Microfinance An Instrument of Sustainable Development?
Nicolas Blondeau

The designation by the United Nations of 2005 as International Year of Microcredit certainly played its part in making this financial instrument even more popular. It was devised in the late 1970s and has since then developed in such a way as to enable groups excluded by the banks to access financial services. Judging by the qualitatively and quantitatively promising results it has achieved, microfinance has within a few decades assumed a preponderant place in the sphere of international cooperation. NGOs, voluntary associations, friendly societies, savings-and-credit cooperatives and private companies have flourished all over the globe and currently serve more than 90 million people worldwide. Might credit, however “micro” it may be, be a weapon that is capable at this point of overcoming poverty?

"Microfinance stands as one of the most promising and cost-effective tools in the fight against global poverty."
Jonathan Morduch, Chair, United Nations Expert Group on Poverty Statistics.

The Capacities of the Poor

Microfinance, defined as "the provision of a set of financial products to all those excluded from the formal financial system"\(^1\) goes beyond microcredit. It includes savings, insurance and money transfer services, financial products adapted to the needs and realities of poor families in Africa, Latin America or Asia, and also in Europe and the United States. More than 3,000 specialist institutions, known as microfinance institutions (MFIs), serving more than 92 million people, are members of the Microcredit Summit Campaign.\(^2\) The sector has seen impressive growth: when it was launched in 1987, this same campaign had barely eight

\(^1\) This definition is broadly accepted by the various players in the sector and is the one given on the main French-language Internet portal, www.lamicrofinance.org.

million clients. The phenomenon is, moreover, set to expand: some estimate the potential demand at more than 500 million! As Maria Nowak emphasizes:

The main difference from classical credit is that it is aimed at a new target: the poor and the excluded. It recognizes their talents, needs and capacities to repay the loans. Instead of eliminating them from the outset from the potential clientele for credit because the methods, criteria and guarantees are not appropriate for them, it invents methods and guarantees that fit their situation. Instead of imposing the purpose of their loan on them, it listens to their needs. In this way, it enables us to see that those excluded from bank credit are endowed, like other people, with the spirit of enterprise and a capacity for judgement and, moreover, that they repay their loans rather better than the rich.\(^3\)

Experience throughout the world has shown that, be it in France or Bolivia, Cambodia or Nigeria, the poor are capable of setting up companies and developing them. Contrary to what was previously thought, the lack of material sureties, illiteracy or the fact of living in remote regions are not factors that need limit the granting of credit.

The repayment frequency, the possible link between credit and savings, the type of product or the provision of training are all elements that can determine the success of an MFI. The three main types of loan are: the individual loan, loans to groups of three to five people, and solidarity group loans (around 20 people). The loan aimed at the poorest clientele is the so-called “solidarity group” loan. To solve the problem of the absence of material sureties, the institution grants a loan to a group of some twenty people, each standing surety for the others. If a problem arises, all are responsible for dealing with it. This system has the advantage of allowing poor, if not indeed very poor, people to access credit by enabling the institution to obtain a repayment rate close to

\(^3\) Maria Nowak is the founder of the Association pour le droit à l’initiative économique (France).
100%. The poorer the clients, the better they repay their loans. This situation may seem paradoxical, but it is very real, as is shown by the example of the Bolivian institutions *Crece* and *Pro Mujer*. Specializing in the granting of this type of credit, each serves more than 60,000 clients! The average loan barely amounts to 200 euros and the repayment rate exceeds 99%. The clients (the very large majority of them women) repay their loans at biweekly meetings, where they have to undergo training. Above and beyond the undeniable social impact, these two institutions are profitable and do not depend on subsidies or donations at all. Obviously, the obligation to form a group of twenty persons does not please everyone. When a client does not repay her loan, social pressure means that the debt is paid one way or another, but the reputation of the bad payer suffers and leaves little opportunity for another chance. The result obtained is the opposite from that sought. Doubtless another type of aid would have been more appropriate… The second type of credit also brings into operation the “joint and several” or “solidarity” principle for a smaller group of people, generally comprising between three and five persons. A material surety may be requested, for example from a single member of the group who agrees to let her property stand as surety for the whole of the credit granted to her group. The average sum loaned hovers around the 500 euro mark, depending upon the region. Repayments are made at longer intervals and the repayment rate remains excellent. Lastly, the third type is individual credit, for which a material surety is most often demanded. The average sum loaned is around 1,000 euros and the clientele comes from the richest among the poor. Each institution adapts these concepts to the reality and culture of its country and the needs of its clientele. A Serbo-Montenegrin institution, for example, has a methodology based on village organization.4 Clients are selected by the community itself – and, indeed, who knows the behaviour and character of clients better than their neighbours in the village? With the sector expanding rapidly, there is pressure for the range of products to expand so as best to respond to the needs of the poor. We are seeing the first faltering beginnings of micro-

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4 This Serbo-Montenegrin institution, named AgroInvest, uses “village elders” to provide assurances regarding the character of its clients and, as a result, achieves a repayment rate close to 100%.
insurance products. And the considerable growth of money transfers in recent years reflects the need of emigrants to send their savings back to their families in the quickest, most cost-effective way possible. The new technologies have a role to play here, in the form, for example, of financial transaction systems designed for the rural context, such as the “remote transaction system” developed, in partnership with Hewlett Packard, by the UML microfinance institution in Uganda, with the purpose of avoiding clients living in rural areas having to travel to the towns. As Kofi Annan emphasizes, “Microfinance is a way to extend the same rights and similar services to low-income households that are available to everyone else”. By comparison with the different tools available for fighting poverty, microfinance has one specific characteristic: the sustainability of its services, involving financial self-sufficiency and, in the long term, independence from donations. The potential for covering costs – and also for making money – through microfinance is no longer at issue. The profitability of the most developed microfinance institutions is by no means inferior to that of the traditional banks, such as Citibank or BNP-Paribas. These tangible results should not lead us to forget, however, that some of these institutions were initially started up by way of donations. In the development phase of an institution, the role that factor plays may, then, be decisive. This combination of social and financial profitability doubtless represents one of the innovative, persuasive characteristics of microfinance.

*A Review of History*

Specialists take the view that microfinance began in Bangladesh with the Grameen Bank, which was founded by Professor

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5 Money transfers to Latin America stood at 23 billion dollars in 2001 and rose to 45.8 billion dollars in 2004; in some countries, they represent more than 10% of GNP. See “Remittance Flows to Latin America and the Caribbean (LAC), 2004”;


7 The return on equity (ROE) of BNP-Paribas was 14% in 2005, a figure below the average of the MFIs in the portfolio of the Incofin investment fund (17%) (www.incofin.be).
Muhammad Yunus, head of the Economics Faculty at Chittagong University. The economic theories he was teaching seemed to him to be out of step with reality and this led him to seek out a concrete solution to the daily problems of the poor. When he met a handicraft producer who explained to him how she was dependent on the moneylender for the purchase of her raw materials, he realized the largest part of her profits was going to the moneylender, not to herself or her family. So he decided to contact the local banks to provide small loans. When they refused, he decided to lend from his own savings. When the repayments fell due, all the women concerned paid their debts. So began what became the Grameen Bank, which now has more than 3.7 million customers. We must not let this development of microfinance blind us to the fact that other systems based on the same principle have existed for a long time in Europe. Following an upsurge in poverty in the sixteenth century, the first known “bank for the poor” was founded in Holland in 1618. From the early eighteenth century onwards, a number of benevolent societies specializing in the provision of credit started up in Ireland. These interest-free loans, intended for the poor, were given on the basis of a group methodology, as used by the Grameen Bank, in which peer pressure was applied when payments were late. In the nineteenth century, these benevolent societies came to be known as “Loan Funds”. They were able to charge interest and collect savings. In 1840, there were 300 of them, covering, between them, 20% of Irish families. In 1843, the Irish government decided to cap interest rates, bringing these Loan Funds into difficulty and leading, in the long term, to their disappearance. The last Loan Fund closed down in 1950. Influenced by the Irish model, the city of Hamburg launched the first “savings bank” on the European mainland in 1801. These “savings banks” were not limited solely to savings; they also engaged in lending. In the mid-nineteenth century, at the prompting of Frederick William Raiffeisen, the idea of the co-operative gradually developed, leading to the creation of the first “Raiffeisen cooperative” in 1864. Between 1885 and 1914

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the number of rural cooperatives in Germany that were based on this conception rose from 245 to more than 15,000. The model was a prototype for rural credit associations, which exist to this day in a scarcely changed form.\(^9\) According to Professor Seibel, 51.4\% of all banking assets in Germany are currently managed by former microfinance institutions.\(^10\) In Africa, Asia and Latin America too, microfinance has existed for many years, one of its many forms being the tontine. This traditional system groups together friends or acquaintances who decide to save a fixed sum on a regular basis. Each is then entitled to utilize the money in turn.

\(A\) \(H\)\(i\)\(g\)\(l\)\(y\) \(D\)\(i\)\(v\)\(e\)\(r\)\(i\)\(f\)\(i\)\(e\)\(d\) \(S\)\(e\)\(c\)\(t\)\(o\)

The number of microfinance clients has increased greatly in recent years: there were seven million in 1997, but the latest available figures show more than 90 million at the end of 2004. 66 million of these were among the poorest category when they took out their first loan. 80\% of them are women.\(^\text{11}\) Microfinance is well and truly a women’s affair. Women are often thrown back on their own resources and have to get by alone, seeing to it that their children have enough to eat, have clothes on their backs and can go to school. In monetary terms, the total microfinance market is currently estimated at 4.5 billion dollars:\(^\text{12}\) this sum is the total of the credit portfolios of all the listed MFIs. Some of these institutions serve several million clients;\(^\text{13}\) others have just started up and have only a few hundred. The MFI sector is often presented as a pyramid made up of three levels. The base comprises several thousand institutions: these often take the legal form of NGOs, depend financially on subsidies and other donations, and are not always managed professionally. Experience

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\(^{9}\) Raiffeisen’s ideas gave rise to a cooperative movement of international scope. In almost 100 countries spread over 5 continents, there are 330,000 cooperatives with 150 million members (Source: Oikocredit www.oikocredit.org/site/microcredit_fr/doc.phtml?p=Raiffeisen+ and+Grameen+Bank2 ).

\(^{10}\) These institutions are both cooperative banks and savings co-operatives. They have more than 39,000 branches throughout Germany with 75 million clients and they manage 2.3 billion euros in assets.

\(^{11}\) S. Harris, \textit{ibid}.


\(^{13}\) In June 2005, for example, the Bangladeshi institution ASA had 3.5 million clients.
shows that some of these institutions have great difficulty surviving and are forced to shut up shop when the subsidies run out. Others have used their donations advisedly, developed an effective credit methodology and ensured that they reinvested the interest produced adequately and came close to covering their costs or actually covered them. They stand apart from their peers in addressing increasingly sizeable requests for finance to their traditional funders, in order to satisfy their growing demand for credit. In this way, they pass to the second level of the pyramid, which comprises several hundred MFIs that are efficient, cover their costs and have a potential for growth. These institutions very often started up thanks to financing from international cooperation budgets. Through their good management and permanent concern to achieve financial autonomy, they have reached a critical mass that enables them to attain financial self-sufficiency and serve a growing number of poor entrepreneurs. Lastly, the third level comprises only some 200-300 MFIs that are of proven profitability. These have often transformed themselves into financial institutions regulated by the local banking authorities and are very efficient. This financial profitability does not prevent them from still being included among microfinance institutions, since their primary market remains that of micro-entrepreneurs.

To serve the financing needs of these last two categories of institution, traditional national and international co-operation are no longer sufficient, as their needs exceed the capacity of international cooperation budgets,\textsuperscript{14} they have, therefore, naturally turned to their countries’ banking systems. Confronted with demand from these institutions, local banks tend to find microfinance too risky a venture and usually refuse to finance it in any way, though this situation is beginning to change.\textsuperscript{15} MFIs are thus faced with the same problem as their clients: non-access to finance. To meet the growing demand, in the late 1990s and early 2000s several private investment funds were set up, alongside the existing para-public institutions, to create a link between the

\textsuperscript{14} Let us remind the reader that in 2004 global international cooperation stood at 50 billion US dollars, a very small percentage of which was directed towards microfinance. For example, barely 1\% of the disbursements of the World Bank goes to microfinance.

\textsuperscript{15} In West Africa, local banks lend to the successful MFIs in local currency and at competitive rates..
capital market and the microfinance sector.\textsuperscript{16} These funds are constantly growing in both number and size. They collect money from private companies, banks, trade unions, religious congregations and private individuals and invest it in MFIs in the form of loans, guarantees or shareholdings. For the European investor, such an investment is meaningful at the social level and gives a decent financial return. Latin America is currently the most mature market and has the most developed institutions. The Latin American MFIs alone represent 1.3 billion dollars in credit portfolios, which is roughly 30\% of the global market.\textsuperscript{17} On the South American continent, the development of this sector is more marginal in some countries, such as Argentina, Brazil or Mexico. Others, like Bolivia, Peru or Ecuador have a highly developed market with a high level of competition, a diverse range of available services and adequate regulation.\textsuperscript{18} Asia, for its part, has some very sizeable institutions, such as the Grameen Bank or ASA in Bangladesh and BRI in Indonesia. These institutions each serve several million clients. In India and China, apart from some successful institutions (such as Share, which has almost 400,000 clients living mainly in the rural area of Andhra Pradesh), the sector is not highly developed. The potential in these countries is immense. In recent years, Asia has actually overtaken South America as the continent with the highest levels of microfinance loans, with a combined portfolio of 2.3 billion dollars – more than 50\% of the global market. These two continents between them account for 80\% of the world market. The picture is also very varied in Africa. There are many savings and credit banks on that continent of all sizes and levels of performance. Some microfinance institutions have achieved impressive results, such as Uganda Microfinance Limited, or Pamecas in Senegal. In Eastern

\textsuperscript{16} Incofin (www.incofin.be), a Belgian cooperative company, is the leader in this market in Belgium. In France, the main funds are Investisseurs et Partenaires, SIDI and La Fayette Investissements. We should add that each of these funds has its own approach, some confining themselves to lending to the largest institutions, others also having shareholdings or targeting less well-known, but promising, institutions.

\textsuperscript{17} The 38 microfinance institutions evaluated by the MicroRate ratings agency had growth rates between 27\% in 2001 and 44 \% in 2004. Damian von Stauffenberg, “Microfinance today: MicroRate 38 Aggregate Portfolio”, October 2005, Luxembourg.

\textsuperscript{18} The reasons for these developments are many and varied and go beyond the scope of this article. In short, they are due to a different combination of the roles of public policies, international cooperation, civil society and the NGOs.
Europe, the sector is developing rapidly, thanks, among other things, to finance from German investment funds. Bosnia-Herzegovina and Montenegro have the most highly developed microfinance sector in the region. We should note that the size of average loans here is around 1,000 euros, on account of the higher cost of living. Lastly, with economic inequality increasing, the developed countries are seeing a significant development in the field of microfinance. ADIE in France and Crédal in Belgium are producing promising results.

The Impact of Microfinance

The positive effects of microfinance have now been identified and verified. There is real progress for clients in terms of increased incomes, reduced vulnerability, access to health care, education and housing and an increase in confidence and self-esteem…

Microfinance does, however, remain a financial tool. One cannot reasonably expect such an instrument to resolve the complex, multidimensional problem of poverty. It is an incomplete solution, which presupposes complementarity with other development tools. Investment in the education and health systems or in infrastructures, for example, remains quite clearly indispensable. In order to reach the poorest members of the population, some microfinance institutions have developed an initial filtering system. The Nigerian LAPO institution is one such. Before granting a loan, it checks on the state and size of the applicant’s accommodation, their diet and the regularity of family incomes. Below a certain level, clients may have access to credit. This system, which is open to criticism in other respects, enables LAPO to keep to its objective of beginning with the poorest. 62% of its clients have, in fact, less than one dollar of income per day when they receive their first credit. The way of assessing the impact of this changing sector has itself developed. At the beginning,

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19 ADIE was founded in 1989 by Maria Nowak. It has made more than 36,000 loans, totalling almost 100 million euros. More information is available at www.adie.org.
20 Crédal is a credit cooperative. It recently won the 2005 Princess Mathilde Prize for its project “Femmes d’affaires, affaire de femmes” [Businesswomen, Women’s Business].
21 While reaching the very poorest, LAPO is also a profitable institution with an ROE of 27.5% in 2005.
attention was focused on extending the lifespan of the institutions. Given the conviction that the financial sustainability of MFIs has an obvious impact on poor clients, and hence on poverty, their performance in social terms was taken as read. New issues subsequently emerged, among them the increased interest of the funders and social investors. Alongside the monitoring of financial performance, concern shifted in the late 1990s to social performance. Then evaluation became more all-embracing, taking in the financial results of the institution, the internal adaptedness of products and services to the very poorest and the impact on the clients (education, health, job creation etc.). The question became: does microfinance offer the poor an opportunity to escape from their situation? Various studies were carried out on this theme. Even if not all of them agree that microcredit makes it possible to increase incomes, a large majority recognize that it reduces the vulnerability of the clients. Thanks to credit appropriate to their needs, a section of micro-entrepreneurs are able to develop their small businesses, increase their incomes and reinvest those gains in their families or businesses. A recent study of the social impact of microfinance in Bangladesh shows an increase in self-employment among clients and improvements in child welfare, with children eating a better diet and registering higher levels of school attendance. The impact of microfinance goes further, then, than the economic level.

Microfinance thus has a bright future before it. The impressive growth of recent years will probably continue at a similar rate. We should rejoice at this, as it means that more excluded persons, who are ready to take risks and show enterprise, will be able to make good use of their skills and have the opportunity to develop their small businesses. This growth will naturally be accompanied by some challenges that cannot be discounted, such as heightened

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22 www.lamicrofinance.org/resource_centers/impactperf/article/16609/#Q2; The French institution Cerise is a pioneer in this field.
24 On a visit to the female clients of the BRAC MFI in Bangladesh, Jeffrey Sachs was struck by one of the astonishing effects of microfinance: the average number of children per woman was barely two, whereas the norm in Bangladesh is between six and seven. Jeffrey Sachs, The End of Poverty: Economic Possibilities for Our Time (London: Penguin Press, 2005), pp. 13-14.
competition, the risk of certain clients becoming heavily indebted, developing legal and regulatory constraints, and the launch of new services such as micro-insurance and the new technologies. The perpetual balance to be struck between financial profitability and social impact will no doubt remain at the heart of the debate, too much importance accorded to the one inevitably leading to neglect of the other. The path is strewn with failures and successes. Let us look to the past in order to draw lessons for the future. Credit is one technique for financing development that can make its contribution to the complex problem of reducing poverty, but it must be accompanied by policies in the fields of health, education, the environment and infrastructures.

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