

## Microfinance Interventions to Enable the Poorest to Improve Their Asset Base

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**M**icrofinance has proven an effective tool in alleviating poverty, particularly among the population living on less than a dollar a day. Worldwide, more than 100 million people now receive microfinance, but not all of them are below the dollar-a-day poverty line. Although microfinance is expanding all over the world, probably fewer than half of the people who have access to financial services through microfinance live on less than a dollar a day. The International Food Policy Research Institute has estimated that India has 70 million borrowers, of whom only about 6 million live on less than a dollar a day, suggesting that the majority of borrowers are above the dollar-a-day poverty line. These people are also poor and should not be ignored. These numbers suggest something that the experience of the Bangladeshi organization BRAC (Box 27.1) has shown to be true—that microfinance has not yet reached the large numbers of very poor people for whom access to finance would lead to better lives. When one is poor and has no money to start a small business that can help improve one's life, access to finance is very important; it is kind of a dream come true.

People also need a service that will help them save small sums of money for a rainy day. Even poor people practice saving in small quantities and would find it useful to have a safe place to put these savings, to which they could add in small amounts—a few cents every week.

Therefore, there is a need for an institution that allows the poor to save and to borrow small sums of money when they need it. The actual amount borrowed would depend on the ability of their enterprise to generate income to repay the loan; the figure could be as low as US\$50.00 or as high as, say, US\$400.00 to

### **Box 27.1 About BRAC**

BRAC (formerly the Bangladesh Rural Advancement Committee) was founded to rehabilitate refugees returning to Bangladesh after the country's 1971 war of independence. BRAC soon faced the long-term task of improving the living conditions of the rural poor and expanded its work into fields such as income generation, health care, population control, and primary education for children. As BRAC grew, it targeted the landless poor, particularly women in rural Bangladesh, a large percentage of whom live below the poverty line with no access to resources. BRAC now works in more than 69,400 villages in Bangladesh and reaches more than 110 million poor people.

BRAC employs a holistic approach to poverty alleviation and empowerment of the poor through programs in health, education, and social and legal empowerment as well as economic development interventions such as microfinance. In BRAC's work, empowerment of women is a precondition for sustainable poverty alleviation. So far, BRAC has organized about 7 million Bangladeshi women into more than 260,000 groups called Village Organizations. These groups form the basis for BRAC's multifaceted programs, which seek to create an enabling environment in which the poor can participate in their own development and improve the quality of their lives. In 2007 BRAC had disbursed more than US\$4.6 billion in microcredit to its Village Organization members, with a recovery rate of 99.5 percent.

In 2002, BRAC went international, using its early experience in the postwar reconstruction of Bangladesh to help a war-ravaged Afghanistan. In 2004 BRAC also registered as a foreign NGO in Sri Lanka to help the country get back on its feet after its eastern coastal provinces were virtually destroyed by the devastating tsunami. In 2006 BRAC launched operations in Africa—currently working in southern Sudan, Tanzania, and Uganda—with plans to expand to several other countries over the next few years.

US\$500.00. This is the service provided by a microfinance institution, and it is one of the activities carried out by BRAC.

### **How Microfinance Works**

How does microfinance work? Microfinance involves organizing poor individuals within a community into groups, encouraging them to save, and lending them small sums of money for which they are jointly liable. Amounts ranging from US\$50.00 to US\$500.00, depending on the enterprise, are lent to individuals in these groups,

who then repay the loans with interest in regular installments over a specified period of time, usually one year. Once the first loan is repaid, the borrowers are able to take further loans, which tend to be progressively larger. Gradually they improve their enterprise, increase their asset base, and lift themselves out of poverty. That is the standard microfinance model, and it works for most people.

For some people—fewer than 10 or 15 percent of borrowers—it does not work, not because their enterprises have failed but because something unexpected has happened in their family, making it difficult for them to repay their loans. For example, the death or infirmity of the family's main breadwinner may cause the borrowing household to default on loan repayments. As a result the borrowing household loses its access to microfinance and is not able to acquire any further financial support. To overcome these issues, BRAC has put in place several measures, including death benefits for borrowing households.

Failure to repay a loan occurs in only a small percentage of cases, however. For the large majority of borrowers, microfinance has proven effective. It is the most effective intervention known to us for attacking poverty at the level of the household rather than the economy.

### Microfinance for the Ultra Poor

The situation for the ultra poor, however, is quite different. BRAC's definition of the ultra poor is not people living on less than 50 cents a day but those living on less than 35 cents a day. BRAC's experience in working with more than 100,000 households in Bangladesh that fall under its definition of ultra poor has shown that these families are not really microfinance clients. Existing microfinance group members within the village choose not to include these individuals in microfinance activities, saying, "No, she can't repay her loan. She's too poor. She is by herself, she has no husband. She works in other people's houses, she has five children, she has no way of taking money and repaying a loan."

So what can be done about the ultra poor? BRAC has recognized that before providing microfinance to the ultra poor, it needs to invest in building up their capacity to fully use such mainstream development interventions. This investment involves transferring assets (such as livestock) to them through a grant—not a loan—of around US\$150.00 and, while these assets are earning income, providing a small stipend for them to live on and to use to send their children to school. For 2 years BRAC "holds their hands," allowing them to graduate out of ultra poverty into "tolerable poverty," at which point they can become microfinance clients. As microfinance clients, they are able to graduate out of poverty using the standard microfinance framework described earlier.

This is what it takes to lift the ultra poor out of poverty. It is an investment, whereas microfinance is a business. Microfinance institutions not only recover their

capital but also earn interest, which allows them to cover their costs and, if they are successful, even make some profit so they can expand their portfolio. The ultra poor need a “ladder” so they can climb up to a level of poverty at which, through microfinance, they can work toward emerging from poverty. This is what BRAC is doing in Bangladesh with its program for the ultra poor. In 2002 the pilot intervention of asset transfer and stipend provision included 100,000 ultra-poor families and was supported with US\$58 million of donor financing. Its success has allowed BRAC to expand the program to 800,000 ultra-poor families, and in 2006 it planned to spend US\$188 million over the following 5 years (2007–11) to guide these families onto the road out of poverty.

### Institutions for Microfinance

Which are the best organizations to offer microfinance—banks or microfinance institutions? If banks were able to provide microfinance, the extension of microfinance would be much easier given that banks are available all over the world. Banks, however, have a fundamentally different culture from institutions that provide microfinance services. Bankers do not go to villages seeking clients; rather people go to banks to borrow money and repay it. In contrast, microfinance institutions go to the villages, look for poor people, organize them into groups, and get them to start saving.

One of the distinguishing features of the service provided by many microfinance institutions is the organizing of borrowers into groups. There is solidarity among microfinance group members, so if an individual member cannot pay this week’s installment, one of the other members will say, “All right, I will help you out this week, and if at some point in the future I don’t have enough money, you can help me.” The success of microfinance is due in large part to the group settings in which these programs operate. Individually, a poor person is powerless, but a group is powerful. A group not only facilitates access to finance and saving services but also offers a gateway into communities for approaching issues that affect them, such as the occurrence of disease. In an organized microfinance group, one member can be trained as a village health worker who can help her community deal with health issues such as dehydration and diarrhea. Microfinance builds a lot of social capital and trust between group members, the full potential of which has not yet been explored. Therefore, much more can be done to realize the full benefits of microfinance.

### “Microfinance Plus Plus”

BRAC is not just a microfinance organization; it is a development organization. It operates what is called a “microfinance plus plus” program, which provides support

in the form of linkages along the different points of a microenterprise's supply chain. For example, when poor rural women borrow money to buy livestock, they often face several problems, including lack of proper feed and veterinary care as well as low demand for milk in rural areas and lack of access to more lucrative city and town markets. BRAC works with its borrowers who buy cows, giving them training in livestock rearing. BRAC's poultry and livestock feed mills provide access to superior-quality animal feed, and its community extension workers provide door-to-door immunization and veterinary care. Through BRAC's artificial insemination program the microentrepreneurs have access to better breeds of cows that yield more milk. On the other end of the supply chain, for its 400,000 borrowers who have bought cows, BRAC has put in place a system to collect milk from them, process it, and sell the final product to more viable city and town markets. Therefore, in addition to providing microfinance, BRAC also provides marketing and input support.

Similarly, when 400,000 of its women borrowers were planting vegetable gardens but lacked access to good seeds, BRAC entered the seed business to provide them with high-quality seeds that help improve the productivity of their enterprises.

Microfinance alone works well, but if it can go a bit beyond pure access to finance—the “plus plus”—by, for instance, connecting borrowers to the right enterprises, providing inputs, and marketing their products, microfinance has an even greater impact.

### Addressing Constraints to Microfinance Expansion

Given the now well-known benefits of microfinance, it is useful to consider why it is not expanding exponentially throughout the world. Constraints to the expansion of microfinance and suggestions of ways to address them are as follows:

1. *Government regulation.* In China, provincial permission is required to start a microfinance organization. Government regulation is fine, but the government should understand what it is trying to regulate. The governments of all countries should give microfinance organizations free rein to provide microfinance to the poorest people. It is important for government representatives, particularly in the central bank, to understand what microfinance is and what it can do for the poor.
2. *Institutional capacity.* Some nongovernmental organizations are content to have 30,000 borrowers. The philosophy at BRAC, however, is that although small may be beautiful, large is necessary. BRAC wants to reach millions of borrowers in order to make a significant impact given the scale of global poverty. Organizations should focus on building their capacity to quickly reach larger numbers of people.

3. *Wholesaling by banks.* Banks should not be microfinance organizations, but they should be wholesalers, and microfinance institutions should be retailers. In other words, banks should offer financing to microfinance institutions.
4. *Training.* To provide 200 or 300 million of the poorest people with access to microfinance it is crucial not only to understand the theoretical underpinning of how microfinance works but also to have large numbers of people who can go to a village to collect money, collect savings, and service loans. Training organizations are needed to develop the capacity of microfinance program staff. Universities, including some in Bangladesh, have started offering master's of business administration degrees in microfinance to develop the quality of human resources involved in operating these programs.