

## **BLM 3.3 - Microfinance – Giving Credit Where Credit is Due**

### **What is Microfinance?**

Microfinance, or sometimes called micro-credit, is the extension of small loans to entrepreneurs too poor to qualify for traditional bank loans. It has proven to be an effective and popular measure in the ongoing struggle against poverty.

### **History of Microfinance**

The first microfinance program — the Grameen Bank — started in Bangladesh in 1976. (Grameen means "rural" or "village" in Bangla language.) The Grameen Bank has been extremely successful and continues to operate throughout the world today. For more information, visit [www.grameen-info.org](http://www.grameen-info.org)

### **Where are Microfinance Programs Found?**

Microfinance programs were originally adopted in developing countries to assist poor rural people in establishing income-generating activities whereby they could break their cycle of poverty. Microfinance programs continue to operate in developing countries throughout the world with the support of a variety of banking institutions and non-governmental organizations.

Today, microfinance programs can be found all over the world in both developed and developing countries. VanCity Credit Union in Vancouver, Canada operates a micro-credit program for small business owners who would not qualify for standard bank loans.

### **How do Microfinance Programs Work?**

Each microfinance program is uniquely adapted to the situation and needs of the community and country where it is operating. Some general operating principles of microfinance projects are described in this section however, they do not all apply to all projects.

Money is loaned to poor people with no or very little collateral who would not qualify for regular bank loans. Loans are provided for income generating purposes, for example:

- purchasing chickens to sell their eggs
- handicraft businesses making baskets, etc., and selling the items at markets
- initial investment for a vegetable garden (tools, seeds), with vegetables sold for profit to pay back the loan.

Loans are provided in small amounts to start. If a person repays his/her first loan, his/her chances increase to receive a larger loan next time. Loans are paid back in small instalments (little amounts each week, as opposed to large amounts at the end of each month). This makes the loans easier to pay back for people living in poverty who may have difficulty saving large amounts due to other expenses that may arise over the course of the month. Loans may come with conditions specific to the business the loan is intended for. For example, a loan for a water buffalo to start a small water buffalo breeding business may come with conditions that the animal is vaccinated and visits a veterinary professional on a regular schedule. These conditions result in a better chance for business success and loan repayment. These types of conditions may be

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monitored by the banking institution or non-governmental organization that is helping to coordinate the loan.

Interest rates vary by microfinance program. Generally, interest is charged at market rate or just below market rate. People applying for these loans are not treated as charity cases, but are given the respect and dignity of any other person. It is simply recognized that their initial assets are different than other people.

Peer lending groups (4-5 people) are established in the loans process. These peer groups monitor and support the lending activities of the group through regular meetings. They also provide a form of peer pressure to help keep people accountable to their loan. In addition to peer review of business plans and having a forum to discuss business ideas, the peer groups can also form new social networks and allow the exchange of more information not related to the businesses and loans.

Many microfinance projects are targeted to women's groups. In general, women have been found to be better savers of money and have had a better success in loan repayment. This makes them a better candidate for microfinance projects. In developing countries, women are also often lacking assets that could serve as collateral, since it is traditionally the men who control financial resources and assets, such as land. This also makes them preferred candidates for microfinance programs.

#### **Microfinance in Action!**

Microfinance loans can be obtained to start any number of businesses. A woman may want to buy equipment to start a sewing business. Another woman may want to buy chickens or ducks, and sell the eggs or mature birds for profit. A group of women may want to start a handicraft business, selling hand-woven baskets. The possibilities are endless! However, each business idea uses an individual's talent and satisfies a market need.

#### **Questions - Microfinance and Poverty**

1. With a partner, create a chart and list all of the advantages and disadvantages of microfinance loans and traditional loans for a borrower.
2. What social or environmental benefits could result from a successful microfinance project for a family? For a community?
3. Do you think a woman's status in the community could change if she were a successful business woman through a microfinance program? Explain.
4. In your opinion, do you think microfinance projects can be successful in breaking the cycle of poverty for poor people in developing countries? Explain your reasoning.