Microfinance and Microcredit

How can $100 change an economy?

It could be for a new tool, a machine, or a shop in the marketplace—millions of the world's poor and low-income people have taken advantage of small loans to improve their lives. Over the past three decades, people have used these loans, known as microcredit, to launch new enterprises, create jobs and help economies to flourish. Poor people have proved time and again that they are able to repay these loans on time. But credit is not the only answer.

They might need other basic financial services, such as insurance, a savings account, or the ability to transfer money to a relative living elsewhere. With access to credit and this range of financial tools, collectively known as microfinance, families can invest according to their own priorities — school fees, health care, nutrition or housing. Rather than focusing on day-to-day survival, people can plan for the future.

Seeking to boost microcredit and microfinance programmes around the world as a way of improving the lives of the poor, the United Nations General Assembly has designated 2005 as the International Year of Microcredit. Though microfinance operates one household at a time, the hope and opportunities it brings resonate throughout entire societies.

One small loan can change a family.

Several can strengthen a community.

Thousands can transform an entire economy.

Elements of microfinance

Microfinance refers to loans, savings, insurance, transfer services and other financial products targeted at low-income clients.

Microcredit is a small amount of money loaned to a client by a bank or other institution. Microcredit can be offered, often without collateral, to an individual or through group lending.

Microsavings are deposit services that allow one to store small amounts of money for future use. Often without minimum balance requirements, savings accounts allow households to save in order to meet unexpected expenses and plan for future investments.

Microinsurance is a system by which people, businesses and other organizations make a payment to share risk. Access to insurance enables entrepreneurs to concentrate more on developing their businesses while mitigating other risks affecting property, health or the ability to work.

Remittances are transfers of funds from people in one place to people in another, usually across borders to family and friends. Compared with other sources of capital that can fluctuate depending on the political or economic climate, remittances are a relatively steady source of funds.

What is an inclusive financial sector?
An inclusive financial sector allows poor and low-income people to access credit, insurance, remittances and savings products. In many countries, the financial sectors do not provide these services to the lower income segments of the market. An inclusive financial sector will support the full participation of the lower income levels of the population to promote economic growth.

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Who are the clients of microfinance?

The clients of microfinance are generally poor and low-income people. Among them may be female heads of households, pensioners, artisans or small farmers. The client group for a given financial organization depends on that organization's mission and goals.

How do financial services help poor and low-income people?

Poor people who have access to savings, credit, insurance and other financial services are more resilient and better able to deal with everyday demands. Studies have proved that microfinance helps clients meet basic needs. For example, with access to microinsurance, poor people can cope with sudden expenses associated with serious illness or loss of assets. Merely having access to formal savings accounts has also proved to be an incentive to save. Clients who join and stay in microfinance programmes have better economic conditions than non-clients. A few studies have also shown that over a long period of time, many clients graduate out of poverty.

What is a microfinance institution?

A microfinance institution (MFI) is an organization that provides financial services targeted to the poor. While every MFI is different, all share the common characteristic of providing financial services to a clientele poorer and more vulnerable than traditional bank clients.

If microfinance is about serving the poor, why does the provision of financial services need to be profitable?

Microfinance institutions need to be profitable in order to cover the costs of reaching out and meeting the demand of underserved segments of the population over a sustained period of time. In addition, after a series of very small loans, a microentrepreneur often wants to expand her business; a microfinance institution must keep up with the demand for larger loan amounts so businesses can grow into small enterprises.

How can poor people afford such high interest rates?

Studies conducted in India, Kenya and the Philippines found that the average annual return on investments by microbusinesses ranged from 117 to 847 per cent. These high returns are commonplace among microentrepreneurs, and while the interest rates seem high, they usually represent only a small portion of microentrepreneurs' total returns. Interest rates charged by informal moneylenders are overwhelmingly higher than those of MFIs. Microcredit interest rates are set with the aim of providing viable, long-term financial services on a large scale, while subsidized interest rates generally benefit only a small number of borrowers for a short period.

Do poor people save?

Poor people save all the time, although mostly in informal ways. They invest in assets such as jewellery, domestic animals, building materials and things that can be easily exchanged for cash.

Access to secure, formal savings services provides a cushion when families need more money for seasonal expenses and in tough times. Secure savings accounts allow people to guard against unexpected expenses associated with illnesses, build assets, prepare for old age or pay for school fees, marriages and births.

Why is microfinance so important for women?

In a world where most poor people are women, studies have shown that access to financial services has improved the status of women within the family and the community. Women have become more assertive and confident. Furthermore, as a result of microfinance, women own assets, including land and housing, play a stronger role in decision-making, and take on leadership roles in their communities.

When is microcredit NOT appropriate?

Microcredit may be inappropriate where conditions pose severe challenges to loan repayment. For example, populations that are geographically dispersed or have a high incidence of disease may not be suitable microfinance clients. In these cases, grants, infrastructure improvements or education and training programmes are more effective. For microcredit to be appropriate, the clients must have the capacity to repay the loan under the terms by which it is provided.

Adapted from the Consultative Group to Assist the Poor with permission.

"The International Year of Microcredit 2005 underscores the importance of microfinance as an integral part of our collective effort to meet the Millennium Development Goals. Sustainable access to microfinance helps alleviate poverty by generating income, creating jobs, allowing children to go to school, enabling families to obtain health care, and empowering people to make the choices that best serve their needs. Together, we can and must build inclusive financial sectors that help people improve their lives."

United Nations Secretary-General
Kofi Annan

Loans that change lives

Uganda: a local call to success

Fatima Serwoni lives in the village of Namunsi in Uganda and runs a small store, selling food and household items. She has built her business with the help of a series of loans from FOCCAS, a local microfinance institution. Since becoming a client, she has increased her weekly income by 80 per cent and has consistently paid the school fees for her four children. With her most recent loan, Fatima purchased a mobile phone kit to start a payphone business, becoming one of the first "village phone operators" of MTN villagePhone, an initiative of Grameen Foundation USA and MTN Uganda. Undeterred by the lack of electricity in her village, Fatima uses a car battery to charge her phone. With the nearest public payphone more than four kilometres away, people in Fatima's community are happy to have convenient and affordable telephone access for the first time. Fatima is pleased with her new business, which has the added benefit of attracting people to her store and generating greater profit to share with her family.

Bolivia: three children finishing school

Fortunata María de Aliaga has sold flowers from a street corner in La Paz, Bolivia, for as long as anyone can remember. When her children were young, she worked long days to give them the opportunity she never had: the chance to go to school. There were days when she barely had enough money to set up shop.

Then, 15 years ago, Fortunata learned about Banco Sol, a bank affiliated with ACCION International. Together with three other women, she qualified for a loan that allowed her to buy flowers in bulk at a much cheaper rate. With a strong repayment record, Fortunata was approved for larger loans and began to borrow on her own. Today, Fortunata is proud to report that she put her savings to good use. "All three of my children finished school," she beams. "And I even had money left to make some improvements to my house!"

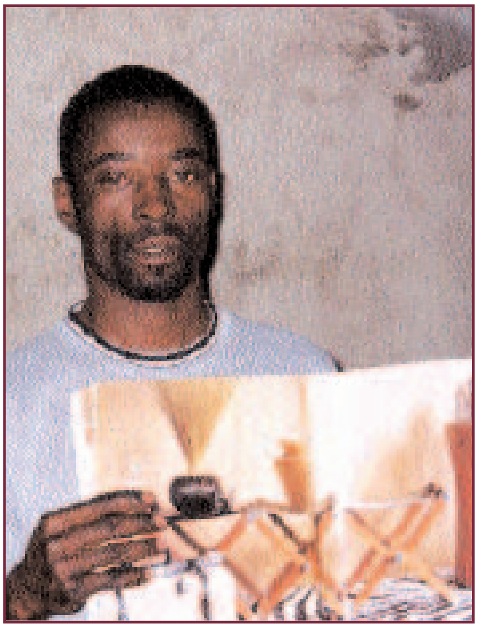
Cambodia: a sturdy roof overhead

Phorn Hun never had property of her own. She lived in a thatched-roof house along the fence of a pagoda. No one, not even private moneylenders, dared to give her a loan. In 1998, however, Mrs. Hun approached ACLEDA Bank and explained her unfortunate situation. She told the bank about her idea to start a noodle business and it offered her a loan of US$ 25. Mrs. Hun's profits enabled her to buy a small piece of land and to build a wooden house with a metal sheet roof, a luxury she could never have afforded before. She is still an active borrower of ACLEDA Bank; she has since had 10 subsequent loans. ACLEDA Bank gave Mrs. Hun a chance at a new and successful enterprise and she capitalized on this opportunity.

Philippines: a blooming business

Gloria Caramat and Beth Sabinian started a floral landscaping business in the Philippines in 1990. With a small business loan from the Center for Agriculture and Rural Development (CARD), Gloria and Beth expanded their business. They now have two properties where their flowers—as well as their business—are blooming. They sell primarily to landscapers and real estate developers. Gloria and Beth are now considering taking a larger loan to help pay for a jeep, which they will use to bring their flowers to new customers. This, they hope, will reduce delivery costs.

Mozambique: carving a niche for artisans



When Aid to Artisans (ATA) first met Mabanda (born Jose Rodrigues Fumo), he was carving under a tree. Originally a sole practitioner, Mabanda now employs four other artisans in his workshop. ATA encourages microenterprise by placing orders with small entrepreneurs like Mabanda, and by sending 50 per cent of the purchase price up front for the artisan's use as working capital. In addition to sandalwood vases, his most successful product is a carved sandalwood statue of a face with streaming hair atop a standing figure, which has been featured in major design magazines. Mabanda leaves the front of the statue in its rough-hewn state and polishes the back to a lustrous patina.

"I sell more now," said Mabanda. "I can work more, knowing that I am going to sell my product. My life has improved because of the large international orders that I am receiving. I earn a lot more money than I did selling in the local market!"

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Microcredit has been changing the lives of people and revitalizing communities around the world for more than three decades. Microentrepreneurs have used loans as small as $100 to grow thriving businesses and, in turn, provide for their families, leading to strong and flourishing local economies. The Year of Microcredit 2005 calls for building inclusive financial sectors and strengthening the powerful, but often untapped, entrepreneurial spirit existing in impoverished communities. Among the goals of the Year are:

- To increase the public's awareness and understanding of microcredit and microfinance, and thus contribute to the alleviation of poverty — one of the UN's key Millennium Development Goals;
- To develop strategies to position microcredit and microfinance as an integral part of financial systems;
- To enable microcredit and microfinance organizations to become more effective providers to the poor and strengthen the capacity of donors and Governments to support these organizations;
- To expand the reach of microcredit and microfinance organizations by encouraging partnerships among Governments, the United Nations, the private and public sectors, and non-governmental institutions.

To find out more about the Year and how you or your organization can get involved, please visit www.yearofmicrocredit.org or contact:

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