

Teacher Background Notes

What is microfinance?

Microfinance 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.

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 microcredit 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 started by making baskets, etc., and selling the items at markets
- initial investment for a vegetable garden (tools, seeds), with vegetables sold for profit

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 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.

Beyond Financial Benefits

There are more than just financial benefits gained from microfinance programs. A woman who receives a loan can be empowered by the experience of successfully operating a small business and the ability to have her own income and assets. Her status in the family and within the community can also rise because of her participation in the microfinance program. She is no longer just seen as a mother and wife, but as a major income provider for the family.

The regular meetings of the peer lending group members provide an opportunity to discuss other family or community issues as well as to share advice and knowledge. For women who traditionally remained at home to perform the many household duties, the microfinance meetings provided a new opportunity to meet with women of similar backgrounds, discuss issues and share experiences. Health and social issues may be discussed as well as knowledge shared among group members resulting in many indirect social benefits of microfinance programs.

Earn Money and Break the Cycle of Poverty

Once a woman is generating income from the new business, both she and her entire family will benefit greatly in all areas of their lives. The money can be used to purchase medicines if a family member becomes ill. It can also be used to purchase livestock which can help with hard labour in the fields or provide a source of protein for a balanced diet or to be sold in the event that an emergency arises. The money can also be used to pay school fees to send children to school. A self-generating income allows the family to manage the resources based on their own needs and strengths. A successful business, initiated through a microfinance program, can be one large piece of the puzzle to breaking the cycle of poverty. To break the cycle of poverty, the big