A Loan Out of Poverty

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In Nicaragua, a woman receives a $200 loan that allows her to reduce the operating costs of her sidewalk stand and expand her business. A farmer in Kenya uses a series of loans of no more than $690 to develop his floundering farm into several profitable enterprises. A woman in Bolivia takes out a series of ten loans over five years to turn her small sweets stand into a sprawling general store and is able to send her children to University (Robinson 113-116). All of these real situations illustrate the benefits of microfinance. The distribution of microloans and availability of financial services to the world's poorest people have helped to empower millions around the world and improved the quality of life in countless households and communities. Microfinance is a practical, positive way to alleviate poverty in developing nations.

Microfinance is essentially the practice of providing small-scale financial services to the poor. With these very small loans, otherwise known as microloans, entrepreneurs from around the world can set up small local enterprises, called microenterprises. With the help of a growing business, poor vendors can increase their income and improve not only their own lives but also the lives of their family members ("About Microfinance"). There are approximately 4.5 billion people on the planet who are classified as either poor or moderately poor. Additionally, approximately 80% of these people lack access to any type of formal financial services that could help them escape poverty (Robinson 10-11). Microfinance encompasses not only distributing small loans, but also providing the borrowers with financial services that would otherwise not be available, such as insurance policies and savings institutions (Sengupta). The typical borrowers of microloans are self-employed entrepreneurs whose occupations can range

from small farming to shopkeeping (Helms 18). Despite the profitability of these local microenterprises, many commercial banks have deemed that lending to the poor is too risky. Furthermore, it is thought by some that the poor are not worthy of receiving loans, for they may not possess the financial skills required to repay these loans in a timely fashion (Sengupta). The inaccessibility of financial services to some of the world's poorest people only perpetuates the issue of poverty. Without available credit men and women essentially become locked into their financial situations. Microfinance Institutions, otherwise known as MFIs, make it their mission to challenge the theories that the poor are undeserving of receiving loans and work to provide the poor with accessible financial services.

While many MFIs have proven the effectiveness of microfinance, one of the most influential institutions is the Grameen Bank, founded by Muhammad Yunus in 1983. Yunus, who won the Nobel Peace Prize in 2006, discovered that much of the poverty in small villages in developing economies was caused by a lack of any available credit. Poor people, who already may not have had access to jobs, also had no money with which to start up their own businesses. Their only hope for receiving any sort of loan was from local, informal money-lenders (Sengupta). While these informal financial institutions are able to provide some sort of access to credit to the poor, they are often unreliable, do not offer many financial services, and cannot help more than a few people in a small community (Helms 140). Yunus began his organization when he lent the equivalent of $27 to women manufacturing bamboo stools in rural Bangladesh (Sengupta). Since then, the Grameen Bank has loaned $7.78 billion to 7.75 million borrowers, 97% of whom are women. Not only did the Grameen Bank popularize the principle of microfinance, it also proved its practicality. The recovery rate of loans made by the Grameen Bank is 98%, which counters the popular belief that the practice of loaning to the poor is too

risky. Additionally, the Grameen Bank has made a profit in all but three years of its existence, even though it stopped accepting donor funds in 1995 ("Grameen Bank at a Glance").

The tremendous growth and success that the Grameen Bank has experienced can be seen throughout the entire microfinance industry. The Grameen Bank model has now been replicated on five continents, and its impact is widespread (Armendariz ix). It is estimated that there are over 3,100 microcredit institution with over 92 million clients today (Yunus). In Beatriz Armendiaz and Jonathan Morduch's book The Economics of Microfinance, they discuss how the microfinance model has been well implemented in regions "As diverse as villages along the Amazon, inner-city Los Angeles, and war-ravaged Bosnia" (2). The immense growth of microfinance institutions furthers their creation and development. As MFIs expand, they are able to lower operating costs while becoming less dependent on donors and more self-sustaining. This gives MFIs a greater competitive advantage and the ability to cut interest rates, which allows them to help a greater amount of people and grow even more (Ramirez). Despite the fact that commercial banks have viewed lending to the poor as unprofitable, the continuing growth and success of MFIs around the world proves that microfinance can be a sustainable industry.

The benefits of microfinance are hardly limited to those who directly receive loans. Research has shown that whenever the world's poorest increase their income, they typically also improve their nutrition, which in turn enhances the quality of life for all members of the household. Other benefits include educating children, improvement of housing conditions, and gaining access to medical care (Robinson 117). For example, in Bangladesh almost all girls who are in a Grameen Bank client household receive schooling, compared to 60% of girls receiving an education in non-client households. With regards to health care, it has been shown in several studies that access to financial services has a strong impact on the health of particularly woman

and children (Helms 31). Not only does an increased income lead to better access to health services, but additionally many microfinance institutions combine availability of credit with training on certain health issues. One example is Intervention with Microfinance for AIDS and Gender Equality, IMAGE, an organization that links HIV/AIDS awareness with microfinance. (Proynk) Typically, improvements in quality of life occur in small increments as a result of microfinance; however, the effects can be felt by all members of the household (Robinson 117).

Perhaps the most valuable result of microfinance is the inevitable improvement in self-confidence. In The Microfinance Revolution: Sustainable Finance for the Poor, Marguerite S. Robinson writes that microfinance institutions not only provide essential financial services:

Commercial microfinance institutions deliver more to the poor than savings services and loans: they provide a demonstration of trust in their clients. The self-confidence of the part of clients that often develops from such a trust is at least as essential for the development of their enterprises as the loan and deposit facilities provided. (37)

Robinson goes on to detail several cases in which the receipt of loans has improved the quality of life for men and women around the world. In one example, a woman in Mexico was able to support her family through her small ceramics business after her husband left her. Yet another woman in Senegal was able to gain valuable business experience and dependence from her husband though her small peanut farm. (Robinson 112-117). MFIs are allowing men and women around the world to be self-sufficient for the first time . By raising incomes, independence, and confidence, microfinance is giving many individuals the means necessary to make sustainable improvements in their lives.

This newfound independence derived from microloans has empowered countless female clients. Many MFIs, such as the Grameen Bank, assist mostly women. In fact, 80% of the clients

of the thirty-four largest microfinance institutions are women (Armendariz 179). In many developing nations, sexism is very apparent and women are denied many business opportunities. In countries where polygamy is accepted and spousal abuse common, gaining financial independence allows women to feel that they are able to support themselves and their children. It has been proven that economic empowerment of women not only leads to financial independence, but also clearly shows a reduction in abuse received from their partners (Kim). The Microfinance Information Exchange Market, otherwise known as the MIX market, a database that provides information on microfinance institutions, states that microfinance "can be a powerful instrument for self-empowerment by enabling the poor, especially women, to become economic agents of change" ("How Does Microfinance Affect the Poor?"). It is widely believed that by giving women the ability to earn their own income and save their own money, microfinance institutions are empowering women and enabling them to better fight gender inequalities (Helms 31).

Despite the many benefits of microfinance, it is not without its flaws. For example, there are many who criticize microfinance institutions for often charging higher interest rates than those of commercial banks. This is an accurate assessment, yet it must be considered that these higher interest rates are nevertheless coupled with high repayment rates that typically hover around 95% (Sengupta). Microloan Foundation, a MFI located in the United Kingdom, details several reasons why interest rates must be higher for microfinance institutions than for commercial banks. Firstly, small loans are more expensive to administer than large loans. Because the average loan made by the Microloan Foundation is around £45, their loans are significantly lower than typical bank loans and therefore cost much more to manage. Additionally, the interest rates must account for the fact that inflation rates in developing

countries are often very high. Interest rates must also be raised because clients of microfinance are often hard to reach and in remote and rural areas. Finally, the risk of lending to poor clients is occasionally higher than it is in lending to wealthier consumers. The Microloan Foundation consistently keeps track of its "portfolio at risk," meaning the loans it has made that are at risk of defaulting. For the Microloan Foundation, the average "portfolio at risk" is typically 1% of the total portfolio, yet during times of famine it can be as high as 40%. Therefore interest rates must account for the possible riskiness of microloans. Nevertheless, the main goal of charging higher interest rates is to ensure long-term sustainability for the MFI ("Interest Rates"). Microfinance institutions typically use donations and subsidies to start up their organizations, yet the high interest rates allow them to be sustainable and able to operate without reliance on outside donors (Armendariz 245).

Another common criticism of microfinance is that it is unable to reach the poorest of the poor, otherwise referred to as the "core poor" (Weiss). Once again, this argument has merit with respect to the initial stages of MFI development. It is well documented that at first, microfinance institutions typically help those who are considered to be either moderately poor or those who are not poor yet very vulnerable, while the extremely poor are neglected (Helms 20). As unfortunate as this may be, it is necessary for a MFI to gain financial independence in order to be able to help the core poor. All microfinance institutions must first target the relatively less risky marginally poor in order to build up savings. (Sengupta). By achieving financial sustainability, MFIs can extend their outreach and help the world's poorest, as the Grameen Bank and other large MFIs have done. Additionally, the extremely poor can greatly benefit from the development of microenterprises. Many entrepreneurs eventually expand their businesses, hire new workers, or develop new operations. This can provide economic opportunities for the

extremely poor that were otherwise not available. Even if microloans are not always made to the poorest of the poor, the core poor can still be affected by their distribution (Robinson 19).

While microfinance may not be without its flaws, it is still one of the best possible means to end world poverty. Perhaps Muhammad Yunus said it best: “A hand up doesn’t always require a handout” (Yunus). When a microfinance institution has achieved financial sustainability, loans can be made to some of the world’s poorest people without any serious risk. The success of microfinance has allowed it to travel around the world, even to the United States. The positive effects of microfinance can be felt not only by an individual borrower but also by entire households and communities. In this way, microfinance gives people the chance to escape poverty not through a subsidy or handout, but rather on their own terms.

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