MAKING MICROFINANCE RELEVANT TO POOR AGAIN

By Moin Qazi

Microfinance – the widely popular system of provision of financial services tailored to fit the needs of low income people - is facing trouble because the purity of its mission has been diluted. When it started, microfinance was a financial tool being used for social good. Now it has increasingly become a social tool used as a way to generate money which is why it has lost a lot of its original sheen. This is one reason why microfinance often runs into heavy weather and hits periodic roadblocks and default crisis. A number of rigorous field studies have shown that even when lending programs successfully reach borrowers, there is only a limited increase in entrepreneurial activity -- and no measurable decrease in poverty rates.

Micro financiers believe that direct evidence is not needed – that as long as microfinance institutions demonstrate high "repayment rates," they can be assumed to be improving lives. The logic goes that if a person is able to repay their loan with interest, they must have used it productively. But this argument flies in the face of most studies it is true that despite many studies on the impact of microfinance been done, not all of them are flawless. The few – and recent – stronger studies show mixed effects. The most encouraging effects are for programs that don't fit the traditional "lend to expand a business" story.

One concern is that as microfinance becomes more commercialized and increasingly concerned with large-scale impact, is that profits will take precedence over social mission. Anything not strictly financial is cut in the name of "efficiency." Profit-minded shareholders see training for entrepreneurs, financial literacy and counseling, skill training, or even the extra five minutes a caring loan officer might spend with a client as a cost rather than an investment.

Since most microfinance clients have little or no security or collateral to pledge, microfinance providers instead turn to what is called in microfinance parlance as "social collateral" which is built through groups of borrowers who guarantee each other's loans. The group concept has two variants –one, the international Grameen model and two, the indigenous Indian model.

The Indian version of microfinance is far more empowering –it is not just lending money. Borrowers in 20-member groups, called self help groups , cross-guarantee each other's loans; they receive skills and business training, peer mentoring, technical support, on-site follow up and on-going access to and also basic inputs in preparing a business plan which provides a basic roadmap for the borrower to reach her economic goals. Group activities allow the women to understand and practice various techniques for running the business collectively. This prepares them for individual entrepreneurship .in a way it is a basic entrepreneurial school.

The international MFI model is a different ball game altogether. Here the sponsor is a profit-oriented venture capitalist, who sees the rural credit market as a powerful business opportunity. The MFI apparently brings great professionalism, innovation and technology to its enterprise of venturing to provide loans that banks do not. Yet MFIs form no groups engaged in governance functions. The groups they promote, joint liability groups, are merely credit groups. Even when they operate through non profits, MFIs are primarily concerned with lending and recovering what they lend to cohorts of people, at rates of interest far higher than what banks charge.

While self help groups meet regularly and require members to participate in group financial decisions and some basic financial training, JLG's are simply a prerequisite for accessing loans. In fact, joint liability groups may in some cases serve to hide situations in which women have lost control of the loan because field staff will interact only with the group leader during collection times and never actually visit the homes of the other borrowers. In the Grameen Bank model, much more is required of women in the way of group meetings and support, but this model is purposefully avoided by Indian MFI's.

"We must think beyond the standard microcredit model. Modern microfinance—savings and insurance, and more flexible credit products—often has generated larger impacts than simple credit," says Dean Karlan , the well known microfinance researcher, and founder of Innovations for Poverty Action. "Financial services can make important differences in people's lives, but we need more innovation and evidence to determine what is best to do, and meanwhile we should set our expectations appropriately."

Poor people need, like everyone else, to have access to safe, sound, reliable and respectful systems in order to fulfill their financial needs. Microfinance still has a place yet in development economics. Paired with other development tools — such as cash transfers — micro lending can offer a sustainable investment option for small entrepreneurs, leading to a renewal in its mission to fight poverty.

(The writer is author of *Village Diary of a Heretic Banker.* He has spent more than three decades in the development sector)