbursement and Deposit of the Grameen Bank, 1983 – 2009



Source: The Grameen Bank Historical Data Series, available at www.grameeninfo.org.

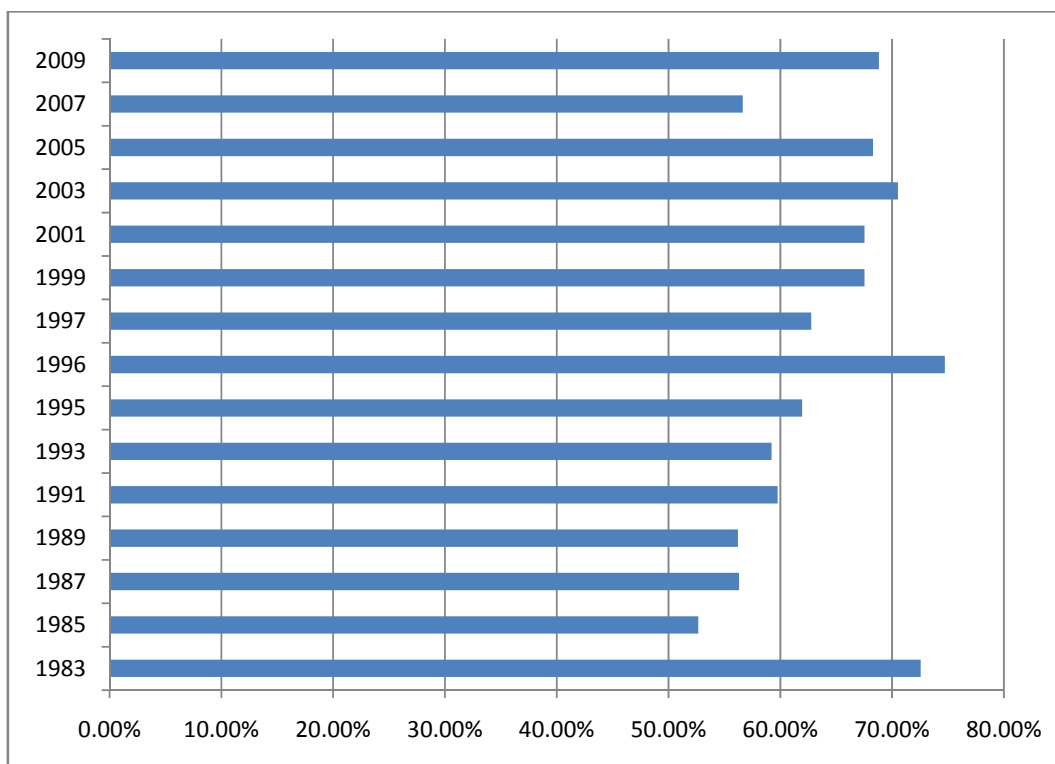
Figure 5 is listing the Outstanding Amount – Disbursement Ratio for the years 1983 until 2009. It basically gives a picture of the relation between the two factors on the balance sheet date of each year. The ratio is computed by dividing the outstanding amount at year end over the disbursement.

The highest outstanding amount-disbursement ratio was recorded in 1996 with 75 percent, whereas the average outstanding amount-disbursement ratio accounts for 64 percent. The change during the Global Financial Crisis shows an interesting pattern:

- In 2007 the ratio dropped by 8 percentage point which resulted from a much higher increase of disbursement by 29 percent while the amount of outstanding loans grew only by 12 percent.
- In 2008 the ratio experienced a tremendous augmentation by 15 percentage point which arose from a decrease of disbursement while the outstanding loans was steadily growing.

- In 2009 the ratio returned to the same level as it was in 2007. This was caused by an increase in disbursement but also in outstanding loans at nearly the same amount.

Figure 5: Outstanding Amount-Disbursement-Ratio of the Grameen Bank, 1983 – 2009



Source: The Grameen Bank Historical Data Series, available at www.grameeninfo.org.

3.4 Professor Yunus' Vision

Professor Muhammad Yunus' vision is the total eradication of poverty from the world. Credit is the last hope left to those faced with absolute poverty. That is why Professor Yunus believes that the right to credit should be recognized as a fundamental human right⁶⁰.

Professor Yunus is focusing on the best way to realize his dream. Over the years he has not only widen the offer of financial supports (e.g. housing loans or education loans), but also created numerous sister organizations to provide additional services to the poor. These included:

- An endeavor to promote traditional hand-woven Bangladeshi fabrics.
- An initiative to re-develop old abandoned fish farms
- A massive project to provide villages with call phone service.

This last business venture was the most notable and from this initiative the company 'Grameen Phone' was founded in 1996. This successful enterprise ultimately grew to become the biggest company in Bangladesh.

Out of his experiences with these initiatives, Professor Yunus formed his concept of 'social business'⁶¹, which is another powerful instrument to fight against poverty. The objective of a social business is not to seek profit but rather to solve social problems. In a social business, the owners can gradually recoup the money invested, but cannot take any dividend beyond that point. Purpose of the investment is purely to achieve one or more social objectives through the operation of the company; no personal gain is desired by the investors⁶². Such a business is self-sustaining and covers all its costs through its operations. Setting up a self-sustaining business is like starting an engine

⁶⁰ Cf. Yunus Centre Homepage, <http://www.muhammadyunus.org/About-Professor-Yunus/about-professor-yunus-vision> [Accessed on September 1, 2010]

⁶¹ THE INDYPENDENT, The Newspaper of the NYC Independent Media Center. Article by Mark Engler from February 19, 2010. *The Godfather of Micro-Credit: Muhammad Yunus' Vision of 'Social Business' Is a Curious Amalgam of Left and Right.* <http://www.indypendent.org/2010/02/18/godfather-of-Micro-Credit/> [Accessed on September 2, 2010]

⁶² Yunus Centre Homepage, <http://www.muhammadyunus.org/Social-Business/social-business/> [Accessed on September 2, 2010]

that never stops running; it does not need any fuel from outside. Within the social business, money is recycled again and again⁶³.

Today, the Grameen Network comprises of nine social businesses, including the Grameen Bank, thirteen non-profit organizations as well as eight for-profit organizations. This network is going to grow even bigger in the near future as Professor Yunus has great plans to create more social businesses, which are not only beneficial to the poor but also to the society and environment.

With this wonderful perspective we can expect a world with much more fairness, more Micro-Entrepreneurs, more social responsible enterprises, and most of all less poverty in the future.

⁶³ Cf. Harvard Business Review. Article by Georgia Levenson Keohane from May 26, 2010. *The Bold Vision of Grameen Bank's Muhammad Yunus*
http://blogs.hbr.org/cs/2010/05/the_bold_vision_of_grameen_banks_muhammad_yunus.html?cm_mmc=npv-_-DAILY_ALERT-_-AWEBER-_-DATE [Accessed on September 2, 2010]

4. How does the Grameen Bank's Micro-Credit work?

Against the advices of most financial experts, the Grameen Bank lends money to the poor without requiring any collateral. Surprisingly this system works very well and 97.21 percent of the clients repay their loans⁶⁴. So what makes the Grameen Bank operates so successfully? What's happening behind the scene?

It took Professor Yunus nine years to turn his Micro-Credit experiment into an official recognized conventional bank. During these years he learned a lot from a range of different sources; the clients, the banks, the local communities and the local authorities. Finally he identified the so called 'factors of collateral' which represent the key concept of the Grameen Bank and the secret of their success.

The collateral factors the Grameen Bank focuses on are exactly the opposite approach than those performed by a conventional bank in seeking collateral to cover their risks. It sounds strange but it seems that acting in a reversal way to that of conventional banks has turned out to be the right way to successfully provide Micro-Credits to the poor.

4.1 Collateral Factor: The Will to Survive

Professor Yunus believes that the best collateral of destitute people is their will of survive. They are real survivalists – no matter how desperate the situation gets, they have learned how to act and adapt themselves to a new environment. This skill is understood and appreciated by Professor Yunus and

⁶⁴ Cf. The Grameen Bank Homepage,
http://www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=175
[Accessed on September 3, 2010]

has been recognized as one of the most valuable collateral at the Grameen Bank⁶⁵.

Professor Yunus focuses on people who are the most socially disadvantaged because he believes that this group has the best collateral factor as mentioned above. To make sure that his loans reach the desired group, he has set-up many obstacles for the applicants. So that people in less financial difficulties would not have the incentive to apply because the barrier they have to overcome would be too much trouble for them⁶⁶.

Empirical studies have shown that Professor Yunus' clientele has an excellent redemption quota which is above 97.21 percent⁶⁷. This is explained by their skills of survival and by their appreciation of receiving the loan. The clients are usually so grateful to get the loan that they promised to work hard and pay back every cent in order not to disappoint Professor Yunus.

For families in severe financial distress, Micro-Credit is often the ultimate instrument to change their living conditions. Hence, in order to give out loan quickly to these people, the Grameen Bank abandons any paperwork which usually takes a lot of time, effort and money to produce and complete. In other words, the Grameen Bank does not create written agreements with their clients and removes this unnecessary bureaucracy⁶⁸.

4.2 Collateral Factor: Woman

Professor Yunus is of the opinion that conventional banks in Bangladesh have been acting in a sexist manner for many years. Banks would only give loan to a woman when she came with her husband to make sure that her husband agrees to her undertaking. In contrast a man does not have to show up with

⁶⁵ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 29.

⁶⁶ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 31.

⁶⁷ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 32.

⁶⁸ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 29.

his wife, and certainly does not have to prove the bank his wife's approval. Therefore Professor Yunus attached great importance to loaning Micro-Credit female clients. During the early years of the Grameen Bank Professor Yunus insisted that at least 50 percent of the clients must be female. Later the percentage of female clients increased almost to 100 percent. This new strategy and its progress have been observed over the years, and have brought valuable insights to the gender issue. The Grameen Bank has noted that the family of a female client benefits a lot more from the financial aid than the family of a male client would. This is because women tend to spend their money on the family especially on the children as every mother wants to give her child the best stable future possible. Men on the other hand are more likely to spend the extra money on themselves and things they need, as they quite often see themselves as being the head of the family and therefore the most important member of the family⁶⁹.

4.3 Collateral Factor: Group Lending

Group lending is another key to the Grameen Bank's success. As previously mentioned the majority of the clients from the Grameen Bank are women and normally housewives and mothers. It is often the first time that these women have dealt with borrowing money from a bank. It is something they are totally unfamiliar with. And they will need to take on the responsibility of the loan. Due to these facts, many women get scared and feel a little overwhelmed by the situation. This is one of the reasons the Grameen Bank decided to form clients into groups. Normally there are five female in the group so that each client does not feel they are being left alone. The formation of group is carried on to a community level and eight groups are summarized into a 'Central-Group'. The clients can share problems and difficulties they encounter with

⁶⁹ Cf. Yunus M., (2006), *Für eine Welt ohne Armut*, page 116-118.

the other group members. Together these housewives feel more confident, secure and strong when they are formed into each group⁷⁰.

The Grameen Bank also prefers group lending for a simple psychology reason; one single person is likely to behave inconstantly which makes him or her unpredictable. But in a group, due to peer pressure this person becomes easier to control. Consequently their repayment manner and reliability can be estimated without great difficulty⁷¹.

The loan application of each team member has to be first approved by the group before the loan application form goes to the Grameen Bank. Therefore group dynamics and teamwork are very important. Due to the pre-approval process by the whole group, the client feels much more morally responsible for the credit requested. Hence if one team member encounters problems in repaying back the loan, the group usually helps them with support and suggests a range of possible solutions to overcome the difficulties⁷². This little team of five members acts like a consulting group that assists each other at any time, in many different ways. But if this group is not able to find an appropriate solution for the borrower who is in financial distress, then the group will pass this issue upwards to the central-group at the community level. Hence the central-group is another important tool for the self-help within the community for awkward situations.

The group members have to decide on a group-leader and a secretary for their group. On the community level a chairman and a vice-chairman will be elected by the members of eight lending groups for a term of office which is usually one year. The candidates can hold the office only once, so that others are given the opportunity to lead.

Another big advantage of group lending is the highly efficient self-controlling. Within the team everyone is dependent on each other, as they only get the Micro-Credit from the bank if the forerunner has successfully repaid the loan. Consequently, team members are anxious to discuss and solve any problems

⁷⁰ Cf. Yunus M., (2006), *Für eine Welt ohne Armut* page 135-136.

⁷¹ Cf. Yunus M., (2006), *Für eine Welt ohne Armut* page 136.

⁷² Cf. Yunus M., (2006), *Für eine Welt ohne Armut*, page 136.

at an early stage. This has a positive side effect for the Grameen Bank because with this efficient self-controlling function the bank does not need to create a complicated system to monitor the loans disbursed⁷³.

4.4 Collateral Factor: Transparency and Trust

Usually when it comes to money, banks are obligated to act discreetly. The confidentiality enforced by banks is usually one of their most important rules. But this is often an element of banking that can be used to cover corruption and dishonesty. For this reason the Grameen Bank decided to operate all its banking transactions in public. In other words, disbursements, deposits, any kind of agreements and solution for problems are carried out in front of all participants. Only in this way can the transparency be guaranteed. This brings two additional positive side effects with it⁷⁴:

- The repayment quota is supported in the long run.
- The openness of the Grameen Bank creates mutual trust.

The Grameen Bank does not attach great importance to the Police, the Lawyers or the Law Courts⁷⁵. This is because everything happens in public with great transparency and the group members as well as the local community help to control the clients. Also it would not be worth go to court for such small loan amounts (i.e. chasing someone who has reneged on a loan of just USD-\$10).

The concept of Professor Yunus' Grameen Bank is based on mutual trust which is very different from how conventional banks operate. Conventional banks often mistrust their clients from the beginning, and to cover all the risk in the case of default, they require their clients to sign lots of forms and

⁷³ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 38.

⁷⁴ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 40-41.

⁷⁵ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 41.

contracts before giving out the loan⁷⁶. As previously mentioned, the Grameen Bank does not waste time and money creating hundreds of thousands of loan contracts for its clients.

4.5 Collateral Factor: Simplicity

What does 'simplicity' mean in the context of the Grameen Bank's Micro-Credit? And why does this represent a collateral factor?

As described before the Grameen Bank does not require its clients to fill out any forms or sign any contracts. In a country where 75 percent of the population is illiterate; this requirement is not deemed as suitable to Professor Yunus. Instead the Grameen Bank involves the clients in the loan disbursement and repayment procedures⁷⁷.

The simpler a process is kept the more transparent and efficient it is. Subsequently, credit brokerage and monitoring will become easier. This is the reason why Professor Yunus considers the simplicity of his bank's disbursement procedure as a collateral factor. Over the years the Grameen Bank has developed an easy and successful system to run Micro-Credits. The system consists of the following features⁷⁸:

- The term of the loan is normally defined for one year.
- The repayment is performed weekly with a fixed amount.
- One week after the loan disbursement, the first installment will be due.
- The interest rate amounts to 20 percent for 50 weeks, this equals to 0.4 percent weekly.
- The weekly installment is scheduled for two percent of the total loan. The repayment duration is normally set for about 50 weeks, which means the loan will be fully repaid within a year.

⁷⁶ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 42.

⁷⁷ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 42.

⁷⁸ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 43.

At first glance, the Grameen Bank's interest rate seems to be high, but when compared to the average interest rate of conventional banks in Bangladesh; it is justified. Due to the moderate economic situation in Bangladesh, the interest rate that corporation pays is generally much higher than in developed countries like Germany⁷⁹.

4.6 Collateral Factor: Diversity

Professor Yunus is convinced that reducing bureaucracy will create more space for individual creativity which in turn will boost the recovery rate. Therefore individual creativity or diversity represents a collateral factor for the Grameen Bank⁸⁰.

In the 1970's system scientists distinguished between two methodologies⁸¹:

a) An Error-Tolerating System

An Error-Tolerating System allows a high number of trials by an organization or a person to achieve the best solution for a problem. With this approach the parties are involved in a permanent learning process without pre-defined objectives. The advantages are that parties can learn from another and interexchange their experience fast and effectively⁸².

b) A Non-Error-Tolerating System.

In contrast a Non-Error-Tolerating System categorizes facts in 'good' and 'bad'. Certainly, bad facts should be avoided as they lead to failure.

⁷⁹ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 44.

⁸⁰ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 45.

⁸¹ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 45.

⁸² Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 45.

In such a system very little or no learning process is generated. Over the years more bureaucracy has built up in industrialized countries which indicate that these countries are moving toward a Non-Error-Tolerating System⁸³.

Professor Yunus is an advocator of the Error-Tolerating System. The Grameen Bank not only allows but also supports different opinions as well as procedures within its institution. Innovation and creativity can only thrive and prosper in an atmosphere that is filled with tolerance, diversity and curiosity⁸⁴. Hence the employees are instructed not to focus too much on the products that the bank provides but rather to pay attention to their clients to find out their personality, habits and living conditions in order to understand their needs⁸⁵.

Grameen Bank applies this concept to all its advisory processes and staff training programs. The key point is not only to listen or learn from the experienced colleagues but also to confront oneself with a certain problem as this triggers a learning process⁸⁶.

The Grameen Bank's training firstly requires the trainee to observe an affiliate to get understanding how the bank operates. Then they will be asked to give a feedback; criticism is welcomed and appreciated. But the solely expression of critique would not be enough; the Grameen Bank also encourages its staff to make suggestions for improvement. These staff members will get the chance to present their ideas to the board where they need to convince them of increased performance when applying their suggested concept⁸⁷. Professor Yunus is confident that no other company, in particular the main stream banks, will ever provide such training⁸⁸.

⁸³ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 46.

⁸⁴ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 46.

⁸⁵ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 47.

⁸⁶ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 46.

⁸⁷ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 46.

⁸⁸ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 47.

4.7 Collateral Factor: Ethics

During a national workshop in 1984, the clients of the Grameen Bank who represented 100 central-groups designed a social development program which has been integrated with the Micro-Credit delivery ever since. The program consists of 16 decisions; which are listed below⁸⁹:

1. We shall follow and advance the four principles of the Grameen Bank – Discipline, Unity, Courage and Hard work – in all walks of our lives.
2. Prosperity we shall bring to our families.
3. We shall not live in dilapidated houses. We shall repair our houses and work towards constructing new houses at the earliest.
4. We shall grow vegetables all the year round. We shall eat plenty of them and sell the surplus.
5. During the plantation seasons, we shall plant as many seedlings as possible.
6. We shall plan to keep our families small. We shall minimize our expenditures. We shall look after our health.
7. We shall educate our children and ensure that they can earn to pay for their education.
8. We shall always keep our children and the environment clean.
9. We shall build and use pit-latrines.
10. We shall drink water from tube wells. If it is not available, we shall boil water or use alum.

⁸⁹ Cf. Yunus M., (2006), *Für eine Welt ohne Armut*, page 146.

11. We shall not take any dowry at our sons' weddings; neither shall we give any dowry at our daughters wedding. We shall keep our centre free from the curse of dowry. We shall not practice child marriage.
12. We shall not inflict any injustice on anyone; neither shall we allow anyone to do so.
13. We shall collectively undertake bigger investments for higher incomes.
14. We shall always be ready to help each other. If anyone is in difficulty, we shall all help him or her.
15. If we come to know of any breach of discipline in any centre, we shall all go there and help restore discipline.
16. We shall take part in all social activities collectively.

These decisions are of general interest among Micro-Enterprise finance practitioners and place primary responsibility on members rather than on the bank for implementation. They are closely tailored to the setting of rural Bangladesh but the important fact is, they do not add to the cost of the credit operations⁹⁰.

4.8 Collateral Factor: Consequence

What happens if a client defaults? Will the Grameen Bank cancel the debt of its client? How does the Grameen Bank handle these issues?

The loan disbursement process of the Grameen Bank is divided in three stages. In the first stage, two members of the group will receive the loan to run their business. It comes to the second stage only if these two Micro-

⁹⁰ Cf. CGAP Microfinance Gateway Homepage,
<http://www.microfinancegateway.org/p/site/m/template.rc/1.9.28426>
[Accessed on October 13, 2010]

Entrepreneurs have successfully repaid their loan. If so, then the Grameen Bank gives out new loans to the next two members of the group. Also they have to repay their loan first before the third and last stage of the disbursement procedure can be carried out. Usually the lead of the group is last to get her working capital⁹¹.

This model of disbursement shows that in case of a default by an individual, other members of the group will be immediately affected. Consequently the entire group has an incentive to help borrowers in hardship.

The statistic proves that the majority of the clients have great competence and ability in running their business. Also they are very talented in handling with the money. Over 90 percent managed to repay their first installment on time which implies that they have earned enough to pay their debt⁹².

The Grameen Bank is very strict in terms of the repayment obligation with its clients. Once Professor Yunus stated that the Grameen Bank has never canceled a client's debt. But also it has never abandoned a client in hardship. Together a solution can be found for any situation without threatening the client's business or living conditions. Although the flexibility of Grameen Bank's solution-finding is unlimited, two important elements must be guaranteed⁹³:

- The repayment must sustain. It can be performed with delays or in reduced amount under a new adjusted repayment schedule.
- The client's business activities must not interrupt.

The Grameen Bank does not allow insolvency, liquidation and other similar bankruptcy codes as an answer to the awkward situation because they would be in conflict with the Grameen Bank's concept. The concept includes two

⁹¹ Cf. Yunus M., (2006), *Für eine Welt ohne Armut*, page 140.

⁹² Cf. Yunus M., (2006), *Für eine Welt ohne Armut*, page 140.

⁹³ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 51-53.

main features which are 'Hope' and 'Believe'. They are considered as a part of the client's basic rights⁹⁴. Therefore to respect the rights and be consistent with the concept, the Grameen Bank encourages clients to preserve the hardship and adjust their repayment schedule rather than forgive their debt and abandon them.

Professor Yunus justifies his approach towards default clients as follows⁹⁵:

- Every client must be treated equally. No one should think that the Grameen Bank provides different conditions to the clients; otherwise the payment behavior will be negatively affected.
- In order to keep the system of Micro-Credit stable, the Grameen Bank must insist on the repayment. If the Grameen Bank forgives the debt on some loans it will consequently cause a drop in the repayment ratio and it will have to raise the interest rate in order to compensate for these default loans.

⁹⁴ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 53.

⁹⁵ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 53.

4.9 How to get a loan from the Grameen Bank

a) Set up the group of five members

If a woman decides to go for a loan with the Grameen Bank, it is her job to find the other four women from her village to form a group. To avoid frictions, it is not allowed to have any family members joining the same lending group. It is preferred by the Grameen Bank to have friends, colleagues and neighbors in the group instead of family⁹⁶.

b) Attending the Grameen Bank-courses and take the loan application test

Once the lending group is set up, an employee of the Grameen Bank will be introduced to them and will explain the bank's principals and procedures to the group members. The Grameen Bank attaches great importance to this step as it wants to make sure that every single client understands what they will be dealing with and the responsibility that they will have to take on. For this reason every potential client is obligated to attend the courses that are held by the Grameen Bank⁹⁷. At the end of the course all the members of the group will have to take a test to make sure they fully understand. This test is taken vocally as the vast majority of the clients are not able to read or write. Therefore it is not allowed to take the test together with anyone else in the lending group. If one of the group members fails the test, then the whole group will be asked to go through the subject matter again until all members pass⁹⁸. This methodology of group assessment re-enforces the team dynamics and ensures that the group works together.

⁹⁶ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 38.

⁹⁷ Cf. Yunus M., (2006), *Für eine Welt ohne Armut*, page 137.

⁹⁸ Cf. Yunus M., (2006), *Für eine Welt ohne Armut*, page 138.

c) Loan acceptance and presentation of the Clients' Business Plan

Once all the team members have passed the test, the Grameen Bank will recognize them as a lending group and then will set-up weekly meetings with the group. At the first of these regular meetings an employee of the Grameen Bank will explain the principals and procedures of the bank once again to the participants. At these meetings the members of the lending group will present their business ideas to the group. They will also discuss how to support each other through tough times, as well as how they improve the general framework of the group and create synergy by combining their diverse businesses.

d) Applying for loan

Before a loan application goes to the Grameen Bank it has to be approved by the group. This is why the weekly meetings are essential, so the group and bank's staff member can get an idea of what each applicant plans do with their loan, and can help them work on a repayment schedule. Despite the pre-approval and the support of the group, each applicant is personally responsible for repaying their loan to the Grameen Bank⁹⁹.

e) Loan disbursement and debt retirement

The average amount of loan requested by the clients is between USD-\$12 and USD-\$15 and the repayment date is usually set six weeks after the disbursement. As a start, the loan is distributed to two members of the group in the first stage, followed by the second stage where new working capital is provided to the next two members. In the third and last stage, a loan is given to the group's leader.

⁹⁹ Cf. Yunus M., (2006), *Für eine Welt ohne Armut*, page 137.

f) Saving Program

The Grameen Bank does not only provide financial aid to the women but also encourages them to save money. For this reason the Grameen Bank has created a Group Fund for its members. It is an obligation for every client to save at least two Takas per week¹⁰⁰. The deposits as well as the repayments are performed during the weekly meetings. The Group Fund is managed by the group on a consensual basis, thus providing the members with essential experience in the collective management of finances. The amount in the Fund is deposited with the Grameen Bank and earns interest. A member can borrow from this fund for consumption, sickness, social ceremony or even for investment (if allowed by all group members).

Overall, getting a loan at the Grameen Bank requires teamwork which creates a close interrelation between the group members and the community. This in turn is good for the group dynamic and therefore builds a strong solidarity within the group and the community. The Grameen Bank believes that lending-groups can work on their own and take on responsibility in terms of approving new loan applications, planning repayment schedule or giving support to members in financial distress. This was one of the most ambitious objectives of the Grameen Bank¹⁰¹.

¹⁰⁰ Cf. Spiegel P., (2006), *Muhammad Yunus – Banker der Armen*, page 39.

¹⁰¹ Cf. Yunus M., (2006), *Für eine Welt ohne Armut*, page 141.

5. Analyzing Micro-Credit

5.1 The Lending Structure and Gender Preference

This section looks at the benefits of Micro-Credit Institutions providing group lending compared with lending to individuals. It also looks at the importance of the clients' gender and its relevance to the way the loans are used and repaid. It then details the Micro-Credit model being used by the Grameen Bank.

5.1.1 Why Group Lending is better than Individual Lending?

There are many reasons why Micro-Credit Institutions prefer lending to groups rather than lending to individuals. One of the most important and significant reason for group lending is the increase in collateral which helps to reduce credit risk. Lending to groups by Micro-Credit Institutions is often referred as a 'Social Collateral Approach'. The following are some of the key features of Social Collateral that makes lending-group more successful than lending to individuals:

- **Peer Pressure**

Individuals within a group are normally controlled by the others in the group. They are influenced by what others think of them and are often reluctant to let the group down. Peers can impose social penalties on each other within their group, which creates an incentive for them to be more responsible for their loans. To make this more effective the group members need an incentive to apply peer pressure. The Grameen Bank achieves this by not allowing group members to borrow Micro-Credits if their fellow group members default on their loans.

- **Moral Hazard**

Moral hazard is created when a client has too small an incentive to use the loan in a prudent manner and invest in a risky project. If she fails and is unable to repay the loan she shifts the risk to the lender¹⁰².

Group liability cannot solve this problem unless the clients in the same group monitor each other. Clients who live in close proximity to each other can observe how others use their loans. There is an incentive for all members in the group to ensure that everyone in the group repays their loan. If the group monitors the individuals in the group, then the overall moral hazard can be reduced. To make this effective the group must have the ability to impose sanctions on fellow group members who are using their loans irresponsibly. Such sanctions include social ostracism, as well as more severe measures such as seizing the delinquent clients' property¹⁰³.

- **Candidate Selection:**

The right selection of individuals within a group will reduce credit risk and increases the value of the group as a whole. This is an important collateral factor. The clients self-select the members of their group with people they know and trust. This reduces incidence of adverse selection and makes entrepreneur selection much more likely.

The problem of adverse selection is caused when lenders can not easily assess the qualities of potential clients. Lenders prefer clients who are motivated and able to repay the loan. But if the lenders cannot ascertain the type of the client, a problem of 'Asymmetric Information' is present. Clients tend to take advantage of this problem and the percentage of individuals requesting loans will be composed of a disproportionate share of 'bad risks'. Ghatak (1999), van Tassel (1999), and Laffont and N'Guessan (2000), following a suggestion made by Stiglitz (1990), have shown that group liability reduces the risk level of

¹⁰² Cf. Guttman J., (2006), *Repayment Performance in Group Lending Programs: A Survey*, page 7.

¹⁰³ Cf. Guttman J., (2006), *Repayment Performance in Group Lending Programs: A Survey*, page 7.

clients. This relies on the fact that the group individuals are all from the same closely knit community and can assess the qualities of fellow group members much better than the Micro-Credit Institution can. In general, clients prefer to have 'safe' clients as fellow group members, as this reduces their risk of having to repay their peers'¹⁰⁴.

- **The Enforcement Problem**

To use the legal system to enforce the client's responsibility to repay a loan can be very costly. Also if the client has no collateral, it is hard for lenders to enforce the terms of a contract if a contract exists. The problems of enforcing group loans were analyzed by Besley&Coate (1995), the use of 'Social Penalties' allows groups to enforce the individual's loan obligations. The members of the group will have an incentive to apply such sanctions, because they may have to make repayments on someone else's loan or they may not be able to receive loans from the same lender if the group defaults¹⁰⁵.

- **Joint Liability**

In typical group lending, every member is at fault if anyone in the group defaults on her repayments. The group acts as a safety net. As banks are keen to reduce risk this joint liability increases the likelihood of obtaining a loan. However, it is worth highlighting that joint liability also creates the potential of a free ride for an individual who is unable to pay a loan¹⁰⁶. To encounter this, the Grameen Bank's model imposes personal liability and empowers other group members to act if any individual within their group is likely to default.

¹⁰⁴ Cf. Guttman J., (2006), *Repayment Performance in Group Lending Programs: A Survey*, page 4.

¹⁰⁵ Cf. Guttman J., (2006), *Repayment Performance in Group Lending Programs: A Survey*, page 10.

¹⁰⁶ Cf. Kowalik M., Martinez-Miera D., (2010), *The Creditworthiness of the Poor: A Model of the Grameen Bank*, page 1.

- **Group Cooperation**

The cooperation of group members enables the Micro-Credit Institutions to bundle smaller individual loans into one reasonable size loan. It also allows coordination to create a mix of inter-dependent businesses. This enhances lending efficiency and value of pre-existing collateral. As the group grows stronger, the individuals within the group assist each other and are likely to work together for the betterment of the group. A good mix of individuals within a group, normally results in a good mix of business skills. As the group members work together, they share knowledge and information, which will improve the business skills of everyone in the group.

The analysis shows clearly that group lending is more beneficial than individual lending for the lenders as well as the borrowers. It is able to take over numerous tasks of the lenders such as peer screening, monitoring or enforcement. In addition, group members can impose sanctions on fellow members which lenders are not able to do. This helps to reduce enforcement costs and insures more reliable loan repayment.

As for the borrowers, they prefer group lending because in a group with friends or neighbors they feel stronger, more secure and confident. By sharing the same financial responsibility they are tied together even more which boosts the team spirit. Hence they know they can rely on the group when facing any difficulties and can expect support and a suitable solution from their fellow.

As good as group lending sounds, I think it could also be a barrier for some borrowers. Due to the strong group dynamic some may feel to be exposed to excessive pressure which they can not handle. They are obligated to explain and justify their investment plan to the group which may not be fully understood and cause a controversy – in the worst case the group refuses the loan application. The weekly group meeting could be very time-consuming

and costly for a stand-alone entrepreneur as she needs to close the shop or to hire an assistant for this certain time. But the most challenging factor, I think would be the commitment of taking proportional responsible for group member's debt in case someone defaults.

In practice however I believe the advantages outweigh the disadvantages and therefore people rather go for group lending than individual lending. This is backed by the excellent repayment performance reported by numerous Micro-Credit Institutions.

5.1.2 Why Gender Preference is an important factor?

There is a whole host of reasons why Financial Aid Institutes prefer to support females within poor rural communities as a way of reducing poverty:

- **Greater Financial Need**

It is an unfortunate fact of life in today's world that females are often paid less than their male equivalents¹⁰⁷. This social injustice is very prevalent among poor communities where females and children are viewed as cheap labor. Females often have less collateral than males and are less likely to be offered financial assistance. Also the lower education levels, as well as limited time and mobility prevent them from engaging with the complex and lengthy procedures usually requested by the formal banking sector¹⁰⁸. The financial struggle they suffer and the detrimental impact it has on them and their children is one reason why Financial Aid Institutes focus a great deal of effort on supporting females in poor communities¹⁰⁹.

- **Benefits to the Local Community**

Another reason it is preferable to financially support females in poor communities is the way they spend their money. Females are much more likely to spend their money on their family. They will use the money to provide for their children or to support elderly or sick relatives. Therefore the money they borrow provides a greater social benefit. Females are also much more likely to spend within their direct community which helps support others in the community by stimulating local businesses. Loans made to females result in a greater increase in household spending than loans made to males. This household

¹⁰⁷ Cf. Institute For Women's Policy Research (2010), IWPR #C350, *The Gender Wage Gap: 2009*, page 1.

¹⁰⁸ Cf. D'Espallier B., Guérin I., Mersland R., (2009), *Women and Repayment in Microfinance*, page 5.

¹⁰⁹ Cf. Kowalik M., Martinez-Miera D., (2010), *The Creditworthiness of the Poor: A Model of the Grameen Bank*, page 3.

spending generates revenue and has a positive impact on the local community, which in turn benefits others¹¹⁰.

- **More Reliable Repayments**

Although females often have less income and therefore less financial collateral than their male equivalents, they have proven to be much more reliable in repaying loans¹¹¹. In September 2010 the Grameen Bank reported a 97.21 percent recovery rate on its Micro-Credits to females¹¹². Although it may take females longer to repay loans, there is a higher recovery rate which reduces the credit risk and makes it preferable to provide Micro-Credit to females.

The Gender Preference given to females over males by Financial Aid Institutes and Micro-Credit Institutions is certainly an important factor in fighting against the gender inequality and poverty which are the most important aim of Micro-Credit.

Due to the lower income compared to their male counterpart, women tend to have weaker bargaining power when it comes to decision-making within the household. Here Micro-Credit can help to adjust this imbalance by strengthening the monetary income of their clients and hence increase their bargaining power¹¹³.

It is in women's nature to care the well being of the family this is why women are more willing to spend their income on the family. This is proved by various empirical studies conducted all over the world which came to the

¹¹⁰ Cf. Roodman D., Morduch J., (2009), *The Impact of Microcredit on the Poor in Bangladesh: Revisiting the Evidence*, page 1.

¹¹¹ Cf. Kowalik M., Martinez-Miera D., (2010), *The Creditworthiness of the Poor: A Model of the Grameen Bank*, page 3.

¹¹² Cf. The Grameen Bank Homepage,
http://www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=175
[Accessed on October 26, 2010]

¹¹³ Cf. D'Espallier B., Guérin I., Mersland R., (2009), *Women and Repayment in Microfinance*, page 6.

conclusion¹¹⁴: “*One dollar loaned to a woman has greater development impact than one dollar loaned to a man*”.

The expenses for the family certainly boost the local economy which in turn is beneficial to the community.

Now it is more comprehensible why gender preference plays such a big role in the Micro-Credit Industry.

In my opinion I think the gender matter presents a great issue in the Islamic world where men have such a powerful dominance over women. Despite the presence of numerous Micro-Credit Institutions in Islamic countries, many women are still facing hurdles when applying for loans. The main obstacle is however to get the approval of their husband. Men as the bread-earner and therefore seen as the head of the family play a dominant role in household decision making. This is exactly what it made so tough for Micro-Credit pioneers to reach for women. It was a piece of hard work which was worth the effort. The continuously rising growth in Islamic countries reported by the Micro-Credit Institutions is revealing that the Islamic world is changing, be it the influence of the developed nations or be it the late feminist movement, people's attitude and acceptance has modified. Micro-Credit is important in order to empower the social and economic role of women in the society and help to eradicate gender discrimination and women's poverty at the same time. Hence it could be said that gender is a significant issue to Micro-Credit and vice versa.

5.1.3 Combining Group Lending with Gender Preference

The Grameen Bank has combined the concept of group lending and gender preference. When providing Micro-Credit it gives precedence to groups of females. Their focus on supporting females groups has proved to be very successful. The Grameen Bank has also added additional features which

¹¹⁴ Cf. D'Espallier B., Guérin I., Mersland R., (2009), *Women and Repayment in Microfinance*, page 6.

increase the success of loan repayment. It stages the loan within the group. It will not lend to others in the group until the first two members repaid their individual loan in full¹¹⁵. If any of the members default on their loan it will prevent others in the group from obtaining their loans in the future. This forces the group to pick the two members with the best potential to repay first. It also encourages them to repay the loan as quickly as possible, to allow the next member of the group to obtain their loan. This mechanism seems to work extremely well. It forces the group to focus on candidate selection, group cooperation and working together. It imposes an additional element of joint liability which helps to reduce moral hazard; this in turn reduces credit risk and has made loan repayment much more reliable.

¹¹⁵ Cf. Yunus M., (2006), *Für eine Welt ohne Armut*, page 140.

5.2 The Cost Effectiveness of Micro-Credit

To analyze whether Micro-Credits is a cost effective method of alleviating poverty it can be compared with other Poverty Intervention Programs.

The following compares the Cost Benefit Ratios (social benefit for each dollar of financial provided) of the Grameen Bank's Micro-Credit program and other Poverty Intervention Projects being run in Bangladesh¹¹⁶.

Table 3: Cost Benefit Ratios for Poverty Intervention Programs in Bangladesh

Microcredit Banks	Grameen (female, male borrowers)	BRAC (female, male borrowers)	
Ratio	0.91, 1.48	3.53, 2.59	
Agricultural Development Banks	BDB	RAKUB	
Ratio	4.88	3.26	
Food Intervention	VGD (two estimates from alternative data sources)	CARE	Food-for-Work (two estimates from alternative data sources)
Ratio	1.54, 1.65	2.62	1.71, 2.02
Basic Infrastructure Development at Village Level	Electricity, paved roads etc		
Ratio	1.38		

Source: Morduch J., Haley B., (2002), *Analysis of the Effects of Microfinance on Poverty Reduction*, page 100.

This data shows that:

- The conventional banks and Agricultural Development Banks are less cost effective than other forms of poverty intervention.
- Basic Infrastructure Development at a local community level was more cost effective than Food Intervention Programs.

¹¹⁶ Morduch J., Haley B., (2002), *Analysis of the Effects of Microfinance on Poverty Reduction*, page 100.

- The Grameen Bank's Micro Credit has a greater Cost Benefit Ratio than any other form of Poverty Intervention Project.
- The Grameen Bank's Micro-Credit Programs for female groups are more efficient than that for males.
- Most importantly the Grameen Bank's Micro-Credit has a cost benefit less than unity and is the only method of poverty intervention that provides more benefits than costs.

The Grameen Bank seems to be more cost-effective than other method of Poverty Intervention Programs. The Grameen Bank's Micro-Credits to female groups provides more benefits than Food Intervention, Rural Based Finance and Infrastructure Development Projects. The Grameen Bank has the lowest cost per dollar and generates more social benefits whilst reducing poverty.

5.3 The Micro-Credit Interest Rates

Over the past two decades Micro-Credit Institutions including the Grameen Bank have often been criticized for the high interest rate they charge clients. Interest Rates have become one of the most controversy issues for the Micro-Credit Institutions as it has captures the attention of both the media and industry analysts. The Global Financial Crisis has highlighted the problems of credit risks and the importance of finding alternative ways to provide finance. Micro-Credit is seen as an important way to provide credit in developing countries. Hence the world's attention has been drawn to be increase in interest rates¹¹⁷.

Nicaragua is one of the most serious cases of high interest rates on Micro-Credits. It was so bad that even the President of Nicaragua, Daniel Ortega, has called for Micro-Credit clients to stop repaying back their loans¹¹⁸.

The main purpose of this section is to analyze whether the interest rates offered by Micro-Credit Institutions around the world are justified or they are intentionally kept high in order to make profit. How are Micro-Credit Institutions able to fulfill their social duties when they charge their clients interest rates that are higher than those offered by other financial institutions, such as conventional banks? Is there any possible ways to reduce the interest rate that Micro-Credit Institutions charge?

5.3.1 Comparing Micro-Credit Interest Rate Levels

The interest rate levels Micro-Credit Institutions' charge, have decreased by about 2 percentage point per annum since 2003. This is a much faster decrease than those offered by the conventional bank rates¹¹⁹.

¹¹⁷ Cf. Gonzalez A., (2010), *Analyzing Microcredit Interest Rates*, page 1.

¹¹⁸ Gonzalez A., (2010), *Analyzing Microcredit Interest Rates*, page 1.

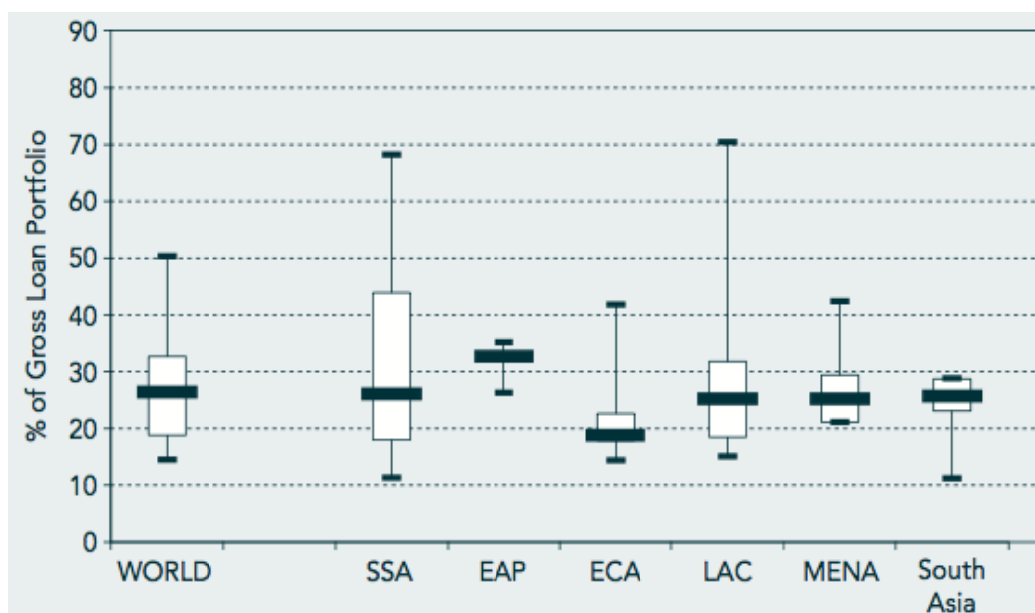
¹¹⁹ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 20.

The median interest income for sustainable Micro-Credit Institutions weighted by the Gross Loan Portfolio (GLP) accounted for 26.4 percent of loans outstanding in 2006¹²⁰.

Figure 6 presents the global and regional distribution of interest yield. The regional analysis comprises the following countries¹²¹:

- East Asia and the Pacific (EAP)
- Eastern Europe and Central Asia (ECA)
- Latin America and the Caribbean (LAC)
- Middle East and North Africa (MENA)
- South Asia (SA) and
- Sub-Saharan Africa (SSA).

Figure 6: Interest Income as Percentage of Gross Loan Portfolio, 2006



Note: EAP = East Asia and the Pacific, ECA = Eastern Europe and Central Asia, LAC = Latin America and the Caribbean, MENA = Middle East and North Africa.

Source: CGAP Occasional Paper (2009) No. 15, *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*; page 5.

¹²⁰ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 4.

¹²¹ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 4.

5.3.2 How Micro-Credit Interest Rates are calculated

In this section various charts are used to examine Micro-Credit interest rates. The figures are taken from a report provided by the CGAP (Consultative Group to Assist the Poor). Sometimes the report showed disparity in data – for example, interest yields, costs or profits may be different in different graphs and tables. The CGAP explains that the discrepancy is caused by the following reasons¹²²:

- Point-in-time data is based on all the 554 Micro-Credit Institutions reporting to MIX in 2006, while trend-line data are based on a different set – the 175 sustainable MFIs that reported for both 2003 and 2006.
- Some figures present average values, which will differ from the median shown in a graph reporting the distribution of individual values.
- Ratios being reported may have different denominators. (For instance, administrative costs as a percentage of interest earnings look much higher than the same administrative costs as a percentage of Gross Loan Portfolio).

Micro-Credit Institutions must require an interest rate that covers their costs in order to operate sustainable in the long run. Therefore the interest rate comprises four main components: Cost of Funds, Loan Loss Expenses, Operating Expenses and Profit¹²³.

¹²² Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 4.

¹²³ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 9.

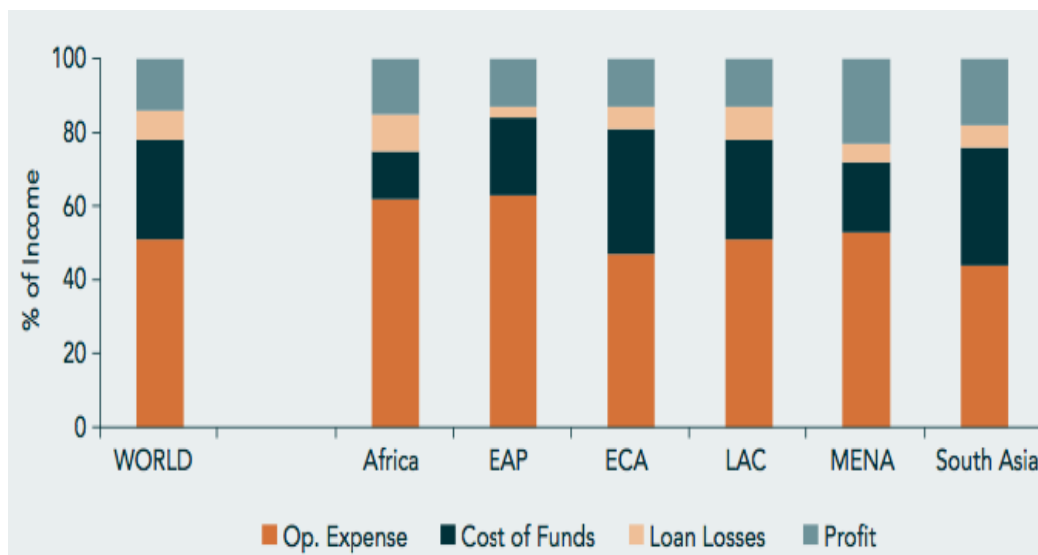
In other words, interest income from loans can be defined as¹²⁴:

$$\begin{array}{rcl} & \text{Cost of Funds} & \\ + & \text{Loan Loss Expense} & \\ + & \text{Operating Expense} & \\ + & \text{Profit} & \\ \hline = & \text{Income from Loans} & \end{array}$$

Lowering interest rates would require lowering one of the four components. Hence to state whether the interest rates charged by different Micro-Credit Institutions are unreasonable, it is essential to analyze each of these components.

Figure 7 shows each of these components expressed as a percentage of the after-tax income. Operating expenses represent the biggest part of the four elements, taking more than half of the income, followed by funding costs, profits, and loan losses.

Figure 7: Costs and Profits as Percentage of Income, 2006



Note: EAP = East Asia and the Pacific, ECA = Eastern Europe and Central Asia, LAC = Latin America and the Caribbean, MENA = Middle East and North Africa.

Source: CGAP Occasional Paper (2009) No. 15, *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*; page 10.

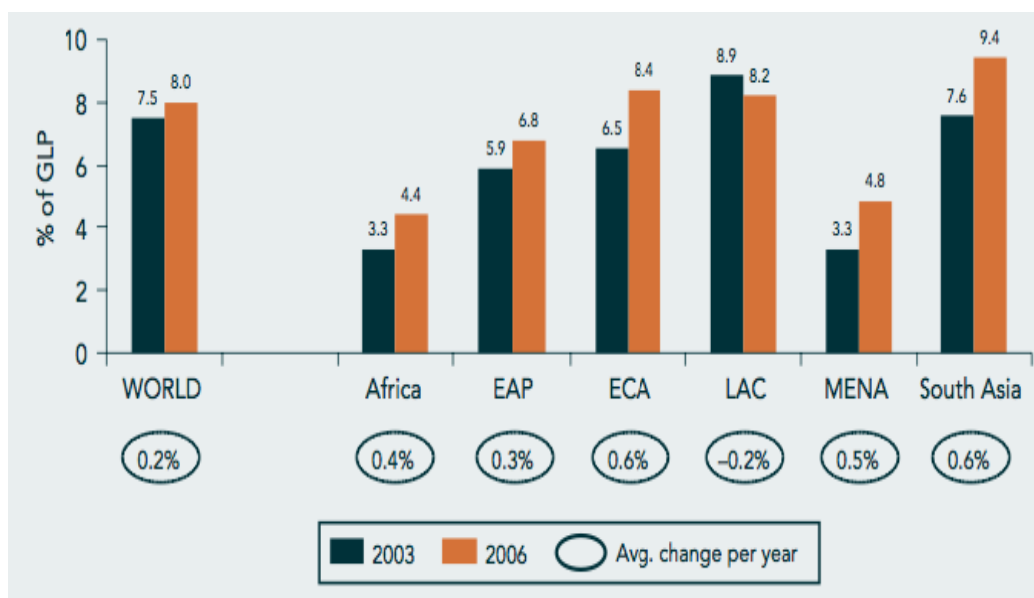
¹²⁴ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 9.

5.3.2.1 Cost of Funds

The research of CGAP (Consultative Group to Assist the Poor) has revealed that Micro-Credit Institutions are paying a relatively high price for raising their fund. As of 2006, the total funding cost (interest expense) for the 554 Micro-Credit Institutions was equivalent to 8.3 percent of their total average Gross Loan Portfolio¹²⁵.

Figure 8 compares the funding costs of 2003 with 2006. Except in the region of LAC (Latin America and the Caribbean), the funding costs have increased around the world. Figure 8 also shows the average change of funding costs per year which is minimal and does not exceed one percent.

Figure 8: Trend in Funding Costs (Interest Expense as Percentage of GLP), 2003-2006



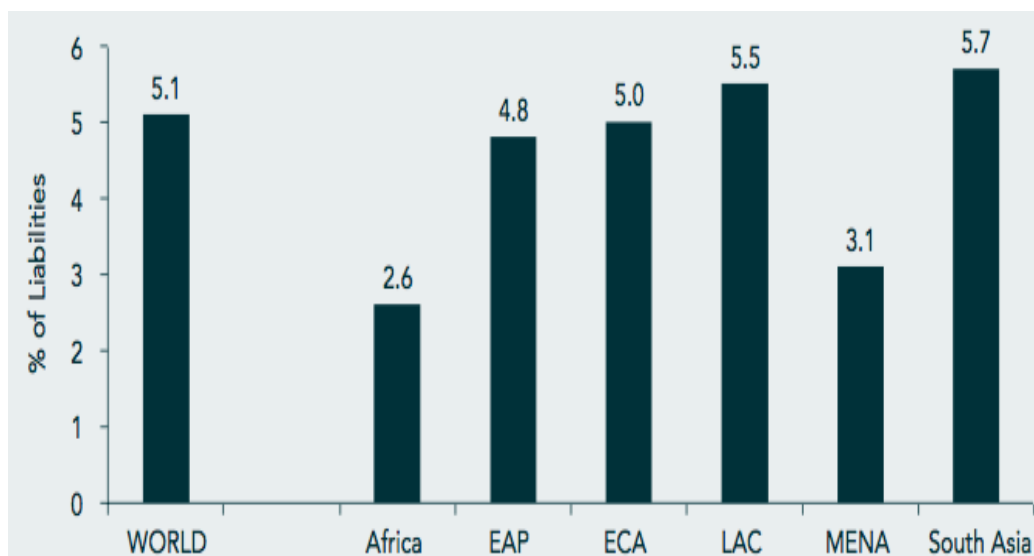
Note: EAP = East Asia and the Pacific, ECA = Eastern Europe and Central Asia, LAC = Latin America and the Caribbean, MENA = Middle East and North Africa. GLP = Gross Loan Portfolio.

Source: CGAP Occasional Paper (2009) No. 15, *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*; page 11.

¹²⁵ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 9.

Compared with conventional banks, Micro-Credit Institutions tend to be less leveraged which means that they finance their portfolio and other assets with equity rather than liabilities. Hence the liabilities of Micro-Credit Institutions reflect basically the funding costs. Therefore in the next analysis the interest expenses are compared with liabilities rather than with the loan portfolio. Micro-Credit Institutions face a relatively high borrowing cost at an average of 5.1 percent, whereas conventional banks pay only 3 percent in the same countries¹²⁶.

Figure 9: Micro-Credit Institutions' Interest Expense as Percentage of Liabilities, 2006



Note: EAP = East Asia and the Pacific, ECA = Eastern Europe and Central Asia, LAC = Latin America and the Caribbean, MENA = Middle East and North Africa.

Source: CGAP Occasional Paper (2009) No. 15, *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*; page 11.

The funding costs that are passed on to the client seem to be at reasonable level as the managers from Micro-Credit Institutions have little control over the rate of funding costs. They are grateful for any funding hence they act more like price takers than price makers referring to the interest rate they pay. For a long term solution however, funding costs can only be reduced by increasing

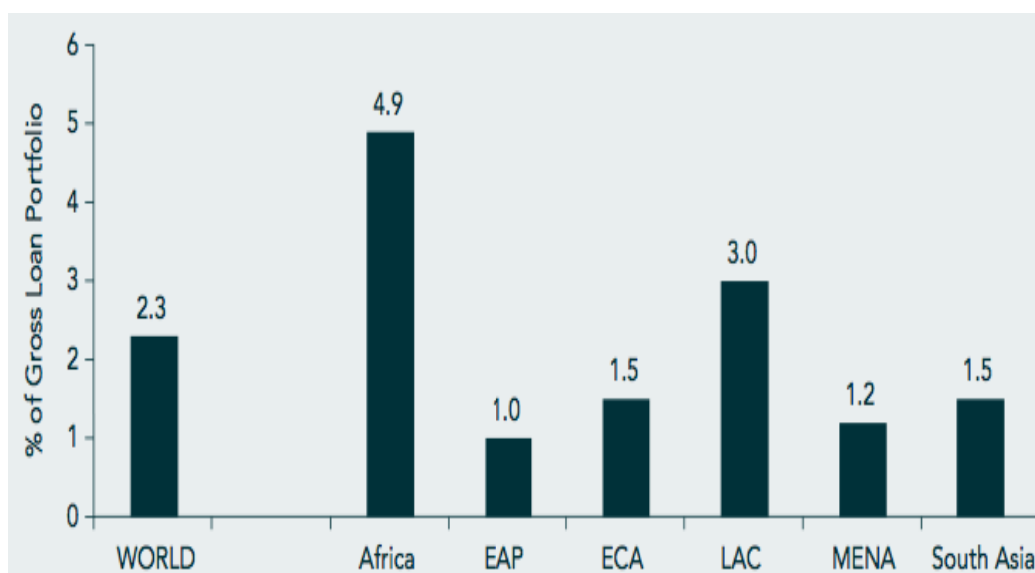
¹²⁶ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 10.

the reliance on deposit. But this may not be available to Micro-Credit Institutions if their country does not have regulation enabling depositing licensing. They also may not be strong enough to meet the challenges created by depositing licensing¹²⁷.

5.3.2.2 Loan Loss Expenses

The client's inability to repay the loan has only a small impact on the Micro-Credit's interest rate. This is because such loan losses are quite low in most Micro-Credit Institutions. The global and regional medians for loan losses weighted by portfolio are displayed in Figure 10¹²⁸.

Figure 10: Global and Regional Loan Losses as Percentage of GLP, Averages for 2006



Note: EAP = East Asia and the Pacific, ECA = Eastern Europe and Central Asia, LAC = Latin America and the Caribbean, MENA = Middle East and North Africa. GLP = Gross Loan Portfolio.

Source: CGAP Occasional Paper (2009) No. 15, *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 12.

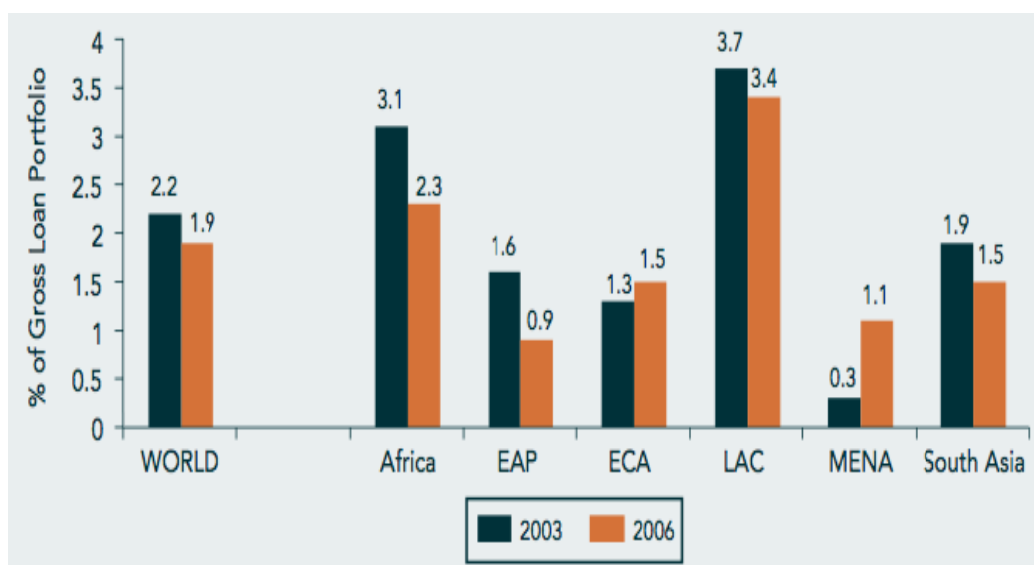
¹²⁷ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 11.

¹²⁸ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 12.

A general rule of thumb says that if the annual loan loss rate of a Micro-Credit Institution exceeds more than five percent, this institution is classified as unsustainable because it has lost control of its client's repayment schedule. The vast majority of Micro-Credit Institutions hold default rates well below those of conventional banks in their countries¹²⁹.

In the next figure the annual loan losses of 2003 are compared with those in 2006. In general it shows a downward movement in most of the regions. Globally the annual loan loss rate has decreased by 0.3 percent and accounts for 1.9 percent in 2006.

Figure 11: Annual Loan Losses as Percentage of GLP, 2003-2006



Note: EAP = East Asia and the Pacific, ECA = Eastern Europe and Central Asia, LAC = Latin America and the Caribbean, MENA = Middle East and North Africa. GLP = Gross Loan Portfolio.

Source: CGAP Occasional Paper (2009) No. 15, *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*; page 13.

The chances of further reducing the annual loan loss rate are very small. However it still has considerable effect on the interest rate that clients have to pay. But keeping the annual loan loss rate too low can also be harm to Micro-

¹²⁹ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 12.

Credit Institutions and their clients. If a Micro-Credit Institution does not include loan losses, it is acting too risk-averse in selecting its clients. This will have negative impact on the expansion of poor people's access to finance and on the profitability of the Micro-Credit Institution. Hence the loan loss expense can not be the element that leads to a high interest rate for the clients.

5.3.2.3 Operating Expenses

As previously shown in figure 7, operating expenses create the biggest part of the interest rate. In other words, the majority of Micro-Credit Institution's income goes for salaries and other administrative costs which make up to 60 percent of the total costs. In 2006 the median operating expenses worldwide amount to 11.4 percent of Gross Loan Portfolio.

It is hard to tell whether the Micro-Credit Institutions are operating efficiently or not. Operating expenses are difficult to analyze because they are influenced by many different factors such as¹³⁰: loan size, age, economies of scale, client stability, transport infrastructure, salary level and rural versus urban locations.

The following are a range of considerations that relate to operation costs:

- **Effect of Small Loan Sizes**

One of the main and significant reasons why Micro-Credit Institutions claim a high interest rate is the excessive additional work that comes with granting many tiny loans compared with a few big loans¹³¹. For instance, lending US-\$ 100,000 in 1,000 loans of US-\$ 100 each will obviously require a lot more in staff salaries than making a single loan of US-\$ 100,000¹³². This fact is proven by regression analysis which

¹³⁰ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 13.

¹³¹ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 13.

¹³² Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 1.

shows a strong inverse relationship between loan size and operating expense, even after screening out the effects of other variables, such as age, economies of scale, productivity, legal status, saving mobilization, region, macroeconomic environment, and some proxies for physical infrastructure¹³³.

- **Economies of Scale**

Economies of scale are referred to the size of the Micro-Credit Institution. Can it be assumed that larger Micro-Credit Institutions have lower fixed operating costs? Due to their size and numbers of clients they would be able spread the entire costs over the total number of their clients so that cost per loan could be reduced which consequently could lower the interest rate¹³⁴.

The regression analysis has provided some surprising results regarding economies of scale. The Micro-Credit Institutions appear to capture most of their economies of scale benefits by the time they reach approximately 2,000 clients. However, they gain relatively little from economies of scale from that point onward. This is because Micro-Credit is very labor intensive. Salaries and staff expenses contribute to the majority of most Micro-Credit Institutions' operating costs. Fixed costs are relatively low compared with variable costs. Micro-Credit Institutions which are still small enough to enjoy the benefit of economies of scale only account for a tiny percentage of the Micro-Credit market. In other words, economies of scale cannot do much to offset the additional operating costs that come from making very small Micro-Credit loans¹³⁵.

¹³³ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 13.

¹³⁴ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 14.

¹³⁵ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 14.

- **Trend of Operating Costs**

Despite the disappointing result from the regression analysis for economies of scale, the ratio of operating expenses has declined over the years. The comparison of the 2003 and 2006 ratio of operating expenses showed a global downward trend. The ratio of operating expenses to loan portfolio has been decreasing by approximately one percentage point per year, from 15.6 percent in 2003 to 12.7 percent in 2006. This trend has shown the same pattern across all regions around the world, except South Asia. In South Asia the operating costs were already quite very low in 2003 and have remained the same¹³⁶.

What has helped the Micro-Credit Institutions reduce their operating expenses?

- ❖ **Learning Curve**

The experience that Micro-Credit Institutions have gained over the years is probably the most significant factor that led to a reduction in operating costs. As institutions grow and mature, they have learned how to run their business more effectively as the procedures became smoother and costs became more predictable. This consequently enables institutions to work with more accurate numbers of the operating expenses¹³⁷.

According to the results of the regression analysis the age of a Micro-Credit Institution is strongly associated with lower operating costs, even after separating out the effects of loan size, economies of scale, and other relevant variables. Over time this positive impact weakened. The percentage of operating costs in the loan portfolio often drops between 2 to 8 percent in each year for the first six years, then 1 or 2 percent for each of

¹³⁶ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 14.

¹³⁷ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 14.

the next five years. Thereafter it is less than 1 percent per year¹³⁸.

❖ **Loan Size**

Small loans tend to be more costly due to higher administrative expenses such as staff salaries. Could this problem be solved when Micro-Credit Institutions just enlarge the loan size?

So far, the analysis of operating expenses has been described as a percentage of the loan portfolio. But using this method, distortion occurs when comparing two Micro-Credit Institutions with equally competent and efficient management; it will make the one with larger loans look better. To solve this problem, the operating expenses will therefore be divided by the number of clients which gives the parameter of 'Cost per Client'. The analysis of this new parameter shows decreasing movement from 2003 to 2006. Hence this makes it clear that the decline in Micro-Credit Institutions' operating expenses result from real efficiency improvements and not just from enlarged loans.

However the analyses do not disclose the avoidable fact that is built into the operating expenses of the Micro-Credit Institutions. Most Micro-Credit markets are immature and not competitive enough, so it is not realistic to expect institutions operating in those markets to be operating as efficiently as possible. Young industries always have correctable inefficiencies until they reach maturity and the Micro-Credit industry is no different. In other words, the Micro-Credit Institutions are generally in line with the normal evolution of efficiency for organizations in a maturing market. Therefore the downward trend in their operating cost is very encouraging¹³⁹.

¹³⁸ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 14.

¹³⁹ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 14.

5.3.2.4 Profit

Profit is probably the element of Micro-Credit interest rates which can be controlled and influenced by the management most easily. This is also the reason why profit has been one of the most discussed issues in Micro-Credit¹⁴⁰.

Some observers are against Micro-Credit Institutions making profit from providing financial services to the low-income people because it should be a support to these people rather than a business opportunity. The idea of private profit on Micro-lending is acceptable, but there is concern that some Micro-Credit Institutions could take advantage of their client's weak bargaining position and extract abusive profit levels¹⁴¹.

- **How high are Micro-Credit Institutions' Profits?**

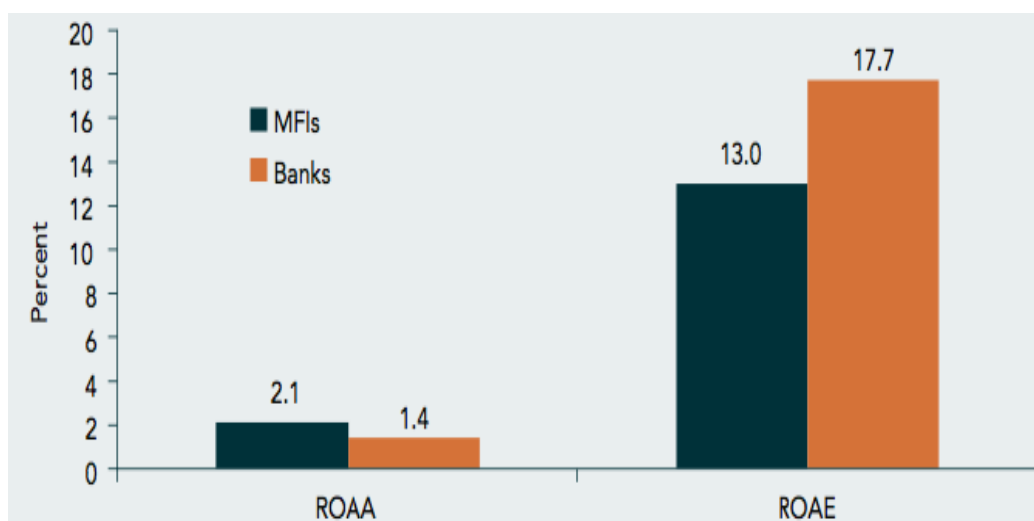
The vast majority of the Micro-Credit markets around the world are still a young and emerging market with a great pool of potential clients that haven't been reached by Micro-Credit Institutions so far. According to the standard economic theory these markets usually show a higher profit than those in more developed markets where competition constrains the prices. In Figure 12, the profitability of Micro-Credit Institutions is compared with the profitability of conventional banks. It is measured by both return on assets and return on equity. When measuring profit against assets Micro-Credit Institutions seem to be better off. This is because conventional banks experience more competition than Micro-Credit Institutions¹⁴².

¹⁴⁰ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 15.

¹⁴¹ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 15.

¹⁴² Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 15.

Figure 12: Returns on Average Assets and Equity – Micro-Credit Institutions vs. Banks



Source: CGAP Occasional Paper (2009) No. 15, *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*; page 15.

But conventional banks are usually higher leveraged than Micro-Credit Institutions. This means they fund more of their assets with other people's money through deposits and other borrowings rather than with their own equity. Hence when measuring profit against equity, conventional banks give a considerable better picture compared to Micro-Credit Institutions. In other words, conventional banks are producing at average five percent higher returns for their owners than Micro-Credit Institutions can do¹⁴³.

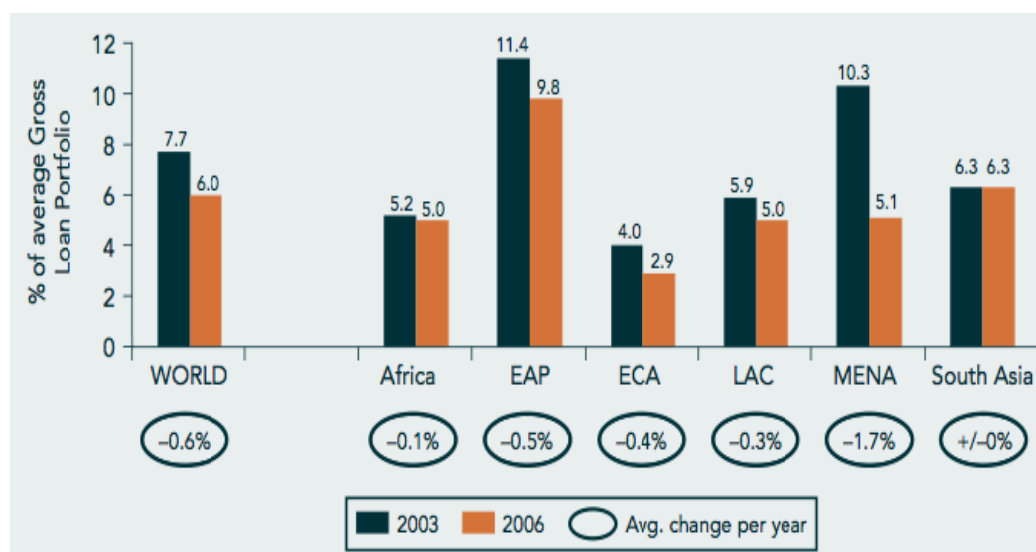
- **The Trend of Micro-Credit Institutions' Profit**

The next figure presents the weighted average after tax profits as a percentage of loan portfolios. It shows a significant downward movement by 0.6 percent per annum during the years 2003 to 2006¹⁴⁴.

¹⁴³ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 15.

¹⁴⁴ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 17.

Figure 13: After-Tax Profit as Percentage of Average Gross Loan Portfolio, 2003-2006



Note: EAP = East Asia and the Pacific, ECA = Eastern Europe and Central Asia, LAC = Latin America and the Caribbean, MENA = Middle East and North Africa.

Source: CGAP Occasional Paper (2009) No. 15, *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 18.

- **What is the impact of Profits on Interest Rates?**

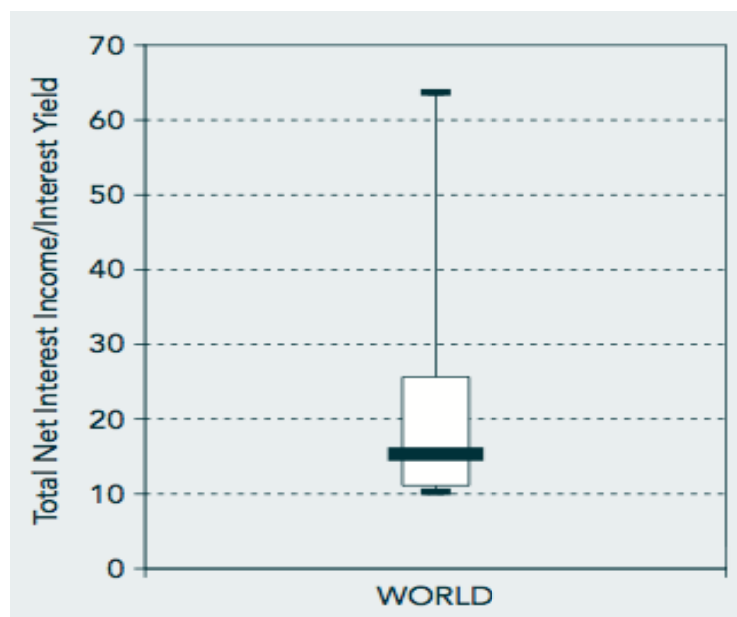
There is no doubt that if Micro-Credit Institutions reduce their profit they could offer a lower interest rate to their clients. But at what level is it appropriate for Micro-Credit Institutions to charge profit on their clients?

Figure 14 shows the net profits of Micro-Credit Institutions as a percentage of the interest they collect from their clients. It shows how much Micro-Credit Institutions are able to lower their interests if profit is completely left out. The graph shows that a Micro-Credit Institution that is at the median could actually reduce its interest rate by 17 percent. In other words, completely eliminating all profit would reduce the median by only about one-sixth, an effect that is smaller than many people might expect. In comparison, the hypothetical interest reduction by

eliminating all profit is less than the drop in rates that actually happened from 2003 to 2006¹⁴⁵.

The insight from this section is that profits are not a predominant driver of interest rates. Even in the event of eliminating all profits in the interest rate equation, the reduction that comes with, would be so insignificant and little that the interest rates still appear abusively high to the public¹⁴⁶.

Figure 14: Micro-Credit Institutions' Net Income as Percentage of Interest Yield, 2006



Note: The thick horizontal bar represents medians; the top and bottom of the white box represent the 75th and 25th percentiles, respectively; and the high and low short bars represent the 95th and 5th percentiles, respectively.

Source: CGAP Occasional Paper (2009) No. 15, *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*; page 19.

¹⁴⁵ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 18.

¹⁴⁶ Cf. Rosenberg R., Gonzalez A., Narain S., (2009), *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?*, page 18.

This detailed analysis of Micro-Credit interest rates has shown why Micro-Credit Institutions in general charge a higher interest rate than normal conventional banks. The research of the four elements (Cost of Fund, Loan Loss Expense, Operating Expense and Profit) which determine the interest rate shows that it is operating expense that forces Micro-Credit Institutions to require a higher interest rate. Micro-Credit is extremely labor intensive which consequently leads to higher operating costs. As a result, to keep a Micro-Credit Institution sustainable, its interest rate has to be significant higher than normal bank's. Therefore the interest rates offered by the Micro-Credit Institutions seem to be at a high but reasonable level, and certainly not abusive.

5.4 The impact of the Global Financial Crisis

The current financial crisis, also known as the 'Global Financial Crisis', was triggered by a liquidity shortfall in the United States banking system in 2007. The result was that some large financial institutions collapse, the national government's had to bailout some of the banks and there was a major drop in the world's stock market. Many economists believe that it is the worst financial crisis since the Great Depression in the 1930s. Many key businesses organizations have failed, there has been a significant decline in consumer wealth, governments had to make substantial financial commitments and there has been a major decline in economic activity. It also created a massive domino effect which caused major problems in Third-World countries around the globe. The following are a few examples of the knock-on effect of the Global Financial Crisis created¹⁴⁷:

- In Peru it caused a collapse in demand of Peruvian Alpaca Wools which led to a plunge in price on the global market by 90 percent.
- In Cambodia it destroyed 51,000 jobs in the Textile Industry.
- India 1.5 million people became unemployed in the Export Industry.

The impact on these underdeveloped countries was severe as there was no economic stimulus plan created by the respective government; also social protection system does not exist, which makes the situation even worse. As a result over 963 million people are suffering from hunger and more than 53 millions fell below the poverty line¹⁴⁸.

Micro-Credit can provide a lot of support for the indigent population when the economy slows down. Studies show that in the Global Financial Crisis, Micro-

¹⁴⁷ Cf. AG Friedensforschung an der Uni Kassel Homepage
<https://www.uni-kassel.de/fb5/frieden/themen/Armut/welthungerhilfe.html>
[Accessed on July 26, 2010]

¹⁴⁸ Cf. AG Friedensforschung an der Uni Kassel Homepage
<http://www.ag-friedensforschung.de/themen/Armut/welthungerhilfe.html>
[Accessed on July 26, 2010]

Credit is an effective way to avoid job loss by helping to keep small businesses operating. In addition Micro-Credit can help those who loss their jobs to start their own Micro-Business.

It is very difficult for someone without employment or a strong credit history to meet bank requirements and obtain a business loan. In the poorer developing regions employment is hard to find and the majority of the people are self-employed¹⁴⁹. They are keen to progress their business but need working capital. This is why Micro-Credit is so important as it can be granted to the poorest of the poor to encourage them into entrepreneurship.

This section analyses the impact of the Global Financial Crisis on the Micro-Credit sector. It provides answer to important questions such as¹⁵⁰:

- How have Micro-Credit Institutions' clients been affected by the Global Financial Crisis?
- Are Micro-Credit Institutions proving to be resilient to this unprecedented economic downturn?
- What is the affect of the Global Financial Crisis on Micro-Credit Institutions business models?
- How do Micro-Credit Institutions' foresee their liquidity situation in the near future?
- Which regions have been most affected by the Global Financial Crisis and why?

¹⁴⁹ The Grameen Foundation Australia Homepage,
<http://www.grameen.org.au/about.htm> [Accessed on July 28, 2010]

¹⁵⁰ Cf. CGAP Brief (2009), *The Impact of the Financial Crisis on Microfinance Institutions and Their Clients*, page 1.

5.4.1 The impact of the Global Financial Crisis on Micro-Credit Clients

Micro-Credit clients unfortunately have to experience two severe international crises in recent years, first the food crisis and then the Global Financial Crisis. The high food prices and the economic contraction led to a squeeze on the client's household income. Studies have revealed that rising food prices will cause clients to withdraw savings cut back on nonfood expenses, and have difficulty with loan repayments¹⁵¹.

Micro-Credit Institution managers from different countries around the world have reported that clients, who were already hurt by inflation, are now doubly impacted by the economic slowdown in developed countries. The job losses in North America and Europe have led to a cut in remittance from relatives abroad who previously sent money home to their family¹⁵². In addition the reduced household spending in North America and Europe results in less products being required from overseas and a reduction in production in many other countries.

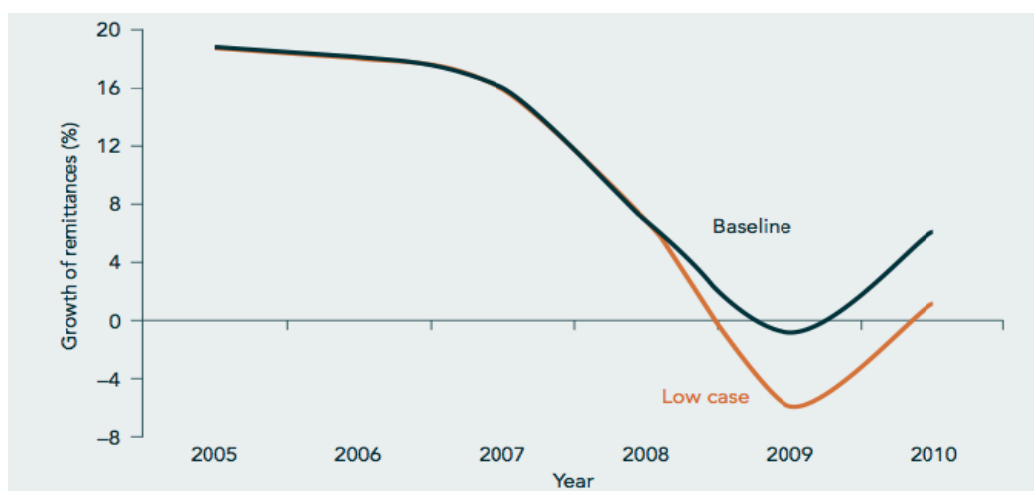
Figure 15 illustrates the growth of remittance flow observed by the World Bank. According to the World Bank the remittance flow from developed countries to developing countries reached its lowest point in 2009, and is returning to a solid growth rate in 2010. Remittance inflows in U.S. Dollars are expected to decrease particular in Mongolia, India, Rwanda, Mali and Pakistan during 2009 until 2010. This means poor families are receiving lower financial assistance from their relatives abroad¹⁵³.

¹⁵¹ Cf. Littlefield E., Kneiding Ch., (2009), *The Global Financial Crisis and Its Impact on Microfinance*, page 1.

¹⁵² Cf. Littlefield E., Kneiding Ch., (2009), *The Global Financial Crisis and Its Impact on Microfinance*, page 1.

¹⁵³ Cf. Littlefield E., Kneiding Ch., (2009), *The Global Financial Crisis and Its Impact on Microfinance*, page 2.

Figure 15: Predicted Growth of Remittance Flows



Source: CGAP Focus Note No.52 (2009), *The Global Financial Crisis and Its Impact on Microfinance*, page 2.

5.4.2 The Funding Structure and Refinancing Risk

The Global Financial Crisis caused a decrease in client's purchasing power and an increase in cash needs. This combination often forces clients to withdraw their savings in order to cover their food and living expenses. For many clients loan repayments become more difficult in times of economic contraction. This in turn causes both liquidity and credit risks to Micro-Credit Institutions¹⁵⁴.

But Micro-Credit Institutions with a substantial amount of deposits are less exposed to refinancing risks compared to Micro-Credit Institutions that rely on international funding and have been hit by the credit contraction¹⁵⁵.

News travels fast in today's world where communications are global. The failure of banks in the USA caused a loss of confidence in Europe and Asia,

¹⁵⁴ Cf. Littlefield E., Kneiding Ch., (2009), *The Global Financial Crisis and Its Impact on Microfinance*, page 2.

¹⁵⁵ Cf. Littlefield E., Kneiding Ch., (2009), *The Global Financial Crisis and Its Impact on Microfinance*, page 3.

which in turn impacted the rest of the world. This Global Financial Crisis had a significant effect on the poor regions of the world. In Eastern Europe and Central Asia Micro-Credit Institutions experienced an increased withdraws of deposits following the Lehman Brothers collapse in the USA¹⁵⁶.

Micro-Credit Institutions worldwide are concerned by how the global liquidity contraction will impact the availability and costs of funds in their country. Micro-Credit Institutions around the world have experienced an increase in the cost of borrowing as liquidity tightens. As investors become more risk averse, money from domestic and international sources has become scarcer. Rate increases have been reported as high as 250 basis points in Eastern Europe, 400 basis points in Latin America and 450 basis points in South Asia. The price hikes have come from international banks and impacted local banks, which depend on the international credit market and have cut back on lending¹⁵⁷.

The funding from banks to Micro-Credit Institutions is normally based on a one or two year tenor, so refinancing over the next couple of years will still be affected by the current Global Financial Crisis. In 2009 three large fund managers estimated the refinancing needs of Micro-Credit Institutions in their portfolio would be US-\$ 1.8 billion. As Micro-Credit Institution prepare for reduced funding they will reduce lending and their growth will slow down. Due to asset and liability management they will probably maintain current clients but reduce new loans and new clients. This will affect asset quality and undermine repayments. In Rwanda a Micro-Credit Institution has slowed down its lending and clients have started defaulting on existing loans as they will not receive new ones in the future and have no incentive to pay old ones¹⁵⁸.

¹⁵⁶ Cf. Littlefield E., Kneiding Ch., (2009), *The Global Financial Crisis and Its Impact on Microfinance*, page 3.

¹⁵⁷ Cf. Littlefield E., Kneiding Ch., (2009), *The Global Financial Crisis and Its Impact on Microfinance*, page 3.

¹⁵⁸ Cf. Littlefield E., Kneiding Ch., (2009), *The Global Financial Crisis and Its Impact on Microfinance*, page 4.

In response to the credit contraction international development agencies have established liquidity facilities¹⁵⁹:

- In October 2008 the Inter-American Development Bank (IDB) created a US-\$ 20 million financing facility to help Latin American Micro-Credit Institutions.
- In November 2008, India's Reserve Bank created a US-\$ 1.5 billion financial facility to SIDBI (India's Development Bank for small industry). The US-\$ 1.5 billion is primarily for emergency use, but SIDBI has the ability to use this funding to assist Micro-Credit Institutions.
- In February 2009, the International Finance Corporation (IFC) a member of the World Bank Group and the German government-owned development bank 'KfW' (Kreditanstalt für Wiederaufbau – which means Reconstruction Credit Institute) created a US-\$ 500 million financial facility for cross-border refinancing of Micro-Credit Institutions.

These financial facilities created funding that is vital in this time of emergency. But this is only short-term and seen as a last resort. They should not overshadow funds from local sources or create disincentives for deposit mobilization. Retaining a strong relationship with socially responsible investors is important. Funding must encourage progressive Micro-Credit Institutions to be licensed to mobilize deposits¹⁶⁰.

At its core the Micro-Credit market is very robust and should survive the Global Financial Crisis intact. But specific markets and Micro-Credit Institutions may suffer serious problems, brought on by independent factors. However the financial contraction may also bring opportunities. Prior to the Global Financial Crisis some Micro-Credit markets were overheated, with

¹⁵⁹ Cf. Littlefield E., Kneiding Ch., (2009), *The Global Financial Crisis and Its Impact on Microfinance*, page 4.

¹⁶⁰ Cf. Littlefield E., Kneiding Ch., (2009), *The Global Financial Crisis and Its Impact on Microfinance*, page 4.

incredible growth rates, deteriorating underwriting standards and dodged risk-returns tradeoffs. Slower growth, scarcer credit, more conservative policies, better products, and even consolidation of weaker institutions into stronger ones may be beneficial in the long run.

This Global Financial Crisis has increased long-overdue consumer protection measures and improved responsible lending. The Global Financial Crisis has also highlighted the value of a deposit-led approach to a permanent financial system that assets the poor with both credit and saving systems¹⁶¹.

5.4.3 The impact the Global Financial Crisis in different Regions

To get a picture how severe each region was affected by the Global Financial Crisis, the Consultative Group to Assist the Poor (CGAP) has carried out an opinion survey in March 2009. Over 400 Micro-Credit Institution managers have responded and provide a good representative of regions and institutional sizes. The insights of this opinion survey are basically as follows¹⁶²:

- **Repayment Problems and Food Price Inflation**

About 60 percent of the surveyed Micro-Credit Institutions managers have claimed that their clients are experiencing difficulties in repaying their loans. The regions Eastern Europe and Central Asia (ECA) as well as Latin America and Caribbean (LAC) are affected most significantly by this problem; followed by the Middle East and North Africa (MENA) region. The respondent rate of managers surveyed for ECA region account for 75 percent, for LAC 67 percent and for MENA 41 percent respectively. The most affected by the Global Financial Crisis are clients who work in agriculture, manufacturing and trading¹⁶³.

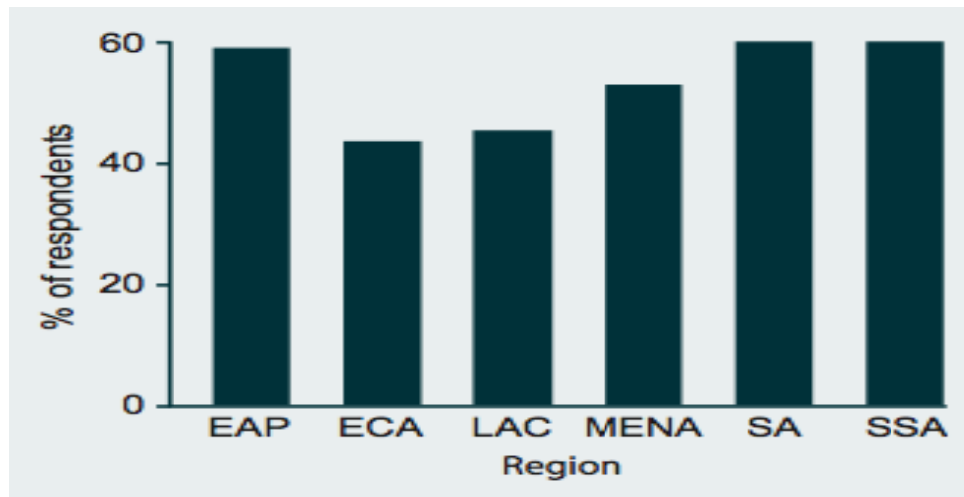
¹⁶¹ Cf. Littlefield E., Kneiding Ch., (2009), *The Global Financial Crisis and Its Impact on Microfinance*, page 7.

¹⁶² Cf. CGAP Brief (2009), *The Impact of the Financial Crisis on Microfinance Institutions and Their Clients*, page 1.

¹⁶³ Cf. CGAP Brief (2009), *The Impact of the Financial Crisis on Microfinance Institutions and Their Clients*, page 2.

Micro-Credit Institution managers also indicated that their clients are spending more of their income on food compared to October 2008. The Figure 16 shows that clients from South Asia (SA) and Sub-Saharan African (SSA) are suffering most from the food price inflation. The respondent rates for both regions are at equal level with 62 percent¹⁶⁴.

Figure 16: Clients are spending more of their income on food now than six months ago



Note: EAP = East Asia and the Pacific, ECA = Eastern Europe and Central Asia, LAC = Latin America and the Caribbean, MENA = Middle East and North Africa, SA = South Asia and SSA = Sub-Saharan Africa.

Source: CGAP Brief (2009), *The Impact of the Financial Crisis on Microfinance Institutions and Their Clients*, page 2.

- **Dramatic slowdown in Portfolio Growth**

Micro-Credit reached its peak growth in 2007 with a 47 percent increase. The opinion survey revealed that the growth of Micro-Credit has now come to stagnation. 65 percent of the surveyed managers reported that their Gross Loan Portfolios were either flat or had decreased over the last six months. Overall, the credit crunch and the

¹⁶⁴ Cf. CGAP Brief (2009), *The Impact of the Financial Crisis on Microfinance Institutions and Their Clients*, page 3.

economic recession are forcing most Micro-Credit Institutions to slow the growth of their Micro-Credit portfolios¹⁶⁵.

- **Portfolio Quality down Globally**

The opinion survey also shows a deterioration of the Micro-Credit portfolio's quality. Increased risk in the Gross Loan Portfolio as a result of the Global Financial Crisis has been confirmed by 69 percent of the respondents. This is a trend among Micro-Credit Institutions of all sizes and types around the world. It reflects the increased economic hardship of their clients. Eastern Europe and Central Asia has been hit the most by delinquency loans. 88 percent of Micro-Credit Institutions have reported on increase in portfolio at risk. Fortunately not so many Micro-Credit Institutions have reported an increase in portfolio at risk in East Asia and the Pacific or in the Middle East and North Africa regions¹⁶⁶.

- **Liquidity Constraints**

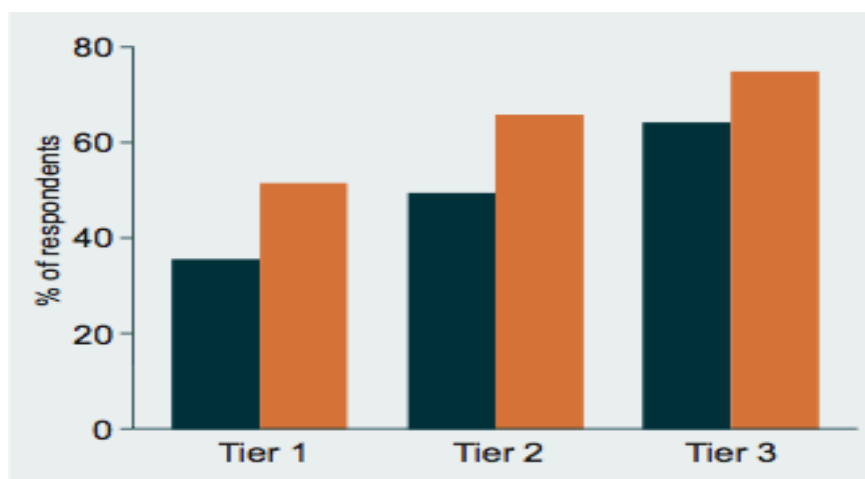
Figure 17 shows that 52 percent of the Micro-Credit Institution respondents reported, facing liquidity constraints over the past six months. The medium and smaller Micro-Credit Institutions are more affected than large ones. 35 percent of the large Micro-Credit Institutions (Tier 1) were affected compared with 64 percent of small Micro-Credit Institutions (Tier 3). The situation shows little sign of improving and 74 percent of small Micro-Credit Institutions predict the situation to worsen in the near future. 57 percent of Micro-Credit Institutions in South Asia and 68 percent of Micro-Credit Institutions in Sub-Saharan Africa reported liquidity problems. In contrast the Micro-Credit Institutions mobilizing of savings have been less affected by the

¹⁶⁵ Cf. CGAP Brief (2009), *The Impact of the Financial Crisis on Microfinance Institutions and Their Clients*, page 3.

¹⁶⁶ Cf. CGAP Brief (2009), *The Impact of the Financial Crisis on Microfinance Institutions and Their Clients*, page 3.

Global Financial Crisis and 57 percent of Micro-Credit Institutions are keen to expend loan portfolios. This highlights that access to savings and funding diversification are very important factors¹⁶⁷.

Figure 17: Liquidity Constraints by Tier



Note a: Tier 1 = Large sized Micro-Credit Institutions, Tier 2 = Medium sized Micro-Credit Institutions, Tier 3 = Small sized Micro-Credit Institutions.

Note b: Blue Bars = Liquidity Constraints as of May 2009, Orange Bars = Liquidity Constraints over the next 6-12 months.

Source: CGAP Brief (2009), *The Impact of the Financial Crisis on Microfinance Institutions and Their Clients*, page 3.

- **Micro-Credit Institutions response: Interest rates steady, but hiring slows**

With an estimated rising in the cost of funding of between 2 and 4 percent many Micro-Credit Institutions may be tempted to pass on their costs to their clients. But this would be extremely unpopular and prove difficult to increase existing loans to clients who are already struggling. It could also result in a massive increase in the amount of clients who default on their loan. Due to this, 61 percent of Micro-Credit Institutions have made no change in their lending rates to existing

¹⁶⁷ Cf. CGAP Brief (2009), *The Impact of the Financial Crisis on Microfinance Institutions and Their Clients*, page 4.

clients. In fact 9 percent of Micro-Credit Institutions have stated that instead of increasing rates they will try to lower them. To counter the increase in funding costs many Micro-Credit Institutions are keen to reduce operational costs. 23 percent of Micro-Credit Institutions have reported that they have reduced their staff numbers to reduce costs¹⁶⁸.

Whenever there is a crisis the most vulnerable, particularly women and children suffer the most; these are one with the greatest needs for financial assistance. For the Micro-Credit Institutions the credit risks and liquidity issues are the biggest concern. The situation is likely to worsen but the Micro-Credit Institutions seem to remain optimistic. Many Micro-Credit Institutions are taking measures to counter the crisis. They are adapting and evolving. Some Micro-Credit Institutions may not survive but the ones that make it through this Global Financial Crisis will be much stronger. The Global Financial Crisis has served as a test of the ability and resilience of Micro-Credit. Although the Global Financial Crisis has had a major detrimental effect on the Micro-Credit Institutions, ultimately the Micro-Credit industry will evolve and become stronger because of it¹⁶⁹.

¹⁶⁸ Cf. CGAP Brief (2009), *The Impact of the Financial Crisis on Microfinance Institutions and Their Clients*, page 4.

¹⁶⁹ Cf. CGAP Brief (2009), *The Impact of the Financial Crisis on Microfinance Institutions and Their Clients*, page 4.

5.5 The Weaknesses of Micro-Credit

This section looks at a range of reported weaknesses and critiques of Micro-Credit that have been highlighted by various sources.

5.5.1 The impact of Local Circumstances

The ability of Micro-Credit to reduce poverty depends mainly on the local circumstances. Poverty is created by numerous different circumstances and these may not be conducive to a successful Micro-Credit environment. Poverty is often the result of poor economic growth, unequal distribution of wealth or high growth in population, but it could also be caused by war, famine, natural disasters, political unrest, or a host of other reasons. Such conditions will prevent even the most established Micro-Credit programs¹⁷⁰.

5.5.2 Pre-Conditions that prevent Micro-Credit from working

Micro-Credit will not work if certain pre-conditions exist. Regardless of the type or model being used, Micro-Credit will not work in areas where¹⁷¹:

- an emergency situation exists
- there is chronic destitution
- no infrastructure or access exists
- disease and suffering are wide-spread
- there is a low or very dispersed population
- the community is reliant on a single source of income
- there is potential of an upcoming crisis.

¹⁷⁰ Cf. Morduch J., Haley B., (2002), *Analysis of the Effects of Microfinance on Poverty Reduction*, page 95.

¹⁷¹ Cf. Morduch J., Haley B., (2002), *Analysis of the Effects of Microfinance on Poverty Reduction*, page 95-96.

5.5.3 Regional Conditions that impact Micro-Credit

It is important to consider the culture and customers of a region when implementing a Micro-Credit model in a different country. A replication of the Grameen Bank model was used in Malaysia and Malawi. It was found to be successful in Malaysia but was fraught with problems and a complete failure in Malawi. The success of group lending relies heavily on peer pressure but in some countries the culture discourages intervention in private affairs and individuals are less inclined to take on responsibility for others¹⁷². The Grameen Bank's model focuses mainly on providing credit to females, but in some cultures it is not social acceptable for women to borrow money. The lessons to be drawn from this are that the Micro-Credit model must be adapted to meet the specific culture and customers of the region.

5.5.4 Why Micro Credit can not reach all Poor Communities

Even when Micro-Credit is well targeted to address the poor, only a fraction of the target population can be reached. An example is the Tšhomišano Credit Program (TCP) administered by the Small Enterprise Foundation (SEF) in Tzaneen, South Africa; who have only managed to reach 20 percent of the poorest communities. To implement an effective Micro-Credit program the communities need to have a pre-existing infrastructure in place, which does not exist in many rural areas. Alternatively, focusing too much Micro-Credit in a region could have the negative effect of encouraging too many Micro-Businesses and increasing competition with the potential to take jobs away from other businesses¹⁷³.

¹⁷² Cf. Snow D., Buss T., (2001), *Development and the Role of Microcredit*, page 303.

¹⁷³ Cf. Morduch J., Haley B., (2002), *Analysis of the Effects of Microfinance on Poverty Reduction*, page 97.

5.5.5 Why not all Poor Communities will benefit from Micro-Credit

Micro-Credit should not be used as a social safety net. The old, the sick and the indigent who are unemployable will not benefit from a Micro-Credit program. They would not use the loans productively and would be burdened with debt, administration and re-payment responsibility it creates¹⁷⁴.

Not all poor rural communities are able to benefit from Micro-Credit. Making the most effective use of the loan requires entrepreneurial skills that most people lack. Micro-Credit needs to target only those who lack capital but have the ability to initiate activities with growth potential. Those who are unable to become self-employed or wage-employment may be more appropriate¹⁷⁵.

The popularity of Micro-Credit may encourage people to form groups and obtain credit that they do not need and can not repay. It may result in the creation of Micro-Businesses that are barely subsisting. It may encourage waged-employed workers to try becoming self-employed. Micro-Credit is not always the best source of financial assistance that the poor can be offered¹⁷⁶.

Micro-Credit is aimed at stimulating very small businesses, but not all people can operate Micro-Businesses successfully or pay back loans obtained. Offering credit may make some people worse off by obligating them into debt they can not repay¹⁷⁷.

¹⁷⁴ Cf. Morduch J., Haley B., (2002), *Analysis of the Effects of Microfinance on Poverty Reduction*, page 95-96.

¹⁷⁵ Cf. Morduch J., Haley B., (2002), *Analysis of the Effects of Microfinance on Poverty Reduction*, page 96.

¹⁷⁶ Cf. Morduch J., Haley B., (2002), *Analysis of the Effects of Microfinance on Poverty Reduction*, page 96.

¹⁷⁷ Cf. Morduch J., Haley B., (2002), *Analysis of the Effects of Microfinance on Poverty Reduction*, page 96.

5.6 Challenges and Opportunities for Micro-Credit

This section focuses on the challenges and opportunities that Micro-Credit faces. It then reveals the strategies set by institutions to overcome the difficulties or to enhance their chances respectively. The analysis starts off with the challenges and goes on to the opportunities at the end.

Challenges of Micro-Credit:

5.6.1 Shortage of Professional Employees

As previously in chapter 2 already mentioned, the demand for Micro-Credit has increased steadily over the years and so is supply. As a consequence the number of Micro-Credit Institutions rose rapidly and the services offered were expanded. Today such an institution provides not only Micro-Credit but also Micro-Insurance as well as services of a conventional bank like deposits and money transfers. Micro-Credit has proved to be a very personnel intensive business, together with Micro-Insurance and other services; it would even result in a greater need of qualified staff. But professional employees especially in the management are scarce and hard to recruit because Micro-Credit Institutions usually don't have enough budget to afford experienced managers which in turn would have an impact on the performance and success as both parameters are indirectly influenced by the management¹⁷⁸.

But how could this problem solved without overstretching the budget? In a journal for development and cooperation, Mr. Oliver Schmidt an advisor for Micro-Finance Education at Mountain of the Moon University has introduced two possible ways to overcome the difficulty. The first concept looks for a suitable candidate outside the organization, preferable a graduate straight from the college or university who enjoyed Micro-Finance trainings. This person will bring a solid and the latest theoretical knowledge to the organization but lacks in experience which has to be gained over the years.

¹⁷⁸ Cf. E+Z/D+C Homepage, <http://www.inwent.org/ez/articles/166627/index.de.shtml> [Accessed on January 20, 2011]

Hence it takes quite a while until this person gets a fundamental knowledge of the Micro-Credit business including an extensive work experience in order to take over responsibilities of a manager.

The second concept focuses mainly on long-serving employees within the organization in particular the sales division. Generally senior sales representatives are considered as ideal candidates for a manager position due to their expertise and the well maintained customer relationship. The only weakness is their education level which mostly does not go beyond a high-school degree. Becoming a manager is not a matter of holding a certain degree but this person should be able to implement his ample experience in some solid business models as well as standardized processes which usually require a fundamental understanding of business administration. Therefore when applying the second concept it would be necessary to send the elected sales representative back to school which may also take a couple of years¹⁷⁹.

Either way it takes time to form a manager. Unfortunately this fact is often neglected by many Micro-Credit Institutions. The majority fail to build up a professional Human Resource Department to recruit and also to maintain qualified employees. It is absolutely essential to invest in human resources and human capital even if the budget is limited. Hence Micro-Credit Institutions may consider to increase the number of employees or to improve the working environment. As salary payment always plays a significant role to employees they also may rethink their compensation model for instance going from a fixed salary payment to a performance-related payment. But most importantly is that Micro-Credit Institutions should provide a bright prospective to their engaged and potential employees¹⁸⁰.

¹⁷⁹ Cf. E+Z/D+C Homepage, <http://www.inwent.org/ez/articles/166627/index.de.shtml> [Accessed on January 20, 2011]

¹⁸⁰ Cf. E+Z/D+C Homepage, <http://www.inwent.org/ez/articles/166627/index.de.shtml> [Accessed on January 20, 2011]

From my point of view, I think like any other company, Micro-Credit Institutions should also make themselves attractive to the labor market and not to be taken as a NGO. Great attractiveness and good reputation make recruiting and maintaining qualified employees easier. This in turn would help Micro-Credit Institutions to keep up with the steady and quickly growth of demand.

5.6.2 When Micro-Credit Institutions miss their Mission

By the end of 2010 Micro-Credit hit rock bottom when this terrible crisis in Andhra Pradesh, India was revealed and made the headlines of some international well-known newspapers which led to a spark debate over the benefit of Micro-Credit among the economists once again. The crisis had reached a critical stage and claimed about five dozen suicides due to client's over-indebtedness at that time¹⁸¹.

How could such a tragedy happen? Are the institutions not supposed to understand, support and accompany their clients through hard times? According to Grameen Bank's principle the bank is obligated to help and adjust the client's repayment schedule if the client encounters difficulties. Hence what makes the borrowers in Andhra Pradesh so awfully desperate that they decided to commit suicide and leave their family behind?

In recent years there has been a tremendous increase in Micro-Credit organizations but not every organization had the same objective which should be to help the rural poor and getting them out of poverty. That is certainly the main idea of Micro-Credit. But financial people discovered a real business opportunity in this field due to the high interest rates, thus maximizing the

¹⁸¹ Cf. E+Z/D+C Homepage, <http://www.inwent.org/ez/articles/184683/index.en.shtml> [Accessed on February 15, 2011]

profit was their first priority. Some of these organizations have more than doubled their revenues annually¹⁸².

Micro-Credit Institutions which are run by venture capitalists are solely offering loans without gaining a fundamental understanding of client's circumstances and needs. They also do not provide educational support such as reading, writing or counting which is absolutely essential to operate a Micro-Business appropriately. Hence it is not surprising that many borrowers are simply overwhelmed by the amount of work and responsibility they have to face (e.g. run the business, do the book keeping or repay the loans and all at the same time) with just little skills and knowledge. In their totally desperate situation many borrowers start to take a second or third loan from other institutions to repay the installment of their first or second loan respectively which worked out well for only a short period of time. Short-term credit is extremely expensive and without enhanced revenues of the business they soon are no longer able to pay back the loans and have to file for bankruptcy which ultimately caused them to commit suicide¹⁸³.

The public anger was intensified by the recent initial public offering of shares by SKS Microfinance, India's largest for-profit Micro-Lender. SKS and its shareholders raised more than USD-\$ 350 million on the stock market in August 2010. Its revenue and profits have grown around 100 percent annually in recent years. Due to these facts the local government of Andhra Pradesh had quickly taken actions to calm the public and introduced a new law restricting how companies can lend and collect money¹⁸⁴.

Unfortunately this new law came too late for those five dozen suicides. But even though if the law was passed earlier, would it really have saved lives?

¹⁸² Cf. The New York Times Homepage, http://www.nytimes.com/2010/11/18/world/asia/18micro.html?_r=1&sq=andhra%20microfinance&st=cse&scp=3&pagewanted=all [Accessed on February 15, 2011]

¹⁸³ Cf. The New York Times Homepage, http://www.nytimes.com/2010/11/18/world/asia/18micro.html?_r=1&sq=andhra%20microfinance&st=cse&scp=3&pagewanted=all [Accessed on February 15, 2011]

¹⁸⁴ Cf. The New York Times Homepage, http://www.nytimes.com/2010/11/18/world/asia/18micro.html?_r=1&sq=andhra%20microfinance&st=cse&scp=3&pagewanted=all [Accessed on February 15, 2011]

As the new regulation only specifies the distribution and collection of loans it is partly missing the point. It should also prescribe Micro-Credit Institutions to take care of their clients which include the understanding of their situation and provide business as well as financial advices for their Micro-Business. This is exactly what makes Micro-Credit business so labor intensive and costly and therefore the reason for the high interest rates that are charged to the borrowers.

Now it is clear how some Micro-Credit Institutions made million dollar businesses at the expense of its borrowers. They charged exorbitant interest rates without providing costly services.

I personally have concerns regarding stock market listed Micro-Credit Institutions. The reason why enterprises go public is that they can raise capital very easily and fast. But this also means a change in the ownership; as soon as investors buy shares of the enterprise they automatically become the new owner. Although they are not involved in the business operations they still have indirectly control of it through the CEO who is usually elected by the shareholders. Therefore in my opinion listed institutions are more likely to miss their mission than their non-listed competitors because they are primarily working for the shareholders who basically only care about the profit, stock price and dividends. My fear was confirmed by the financial information that is published on the homepage of some listed institutions which announced a return of investment of up to 24 percent. (SKS investor information: http://www.sksindia.com/financial_information.php#3, Compartamos investor information

http://www.compartamos.com/wps/portal/!ut/p/c0/04_SB8K8xLLM9MSSzPy8xBz9CP0os_gADwNLcw93lwP_UHcXAYNiR6cqly9TY2dvl_2CbEdFADFNIxs!/?mosHist=1)

The bottom line is we have to distinguish between the 'good' and the 'bad' Micro-Credit Institutions. Certainly it is tough for the less literate borrowers to

see the difference but a good indicator would be to check whether the Micro-Credit Institution is listed on the stock exchange or privately run.

Looking from another perspective, wouldn't it be also possible that borrowers really couldn't handle with money? Many people from the rural places only enjoyed little education which is why they have limited skills in reading, writing or calculating. Governmental campaigns like the 'Financial Literacy' could be the answer to this problem.

According to the annual report for the President of the United States compiled by the President's Advisory Council on Financial Literacy, financial literacy is defined as¹⁸⁵:

"The ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being".

Basically, it's an understanding of money and financial products that people can apply to financial choices in order to make informed decisions about how to handle their finances.

Many individual nations have recognized the importance of financial literacy and created task forces with the goal of offering education to the population. In 2003 the Organization for Economic Co-operation and Development (OECD) started an inter-governmental project with the objective of providing ways to improve financial education and literacy standards through the development of common financial literacy principles¹⁸⁶. In 2005 the OECD published a report of recommendations for principles and good practices for financial education and awareness which is applicable to both conventional finance as well as microfinance¹⁸⁷. Governmental programs regarding financial literacy are not only run in developing countries but they also became a main focus in developed countries such Australia, Japan, the United States, and the UK.

¹⁸⁵ Cf. President's Advisory Council on Financial Literacy (2008); 2008 *Annual Report to the President*; page 4.

¹⁸⁶ Cf. Wikipedia Homepage: http://en.wikipedia.org/wiki/Financial_literacy [Accessed on March 28, 2011]

¹⁸⁷ Cf. Microfinance Hub Homepage: <http://microfinancehub.com/2010/09/29/financial-literacy-in-microfinance-principles-and-global-initiatives/> [Accessed on March 28, 2011]

Consequently I think if such financial literacy lessons are provided to borrowers it will definitely help them in making informed decisions and as well as in managing the financial resource effectively.

Finally for the case of Andhra Pradesh I think it is important to analyze both participants – the institution as well as the borrowers, in order to draw a conclusion objectively. However one fact is certain, the reputation of Micro-Credit has suffered from this crisis and it is going to be a challenging task for institutions to regain the trust and confidence of many individuals such as donors, economists, foundations, government, and most of all their clients.

5.6.3 The Lack of Supervision

In the early 2000s the Micro-Credit industry experienced a real boost as it became the most celebrated innovation in alleviating poverty and help the poor to improve their quality of life. The increase of Micro-Credit Institutions accounted for almost 40 percent at highest which is equivalent to more than 550 institutions¹⁸⁸ a year. By the time of 2007 there were more than 3.352 Micro-Credit Institutions serving over 154 million of borrowers worldwide. These numbers are incredible but unfortunately they also include those institutions that are less concerned about the wealth of their clients but are more anxious about the profit, just like the lenders described in the previous section. Hence to avoid more fraudulent providers entering the market significant reforms are absolutely essential.

Some of the institutions have also noticed the need of an adequate supervision and urge to set up an entity that observes social responsibilities objectively. In this way unprofessional or unethical operations perform by Micro-Credit Institutions can be detected at an early stage and consequently

¹⁸⁸ Calculation based on Table 1.

prevented. Just as important as the surveillance, is the measurement of the social aims and impact of Micro-Credit Institutions which is quite a complicated and difficult task¹⁸⁹. Due to the complexity of this issue, it will be discussed in the following section.

Alternative solutions to a supervision entity have been introduced by different organizations which are easier to implement and probably more cost efficient. The government could be asked to introduce a code of ethics for institutions that have reached a certain size which would force them to act beneficial for their clients and be more transparent. Another approach will be to establish a central credit agency like the 'SCHUFA' in Europe. The core mission of this agency is to prevent clients from taking numerous loans at different institutions which in turn will avoid an over-indebtedness¹⁹⁰.

Like many other social responsible Micro-Credit Institutions, I also think that an adequate supervision is long overdue. This authority could establish order and create a reasonable overview in the 'Micro-Credit. However, the challenging part would be to clarify the tasks and duties as well as the legal capacity of the supervisory authority.

The idea of setting up a central credit agency seems to be very a reasonable and easy-to-realize approach. The challenging part here would be to verify the clients as the majority of the rural poor do not own any photo identification. However, in my opinion this difficulty can be easily solved by just taking Polaroid pictures of the client may be in combination with a fingerprint. In this way it can be avoided that borrowers take out ten loans at then different Micro-Credit Institutions at the same time.

¹⁸⁹ Cf. Pressemitteilungen-online.de Homepage, <http://www.pressemitteilungen-online.de/index.php/mikrofinanzierung-ist-kein-allheilmittel-besserer-kundenschutz-gefordert/> [Accessed on March 5, 2011]

¹⁹⁰ Cf. Pressemitteilungen-online.de Homepage, <http://www.pressemitteilungen-online.de/index.php/mikrofinanzierung-ist-kein-allheilmittel-besserer-kundenschutz-gefordert/> [Accessed on March 5, 2011]

5.6.4 Difficulty in Measuring the Social Performance of Micro-Credit Programs

The use of Micro-Credit by low-income people does not automatically ensure improvements in their quality of life. Sometimes it could be quite the opposite when they are overwhelmed with the repayment and in the worst case they end up in suicide. Hence Micro-Credit without monitoring or measurement could actually cause more harm than it would be beneficial.

If Micro-Credit can affect people's lives positively which I believe it mostly does then how can this impact, the so called Social Performance be measured and proved?

In 2005 some important foundations including the Argidius Foundation, the Ford Foundation and the Consultative Group to Assist the Poor (CGAP) have formed the 'Social Performance Task Force' to find an appropriate measuring instrument for Social Performance. The Social Performance Task Force comprises over 150 leading microfinance networks, financial service providers, rating agencies, donors and social investors¹⁹¹.

5.6.4.1 Definition of Social Performance and Social Performance Management

The Social Performance Task Force describes Social Performance as follows¹⁹²:

"Social Performance is the effective translation of an institution's social goals into practice in line with accepted social values; these include sustainably serving increasing numbers of poor and excluded people, improving the quality and appropriateness of financial services, improving the economic and

¹⁹¹ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 3.

¹⁹² Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 3.

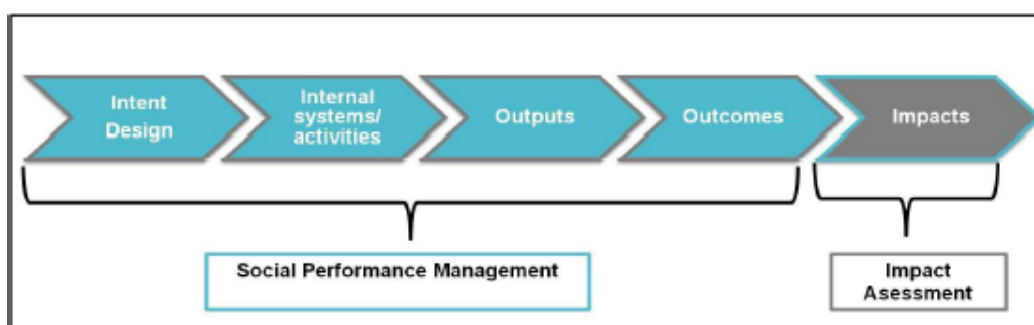
social conditions of clients, and ensuring social responsibility to clients, employees and the community they serve.”

In a nutshell, the Social Performance is an indicator of how well a Micro-Credit Institution has met the social goals outlined in its mission and vision.

There are institutions that show better Social Performance than others by the same quantity and effort of input and resources. How is this possible? What is the secret of their success? In order to understand the difference it is necessary to look behind the scene and learn the process, operation as well as the system that are applied within the institution. In short, the entire concept of an institution is called the ‘Social Performance Management’ which is illustrated in figure 18¹⁹³.

The figure shows that the Social Performance Management is split into four stages followed by the impacts as result. The assessment starts off by analyzing the intent and design of an institution. What is the mission of the institution? Does it have clear social objectives?¹⁹⁴

Figure 18: Dimension of Social Performance



Source: Kirchstein K., Lenel F., Welvers K., Ströh de Martínez Ch., (2010); *Measuring the Impact and Social Performance of Microfinance*; page 6.

¹⁹³ Cf. Kirchstein K., Lenel F., Welvers K., Ströh de Martínez Ch., (2010); *Measuring the Impact and Social Performance of Microfinance*, page 6.

¹⁹⁴ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 4.

The second stage looks on the one hand at the activities that are undertaken by institutions and on the other hand it examines whether appropriate systems are designed and applied within the organization to meet its objective¹⁹⁵.

The next level which is the output evaluates whether the institution's products and services are actually satisfying the needs of the intended target group (for many Micro-Credit Institutions that would be the excluded, poor, and low-income households)¹⁹⁶.

The last stage of Social Performance Management presents the outcome. The core issue here is to find out whether the clients have experienced social and economic improvements¹⁹⁷.

Finally the last feature of the Social Performance Chain is the impact. Here it is important to identify whether the realized improvements can be attributed to institutional activities or not. Also what are the long term sustainable changes produced by these outcomes (e.g. poverty reduction)? What are the unintended consequences?¹⁹⁸

After a brief introduction of the Social Performance and the Social Performance Management it would be interesting to learn about the different assessment tools that are applied to measure the impact of Micro-Credit.

5.6.4.2 The Assessment Tools

In recent years numerous assessment tools have been developed and introduced to the market. They may focus on different steps in the Social

¹⁹⁵ Cf. Kirchstein K., Lenel F., Welvers K., Ströh de Martínez Ch., (2010); *Measuring the Impact and Social Performance of Microfinance*, page 6.

¹⁹⁶ Cf. Kirchstein K., Lenel F., Welvers K., Ströh de Martínez Ch., (2010); *Measuring the Impact and Social Performance of Microfinance*, page 6.

¹⁹⁷ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 4.

¹⁹⁸ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 4.

Performance Management chain and therefore have heterogeneous approaches of measuring. Some tools are more concentrated on the processes and strategy applied within an organization while others attach more importance to the outcome and relies on client's information; or it could be a combination of both that assesses the social performance from the perspective of the institution as well as from the client¹⁹⁹.

There are a lot of assessment tools on the market but to keep it simple this section will only introduce the most common ones that are applied to measure social performance:

a) The CERISE Social Performance Tool

The CERISE tool assesses the social performance of institutions by evaluating their intentions and actions. An analysis of internal systems and organizational processes determines whether institutions have the means in place to attain their social objectives. The CERISE tool uses a questionnaire and guide to examine (1) outreach to the poor and excluded populations, (2) adaptation of products and services for target clients, (3) improvement in social and political capital, and (4) corporate social responsibility. It analyzes the mission statement, board and staff commitment, and targeting methods, to approximate whether poor clients are actually being served rather than analyzing client empowerment at the household and community level. Due to its strong focus on the organizational systems and process, CERISE is definitely a tool that assesses from the institution's perspective. The appeal of the tool lies in its ease of use and the fact that it can be administrated by the Micro-Credit Institutions²⁰⁰.

b) The SPA Tool

The Social Performance Assessment (SPA) tool was developed by Gary Woller with funding from USAID. It uses the collected data from institutions which includes financial and client information as proxies for

¹⁹⁹ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 4.

²⁰⁰ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 5.

the social performance and assumes that new formats and fresh data collection would not be essential. The SPA tool includes a scorecard with a set of indicators under six dimensions of outreach²⁰¹:

- **Breadth of outreach:** This indicator includes the number of borrowers, the percentage of clients with non-enterprise loans, and voluntary savers as a percentage of borrowers.
- **Depth of outreach:** It measures the average loan size, the percentage of female clients, and the percentage of rural clients.
- **Length of outreach:** This factor assesses the financial performance – profitability and the portfolio quality.
- **Scope of outreach:** This indicator includes number of distinct enterprise loan products, number of other financial services, the type of savings offered, and the percentage of clients with three or more products or services.
- **Cost of outreach:** This factor calculates the financial costs in providing services including number of days taken to process loans and number of visits that staff makes.
- **Worth of outreach:** It measures client retention rate, the loan loss rate, and portfolio growth that can be attributed to clients.

The SPA tool is also able to assess the outreach to the community through ten other indicators which include the percentage of operating revenues reinvested back into the community, the percentage of employees that have left, the female – male employee ratio among

²⁰¹ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 5.

professional-level staff, the benefits to employees, and transparency and management access for clients²⁰².

The scorecard will be edited and checked by an independent audit who also evaluates the effectiveness of institutional mission, management and leadership, hiring and training, monitoring systems, incentive systems, and the strategic planning. The final social performance report includes both the organizational scorecard results and the finding on internal processes from the audit²⁰³.

SPA is an indirect assessment tool which means it measures social performance only within the institution. It analyzes the extent of consistency between the key performance indicators and social performance; and it also examines whether internal processes are designed and implemented in a way that harmonize with the policies, behaviors, and outcomes stated in the social mission by the institution²⁰⁴.

c) The ACCION SOCIAL Tool

SOCIAL stands for the six elements of social performance that the ACCION tool seeks to capture: social mission, outreach, client service, information transparency, association with the community, and labor climate. It assesses the impact of a Micro-Credit Institution in fulfilling its social mission and its contribution to broadly accepted social goals. This tool may help to improve the organizational effectiveness by highlighting strengths and weaknesses in social performance and revealing how the institution is perceived by clients, staff, and the community. Another advantage of the ACCION SOCIAL tool is that it comprises a financial assessment which provides valuable information

²⁰² Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 6.

²⁰³ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 6.

²⁰⁴ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 6.

for third parties such as socially responsible investors or donors. By publishing the result of the social and financial assessment it increases the transparency²⁰⁵.

ACCION SOCIAL is both a direct as well as an indirect assessment tool. It estimates the impact of an institution by analyzing the internal and external factors together. ACCION evaluates its social performance assessment through interviewing the management, staff, board members, and clients and reviewing strategies, business plans, and minutes of board meetings. It analyzes information from institution's client database and validates them through comparisons with external surveys, national data, data from Microfinance Information Exchange, market studies, and other secondary information. It also evaluates the breadth and depth of coverage by creating a geographic coverage maps²⁰⁶.

d) The CGAP – Grameen – Ford Progress out of Poverty Index (PPI)

The Progress out of Poverty Index is certainly the most well-known measurement of all the assessment tools. It was the Consultative Group to Assist the Poor (CGAP) together with the Ford Foundation which sought to develop globally comparable client-level indicators that could identify economic levels of clients and demonstrate changes in their condition, without any attribution of causality. The challenge was to select indicators that are simple and low cost, yet at the same time, sufficiently robust and globally applicable. This is why CGAP and Ford funded Grameen Foundation to develop a set of globally comparable client-level indicators. It was Mark Schreiner who managed to create a method to construct country-level 'poverty scorecards' using techniques similar to those applied in credit scoring. The scorecards are based on statistical analysis of national household expenditure surveys. They use a small set of simple, easily observable indicators to

²⁰⁵ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 6.

²⁰⁶ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 6.

estimate the share of clients who are below an established poverty line. The tool is named the Progress out of Poverty Index (PPI) because it can be used over time to determine improvements in client economic levels and their ultimate graduation out of poverty²⁰⁷.

The poverty scorecard measures poverty via simple questions rather than long surveys and complex calculations of income and expenditures (e.g. What are the house's outer walls made of? What kind of toilet does the household have? Does the household own a gas stove? Do all children ages 6-17 go to school? How many TVs does the household own?). Tests have shown that a single scorecard works with high accuracy in both rural and urban areas of a given country²⁰⁸.

Beside the poverty scorecard there is another questionnaire including five indicator poverty indexes which is designed for the staff member of the institution or an external surveyor when visiting client's home to obtain the answers. Depending on the country which is to be evaluated the indicators and the scores for each question are determined through an econometric analysis of the national household expenditure data for that specific country. Afterwards the average score of all clients will be calculated and compared with a previously constructed 'poverty likelihood' table to determine the percentage of clients falling below the poverty line²⁰⁹.

The Progress out of Poverty Index is definitely an indirect assessment tool as it relies mainly on surveys and questionnaires by the clients as well as the staff members of the institution.

²⁰⁷ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 7.

²⁰⁸ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 8.

²⁰⁹ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 7.

e) The FINCA's Client Assessment Tool

FINCA's Client Assessment Tool (FCAT) is a comprehensive tool that includes demographic information, loan information, household expenditures, asset accumulation, social metrics (health, housing, and education), business metrics, and client satisfaction and exit interview questions. Such an interview could last up to 40 minutes which will be recorded and then evaluated²¹⁰.

FINCA is another direct social performance assessment tool that focuses on client's information.

This section has introduced different assessment tools including their focus and concept. It has shown that measuring the impact of a Micro-Credit Institution is indeed not an easy task but institutions as well as rating agencies are keen to advance and improve the assessment concepts in order to deliver better results for every interested party such as governments, funders, and certainly the clients. Therefore evaluating social performance has become more important than ever which has definitely positive effect on the transparency.

The assessment tool does not necessarily induce institutions to pursue the same social objectives but it will ensure that all institutions are accountable for what they advertise. Due to the great focus on social performance assessment today it can be assumed that it will have a positive impact on the actual social performance in the near future through reaching larger numbers of far poorer people, improving services to help clients reduce their vulnerability and improve their economic conditions as well as through contributing positively to the communities in which institutions work²¹¹.

²¹⁰ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 8.

²¹¹ Cf. CGAP Focus Note No. 41, (2007); *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, page 10.

The call for more transparency in the Micro-Credit Industry has led institutions to create various assessment tools to evaluate not only the financial but also the social impact on borrower's life. The assessment tools differ in the focus as well as in the method of measuring. It can be analyzed either from the institution's or client's perspective; or a combination of both. The goal of the social performance assessment is on the one hand to protect the borrowers from loan sharks by learning the social aims of institutions and ensure that they serve and help the borrowers; and on the other hand to determine the extent of the financial and social impact brought by Micro-Credit which increases the transparency and also certainly serve as evidence for Micro-Credit supporters to prove that Micro-Credit is an effective instrument to reduce poverty.

I have a positive opinion about assessing institutions but I think there is a lack of regulation. As previously mentioned the intention of performing the social performance assessment is to increase transparency which consequently allows a better comparison of institutions. But assuming that institutions are measured by different assessment tools; wouldn't they show different results at the end? Is it really comparable then? How can we ensure that they are not comparing apples to oranges?

Another question would be the consequences if a loan shark is detected. Will it be reported and to whom? Who guarantees that this certain institute will be excluded from the market then?

As the assessment of social performance is still in its infancy; it therefore leaves some questions unanswered. It needs to be further developed but I am sure that it will prosper and gets indispensable for Micro-Credit Industry.

5.6.5 Poor Distribution System of Micro-Credit Institutions and Lack of Information about the Existence of Micro-Credit in the Rural Areas

According to a paper of March 2010 published by the Tata-Dhan Academy, Micro-Credit has only reached about 10 percent of its potential market so far²¹². One of the reasons for this extremely low outreach is that many impoverished people are living far off rural areas, often in remote villages; therefore it is hard for them to reach the institutions and of course the other around. Another reason is that institutions may already feel satisfied with their current client base in certain cities and therefore do not desire to expand and reach out for the poorest households²¹³. Beside the geographical obstacle people from remote places are facing another issue which is the lack of knowledge about the existence of financial services for the poor²¹⁴.

At first glance this problem doesn't seem to be hard to solve; it only requires Micro-Credit Institutions to enhance their marketing activities in order to achieve higher public awareness. But would this advertising effort really reach the remote rural areas and how much would it cost? Hence it is to find a way to increase outreach most cost effectively.

A number of Micro-Credit Institutions have introduced innovative delivery methods in remote places. Like in Constanta, Georgia, institutions have set up service points which are part-time run offices. These service points are typically rented from a partner branch and employ a loan officer for two days a week and a supervisor on part-time basis. The advantage of such little part-time run offices is the fairly low operating cost and the good operational self-sufficiency²¹⁵.

Another method of innovative delivery has been presented by institutions in Demos, Croatia. The concept consists of posting and distributing of leaflet, running door-to-door promotions; liaising with village leaders to organize

²¹² Cf. Tata-Dhan Academy (2010); *Deepening Microfinance*; page 7.

²¹³ Cf. Microfinance Hub homepage: <http://microfinancehub.com/2010/11/09/microfinance-problems-5-challenges-for-microfinance-providers-part%C2%A02/> [Accessed on March 23, 2011]

²¹⁴ Cf. Microfinance Hub homepage: <http://microfinancehub.com/2010/02/09/problems-faced-by-microfinance---micro-entrepreneurs/> [Accessed on March 23, 2011]

²¹⁵ Cf. E.Yves (2007); *Designing adequate microfinance products and services*; page 4.

orientation sessions and rewarding the 'Client of the Year' (i.e. the client who enlists the highest number of new client gets a reward)²¹⁶.

I personally think both of the innovative delivery methods are great except the feature of posting and distributing leaflet. As people from the rural areas are usually little literate they might not be able to read or understand the leaflet. This is why I don't think it would be an effective feature to help reaching the poorest households. But I like the idea of setting up service points and arranging orientation sessions to bring Micro-Credit into the remote villages.

Eventually this challenge of poor distribution system of Micro-Credit Institutions can also be interpreted as opportunity. It represents a great potential of growth and expansion.

Opportunities of Micro-Credit:

5.6.6 Modifying Loan Products for Climate Change Victims

In the last decades a climate change could significantly be observed which brought severe natural disasters and caused thousands of million dollars in damages. The Intergovernmental Panel on Climate Change (IPCC) has estimated that by 2100 global temperatures will increase between 1.1 and 6.4 degrees centigrade if no attempt is made to reduce greenhouse gas emissions. Consequently the sea level will rise which in turn decreases the availability of water. Also there will be a higher incidence and severity of natural disasters, such as floods, cyclones and droughts which will catastrophic impact on the poor as many of the world's poor are directly dependent on the environmental ecosystem for their survival²¹⁷. As a result,

²¹⁶ Cf. E.Yves (2007); *Designing adequate microfinance products and services*; page 5.

²¹⁷ Cf. IPCC (2007); *Climate Change 2007: Synthesis Report, Summary for Policymakers*

the number of people in poverty will increase; by 2100 between 145 and 220 million additional people may fall below the USD-\$ 2-a-day poverty line²¹⁸.

Micro-Credit helps the poor by engaging them in productive activities. This mission will become harder to accomplish in a sustainable manner (economically and socially) due to the effects of global warming. Micro-Credit Institutions have in the last years refined their services to the rural population adding more sophisticated leasing loans for agricultural equipment and agricultural loans to their product portfolio²¹⁹. Still, very little work has been done on adapting Micro-Credit to climate change, in spite of the projected devastating effects on crop output of global warming.

How can Micro-Credit adapt to climate change and help to alleviate the negative effects of climate change and natural disaster on their customers?

Micro-Credit can be modified depending on the type of shock borrowers might suffer. For instance, in areas which are becoming more prone to flooding, institutions can encourage aquaculture initiatives among farmers, floating gardens, investments on raise tube wells for safe water and new houses to be built on raised beds or raised embankments²²⁰.

Manuel Bueno, an investment analyst and knowledge management specialist, who is working in the Grassroots Business Fund in Washington D.C., introduced two recommendations for adapting the loan to natural disasters. Firstly, institutions usually demand from their borrowers loan repayment schedules that entail fixed installments during the duration of the loan. It might be very difficult for borrowers to repay loans when a natural disaster takes place. Therefore, institutions should consider introducing certain caveats or incentives in their loan contracts to allow for greater flexibility in the repayment schedule should certain events occur. This method is line with most of Bangladeshi institutions which allow their members to reschedule their installments, lower the installment amount or extent the repayment period during floods. Such changes have been shown to significantly ease the

²¹⁸ Cf. N. Stern (2007); *The Economics of Climate Change*, page 126.

²¹⁹ Cf. Journal of Microfinance; *Volume Six, Number Two*; (2004); page 136.

²²⁰ Cf. Next Billion Homepage: <http://www.nextbillion.net/blog/climate-change-and-microfinance-2-of-2> [Accessed on April 1, 2011]

burden on borrowers without increasing client default rates. The advantage of this method is that it can be applied to any region regardless of the type of climate change risks it is expected to suffer²²¹.

The second method to adjust loans to the climate change can be achieved by modifying some terms of the loan contract. Customers who live in areas that are prone to droughts or rising sea levels will require different terms in their loan contract. Of course this is depending on the purpose of the loan whether it is devoted to water management, agriculture and fishing, forestry, health, or housing²²².

For instance, a borrower takes a housing loan in a region that is expected to suffer floods, cyclones and tidal surges. The Micro-Credit Institution can introduce terms on the loan contract that would force the borrower to build the house above flood levels by making use of stilts, raised beds, or raised embankments. In the case of water management loans in areas which are at risk of floods, institutions can provide loans on the condition that tube wells are constructed at raised levels to protect against contamination. In the case of agriculture loans in areas with higher chances of drought, the terms of the contract should encourage to stay away from water intensive crops, such as rice, to less needy crops, such as maize, groundnut or sunflower. These options have barely been explored by institutions so far²²³.

If all initiatives are embedded within loan products adequately, it could have great positive social impacts and generate significant profits for the Micro-Credit Institutions involved²²⁴.

Natural disasters have become more common in the past few years due to the global warming and it always seems to hit the poor at hardest. Therefore I

²²¹ Cf. A. Dowla, D. Barua (2006); *The Poor always pay back*.

²²² Cf. Next Billion Homepage: <http://www.nextbillion.net/blog/climate-change-and-microfinance-2-of-2> [Accessed on April 1, 2011]

²²³ Cf. Next Billion Homepage: <http://www.nextbillion.net/blog/climate-change-and-microfinance-2-of-2> [Accessed on April 1, 2011]

²²⁴ Cf. Next Billion Homepage: <http://www.nextbillion.net/blog/climate-change-and-microfinance-2-of-2> [Accessed on April 1, 2011]

really share the same view with Mr. Manuel Bueno about the need of modifying loan products in order to help the poor in hardship.

However, one of his recommendations is not a new concept which is the rescheduling of borrower's installments. This concept has been applied by the Grameen Bank in Bangladesh years ago and works very well. Hence it could serve as role model and consultant to other Micro-Credit Institutions when they incorporate the idea.

His second recommendation is based on a loan contract which is to be customized depending on borrower's intention for the loan as well as on her living area whether it is prone to natural disaster such as drought, flood or cyclone. This concept has good intentions but it will intervene in borrower's privacy as it sets certain conditions for the usage and therefore it will have some restriction in borrower's freedom of choice.

Overall I think these are great initiatives of modifying Micro-Credit towards climate change. Although global warming has become an increasingly important issue over the years the majority of the institutions have missed to address their focus on this topic which has to be caught up quickly in order to help the poor in case of a natural disaster in the future.

5.6.7 Job Creation within the Institution

Micro-Credit Institutions do not only create millions of Micro-Entrepreneurs by giving out loans to low-income individuals but they also provide thousands of jobs within its organization.

Micro-Credit is known for its high labor intensity and since the number of new institutions is rising and existing organizations are expanding, the demand for loan officers and other employees to assist the borrowers is greater than ever before. The development of the labor force during 2007 and 2009 in the Micro-Credit industry in Bangladesh is shown on the table 4.

Table 4: Micro-Credit Employment in Labor Force

Items	Total Staff in Microfinance		
	As of Dec. 2009 (N=744)	As of Dec. 2008 (N=612)	As of Dec. 2007 (N=535)
(1) MFI-NGOs	334,529	197,732	171,599
(2) Grameen Bank	23,283	24,240	25,283
(3) PDBF	2,215	2,139	2,273
(4) RDS (IBBL)	1,737	1,655	1,819
Grand Total	361,764	225,766	200,974

Note: N refers to MFI-NGOs

Source: Bangladesh Microfinance Statistics 2009, *Development of Microfinance Sector in Bangladesh*, page 5.

The total number of employees has increased by 24.794 which is equivalent to 12.34 percent in 2008 compared to the previous year, and it experienced a significant rise in 2009 by 135.998, equivalent to 60.24 percent²²⁵.

This statistic gives a clear direction on how the number of employees might develop in the future.

In my opinion I think there is still a great growth potential in employees as institutions altogether have only been able to reach a tiny fraction of the low-income population so far. Hence there is still a lot of work to do which definitely can not be preceded without engaging more employees.

²²⁵ Calculation based on table 4.

5.7 Does Micro-Credit Reduce Poverty?

The key question of this whole thesis is “Can Micro-Credit Reduce Poverty?” It may seem obvious that Micro-Credit can alleviate poverty in the short-term but can it reduce poverty in the long-run?

This section looks at the impact of Micro-Credit on the individual and the community. It also looks on the impact of using Micro-Credit in isolation and then in conjunction with other poverty intervention programs.

5.7.1 The Impact of Micro-Credits on an Individual

Providing financial assistance through a mechanism like Micro-Credit is intended to reduce poverty, but this is only a short-term fix not a long-term solution. In the short-term the Micro-Credit will resolve the individuals' immediate needs but it still leaves them in debt. All the Micro-Credit does is simply consolidates and transfers the individuals debt to the Micro-Credit Institution. In this case the Micro-Credit may have alleviated the client's immediate financial suffering but has not reduced their poverty.

In isolation a Micro-Credit does not reduce the poverty of the individuals unless it is supported by other facilities. Basically, if Micro-Credit Institutions merely act as financial institutions then they will not reduce poverty in the long-run. To be successful the Micro-Credit Institution has to provide a support package that offers an effective way for the clients to improve their life. They have to change the way the client deals with the situation successfully. Many Micro-Credit Institutions have developed lending models that include additional features, but perhaps the most successful of these Micro-Credit Institutions is the Grameen Bank. Their Micro-Credit model has received international recognition and has been replicated in over 100 countries.

The Grameen Bank model is based on a range of elements that force the individual to improve their situation. Probably the most important one is the

lending criteria. For an individual to receive Micro-Credit they must provide the Grameen Bank a plan of what they will do with the loan. This forces the individual to come up with their own solution to their situation. The Grameen Bank then ensures that they stick to their plan. Although not all the clients are successful – the vast majority are. In fact the research shows that 97.21 percent of the clients managed to repay the Micro-Credit.

5.7.2 The Impact of Micro-Credit on the Community

It is important to recognize the impact of the Micro-Credit on the local community. The result of numerous Micro-Credits within the same community has a compounding effect which can create a positive effect on the community. In other words, as the individual use the money they gain from the Micro-Credit to improve the situation; they often spend it within their direct community. The Grameen Bank focuses it's Micro-Credits on females who are much more incline to use their funds on their family and increase household spending which will benefit the local community. As more and more individuals alleviate their immediate poverty, the community grows more. This creates a positive cash flow situation, which in turn can benefits others in the same community. However again, this could be a short-term fix rather than a long-term solution.

In general, the aim of these Micro-Credits is to empower entrepreneurs to create local business, which again benefit the community.

5.7.3 How Micro-Credit works in conjunction with other Programs

Micro-Credit programs that make poverty reduction an explicit goal and make it a part of their organizational culture are far more effective at reaching poor

households than those that value finance above all else. They are also more likely to alleviate poverty in the short-term and reduce poverty in the long-run.

Therefore well designed Micro-Credit program are likely to have a positive impact on the individual and the community. But for this positive impact to be sustainable the Micro-Credit should work in conjunction with other poverty intervention programs such as²²⁶:

- Social Welfare-Programs
- Education and Training Programs
- Basic Health Care Programs
- Family Planning Programs
- Economic Programming.

In isolation a Micro-Credit is simple a financial transaction. It may be successful in assisting on individual and their community or it may not. To increase the benefits that Micro-Credits can bring it should form part of a large overall plan to reduce poverty.

5.7.4 Whom should Micro-Credit Institutions target?

The key to providing Micro-Credits that will impact poverty is to select the right clients. The sick, mentally ill, destitute, and transient are all in need of assistance. There are many who live below the poverty line but are not good candidates for Micro-Credit. Most researchers agree that these groups of people are better candidates for direct basic assistance from other aid institutions. For the mechanism of Micro-Credit to effectively reduce poverty and provide benefit to the poor communities it needs to focus on these who have the entrepreneurial abilities to change and improve their situation in the long-run.

²²⁶ Morduch J., Haley B., (2002), *Analysis of the Effects of Microfinance on Poverty Reduction*, page 99-113.

There is no evidence of an inverse relationship between a client's level of poverty and their entrepreneurial ability. It is often hard for Micro-Credit Institutions to select the right candidates. The Grameen Bank model overcomes this by letting the lending groups self-select their members. It is human nature to want to be successful and in general a group will select the most beneficial members.

5.7.5 Micro-Saving is as important as Micro-Credit

There is a general consensus that Micro-Savings are just as important as Micro-Credits. Savings play a key role in preventing the seasonality of cash-flow problems and create an insurance against future hardship²²⁷.

Micro-Credits will alleviate short-term poverty, but it is Micro-Savings that are required to prevent long-term poverty. If the client's Micro-Business is successful they must be encouraged to invest in Micro-Savings to insure themselves against future hardships.

Borrowing patterns and the inclination to save have been found to be similar across clients at different levels of poverty in different countries. If applied successfully then Micro-Credit and Micro-Savings together have the potential to alleviate poverty in the short-term and reduce it in the long-run.

5.7.6 So can Micro-Credit Reduce Poverty

At a local level Micro-Credit has the potential to reduce poverty but this greatly depends on following factors:

- the use of a prudent Micro-Credit model
- the selection of the right entrepreneurial clients

²²⁷ Morduch J., Haley B., (2002), *Analysis of the Effects of Microfinance on Poverty Reduction*, page 3.

- the benefits the clients provide to their community
- the use of other poverty intervention programs
- the use of Micro-Savings to reduce future hardship.

The Micro-Credit model being used by the Grameen Bank was found to improve the livelihood of its clients. It boosted net worth by 46 percent and increased household income by 29 percent²²⁸. Although this model will not work for all cultures it could be use as a template and adapted as required.

²²⁸ Cf. Snow D., Buss T., (2001), *Development and the Role of Microcredit*, page 302.

6. Conclusion

6.1 In Summary

There are over three and a half thousands Micro-Credit Institutions around the world. Although they all have the same basic objectives, they operate in variety of different ways. They are affected by different regulations and need to provide a service that's acceptable to the culture of their country.

The principles of Micro-Credit have been around for hundreds of years, but it is only in the last two decades that it has risen to prominence. Until the start of the Global Financial Crisis the Micro-Credit industry was expanding dramatically around the world. The liquidity contractions have slowed down the Micro-Credit industry, but now as the situation is improving there are great opportunities for Micro-Credit Institutions to play a major role in reducing poverty that the Global Financial Crisis has caused.

This thesis has looked at the concepts of Micro-Credit in general and then focused in detail on Professor Yunus' Micro-Credit program which is operated by the Grameen Bank in Bangladesh.

This thesis started by explained what Micro-Credit is and how it works, then went on to analyze seven key issues and concerns regarding Micro-Credit. Having done this it can now draw its conclusion; however it is important to bear in mind that this thesis is based on the current global situation and has used the Grameen Bank as a prime example of a Micro-Credit Institution.

6.2 In Conclusion

Micro-Credit is a financial instrument that can benefit the poor and disadvantaged individuals and communities around the world. If implemented correctly Micro-Credit has the potential to alleviate financial hardship.

The use of group lending and gender preference plays a very important role in the Micro-Credit model. The Grameen Bank's model based on female groups has been extremely successful.

Micro-Credit is a cost-effective way to alleviate poverty. The Micro-Credit program used by the Grameen Bank is much more cost-effective than other methods of poverty intervention programs being used in the same country.

The misconception that Micro-Credit Institutions make large profits at the expense of their poor clients is not true. The Micro-Credit interest rates are high compared to conventional banks, but this is due to their high operational costs and in comparison the profit margins are very low.

The Global Financial Crisis had a major impact on the Micro-Credit Institutions and their clients. The liquidity contraction reduced the availability of funds and increased the cost of credit. The majority of Micro-Credit Institutions have tried to avoid passing on the increased costs to the clients, by reducing their operational costs.

Micro-Credit is not always the most suitable solution and to be successful it requires a level of entrepreneurship in its clients. Local circumstances must also be taken into consideration as Micro-Credit will not work if there are certain pre-conditions in place.

Micro-Credit can reduce poverty at a local level as it can stimulate self-employment and create household spending that will benefit the direct community. To successfully achieve this as a long term solution Micro-Credit should be applied in conjunction with Micro-Savings.

Transparency of Micro-Credit can be increased either by introducing a supervision authority to observe the institutions, or by publishing the result of the social performance assessment, or both methods combined together. Increased transparency will not only bring clarity in many important subjects of Micro-Credit (e.g. the interest calculation, the usage of profit, and the code of ethic implemented within the institution), but it will also detect institutions that behave unprofessional and abusive towards the borrowers. This consequently

will boost the confidence of investors as well as clients and makes comparison of the institutions more easily.

Micro-Credit currently only covers 20 percent of its potential market which means there is still plenty of room to grow, thrive and prosper. To achieve higher coverage and reach the poorest of the poor in remote rural areas, little local services points could be established to give information and organize events or meetings such as orientation sessions. The greatest opportunity however, is to assist people in areas that are prone to natural disasters by modifying the loan products which places incentives for the borrowers to create a more stable and solid living environment for themselves (e.g. encouraging people to build houses on raised embankment or to establish raise tube wells for safer water in areas periled to floods).

In isolation Micro-Credit can not reduce poverty at an international level as it does not address the major issues that created wide-spread poverty such as war, famine, political unrest, natural disaster and global crisis.

However, Micro-Credit can play a major role at an international level and should be applied in conjunction with other poverty intervention programs.

Micro-Credit is not only a poverty alleviation program that can be used in the Third-World countries, but it can also be applied in the poor communities in North America and Europe. As the world recovers from the Global Financial Crisis, Micro-Credit has a major role to play. If it was as successfully in every country as it is in Bangladesh the Micro-Credit could make a major difference and can change the world.

Regardless of the circumstances that created poverty the fact is that poverty is result of either unemployment or low income or low productivity. If it is unemployment then job creation is an appropriate cure. If it is low income then

wealth re-distribution may be required. If it is lack of productivity, then capital investment may be required²²⁹.

The Grameen Bank has been successful in bringing Micro-Credit to the poor communities, by creating a methodology that enables groups of individuals to use a cycle of loans to build on their existing skills and earn a better income. The Grameen Bank's methodology is to empowering the poor to utilize the skills they have to help themselves. Professor Yunus states that "Charity is not an answer to poverty as it creates dependency and takes away individual's initiative to break through the wall of poverty". He believes that, "unleashing of energy and creativity in each human is the answer to poverty"²³⁰.

In conclusion I personally don't think that Micro-Credit can eradicate poverty but it can alleviate it. Micro-Credit only works under certain pre-condition which makes the scope of application very limited. Moreover its success also depends on the regional culture and custom as the concept of group or female lending is not well accepted in some countries. In my opinion Micro-Credit is a tool which is more suitable for urban or suburb on low-income individuals because it is way easier for these people to become Micro-Entrepreneurs than their equivalents on the countryside. For example, a farmer asks for a Micro-Credit to open up a little shop to sell her organic homemade products. She soon will face two difficulties, firstly the little density of population on the countryside which means she may not have enough customers to keep the business running and may not survive through occasional customers. Secondly she is very dependent on the seasonal harvest. The typical Micro-Credit loan schedule requires her to pay weekly installments. But due to her strong reliance on the harvest she may not be able to repay the loan during the winter. This is the reason why Micro-Credit is unable to reach the poorest of the poor.

²²⁹ Cf. Morduch J., Haley B., (2002), *Analysis of the Effects of Microfinance on Poverty Reduction*, page 96.

²³⁰ Cf. The Grameen Bank Homepage
http://www.grameen-info.org/index.php?option=com_content&task=view&id=28&Itemid=108
[Accessed on October 28, 2010]

But it is definitely a great tool for low-income individuals to improve their social and economic situation and lift themselves out of poverty through their own hard work.

Finally if Micro-Credit installs the principles of Micro-Savings and works in conjunction with other poverty intervention programs it could achieve a way more significant alleviation of poverty in the world.

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Zusammenfassung (German Abstract)

Die vorliegende Arbeit beschäftigt sich mit der Frage, ob der unter den Ökonomen umstrittene Mikro-Kredit die missliche Lage der sozial Schwachen nachhaltig verändern, und sie dadurch aus der Armutsfalle befreien kann.

Mikro-Kredite sind Kleinstkredite, die an die Bedürfnisse armer Menschen angepasst sind und vorwiegend in den Entwicklungsländern vergeben werden. Sie reichen von einem Euro bis unter Tausend Euro und erfordern außerdem keine materielle Sicherheit vom Kreditnehmer wie es von traditionellen Bankhäusern sonst üblich ist. Mikro-Kredite folgen dem Prinzip „Hilfe zur Selbsthilfe“ und dienen für den Aufbau eines existenzsicherenden Kleingewerbes

Die Grameen Bank, gegründet vom Wirtschaftsprofessor Muhammad Yunus in 1983 in Bangladesch, ist heute einer der wichtigsten Mikrokreditgeber weltweit. In 2006 erhielt der Professor für seine Bemühungen um „die wirtschaftliche und soziale Entwicklungen von unten“ den Friedensnobelpreis.

Anhand des Konzeptes der Grameen Bank werden die wichtigsten Eigenschaften des Mikro-Kredites wie die Genderpreferenz, Gruppen-solidarität oder der viel diskutierte Zinssatz analysiert. Des Weiteren werden Chancen und Schwächen sowie die Auswirkungen der globalen Finanzkrise auf die Mikro-Kredit Industrie untersucht. Abschließend gibt die Arbeit Aufschluss, ob Mikro-Kredite tatsächlich das Potenzial haben die Armut auf dieser Welt zu reduzieren.

Die Arbeit kommt zu dem Ergebnis, dass Mikro-Kredite ein wichtiges Instrumentarium für die Armutsbekämpfung darstellt. Sie verschaffen den Mittellosen, die sonst aufgrund mangelnder Sicherheit vom üblichen Finanzmarkt ausgeschlossen sind, den Zugang zum Kapital, und ermöglichen ihnen somit ein Start ins Unternehmertum. Im Umkehrschluss bedeutet dies jedoch, dass Mikro-Kredite nur an Personen vergeben werden können, die eine Geschäftsidee besitzen und Unternehmer werden wollen. Folglich sind

Mikro-Kredite in ihrer Anwendung stark beschränkt und sind daher nicht in der Lage alle notleidende Menschen dieser Welt zu erreichen.

Aber selbst für die Kreditnehmer würden Mikro-Kredite mehr Schaden als Nutzen bringen, argumentieren so manche Kritiker. Die Behauptung stützt sich hauptsächlich auf die Zinspolitik der Mikro-Kredit Institutionen, die im Vergleich zu konventionellen Banken einen weit höheren Zinssatz einfordern. Dies lässt Mikro-Kredite nicht unbedingt als „Wunderwaffe“ gegen die Armut erscheinen. Ein Blick in die Analyse zeigt, dass die Kreditgeber gezwungen sind den hohen Zinssatz zu verlangen, wenn sie gewinnbringend erwirtschaften und sich dadurch eine Existenz ohne Spenden sichern wollen. Die Erfahrung mit Spenden bzw. Entwicklungshilfen haben erwiesen, dass diese ineffizient und gar kontraproduktiv fungieren. Darüber hinaus stellen sie eine Abhängigkeit dar, die zu politischen Zwecken ausgenutzt werden könnte. Spenden stellen außerdem keine stabile und dauerhafte Einkunftsquelle dar wodurch die Nachhaltigkeit der Institutionen gefährdet wird. Eine weitere Ursache für den hohen Zinssatz ist die extrem personalintensive Betreuung und Bearbeitung der Mikro-Kredite. Dies kann anhand eines simplen Beispiels gut veranschaulicht werden; die Bearbeitung von Zehn Mikro-Krediten zu jeweils Tausend Euro (ergibt in Summe also ein Kreditvolumen von Zehntausend Euro) ist aufwendiger und zeitintensiver als die Bearbeitung eines einzigen Kredites zu Zehntausend Euro. Zusätzlich bieten Institutionen noch „Haus-zu-Haus“ Betreuungen sowie Schulungen an; schließlich sollen Kreditnehmer, die oftmals nur unzureichend lesen und schreiben können, auf das künftige Geschäftsleben vorbereitet werden. All diese Kosten spiegeln sich letztendlich in den Zinssätzen wider. Dennoch kann die Grameen Bank eine Rückzahlungsquote von über 90 Prozent ihrer Kunden vorweisen. Dies zeigt, dass das Konzept dieser Mikro-Kredit Bank sehr wohl funktioniert und die Kreditnehmer sich nicht unbedingt von den Zinsen überfordert fühlen.

Die Schlussfolgerung ist nun, dass Mikro-Kredite einen erheblichen Beitrag zur Armutsreduktion in den Entwicklungsländern leisten kann. Aber aufgrund ihrer begrenzten Anwendungsmöglichkeit sind sie nicht für jeden geeignet

und sind daher auch nicht in der Lage die Armut komplett aus der Welt zu schaffen.

Curriculum Vitae

Persönliche Date

Vorname: Ting-lan
Nachname: Yang
Geboren: am 31. Mai 1981 in Hsin-chu, Taiwan
Wohnhaft: 1180 Wien

Ausbildung

1987 – 1995 Volksschule und Bundesrealgymnasium Wien VIII
1995 – 2000 Höhere Lehranstalt für Tourismus, MODUL
2000 – 2001 Colegio Delibes, Salamanca, Spanien
2000 – 2011 Universität Wien, Fakultät für Wirtschaftswissenschaften
Studienrichtung: Internationale Betriebswirtschaft mit
Schwerpunkten Corporate Finance und Externe
Rechnungswesen
2006 – 2008 Universität Wien, Institut für Oastasienswissenschaften
Studienrichtung: Sinologie

Arbeitserfahrung

2007 – 2010 Revisionsassistentin in der Kanzlei von *Ernst & Young*
Wirtschaftsprüfungs GmbH
2006 – 2007 Praktikantin bei *Bluespring Consulting GmbH*
2003 – 2006 Verkaufsassistentin bei *Metropolitan Museum of Vienna*
Sommer 1999 Praktikantin bei *RAD & REISEN* Reisebüro
Sommer 1998 Praktikantin im Hotel *City Club*

Weitere Kenntnisse und Fähigkeiten

Sprachen: Mandarin (Muttersprache), Deutsch (2. Muttersprache),
Englisch (verhandlungssicher), Spanisch (fließend),
Taiwanesisch (fließend).

EDV Kenntnisse: Microsoft Office, Monarch, ACL, Caseware, Groove.