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## **Introduction**

Microfinance, microcredit, village banking. In the last decade these phrases have become hot buzzwords in the business, economic, and international development communities. With the United Nations naming 2005 the Year of Microcredit, the popularity of this idea shows no sign of slowing. Encouraged by pioneer successes, the number of organizations providing microcredit services have also been on the increase, with estimates around 10,000 organizations worldwide. This paper will first offer a basic explanation of microfinance, then offer a comparative analysis of 3 organizations offering these services, and conclude with my thoughts on this controversial field and whether it is one in which I would pursue a career.

## **Microfinance at a glance**

More than 3 billion people, or ½ the world's population, live on less than \$2 a day. Microfinance can broadly be describes as providing financial services to the worlds impoverished people who do not have access to traditional, commercial financial instruments. This movement to “help the poor help themselves,” was pioneered by Muhammad Yunus, who has since been named the Father of Microcredit. A professor at Stanford University, Yunus began his project in Bangladesh as an experiment, and in doing so founded the Grameen Bank. The primary service of most microfinance organizations (MFI's) is to provide credit to the owners of small businesses so they can

begin to grow their enterprises, increase their profits, and lift themselves out of poverty. Many organizations also offer savings programs and educational supplements in addition to credit, in an effort to more quickly raise the quality of life for their families.

I was fortunate enough to work as an intern with Finca Peru. Although now unaffiliated, this organization was the original location for the now worldwide MFI Finca International. Prior to and during my internship, I spent considerable time researching various MFI's; their methodology, history, and future goals. I am going to focus on 3 aspects of 3 very different organizations. I will explore the history, current situation and methodology, and future plans for The Grameen Bank, Compartamos, and Finca Peru.

### **History**

Muhammad Yunus founded the Grameen Bank in 1979, as mentioned briefly earlier. It started in Jobra, a small village in Bangladesh, and quickly spread throughout the country. While other projects of similar nature were going on at the same time, the Grameen Bank is arguably the first of it's kind, and set an example many would follow.

Compartamos is a MFI located in Mexico. It was founded in 1990, as an affiliate of the well-known U.S. based Accion International. It has since grown to be the largest MFI in Mexico, and all of Latin America. This is partly attributed to Mexico's large population, and also the aggressive growth strategy implemented by Compartamos.

Dr. Aquilles Lanao and his wife, Morenita, founded Finca Peru in 1990. The project started in the rural region around Ayacucho, but over the course of several years spread to the city of Ayacucho, Huancavelica, and Lima. By 1998 Finca Peru was financially self-sufficient.

### **Current situation and methodology**

The Grameen bank currently is the largest MFI in the world, with 7.21 million clients. As many MFI's do, the Grameen Bank focuses its efforts on women entrepreneurs, with 97% of their clients being female. The reasons for this gender preference due to the fact that women have proved more responsible borrowers, and also to empower women as heads of households. Financial literacy and independence is a way for women to control their lives, and improve the lives of their children.

The Grameen bank requires no collateral in return for loans. Rather, the bank forms "solidarity groups" of 5 people, only 2 of whom are granted loans. Once those original 2 pay back their loans, the rest are able to take out loans as well. This method of positive peer encouragement and pressure has proven very successful, and the Grameen Bank has a 99% payback rate. This is far above conventional bank payback rates. The loans are collected over almost a one-year period. These 50 tiny weekly installments make payments easy and allow for savings in addition to principal and interest payments.

This organization also helps educate its members through a system of "the 16 decisions," that cover everything from health to hygiene to nutrition. Some examples include "We shall grow vegetables year-round," and "We shall always be ready to help each other." This list of 16 commandment-like orders addresses many of the societal problems facing Indian households that perpetuate poverty, such as the dowry system.

Compartamos, although smaller than the Grameen Bank, is still considered very large as far as MFI's go, with a client base of over 700,000, all of who are located in Mexico. This bank also uses a solidarity group method mentioned above, but this time in groups of 12. The average loan size is \$685 and 98% of the clientele are women.

Compartamos has been the subject of great controversy in the past few months. Historically a non-profit organization, this bank changed its' status to for-profit in 2000. In June 2007, the company went public and listed 30% of the company value in stock on the Mexican Stock Exchange. The initial public offering was hugely successful, and raised \$450 million dollars for the company. The stock price increased 22% on the first day of trading alone, and has continued to increase since June.

The money raised from this offering certainly could be used to increase the scale of the company, and provide loans for many more people. Many people think that this was a strong move for Compartamos, and proves that it is possible to help people while making a profit at the same time. However, this stock offering has raised many concerns and questions about the motivations of the company. Many people are concerned that the poor people of Mexico are not the one's benefiting from this stock offering, and in fact may be paying a high price. One issue is the interest charged by Compartamos. At about 86% per year, the interest rate is indeed quite high. Although with a higher risk group of borrowers, and the high costs associated with providing so many small loans, some would think this interest rate is justifiable. However, when compared to the success of the Grameen Bank, which charges just 16% per year, Compartamos is subject to criticism.

Once private, personal investors are involved, many feel that the priorities change dramatically, from helping the poor to solely maximizing profit. Selling stock is essentially selling ownership of a company, and in doing so may result in a conflict of interest. Grameen bank, on the other hand, takes great pride in the fact that 90% of the company is owned by the borrowers themselves. This insures that the best interests of the borrowers themselves always come first in any decision making process. Yunus stated in

the New Yorker (about people who want to make money in microfinance endeavors) “Let them make money—but why do you want to make money off the poor people? You make money somewhere else. Here, you come to help them. When they have enough flesh and blood in their bodies, go and suck them, no problem. But, until then, don’t do that.

Whatever money you are taking away, keep it with them instead, so they can come out more quickly from poverty.” The founder of Finca Peru, Dr. Lanao, also says that when one wants to make a profit, one cannot truly concentrate on helping the poor. There are very obviously two distinct sides to this issue, and the argument will likely continue for many years.

Finca Peru is a third company, very different still. It is the smallest organization discussed, with 8,000 members. However, in a country of this is a relatively large organization. 92% of the clientele are women, and the staff is almost 100% women. Finca Peru is a non-profit and has been since its’ 1990 founding.

“Bancomunal” is the term for the individual banks that make up Finca Peru. Each is comprised of about 15-30 “socias,” or members. There are 345 bancomunales, and the number grows yearly. The members themselves are responsible for asking friends and coworkers to observe a meeting, and see if they are interested in joining Finca. Each bank meets once a week at the centrally located headquarters in Ayacucho, and last about an hour.

Finca does require a \$30 savings prior to membership, which is used as collateral against a first loan of \$100. This is paid back over a 16-week cycle. Upon successful completion of the cycle, the borrower can then receive a slightly larger loan, and so on.

The average loan is \$179. The interest is 14% per 16 week cycle, which although is lower than Compartamos, is still considerable.

One aspect of Finca that is different than many organizations, including the ones mentioned in this paper, is the emphasis on savings. Members are required to save 47% of the loan amount, paid in small installments each week. In addition, they are strongly encouraged to put “ahorros voluntarios,” or voluntary savings, into their accounts. Almost every member puts a small amount of voluntary savings away each week. Finca emphasizes the importance of savings for several reasons. First, it is almost impossible for a woman to save in the house, without a formal program. This is because often in South America any money inside the house, regardless of who made it, is property of the men. A formal program is a safe place to keep money. The other main reason is vulnerability. A savings account assures that bank members less likely to be vulnerable during times of emergency, disaster, or economic regression. Enlightening members as to the importance of savings is also a way to teach financial literacy, and how to plan for the future. The average member has almost \$300 in savings, and many far exceed this amount.

Another interesting aspect of Finca is the “capacitacion,” or education program. At each weekly meeting, ½ hour is devoted to teaching members about a variety of subjects, from healthcare to the importance of generosity, to the methodology of Finca. The organization makes very clear the terms of each loan, and where each number comes from. The “promotoras,” or women who lead the bank sessions, ask questions and make sure the session is interactive and interesting. For many very poor women this is the only education they have received.

The final interesting aspect of Finca is the “Cuenta Interna,” or internal account. All the money from an individual bank that gets paid back throughout the 16 weeks, as well as voluntary and programmed savings and interest, get put into an internal account for that bank. Periodically throughout the 16 weeks, members can solicit a second loan from this account, which then must be paid off in addition to their original loan. This system is particularly interesting because each “bancomunal,” very much becomes its own self-sufficient bank. The amount available to its members directly relates to the amount of money paid back and savings. This helps each member clearly understand the methodology of the bank, and also see results from their investment.

### **Future**

Because this is a relatively new industry, it is hard to say where it will go in the next 20, 50, or 100 years. There has been relatively few studies done, and as a result there are a multitude of ideas as to how this field may develop.

The Grameen Bank continues to be progressive. It has begun providing interest-free long-term loans to beggars, who have traditionally been considered unbankable. The Grameen Bank remains very close to its vision that everyone is deserving of a dignified life and with the proper resources, everyone can attain such a life. Another progressive project by the Grameen Bank is “Village Phone.” Basically, this program supplies a woman a loan to purchase a cell phone and other proper equipment, and then that woman makes money by selling airtime per minute to other people in her village. This system has been incredibly successful in rural Bangladesh and Uganda, with plans to expand elsewhere. The people who solicit the phone use also benefit greatly, and save time because previously they had to walk several hours to communicate. They also save

money because the village phone operators charge less than traditional communication providers.

Spokespeople from Compartamos insist the company remains altruistic in their goals, and that providing optimal banking services to the poor will continue to be the priority. The success of the Compartamos stock will remain to be seen, as will its reputation as a company.

Finca Peru has goals to expand its reach, especially into the rural areas of Peru, which are traditionally hard to reach because of poor transportation and low population density. Dr. Lanao, who is now 84, remains president and spokesman for Finca Peru, and has several new projects underway. One of these is a farming cooperative and guinea-pig breeding program (the small animal is a Peruvian delicacy and important source of protein).

### **My thoughts**

After reading so much material about microfinance operations worldwide, I feel very fortunate to have gotten hands-on experience at an exceptional organization. I took this internship in an effort to learn more about a field in which I hoped to pursue a career, and I still do. Although this is a controversial field, I think that the controversy is actually a good thing. It has raised interest, and gotten people talking and asking questions. This is a very young field, and I am very excited to see where it goes in the future.

As a business administration and finance major at the University of Oregon, it is no surprise that I believe in the power of money. I think that financial literacy is of the utmost importance, and that it can and will help people out of poverty. We are at a time when eradicating poverty, while undoubtedly a daunting task, is possible. With some of

the worlds brightest people working toward this goal, as well as technology and globalization increasing rapidly, I believe that within my lifetime we will see a different world. There are many facets of international development that I can see myself working in, one of which is microfinance. This internship has given me not only a first hand look at the operations of a very successful MFI, but also got me thinking about all the ways in which I can use my skills and intellect to help the people of the third world, and to that I am committed.