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SWP 17/94 MICRO-CREDIT - THE BENIGN PARADOX

**Professor MALCOLM HARPER
Enterprise Development Centre
Cranfield School of Management
Cranfield University
Cranfield
Bedford MK43 0AL
United Kingdom**

Tel: +44 (0)1234 751122

Fax: +44 (0)1234 781806

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MICRO-CREDIT - THE BENIGN PARADOX

Introduction

Poverty alleviation is about re-distribution, about sacrifices by the rich and about cross-subsidy; how can the poor be a profitable market, and if they ever are, how can their purchases be profitable for them as well as for whoever is selling to them ? In most fields, such as health, education and basic foodstuffs, we have to accept that the late Tom Lehrer's dream of 'doing well while doing good' is just not possible, and that is why we have foreign aid, voluntary organisations, taxation and the whole apparatus of non-commercial transfers of resources.

Those of us who live by this 'trade' must recognise that our work can never in itself solve the problems of the poor; what we can and must do is to search whenever possible for methods of delivering services which the poor can afford and will enable them to become less poor, and can at the same time ultimately be profitable businesses. Only then will it be possible for the services to be made available on the massive scale that is necessary for them to reach all the people who need them. Then the market will be able to take over and we shall achieve the ultimate goal of any assistance agent, which is surely to be redundant because of his own success.

Lending money to poor people to enable them to increase their incomes through micro-enterprise, which has become known as 'micro-credit', may be one activity where this goal has been demonstrated to be possible, where everyone can benefit, where nobody is the loser, and where enlightened self-interest can coincide with the relief of poverty.

If this was completely true and self-evident, there would be no need to discuss it in a paper of this sort, because the market would have done its job, as it has for soft drinks and so many other items which are widely and profitably marketed even in the poorest places. Perhaps, however, we are confronted with quite new approaches to financial intermediation. These approaches are based firmly on traditional practices, but they appear radical and unprofitable

to the formal institutions which must adopt them if financial services are to become widely available to everyone.

I propose in this paper briefly to describe some examples of profitable or at least cost-covering micro-credit, which exemplify a variety of ways of achieving this desirable but so often unattainable goal of benefiting everyone. These cases are only a small sample of the many quite different methods which are being tried, in different countries. It may however be possible to identify some common features in the successful provision of reasonably priced financial services to poor people, to suggest some of the reasons why these financial methods have not been more widely adopted by existing banks, and to recommend ways in which their reluctance may be overcome.

One approach uses a rather rigid form of group facilitation, another adopts a system akin to venture capital, where the lender shares in unexpectedly good returns but also shares the losses when borrowers' businesses fare worse than was hoped, and a third uses modern cash handling technology and a 'mass-production' approach to lending. The fourth method, which is still in its infancy, involves lending to pre-existing community savings and credit groups, who on-lend the money to their members. They have been deliberately chosen in order to demonstrate the wide variety of ways in which the same goal is being achieved. They all, however, charge what appear to be very high rates of interest, and they reduce transaction costs and increase repayment rates in innovative ways so that they can be genuinely self-sustaining.

The Problem and the Opportunity

There are in the poorer parts of the world, and in richer ones too, large numbers of men, and many more women, who are presently working very hard indeed for tiny rewards, or are not working at all because the returns available barely cover the cost of renewing the energy they might expend. These people can enormously improve their lot if they have access to very small amounts of capital, which is presently not available to them from formal institutions.

Such people are denied access to capital for what appear to be very good reasons; the transaction costs of dealing with a loan, or of accepting savings, are similar, regardless of the amount of money lent or saved, and poor people, by definition, do not have collateral in case of non-repayment. It is therefore unprofitable to lend them money, and impossible to recover it if they will or cannot repay. It is hardly surprising, therefore, that commercial banks, everywhere, have failed to satisfy the financial service needs of the poor.

The returns that can be earned on these tiny sums would themselves be the envy of the world's financiers. This is not because the sums of money are large, but because small amounts of capital can enable poor people to earn something closer to a decent return for their labour. The capital is tiny, and the returns are also tiny in absolute terms. but they are often astronomic when expressed as a percentage of the capital.

Sadly, the opportunity cost of these people's labour is low or even non-existent, so that the whole of the increased earnings can be expressed as a return on the sum invested. It is very rare indeed to find a real micro-enterprise where the annual return on the capital invested is less than one hundred per cent, in real rather than nominal terms, and figures of several thousand are not uncommon. It is important to stress again that the sums involved are so small that the returns are still miserable in absolute terms, but relatively they are enormous. In this lies the opportunity.

The following table gives a few real-life examples from various countries; readers will be able to add similar cases from their own experience.

Business	Existing earnings per month	Additional capital needed	New earnings	Addition to earnings	Monthly return percent
Egg Vendor	\$50	\$20 to avoid money lender	\$75	\$25	50%
Barber	\$100	\$25 for new chair	\$110	\$10	10%
Tailor	\$60	\$50 for cloth for ready-made	\$80	\$20	33%
Rickshaw Driver	\$30	\$200 to buy own rickshaw	\$36	\$6	20%
Puffed Rice Maker	\$10	\$40 to buy own raw material	\$20	\$10	100%

Even higher incremental rates of return can be earned by people who are presently not earning at all, and who can start a micro-enterprise if they have access to capital. It is self-evident that the returns, in percentage terms, are in inverse proportion to the amounts involved. It is all too well-known that the poor pay more than the rich for most services, such as water, staple foods and even education and health care. In the case of capital, however, they also earn more, proportionately, on the meagre amounts they need for petty income-generating activities; this suggests that they can pay more for their capital, and indeed they do. Poor people can obviously not afford to pay more than the rich for the necessities of life, even though they often have to, but the above figures show that they may be able to afford to pay a high price for capital. It appears paradoxical, but credit may be one thing for which the poor may be able to pay more than the rich.

Money lenders are of course the main suppliers of money to the poor. They do it as straight lenders or as traders who bind outworkers to them by supplying raw materials on credit or by advancing money against forthcoming crops. The rates of interest they charge are notoriously high, but it is nevertheless unusual to find moneylenders living in palaces; the risks are large, the scale of the activity is small, and they have to provide a close, personal and therefore costly

service both to satisfy their customers' needs and to minimise their own losses. In some countries moneylenders also have to avoid or buy off the law, since usury is illegal, and this adds a further premium of illegality to the price of the capital they provide.

The high returns on capital earned by the poor mean that they can afford to pay the very high rates of interest demanded by moneylenders, even though these rates often reduce their own earnings to a pitifully low level. If the only way genuinely to satisfy the capital needs of the poor is through the kind of service provided by moneylenders, then viable lending to the poor must be extortionate, and their high returns must be shared with their informal bankers. Is there any way in which the poor can have access to credit at more reasonable rates, which are still sufficiently remunerative to the lender to allow the business to be viable and thus to expand beyond the modest scale permitted by subsidy or charity ?

Some Examples of Institutional Micro-credit

There are of course many local groups and voluntary organisations which have established micro-credit programmes which cover some part of their operating costs from interest earnings, but these generally operate on a local scale. They may reach a few hundred or a few thousand people, and some succeed in covering most of their costs, but the overall impact is very small. Only when this market is addressed by the existing commercial banks, or by new lending institutions established for the purpose, will the benefits become available to more than a tiny fraction of the vast numbers of people who need them.

There are in fact some specialised institutions which are taking advantage of this benign paradox of the poor being able to pay more, and which have enabled very large numbers of poor people to extricate themselves from the lowest levels of poverty. The best known example is probably the Grameen Bank in Bangladesh, which is lending small sums of around

sixty dollars, and recovering about 98% of them, to over one and a half million people, of whom 96% are women.

In Indonesia, over three million relatively poor rural people are now able to access from commercial banks the small sums of capital they need at an affordable cost. In Sudan, surely one of the world's most troubled economies, the banks are using with the traditional Islamic principles of risk and profit sharing finance by working in partnership with poor people, again mainly women, to the mutual benefit of both parties.

Opinions differ as to the meaning of the word self-sustaining. A service must however cover its operating costs and the cost of the money it lends, or at least that part of this money that is borrowed from the client group or from unsubsidised institutional sources, before it can be made widely available beyond the scope of aid, charity or subsidy. In order to allow readers to judge for themselves as to the viability of some of these institutional initiatives, we shall present summarised financial data for typical branch operations of three very different organisations which claim to have attained self-sustainability. These cases should also serve to give some idea of the very different methods of operation which can be employed to achieve the same objective, namely self-sustaining financial services for the poor.

The Bangladesh Rural Advancement Committee (BRAC)

The Grameen Bank is certainly the best known micro-credit institution in Bangladesh, and perhaps in the world, and its methodology has been widely imitated, not only in Bangladesh and other poor countries in Asia and Africa, but also in the somewhat less likely circumstances of Chicago, New Hampshire and elsewhere in the United States. Grameen Bank is only one of many institutions providing financial services to the poor in Bangladesh, however. BRAC is serving over four hundred thousand people, of whom the majority are women, and it differs

from Grameen in that it also offers a range of other services, particularly primary education and health care, as well as savings and credit.

BRAC's management have taken the decision to transfer its banking operations to the newly established BRAC Bank, branch by branch, as they reach self-sustainability. Ultimately, it is hoped, this bank will not only cover its own costs but will earn a profit which can help to pay for the other services which can never completely pay for themselves, such as village primary schools or health clinics.

The BRAC branch in Gazaria, an island community in the delta area some fifty kilometres from Dhaka, is typical of the longer-established branches which are becoming eligible for transfer to the new bank. The branch has a staff of 23 people of whom 15, including the manager, are mainly engaged in the savings and credit operation, which serves 6450 clients. The clients are organised into 129 groups with an average of some 50 people in each; 92 of these groups are for women, and the other 37 for men. The other branch staff supervise the 77 primary schools and other BRAC activities in Gazaria.

In order to be eligible for credit, the group members have to complete a 30 days conscientisation training course, and they have each to save a minimum of five cents a week for six months, in order to demonstrate their commitment and loyalty to the group. Since only the poorest people are allowed to join, whose families have less than half an acre of land and thus depend on wretchedly paid day labour for most of their income, even this weekly savings requirement involves a significant sacrifice.

Each group holds a meeting once a week at a predetermined time and place, and a BRAC staff member attends to collect the savings and any repayments, and to listen to orally presented loan proposals. If these are approved by a majority of the group members the BRAC worker submits them to the Branch manager; if he approves, the loan is disbursed to the

borrower after fifteen days at most. Five per cent is deducted from the loan at the time of disbursement for credit to the borrower's savings account, and a further four per cent is deducted for a group emergency trust fund,

The groups are jointly and severally responsible for repayment, and overdue amounts can be charged to these funds, but this rarely occurs, since members virtually always recover overdue accounts by one means or another. If their fellow-member is genuinely unable to repay, they may decide to pay on her behalf or to deduct the amount from their trust fund.

The BRAC clients use their loans to finance a wide range of activities, such as petty trading, rice processing, short-term farming ventures, often on land which is temporarily leased for the purpose, and goat and cattle purchase. The sums are small, as are the returns, but in percentage terms they are more than enough to enable the clients to pay the high rates of interest which are necessary to cover the very labour-intensive banking operation, and the surplus is enough to make a significant difference to the borrowers' standard of living, even during the period of repayment.

In November 1992 the financial position of the BRAC Gazaria branch was approximately as follows: the figures are expressed in US dollars at the rate of 60 Bangladeshi taka to \$1.00; the totals appear small, but many rural people in the position of BRAC clients earn as little as twenty cents a day.

Assets		Liabilities	
Cash at bank	\$ 1100	Members' Savings	\$ 63300
Loans to Members	\$ 135000	Group Trust Funds	\$ 16700
Bicycles and eqpt.	\$ 1700	Funds from Head	
Land and Building	\$ 18900	office	\$ 76700
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Total	\$ 156700		\$ 156700

The BRAC Gazaria branch maintains a current account at a nearby public sector commercial bank, from which it can avail of overdraft facilities when necessary. The members pay interest on their loans from BRAC at an annual rate of 20%, on a declining balance basis; the total of 9% deducted at disbursement for their savings and trust funds, plus an additional 1% life insurance premium, mean that the real cost of the funds to the borrowers is well over thirty per cent. No charge is made by the BRAC head office for the funds which are needed by branches over and above their members' savings and trust funds, but a 6% annual cost is shortly to be introduced in order to cover head office banking administration charges.

The current annual operations of the Gazaria branch can be summarised approximately as follows:

Interest Income	\$ 25200
Interest on members savings and trust funds @ 9%	\$ 6000
Wages and Salaries	\$ 13100
Travel and allowances	\$ 1500
Maintenance & Depreciation	\$ 2000
Total	<u>\$ 22600</u>
Profit	\$ 2600

This profit will cover rather more than half of the six per cent charge for Head Office funds; greater reliance on members' own funds would of course increase the deficit. BRAC management are however confident that the Gazaria branch, as well as most of the other longer established branches, will soon achieve genuine profitability, in spite, or perhaps because, of their deliberate concentration on the poorest clients. The BRAC capital fund is being eroded by inflation to the extent of approximately 10% annually, but increases in members' deposits are maintaining and indeed increasing the real value of total funds available at a considerably faster rate than this.

The Sudan Islamic Bank

The Koran explicitly prohibits lending money at interest; profitable trading, however, is recognised as being perfectly legitimate, and Mohammed himself is said to have started his career as a trader, financed by a wealthy widow who later became his wife. Their dealings, however, were on a profit sharing rather than a fixed interest basis.

We are today familiar with venture capital as a means of financing new and growing businesses, but this form of investment has only recently been introduced in the less developed countries, and then only for larger formal ventures. The 'Musharaka' or partnership variant of Islamic finance is being used by the Sudan Islamic Bank to provide capital for very small ventures indeed. It is in addition protecting the bank from the worst of the effects of inflation, which is currently running at something between one and two hundred per cent per year in the Sudan.

The Bank has been engaged in partnership financing of very small-scale enterprises for some years. Until recently they have concentrated on rural activities, such as potato cultivation and poultry production; in some cases the bank has been an active partner, assisting with the supply of inputs and services, and the marketing of the crops. This experience has been generally satisfactory, and because the bank's share of the profits is calculated as a proportion of the final profits, rather than being related to the original investment, the returns have been automatically corrected for inflation.

More recently, however, the Bank established a special branch in one of the poorer areas of Omdurman, the original capital of Sudan which is in fact much larger than Khartoum, the adjacent colonial capital on the other side of the River Nile. The population of the city has been enormously increased in recent years by the influx of refugees from Sudan's troubled neighbours, and by Sudanese people who have had to leave rural areas because of long periods

of drought. This first specialist branch has been opened because the Bank wishes to serve these people, in order to reach a new and profitable market and to fulfil its social obligations. They have already decided to open six similar branches in other parts of the capital and elsewhere, because of the immediate success of the initial pilot.

Each partnership is based on an agreed estimate of the likely profits. Some partnerships, particularly in agricultural or trading businesses, are based on one transaction. The bank and the client agree on a reasonable reward for the client's labour and management, and the balance is divided in the same proportion as the two partners' investments. If the venture fares better than expected, or if prices have risen because of inflation, both share the higher surplus, but if the venture does not go as well as it was hoped, they get less. If it fails altogether, both partners lose their investment and the client loses his labour as well, but he is not additionally burdened by a loan obligation as he would be under 'Western' banking practice.

Partnerships in on-going businesses are similar, except that the bank, and the client, do not automatically recover their investment; the bank remains a partner, and continues to receive its agreed share of the surplus, after allowing for the labour and management of the client. The client is free to buy out the bank's share, at its original cost, after an agreed period which is long enough to allow the bank to earn a reasonable return on the transaction.

The branch has been in operation for just one year, and its current financial position can be summarised as follows: (the figures are expressed in US dollars converted at the rate prevailing in January 1993; the total sums appear very small, but it should be remembered that many people in Sudan earn less than one dollar a day)

Assets		Liabilities	
Partnership investments	\$ 54000	Customer Deposits	\$ 176000
Other investments	56000	Bank's original investment	16000
Furniture and banking eqpt.	16000		
Stocks of machinery	65000		
Cash	1000		
Total	<u>\$ 192000</u>		<u>\$ 192000</u>

The 'other investments' are effectively loans, made on the basis of one of the other Islamic financing systems, whereby the bank buys an asset and then resells it to the client at a disclosed rate of profit. The sale price is paid back to the bank according to an agreed schedule, so that this in effect differs very little from conventional banking. Because of the high and unpredictable level of inflation, the Bank is now focusing on risk sharing partnerships, and few further purchase and re-sale investments are being made.

The Bank intends this branch to be self-sustaining not only in terms of earnings but also in terms of matching its deposits with investments, or credits; the branch has therefore invested the surplus deposits in sewing machines and other similar items of capital equipment which its clients use. These will be used for future investments, and the bank is protecting itself and its clients from inflation by holding its assets in readily marketable equipment rather than in cash or other financial instruments.

The operations of the branch over its first year can be summarised as follows:

Income from Investments		\$ 32000
Wages and Salaries	\$ 9600	
Rent	\$ 2400	
Depreciation	\$ 9880	
Total	\$21880	
Total Profit of branch		\$ 10120
80% payable to depositors		\$ 8096
20% retained by Bank		\$ 2124

The Bank actually re-invests its own share of the branch's profits in welfare services in the community, such as health and education, but this is in the nature of an initial goodwill gesture. The profits on the Bank's original investment in the branch are considered more than adequate, particularly in the first year of operation, and it is planned to extend the experiment more widely in the near future.

The Bank is financing about 400 people. Two hundred and sixty of them are investment partners, or borrowers as they would be called in a traditional bank, and 80% of them are women. The bank has invested an average of around \$150 in each venture. Most of these partners are also depositors, and there are also two hundred additional depositors who are not also using the bank as a source of finance. The partners are involved in a typically wide range of petty urban enterprises; about sixty of them are tailors, and others are manufacturing processed foodstuffs, shoes, school chalk, cheese and wood and metal furniture. Yet others are raising goats or poultry, and many other partners are involved in petty rural trade.

So far, there have been no defaults. This does not mean, of course, that every business has been a successful investment; since payments to the Bank's by its partners are dependent on business profits, there is little incentive for the partners to conceal their problems from the bank, and the danger may be that they may pretend that their results are worse than they really are. The Bank is directly involved in some of the partnerships, particularly when they depend on scarce raw materials or other inputs which can only be accessed on a large scale through contacts with senior officials.

The Bank has a total of ten professional staff, of whom seven are women. This includes three field staff, and three other customer service staff in the office, who maintain regular contact with the partners. They keep control accounts for each partnership at the branch, including those businesses whose owners are illiterate and therefore maintain no accounts for themselves, and disbursements of working capital are made only as needed; this ensures that

the Bank is kept aware of the current operations, and it also limits the Bank's exposure if things start to go seriously wrong.

This success of this method of financing micro-enterprise may to an extent be related to the fact that Sudan is very much a shortage economy, where individual business people need the intercession of a large and powerful partner such as the Sudan Islamic Bank, the second largest in the country, in order to have access to many facilities. The partnerships also benefit from the traditional Sudanese attitude to trust; the relationship between a lender and a borrower is clearly less equitable than that between two partners, however different they may be in size and financial strength, since partners share both gains and losses. It is all too easy to suggest reasons why a system that operates in one society will not operate in another, but there are aspects of the Islamic Musharaka system from which everyone can learn.

The Banco Nacional de Comercio Interior - Mexico

The Banco Nacional del Pequeno Comercio (National Bank for Small Traders), which is now known as the Banco Nacional de Comercio Interior (BNCI), or National Bank for Domestic Commerce, was set up by the Government of Mexico in 1943. Its task is to provide credit to small-scale traders, in order that the many people engaged in these fields could benefit from institutional credit.

In 1988 there were some 640,000 separate trading businesses in Mexico. There were a small number of chain stores and other large firms, but the vast majority were very small enterprises, providing work for around two people each, including their owners. By 1993 BNCI was extending credit to some 85,000 separate establishments, or over ten per cent of the total market.

BNCI now has 135 branches, 27 of which are in the capital city, while the others are in smaller towns elsewhere in the country, and it employs just over 3000 people. In addition to the loans for small-scale traders which make up the bulk of its business, BNCI also lends a small proportion of its portfolio to larger firms so that they in turn can advance credit to smaller firms.

Banpeco has always endeavoured to reduce its transaction costs. One approach has been to appraise loans more on the basis of the market in which clients are tenants rather than on a client by client basis. The Bank has over time developed formulae for the amount of capital that each type of trader needs. The amount varies according to the size and location of the stall, which affects the volume of sales achieved, and the type of goods traded. The credit which is offered varies accordingly.

Banpeco has also reduced appraisal costs by changing from term lending to a system of overdrafts; each business can draw up to a maximum amount on demand. Interest is calculated daily on the amount outstanding. The rate of interest is 34% per year, which is about 4% higher than the rate charged to larger borrowers by other banks. When a client's account is in credit, interest is credited by Banpeco at an annual rate of eight per cent.

Another more recent approach to reducing transaction costs is by using a credit card system and automatic cash dispensers. Clients are given a card which can be used to withdraw cash up to their credit limit from the numerous cash dispensing machines which have been installed by many banks, particularly in Mexico City. The machines can also receive cash, so that clients can pay into their accounts through them as well, and although Banpeco pays a fee of 3% of each transaction to the bank which owns the machine this is less expensive than the cost per transaction over the counter at a branch.

Banpeco pays interest of between 12% and 15% on deposit accounts, depending on the term, and 8% on passbook savings accounts. Clients used to be required to accumulate savings to a level of 10% of their proposed credit line as a condition of borrowing, and to retain this amount, but some traders complained that this was unfair in that they had better uses for their money. Banpeco therefore dropped this requirement, and clients are no longer compelled to save before being allowed to borrow, nor are they required to have savings accounts.

In its early years the Bank based its branches in stalls in the public markets themselves, because this was inexpensive and very convenient for their clients. This practice has since been discontinued, because the stall spaces were very small, security was difficult, and an increasing number of clients were not operating within the market, but were occupying shops outside. They were reluctant to do their banking in the market but the market stall tenants did not mind crossing the street to a bank branch outside.

The Merced Branch of BNCI is situated across the street from the central vegetable market; this is the largest market in Mexico city, and has over 4000 stall holders selling vegetables alone. The main business of the branch is with these stall holders; they own the right of occupancy of their stalls, subject to regular payment of their very modest rents, and BNCI has an agreement that if a customer defaults on a loan the bank has the right to seize and dispose of the stall in order to recover the amount due. The Merced branch has only once exercised this right in the last few years; their field staff visit clients who are in arrears as soon as the position becomes evident, and they usually pay after some discussion and simple advice. Those who do not wish to continue their businesses can sell their stalls, and the proceeds are always sufficient to pay back any outstanding instalments to BNCI.

The procedure for extending credit is more or less the same at any branch; the bank's staff do a detailed study of the market, assessing a sample of traders in each category of goods in order to assess the capital requirements. Individual traders then apply to the branch; there are 20

staff working there and one of the three field workers briefly visits the client at his or her stall in order to check that it falls more or less into the previously calculated norms, and if all is well the account is opened with a credit limit up to the prescribed amount. The limit can be increased either because of inflation or when the trader can show that his business has increased so that he needs a larger facility.

The Merced branch was at the end of February 1993 extending credit to 2325 clients, of which ten were classified as non-performing accounts because their repayments were three months or more in arrears. About half the clients are women, and many of the businesses are run by husband and wife teams. The average loan is about \$1300, but the 2000 market stall holders are borrowing an average of little over \$300 each; the higher average is caused by a few larger accounts held by wholesale traders operating outside the market.

The Merced branch is one of four in the same area of the city. The area office is located in the same building as the branch, but the branch manager has a reasonable degree of lending discretion up to a certain limit; an approximate balance sheet for 31 12 92 and profit and loss account for the month of December are as follows:

Assets		Liabilities
Cash	\$ 17,000	Customer Savings and Deposits \$ 4,520,000
Current Loans	3,026,000	
Overdue Loans	124,000	
Equipment	5,000	
Deposit to HQ	1,348,000	
Total	<u>\$ 4,520,000</u>	<u>Total \$ 4,520,000</u>

Profit and Loss Account for December 1 to 31 1992

Interest on Current Loans	\$ 88,000
Interest Paid on H/O deposit	20,000
Other interest	15,000
Commissions	10,000
Other Income	18,000
Total Income	\$151,000
Interest paid on Deposits	\$ 58,000
Net Income	\$ 93,000
Operating Costs	23,000
Administrative costs	41,000
Depreciation	5,000
Total Costs	\$ 69,000
Net Profit	\$ 24,000

Lending to Groups

Some commercial banks however, notably in India, have identified an approach whereby they can reach out to this market, and can at the same time pass on part of the transaction costs to existing intermediaries. They are taking deposits, and lending money, through new or preferably existing community groups, which act as genuine retailers of the financial services. Unlike the groups used by the BRAC or Grameen Bank systems in Bangladesh, these groups actually borrow money from the banks to supplement their own savings, and then on-lend it to their members, usually on terms and for purposes which they themselves determine, without reference to the bank which provided a part of the funds.

In some cases the groups are assisted or even initiated by NGOs, and Myrada in Karnataka and Tamil Nadu, and others elsewhere have played a major role in this initiative. In other cases, however, the banks or other lenders have made contact with existing groups, usually of women, and have extended substantial loans to them after only a rather brief appraisal, which focuses not on the economic activities undertaken by the members but on the 'track record' of the group in its micro-banking' activities with its own members' funds, and its apparent cohesion.

The lender may take a lien on a proportion of the groups' own savings, which have to be held on deposit in the lending banks and may be drawn on in case of arrears. Although such operations are relatively recent, so that it is too early to draw final conclusions, it does seem to be possible to achieve close to 100% on-time repayment from the groups, with low transaction costs for the lender, and no other intermediary NGO or other expenses.

The Kenya Rural Enterprises Programme has some three years of comparative experience with this form of lending and with the more structured and far more expensive Bangladesh approach; to date, they have concluded that it is far more profitable to lend to groups for on-lending, rather than to use them only as first line collectors and appraisers, and they are vigorously expanding this form of lending as a basis for long term unsubsidised operations.

It is not yet possible to produce a segregated set of accounts to show the financial impact on the lender of this fourth type of micro-credit in the same way as for the first three examples, since one of the main merits of this approach is that it can easily be fitted into normal branch banking operations. This means that it is not as easy to separate out the revenues and costs as when a separate specialised operation has to be set up.

KREP, although they are not a bank, and they cannot take deposits and do not have to cover the costs of their funds, have carefully monitored the results of lending to pre-existing groups, under what they call their 'Chikola' programme. They had by mid-1994 disbursed funds to some 180 groups, over a period of three years. Not one payment from the groups to KREP has ever been even one day late, and the income from interest charges on these loans has been almost three times the management costs. The surplus would approximately cover the cost of funds if KREP had to borrow from commercial sources. It is clear that the transaction costs are far lower than for individual loans, because only one bulk loan is made and the costs of on-lending are borne entirely by the group.

When commercial banks make this type of loans to groups they do not have to charge higher rates of interest than for their traditional loans, because the bulk loan to the group is for a reasonably large amount; the final borrowers pay far higher rates for their loans from what is in effect their own bank. The bulk lender has no control over the on-lending rate, and many such groups charge themselves as much as five percent or more per month. They know very well that the returns on the capital invested in their micro-enterprises allows them to pay these rates, and the interest payments can be credited to their fund, to allow them to make more and bigger loans in the future, and to provide backing for increased bank loans if they need them.

Common Features

These four systems, and the many others like them, have achieved remarkably high rates of recovery, which contrast very favourably with traditional government or donor sponsored poverty oriented loan schemes. The proportions of non-performing loans are also far lower than those experienced by many international commercial banks in the sovereign or property based lending portfolios; on time repayments of less than 95% are unusual, and some programmes have attained 100% repayment over one or two years.

The systems are very different from one another, but they share certain features. They all involve higher than so-called 'commercial' or 'market' rates of interest; the comparison is however unreal, because their clients do not have access to loans at 'market rates', as these are normally understood. For them the alternative market for credit is the moneylender, and these rates are far lower than they are used to paying from such traditional informal sources.

Most of these programmes also serve far more women than men. This is not usually because they set out to reach women in particular, but because women repaid better, and women generally respond more favourably to the group or community based methods which are often employed. Women are often treated as a weaker group who need assistance more than men;

this is certainly true in the case of access to traditional institutional credit, but in the area of micro-credit, their performance has shown them to be stronger. A programme with a majority of women clients, or one with only women, is more likely to achieve self-sustainability more quickly than one with a majority of men.

Most micro-credit systems achieve sustainability not only by charging apparently high interest rates, but also by shifting part of the transaction costs onto the borrowers, through groups or other means. This reduces the lender's costs, and it also improves the quality of loan appraisal, supervision and collection, since the borrowers' own neighbours are generally far better at the details of loan management in the field than are even the best trained bankers.

This delegation can of course be dangerous, unless the group to whom the functions are delegated has the capacity to undertake them. As micro-business people and members of their communities, the members are likely to have the necessary knowledge and skills, but community groups can easily be 'hijacked' by local vested interests.

Well designed micro-credit systems automatically discourage better-off people who might want to exploit them, since the loans are small, the interest costs are high and regular weekly meetings, with fixed savings requirements, are tiresome. One of the strongest arguments for self-sustainability, in fact, is that credit, like any other product or service, is only likely to be exploited if it is subsidised.

The Constraints to further Adoption

These are only four examples of large scale cost-covering micro-credit, and there are several others, but they are still only isolated islands in a general sea of unrelieved poverty. Institutional micro-credit, in one form or another, may not be as profitable for its suppliers as cola drinks, but it does appear to have the potential to benefit poor people, with little or no

subsidy, and to help millions of needy families to avoid some of the harshest effects of economic change. Large numbers of voluntary organisations are learning from what has been achieved and starting their own programmes, but their outreach is limited and their strength lies in their ability to do things which can never be profitable.

The commercial banks, on the other hand, are in the business of financial services, they have large and often under-used branch networks, in rural and urban areas, they are often already generating substantial deposits from the savings of owners of micro-enterprises, they need new profitable business and they need to demonstrate their commitment to equitable development; why have they not enthusiastically grasped this new market, for their own and their clients' benefit, and how can their reluctance be overcome?

The railways allowed the airlines to take away their long-haul passenger business rather than starting their own airlines, and IBM was too late to appreciate the significance of the personal computer; market leaders rarely perceive the future realities of their businesses, and commercial banks may be no different. There are also some particular features of many successful micro-credit programmes which may help to explain why they have not been more widely adopted by bankers.

They are essentially 'bottom-up' as opposed to 'top-down' initiatives, usually with a firm base in traditional informal savings and credit systems. The clients have a strong sense of partnership with the institution, they are from the poorer sectors of the population, by design, and they are mainly women. The transaction costs are also inevitably high, so that the viability of the programmes depends on interest or other charges which are far higher than normal.

It is hardly surprising that most bankers regard services to the poor as a public relations or social responsibility exercise, which must of necessity be subsidised by mainline business, and must therefore be limited in scope. High charges are clearly inconsistent with this view, and

few bankers are willing to introduce a form of business which deliberately excludes any but the poorest customers, and then requires that they should be charged an apparently extortionate price. It would seem bound to be at the same time a repayment and a public relations disaster.

Banks also have few links with traditional systems, and are perceived by most poor people as alien institutions, whose services are mainly for the rich. Their main role in colonial times was to take savings from the rural poor and to lend them to the urban rich; some poor people have savings accounts with banks, but current accounts, overdrafts and loans are as unfamiliar to them as the idea of lending them money is to the bankers.

The Way Ahead

There appear to be a number of different approaches, whereby very small amounts of loan funding can be channelled to poor people, and recovered from them, in a way which allows them substantially to improve their own livelihoods and which also allows the financial institution to cover the costs, including the cost of funds, and even to make a modest profit to develop a substantial equity base for future unsubsidised expansion.

The case studies have not addressed the issue of start up costs, and most programmes are not making a proportionate contribution to head office costs, but they do appear likely to be able to do so in the near future. Although none of the micro-credit programmes appears likely to be able to pay a dividend on the initial capital invested in it, it does seem to be possible for such programmes to achieve sustainability, and growth, provided they are capitalised at a sufficient level to enable them to access other funds, and to offer reasonable security for their clients' savings.

Like soft drinks or cigarettes, financial services can apparently be distributed through numerous alternative channels, and each producer has to select the most appropriate

'marketing mix' in relation to the particular consumers he wishes to reach. Credit is presumably at least as desirable a product as most fast moving consumer goods, and commercial bankers should surely view micro-credit not as an matter of charity, or of officially prescribed lending targets, but as a vast and largely untapped market opportunity.

If this change of attitude can be achieved, the banks themselves will be able profitably to expand their deposit base and their advances, and the vast mass of the presently 'unbanked' will be able to benefit not only from the substantial material return on their investment, but also from the genuine sense of empowerment which can come from access to capital not as charity but on a commercial basis. There are few mass-market opportunities where every party can gain so much.

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