Microfinance: A Comparative Analysis of Varying Contexts, Current Needs, and Future Prospects between Developing and Developed Countries

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A Thesis

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ABSTRACT

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The concept of microfinance has been widely applauded and implemented around the world, and is being seen as a panacea for many social ills rooted in poverty. This thesis examines microfinance as the most recent and extremely popular development tool in the international development sector that has believed in standardized solutions towards world poverty since a long time. In less than three and a half decades, microfinance has made its way across most continents with slight variation in models as per the local needs and milieu.

The argument of this thesis is that every country has a unique socio-economic-political-legal context, a unique culture, a dominant ideology, a set of values and governance structure; that poverty in the poor countries and poverty in the rich countries face completely different sets of challenges and threats. The need for financial services and the reasons to administer them may be starkly different in different contexts and therefore the same standard solution, in this case microfinance, may not work everywhere or may even backfire in some cases.

Using three case studies, secondary data, and meta-analysis approach this thesis explores, juxtaposes, compares and contrasts, the main differences in the practice of microfinance and microcredit in developed and developing countries such as India, Bangladesh and United States of America. Based on the arguments presented, this thesis concludes that microfinance is not a ‘one size fits all’ solution to worldwide underdevelopment and poverty; and measures that may work in certain developing countries, may not work the same way in developed countries owing to socio-economic-political-legal differences.
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With the hope of continuing my efforts towards the unheard and the uncared

*Tripti Srivastava*
LIST OF ACRONYMS

ACCION ------------------------ Americans for Community Cooperation in Other Nations
AEO -------------------------- Association for Enterprise Opportunity
AFDC -------------------------- Aid for Families with Dependent Children
AUSA -------------------------- Accion USA
AusAID ------------------------ Australian Government Overseas Aid Program
CBO --------------------------- Community Based Organization
CDBG -------------------------- Community Development Block Grant
CDFI -------------------------- Community Development Financial Institution
CGAP -------------------------- Consultative Group to Assist the Poor
CIDA -------------------------- Canadian International Development Agency
CRA --------------------------- Community Reinvestment Act
CWED -------------------------- Coalition for Women’s Economic Development
DFID -------------------------- UK Department for International Development
EA --------------------------- Emergency Assistance Program
GB --------------------------- Grameen Bank
GDP -------------------------- Gross Domestic Product
GGS -------------------------- Grameen Generalized System
HUD -------------------------- Department of Housing and Urban Development
IBRD -------------------------- International Bank for Reconstruction and Development
IGO -------------------------- International Government Organization
IMF -------------------------- International Monetary Fund
JOBS -------------------------- Job Opportunities and Basic Skills Training program
MDG ------------------------ Millennium Development Goal
MFI ------------------------ Microfinance Institution
NABARD --------------------- National Bank for Agriculture for Rural Development
NGO ------------------------ Nongovernment Organization
PMB ------------------------ Profit Maximizing Business
PRIME ---------------------- Program for Investments in Micro-entrepreneurs Act
ROSCA----------------------- Rotating Savings and Credit Associations
SAP ------------------------ Structural Adjustment Program
SBA ------------------------ Small Business Administration
SDI ------------------------ Subsidy Dependence Index
SEED ----------------------- Self-Employment and Enterprise Development Demonstration
SEID ----------------------- Self-Employment Investment Demonstration Program
SHD ------------------------ Sustainable Human Development
SHG ------------------------ Self-Help Group
SIDA ----------------------- Swedish International Development Cooperation Agency
SIDBI ---------------------- Small Industries Development Bank of India
TANF ----------------------- Temporary Assistance for Needy Families
UN ------------------------ United Nations
UNCDF --------------------- United Nations Capital Development Fund
USA ------------------------ United States of America
USAID ---------------------- United States Agency for International Development
WSEEP ---------------------- Women’s Self Employment Project
WW II ---------------------- World War II
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INTRODUCTION

“It could be a scene from Macbeth. Two women hover over boiling cauldrons, stirring large lumps of curdling blood, impervious to the smoke swirling around them…”

But no, this is a chicken feed business, and boiling blood is the first step… Grace Galus Ulaya, with a manner that befits her first name, runs a small, rudimentary assembly line in her father’s backyard. There she produces dried blood, a nutritional ingredient in chicken feed… She lets the blood boil until it starts to form hard lumps and the juices burn away. When there is no liquid left, she transfers the lumps to a plastic tarp on the ground where she allows them to dry. Once fully dry, she sifts the lumps through a metal mesh sheet to form a grainy mixture. She then measures the dried-blood grains by the kilo, pouring them into plastic sacks. Finally, she sells the sacks to other businessmen, up the chain of chicken feed production, to be combined with other ingredients – crushed bones, corn husks and sunflower seeds.

In June 2009, after being turned down by other banks due to lack of prior credit, Grace secured a loan from ACCION microfinance partner Akiba Commercial Bank for 600,000 Tanzanian shillings (USD $448)… To offset the challenges and bring in more income, she runs a third business, also in her backyard, and this one boiling cow fat to make engine lubricant. The loan from Akiba has contributed to this process too.

Akiba Commercial Bank, a microfinance pioneer in Tanzania, is also helping Grace save money, by requiring that each of its clients have a savings account with them in conjunction with their loan… While 33-year-old Grace still lives at home with her father, mother and older sister, Modesta, she dreams of saving enough money to own her own plot of land one day. And support from Akiba is a step in that long assembly line too” (Accion, n.d.1).

This is a rather dramatic story, a story of doom and gloom, but also a story with a little bit of hope. But there are millions other such stories, the stories of empowerment of millions of poor through access to financial services, providing them with an opportunity to borrow and save such small amounts of money that are negligible and insignificant to most of the people reading this text. This is the story of a poor man’s dream that is finally coming true. This is the story of microfinance, told and retold almost like folklore, and heard with utmost fascination and bewilderment by the world.

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The simple concept of microfinance that involves informal lending practices has existed even before any media of exchange or currency were developed (Elahi and Danopoulos, 2004); but today the term microfinance has revolutionized the developing world and has become almost synonymous with the name of Mohammed Yunus, the 2006 Nobel Peace Prize laureate and founder of Grameen Bank in Bangladesh, one of the largest and best known microfinance institutions in the world.

Mohammed Yunus inadvertently embarked on this famous journey when he met with a poor woman in 1974 from a small village in Bangladesh who made bamboo chairs to earn a humble living. The hopeless woman was left with barely any profit margin after paying the exploitative village moneylender from whom she used to borrow money to buy raw bamboo. Offering a mere total of $27 as a loan to a group of 42 villagers, Yunus began his journey to eradicate poverty and empower marginalized people to become financially independent and lead a dignified life. Continuing with his efforts, Yunus established Grameen Bank in 1983 to offer small loans to entrepreneurs who are too poor to qualify for traditional bank loans. He felt that the main reason why people cannot break away from poverty is because they do not have access to financial services like loans, savings, insurance, and remittance. Apart from having very small or micro financial needs that yield negligible profit margins to the bank, they are considered a big risk as they often lack a security deposit or a guarantor to guarantee repayment of the loan.

In general, microfinance is a very simple concept that mainly entails provision of financial services such as credit, savings, insurance, and remittance to those who are marginalized or excluded by commercial financial institutions because of a lack of collateral and high risk of default. It is estimated that almost three billion people, half the world population, are in need of formal financial services (Christen, Rosenberg, and Jayadeva, 2004). However, while
microfinance has so far proved to be an effective tool in poverty alleviation, it cannot work in every situation effectively (Cheney, 2004). Development process in any given country is highly contextual and depends on various internal as well as external concomitant forces (Sachs, 2005).

For almost a quarter of a century, Grameen Bank and Mohammed Yunus worked stoically in the villages of Bangladesh. However, it was not before the turn of the 20th century, when the rich-poor divide was increasing worldwide and the developmental efforts of the century were found to be more or less ineffective in the developing world, the world finally acknowledged a charismatic leader, an economist and a visionary in Muhammad Yunus. He challenged the top down approach towards development that had prevailed in the world for a long time and advocated the need of financial services among the poor.

At the international development stage, Yunus exhorted that development should be equal, equitable, sustainable, bottom up, and participatory; the poor need opportunity not charity from the world. Today with the support of the likes of Bill and Hillary Clinton, Jimmy Carter and most recently Barack Obama among many other world famous leaders and government heads, microfinance has expanded to a large number of countries around the world. The concept of microfinance and microcredit has indeed come a very long way as many developmental agencies have started to comprehend its essential role in poverty reduction; and financial institutions are slowly realizing enormous economic opportunities in the microfinance domain. The United Nations established Millennium Development Goals have recognized microfinance as a key tool in the eradication of extreme world poverty, and most development organizations and donor agencies have supported the idea.

Due to this sudden increase in popularity of the microfinance services, the central argument of this thesis is that microfinance is not a panacea to the world poverty and is highly
dependent on the socio-economic, political, and legal context of a country. There is an argument to be made that it is not a so called ‘one size fits all’ solution to global poverty. For this purpose three opposing case studies of microfinance practice have been selected to highlight the similarities and differences in the practice of microfinance in developing as well as developed countries. Grameen Bank has been chosen as one of the case studies to illustrate the practices and needs of a poor country’s population. Accion USA, a microfinance institution operating out of New York, is a contrasting case study in the United States that brings out the evolutionary difference of microfinance practices in the U.S. and the unique challenges and opportunities it faces currently. A general overview of the self help group approach to microfinance, a variant of the Grameen model that is successfully practiced in India, has also been presented to develop a better understanding of another very popular microfinance approach. The case studies of Grameen Bank and Accion USA and microfinance as practiced in India bring out the evident differences in the evolution and practice of microfinance in different contexts, and why the same solution would not work for a seemingly similar problem of poverty and underdevelopment.

**The theoretical context**

The idea of a culture and common consciousness where it is believed that every society has a specific logic of development has been debated for a very long time, especially since the birth of a nation state in the French revolution, where the concept of ‘one political state, one language, and one culture’ was first postulated (Austin-Broos, 1987). As culture and ideology have been used as the primary instrument in exploring the beliefs, values, strategies, and
Institutions in a society, many scholars opine that political units must have one culture and set of values, which may be imposed by the society’s elites, if necessary\textsuperscript{2}.

From the thought stated above this thesis draws from the theoretical perspective of constructivism and the Gramscian theoretical ideas on intellectual hegemony to examine the practice of microfinance practices in varying cultural contexts.

Constructivism as a perspective involves ‘deconstructing’ something (Balaam and Veseth, 2008). Most theories and perspectives try to reason out the causality of an event or a specific nature of a state or a society or a market, without paying much attention to the social contexts that went into the construction of these realities\textsuperscript{3}. As a perspective constructivism contends that state preferences and the way it shapes its policies, laws, rules, norms, and institutions point out to its deep rooted values and belief system. States are therefore not just political actors but also social ones, as if they have a mind and soul of their own. This perspective thus tries to explain why states choose different paths to development, adopt specific policies, prefer offensive or defensive or neutral profile in conflict situations and attempt to address similar issues in their own unique ways. And this state behavior is shaped by the beliefs, identities, and practiced norms of the elites of that society. These handfuls of social or political elites create and change the culture through prevalent ideas and practices, and the culture takes a specific shape, structure, and construct with time. Thus constructivism sees power not just in terms of military, economic or political power but also in terms of ideas, culture, and language (Mingst, 2008).

The other related theoretical framework used in this thesis is that of Gramscian intellectual hegemony that explores relationships of power. Antonio Gramsci, an Italian Marxist,

\textsuperscript{2} Ibid
\textsuperscript{3} Ibid
believed that the elites or dominant class in the society maintain their position through two fundamentally different mechanisms – coercion and consent. Use of coercion to maintain power is obvious and self-explanatory but use of consent involves creating an intellectual hegemony. The elites promote the ideology and an official propaganda that supports and legitimizes their position and values, thus creating long term domination by gaining consent among others. By creating a mass consent, no one opposes or challenges their actions or institutions they create and rather support their ideology in agreement. And if someone resists or contests the dominant ideology, hence also the state policies, laws, and institutions, is taken as a deviant and faces persecution. Consent is therefore a far more powerful mechanism of maintaining power than brute coercion (Buttigieg, 1996; Crehan, 2002; Balaam and Veseth, 2008).

Simply put, society creates ideology and ideology creates society (through social agents) in a continuous two way process, and we make the world what it is (Onuf, 1998). The rules of a society or a culture are set by social agents and in return, these rules give these agents goals and choices. Making rules, goals and choices give rise to a pattern of institutions that gives the society a structure and a nature. Indirectly therefore, these social agents give a structure to the society and themselves work within the confines of that structure or construct.

These theoretical concepts of constructivism and intellectual hegemony have been used throughout this thesis to discuss the rise and promotion of microfinance in different societies. The attempt is to not just bring attention to contrasting case studies or their theoretical explanations but also to make some sense of their respective cultural contexts and dynamics.
Methodology

A broad range of secondary data have been collected and analyzed to fulfill the research agenda of this thesis. Annual reports, internal organization documents, and online data were utilized in the case studies on Grameen Bank and Accion USA. In person and telephone interviews were used to enhance the depth of the case study on Accion USA. The case study on the Grameen Bank has drawn significantly from the Grameen Bank website, its online annual reports and statistical figures, two books authored by Yunus *The Banker to the Poor: Micro-lending and the Battle Against World Poverty*, and *Creating a World without Poverty: Social Business and the Future of Capitalism*, and from a book by Hashemi and Schuler *Sustainable Banking with the Poor: A Case Study of Grameen Bank*.

Review of literature published within last few years has immensely added in shaping the arguments presented in this thesis. Many online sources have been utilized, especially in the later chapters, that have proved extremely useful in gathering information on the most recent debates in the arena of microfinance and international development that have not yet been published in many scholarly articles or books.

Overview

In the opening chapter, the thesis briefly traces the rise of microfinance as a popular tool towards development and poverty alleviation in the international development arena. In Chapter 2, the common terminologies used in the microfinance sector have been covered to enable a reader fully grasp the depth of arguments made later in the thesis. In the following three chapters,
three contrasting examples have been presented as an evidence of difference in practice of 

microfinance in the developing and the developed countries not just because of the practice itself 

but also due to its constructivist explanations. The first case represents the post colonial social 

and economic development efforts of a newly liberated nation with abject poverty and 

skepticism towards neoliberal ideologies. The second depicts a nation that was initially 

disconnected from the mainland country and was frustrated with enormous poverty and skewed 

distribution of resources by the national government; that later chose to become an independent 

state but still had socio-economic challenges and natural disasters to address. The third stands for 

a major world power, one of the strongest economies in the world and a strong believer of 

neoliberal ideology. Chapter 6 presents the comparative analysis of these three cases to bring out 

the differences not just in terms of practice of microfinance but also in terms of rationale behind 

promoting it, the differing social construct and underlying values of the respective societies and 

how it impacts everything that they do.

Finally, the last chapter of the thesis brings attention to a shift in not just contemporary 

attitudes towards poverty and development but also shifting terminologies. A mere shift from the 

word ‘poverty’ to ‘marginalized’ or ‘socially excluded’ has forced people to think out of the box 

and innovate new solutions. Inclusive finance, as it is now being called, aims at including 

everyone who was left out by the traditional financial system. Considering the critiques of the 

old microfinance practices, new debates are calling for a concerted effort of all the stake holders 

and interest groups. However, this thesis cautions that once again the socio-economic-political 

construct of a country may impede successful implementation of inclusive finance equally 

everywhere.
CHAPTER 1

RISE OF MICROFINANCE TO THE WORLD’S CENTER STAGE

A BRIEF ACCOUNT

New estimates released by the World Bank in August 2008 indicate that approximately 1.4 billion people in the world live at or below $ 1.25 per day (United Nations, n.d.\textsuperscript{4}). While poverty in itself is one of the biggest challenges that the world faces today, it ramifies into many other serious problems. Many scholars opine that extreme poverty, land maldistribution and landlessness in the world today is one of the major contributors in the rise of global unrest, violence and terrorism; and that a peaceful progressive world cannot be achieved without addressing global poverty (Huntington, 1968; Sachs, 2002; Sachs 2008). Undoubtedly terrorism has become one of the biggest concerns of our time, and while the U.S. alone has approved $ 944 billion for the war on terror since 9/11 (Belasco, 2009), attempts at reducing global poverty in the last century have been minor and incoherent as compared to the war on terror. However, with the emergence of microfinance as the new mantra for global development and poverty alleviation, an invigorated and concerted global effort is being made to answer global poverty once again.

A 2008 United Nation Factsheet\textsuperscript{5} proclaims that microfinance has proved to be an effective tool to increase income, self-employment and empowerment among the poor. With access to financial services like loans and savings, microfinance clients, most of whom are


\textsuperscript{5} Ibid
women, have started micro-enterprises that generate income. Besides, microfinance has also enabled the poor to establish support networks that improve health, education, and in meeting unexpected needs (United Nations, n.d.\textsuperscript{6}).

While microfinance has clearly caught everyone’s attention as an answer to global poverty in the 21\textsuperscript{st} century, its rise to the center stage of world development is a fairly recent event. This opening chapter briefly traces the international attempts at global development and reduction in world poverty in the last century; and how microfinance has emerged as a much celebrated solution towards global development and poverty alleviation.

\textbf{1.1 Previous attempts to address underdevelopment and global poverty}

Poverty and underdevelopment were not the top priority of global governance institutions that were established in the early and mid 20\textsuperscript{th} century that focused on the prevention of next World War, containment of future economic upheavals, and control of communism (Greig, Hulme, and Turner, 2007). The end of WW II with the nuclear bombardment of Hiroshima and Nagasaki brought a sense of urgency to prevent future nuclear warfare and international economic turmoil. Partly in response to these conditions, the Bretton Woods System was established in 1945 (Thomas, 2001). The Bretton Woods system had originally established the International Bank for Reconstruction and Development, now the World Bank, with the purpose of physical reconstruction of Europe, and making post WW II development loans for infrastructure projects (Rich, 1994; Kukreja, 2008). However, unlike the World Bank’s role in poverty alleviation today, its role immediately after inception was decolonization, national economic planning, agricultural modernization, industrialization and managing the Cold War;

\textsuperscript{6} \textit{United Nations} website; retrieved March 26, 2010; from http://www.un.org/millenniumgoals/2008highlevel/pdf/newsroom/Goal\%201\%20FINAL.pdf
but as mentioned earlier, poverty was not a central issue in the debates on world development. Though planners and policymakers were aware of widespread world poverty, especially in newly liberated colonies, they believed that a general economic growth would decrease poverty as overall national income increased over time (Greig et al, 2007).

1.2 Development of orthodox view on development

In the 1970s, in addition to the roles and responsibilities assigned to them at their inception, the IBRD and the World Bank group also started making loans to poor countries to promote large scale infrastructure development projects like building dams, highways, and power plants in order to spur international development (Greig et al, 2007). The logic for international development used by these International Government Organizations (hereafter referred to as IGOs) at that point in time was rooted in the ‘Modernization theory’. The theory explained why some countries had lagged behind in progress while others had successfully moved on. According to this theory, there are certain values in the modern societies that are missing in traditional poor societies and if the poor countries emulated the ways that have led to economic growth in developed countries, then they would be able to achieve the same economic growth and modernity (Andersen and Taylor, 2005).

Modernization theory thus led to what is now called the orthodox view on development that is based on the assumptions that there exists a possibility of unlimited economic growth in free markets; and that wealth would eventually seep down to the poorest section of the society if a country’s GDP was increasing with time (Thomas, 2001). Thus the measure of development in a country until the late 1980s was largely focused on macro indicators such as industrialization, economic growth, and increase in GDP per capita.
The orthodox view on development despite its success in conventional terms, failed to explain the rapidly widening rich-poor gap between 1965 and 1990 throughout the world in general and in the developing countries in particular, as shown in Figure 1.1 below (Korzeniewicz and Moran, 2003).

Many of these large scale projects influenced by modernization theory were ill conceived and mainly benefitted the wealthy elites but not the poor masses (Visvanathan et al, 1997; Greig et al, 2007). Moreover, despite the attempts of the World Bank and the IMF, most developing countries entered the 1990s more indebted than they were in the 1980s (Thomas, 2001; Greig et al, 2007). It was obvious that modernization theory and the orthodox view on development had
failed to bring sustainable and equal growth in all the sections of the global society. Development and economic growth had not trickled down to the poor as expected, and a rise in GDP per capita did not mean that everyone in a country was developing equally.

Angus Maddison’s research (1995, 2001, 2003) shows that inequality in the world income and population growth is a recent phenomenon. It roughly estimates the increase in world population and the increase in world GDP per capita between 1820-1998 and shows that the rise in world population was accompanied by an approximately similar increase in GDP per capita as illustrated in Figures 1.2 and 1.3 below (Maddison, 2001; Sachs, 2005).

Maddison also points out that about 200 years ago in 1820 A.D., all the regions of the world (Europe, Americas, Asia & Africa) were comparable in terms of GDP per capita, but as
shown in Figure 1.4 below, by 1998 there were significant differences in them (Maddison, 2001; Sachs, 2005).

![GDP per Capita by Region in 1820 and 1998](image)

**Figure 1.4**

*Source: Sachs, 2005; p. 29*

In fact, according to a September 2008 United Nation Factsheet, between 1981 and 2005 poverty had remained constant at around 50% in Sub Saharan Africa, though it had fallen in other developing regions of the world (United Nations, n.d.\(^7\)). With increasing world poverty and the debt crisis of the 1980s, the IMF started to address structural economic crises in developing countries. Thus, dawned the era of the famous (or infamous) Structural Adjustment Programs (hereafter referred to as SAPs) – where conditional loans were offered to governments in order to address global capital concerns (Greig et al, 2007). It is actually considered a matter of infamy in some scholarly circles that despite the debt crisis in the 1980s when the heavily indebted poor

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countries were unable to repay their debts, they had to take SAPs but still pay their debts, when the U.S. had helped rebuild Europe by doling out funds through the Marshall plan and not through loans (Sachs, 2005).

The SAPs promoted by the World Bank and the IMF in the 1980s and 1990s mainly addressed four critical issues that were considered essential for economic development by the orthodox view on development - poor governance, excessive government intervention in the markets, excessive government spending, and too much state ownership (Sachs, 2005). Thus by administering SAPs, it was ensured that the country would liberalize their markets by removing too much state intervention, reduce state ownership of enterprises, and lessen government spending. These interventions were also based on modernization theory’s tenet that poverty was a result of endogenous factors alone and if they were corrected, modernization and development would follow.

1.3 Criticism of orthodox view on development

SAPs have now been widely criticized for assuming that the prototype western societies, that are staunch believers of free market, and the newly liberated countries after WW II had an equal status and preconditions when they started climbing the development ladder like plenty of untapped markets, overseas colonies for cheap supply of labor and raw materials, no international organization overseeing world trade rules and patents to name a few (Gore, 2003). Despite the fact that these replicator countries, emulating developed countries as per the modernization theory, would benefit from foreign aid and technological advancements that have already been made in the west, the most important distinction between the western prototype and the postwar emulator countries was that though the developing countries had a much shorter path
to modernity, the path was far steeper for them. The bindings of international trade and developmental loan regime that had been established by the Bretton Woods system favored the more powerful and developed countries and the emulator countries could never prosper in the same way as western countries did during the industrial revolution when there were no patent laws or formalized international trade obligations (Greig et al, 2007). It is rather naïve to equate the 18\textsuperscript{th} century England and 19\textsuperscript{th} century America with the 20\textsuperscript{th} century newly liberated colonies that had to not just resurrect a broken economic system, owing to long colonization, and fill the political vacuum but at the same time also compete with the western giants in an international free market. Thus the orthodox view on development and the modernization theory overlooked the exogenous forces that resulted in underdevelopment.

And lastly, one of the biggest critics of the modernization theory have been the believers of Immanuel Wallerstein’s Modern-Worlds System Theory, which refutes the tenet that a relationship between a modern and a traditional society is mutually beneficial and reciprocal, as assumed through the international free trade regime. Modern-Worlds System theory, an offshoot of Marxism, propounds that such a relationship divides the global society into three interacting zones – the core consisting of developed countries, the periphery consisting of least developed countries and the semi-periphery consisting of developing countries – and is based on the core’s domination and exploitation of the other two, to a varying degree (Wallerstein, 1975; Balaam and Veseth, 2008).

Based on these criticisms of the modernization theory and IMF and World Bank policies, it was condemned how the World Bank would not give loans to a government who does not follow IMF prescriptions (Bello, 1994). The World Bank, apart from being the biggest lender of public money, is also the leading engine of development research in the world and a supposedly
‘impartial knowledge bank’ on development. Its decision to not lend money to a government is religiously followed by development banks worldwide. Thus it is evident that the IMF and the World Bank can overpower any country that needs their assistance and dictate their terms most easily. Propagating the intellectual hegemony of the developed countries, who have a majority voting right in both the IGOs, they have therefore been criticized for fostering a paradigm maintenance as desired by them (Peet, 2009).

Throughout the 1990s the IMF and the World Bank were heavily criticized for their strict SAPs against loans that were offered to the developing countries. It was also argued that these two institutions were created in the first place to balance the ill effects of globalization and smooth out shocks created in international markets, but what these IGOs had done over the four decades was to only accelerate globalization (Gore, 2003; Woods, 2006). At their inception the role of these IGOs was only meant to be advisory, which has proved to be far from neutral through their conduct so far (Chossudovsky, 1998; Woods, 2006).

### 1.4 Alternate view on development – the sustainable human development approach

The previous section argues that since their inception the World Bank and the IMF considered the causes of underdevelopment and poverty to be endogenous or national but prescribed a solution that was exogenous and global in the form of trade liberalization (Gore, 2003). The new thought in international development emphasizes various exogenous factors that affect a poor country’s development possibilities today (Sachs, 2005):

- The poverty trap where poor countries lack one or more of the six basic capitals – natural, human, business, infrastructure, knowledge, and public institutional capital
• Physical geography including natural resources, climate, landlocked countries especially with difficult mountainous or desert regions
• The fiscal trap when the government may not have resources to create infrastructure necessary for economic growth
• Governance failures may lead to lack of public infrastructure, morbidly high corruption, domestic conflict
• Cultural barriers that may prevent a huge section of population from joining the workforce based on gender, religion, or race
• Geopolitics such as infliction of trade barriers from the international community or a state of constant conflict with neighboring countries; lack of innovation
• The demographic trap when poor families decide to have lot of children to create more hands to pool in the family income.

Based on these arguments, Sachs (2005) advocates that there is a dire need for clinical economics which, much like clinical medicine, gives customized solutions based on differential diagnosis and does not prescribe the same standard medicine to everyone who may have similar symptoms. With a constructivist approach, it may be inferred that all countries have a different socio-economic and political construct and that their problems cannot be categorically treated as purely social or purely economic and so on. Their institutions, political and social elites, and the overall culture has certain values that has now become so inherent in their system that strict generic prescription like SAPs would not help them, or in some cases may even harm them.

This alternate view called for holistic and sustainable development that fulfills material and nonmaterial human needs of all sections of a society (Thomas, 2001), against the orthodox
view on development that advocated overall GDP growth (Gore, 2003). Through external expert led modernization theory, donor conditional SAPs, and global free trade, the old view believed in a top down approach to development; whereas the new alternate view advocates customized solutions, stakeholder participation, and equal partnership arrangements between developing countries and aid donors.

This people centered bottom up approach, also termed as Sustainable Human Development (hereafter referred to as SHD), became one of the key points in the Millennium Development Goals (hereafter referred to as MDGs) adopted by the UN in September 2000 under the UN Millennium Declaration, committing the nations to a new partnership to shrink extreme global poverty and setting time-bound targets (UN Millennium Project website, n.d.8).

1.5 Rise of microfinance at the world stage

In the last few years before the turn of the millennium when the world was retrospective on the previous century’s achievements, or lack thereof, and also receptive to possible changes in the global paradigm, the work of Muhammad Yunus at the Grameen Bank rose to prominence among many other scholars and policy advocates.

Yunus viewed development as a human right, rejected the orthodox view on development and had called for a redefinition of the term ‘development’ in the early 1990s (Yunus, 1994). Yunus insisted that GDP per capita was a poor measure of development and brought attention to the practices of the Grameen Bank in Bangladesh that offered microloans to the poor without collateral. He juxtaposed the World Bank and the Grameen Bank, one as disabling and the other

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8 UN Millennium Project website; retrieved March 26, 2010; from http://www.unmillenniumproject.org/goals/index.htm
as enabling, and challenged that the borrowers should not be blamed if they default (Yunus, 1994);

I have always disagreed with this kind of definition of development. I think it misses the essence of development. To me, changing the quality of life of the bottom 50 percent of the population is the essence of development… This is where growth and development part their ways. Those who believe that growth and development are synonymous, or move at the same speed, assume that the economic layers of society are somehow linked to each other like so many railway carriages, and that one only need stoke the engine for the entire train and everyone in it to move forward at the same speed… Micro-credit pushes the entire train forward by helping each passenger in the rear (or third class) carriages. This cannot reduce the speed of train, it can only increase it, which most of today’s so-called development projects fail to do (Yunus, 2007, pp. 211-212).

The message that the poor should be given a chance to help themselves, not through strict macro level prescriptions but through an enabling policy environment at local, national and international levels, appealed to many global policy makers who were looking for workable solutions towards all the criticism they had faced in past decades. In early 1997, about 2900 people from 137 countries and 1500 organizations gathered in Washington, D.C. for an international summit on microfinance to discuss mechanisms for expanding credit to the world’s poorest poor (microcredit summit campaign, n.d.⁹). The meeting also initiated the "Global Fulfillment Campaign" which aimed to provide credit access to an additional 100 million poor families by the year 2005 (Reinicke, 1999-2000).

Finally, in September 2000 the number one goal as adopted under the Millennium Development Goals was set as ‘eradicating extreme poverty and hunger’ and providing microfinance services to increase self employment and empowerment among the world poor was

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⁹ Microcredit Summit Campaign website; retrieved March 26, 2010; from http://www.microcreditsummit.org/about/about_the_microcredit_summit_campaign/
identified as a key strategy (United Nations, n.d.\textsuperscript{10}). Following suit of MDGs, most developing country governments now have poverty reduction strategies created in consultation with the World Bank and the IMF that have microfinance elements as a solution to reduce chronic poverty in the world (World Bank, n.d.\textsuperscript{11}; IMF, n.d.\textsuperscript{12}).

The UN declared 2005 as the ‘Year of Microcredit’ to promote microcredit as a central instrument to eradicate world poverty. The microcredit concept has been also adopted and promoted by other leading government aid organizations like United States Agency for International Development (USAID), UK Department for International Development (DFID), Canadian International Development Agency (CIDA), Australian Government Overseas Aid Program (AusAID), Swedish International Development Cooperation Agency (SIDA) to name a few. (Wilkinson and Hughes, 2002).

The simple concept of microfinance propagated by Yunus has gained tremendous popularity at the world stage and it is being celebrated and replicated worldwide in poor as well rich countries. Provision of microfinance services to the poor is not an altogether new thought, it simply rose in popularity around the turn of the millennium because of success of many microfinance institutions in the developing countries.

It would be argued in the later chapters that propagation of microfinance services in the developing countries has a different context than in the developed countries. Its rationale depends on the socio-economic and political construction and inherent cultural values of that specific country. The next chapter throws light on history and practice of microfinance in the

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\textsuperscript{10} United Nations website; retrieved March 26, 2010; from http://www.un.org/millenniumgoals/2008highlevel/pdf/newsroom/Goal%201%20FINAL.pdf

\textsuperscript{11} The World Bank website; retrieved March 26, 2010; from http://search.worldbank.org/all?qterm=PRSC

\textsuperscript{12} International Monetary Fund website; retrieved March 26, 2010; from http://www.imf.org/external/np/exr/facts/prgf.htm
\end{small}
past and its various operational models in order to facilitate a better understanding of microfinance concepts that would be used in the later chapters’ arguments.
CHAPTER 2

MICROFINANCE – HISTORY AND PRACTICES

The microfinance movement has spread like a wild fire in the world of international development and has already reached out to many continents via cross pollination. The most striking and appealing factor affecting its popularity is that it has emerged from the muddy alleys of developing countries like Bangladesh or Bolivia and not from upscale offices of the World Bank economists (Armendariz de Aghion and Morduch, 2007).

Clearly microfinance is now being seen as a solution to world poverty that works. Microfinance has been promoted as a neoliberal solution to poverty that operates through market mechanisms, provides incentives to work and promotes the spirit of self help among poor through market based competition, giving them an opportunity to climb out of poverty instead of relying on charity (Lucarelli, 2005). Yunus has also argued that microfinance is in tune with the central thesis of capitalism and is based on self initiative, competition, innovation, and efficiency with least government interference in the market. He opines that as there can be no profit without capital, and in absence of loans and other financial services the poor are not in control of their lives. However, if an enabling environment is provided to them through provision of credit, they are completely capable of helping themselves and achieving a bottom up economic development without outside help or intervention (Yunus, 2007a).

In words of Adam Smith, the father of economics, “Money, says the proverb, makes money. When you have got a little, it is often easy to get more. The great difficulty is to get that
little” (Smith, 2007). Microfinance aims to address this issue of providing the initial ‘little money’ and help the poor make more money.

2.1 An overview of microfinance concepts

Given the sudden increase of interest in microfinance as a tool for global development and poverty alleviation, it is very important to clearly understand some of the operating definitions and this section provides an overview of this subject. The Millennium Development Goal of eradicating extreme poverty and hunger recognizes the fact that much like everyone else, the poor also need diverse financial services whether to run a small business, build assets through savings, or cover sudden consumption or risk expenditures through savings and insurance. The poor are often denied these services because they are considered unprofitable and risky as they need ‘micro’ services or lack collateral and therefore fail to climb out of poverty (Srivastava, 2005; Yunus, 2007a).

Microfinance caters to clients belonging to different poverty levels - vulnerable non-poor, upper poor, poor, and very poor. It is therefore important to note that microfinance clients are a diverse group of people that require diverse products such as loans, savings, money transfers and micro-insurance (Consultative Group to Assist the Poor or CGAP, n.d.13). Microcredit, though often used synonymously to microfinance, is only a part of financial services offered through microfinance, other services being micro-insurance, micro-savings, and micro-remittance.

Microcredit, simply put, is the provision of small loans to the poor in rural, semi-urban and urban areas for self-employment income generating projects, allowing them to sustain

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13 Consultative Group to Assist the Poor website; retrieved March 26, 2010; from http://www.cgap.org/p/site/c/template.rc/1.11.947/1.26.1304/
themselves with dignity (Grameen Bank, n.d.; Reserve Bank of India, n.d.). These self-employment income generating projects are technically called microenterprises that encourage the poor to generate or augment their income using their own entrepreneurship skills, creativity, and aptitude and not get blamed for their state of perpetuating poverty, lack of literacy or employment skills (Edgecomb, Klein, and Clark, 1996).

These financial services are offered by a microfinance institution (hereafter referred to as MFI), which is broadly defined as any institution that provides services to the clients who are poor or vulnerable and are neglected by conventional banks (Hardy, Holden and Prokopenko, 2003; Christen, Rosenberg, and Jayadeva, 2004). Unlike banks, the MFIs may or may not have the same financial intermediation function of collecting money for safe keeping and loaning it to another borrower for a profit margin (Remenyi, 2000; Elahi and Danopoulos, 2004).

The MFIs can be government owned nonprofits or a nongovernment nonprofit, nongovernment cooperatives and credit unions, postal savings or non-postal savings banks, or a for-profit organization that may be a commercial bank or licensed nonbank financial institution (Consultative Group to Assist the Poor, n.d.). They may be legally formal bodies bound by government restrictions or legally informal bodies such as solidarity group savings, covered later in this chapter; and the types of services offered by them may be contingent upon the legal credentials of MFIs. Regardless of design, the MFIs are different from commercial, small-scale, informal financial entities such as village moneylenders and pawnshops that exploit the poor with unfair terms of loans and have no intention of helping the poor in any way (Hardy, Holden

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16 Consultative Group to Assist the Poor website; retrieved March 26, 2010; from http://www.cgap.org/p/site/c/template.rc/1.26.1302/
and Prokopenko, 2003). Different microfinance models, practices, and the structure and functioning of Grameen Bank will be presented later in this chapter and also in the next one.

2.2 Need for microfinance services among poor

The high repayment rate of Grameen Bank has impressed every commercial bank in the world when the otherwise considered risky and untrustworthy poor have returned their loans even when they don’t have collateral to lose. Apart from the unique structure and functioning of Grameen Bank covered in the next chapter, it is actually the need for financial services that keeps the poor from loan default, cheating or wandering; they know that till the time they keep their words, their future needs would be met with trust. The clients want to return to the bank in the future despite the high rate of interest due to the fact they are offered these collateral free services almost at their door steps and can offer multiple small amount transactions unlike any other financial institution.

More than microcredit, the biggest financial needs among the poor have always been the need to save given their uncertain source of income, overall vulnerability due to natural disasters or sudden death of the bread earner in the family (Armendariz de Aghion and Morduch, 2007); and the need to smoothen out sudden consumption expenses like a wedding, house repair or unforeseen health related crisis (Karnani, 2008). Having been considered a risk by formal financial institutions, or due to imposed transaction fee or minimum balance requirements, or because the saving institution is too far away that they may have to sacrifice few hours of daily wages to access it (Basu and Srivastava, 2005; Gaiha and Nandhi, 2008), the poor mostly save through informal ways like Rotating Savings and Credit Associations or ROSCAs (discussed later in this chapter) or invest into assets that can be turned liquid with relative ease like gold or
jewellery (Consultative Group to Assist the Poor or CGAP, n.d.\textsuperscript{17}). However, such savings or assets are highly vulnerable to risks of cheating or theft and therefore the poor need microfinance services as much as the rich do, if not more. Moreover, microfinance assures security of saved money and allows easy accessibility with flexible operation hours and frequent small transactions.

This does not mean that the poor only need financial services to save or to borrow. They also need other financial services such as insurance, money transfers, and remittance to make small everyday decisions about personal life or business. Microfinance proponents opine that though microfinance may not help in all the maladies caused by poverty, however it can help the poor be in charge of their lives and reduce their vulnerability (Helms, 2006). Provision of all these services might even help the poor climb out of poverty, build assets, improve living conditions like education, nutrition and health care, and reduce their vulnerability in the long run through financial planning and making calculated decisions. For many, being in control or in charge of their lives has been denied to them for generations and hence they have failed to accumulate assets due their inability to save, invest, insure and do long term planning (Yunus, 1997).

These basic explanations for the need of microfinance are in line with the bottom up approach towards development that puts the poor in charge of their own lives in a sustainable way, and the governance structure does not impose a top down technique, but merely facilitates the process by making the system more accessible and equitable for everyone.

\textsuperscript{17} Consultative Group to Assist the Poor website; retrieved March 26, 2010; from http://www.cgap.org/p/site/c/template.rc/1.11.947/1.26.1302/
2.3. History of microfinance

Despite the need among poor and recent upsurge in its popularity, it is important to understand that microfinance is not a new concept that was invented and introduced to the world by Yunus. What Yunus did capitalize on was the strength of the group lending model and combined it with the basic economics of a financial institution to prove that the poor have a capacity to help themselves and pay back their debts even with high rates of interest. He brought attention to not just the need for financial services among the poor but also the fact that the poor have the capacity, willingness, and intentions to pay back their debts, given certain flexibility and support (Dowla and Barua, 2006).

In fact, given the high repayment rate despite high rates of interest, the microfinance industry is now being considered viable and profitable and ‘the bottom of the pyramid’ is being considered for holding a great potential of untapped business opportunities (Prahalad, 2004). However, as stated earlier that though the poor have been marginalized from financial services due to lack of collateral, microfinance has been practiced throughout the world for a long time with different names and forms. In order to understand how microfinance has worked in different cultures, it is essential to look at its history and variety of practices in different societies.

Informal credit based on trust existed even before the media of exchange or currency were developed (Elahi and Danopoulos, 2004). Friedrich Wilhelm Raiffeisen started the Cooperative movement in Germany in the 1800s (Helms, 2006) and the Irish Loan Fund system was developed in the early and mid 1800s, when loans were offered to poor farmers from MFIs other than commercial banks (Hollis and Sweetman, 1998). These loans did not completely alleviate poverty among the Irish poor in pre-Famine Ireland, but they did contribute to rural economic development and intensified non-crop activities and other consumption purposes.
The concept of a rural cooperative, where members voluntarily come together to address common political, economic, socio-cultural needs and may have a member financing and savings component, had also spread to rural Latin America in the early 1900s and eventually spread to the developing countries in Asia. Some of these programs were philanthropic in concern, while other were for profit business models, and still others were taken up by socialist governments in the mid 20\textsuperscript{th} century to provide subsidized loans to the rural poor in agrarian economies (Adams and Von Pischke, 1992; Morduch, 1999; Armendariz de Aghion and Morduch, 2007).

Offering financial services to the poor without collateral has therefore existed for a long time but the rise of popularity of microfinance, as it is understood today, is an effect of the increase in the size of markets (Jurik, 2005). In a small local economy, it was common to lend money to farmers or entrepreneurs based on their name and faith, as information about the trustworthiness of the borrower was easily available and the client was trusted to return the loan if not in this harvest then in the next one. However, as market size increased and small banks merged into big city based banks, the local information and trust was lost (Jurik, 2005). The educated and urban bankers had no social or emotional connect with the small rural farmers like the old village banks did, and therefore they could no longer trust them to return their loans in the absence of collateral. It is this lack of information, impersonal relationships, and fear of default on loan repayment that led to the practice of collateral and the poor were systematically marginalized from financial services due to lack of collateral or a guarantor (Jurik, 2005; Armendariz de Aghion and Morduch, 2007).

Microfinance and microcredit has also been tried in the past by many international bodies, albeit with a different technical terminology, even before Yunus first began his famous journey in 1974. The International Labor Organization had completed a study in Kenya in 1972
that women operated enterprises in the informal sector leads to economic development and should be promoted through offering credit (Raheim, 1997). In the 1970s USAID and other UN agencies experimented with microenterprise development in Latin American, Indonesia, India, and Bangladesh (Berger, 1989). However, the World Bank only took up microfinance in the mid-1990s by establishing the Consultative Group to Assist the Poorest (hereafter referred to as CGAP), an independent policy and research organization to promote financial access among the world's poor (Buckley, 2002); and in 2005, the UN devoted the entire year to give a worldwide impetus to microfinance research and practice through the declaration of the International Year of Microcredit (International Year of Microcredit website, n.d.18).

Microfinance has therefore existed in many forms all around the world but it gained its current popularity after the success of Grameen Bank, strong policy advocacy undertaken by Yunus and his supporters in the 1990s, and its subsequent adoption as a key strategy in the attainment of MDGs.

2.4 Microfinance models

As broad as the subject of microfinance is, it involves many services such as credit, savings, insurance, and remittances; and with the differing nature of the MFI involved in the process - formal or informal, nonprofit or for profit, with unique local needs, and economic regulations posed by the government, there are a number of microfinance models and practices that have evolved over time. These models vary not just in terms of services, source of funding, and clientele, but also in terms of their vision and mission. However, it is also very evident through the description given below that these models exist as variants of the same idea and

18 International Year of Microcredit website; retrieved March 26, 2010; from http://www.yearofmicrocredit.org/pages/whyyear/whyyear_learnaboutyear.asp
differ only slightly in their structure and function, or they may even exist in combinations. This section will briefly discuss various common microfinance models and how they have been practiced in different local contexts with different permutations and combinations.

An individual lending model is the most common and oldest microfinance model in the world. As the name suggests, it does not involve concept of group formation or peer pressure and collateral may or may not be required for a microloan. However, in many cases skill development and skill diversification components are attached with this model whereby it is mandatory for members to undergo a training program to enhance their business and entrepreneurial skills (Grameen Bank, n.d.\(^\text{19}\); Global Development Research Center, n.d.\(^\text{20}\); Financial Investment Planner, n.d.\(^\text{21}\)).

The rotating savings and credit associations or ROSCAs is the oldest, most common, and probably the most popular informal model of group based microfinance. It consists of a group of homogenous individuals with similar and comparable socio-economic background who trust each other and make regular cyclical contributions to a pool of funds. Members meet regularly and collect a fixed amount of money from everyone. At the end of every meeting one member gets all the money collected during that meeting which is equal to the total contribution he has made in the entire cycle (Grameen Bank, n.d.\(^\text{22}\); Global Development Research Center\(^\text{23}\).

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\(^{20}\) Global Development Research Center website; retrieved March 26, 2010; from [http://www.gdrc.org/icm/model/1-credit-model.html](http://www.gdrc.org/icm/model/1-credit-model.html)

\(^{21}\) Financial Investment Planner website; retrieved March 26, 2010; from [http://www.financialinvestmentplanner.com/Economy_Microeconomics_Lending-models.html](http://www.financialinvestmentplanner.com/Economy_Microeconomics_Lending-models.html)


\(^{23}\) Global Development Research Center website; retrieved March 26, 2010; from [http://www.gdrc.org/icm/model/1-credit-model.html](http://www.gdrc.org/icm/model/1-credit-model.html)
Due to its unique nature of operation, there is no need of accounting or depositing the money with anyone as all the money that is collected in one meeting is given to one member, usually decided through group consensus or lottery in the same meeting (Armendariz de Aghion and Morduch, 2007).

ROSCAs have the advantage of promoting commitment to small but regular savings although no interest is received on cyclical contributions. Another attractive feature is the dependable lump sum income that may encourage asset building and promote social ties. ROSCAs have been extremely popular not just among poor but even in rich urban settings (Jurik, 2005; Armendariz de Aghion and Morduch, 2007). The reason behind success of ROSCA is that the members may not have other ways to save or invest, although this may indirectly turn into a disadvantage of loss of long term benefit on capital. Another disadvantage is that the size of savings is not flexible and also that a member cannot withdraw his savings whenever he/she wishes and will only get the lump money when his/her turn comes (Armendariz de Aghion and Morduch, 2007). Moreover, ROSCAs are unlikely to work among very poor circles that do not have the capacity to spare a stipulated amount of money regularly or trust fellow members to contribute every time, thus risking the longevity and sustainability of a ROSCA (Jurik, 2005).

An association model is formed when a community decides to engage in microfinance activities such as savings. Membership in such a community group can be along the lines of political, religious, cultural or some other community or work based issues. An association may or may not be a formal body and is different from a nongovernment organization or NGO as NGOs are bodies that are external to the community whereas associations are formed by

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24 Financial Investment Planner website; retrieved March 26, 2010; from http://www.financialinvestmentplanner.com/Economy_Microeconomics_Lending-models.html
members within a community (Grameen Bank, n.d.\textsuperscript{25}; Global Development Research Center, n.d.\textsuperscript{26}; Financial Investment Planner, n.d.\textsuperscript{27}).

A cooperative is a type of association where members voluntarily come together to address common political, economic, social and cultural needs. A cooperative is a democratic enterprise which may or may not have a member financing and savings component (Grameen Bank, n.d.\textsuperscript{28}; Global Development Research Center, n.d.\textsuperscript{29}; Financial Investment Planner, n.d.\textsuperscript{30}).

A credit union on the other hand is a formal and democratic nonprofit that functions as a cooperative focused only on financial activities. Much like a ROSCA the members save their money together but unlike it, they loan it to each other at a reasonable rate of interest to cover operating cost of the cooperative (Grameen Bank, n.d.\textsuperscript{31}; Global Development Research Center, n.d.\textsuperscript{32}; Financial Investment Planner, n.d.\textsuperscript{33}). The credit union owned by its members that share some common bond such as a church, office, or community location and has no external shareholders (McGuire and Conroy, 2000). Each member has a voting right on issues such as interest rates or loan size, leadership is rotated and may be paid or unpaid (Jurik, 2005).

\textsuperscript{25} Grameen Bank website; retrieved March 26, 2010; from http://www.grameen-info.org/index.php?option=com_content\&task=view\&id=43\&Itemid=93
\textsuperscript{26} Global Development Research Center website; retrieved March 26, 2010; from http://www.gdrc.org/icm/model/1-credit-model.html
\textsuperscript{27} Financial Investment Planner website; retrieved March 26, 2010; from http://www.financialinvestmentplanner.com/Economy_Microeconomics_Lending-models.html
\textsuperscript{28} Grameen Bank website; retrieved March 26, 2010; from http://www.grameen-info.org/index.php?option=com_content\&task=view\&id=43\&Itemid=93
\textsuperscript{29} Global Development Research Center website; retrieved March 26, 2010; from http://www.gdrc.org/icm/model/1-credit-model.html
\textsuperscript{30} Financial Investment Planner website; retrieved March 26, 2010; from http://www.financialinvestmentplanner.com/Economy_Microeconomics_Lending-models.html
\textsuperscript{31} Grameen Bank website; retrieved March 26, 2010; from http://www.grameen-info.org/index.php?option=com_content\&task=view\&id=43\&Itemid=93
\textsuperscript{32} Global Development Research Center website; retrieved March 26, 2010; from http://www.gdrc.org/icm/model/1-credit-model.html
\textsuperscript{33} Financial Investment Planner website; retrieved March 26, 2010; from http://www.financialinvestmentplanner.com/Economy_Microeconomics_Lending-models.html
Credit unions have a tremendous advantage over ROSCAs as they offer the opportunity to borrow any time and not just save. Moreover, there is no obligation for savers to borrow or for borrowers to save. However, the funds must be stored safely and accounting expertise is required as chances of cheating or corruption increase (Armendariz de Aghion and Morduch, 2007).

The village banking model involves community based associations that deal with credit as well as savings. These associations are formed by 25-50 poor individuals who want to be self employed. The association’s source of fund may or may not be external and is democratically run by the members who take collective responsibility of any loan offered through the association (Grameen Bank, n.d.; Global Development Research Center, n.d.; Financial Investment Planner, n.d.).

In a community banking model, the entire community is taken as a unit and microfinance services are provided through a semiformal or formal institution established with the help of a NGO or a community based organization (hereafter referred to as CBO) that provides training to the community to operate as a bank. A community bank model may have savings and microenterprise elements and generally it promotes a larger community development program through financial activities (Grameen Bank, n.d.; Global Development Research Center, n.d.; Financial Investment Planner, n.d.).

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34 Grameen Bank website; retrieved March 26, 2010; from http://www.grameen-info.org/index.php?option=com_content&task=view&id=43&Itemid=93
35 Global Development Research Center website; retrieved March 26, 2010; from http://www.gdrc.org/icm/model/1-credit-model.html
36 Financial Investment Planner website; retrieved March 26, 2010; from http://www.financialinvestmentplanner.com/Economy_Microeconomics_Lending-models.html
37 Grameen Bank website; retrieved March 26, 2010; from http://www.grameen-info.org/index.php?option=com_content&task=view&id=43&Itemid=93
38 Global Development Research Center website; retrieved March 26, 2010; from http://www.gdrc.org/icm/model/1-credit-model.html
A **group** model involves collective responsibility and security offered by a group of homogenous members with similar and comparable socio-economic background. It was mainly devised to overcome the risk involved in individual lending model and the group as a whole is empowered in the process in terms of education and awareness of financial processes, collective bargaining, and the power of peer pressure (Grameen Bank, n.d.\(^40\); Global Development Research Center, n.d.\(^41\); Financial Investment Planner, n.d.\(^42\)). The group lending model is popular in rural as well as urban areas. It reduces institutional transaction cost, tends to have high repayment rate due to peer pressure, and is often preferred by the poor, especially women, as they may feel more confident in a group setting.

The **Grameen** model evolved as a special case of group model under the Grameen Bank and its pioneer Mohammad Yunus in Bangladesh. A bank unit is set up at a location that covers 15-22 villages and groups are formed with five members each. In the initial stages the group must conform to the rules and norms set by the bank, and after a period of one month the first two members are given a loan. Once these two members have returned their loan and interest in fifty weekly installments, the other group members become eligible for loans. Such operational practice involves no collateral but strong group pressure on all the members to conform to bank rules and do not default on weekly payments (Grameen Bank, n.d.\(^43\); Global Development Research Center, n.d.\(^41\); Financial Investment Planner, n.d.\(^42\)).

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\(^{39}\) Financial Investment Planner website; retrieved March 26, 2010; from [http://www.financialinvestmentplanner.com/Economy_Microeconomics_Lending-models.html](http://www.financialinvestmentplanner.com/Economy_Microeconomics_Lending-models.html)


\(^{41}\) Global Development Research Center website; retrieved March 26, 2010; from [http://www.gdrc.org/icm/model/1-credit-model.html](http://www.gdrc.org/icm/model/1-credit-model.html)

\(^{42}\) Financial Investment Planner website; retrieved March 26, 2010; from [http://www.financialinvestmentplanner.com/Economy_Microeconomics_Lending-models.html](http://www.financialinvestmentplanner.com/Economy_Microeconomics_Lending-models.html)

However, while peer pressure may lead to high repayment rates it can potentially backfire sometimes. In this model, if one member defaults the entire group gets disqualified and therefore in that case the entire group may decide to default collectively (Huppi and Feder, 1990; Armendariz de Aghion and Morduch, 2007). This model will be covered in further detail in the next chapter.

The intermediary or the partnership model involves a mediating individual or organization such as a NGO, CBO, and government or nongovernment, for-profit or nonprofit bank between the borrowers and the lenders such as government agencies, commercial banks, and international donors. These intermediary bodies, which may be at the local, regional, national or international level, create awareness among the borrowers and help them build credit to graduate to direct borrowing from the lender (Grameen Bank, n.d.; Global Development Research Center, n.d.; Financial Investment Planner, n.d.). There are usually other development related activities associated with the intermediary body. Ideally in this model all the parties involved win, as the poor get access to financial services, the financial institution get access to an untapped market, and the intermediary body, which is usually a nonprofit NGO, is able to reach its social goal and cover operating costs through a fee charged from the financial institution.

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44 Global Development Research Center website; retrieved March 26, 2010; from http://www.gdrc.org/icm/model/1-credit-model.html
45 Financial Investment Planner website; retrieved March 26, 2010; from http://www.financialinvestmentplanner.com/Economy_Microeconomics_Lending-models.html
46 Grameen Bank website; retrieved March 26, 2010; from http://www.grameen-info.org/index.php?option=com_content&task=view&id=43&Itemid=93
47 Global Development Research Center website; retrieved March 26, 2010; from http://www.gdrc.org/icm/model/1-credit-model.html
48 Financial Investment Planner website; retrieved March 26, 2010; from http://www.financialinvestmentplanner.com/Economy_Microeconomics_Lending-models.html
The most recent but now extremely popular microfinance model is the **online lending** model such as **Kiva**. This model connects individual lenders to a community based intermediary called Kiva partners, who receive money through Pay Pal or credit card payments, and disburse, as well as collect, funds from the borrowers. The intermediaries keep the interest paid on loans to cover their operating costs and the principal amount is returned to the lenders through Kiva. The lenders may decide to relend the same money online to another borrower or donate it to Kiva or withdraw it back (Coates and Saloner, 2009; Kiva, n.d.\textsuperscript{49}). The online lending model has a unique advantage of keeping the operational cost low and mobilizing funds from all over the world by providing borrower’s information and motivating philanthropic donors by maintaining transparency and accountability. Moreover, it rotates the same money to benefit many borrowers and the lender receives a ‘feel good’ factor, even if they choose to take their money back once the borrower returns it.

**2.5 Characteristics of the new microfinance practices**

The main feature that distinguishes the emergent microfinance movement from the older existing microfinance models discussed in the previous section is that contemporary MFIs typically have a source of income other than member savings (Armendariz de Aghion and Morduch, 2007). But the most distinguishing feature of today’s microfinance practice is the critical role played by nonprofit NGOs (Fairley, 1998; Elahi and Danopoulos, 2004). Many scholars believe that the traditional microfinance models such as ROSCAs or credit unions were profit oriented and judged the borrower’s credit worthiness by considering whether or not to accept a member; whereas NGOs are community based, usually nonprofits, poor centered and nonjudgmental, that is, they believe that poverty is a result of myriad socio-economic factors and

\textsuperscript{49} Kiva website; retrieved March 26, 2010; from http://www.kiva.org/about/how
that poor are capable of self help if they receive empowerment through access to financial services, education, awareness, and self confidence (Fairley, 1998; Elahi and Danopoulos, 2004).

Thus while older models had limited collective personal funds to lend to borrowers, with the involvement of NGOs as intermediaries with banks, the fund pool has increased enormously. The local NGOs play the critical role of holding correct information about trustworthiness of borrowers that was held by local moneylenders in past, and therefore the need for collateral is bypassed in most cases (Armendariz de Aghion and Morduch, 2007). NGOs and group lending model therefore offer a great opportunity to intervene in the market forces without disrupting it in the way subsidized rural banks did in the 1960s and 1970s. In such a scheme of operation, the poor pay competitive interest rates and the forces of demand and supply for credit work perfectly much as they would in a free market.

Another feature that is different from past microfinance practices is the attention received by the female poor. With 70% of the world poor being women, the feminization of poverty has been immensely criticized worldwide and is a matter of great concern even today (Auwal and Singhal, 1992; Naidoo, 1994; Jurik, 2005). Women have been historically disadvantaged because of a lack of access to education, employment, financial services, and the nature of social construct in most traditional societies. Despite the fact that women tend to spend a more substantial part of their income on their families than men do and repay their loans on time, they have failed to grow equally and equitably as men under similar life circumstances (Auwal and Singhal, 1992). Grameen Bank has been a forerunner in women empowerment as women
represent 97% of its over eight million clients (Grameen Bank, n.d.\textsuperscript{50}). With a repayment rate of 98% it is a role model for most MFIs today.

Especially in developing countries, the new microfinance approach also often pays attention to other local agendas beyond finance such as education, mother and child health care, community economic development projects like clean water or irrigation systems among many others (Naidoo, 1994; Jurik, 2005). This type of collective organization toward women welfare or empowerment of poor in general depends on local needs or relevance to the context and new microfinance organizations have done just that (Schreiner and Morduch, 2002).

In conclusion, with myriad microfinance models and a historical overview of informal financial practices, this chapter attempts to provide an introduction of technical terms and vocabulary in the field of microfinance and set up a prelude for the arguments presented in the later chapters. As evident, lending to the poor who have been excluded from the mainstream commercial banking is not a new concept and has existed in many forms in rural as well as urban societies as per their local needs and cultural values of trust and brotherhood; therefore, context is vitally important in the practice of microfinance as would be discussed in the ensuing chapters.

\textsuperscript{50} Grameen Bank website; retrieved March 26, 2010; from http://www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=175
CHAPTER 3
AN OVERVIEW OF NEED AND PRACTICE OF MICROFINANCE
THE CASE OF INDIA

3.1 Current facts

With all the different microfinance models discussed in the previous chapter, there are about 133 million borrowers in 3,316 MFIs worldwide (Rhyne, 2009). However as shown in Table 3.1 below, depending on the way in which MFIs are defined, grouped and counted, 2004 and 2006 CGAP research projects conducted on ‘double bottom line’ MFIs show an existence of 120,574 such financial institutions worldwide that hold 750 million savings and loan accounts collectively\(^\text{51}\) (Christen, Rosenberg, and Jayadeva, 2004; Helms, 2006). A double bottom line financial institution is one in which in addition to a financial objective, the institution also has a social objective. Their financial objective is a means to an end rather than an end in itself.

<table>
<thead>
<tr>
<th>Region</th>
<th>MFIs</th>
<th>Co-Ops &amp; Credit Unions</th>
<th>Rural Banks</th>
<th>State/ Agricultural/ Development Banks</th>
<th>Postal banks</th>
<th>Total</th>
<th>Percent of Total</th>
<th>Account per 100 people</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia and the Pacific**</td>
<td>107,255</td>
<td>14,579</td>
<td>17,677</td>
<td>140,752</td>
<td>277,388</td>
<td>557,651</td>
<td>83</td>
<td>17</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>1,422</td>
<td>11</td>
<td>Not available</td>
<td>30,712</td>
<td>16,525</td>
<td>48,670</td>
<td>8</td>
<td>13</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>6,246</td>
<td>5,940</td>
<td>1,117</td>
<td>634</td>
<td>12,854</td>
<td>26,791</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Europe and Central Asia</td>
<td>495</td>
<td>5,692</td>
<td>Not available</td>
<td>28</td>
<td>11,503</td>
<td>17,718</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>5,156</td>
<td>8,620</td>
<td>162</td>
<td>81</td>
<td>179</td>
<td>14,198</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>120,574</td>
<td>34,842</td>
<td>18,956</td>
<td>172,207</td>
<td>318,449</td>
<td>665,028</td>
<td>100</td>
<td>13</td>
</tr>
</tbody>
</table>

* These figures do not include (non postal) savings banks because the number of account was not available. The researchers assume that non-postal savings banks would add 150 million, bringing the total number of all alternate finance institution accounts to well over 750 million.

** China and India are included: China = 156,924; India = 187,812

Table 3.1
Source: Christen, Rosenberg, and Jayadeva. “Financial Institutions with a ‘Double Bottom Line’,”
Occasional paper no. 8, CGAP, July 2004

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\(^{51}\) These accounts are in different classes of financial institutions that cater to the markets below the level of commercial banks and have a social goal; and for which a substantial fraction, but not necessarily all, of their clients are poor or near poor probably including some people who could also use a commercial bank. The authors Christen, Rosenberg, and Jayadeva refer to them as Alternative financial institutions or AFIs.
As high as 83% of these double bottom line financial institutions exist in Asia and Pacific region alone (48% in East Asia and Pacific, 36% in South Asia), 8% in the Middle East and North Africa, 4% in Sub-Saharan Africa, 3% in Europe and Central Asia, and 2% in Latin America and Caribbean (Christen, Rosenberg, and Jayadeva, 2004; Helms, 2006). It is evident through these facts and figures that there is a high demand for microfinance in the world especially in developing countries. According to Table 3.2 illustrated below, it is estimated that about 2 to 3 billion people, including both poor and non-poor, are in need of access to wide range of financial services. The situation is particularly exacerbated in the poor and developing countries, where more than 90 per cent of people do not have access to formal financial system. (Christen, Rosenberg, and Jayadeva, 2004; Helms, 2006; UNDP, n.d.52).

<table>
<thead>
<tr>
<th>Estimating AFI Market Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Demand</strong></td>
</tr>
<tr>
<td>World population</td>
</tr>
<tr>
<td>Minus rich countries and commercial bank clients in other countries</td>
</tr>
<tr>
<td>Minus people below or above working age</td>
</tr>
<tr>
<td>Equals AFI target market</td>
</tr>
<tr>
<td><strong>Supply</strong></td>
</tr>
<tr>
<td>Combined savings/Loan accounts in AFIs including savings banks (from previous table), plus estimate for non-postal savings banks</td>
</tr>
<tr>
<td>Minus inactive savings accounts</td>
</tr>
<tr>
<td>Equals active savings and loan accounts</td>
</tr>
<tr>
<td>Minus allowance for multiple accounts per client (one-fifth of line 7)</td>
</tr>
<tr>
<td>Equals active AFI clients</td>
</tr>
<tr>
<td><strong>Market Coverage</strong></td>
</tr>
<tr>
<td>Active clients as % of target market (line9/line4)</td>
</tr>
<tr>
<td>Individuals with access as % of target market (line 10 x 2)</td>
</tr>
</tbody>
</table>

Table 3.2

3.2 Different contexts, different attempts, different practices

As mentioned in the previous chapter, despite the common mission of serving the under or unserved clientele, MFIs vary greatly in terms of vision, mission, clientele, lending model, requirement for collateral or a viable business plan or mandatory financial and managerial training workshops etc. They also may or may not have other development or support activities such as childcare, reproductive health awareness, gender empowerment, advocacy for education or safe sex associated with them, beyond offering savings and credit (Christen, Rosenberg, and Jayadeva, 2004). As discussed below, there are successful examples of practice of microfinance other than the Grameen Bank model that bring attention to the breadth of the microfinance spectrum.

**Foundation for International Community Assistance** or FINCA, one of the microfinance leaders in the world today, was established as a nonprofit in 1984 in Costa Rica by John Hatch, an international development veteran. FINCA is one of the pioneers of the village bank method and coordinates a network of affiliates in Africa, Asia and the Americas. Mainly funded by USAID, private foundations and individual donors, FINCA serves poor clients, mostly female, by providing them microcredit for microenterprise initiatives and also offers savings opportunities and technical assistance (Jurik, 2005). The poor are organized into groups of 10-35 members who regularly meet to access collateral free loans ranging from $ 50-500; the repayment rate is 96% (FINCA, n.d.\(^5\)). FINCA has immensely impacted the lives of its borrowers and an interview study in El Salvador shows that the borrower’s income increased by 145% along with a significant increase in savings as well (Jurik, 2005).

\(^5\) *Foundation for International Community Assistance* website; retrieved March 30, 2010; from [http://www.finca.org/site/c.erKIP2PCIoE/b.2700241/k.98F7/FINCAs_History.htm](http://www.finca.org/site/c.erKIP2PCIoE/b.2700241/k.98F7/FINCAs_History.htm)
Founded in 1961 in Venezuela by a group of U.S. volunteers, Americans for Community Cooperation in Other Nations or ACCION international is a private nonprofit umbrella agency for MFIs in Latin America, the Caribbean, Africa, and the United States. It works through a chain of franchise MFIs, one of which (Accion USA) has been covered as a case study in this thesis as an example of a MFI in the United States. ACCION International attempts to foster financial self sufficiency through investment, dividend & fee income, and contracts & training fees, though it does receive some donations from private donors, foundations and the U.S. Department of Treasury (Jurik, 2005; ACCION international, n.d.\textsuperscript{54}). ACCION international offers individual loans with collateral but has also developed a collateral free group lending model to provide microcredit only and also offers some technical assistance and training to those clients who cannot provide collateral or a cosigner (Servon, 1999; Jurik, 2005). Through a series of small loans, it offers step loans until a borrower graduates to become eligible for borrowing through traditional banks. As of 2002, ACCION’s average loan size was from $300-$500 in Latin America and Africa, and approximately $6,000 in the United States. It currently has a reported repayment rate of 97% and has reported a 30% increase in income among its borrowers. (Jurik, 2005). It has also played a pivotal role in the creation of commercial MFIs like BancoSol in Bolivia, Mibanco in Peru and Finamerica in Colombia. BancoSol is the first commercial bank in the world dedicated solely to microenterprise lending (Jurik, 2005).

Self-Employed Women’s Association or SEWA was started by Ela Bhatt in India in 1972 as a registered trade union for women working in the informal sector based jobs; and is described as a confluence of three movements - the labor movement, the cooperative movement and the women’s movement. Microfinance is one of the important goals of SEWA but it also

\textsuperscript{54} Accion International website; retrieved March 30, 2010; from \url{http://www.accion.org/Page.aspx?pid=508}
focuses on socio-economic development such as work security, income security, food security, social security, minimum health care, child care, shelter and collective empowerment of its over 2 million members (Desai, 2002; Jurik, 2005; SEWA, n.d.55). It utilizes the village banking model and after working as an intermediary MFI for some time, it established its own cooperative bank in 1974 to provide microfinance services to its members, who as shareholders own the bank (SEWA, n.d.56). As a sustainable bank, SEWA borrows and lends at the market rate, has a repayment rate of 95%, and like ACCION international, it practices both the individual lending model with collateral or guarantor and group lending model with group savings as collateral depending on the local need and context (Jurik, 2005). Participation in SEWA has lead to an increase in member incomes, better work conditions, awareness generation and community participation.

In comparison to these MFIs, microfinance as practiced in European countries is an innovation to counter unemployment, among any section of the society and not just the poor (Jurik, 2005). In many countries, including France and Britain, the unemployment compensation is provided as a lump sum microcredit for microenterprise along with some technical assistance; and in case the client’s business could not succeed, he or she can receive the unemployment benefits again with a condition that he or she would compensate the loan through higher unemployment insurance once he or she secured another employment (Jurik, 2005).

The above examples of successful international MFIs provide a general overview of microfinance as practiced by nonprofits and for-profit organizations. However, as mentioned in the previous chapter, there have been attempts by many governments to provide subsidized credit

55 Self-employed Women's Association; retrieved March 30, 2010; from http://www.sewa.org/About_Us.asp
56 Ibid
to the rural poor through state owned banks in the past. Many of these attempts proved futile and left a legacy of economic inefficiency, corruption, heavy losses, and misuse by undeserving rich borrowers (Armendariz de Aghion and Morduch, 2007; Gaiha and Nandhi, 2008). One such instance is exemplified by the state owned Indian banks in south Asia. After a failed attempt of government sponsored microfinance, India reformed its policies and has emerged as a successful example of group lending through intermediary MFIs.

3.3 **India’s three different attempts at microfinance –**

(a) **The Failure of State-Owned Development Banks**

Subjected to over two centuries of imperialism, under the mercantilist policies of the British crown, India faced typical export of cheap raw materials and expensive import of finished products. After gaining independence from the British in 1947, India had little industry & infrastructure, untrained human capital, food scarcity, and abject poverty. The prolonged British rule had made India very wary and suspicious of the capitalist west and international trade; therefore young India’s indigenous political elites chose a socialist set up, which was highly influenced by Gandhi’s approach to development. It focused on self reliance through development of small cottage industries that emphasized the *swadeshi* (goods made within one’s own country) movement and generated local employment in return. Thus India was constructed as a socialist state, focusing on development of small industry and choosing to stay away from the free market economy and the spirit of capitalism.

Given the mass abject poverty, the Indian government made special endeavors in the banking sector to reach out to the poor and undertook a banking sector reform that nationalized most of its commercial banks in 1969 based on the belief that the colonial banking system was
inclined towards the capitalists and ignored the rural poor, who were the vast majority in India (Basu and Srivastava, 2005; Roland, 2008). In 1977, in order to boost provision of credit in deep rural areas termed as the ‘priority sector’, the Reserve Bank of India, India’s Central Bank, came up with a new branch licensing policy that required a bank to open four new branches in an ‘unbanked’ location in order to open one new branch in a ‘banked’ location, a location that already has one or more bank branches (Gaiha and Nandhi, 2008). Such state agricultural banks charged lower interest rates on loans than the actual market rates, and gave higher interest rates on savings with the hope of making subsidized financial services accessible to the farmers and the rural poor (Armendariz de Aghion and Morduch, 2007; Gaiha and Nandhi, 2008).

This process led to heavy subsidization while huge losses were incurred due to high default rate and high transaction cost of financial services offered; moreover, the majority of cheap credit benefitted the politically well connected and already rich borrowers but not the target population (Armendariz de Aghion and Morduch, 2007; Gaiha and Nandhi, 2008). The Indian bank reform from 1969 to 1990 is therefore often cited as a very typical example of a failed attempt of state owned banks to provide microfinance services to the poor and exemplifies the legacy of subsidies, corruption, and economic inefficiency.

(b) The SHG-Bank linkages after 1991

The turning point in the Indian economy came with the financial crisis of 1991 when it had to borrow funds from the IMF. This event broke down the inward looking economy and the distrust of foreign direct investments; and Structural Adjustment Programs were implemented for the first time since independence in 1947 (Das et al, 2005; Gaiha and Nandhi, 2008). This involved deregulation of interest rates, competing state owned and private banks in a common market, and most importantly a new emphasis on a nationwide microfinance initiative that linked
NGOs and informal groups called Self-Help Groups (hereafter referred to as SHGs) with Banks; which is now referred to as ‘SHG-Bank Linkage’ model (Basu and Srivastava, 2005; Gaiha and Nandhi, 2008).

Following the structural reforms, in 1992 a pilot project of linking 500 SHGs with National Bank for Agriculture for Rural Development (hereafter referred to as NABARD) was initiated under a policy of the Reserve Bank of India. NABARD is the apex development bank established under the National Bank for Agriculture and Rural Development Act and Preamble in 1981 to promote and develop agriculture, small scale industries and all the allied economic activities (NABARD, n.d.\textsuperscript{57}).

Under the SHG-Bank linkage scheme, a group of 15-20 individuals, mostly women with similar socio-economic background, is formed either directly by a rural bank or through an intermediary NGO and the SHG is given a loan by the same bank (Dasgupta, 2005; Gaiha and Nandhi, 2008). However, in order to get a loan, a self-help group must save collectively under a group name with the same bank. The ratio of loans to savings is usually kept at 1:2 but exceptions of 1:4 have also been reported (Gaiha and Nandhi, 2008). The group is treated as an entity in itself and therefore loans are offered to the group and not an individual. The loan money is then borrowed by individual members one after another and the group democratically decides which member will get the loan first, for what time period and at what rate of interest. Thus, in SHG-Bank linkage both peer pressure and group savings act as collateral. In order to promote SHG-Bank linkages, NABARD provides subsidized refinancing support to commercial banks to encourage them to lend to SHGs. It aimed to serve 1 million SHGs by 2008, which have grown approximately 2000% between 1999-2003 (Basu and Srivastava, 2005).

\textsuperscript{57} National Bank for Agriculture and Rural Development website; retrieved March 29, 2010; from \url{http://www.nabard.org/nabardact.asp}
(c) The MFI intermediary approach

The Indian microfinance sector has also received much success through the MFI intermediary approach, a variant of the group and Grameen model. This approach has been largely funded by the Small Industries Development Bank of India (hereafter referred to as SIDBI) that was set up in January 1999 and later supported by DFID since 2001, by the Rashtriya Mahila Kosh or RMK (National Women’s Fund) established under the Department of Women and Child Development of the Government of India in 1993, and by Friends of Women’s World Banking India or FWWB (Basu and Srivastava, 2005; Radhakrishna and Ray, 2006; Gaiha and Nandhi, 2008).

In this model just like a SHG, the MFI acts as an intermediary but borrows directly from commercial banks and above cited sources of funding at market rate (Gaiha and Nandhi, 2008). However, unlike the SHG-Bank linkage model, savings are not mandatory and the MFI records, tracks and decides the loan mechanism; though the repayment is done as usual through group sessions and practice of peer pressure (Basu and Srivastava, 2005; Gaiha and Nandhi, 2008).

The Indian MFIs have reached out to millions of borrowers but very few offer services beyond credit and savings. Though the MFI intermediary approach offers similar advantages as the SHG-Bank linkage model, the cost of transaction for Indian MFIs have been higher because they have not benefited from grants/subsidized funding like Grameen Bank. Being funded by SIDBI, RMK, FWWB or commercial banks, they take funds at market rate, and achieving profitability and sustainability has been more difficult for Indian MFIs than those working in other countries (Basu and Srivastava, 2005).

The SHG-Bank linkage model combines the advantages of ROSCAs (savings), credit unions (loan against savings), group model (peer pressure and collective liability), and individual
lending model (interest is received on group savings). This model has also been highly successful in terms of women empowerment such as self-confidence, greater respect in family and community, economic independence and other related developmental issues like promotion of female child education, health and hygiene, and practice of birth control in orthodox rural communities. Moreover, the SHG-Bank linkages have made use of the vast network of state owned banks established during 1969-1990 and have reached out deep to rural areas that were left out before (Basu and Srivastava, 2005; Gaiha and Nandhi, 2008).

The MFI intermediary model also offers similar advantages but unlike the SHG-Bank linkage model, the borrowers are not tied down to credit limits as a certain proportion of group savings and the loan cycles are shorter. Out of the two approaches, the SHG model dominates in terms of outreach and profitability (Basu and Srivastava, 2005; Gaiha and Nandhi, 2008).

To sum up, this chapter briefly summarizes the need for microfinance services in the world today, and traces few successful MFIs in different regions of the world that reflect the breadth of microfinance spectrum. Following different models and approaches, these examples reflect the deep rooted values and needs of that particular society. Especially explicit in the case of India, where indigenous political elites when entrusted with the responsibility of making a nation, chose a socialist set up due to their anti-capitalist values and belief in social equity. Thus the society and its dominant values of nonviolence, social equity, and tolerance shaped these leaders world view and in return, these leaders further shaped institutions, policies, and laws that constructed the society. Due to the clutches on the caste system in traditional Indian society, the elites believed that poverty in India is as much a social outcome as it is economic; and political equality cannot be ensured without social and economic equality. Therefore the state owned banks in contrast to private banks aimed at reaching out to poorest of the poor and not serve only
a handful rich. Further policies that mandated opening up of new branches in unbanked rural areas and provide subsidized credit to the poor can be taken as a good constructivist explanation of why a country and its elite chose one thing over another. Though these state owned banks failed due to corruption and economic losses, still the vast web of banks established due to India’s Central Bank’s policy later benefited the SHG-Bank linkages and the MFI intermediary approach immensely. Thus there exist different reasons for development of microfinance in different cultures and there is no single defined way to put them all together.
CHAPTER 4

GRAMEEN BANK IN BANGLADESH
A CASE STUDY

In the 21st century Grameen Bank has emerged as the epitome of successful MFIs worldwide with a self reported repayment rate of 98% and over eight million borrowers, 97% of them being females; it is indeed a role model in the international development arena (Grameen bank, n.d.58). A Business Times journalist, Bahra writes on Yunus and the Grameen Bank, “Banker to the poor Muhammad Yunus works to a simple philosophy. He looks at the way in which conventional banks work and then does the opposite” (Bahra, n.d.59). In the same article, she quotes Yunus “They go to the rich, I go to the poor. They go to men, I go to women. They go to the urban areas, I go to the rural ones. They look for collateral, I look for collateral-free.” At every step Yunus and the Grameen Bank have therefore broken the business and financial stereotype set by traditional banks.

4.1 History

Bangladesh shares a similar history and values as India. It was a part of unified India till 1947 and when the British left India, the state of East Bengal became a part of Pakistan. As the land of East Bengal was totally separated from the mainland of Pakistan, there was a growing dissatisfaction among its residents of the skewed distribution of resources by the Pakistan

59 Business Times online; retrieved April 6, 2010; from http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article5269634.ece
government. East Bengal gained independence from Pakistan in 1971 and was rechristened as Bangladesh.

Yunus inadvertently embarked on this successful journey by providing a collateral free loan of a negligible amount of $27 to a group of 42 villagers in 1974 to help them finance their rural enterprise and pull themselves out of debt (Srivastava, 2005). Yunus believed that with irregular income and no collateral to offer, these poor were subjected to ‘financial apartheid’ when the commercial banks discriminated the poor because of high default risks, increased transaction costs, small loan amounts and high frequency of transactions (Chowdhury, 2008). Due to a lack of formal financial services whether to run a small business or to cover sudden consumption or risk expenditures the poor turn to usurious village moneylenders often offering self labor as collateral, where in case of loan default, the borrower would work for the moneylender free of cost till an agreed period of time that often ran into many years, and paying interests rates as high as 48% (Basu and Srivastava, 2005). Unable to save, invest, and borrow the poor fail to build assets in the long run that results in generations of chronic poverty (Srivastava, 2005; Yunus, 2007).

With the intention to provide financial services to the poor the Grameen Bank was established under the Grameen Bank Ordinance in 1983 (Ordinance No. XLVI of 198360) to be regulated by the Central Bank of Bangladesh with a special directive to provide microfinance services to the rural poor who did not qualify for financial services offered by commercial banks (Hashemi and Schuler, 2003; Government of People’s Republic of Bangladesh, n.d.61).

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61 Ibid
4.2 Management Structure

With Yunus as the Managing Director, there are 9 female borrowers as serving as board members on the 13 member Grameen Board, and the other 3 board members are government-appointed senior civil servants (Hashemi and Schuler, 2003; Grameen bank, n.d.\(^62\)). Other than Yunus all board members have voting rights and serve a three year term on the board (Hashemi and Schuler, 2003). As per the latest 2008 annual report, Grameen Bank has 40 zonal, 264 area, and 2,539 branch level offices (Grameen Bank, n.d.\(^63\)). As shown in Figure 4.1 the organization heart of the Grameen Bank indicates its democratic structure and functioning.\(^64\)

![Grameen Bank Organization Chart](http://www.grameen-info.org/index.php?option=com_content&task=view&id=675&Itemid=670)

Figure 4.1

Grameen Bank Organization Chart


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In the early years over three quarters of Grameen’s funding came from the Central Bank and the remaining one quarter from international donors and agencies (Hashemi and Schuler, 2003); the last donation that Grameen received was in 1998 and has been self sustaining since then (Grameen Bank, n.d.\textsuperscript{65}). Though in the past Grameen received preferential rates, now it borrows money at commercial rates and most of the loan money is mobilized through deposits from its borrowers (Grameen Bank, n.d.\textsuperscript{66}). Grameen borrows hold 94% of its shares and the rest are held by the Bangladesh government, thus making the Grameen borrowers owners of the bank (Grameen Bank, n.d.\textsuperscript{67}).

4.3 Lending methodology and operations

The Grameen Bank works with a group lending model which is now famous as the Grameen model, where every member of the group in turn gets a collateral free loan (Yunus, 2007a). Through peer pressure, the members ensure that the loans are paid on time because with default of one group member, the entire group is disqualified for future loans (Grameen Bank, n.d.\textsuperscript{68}). To become a group member, a person should own less than 0.5 acres of land and the household assets should not be worth more than 1 acre of medium quality land (Rahman and Hossain, 1995; Hashemi and Schuler, 2003). This ensures that only poor households benefit from Grameen services, though even by this criterion half of the rural Bangladesh population is eligible (Hashemi and Schuler, 2003).

\textsuperscript{65} Grameen Bank website; retrieved June 6, 2010; from http://www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=175

\textsuperscript{66} Ibid

\textsuperscript{67} Grameen Bank website; retrieved June 6, 2010; from http://www.grameen-info.org/index.php?option=com_easyfaq&task=cat&catid=80&Itemid=524

\textsuperscript{68} Grameen Bank website; retrieved June 6, 2010; from http://www.grameen-info.org/index.php?option=com_content&task=view&id=24&Itemid=127
The average income generation microloan amounts to $100 that last for a year on a market competitive rate of 20%; small installments are paid on weekly basis and they start a week after the loan money is disbursed (Hashemi and Schuler, 2003; Yunus, 2007a). All transactions are simplified for easy comprehension, are held in local public areas to avoid corruption and distrust, and also to promote women participation who are otherwise secluded from outside activities in the traditional Bangladeshi society. However, Grameen Bank does not provide any type of training or technical assistance to its borrowers because Yunus believes that the poor know what to do with their money and how to put it to best use in a microenterprise (Yunus, 2007a). This concept has been called microminimalism (Weber, 2002).

With regular repayment, the borrowers become eligible for loans other than income generation loans such as housing, technology, crop processing, other seasonal activities, and student loans that are subject to simple interest on a declining balance method (Grameen Bank, n.d.69). Grameen Bank charges different rates of interests on different loans. 20% for income generating activity loans on a declining basis, 8% for housing loans, 5% for student loans when the student graduates from the institute in about 3-5 years otherwise 0% interest is charged till the student has graduated. Grameen Bank offers loans even to beggars at 0% interest rate and waives off the loan in case of death of an individual (Grameen Bank, n.d.70). This lies in stark contrast to traditional microfinance where money lenders would hold the next male kin responsible for the loan repayment in case of death of the actual borrower.

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In order to promote propensity to save and group cohesion among group members, 5% of each loan is deposited in the group saving account on a weekly basis and savings can be accessed only with a democratic decision reached by the entire group (Yunus, 2007a). An attractive 8.5% - 12% interest is offered on savings deposits, on both voluntary individual savings and mandatory group savings, when commercial banks in Bangladesh typically offer 7.5% (Grameen Bank, n.d.\textsuperscript{71}). Through these saving account deposits and interest rates on loans, a new branch is expected to break-even within the first year of its operation.

Other than financial services provided to the poor, Grameen has affiliated with various organizations to provide valuable services to its clients like enhanced agricultural productivity and risk avoidance (Grameen Krishi Foundation), fish breeding technology (Grameen Mothsho Foundation), low cost accessible energy (Grameen Shakti Foundation), marketing of handloom (Grameen Uddyog and Grameen Shamogri), coping with health problems (Grameen Health Programme), and access to information and communication in rural areas (Grameen Telecom) among many others (Hashemi and Schuler, 2003; Grameen Bank, n.d.\textsuperscript{72})

4.4 Profitability and sustainability

Grameen Bank has disbursed Tk 537.51 billion (US $ 9.31 billion) since its beginning, and has mobilized its entire current outstanding loan through deposits (Grameen Bank, n.d.\textsuperscript{73}). As shown in Table 4.1, it does not just cover its operational cost on its own but also reports

\textsuperscript{71} Grameen Bank website; retrieved June 6, 2010; from http://www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=164
\textsuperscript{72} Grameen Bank website; retrieved June 6, 2010; from http://www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=164
\textsuperscript{73} Ibid
annual profits with the exception of years 1983, 1991, and 1992 when Bank’s operation cost shot up due to a government enforced mandatory hike in employee salary (Grameen bank, n.d.\textsuperscript{74}).

Table 4.1: Grameen Bank Historical Data Series 1976-2009 (Amount in Million Taka)

<table>
<thead>
<tr>
<th>Year</th>
<th>Cumulative Disbursement (All Loans)</th>
<th>GB Members' Deposit as % of Total Deposit</th>
<th>Total Number of Members</th>
<th>Percentage of Female Members</th>
<th>Number of Branches</th>
<th>Annual Profit/Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>0.008</td>
<td>-</td>
<td>10</td>
<td>20</td>
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<td>1</td>
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<tr>
<td>1977</td>
<td>0.08</td>
<td>-</td>
<td>70</td>
<td>14</td>
<td>1</td>
<td>-</td>
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<tr>
<td>1978</td>
<td>0.35</td>
<td>-</td>
<td>290</td>
<td>24</td>
<td>1</td>
<td>-</td>
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<tr>
<td>1979</td>
<td>3.06</td>
<td>100</td>
<td>2200</td>
<td>41</td>
<td>6</td>
<td>-</td>
</tr>
<tr>
<td>1980</td>
<td>20.17</td>
<td>100</td>
<td>14830</td>
<td>31</td>
<td>24</td>
<td>-</td>
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<td>53.70</td>
<td>100</td>
<td>24128</td>
<td>39</td>
<td>24</td>
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<td>30416</td>
<td>39</td>
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<tr>
<td>1983</td>
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<td>100</td>
<td>58320</td>
<td>46</td>
<td>86</td>
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<td>1469.49</td>
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<td>295</td>
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<tr>
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<td>2279.52</td>
<td>98</td>
<td>339156</td>
<td>81</td>
<td>396</td>
<td>.44</td>
</tr>
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<td>1988</td>
<td>3559.95</td>
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<td>490363</td>
<td>86</td>
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</tr>
<tr>
<td>1989</td>
<td>5328.23</td>
<td>73</td>
<td>662263</td>
<td>89</td>
<td>641</td>
<td>2.25</td>
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<tr>
<td>1990</td>
<td>7590.70</td>
<td>64</td>
<td>869538</td>
<td>91</td>
<td>781</td>
<td>3.10</td>
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<tr>
<td>1991</td>
<td>10230.30</td>
<td>69</td>
<td>1066426</td>
<td>92</td>
<td>915</td>
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<tr>
<td>1992</td>
<td>15434.00</td>
<td>64</td>
<td>1424395</td>
<td>94</td>
<td>1015</td>
<td>-5.65</td>
</tr>
</tbody>
</table>

\textsuperscript{74} Grameen Bank website, Retrieved June 6, 2010 from \url{http://www.grameen-info.org/index.php?option=com_easyfaq&task=cat&catid=80&Itemid=200}
<table>
<thead>
<tr>
<th>Year</th>
<th>Loans Given</th>
<th>Repayment Rate</th>
<th>Loans</th>
<th>Repayment Rate</th>
</tr>
</thead>
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<td>1993</td>
<td>26056.10</td>
<td>94</td>
<td>1814916</td>
<td>1040</td>
</tr>
<tr>
<td>1994</td>
<td>39968.50</td>
<td>94</td>
<td>2013130</td>
<td>1045</td>
</tr>
<tr>
<td>1995</td>
<td>53632.00</td>
<td>94</td>
<td>2065661</td>
<td>1055</td>
</tr>
<tr>
<td>1996</td>
<td>65509.80</td>
<td>94</td>
<td>2059510</td>
<td>1079</td>
</tr>
<tr>
<td>1997</td>
<td>81780.40</td>
<td>95</td>
<td>2272503</td>
<td>1105</td>
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<tr>
<td>1998</td>
<td>100899.80</td>
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</tr>
<tr>
<td>1999</td>
<td>116597.70</td>
<td>95</td>
<td>235083</td>
<td>1149</td>
</tr>
<tr>
<td>2000</td>
<td>130559.10</td>
<td>95</td>
<td>2378356</td>
<td>1160</td>
</tr>
<tr>
<td>2001</td>
<td>146538.20</td>
<td>95</td>
<td>2378601</td>
<td>1173</td>
</tr>
<tr>
<td>2002</td>
<td>162286.24</td>
<td>95</td>
<td>2483006</td>
<td>1178</td>
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<tr>
<td>2003</td>
<td>183575.33</td>
<td>95</td>
<td>3123802</td>
<td>1195</td>
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<tr>
<td>2004</td>
<td>209166.76</td>
<td>96</td>
<td>4059632</td>
<td>1358</td>
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<tr>
<td>2005</td>
<td>3248163.17</td>
<td>96</td>
<td>5579399</td>
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</tr>
<tr>
<td>2006</td>
<td>306368.63</td>
<td>97</td>
<td>6908704</td>
<td>2319</td>
</tr>
<tr>
<td>2007</td>
<td>356798.22</td>
<td>97</td>
<td>7411229</td>
<td>2481</td>
</tr>
<tr>
<td>2008</td>
<td>418903.07</td>
<td>97</td>
<td>7670203</td>
<td>2539</td>
</tr>
<tr>
<td>2009</td>
<td>498311.47</td>
<td>97</td>
<td>7970616</td>
<td>2562</td>
</tr>
</tbody>
</table>

Important note: 1976 figures show the loans given through Janata Bank. It does not include the loan personally given by Professor Muhammad Yunus. Grameen Bank became operational as an independent bank on October 2, 1983.


The Grameen Bank group lending model does not just ensure high repayment rate but also helps in minimizing cost that would be otherwise spent on background check of borrowers and minimizes the need to open lot of branch offices (Yaron, 1991; Yunus, 2007a). Due to its parsimonious operations and the staff’s monetary discipline including non-air conditioned offices
and use of bicycle or mini-bus for official travel, even for Yunus himself, Grameen Bank ensures that all the income and profit is spent on the poor borrowers’ benefit.

4.5 Impact

Supporters of the Grameen Bank believe that its loans have immensely impacted the lives of Bangladesh rural poor. Bank member households have reported a 43% higher income than control group household (Basu and Srivastava, 2005; Jurik, 2005). Moreover, member households also report increased asset possession, augmented food and other consumption expenditures, higher investment in education, housing, health and sanitation (Basu and Srivastava, 2005) and sustainable reduction in poverty and vulnerability in the long run (Wahid, 1994; Khandker and Chowdhury, 1995; Hashemi and Schuler, 2003; Basu and Srivastava, 2005).

Above all, its supporters believe that Grameen Bank has brought about women empowerment in the traditional patriarchal Bangladesh society; with decreased fertility rates, reduced chances of domestic violence, and increased chances to earn income, women have gained a voice in family and community matters that was unheard of in the past (Naidoo, 1994; Hashemi and Schuler, 2003; Jurik, 2005; Armendariz de Aghion and Morduch, 2007). They argue that women who have been oppressed since time immemorial in these traditional societies due to lack of collateral, education, and freedom of mobility, are not just economically empowered but are also socially liberated through participation in the Grameen Bank (Fernando, 1997; Servon, 1998; Rankin, 2002). Research suggests that a 100% increase in the volume of borrowing by a female client would result in a 5% increase in nonfood per capita expenditure in a household as compared to only 2% increase when the borrower is male (Khandker, 2003).
Therefore according to proponents of microfinance, lending money to women, who spend much larger parts of their income on the family than men but still have higher repayment and lower default rates (Kabeer, 1994; Armendariz de Aghion and Morduch, 2007) is not just beneficial to themselves but also to their family, community and even the Bank (Morduch, 2000; Rankin, 2002).

Grameen supporters also claim that it encourages its members and borrowers to promote socio-economic, health care, and education related areas. Before starting every meeting Grameen members chant the 16 decisions such as small family, education for all children, not living in dilapidated houses, growing and consuming more vegetables, safe drinking water, and use of pit latrines among many others and adopt and saluting practices not just promote group identity but also build awareness and discipline among the members (Grameen Bank, n.d.\textsuperscript{75}). Grameen’s success has thus been attributed to many concomitant factors by its supporters. Some of them include charismatic and futuristic leadership of visionary Yunus, discipline within Grameen staff and among borrowers, transactions happening within the community in a public spot, and procedural transparency and trust among many others (Hashemi and Schuler, 2003).

4.6 Grameen Bank II

Feedback and constructive criticism has led to incremental goal setting and institutional reform in the Grameen Bank. Many of the criticisms against Grameen Bank were recently addressed through a reform in the Grameen Bank and the Grameen Generalized System (GGS)

\textsuperscript{75} Grameen Bank website; retrieved June 6, 2010; from http://www.grameen-info.org/index.php?option=com_content&task=view&id=27&Itemid=176
or Grameen Bank II that was established in 2001 (Yunus, 2007a). The older version of Grameen is now referred to as Grameen Classic System or GCS (Grameen Bank, n.d.\(^76\)).

Apart from the sustainability critique, one of the main criticisms against the original Grameen Bank was that it was unforgiving to people who defaulted on their loans. If one member failed to pay his/her installment irrespective of the reason, the entire group of five members was disqualified for future loans (Armendariz de Aghion and Morduch, 2007). This forms the pivot of group lending mechanism where peer pressure is exercised to prevent a member from defaulting under any circumstances. However, with increased cases of debt spirals when a member took alternating loans from the village moneylenders to pay back Grameen loan and vice versa, Grameen II was created as a reformed bank (Armendariz de Aghion and Morduch, 2007).

Grameen II offers two main loans – an easy basic loan and a flexible loan. An easy basic loan can be repaid from three months to three years; the loans can be paid in weekly installments of different amounts, instead of a fixed amount as previously practiced. However, in case a borrower gets a bad record of nonpayment, he/she is offered an exit route from the basic loan through a flexible loan of a lesser ceiling spread over a longer period of time (Yunus, 2007a). A flexible loan is nothing but a rescheduled basic loan with different operational rules. It is only when the borrower fails to pay back even the flexible loan that he/she is dropped from the group and the loan is written off as bad debt.

Yunus describes the basic loan as the "Grameen micro-credit highway" as shown in Figure 4.2 below. The borrower can pay regular installments and keep moving as per her

schedule with ease, comfort, and no interruption on the micro-credit highway. If she is regular and disciplined, she can pick up speed and can shift to higher gears, that is, on the Grameen highway she can upgrade her loan size after each loan cycle. But in case she runs into trouble, does not make regular payments and she cannot keep up with the highway speed, she can take an exit from the microcredit highway on to a detour called a "flexible loan" or "flexi-loan". This exit permits a slower speed and she can pay her smaller amount installments timely by extending the loan period. Taking this exit allows her to continue on with her journey towards development “…but only through a winding narrow road for a while” (Grameen, Bank, n.d.77).

Figure 4.2: Grameen Microcredit Highway Metaphor


Finally, in case of need a group member can now withdraw his contribution in the group savings accounts along with accumulated 8.5% annual interest after a period of ten years of initial group formation (Hashemi and Schuler, 2003). After the first such withdrawal, members can withdraw their savings once every three years.

4.7 Future vision

Reflecting on the future of microfinance, Yunus envisions not just providing financial services to the poor but also establishing a “Grameenized private sector”, a social-consciousness-driven private sector (Yunus, 2007a; Yunus, 2007b). He refutes the classical economics based assumption that the rational actor is a mere profit maximizer and is interested only in self. In the future, he sees micro-borrowers and micro-savers to get organized and collectively own big enterprises, and even infrastructure companies as shareholders to end the vicious cycle of chronic poverty (Yunus, 2007a; Yunus, 2007b). Grameen bank is just the beginning of such an enterprise where 94% of the equity is owned by the poor and 6% is owned by the government (Grameen Bank, n.d.78).

Yunus defines a social business as a “non-loss, non-dividend enterprise, created with the intention to do good to people, to bring a positive change to the world” that is different from ‘corporate social responsibility’ (Yunus, 2007b). In organizational structure, a social business would be just the same as what Yunus calls ‘a Profit Maximizing Business or PMB’. There would be a ‘social stock market’ where socially motivated people would buy so called social business shares; shareholders would not receive any profit on shares and the profit would be

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reinvested into the social business. The shareholders can sell the shares and receive the original amount they paid for it, and reinvest in some other social business, hence the same money would bring about benefit to not just one but many social businesses. Social business enterprises would compete for investment very much like the PMBs, but it would be a healthy and friendly competition and they could even merge with other social business enterprises. Thus, Yunus’s social business would be self sustaining (Yunus, 2007b).

It has been argued by many researchers and scholars that a huge section of world population is in need of microfinance services and many successful international MFIs like FINCA International, SEWA, Accion International, Indian SHG-Bank Linkages among many others, have demonstrated that microfinance makes a significant contribution in the lives of the poor. Much like the case of India, where the state owned banks tried to reach out to the poorest of the poor whether or not they were ‘bankable’, the Central Bank of Bangladesh supported the Grameen Bank with a similar motive. The same constructivist approach that befits the case of India, holds true in the case of Bangladesh as well.

However, MFIs in the developed world have very different contexts and issues to deal with than their developing country counterparts. The next chapter covers microfinance as practiced in the developed economy of the United States of America, in order to develop the main argument of this thesis that microfinance is not a “one size fits all” solution to the world poverty.
CHAPTER 5

ACCION USA IN THE UNITED STATES OF AMERICA
A CASE STUDY

As discussed in the previous chapters, microfinance has been practiced in most parts of the world for a long time but there has been a recent upsurge in its popularity due to many successful MFIs especially in Asia, Africa, and Latin America. For this reason, microfinance models have been replicated in all parts of the world and many adaptations have been made as per the local needs and milieu. This chapter discusses the practice of microfinance in the United States of America, a developed country, to compare and contrast it with microfinance practices in the developing countries.

Microfinance in the U.S. is more inclined towards microcredit and microenterprise development due to its socio-economic and political context that will be discussed in detail in this chapter. This chapter aims to highlight the microfinance movement in the U.S. and how it has been shaped by the dominant political and economic ideology of neoliberalism; that how the values inherent in the society has shaped this ideology and how the ideology has shaped the construct of the society in return. The chapter first presents a prelude to the rise of microfinance in the U.S. and then discusses the evolutionary phase that it has gone through in the past century. With the help of the case study on a U.S. based MFI, the next chapter compares and contrasts microfinance practices in the developing and the developed countries and finally discusses the challenges and opportunities this sector holds for both.
5.1 Prelude to the U.S. microfinance – reasons for its rise and popularity

Microcredit and microenterprise, which is a small but integral part of microfinance schema, first became popular in the U.S. during the 1980s deregulation era under the Reagan administration, when traditional banks closed down their branches in less wealthy areas and the poor had to turn to services like check cashing, pawn shops or other informal institutions for credit or other financial services (Light and Pham, 1998). Along with the increase in globalization and the dawn of the era of job outsourcing, the unemployment problem in the U.S. intensified (Blau, 1999; Rosen, 2002; Jurik, 2005). Recessions, public sector downsizing, and outsourcing left the poor with temporary, part time, low paying jobs that most importantly did not provide health care benefits and wreaked havoc especially among the American poor (Jurik, 2005). Moreover, sharp reductions in government farm subsidies and import quotas made farming far less lucrative than before, and rural families struggled to find jobs to replace or supplement their diminishing income (Jurik, 2005).

Therefore, the history of microcredit and microenterprise in the U.S. are informed not just by the success stories of southern MFIs, but are also rooted in economic development efforts and contemporary needs of the American society.

5.2 Previous attempts in the U.S. to reduce poverty and increase employment

While being one of the strongest economies in the world and famous as the land of dreams and opportunities, the United States of America has an underbelly, too. In 2008 the U.S. had a poverty rate of 13.2% (U.S. Census Bureau, n.d.\textsuperscript{79}) and an unemployment rate of

\textsuperscript{79} \textit{U.S. Census Bureau} website; retrieved June 13, 2010; from \url{http://www.census.gov/prod/2009pubs/acsbr08-1.pdf}
approximately 10% (U.S. Department of Labor, 2010\textsuperscript{80}). Out of the total GDP of $14, 623.9 billion for 2010, the U.S. government’s total expenditure on unemployment compensations alone would be $253.8 billion, that is slightly more than one third of the entire spending on welfare ($750.5 billion) (U.S. Government Spending, n.d.\textsuperscript{81}). Thus, the U.S. government will spend 1.74% of the total 2010 GDP on unemployment compensations.

The history of unemployment compensation and other government sponsored welfare programs goes back to the Great Depression era with Franklin Roosevelt’s introduction of New Deal programs. Similarly Lyndon Johnson’s Great Society programs in the 1960s aimed at waging a war on poverty and initiated programs on housing, food provision, employment in the government sector etc. (Servon, 1999; Jurik, 2005). Probably it was during the 1950s and 1960s when the seeds of microenterprise development were first sown in America, though not with the same intention as in the developing countries.

The federally sponsored U.S. Small Business Administration (hereafter referred to as SBA) was established in 1953 that offered small loans to start and build a successful business that would support the American economy (U.S. Small Business Administration, n.d.\textsuperscript{82}). The federally funded Model Cities Program was established in the 1960s to provide additional financial and technical assistance to many poor cities and large slums. It mainly aimed at increasing better housing facilities, creating jobs and income opportunities, and reducing dependence on welfare payments apart from improving educational and health care facilities (Cullingworth and Caves, 2009; Servon, 1999). During 1970s and 1980s, business assistance

\textsuperscript{82} U.S. Small Business Administration website; Retrieved June 13, 2010; from http://www.sba.gov/aboutsba/index.html
programs were funded through Community Development Block Grants (hereafter referred to as CDBG) by the Department of Housing and Urban Development (hereafter referred to as HUD) or Department of Labor implemented in cities that showed signs of socio-economic distress (Cullingworth and Caves, 2009; Servon, 1999). In order to meet this objective, real property was acquired, demolitions were made, recreational and business opportunities were created and overall planned economic development was enforced.

However, with a constructivist explanation where the capitalist neoliberal ideology shaped the institutions and laws of this society, most of these programs were aimed at promoting economic activity in general and not on poverty alleviation in particular. Therefore the focus has always been on microcredit and microenterprise development and not on the wider microfinance services such as savings and insurance and overall empowerment of the poor, a prime focus of MFIs in the developing countries. Clearly, the primary intention has been to reduce spending on welfare programs and boost the economy but not necessarily the sustainable development of the American poor and underprivileged. With a capitalist construct, the American society values competition, self initiative, and free market and believes little in welfare spending or subsidization of any sort.

Government spending on the poor and expenditures on the welfare programs has always been a controversial topic in the U.S. and has been a hot debate topic especially during election campaigns (Piven, 2002; Jurik, 2005). To its critics, welfare is seen as a promotion of a culture of dependence on the tax monies of hard working Americans. During the 1980s both Reagan and Bush reduced welfare expenditures as they were expensive and against the capitalist ideology of competition and incentive in excellence (Jurik, 2005). During the welfare reform of the 1990s, Clinton replaced a number of social programs such as Aid for Families with Dependent Children
(AFDC), the Job Opportunities and Basic Skills (JOBS) Training program and the Emergency Assistance (EA) program with Temporary Assistance for Needy Families (TANF) that reduced welfare expenditure and tightened the eligibility criteria of recipients (U.S. Department of Health and Human Services, n.d.\textsuperscript{83}). Thus cutting down welfare expenditure, reducing the size of the government and jobs in the public sector, and an increased emphasis on neoliberal philosophy has brought many changes in American as well as in overall world economics and politics in recent times (Blau, 1999). These attempts to emphasize free markets and reduce government intervention and expenditure have been called structural adjustments in the developing countries as discussed in Chapter 1 and supply side economics in the developed countries.

5.3 The early years of U.S. microfinance

Once again it is important to note that U.S. microfinance has been more focused on microcredit and microenterprise or small business development, and though one can draw parallels between American and third world microfinance or microcredit initiatives, they are not the same in strict sense of the word. The most important factor at play is that while the rise of microcredit and microenterprise in the U.S. has been a marriage of convenience between welfare reduction strategies and economic development programs (Servon, 1999; Jurik, 2005), the rise of microfinance in the developing was primarily based on sustainable and equitable economic opportunities to the poor. While welfare programs in the U.S. focused on services to individuals, economic development programs aimed at boosting the economy at large, benefitting the individual in the process. Thus the economic recessions, the debate of welfare reform and thrust

\textsuperscript{83} U.S. Department of Health and Human Services website; retrieved June 13, 2010; from http://www.acf.hhs.gov/programs/ofa/tanf/about.html
on economic development programs made the political environment conducive for the growth of microfinance in the U.S. (Servon, 1999; Jurik, 2005). This reason for the rise in popularity of microfinance services was different from the reason for its rise in developing countries, where unlike the values of the neoliberal ideology, the focus was on offering financial services to the poorest of the poor.

Though the SBA was established in the 1950s and the Model Cities program began in the 1960s, it was mainly in the 1980s that microfinance emerged as an experiment to address the rising employment insecurity and the resultant dependence on welfare payments (Jurik, 2005). Much like microfinance and microcredit in the developing world where self initiated microenterprises are promoted to help people climb out of poverty, many self employment programs like the U.S. Department of Health and Human Services funded Demonstration Partnership Program in New York and Vermont (1986), federally funded Self-Employment Investment Demonstration Program (SEID) in Iowa, Maryland, Michigan, Minnesota and Mississippi (1986), the U.S. Department of Labor and Department of Trade and Economic Development funded Self-Employment and Enterprise Development Demonstration (SEED) in Washington and Massachusetts (1989-1990) were promoted in the U.S. (Jurik, 2005).

These programs suggested that these self-employment initiatives created new jobs and most of the self-employed AFDC recipients stopped taking welfare payments altogether or added income to their welfare benefits (Jurik, 2005). Though these programs cannot be termed as microfinance in strict terms as understood in the developing world, these were the seeds of microenterprise development in 20th century America that can be deemed as a parallel to microcredit initiatives of leading MFIs, and many developing countries government supported microcredit based self-employment programs.
5.4 Current policy support and funding

By the onset of the 1990s, such microcredit programs and microenterprise development as stated above were among the top choices to counter unemployment, promote economic development and upward social mobility among the poor in the U.S. (Balkin, 1992; Johnson, 1998). With the election of Bill Clinton into the White House, microfinance received great support and attention during both terms of his presidency (Schreiner and Morduch, 2002). Clinton, in fact had facilitated the replication of the Grameen Bank way back in 1988 as the Governor of Arkansas, and the organization ‘Good Faith Fund’ became one of the earliest microfinance programs in the U.S.

A strong thrust to U.S. microfinance and microcredit came in 1992 under the first major legislation for microenterprise development enacted under the SBA Microloan Demonstration Program, which became a permanent program in 1997 (Carr and Tong, 2002). Under this program, SBA provides loans and technical assistance to private nonprofits and small businesses to help the poor or near-poor rise out of poverty through self employment (SBA, n.d.84).

Another landmark legislation ‘the Reigle Community Development and Regulatory Improvement Act’ came in 1994 that established the Community Development Financial Institution (hereafter referred to as CDFI) initiative of the U.S. Department of Treasury under the Clinton administration. A certified CDFI is a specialized financial entity such as Community Development Banks, Community Development Credit Unions, Community Development Loan Funds, and Community Development Venture Capital Funds (Hawke, 2002; CDFI report, 84 U.S. Small Business Administration website; retrieved June 13, 2010; from http://www.sba.gov/aboutsba/index.html
that receives funding and tax credits from the U.S. Department of Treasury to provide financial services to the low income population who are not served by traditional commercial banks (CDFI, n.d.86).

The CDFI initiative strengthened the Community Reinvestment Act (hereafter referred to as CRA) of 1977 that was launched to obligate commercial banks to lend to lower income population (Federal Financial Institutions Examination Council, n.d.87; Jurik, 2005). The purpose of CRA enactment was to counter the disinvestment in inner city or minority neighborhoods that resulted from segregatory practices of traditional banks and to prevent shift of employment opportunities to suburban areas (Kavous, 2006). Thus though CRA was aimed at profitable lending in local communities and increasing investment by necessitating commercial banks to receive a minimum CRA credits by lending to the poor in low income neighborhoods if they want to open new branches or acquire or merge with other business enterprises, the attempt was found mostly ineffective (Jurik, 2005). However, with the CDFI initiative even the commercial banks could receive their CRA credits by lending through certified CDFIs as intermediaries without increasing their operational costs (Federal Financial Institutions Examination Council, n.d.88; Jurik, 2005).

A CDFI can raise funds from bank as well as nonbank financial service companies, foundations, religious institutions, individuals, and the government. It is a win-win situation for all the parties involved as CDFIs have various sources to access capital, the banks can lend to

86 CDFI website; retrieved June 13, 2010; from http://www.cdfifund.gov/who_we_are/about_us.asp
nontraditional clients and meet their CRA credit requirements, and the government can insure that the underserved community is not being left out and possibilities of investment in the inner cities is not lost (Hawke, 2002).

One of the most important steps to facilitate the microenterprise development process in the U.S. was the establishment of the Association for Enterprise Opportunity or AEO in 1991, which is the first member based microfinance trade association in the U.S. AEO is involved in research, policy advocacy, evaluation, recommendation of best practices, and play an instrumental role in the offering of government incentives to banks to loan smaller amounts to microentrepreneurs especially in poor communities (Association for Enterprise Opportunity, n.d. 89).

AEO also played an instrumental role in the passage of the Assets for Independence Act, a part of the Community Opportunities, Accountability, Training, and Educational Services Act of 1998, that sponsored demonstration programs to promote asset building among the poor (Jurik, 2005). Under this program, TANF recipients saved regularly in savings accounts and the saved amount was matched by the government. AEO also played an instrumental role in SBA legislation and welfare reform where TANF recipients were allowed to start a small business while still receiving welfare checks (Jurik, 2005). And finally, AEO lobbied for the SBA Reauthorization Act of 1997 that made the Microloan Program a permanent part of the SBA and funded women’s businesses; similarly the Program for Investments in Microentrepreneurs Act or PRIME was passed in 1998 that provided two federal dollars for every state dollar to provide business skills to microentrepreneurs (Jurik, 2005).

The issue of funding in the microfinance sector is much debated as discussed in the next chapter, but unlike its southern counterparts, the U.S. microfinance sector is mostly funded by government sources such as the Federal Housing Finance Board, Federal Financial Institutions Examination Council, Small Business Administration, USDA Intermediary Relending Program, and U.S. Department of Housing and Preservation (Opportunity Finance Network, n.d.\textsuperscript{90}). The sector caters to the needs of the unemployed and small business owners (Jurik, 2005). However, in addition to other than federal/state/local government funding, U.S. microfinance programs also receive support from private foundations, banks, businesses, churches, fee or consulting charges, and individual donations as shown below in Table 5.1 (Jurik, 2005).

\begin{table}[h]
\centering
\small
\begin{tabular}{lcc}
\hline
Funding Sources & Number & Percentage \\
\hline
Federal government & 25 & 50 \\
State government & 20 & 40 \\
Local government & 16 & 32 \\
Foundations & 30 & 60 \\
Banks & 20 & 40 \\
Individual donations & 9 & 18 \\
Churches & 5 & 10 \\
Businesses & 9 & 18 \\
Fees/consulting & 10 & 20 \\
Operations funds & & \\
$200,000 or less & 18 & 36 \\
$200,001–400,000 & 17 & 34 \\
$400,001 and above & 15 & 30 \\
Mean operations budget & $309,298 & \\
Median operations budget & $257,000 & \\
\hline
\end{tabular}
\caption{Source of Amounts of Operations Funds (in U.S. MFIs)}
\end{table}

Source: Jurik, 2005, p. 87

In order to cross subsidize some of their operational costs, most microfinance programs also partner with banks, small business development centers, social service agencies, and community development groups (Jurik, 2005). Through such partnerships, the microfinance

\textsuperscript{90} Opportunity Finance Network website; retrieved June 13, 2010; from http://www.opportunityfinance.net/industry/industry_main.aspx?id=232
program does not have to pay for additional activities that are needed for its smooth functioning. Such programs gained popularity during the 1980s and currently there are over 300 microfinance programs operating in the U.S. providing credit, training, and other support to microentrepreneurs (Jurik, 2005). Drawing funding from different sources, these programs operate in thirty out of fifty states in the U.S. (Armendariz de Aghion and Morduch, 2007).

5.5 Facts about U.S. microfinance

In the United States, a microenterprise has been described as “a sole proprietorship, partnership or family business that has fewer than five employees. It is small enough to benefit from loans of $35,000 and generally too small to access commercial banking services”. The size of an average microloan is approximately $5100-$7000 (Association for Enterprise Opportunity, n.d.91; Accion USA, n.d.92; Aspen Institute’s FIELD Fact Sheet, 2000).

According to AEO, at present there are over 24 million microenterprises in the U.S. that represents 18% of all private nonfarm employment and 88% of all businesses (Association for Enterprise Opportunity, n.d.93); and approximately one out of every six private sector employees is employed by a microenterprise. Thus microenterprises have been considered the backbone of the U.S. economy.

91 SVBIC website; retrieved June 13, 2010; from http://www.svbic.com/?q=node/26
Many microfinance projects like the Women’s Self Employment Project (WSEP) in Illinois, the Good Faith Fund in Arkansas, and the Coalition for Women’s Economic Development (CWED) in Los Angeles were initiated in the U.S. in the 1980s based on developing country models like the Grameen Bank (Jurik, 2005). However, as will be discussed in the next section, most U.S. MFIs moved away from group lending towards the individual lending model due to economic, social, and political characteristics of the country. Though the group lending model is still practiced by few MFIs in the U.S. like Grameen America, a MFI working since 2008 that intends to replicate the Grameen model in the U.S.; such MFIs are rare.

This section presents a brief case study on a leading U.S. based MFI called Americans for Community Cooperation in Other Nations or Accion USA (hereafter referred to as AUSA) to illustrate the typical practice of microfinance in the U.S.. The information covered in this case study is partly based on in-person and telephone interviews of Erica Dorn, the Kiva Program Coordinator and Volunteer Partnerships Manager at AUSA New York office, and partly from secondary sources such as the AUSA website, annual reports, and handouts from the AUSA office. The questionnaire used for the case study interview has been attached as appendix 1.

AUSA’s clients have very familiar problem stories to narrate that are extremely common in America.

“Ruben Ramirez was denied a credit card four times before he learned about ACCION USA’s Credit Builder program. When applying for his first $500 loan, Ruben recalls, “I couldn’t believe it! I asked the loan officer, ‘You trust me?’ and she said, ‘Of course!’” He has since taken out another $500 Credit Builder loan from ACCION USA, as well as a small business loan of $2,000 for working capital… started his own company—High Performance Tile. A short two years since he received his first Credit Builder loan from ACCION USA, Ruben now has
more than $100,000 in contracts, employs as many as 10 workers, and just purchased a new truck—which he financed without complication through the dealership” (AUSA 2007 Annual Report).

5.61 Organizational Chart

![Organizational Chart](image)

Figure 5.61

Source: Accion USA’s internal document

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5.62 Overview

Accion USA is a private 501 (c)(3) registered nonprofit and is a franchise of Accion International as discussed in the previous chapter. It operates out of New York as a MFI serving individuals who cannot access financial services from a traditional bank. Since its inception in 1991, AUSA has loaned over $119,469,314 as 19,680 microloans to small business owners and has over 3000 active borrowers across 46 states (AUSA, n.d.⁹⁵). In totality, AUSA and its affiliates provide 75% of microloan services in the United States and 40% of its clients are females and 86% are minority (AUSA, n.d.⁹⁶). Headquartered in New York, AUSA has branch offices in Miami Florida, Atlanta and Savannah Georgia, and Boston Massachusetts. It also has a network of licensees in Texas, Louisiana, New Mexico, Colorado, Arizona, Illinois, and California.

AUSA believes that many microentrepreneurs are refused business loans from traditional banks because of small loan size, lack of formal credit history, informal nature of business, lack of required prior period of business operation, language barriers, or high risk industry. Such challenges are especially difficult for recent poor or low to moderate income immigrants, minority groups, and women. AUSA does not just offer microcredit to microentrepreneurs, but also credit building services by reporting the client’s payment history to credit bureaus such as Experian, Equifax, and TransUnion (AUSA, n.d.⁹⁷).

⁹⁵ Accion USA website; retrieved June 13, 2010; from http://www.accionusa.org/home/support-u.s.-microfinance/about-accion-usa/who-we-are.aspx
⁹⁶ Accion USA website; retrieved June 13, 2010; from http://www.accionusa.org/home/support-u.s.-microfinance/about-accion-usa/who-we-are.aspx
AUSA also offers financial education workshops as the business operation in a mature and developed economy like the U.S. needs many professional skills like accountancy, record maintenance, inventory management, and marketing and sales. It also provides useful information on tax return filing, though tax return papers are not mandatory for a loan request. This is due to the fact that many borrowers are engaged in informal business, or have more than one job and the microloan only adds to their income pool, or they are welfare recipients and their total income does not exceed mandatory filing threshold.

AUSA partners and networks with various training providers like credit counseling centers, business assistance centers, business libraries, economic development corporations, law firms, commercial banks, immigrant centers, churches, community organizations, and day cares to provide services to its clients that it cannot afford to provide by itself but those services are considered necessary for a successful business operation. AUSA also partners with educational institutes like the New York University, Columbia University at New York, Yale University, and Harvard University etc. for consulting projects, curriculum development, and Webinars.

5.63 Lending methodology

In order to meet the specific needs of poor or low to moderate income microentrepreneurs, AUSA offers up to $30,000 loans for start-up businesses with less than 6 months in operation, credit builder loans for $700 to build credit for the first time, and up to
$10,000 as credit development loans to help borrowers to continue their credit history (AUSA, n.d.\(^9\)).

AUSA offers general microloans from $500 up to $50,000 with an average loan size of $5,500. It works on the individual lending model and a loan consultant assesses the credit capacity and business plans of borrowers on a one-on-one basis in order to minimize default risk. Only one loan is offered to an individual at a time in a given family, though he/she could take many subsequent loans depending on their payment history. In contrast to most developing country models, all microloans are securitized by collateral that is usually 33% of the requested loan amount or demands a loan cosigner in sound financial state at the time of the loan application. The rate of interest charged on microloans ranges between 8% - 15% and loan installments are returned on monthly basis. The interest rate is determined by borrower’s credit history, cash flow, and business experience; interest rates are fixed and do not decrease with outstanding loan amount. AUSA has a loan repayment rate of 91%.

The most common loans provided by AUSA are professional loans such as office, medical, education, food and beverage businesses, retail businesses such as clothing, cosmetic, and jewelry, transportation and auto vehicle enterprises, beauty and salon service centers, construction and repair firms, arts and crafts production, and personal services like day care fees and language classes.

\(^{9}\) Accion USA website; retrieved June 13, 2010; from http://www.accionusa.org/home/support-u.s.-microfinance/programs-and-impact/microlending-programs.aspx
**5.64 Funding**

AUSA’s annual budget is approximately $3 million and its funding comes from a variety of sources like the CDFI Fund from the U.S. Department of the Treasury, SBA fund, foundation grants, private donations, and Kiva. It was reported during the interview that it is only 50% - 60% self sustainable due to the high operating costs in a developed country, lower profit margins due to small loan size, comparably low rates of interest than its international counterparts, and a lower repayment rate as a result of the individual lending model.

**5.65 Impact**

A 2008 client outcome study conducted in partnership with the Aspen Institute showed that AUSA’s client businesses create about 2.4 new jobs per business, have a survival rate of 98% for existing businesses and 89% for new businesses, and increase the microentrepreneur’s take home salary by 51% of the times with a median increase of over $ 4,500 (AUSA, n.d.99).

With all these impressive figures AUSA prefers to call itself an ‘incubator of businesses’ than a MFI, as it helps microenterprises thrive in an extremely competitive environment where they would not have existed due to a lack of the financial services they need. AUSA doesn’t claim to serve only the poorest section of the society, and mostly caters to the needs of low to medium income families. It is evident that the rise of microfinance in the capitalist American society has been largely affected by the neoliberal ideology that has shaped its institutions, policies, rules, and norms. A comparative analysis of MFIs in developing and developed countries is presented in the next chapter to shed more light on different contexts and different

practices; and how MFIs around the world have adapted themselves according to the local needs and dominant ideology.
CHAPTER 6

A COMPARATIVE ANALYSIS

Despite the fact that microfinance in both the developing as well as developed countries utilizes market based solutions towards poverty and seeks to empower the community through access to financial services, there are significant differences among programs from the developing and the developed countries. As mentioned in the previous chapter, though initially targeted towards the poor, over a period of time it was realized that former welfare recipients often lacked resources and skill and despite expensive training could not run a successful enterprise and defaulted on loans (Jurik, 2005). U.S. microfinance has therefore slowly shifted its focus from poor to working poor owing to its contextual needs and cultural milieu.

In terms of methodology or model type, there is no single way of microfinance practice in the U.S. (Edgcomb, Klien, and Clark, 1996). Within the diverse microentrepreneur population, the programs and services are diverse, too, with both group or individual lending models or even a mix of the two. But there are certain common core elements among all the programs like focus on economic development, non-charity self sustainable orientation, emphasis on individuality, client’s choice and motivation, importance of technical training and enterprise success rate to name a few (Edgcomb, Klien, and Clark, 1996).

The first and foremost difference between U.S. microfinance and that from a developing country is the shift away from the peer lending model. The individual lending model is far more popular than the group lending model in the U.S. because in tune with the constructivist explanation, individuality and anonymity are much more consistent with American values and
norms. Group processes are time consuming and group formation is much more difficult owing to large geographical distances between clients’ residences and also due to members’ heterogeneous or different backgrounds (Johnson, 1998; Taub, 1998; Servon, 1999; Jurik, 2005).

Social homogeneity or comparable socio-economic life condition plays a very strong role in group lending models practiced in Bangladesh or other developing countries where peer pressure and social collateral play a pivotal role in the success of the lending model. Living together in densely populated areas for generations, group members have shared social context and many common bonds like ethnicity, language, and socioeconomic background that leads to trust and faith (Kibria, Lee, and Olvera, 2003). In the U.S., though small homogenous ethnic communities, usually immigrant, do exist but trust and group accountability is too low especially when the groups are formed artificially due to the requirement of unrelated non-family based group members (Taub, 1998).

There is also a belief that the individual lending model also better prepares the clients to graduate to mainstream financial institutions (Accion USA, n.d.\(^{100}\)). This shift from the peer lending model by itself has many implications. First, as the reported problems is group formation also increasingly consumed valuable staff time (Jurik, 2005), more staff were needed to do the same amount of work, thus pulling the operational cost further up (Edgcomb, Klein, and Clark, 1996). Second, the absence of peer lending and monitoring in U.S. programs are not just much more expensive but the risk of default is higher too and necessitates the requirement of collateral (Edgcomb, Klein, and Clark, 1996; Jurik, 2005). Third, in order to keep the default rate low and keep the repayment process efficient, the staff in U.S. based programs assumed much more control and authority over the borrowers, which in turn undermined borrower’s empowerment

\(^{100}\) Accion USA website; retrieved June 13, 2010; from http://www.accionusa.org/home/support-u.s.-microfinance/learn-about-u.s.-microfinance/u.s.-vs.-international-microfinance.aspx
goal (Jurik, 2005). And finally, the absence of a peer lending model also decreased the chances of recruitment of reliable clients and therefore various MFIs now compete among themselves for more desirable clients, screening out the neediest clients in the process (Jurik, 2005). Thus it is evident that due to different social context, values, and beliefs, a popular model that works flawlessly in the streets of Bangladesh or India fails to generate the same result in a society that is built upon a different ideology and values.

Another significant difference between developing and developed countries’ programs stems from the previously mentioned fact that due to the issues of sustainability and loan defaults, U.S. microfinance focuses more on working poor and/or moderate income borrowers than the very poor clients (Charles Stewart Mott Foundation, 1994). Therefore, the focus on microfinance does not move beyond microcredit to other developmental services like women empowerment, education, health and hygiene, and contraception (Johnson, 1998; Jurik, 2005).

In fact, it is argued that the U.S. microfinance sector does not provide a conducive environment for asset building among poor (Taub, 1998). When microloan borrowers are welfare recipients, they can continue receiving welfare checks only until they have total assets below a certain limit; unlike the developing countries they cannot even operate their enterprise from their subsidized housing and self employment may add to their disadvantage than to their advantage (Clarke and Kays, 1999). Moreover, while a microenterprise can bring them slight increase in income, losing welfare may mean losing healthcare (Schreiner and Woller, 1999), a fear seldom found among microentrepreneurs in Bangladesh as the government provide no similar safety nets as the U.S. government, and a microenterprise only adds to their benefits (Clarke and Kays, 1999; Buyske, 2004a). This discourages the immediate incentive among the American poor
cliente to start a microenterprise and accumulate assets over time (Taub, 1998). Thus a
different arrangement of welfare laws of the land actually prevents the increase in number of
microenterprises, micro loans, and subsequent asset accumulation.

Another difference is the level of competition that the U.S. based microenterprise face
with retail chains like Walmart or McDonalds (Schreiner and Morduch, 2002), whereas
microenterprises in Bangladesh can flourish in an informal market where survival options are
plenty, business losses are small, and paying tax on informal businesses is not mandatory by law
(Buyske, 2004b). Besides, operating a microenterprise is a far easier and viable option in
developing countries’ markets where finding cheap wage informal labor is not regulated by law
as usually there is no minimum wage ceiling (Buyske, 2004a).

The focus of U.S. based programs is on borrower training which is necessitated by the
maturity of economy and business operation complexity in comparison to an informal economy
(Edgcomb, Klein, and Clark, 1996; Taub 1998; Servon 1999; Jurik, 2005). It is argued that
operating an enterprise in the U.S. needs far better financial education and management skills
than what is needed in developing countries. The American microentrepreneurs have to deal with
licenses, taxes, inspections, regulations, and zoning laws among many others, and they cannot
successfully operate an enterprise without basic understanding and knowledge about them (Taub,
1998; Servon, 1999; Federal Reserve Bank of Dallas, n.d.101). Services like childcare, food
production, or restaurants are highly regulated industries in the U.S. (Servon, 1999) and MFIs
may be reluctant to provide loans to clients who do not have required licenses or certificates
thereby screening them out (Taub, 1998). Therefore training on financial and managerial issues

101 Federal Reserve Bank of Dallas website; retrieved June 13, 2010; from
http://dallasfed.org/research/swe/2006/swe0605b.html
becomes essential in a developed country and consumes time and resources of microfinance service providers.

Another distinguishing factor between American and developing countries’ models is the loan size, which is $5,500 in the U.S. and less than $1,000 in developing countries (Accion USA, n.d.\textsuperscript{102}). While the average loan size is much smaller in developing countries, usually the rate of interest charged is higher to cover the operating cost. However, the American counterparts keep the interest rate lower but in order to cut costs and avoid default risks, they cater mostly to low to middle income individual clients and only about 33\% or less of their clients are actually poor (Jurik, 2005). In order to have high performance indicators, poor clients who are likely to default are discouraged from joining the program in the first place or are dropped out in initial stages (Jurik, 2005).

And lastly, the focus of U.S. microfinance industry is largely, if not solely, focused on microcredit and not other financial services, especially savings. It is important to note that microcredit can be truly embedded in market when there is an emphasis on asset building and capital accumulation so that poor can pull themselves out of generations of poverty. This promotion of savings and asset building has been termed welfare capitalism where capitalism actually promotes the welfare of the clients and not just strengthens the market.

\textsuperscript{102} Accion USA website; retrieved June 13, 2010; from \url{http://www.accionusa.org/home/support-u.s.-microfinance/learn-about-u.s.-microfinance/u.s.-vs.-international-microfinance.aspx}
6.1 Challenges and opportunities in U.S. microfinance

So far it has been argued that the microenterprise programs in the U.S. were mainly seen as a tool for economic development; and the greater emphasis has always been on microenterprise success, financial sustainability, high loan repayment rate, and an increase in family income. Hence the target of U.S. microfinance has shifted from poor to ‘working poor’ (Charles Stewart Mott Foundation 1994). Moreover, government funding has also affected the nature of program goals, operations, types of businesses to be funded, and emphasis on training programs (Jurik, 2005). In order to seek rationed funding, microfinance programs portrayed a professional, accountable, sustainable, and business like work model rather than being a socially oriented and more humane model (Jurik, 2005).

With the rise in number of microfinance programs over the years, overall funding has become much scarcer and competition to seek funds has grown fierce. This drive to seek more funds sometimes force the MFIs to adhere to the norms of the funding source such as sustainability, low default rate, and high success rate for a client’s business. This may drive them away from their core mission, local geographical limits, target population, loan size, type and duration of mandatory training, and lending model (Jurik, 2005).

Due to all these factors, U.S. microfinance programs inadvertently screened the poorest section of the society and focused more on those clients and businesses whom they can ‘incubate’ and turn to bigger and sustainable businesses. Overlooking the poorest of the poor,
currently U.S. microfinance is only catering to 2% of the people who are in need of formal financial services (Accion USA, n.d.\textsuperscript{103}).

To sum up, microfinance in the U.S. faces various challenges like low demand for products of microenterprises in comparison to developing countries, faces scarcity of funding and the industries are much more formal and regulated, which increases the need for training and makes MFI operations very expensive (Talen, Weiss, and Sarkar, 2002).

To look at the brighter side, U.S. microfinance has tremendous potential in terms of growth, that is, it harbors a huge market as very little has been done in the microfinance sector as compared to its southern counterparts. It also leads to empowerment of nontraditional clients, especially minorities. The microfinance industry in the U.S. suffers from acute shortage of research and except for few scholars and researchers, this area has not been probed as much as it has been done in developing countries. Being a challenge and an opportunity at the same time, this sector needs and harbors tremendous potential for long term research.

\textbf{6.2 Challenges and opportunities in Developing Countries’ microfinance}

On the other hand, microfinance in the developing countries faces very different set of strengths and weaknesses, opportunities and challenges. Though it is far more successful in maintaining its focus on the poorest of the poor and empowerment of clients, especially female clients, the challenge of peer pressure and social disgrace in traditional societies is immense. As strength, microfinance services are provided based on trust and personal relationships, it has been criticized for high rate of interest and a possible debt spiral among defaulting clients. The

\textsuperscript{103} Accion USA website; retrieved June 13, 2010; from http://www.accionusa.org/home/support-u.s.-microfinance/learn-about-u.s.-microfinance/about-u.s.-microfinance.aspx
criticism of developing countries’ based MFIs, covered in further detail in the next chapter, is also a result of high amount of researches that have been conducted in those areas that expose many loop holes in the system.

However, much like U.S. based microfinance, there exists an opportunity as well as a challenge to conduct long term scientific researches on these successful MFIs to elucidate and substantiate their work.

Clearly, the U.S. and developing countries microfinance have very different visions, operations, and statistics. The comparative Table 6.1 below compares the main features of three main microfinance approaches discussed in this thesis i.e., as practiced in Bangladesh, India, and the U.S.

Table 6.1

Comparative table of Indian SHG-Bank Linkages, Grameen model, and the American individual lending model

<table>
<thead>
<tr>
<th>Features</th>
<th>India (SHG)</th>
<th>Grameen Bank</th>
<th>U.S.</th>
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<tbody>
<tr>
<td>context</td>
<td></td>
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<tr>
<td>Rationale for microfinance</td>
<td>Social justice and social equity</td>
<td>Social justice and social equity</td>
<td>Reduction on welfare expenditure and promotion of economic activity</td>
</tr>
<tr>
<td>Measures of success</td>
<td>• Provide service to nontraditional clients</td>
<td>• Provide service to nontraditional clients</td>
<td>• Provide service to nontraditional clients</td>
</tr>
<tr>
<td></td>
<td>• Low rate of loan default</td>
<td>• Low rate of loan default</td>
<td>• Low rate of loan default</td>
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<tr>
<td></td>
<td>• Asset accumulation by the poor</td>
<td>• Asset accumulation by the poor</td>
<td>• Creation of new businesses and jobs</td>
</tr>
<tr>
<td></td>
<td>• Target rural poor</td>
<td>• Target rural poor</td>
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<thead>
<tr>
<th>Clients</th>
<th>Model</th>
<th>Services</th>
<th>Role of MFI staff</th>
<th>Meetings</th>
<th>Savings deposit</th>
<th>Initial loan amount</th>
<th>Effective interest rate</th>
<th>Development services</th>
<th>Target Market</th>
<th>Challenges for MFI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primarily women</td>
<td>Group lending. 15-20 clients per group</td>
<td>Savings and credit</td>
<td>Guide and facilitate</td>
<td>Monthly</td>
<td>Mandatory in case of SHGs. Rs20-100/month</td>
<td>Rs. 5 – 10,000 approx. ($0.10 - $200)</td>
<td>24-28%</td>
<td>Some associated programs</td>
<td>Nontraditional clients • Poorest of the poor • Women</td>
<td>Unsustainability • Limited funding • Keeping the interest rate low • Expensive operations • Too much scrutiny by external researchers • Quantifying/proving impact made by the MFI</td>
</tr>
<tr>
<td>Primarily women</td>
<td>Group lending. Usually 5 clients per group (organized into centers of 4-6 groups)</td>
<td>Credit – regular cycle</td>
<td>Organize (groups dependent on staff)</td>
<td>Weekly</td>
<td>Mandatory. Tk 5-25/week</td>
<td>Tk. 2 – 5000 approx. ($0.03-$70)</td>
<td>32-38%</td>
<td>Small social projects</td>
<td>Nontraditional clients • Poorest of the poor • Women</td>
<td>Sustainable but the fact has been questioned by many. • Keeping the interest rate low • Expensive operations • Too much scrutiny by external researchers • Quantifying/proving impact made by the MFI</td>
</tr>
<tr>
<td>Primarily men</td>
<td>Individual lending</td>
<td>Credit</td>
<td>Organize</td>
<td>Monthly</td>
<td>Flexible. Not mandatory.</td>
<td>$500 - $50,000 (average $5,500)</td>
<td>8-15%</td>
<td>Enterprise support</td>
<td>Nontraditional clients • Working poor</td>
<td>Limited funding • Unsustainability • Low demand for products of microenterprises • Need for business related training of clients • Expensive operations • Higher default rate • Quantifying/proving impact made by the MFI</td>
</tr>
<tr>
<td>Challenges for Clients</td>
<td>Strengths</td>
<td>Industry is very formal and regulated</td>
<td>High competition from retail chains</td>
<td>High rate of interest on loans</td>
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<tr>
<td>High rate of interest on loans</td>
<td>Has substantiated that microfinance can be profitable, generating interest of the commercial financial institutions</td>
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<tr>
<td>Microminimalism or no business training of clients</td>
<td>Serves poorest of the poor</td>
<td></td>
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<tr>
<td>Peer pressure</td>
<td>Empowerment, especially for women</td>
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<tr>
<td>Social disgrace in case of loan default</td>
<td>Collateral free</td>
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<tr>
<td>Cannot access personal savings as and when needed</td>
<td>No need of credit history</td>
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<tr>
<td>Sometimes harsh treatment by male loan officers</td>
<td>Savings and asset building over long term</td>
<td></td>
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<tr>
<td>May fall in the loop of debt</td>
<td>Personal relationships with the bank officers</td>
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<table>
<thead>
<tr>
<th>Criticisms</th>
<th>Impact made by the MFI</th>
</tr>
</thead>
<tbody>
<tr>
<td>High rate of interest on loans</td>
<td>Does not target poorest of the poor</td>
</tr>
<tr>
<td>Microminimalism</td>
<td>High rate of interest on loans</td>
</tr>
<tr>
<td>Scarcity of long term research</td>
<td>Requirement of collateral</td>
</tr>
<tr>
<td>Peer pressure especially on women</td>
<td>Requirement of credit history</td>
</tr>
<tr>
<td>Cannot access personal savings as</td>
<td>Impersonal</td>
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</tbody>
</table>
Through arguments presented in this chapter, it is evident that microfinance in the U.S. has a very different vision and approach as compared to its developing countries’ counterparts and that it faces different challenges and opportunities owing to a different socio-economic milieu. This chapter compares and contrast three opposing cases covered earlier in this thesis and concludes that due to a different constructivist explanation of its culture, these societies have followed different ideologies and social values and the political elites chose policies that furthered their own beliefs and created a consent among the masses.

The next chapter presents the discussion on the criticism microfinance has faced over the years, and how it is still evolving with time. It briefly presents the next level of microfinance and how it will impinge upon the microfinance sector in the U.S., to finally argue that the same recipe towards development many not work everywhere.
CHAPTER 7

CRITICISM AGAINST MICROFINANCE AND RECENT DEBATES

Despite being the icon in the international development world, Grameen Bank and its international counterparts have been minutely scrutinized and criticized over various issues. The critique is mainly targeted at developing country based MFIs as maximum research has been conducted on them and MFIs in developed countries do not face the same amount of scrutiny due to much lesser amount of data available.

7.1 Criticism against microfinance

The biggest critique against microfinance is its financial unsustainability. Grameen Bank now claims that it has not received any donation since 1998, that it finances its current outstanding loan through savings mobilization, and even earns a profit every year (Grameen Bank, n.d.104), the statement has been challenged by a number of scholars (Morduch, 1999b; Hashemi and Schuler, 2003). It is argued by many that the accounting practices at the Grameen Bank do not follow standard accounting practices and if its account books are scrutinized closely it would be evident that ‘categories and expenses are moved around to ensure that Grameen posts a modest profit’ (Morduch, 1999b). Moreover, according to the critics, the account statements do not reflect the subsidies received in the form of grants and indirectly subsidized credit, for instance a grant for staff training; these donations though do not directly made towards the capital fund, do indirectly subsidize expenses that would have occurred otherwise (Morduch, 1999b; Hashemi and Schuler, 2003; Armendariz de Aghion and Morduch, 2007). As shown in

Figure 7.1 below, it is a highly debated issue whether the reported profits can be deemed as actual profits when a huge fraction of inputs is subsidized (Morduch, 1999b).

Figure 7.1

Source: Morduch, 1999b, p.242

Critics argue that if the profits were as high as reported, it would not take commercial banks (with few exceptions) so long to sense the business opportunity and stay away from the yet untapped microfinance market (Morduch, 1999b; Buyske, 2004). They opine that even Grameen’s attempt to raise capital through public bonds should be considered subsidization in the sense that the bonds are guaranteed by the Bangladesh Government (Morduch, 1999b). The famous Subsidy Dependence Index (hereafter referred to as SDI) developed by Yaron estimates that though Grameen’s dependence on subsidies has declined over the years, effectively it is still being subsidized as explained in the previous paragraph (Yaron, 1992; Morduch, 1999b; Hashemi and Schuler, 2003). Calculations based on Yaron’s SDI estimate that without the
subsidies received from 1985-1996, the Grameen Bank would have to raise its interest rate by 75% in order to cover costs (Armendariz de Aghion and Morduch, 2007). The criticism on subsidies and financial sustainability is not limited to Grameen only but applies to MFIs worldwide. It is argued that subsidies lead to inefficiencies and that sustainable programs have a higher probability of reducing poverty in the long run without depending on philanthropic donations (McGuire and Conroy, 2000).

Another critique against the Grameen Bank is directed at its supposed biggest strength of women empowerment. The design and practice of the key feature of peer pressure compliance has been considered antifeminist by many scholars, especially in conservative societies, as women get easily dominated by the loan officers who are usually males (Hossain, 2002). Contrary to what would be assumed, only 9% of Grameen staff is female, as an officer must hold a graduate degree and a non-officer should be at least a high school graduate with a certificate, which is not just difficult but almost rare to find among Bangladesh women (Hashemi and Schuler, 2003). The critics argue that being an easier target of domination, women are systematically preferred over male borrowers (Hossain, 2002). Moreover, many scholars opine that most of the times the borrowed money actually goes to the female borrower’s husband and in-laws or is used for consumption smoothening purposes such as a wedding or health emergency and the borrower is much more indebted than she was before the Grameen loan (Hossain, 2002). As the onus of loan repayment lies on the female borrower, who is much more vulnerable to the group’s social stigma and loan officers’ threats, some researchers believe that they compensate by cutting their personal expenses such as nutrition or health care to pay the debt (Bakker and Silvey, 2008). According to many, the situation may get even worse when they enter into the vicious cycle of borrowing from other informal sources such as village
moneylender with extremely exploitative interest rates to repay one debt or the other (Armendariz de Aghion and Morduch, 2007). As per this argument, some believe that microcredit may thus lead to ‘microdebt’ trap and make women or borrowers in general worse off than they were without it. Some critiques even argue that the emphasis on female microentrepreneurs gives a further incentive to men to shrug their family responsibilities and draws attention further away from other sources of gender inequality (Jurik, 2005).

Beyond the feminist critique of microfinance, others have raised concerns about the practice of the group lending model, where peer group pressure may lead to conflicts, if not crimes, forcing the defaulting member to withdraw from the group or may even lead to seizing their assets to pay debts, which may nullify the net social benefit and defeat the entire purpose of microfinance services to the poor (Hashemi and Schuler, 2003; Gomez and Santor, 2008).

In the philanthropic circles, Grameen has also been criticized for the exorbitant interest rate of 20% on loans offered to the poorest of the poor (Hossain, 2002). Defendants of microfinance counter argue that the high rate of interest is needed to cover the increased operational costs of accessible banking, to cover loan defaults, the cost of funds itself, and to raise capital for future expansion (Fernando, 2006).

Grameen Bank has also been criticized by many for restricting its members from withdrawing the savings from the group savings account, which can only be accessed in cases of emergencies by the group who then decides if the needy member should get the ‘loan’ from his own savings and at what interest rate (Hashemi and Schuler, 2003). Though the members are free to make many small transactions from their individual saving accounts, critics argue that it is likely that the poor only have savings that they have painstakingly saved in the group account.
complying with Grameen’s policy. Grameen defends this practice by arguing that group funds promote saving habits and asset building among the poor in the long term, otherwise the poor would withdraw their already miniscule savings for any ordinary need. It also enhances the group’s solidarity as the member would lose his/her savings if they leave the group (Hashemi and Schuler, 2003). This serves as an incentive to stick to the group and adds to its longevity, which in turn brings other benefits to its members in the form of bigger and more diversified loans.

Another critique of microfinance is the argument that it promotes and legitimizes structural adjustment policies that advocate less government expenditure on welfare (Desai, 2002; Jurik, 2005). The neoliberal solution to poverty undermines government’s role as a provider of public goods like education and healthcare and leads to a shift of responsibilities from the government to the poor themselves (Karnani, 2008). Critics argue that though microfinance has a purpose of helping the poor help themselves, it cannot substitute for the provision of public goods that only governments can provide. However, it can be counter argued that the fact remains that the government of these countries are failing to provide these public goods, in which case someone/something should step up and fill the gap and not keep waiting for the government to act.

In a related criticism against microminimalism that involves provision of credit without any training or technical assistance, many scholars criticize the assumption that the poor have innate entrepreneurial skills, that they avail microcredit to set up an enterprise by choice, and can lift themselves out of poverty especially when operating in informal, high risk prone, and marginal profit generating enterprises (Jurik, 2005; Karnani, 2008). They fear that in the absence of structural macroeconomic policy support, without adequate consumer protection law, the poor
may actually fall into a debt trap (Adams and Von Pischke 1992; Jurik, 2005). Moreover, some scholars point out that the microfinance revolution has been criticized for putting a special focus on just microcredit and not on microfinance in its entirety (Kristof, 2009). Though savings is a small part of the entire schema, the focus is more on microcredit rather than savings or investment or other financial activities, which may immensely help the poor and help them grow their money.

And finally, the success of Grameen Bank and other MFIs has been questioned by many on scarcity of relevant research data that tracks microcredit borrowers over a period of many years; most of the success indicators are considered proxies such as total number of borrowers, number of loans made, and loan repayment rate that do not necessarily prove the impact of microfinance on poverty alleviation (Jurik, 2005). Many scholars and policy advocates fear that glorious and successful case studies, short term assessments, and proxy indicators may fail to accurately measure the long term impact on borrower’s income and whether he/she actually managed to climb out of poverty (Jurik, 2005). They even doubt studies that do follow borrowers over long terms as they may not yield accurate results in absence of a comparable control group (Gulli, 1998; CGAP, n.d.\textsuperscript{105}); and challenge whether the successful borrowers climbed out of poverty because of microfinance services or some other unique factor like the client’s own perseverance and ambition, skill sets, educational or health status, and social network among many others (Gulli, 1998; Armendariz de Aghion and Morduch, 2007; CGAP, n.d.\textsuperscript{106}).

Another research methodology related problem is pointed out by many researchers. They are concerned with sample mortality, where least successful borrowers leave the cohort at early

\textsuperscript{105} Consultative Group to Assist the Poor website; retrieved June 6, 2010; from http://www.cgap.org/p/site/c/template.rc/1.26.11415/

\textsuperscript{106} Ibid
stages leaving only determined successful borrowers over the course of entire study; thus creating a bias in the overall research results and the MFI may look more successful than it really is (Jurik, 2005). Similarly, the problem of sample self-selection is doubted by many researchers, where nonparticipants opted out of the program due to fear of religious or social sanctions or because they felt that a microenterprise would not generate enough profit, and hence only resolute borrowers availed the services to begin with. This may introduce a bias in the research results on impact of microfinance in economic development (Armendariz de Aghion and Morduch, 2007). A suggested solution to this problem could be to study those who dropped out of the microfinance program in order to assess its correct impact.

Through the critique of microfinance presented above, it is clear that many of these questions may be answered with appropriate long term research data. It is also true that feedback and constructive criticism helps in softening up the policy environment over a period of time, in recombination of existing ideas, and in incremental model of goal setting (Kingdon, 2003). Criticism on current models or practices and debates on the effectiveness of microfinance and its role in poverty alleviation have incrementally moved the goal to the next level. Various interest groups such as international development organizations, national governments, financial institutions, NGOs, social activists and visionaries, politicians, and mass communication media with varied intentions and agendas have participated and contributed to this evolution.

A decade deep into the new millennium the world stage is abuzz once again on the issue of how to make microfinance more inclusive by reducing financial exclusion and harness the potential this sector has to offer. This chapter discusses the next level of microfinance that is being called ‘inclusive finance’, and what type of policy changes and cooperation is sought from various interest groups to plug the existing loop holes in the current microfinance fabric; making
it further accessible to the unserved or underserved population, accelerating the international development process in the developing world as a final outcome.

In the end, the last section of this chapter discusses the policy interventions needed by U.S. microfinance in particular, and how they may or may not coincide/overlap with their international counterparts. The chapter ends with the conclusion that just the way practice of microfinance differs with differing contexts, the same policy intervention everywhere may not offer the best solutions to every society.

7.2 New debates

Realizing microfinance’s potential and in order to address its past shortcomings, many new policy debates at the global level have been initiated. It is argued that despite their social mission, most MFIs fail to reach the poorest of the poor and have a large percentage of nonpoor clients (Gulli, 1998; Jurik, 2005); even Grameen Bank reports its inability to reach the bottom 10% of Bangladesh’s population (Jurik, 2005). Therefore there is a worldwide push to take the microfinance industry to the next level and make it more inclusive so that it offers appropriate financial products and services to all segments of the population (Rhyne, 2009; UNCDF, n.d.\textsuperscript{107}). It is felt that offering only microcredit or micro-savings opportunities are not enough for sustainable development of the poor, and inclusive finance would need support from sound policy, legal and regulatory frameworks.

The microfinance industry has so far not been able to benefit all the poor people it would like to serve and it has worked better in some places or circumstances than others; it has

therefore been advocated by many that only those MFIs should be supported by donors or
governments who show a promise of self-sustainability (McGuire and Conroy, 2000). Scholar
are divided between two groups, one that supports subsidization of microfinance as the net social
benefit it creates exceeds its costs; and the second group that advocates commercialization of
microfinance based on economic efficiency and efficacy argument.

### 7.3 Defendants of microfinance subsidization

Morduch (1999b) who is one of the leading scholars on the subject of unsustainability of
MFIs, reasons that in order to evaluate the correct value of a MFIs performance, in his article
referring to Grameen, and whether or not it should receive subsidization of any kind, a dollar
earned by a poor man should be compared against a dollar earned by a rich man; and if the social
value of poor man’s dollar exceeds rich man’s dollar, then Grameen’s subsidization has greater
social returns than its monetary costs; and even has many spillovers and positive externalities on
welfare of nonparticipants (Morduch, 1999b; McGuire and Conroy, 2000; Schreiner and
Morduch, 2002).

It is further argued that MFIs like Grameen have shown decreasing dependence on
donations since its inception and it has a potential to thrive without any type of subsidized
income in the future (Hashemi and Schuler, 2003). However, in order to be sustainable Grameen
will have to increase the already high interest rates and cut operating cost spent on staff, which
will not just put higher pressure on borrowers and they may default but also cut down staff
morale (Morduch, 1999b). The MFIs that specifically target the extreme poor have high
operating costs and loan default rates, if they are pressured to find more and more profits, it will
ultimately lead to a screening of high risk borrowers who were the sole reason why microfinance came into being (Jurik, 2005). Thus financial sustainability and a MFI’s social mission show a clear trade off and search for profit will affect Grameen’s vision as the focus would shift away from the poorest sections of society (Morduch, 1999a, Jurik, 2005; Armendariz de Aghion and Morduch, 2007).

Many scholars feel that microcredit creates a ‘net social benefit’ and that focus on cost recovery and profit generation ignores social outcomes (Daniels, 2001); and if research has not clearly proved so far that microfinance leads to an increase in income, other measuring units like women empowerment, nutrition, education, and use of contraceptives should be factored in microfinance’s success statistics (Armendariz de Aghion and Morduch, 2007). A form of short term subsidy that can immensely benefit MFIs without raising many eyebrows is to subsidize aspects that the MFI would otherwise not provide, such as formative and summative evaluations, and technical assistance workshops (Armendariz de Aghion and Morduch, 2007).

7.4 Proponents of commercial microfinance

From experience the infant industry logic has completely failed the international trade sector as it is difficult to wean off infants once they get used to dependence or protection, therefore even if initial subsidization is provided to MFIs, it might be helpful to develop a strategic sustainability time line that MFIs should strive to meet (Armendariz de Aghion and Morduch, 2007).

In order to raise capital and earn profits for self sustainability recently many MFIs, for instance Mexican MFI Banco Compartamos, have adopted business like models and have made
public offerings such as investment bonds (Counts, 2008). However, this attempt has been criticized for the fact that the profits would be returned to investors and not used to lower interests paid by poor borrowers therefore putting financial returns above the welfare of the poor (Rankins, 2002; Counts, 2008). Critics like Alex Counts believe that profits are possible in the microfinance sector along with its social vision, but MFIs should look for profits in high volumes through more borrowers and not in high margins through higher interest on loans (Counts, 2008). Thus, commercial microfinance can be sustainable as well as pro-poor and should be the next aim of the development sector.

7.5 The next level of microfinance: Inclusive finance

Microfinance since the beginning has been backed by the neoliberal school of thought and it is believed that operating as a sustainable, profit generating industry would not just provide better support to the borrowers but also attract interests of policymakers, donors and aid agencies like USAID, international development organizations such as the IMF or the World Bank, and the commercial financial institutions like banks (Jurik, 2005; United Nations Forum to Build Inclusive Financial Sectors, 2005). Therefore, the new solution sought in the microfinance sector is to include more and more people who have been excluded by the mainstream financial sector thereby making the phenomenon more inclusive (UNCDF, n.d.\textsuperscript{108}).

Inclusive finance thus supports sustainability, commercialization, and competition in the microfinance sector; and calls for a concerted effort between the public and private sector

(UNCDF, n.d.). It is now believed that poverty alleviation besides micro level intervention, also requires a macro level intervention. In order to include larger sections of the population into financial services, the services for the poor should be integrated with the mainstream financial system at the retail financial service provider or micro level; auditors, rating agencies, professional networks, trade associations, credit bureaus, transfer and payments systems, information technology, technical service providers, and trainers or meso level; and at legislative and policy framework or macro level (Helms, 2006).

The tradeoff between sustainability that involves search for profits and outreach to the poor can be minimized by bringing attention to the business opportunity that exists in the untapped market existing at the bottom of the pyramid and expand the demand for financial services at the grassroots level (Brinsden, 2005). The so called bottom of the pyramid is constituted by billions of people living on less than $2 per day, thus making it the biggest untapped market so far, and with the concerted efforts among governments, financial institutions, donor agencies, and NGOS and civic groups it has the capability of becoming ‘the next market’ (Prahlad, 2004).

Most commercial banks have ignored the microfinance sector till now and the ones who have meddled with it, have seen it more as a corporate social responsibility endeavor or an act of charity rather than as a sound business strategy (Brinsden, 2005). So far commercial banks have shied away from the microfinance sector primarily because of interest rate ceilings and other regulatory restrictions, the belief that the banks would need extensive, which in turn are expensive, working branches in all the areas of operation, and the quintessential fear of lending to the risky poor (Brinsden, 2005; Armendariz de Aghion and Morduch, 2007).

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The promise of high interest on loans coupled with high loan repayment rate, that may attract commercial banks to microfinance sector, is countered by the 'usury laws’ set by governments that fix a ceiling on maximum possible interest rate that can be charged on a loan (Brinsden, 2005). As the risk of loan default can be and has been minimized by the work of development agencies to a considerable extent due to their expertise on local market information, commercial banks can potentially venture into this sector by partnering with development agencies without the previous inhibitions (Armendariz de Aghion and Morduch, 2007). As shown in Figure 7.2 below, the banks may decide to provide services directly or develop a bank-intermediary business model depending on which model better suits its needs.

Figure 7.2: Decision Tree for Commercial Banks in Microfinance

In turn, it is proposed that the governments need to remove the interest rate ceilings on loans and let the market forces work in the true sense (UNCDF online newsletter issue 2, 2004\textsuperscript{110}; United Nations Forum to Build Inclusive Financial Sectors, 2005\textsuperscript{111}). In addition to liberalization of regulatory frameworks, it is also suggested that the governments need to maintain macroeconomic stability, prevent distortion of markets through subsidized lending, and reduce political interference in the management of private institutions (UNCDF online newsletter Issue 3, 2004\textsuperscript{112}). Hence, in order to integrate microfinance with the mainstream financial sector, government and regulators, development agencies, and commercial banks will have to engage in a concerted effort in a fashion shown in Figure 7.3 below (Brinsden, 2005).

This concerted effort should lead to a win-win situation for all the parties involved as the promise of economic development will not just help the unserved or underserved clients but also governments, development agencies and commercial banks; and bring about financial and economic opportunities to the people who have been excluded from mainstream financial services. Banks like Rakyat Indonesia, BancoSol in Bolivia, and ACLEDA in Cambodia have proved that it is possible to make profit in a microfinance bank and compete with commercial banks in the same market (Brinsden, 2005).

\textsuperscript{111} International Year of Microcredit website; retrieved June 11, 2010; from http://www.yearofmicrocredit.org/docs/Advisors_Group_UN_IYOM_8Nov2005.pdf
The discussion on inclusive finance has been extended beyond credit provision to the clients and has focused on other financial services like savings and remittances that are as much needed as credit facilities. As the poor are especially vulnerable in terms of income flow, they may earn profits during one week or month and run losses in another, one of the biggest problems poor, especially migrant labor, face is lack of opportunity to save their money safely in an institution which they can use in times of need (Armendariz de Aghion and Morduch, 2007).
Respecting the special needs and features of microfinance, the governments should create enabling policy framework through ‘microfinancial intermediation’ that ‘refers to the management of flows of small amounts of capital within an economy’. For savings, government may encourage availability of small savings products and promote their accessibility to the poor; and for remittances, governments should improve access to efficient and secure money transfer, and encourage reduction in the transaction cost (UNCDF online newsletter Issue 3, 2004\(^{113}\)).

### 6.5 New role of donors

The role of donors in inclusive finance has been diverted from direct provision of subsidized capital to other very important activities like assistance on setting up of initial infrastructure of MFIs with good past record, development of retail financial institutions that may involve opening new branches in unserved areas, development of financial services and products before they become profitable and self sustainable, research and development of innovative ideas and practices, and promotion of quality and transparent data report (Otero, 2005; UNCDF online newsletter Issue 3, 2004\(^{114}\)). In this way, the donors would subsidize the institution in the short term and not the clients in the long term, making them dependent (Armendariz de Aghion and Morduch, 2007). The donors would thus complement private capital and not substitute it.

The generation of good data and best practices has been especially emphasized in the inclusive finance deliberation, as it helps not just in enabling policy formulation but also in judging whether such a policy is helping or hindering the financial sector. If investors find such


an opportunity trustworthy and reliable data helps in drawing conclusions on relationship between development and financial access, they would support inclusive finance (United Nations Forum to Build Inclusive Financial Sectors, 2005). Donors can also support the early stages of programs that use technology such as mobile telephony and telephone banking, to provide financial services in unbanked areas as use of such technology would dramatically reduce operational costs. This would also need support from governments by making policies that are more permissive of such innovative ideas.

Based on the findings generated in the international year of microcredit, the UN also recommended national governments to develop common indicators and methodologies and while working in consultation with the IMF and the World Bank, they should use this data to judge the success of inclusive financial sector in different regions of the world (United Nations Forum to Build Inclusive Financial Sectors, 2005).

7.7 Intended impact of inclusive microfinance in the developing countries

As explained in the previous section, inclusive microfinance would rest on the partnership of governments, financial institutions, NGOs and civic groups, donors, international organizations and aid agencies. Despite certain loop holes, the promise of microfinance has been realized since the time it was adopted as a key strategy in the achievement of MDGs; and especially the developing countries across the world are finding it a promising poverty alleviation strategy.

In order to make this a reality, before any other party’s move, it is the governments in the developing world who will have to establish a policy framework that is supportive of inclusive finance like removing interest rate ceiling, liberalizing other regulatory framework, maintaining
macroeconomic stability, preventing distortion of markets through subsidized lending, and reducing political interference in management of private institutions (UNCDF online newsletter Issue 3, 2004\textsuperscript{115}). This process would therefore involve a highly proactive role of central banks and the national governments.

Following the encouraging policy environment, commercial financial institutions and NGOs/MFIs will enter the market together as partners, while the donors will provide support primarily in terms of research and development and initial subsidization of products. The international organizations such as the IMF and the World Bank would meanwhile study the impact of inclusive finance on the development of almost 3 billion people worldwide who are in need of financial services; and disseminate best practices to enhance this impact.

This schema of work would not just help the poor worldwide but also tap the huge market that reportedly lies at the bottom of the pyramid.

7.8 Will inclusive finance work everywhere?

Undoubtedly, the promise of inclusive finance is enormous, as more and more people will participate in the national economy, the stronger the economy would become. Especially with the context of American discomfort with the government expenditure on welfare and strong belief in free market forces, it may seem that inclusive microfinance can prove to be immensely important in the U.S. economy.

Issues of self sustainability of American MFIs have been brought up in recent summits and seminars, and along with experimentations of different business models that involve raising profit margins through provision of fee based services like check cashing and remittances and

use of technology for lending and training purposes, partnering with commercial banks is one of the leading proposed solutions towards sustainability (Bernanke, 2007\textsuperscript{116}). However, there are certain issues that have been sought by American activists and scholars and need to be addressed before the discussion on inclusive finance can even be initiated.

The first issue deals with passing of new tax laws that encourage the growth of social businesses and recognize that social businesses maximize benefits of poor and low income people in America and should be taxed differently than present (Carbonell, 2004\textsuperscript{117}). Second, MFIs should be allowed to hold federally guaranteed savings deposits directly; and third, a welfare reform that redesigns welfare and Medicaid laws that do not discourage the poor in setting up their own enterprises and augment their income without losing welfare (Carbonell, 2004).

Though these issues are of high significance and would further the microfinance initiative in the U.S., the pivot of inclusive finance, that is, the role of government in setting up an enabling policy framework is the biggest challenge in the American context. Inclusive finance advocates that the governments need to remove the interest rate ceilings on loans and let the market forces decide the interest rates, liberalize other regulatory frameworks, prevent distortion of markets through subsidized lending, and reduce political interference in management of private institutions.

Having said that, the peculiar nature of U.S. governance structure where the central government shares sovereignty with state governments (State Department’s Bureau of

\textsuperscript{116} United States Federal Reserve website; Retrieved June 11, 2010; from http://www.federalreserve.gov/newsevents/speech/bernanke20071106a.htm

International Information Programs, n.d.\textsuperscript{118}, poses serious challenge to the very idea of inclusive finance. Each state in the U.S. has its own laws, regulations, and exemptions on the maximum rate of interest that can be charged on a loan, known as the "usury limit" of the state (Washington State Department of Financial Institutions, n.d.\textsuperscript{119}; Division of Financial Institutions State of Hawaii, n.d.\textsuperscript{120}; Usury Law, n.d.\textsuperscript{121}). The state usury limit is affected by many factors like market conditions, lender risk, type of lender, type of transaction, and federal or state laws (Washington State Department of Financial Institutions, n.d.\textsuperscript{122}). While there are states like Delaware and South Dakota that have no cap on interest rates on loans, there are also states that have very low interest rate ceiling that financial institutions operating in those states can charge (Public Broadcasting Service, n.d.\textsuperscript{123}).

Therefore, a liberalizing policy framework on interest rate ceiling in the U.S. would be an extremely tedious, if not out of bounds, work. Though theoretically under the Commerce Clause of the U.S. Constitution, the U.S. government could step into lending practices that are subject to state usury laws, the congress has not stepped in these matters so far (Usury Law, n.d.\textsuperscript{124}). This fact adds a significant twist in the argument of inclusive finance in the American context. Just as credit card clusters were formed in no interest cap states after the famous 1978 Supreme Court

\textsuperscript{118} State Department’s Bureau of International Information Programs website; retrieved June 11, 2010; from http://www.america.gov/st/usg-english/2007/January/20071128094357abretnuH0.8318903.html
\textsuperscript{119} Washington State Department of Financial Institutions website; retrieved June 11, 2010; from http://www.dfi.wa.gov/consumers/interest_rates_law.htm
\textsuperscript{120} Division of Financial Institutions State of Hawaii website; retrieved June 11, 2010; from http://hawaii.gov/dcca/dfi/topics/ba_usury01.html
\textsuperscript{121} Usury Law website; retrieved June 11, 2010; from http://www.usurylaw.com/
\textsuperscript{122} Washington State Department of Financial Institutions website; retrieved June 11, 2010; from http://www.dfi.wa.gov/consumers/interest_rates_law.htm
\textsuperscript{123} Public Broadcasting Service: Snapshot of the industry website; retrieved April 6, 2010; from http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/map.html
\textsuperscript{124} Usury Law website; retrieved June 11, 2010; from http://www.usurylaw.com/state/alabama.php
verdict on Marquette National Bank vs. First of Omaha Service Corp.\(^{125}\), major financial reshuffling would happen in case a state government decides to remove interest rate ceilings on loans as envisioned under inclusive finance. It might cause a movement of big banks who have chosen to stay in states with certain interest ceiling due to some other legal advantages, to no interest cap states once they realize the untapped market potential of unbanked population. This may cause heavy losses to states that lose large businesses and taxes coming from it and its employees, affecting state economies.

Besides, just as federal government funds led to changes in operations and services provided to the poor in U.S. based microfinance programs where due to incentives to mold microfinance processes and outcomes in the way desired by funding source’s criteria affected programs missions and services as discussed in the previous chapter; similarly once commercial banks partner with development agencies, their profit driven missions may once again overshadow inclusive finance’s mission and the poorest sections are either screened out systematically or are ‘usuriously’ exploited for profit margins (Hardy, Holden, and Prokopenko, 2003). This is especially likely in the U.S. owing to lack of large number of socially driven MFIs or development agencies in comparison to the developing world, and if inclusive finance is ever practiced it would be mainly through commercial banks directly.

Though in absence of substantial research that proves impact of inclusive finance, changes in usury laws and massive movement of banks to no cap interest states, seems like a farfetched idea as of now; however, it might turn to a reality if inclusive finance is established successfully in countries like Bangladesh or India where the entire national territory is governed

\(^{125}\) These (credit card) clusters were largely formed by a 1978 Supreme Court decision (Marquette National Bank v. First of Omaha Service Corp.) that determined national banks only have to obey the interest-rate caps of the state they are chartered in, not that of the state where a bank's customer lives. This means that when a bank from a state without limits on interest, like Delaware, issues credit cards to people living in states like Minnesota, which caps credit card interest at 18 percent, the customer can be charged any rate of interest. (Source: Public Broadcasting Service website; retrieved June 11, 2010; from http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/map.html)
by a single central bank, and following their success with inclusive finance, American states liberalize their usury laws that may lead to a situation described above.

Moreover, search for profits sometimes tempt financial institutions to take risky decisions as happened in the subprime crisis of 2007 that dragged the entire country, and to an extent the entire world, into one of the worst recessions of our times. Similarly the idea of inclusive finance and lending to the poor, even with best development agencies partners and favorable policy framework, may be viewed with suspicion for a very long time to come. Some may even argue the consequence of any such bad business choices, if a big commercial bank goes bankrupt due to it.

And lastly, any change in policy especially in monetary and tax policies has a spillover effect on other economic phenomena like budget deficits, inflation, and legal frameworks; and a financial sector reform may or may not be compatible with other implications. The example of Philippines shows that removal of such restrictions led to oversupply of services due to increase in number of service providers, and less competition in the market (Jacquand, 2004). many such technical as well as political tests take the idea of inclusive finance even farther from reality in America that is just coming out of a bad recession and has a burgeoning deficit problem.

American history, its political construct, and socio-cultural context therefore do not seem to befit the concept of inclusive finance.
CONCLUSION

What draws this thesis together is the rise in popularity of microfinance services worldwide and the need to chalk out similarities and differences in not just practices or model types but also the socio-economic and political construct of a society that chooses and adapts them. The central argument of this thesis is that microfinance is not a ‘one size fits all’ solution to development and poverty. It draws attention to the fact that when one thinks of grafting microfinance practices from one land to another, much thought should be given to not just the model type or funding sources or rates of interests but also to the constructivist explanation of that particular society and the prevalent intellectual hegemony of the ruling elites; that is, the social context that goes into the making of that society and what paradigm the dominant elites want to maintain.

In examining these issues, this thesis makes use of the constructivist perspective and the thought of Gramscian intellectual hegemony as a method of arguing the essence of its central argument. With the help of these theoretical concepts and through the cases presented, it has been inferred that values and ideologies shapes the society’s construct and this very social construct further strengthens the dominant ideology and values through its institutions and laws. The ruling elite, social, economic, or political, try to maintain the favorable ideology and social construct either through coercion; or through setting up supportive institutions and laws that create a consent and agreement within the society that is far stronger than coercion.
Main findings

Economic and social opportunities in any given society are seen as complements where one adds value to another. Development economics that talks about economic aspects related to the development aspects that improve the output potential of the entire population by providing food, education, and healthcare, is directly and strongly influenced by growth economics or ‘growth of real income per head’ (Sen and Dreze, 1998). Development economics is thus considered “something of a bastard child of growth economics”, as an increase of GDP per capita indirectly manifests itself in development related aspects of the society but this does not happen at all instances. There could be times when growth economics progress is not accompanied by development economics progress (Sen and Dreze, 1998).

Therefore a government has a very important role of promoting growth economics and development economics simultaneously in the society. Many a time, pure market mechanism does not contribute to development economics and the government has to provide for certain needs of the poor such as food, education, and healthcare in the form of subsidies (Sen and Dreze, 1998). In the state owned Indian banks example as discussed in Chapter 3, the government was trying to complement the market mechanism by catering to the financial needs of the poor excluded by the market. In the case of microenterprise development in the U.S., the government through HUD and SBA loans was mainly trying to supplement the market and boost the economy and reduce welfare expenditure.

Thus, the initial rise of microfinance services in the U.S. had a different context, rationale and motive than its developing countries’ counterparts; and these different motives and visions created digressions from the borrowed microfinance models of the developing world. Though it is a highly debatable issue whether the Grameen model can be replicated in the U.S.,
microfinance in the U.S. has evolved into a very different variant owing to different socio-economic-cultural contexts, and policy frameworks.

As argued throughout this thesis, rise of microcredit and microfinance has been a process embedded in the social and economic orientation of a society. The success of the Grameen model in Bangladesh or SHG-Bank linkages is not just because of their unique functioning, but also because of the social needs, implementation methodology, and the nature of institutions is deeply embedded in the socio-economic, and policy framework of the country.

Therefore despite being inspired by the microfinance services of the developing world, over the years U.S. programs have adapted to the socio-economic and political milieu dominant in America and are now embedded in its unique socio-economic context. With the emphasis on reduction of welfare expenditure and increased focus on economic development, most of the microfinance and microenterprise programs were experiments to address these two important factors, and they also became popular due to frequent recessions and outsourcing of jobs to cheap labor markets overseas.

Despite the underlying fact that microfinance in both the developing as well as the developed countries utilizes market based solutions towards poverty and seeks to empower the community through access to financial services, there are significant differences between their programs. As mentioned in Chapter 5, though initially targeted towards the poor, over a period of time it was realized that former welfare recipients often lacked resources and skill and despite expensive training could not run a successful enterprise in a mature economy and defaulted on loans. U.S. microfinance has therefore slowly shifted its focus from poor to working poor owing to its contextual needs and cultural milieu.
However, one unifying finding that strongly emerges out in this thesis is the pivotal role played by nonprofits in development and practice of microfinance in both developing and the developed countries. These organizations are almost always community based and offer a more personal relationship to the clients in varying degrees, in comparison to a commercial bank. Another common factor in these organizations is their better reach out to women, minorities, and other historically disadvantaged sections of the society as compared to traditional financial institutions.

**In conclusion**

This thesis brings attention to different practices of microfinance worldwide and how the concept has not only existed since centuries but has also evolved through constant adaptations worldwide according to local needs and context. Based on the arguments presented, it is evident that microfinance in the U.S. has not reached out to the poorest sections of the society owing to the nature of its institutions, laws, and market orientation. Due this reason, many scholars have concluded that unlike developing countries, ‘Microfinance will never be the solution to the U.S. poverty’ (Schreiner and Morduch, 2002); and even if it were effective it is not chosen by most poor in absence of other supportive policies such as policy on tax and welfare in America.

The only clear solution to this situation is to have strong evidence and research data not just in developing countries but also in developed countries where microfinance is practiced. The research should focus on figures and statistics that are convincing at the international level, for example, how microfinance impacts the human development index in the long run or how microfinance impacts the quality of jobs created instead of focusing only on number of jobs created. This suggested research should be long term, scientific, valid, unbiased, and ethical that
should keep re-evaluating the results over a long period of time. Organizations like the World Bank and the IMF and various international aid organizations should put a special emphasis on research, even more than loaning money to the poor. Even international donors, as suggested in the last chapter, should support the MFIs through research grants and not subsidize the institution itself.

In the meantime, without evidence and in absence of thorough research it is not advisable to frame universal best practices and adapt it everywhere. A ‘one size fits all’ model should be tried with caution even in the developing world, and for sure in the developed world that has starkly different needs, construct and context. Based on the comparative analysis presented in this thesis, it is clear that socio-economic and political context and the prevalent ideology in each country creates unique opportunities and challenges that must be taken into consideration while grafting programs or practices from another society.

“Attempts to mechanically transport ideas from one historical period to another would fail if it were not for the objective social conditions in which such concepts can be applied. Indeed, it was Gramsci’s rejection of the notion that there were ‘iron laws’ which were appropriate in every situation which allowed for the expansion of his ideas out of the strait-jacket of abstract empiricism and sterile economism

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APPENDIX 1

CASE STUDY QUESTIONNAIRE

1. Is the organization a nonprofit?
2. Sources of fund
3. Linked with kiva? How?
4. Services offered beyond credit
5. Need for marketing/sales/managerial skills – provision of nonfinancial services
6. Is the training mandatory for loans?
7. Any training fee charged?
8. Networking with educational institutions for research/training
9. External evaluations of profit/loss
10. Is it a Community Development Financial Institution or CDFI (Subsidized income/subsidies from the government)?
11. Are there certain requirements from the U.S. Department of Treasury in order to become a certified CDFI?
12. Any integrated programs with other organizations (govt. or nongovt.) that subsidize a section of facilities provided (eg. food, legal aid, evaluation, research development); anything that helps the borrower or the process and the organization will otherwise not provide?
13. Lending model? How does this model work?
14. Why this model? Was it always the same or it changed over the years?
15. In case of group model, do the clients have any authority in terms of other’s business plans/ amount of loan/lending order/interest charged or duration of repayment?

16. Have there been any conflicts among group members (if practicing group model)?

17. When is the first installment due?

18. How do you assess the need of the community?

19. How are groups formed (self selection of group like in Grameen Bank or members put together by the org. like FINCA international)?

20. Is there a borrowers” eligibility criteria?

21. How is the problem of ‘adverse selection’ handled? How is ‘local information’ gathered?

22. Do borrowers have their own business plan or they are advised by your organization?

23. How far away the borrowers live from office?

24. Can they start a business anywhere they want?

25. What kind of govt. paperwork/ tax returns they have to file? Do you assist them in that?

26. Can people who are on welfare take loans?

27. How does it affect their welfare payments?

28. What are the loan types – for business enterprise only, or even for consumption purposes?

29. Are the clients offered higher loans from the organization or are simply given an initial loan for credit building?

30. Size of collateral (if at all)/ impact on loan size

31. What happens in case of default?

32. Linkages with banks/credit unions? What is the agreement on interest rates with banks?
33. Do you refinance? Do they offer shares in the market? What is the % profit returned to the investors?

34. Any data to support if loans are ‘developmental’ i.e., impact on long term poverty/asset building?

35. No. of below poverty line clients

36. No. of women clients

37. No. of minority clients

38. Do they serve only these and have special provisions for the above 3 categories?

39. Loans to immigrants? How long the borrower should have stayed in the community served?

40. Size of savings required (proportional to the loan sought), if at all?

41. What is the organization structure/main departments in the org.?

42. Most common businesses among the borrowers?

43. Do organization staff receive training before they start offering services to the clients?

44. How is a policy level decision reached?

45. Who owns the building/infrastructure?

46. Loan repayment through credit card?

47. How do you promote savings and asset building?

48. Sustainability in percentage?