❑ MICROFINANCE AND THE GLOBAL DEVELOPMENT CHALLENGE

By Alex Counts, President, Grameen Foundation USA

It has been clearly shown that microfinance can have a major impact on reducing poverty at both the local and national levels, says Alex Counts, president of Grameen Foundation USA, an organization that provides financing and technical assistance to financial institutions that offer loans to the world's poor. One key to a successful microfinance operation, he says, is government regulatory policies that support small business development.

Counts, a former Fulbright Scholar in Bangladesh who worked closely with Dr. Muhammad Yunus, founder of the Grameen Bank, examines the essential building blocks of the microfinance sector today. Among his findings are that women-run businesses often are associated with the best credit risks and more likely to funnel earnings into their children's education and that formal business training is not always a prerequisite to successful business development.

With 1.3 billion people living in abject poverty worldwide and an internationally accepted goal to reduce that number by half by 2015 (as part of the Millenium Development Goals), targeted, scaleable, and sustainable pro-poor strategies are needed as never before.

Poverty is arguably both a cause and an effect of many international problems, including global hunger, environmental degradation, overpopulation, illiteracy, civil strife, economic stagnation, and armed conflict. If the international community seeks to address these interrelated issues in a serious and holistic manner, then approaches such as micro-finance should be at the forefront of the global agenda.

The microfinance industry has its origins in experimental efforts in the 1970s to provide financial services, mainly loans, and non-financial business advisory services to the poor. One of the earliest pioneers was the Grameen Bank Project of Bangladesh. Initiated by Professor Muhammad Yunus in 1976 as a response to the 1974 famine, which had devastated this newly independent nation, it was essentially an intensive trial-and-error experiment to find out how the economic activities of the poorest people in one of the world's least developed nations could be supported. Loans of as little as $25 were provided to finance livestock-raising, trading, all manner of cottage industries, and services. Those who repaid were able to access larger loans and take advantage of other investment opportunities. Other methods were tried, but providing financial services, especially individual loans delivered through a group mechanism, was the one that stuck.

By 1983, enough had been learned and sufficient promise had been shown that the Grameen Bank Project was converted into an independent bank specializing in providing financial services to the landless poor, especially women. During the pilot phase (1976-1983), outreach grew from fewer than 100 clients to more than 45,000. Once the bank was launched, a period of sustained growth resulted in outreach of 850,000 by 1990, 2.4 million by 2000, and 3.0 million as of December 2003. Some 200 other providers in Bangladesh, many of them successful Grameen imitators, today reach another nine million families.

Astonishingly, a poor woman in Bangladesh is three times more likely to be a member of a private institution that provides her access to convenient and affordable financial services than she is to be excluded from this access. Worldwide, fewer than 15 percent of poor women are so fortunate. Of course, this shows the growth potential if sustained and leveraged investments are made on a country-by-country basis. With less than 1 percent market penetration in Pakistan, for example, the priority goals for the years ahead come into sharp focus.

By the mid-1990s, according to independent and highly credible research, some 120,000 Grameen families were crossing the poverty line each year, usually in the fifth or sixth year after beginning to participate. So while microfinance is hardly a quick fix or a panacea, it was achieving levels of poverty reduction on the micro level that were unusual, if not unprecedented. Furthermore, in most years, Grameen Bank turned a modest profit. Grameen, like most microlenders, has maintained a repayment rate between 95 percent and 99 percent for most of its history and does so at present. (Natural disasters and other shocks have pushed it lower on a few occasions, most recently in the late 1990s.)

The lessons of Grameen Bank's pilot phase, which have been studied and debated by the development profession and independently confirmed by other pioneers, were the essential building blocks of the microfinance sector today. They can briefly be summarized as follows:

- Only if the poorest women are actively sought out and targeted through effective marketing strategies – house-to-house "motivation" campaigns by local loan officers, means tests, or other similarly effective strategies – are they likely to benefit from microfinance programs.

- Perhaps counter-intuitively, even the poorest people (i.e., those earning less than $1 per day per capita) do not, in general, need formal training before launching a business supported by a microfinance institution (MFI). Their "survival skills," honed in an environment where there is neither a safety net nor wage employment to fall back on, are well developed, though severely undercapitalized. Providing capital, in a structured format where peer accountability is emphasized, is the most efficient and respectful means of ensuring rapid progress. Costly business training and technical assistance programs can therefore often be dispensed with or used only in exceptional cases.

- Women are often the best credit risks, and they are much more likely to use their profits to benefit their children by making investments that are most likely to break the generational cycle of poverty. In one World Bank study of the Grameen Bank and two other large MFIs in Bangladesh, a direct and positive relationship was found between the amount a woman borrowed and the likelihood that her daughter would go to school. A similar relationship was not found in the case of male borrowing.

- Microfinance can be provided in a business-like manner and still materially benefit large numbers of poor families as long as the overriding poverty reduction objective and social empowerment vision remain paramount in the minds of MFI leadership and field staff. Incentives for front-line employees (by management) and for MFIs themselves (by their stakeholders, including donors and boards) are essential to ensuring this. I was recently asked to join the board of Bank Fonkoze, Haiti's first bank for the poor, so that I could serve as the "conscience" of this new institution (which evolved from its roots as an non-governmental organization) and help ensure that mission drift be minimized even as it becomes a commercial financial institution.

Essentially, the lesson of microfinance in the 1980s was that poverty reduction could be franchised, under certain conditions. This discovery has led to impressive growth of the microfinance movement globally. According to the Microcredit Summit Campaign (www.microcreditsummit.org), some 67.6 million families are benefiting worldwide. Of those families, an impressive 37.7 million were among the "hard core poor" when they started participating. This is no longer a single success story driven by a charismatic leader (if it ever was), but rather a growing international effort to attack poverty in a systematic manner.

Grameen Foundation USA, established in 1997, has been at the forefront of helping MFIs to expand their operations and improve qualitative performance by providing financing, technical assistance, and technology consulting (often through volunteers).

The lessons of the two decades after Grameen became a bank provide policy-makers with the tools they need to create enabling environments. Those environments in turn will allow microfinance to reach its full potential to reduce poverty as it arguably has in Bangladesh, where more than two-thirds of poor families are benefiting from one of the 200 MFIs there. Some of the lessons learned include:

- Not only do we know that the poor desperately need credit and can borrow on terms on which the MFI can lend profitably; we have also learned that the poor are eager to have convenient savings and insurance services. By providing these services, MFIs can create new and sustainable sources of capital and at the same time mitigate their risk as lenders. Regulatory support for these activities is rare but critical to the continued if not accelerated growth and sustainability of MFIs.

- Microfinance is perhaps best thought of as a platform, rather than simply as another intervention. It creates an infrastructure where the poor, previously seen as isolated and without material assets or social capital, can be mobilized in large numbers and provided finance to participate in economic and social initiatives. Critical mass can be achieved and brand loyalty engendered much faster when operating through the microfinance channel.

Creating a network of poor and formerly poor families with convenient access to financial services allows them to participate in social and commercial schemes in large numbers, either as vendors or consumers, or both. For example, the Grameen Bank joined with Telenor of Norway and established a mobile telephone company in 1997. Today, 45,000 Grameen borrowers in 45,000 villages (two-thirds of Bangladesh's total) have taken loans to buy mobile phones and establish pay phones serving their villages. They do so profitably – for themselves, for the Grameen Bank (the lender), and for GrameenPhone, which, providing the infrastructure and the service at a wholesale rate, earned a $45 million pre-tax profit last year. Grameen Foundation USA's Grameen Technology Center has just launched a replication of this project in Uganda. Another company, Grameen Kalyan, has opened 15 health clinics alongside Grameen Bank branches and has allowed borrowers to have a yearly insurance premium of under $2 automatically deducted from their savings accounts. This initiative has produced improvements in public health. Moreover, the clinics have achieved 70 percent cost recovery in a few years' time and expect to break even before long.

• Governments have an important role to play in microfinance. But they should not focus on providing microfinancial services to the poor directly because such action tends to be politicized and inefficient. Rather, they can create supportive regulatory frameworks and allocate financing to MFIs through wholesale funds or other mechanisms that are not subject to politicization. The case of Morocco is instructive. In 1997, it was one of several Arab nations whose microfinance sector had total outreach of about 10,000 clients. By instituting a series of mostly supportive regulatory measures and allocating $10 million through the Hassan II Fund, the Moroccan microfinance sector leap-frogged Egypt (which had led the region in outreach and other indicators) and passed the 200,000 client mark in 2002. During the same period, Lebanon and Jordan, for example, experienced very modest increases, if any, in their sectors' outreach. Similarly, the level of microenterprise development in China is hampered largely by the lack of a supportive regulatory environment, according to a recent paper issued by Grameen Foundation USA. (See http://www.gfusa.org/chinareg.htm). A summary of GF-USA's recommendations for creating a pro-microfinance regulatory regime can be found at http://www.gfusa.org/gbrp/whitepaper.htm.

Information and communications technology has a critical role to play in the recent and future growth of the microfinance sector. Automation of the microfinance process, which traditionally was done manually, has tremendous potential to increase efficiency as well as reduce the scope for error and fraud among loan officers, of which Grameen Bank alone has more than 7,000. Technology can also be a tool to allow the poor to create more profitable businesses, as the GrameenPhone case clearly suggests. Finally, standardizing data transmission protocols will make it more transparent that the poor and the institutions that serve them are good credit risks. In turn, private capital markets will increasingly invest in microfinance on a commercial basis, particularly in nations such as India where there are regulatory incentives to invest in anti-poverty programs. It has now been clearly shown that microfinance can have a major impact on poverty at the microlevel and at the national level but only if policy-makers and others – mainly government officials (especially banking regulators) and private and public donors – make it a priority. If they choose to do so in a manner consistent with best practices, they will be seeding an industry that can sustain itself without indefinite subsidies and that can work synergistically with other poverty-reduction efforts. Perhaps no better investment can be made in reaching the Millennium Development Goals and achieving a measure of true security – in the broadest meaning of the word – for all in our lifetimes. ❑

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