Leadership Council for Human Rights

Microfinance White Paper

Introduction

According to the United Nations Capital Development Fund, 500,000,000 people around the world do not have access to a bank. This represents a staggeringly high number of vulnerable non-poor, working poor, unemployed and destitute individuals who are entirely cut off from the benefits of having a bank. These millions cannot get credit, open savings accounts, transfer money, or make use of any other financial services. They are poor and have no collateral, so commercial banks will not work with them. Without credit, they have few opportunities to work their way out of the vicious cycle of poverty. Instead, they must resort to taking money from predatory lenders in order to eke out an existence, paying astronomical interest rates and effectively becoming slaves to a system designed to keep them at the bottom of the socio-economic ladder. What little savings they manage to earn must be rolled up under mattresses, hidden away from thieves, making those earnings extremely vulnerable.

The advent of microfinance, or banking for the poor, occurred three decades ago when an organization called Grameen began giving tiny loans to poor women entrepreneurs in Bangladesh. Other outfits soon followed in Central and South America, notably ACCION International, a Boston-based organization that pioneered the idea of non-profit microfinance groups becoming licensed banks to greatly expand their services to the poor. Microfinance, while it relies on the simple notion that poor people are credit-worthy and can establish good credit, has proven to be a revolutionary concept. It not only gives poor people the credit they need to become entrepreneurs, it has the power to transform lives.

How Microfinance Changes Lives

- Microfinance opens the door to people who would otherwise have no access to financial services.

- Poor people can get credit from an established microfinance institution (MFI) at a reasonable interest rate instead of from a loan shark or other predatory lending agency.

- Micro entrepreneurs can use loans to buy supplies for their business in bulk, saving money on materials and increasing profits.

- MFIs offer a safe place for the poor to deposit their earnings, making their savings less vulnerable to theft, fire, etc.

- With increased funds, micro entrepreneurs can improve their families' nutrition, general healthcare, and education. Children of micro entrepreneurs are less likely to suffer from malnourishment and more likely to go to school. Across the board, access to credit through microfinance dramatically raises the recipients' standard of living.

- Microfinance allows for the creation of new businesses, promoting overall economic growth.

- Building micro economies promotes positive social change.

- Women earn their own money and experience greater social equality through microfinance. Women from the bottom tier of the economic and social structure are elevated in status and become more powerful agents for change within their communities.

Microfinance Cracking Capital Markets

Microfinance has become a buzzword recently. At the conference "Who Will Buy Our Paper: Microfinance Cracking Capital Markets?" held in New York City February 6-7, 2006, investors and microfinance groups converged to harness the buzz.
Seminal themes from the conference are described below:

- *Sustainability* – To be a viable in the long term, MFIs must not run solely on donor funding, which is unreliable, and instead should make a profit off of microfinance (i.e. charge interest on micro loans, issue bonds, examine other investment instruments as money makers).

- *Mainstreaming of microfinance* – In the 30 years since the birth of microfinance, the concept of 'banking with the poor' has become big business. 2005 was declared the "Year of Microfinance" by the UN, which led to a greater awareness of what microfinance entails. It is no longer scoffed at as a charity operation, but instead eyed as a profitable opportunity by investors. Instead of serving a niche market, MFIs are reaching out to an increasingly large segment of the population in countries like Mexico, Peru, Bolivia and Columbia. Mainstreaming also means that microfinance has put more emphasis on the working poor and at-risk of poverty clientele than on the destitute, who are widely overlooked by larger, more profitable MFIs because they are hard to reach and may be considered a risky segment of the population to which to give loans.

- *Socially conscious investors* – As microfinance has become mainstream, investors have begun to put big money into the field (buying bonds issued by licensed MFIs, equity funds, etc.) because these investments not only yield a decent return, they also help the poor. An investor who wouldn't write a $10,000 check as a donation is much more likely to put his or her money into MFI issued bonds.

- *Microfinance providing a full range of financial services* – Microfinance is no longer just about credit for the poor. MFIs are increasingly expanding their services to include savings accounts, wire transfers, and debit cards – just like commercial banks.

- *MFIs as licensed banking institutions* – To provide the full range of banking services, MFIs must shed their identity as non-profits and become licensed banking institutions. This means that they are subject to much greater regulation, but also that they can help the poor through avenues unavailable to non-profits. Banco Sol and Mibanco are two examples of microfinance banks in South America that have flourished since going through the licensing process.

- *Microfinance cracking capital markets* – Microfinance has successfully cracked capital markets. Citigroup and Deutsche Bank have dedicated significant resources to promoting microfinance and others are looking to do the same. Representatives from such firms as TIAA-CREF, ING Capital, Morgan Stanley, Standard and Poor's, Goldman Sachs, Ford Foundation, Merrill Lynch, Smith Barney, JP Morgan Chase Bank, Capital One and others attended the microfinance conference to talk to MFIs and to develop investment partnerships.

Small-Scale Microfinance

The evolution of microfinance from a non-profit endeavor into a commercial one has helped millions of poor customers who rely on it for financial services. As large MFIs continue to tap capital markets they will vastly expand the number of clients reached, but they will be forced to leave behind an important group within their constituency – the very poor and the destitute. As noted in the conference themes above, these individuals are considered high-risk and may not be able to pay back their loans as quickly or easily as the working poor and vulnerable non-poor.

The very poor, though, are the ones in greatest need of credit to improve their lives.

In rural, isolated regions such as the Central Highlands of Vietnam, small loans of just several hundred dollars could have an incredible impact on the lives of the indigenous peoples there, especially women, who are confronted with absolute poverty and the possibility that their sons and daughters will be trafficked as modern-day slaves.

In the Central Highlands, a mountainous sprawl of provinces inhabited by various tribal groups, women use local raw materials to make handicrafts, also selling fresh produce at open-air markets. With a minimal amount of credit, these women could expand their operations, purchasing raw materials at better bulk rates, hiring additional workers, and gaining more control over the selling price of their goods (instead of being forced to settle for whatever meager amount is being offered by a prospective buyer). In a place where children do not know what it means to feel full after eating a meal, and where access to basic healthcare and emergency medical services is extremely limited, small-scale microfinance would provide tangible results to help a population facing multiple threats, including loss of land and culture, religious persecution and assimilation policies.

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