



Three crises of Microfinance: implications for Asia & Latin America

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What is Microfinance? Taken largely from [Karlan and Goldberg \(2011\) chapter 1](#) of the *Microfinance Handbook*, provides a survey of MFI evaluations

- (1) Small transactions and minimum balances: loans, savings, or insurance.
- (2) Loans for entrepreneurial activity (a billion entrepreneurs? See B&D, 2011, *Poor Economics...*)
- (3) Collateral-free loans (informal sector, not assets)
- (4) Group lending Grameen I (not Grameen II)
- (5) Focus on poor and poorest clients .
- (6) Target female clients.
- (7) Simple application process.
- (8) Target services at underserved communities.
- (9) Market-level interest rates? (or capped?)

Three crises of Microfinance in Asia

1. Regulatory backlash: high interest rates and aggressive lending/collection leads to suicides and public backlash against microfinance in Andhra Pradesh ...

Mohammed [Yunus calls for 25% interest cap](#)

2. Experimental RTS evidence MIT-JPAL finds no impact of Microfinance on poverty Roodman & Morduch, 2010 question key World Bank Bangladesh studies....

3. Transparency credibility of direct lender Kiva: D. Roodman accuse NGOs Kiva and Whole Planet of not really matching customers and donors as suggested by web page, [NY Times described the controversy.](#)

After many good years Grameen bank and Asian microfinance encounter some turbulence,

- The 2006 Nobel Peace Prize is given jointly to Muhammad Yunus and Grameen Bank *"for their efforts to create economic and social development from below..."** (click graphics to see prize profiles)
- Almost from day prize awarded, Microfinance & Grameen have run into difficulties...
- Yunus forced to leave Grameen Bank after a Norwegian documentary accuses him of mishandling a \$100 million grant (see NY Times 2011 [Microlenders honored, now struggling](#)) But even MFI critical blogger Davic Roodman defends Yunus & Grameen bank (see the Nine [ladies snap back, 3-7-2013](#) and "[much Grameen Bank Investigation...](#)" means in very difficult environment, as Yunus attacks LatAm and other private MFI see also Compartamos PBS video.



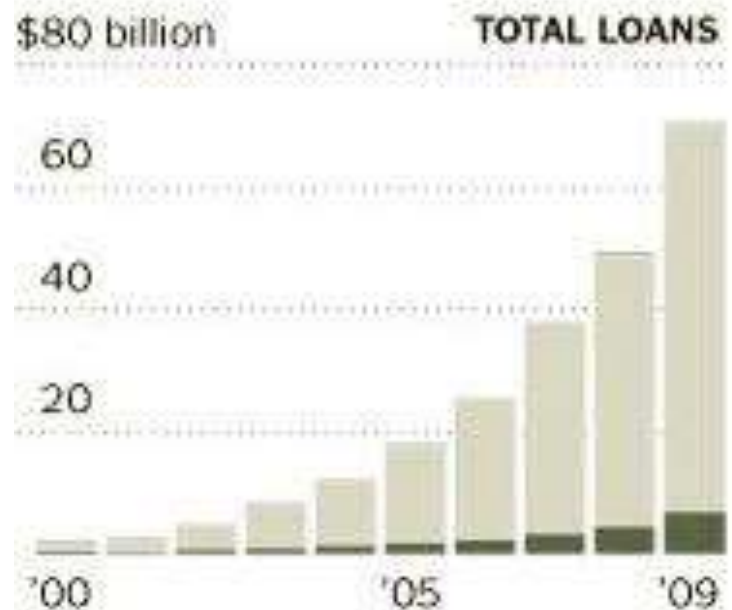
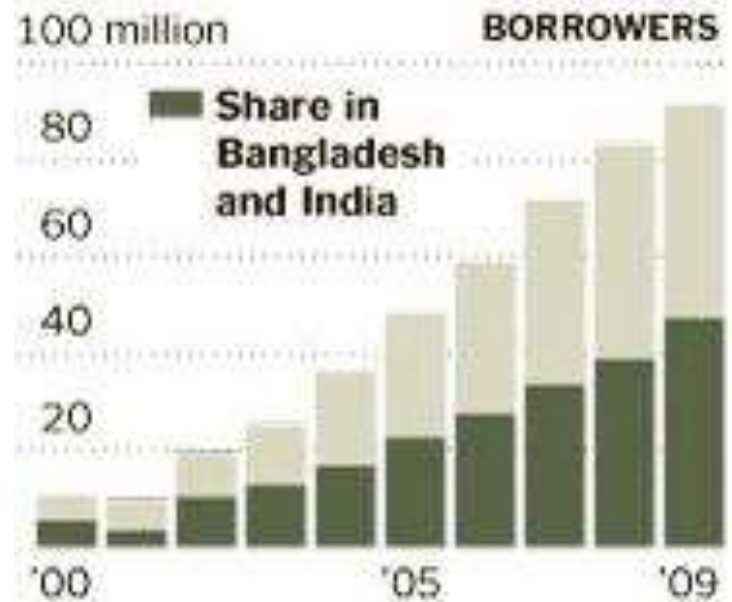
* The Nobel Peace Prize 2006". Nobelprize.org. 14 Jun 2012
http://www.nobelprize.org/nobel_prizes/peace/laureates/2006

VIKAS BAJAJ

chronicles crisis in NY Times

Lending to the World's Poor

Government officials in India and Bangladesh have said microcredit lenders exploit the poor. The two countries account for more than half of the world's microcredit borrowers, although they account for a far smaller share of the total money lent.



Source: Microfinance Information Exchange

Many things go wrong in Andhra Pradesh 2011



Residents of Madoor village in Andhra Pradesh, India. Leaders in the state have accused microloan lenders of impoverishing customers.

New York Times photo and story by [VIKAS BAJAJ](#) Published: January 5, 2011

Shocking developments in Andhra Pradesh



Excellent Aljazeera [Asia 101 Special on Microfinance in Andhra Pradesh](#) (don't watch the first half w/o watching the 2nd Half)

3/24/2014

As updated April 1st 2013

Microfinance in Asia and LatAm differ but both have long traditions, deep roots

Asian Microfinance

- More rural, smaller \$100-\$200 loans, shorter term, lower rates
- Grameen I: group lending targets women
- 1997 Grameen II individual loans + savings accounts
- Built into NGOs that provide safety nets (BRAC, Grameen)
- Hidden subsidies documented by Morduch (1999) – what Roy, 2010 calls “public vs. private transcript”

LatAm Microfinance

- High interest rate more urban loans less subsidized targeted
- Large Latin informal sector
- Larger \$1000+ loans , fewer borrowers.... 10M loans averaging \$1100 for a total of \$12B in 2011 (see
- Accion not Grameen first MFI? [Ricardo Hausmann says yes...](#)

South Asia: 39 million borrowers average loan \$161 for a total of \$6.5 billion

Total MFIs in South Asia, across all possible dates: 474

Gross Loan Portfolio \$USD 2011:	\$6.5 billion
Number of active borrowers in 2011:	39.4 million
Average loan balance per borrower 2011:	\$161
Deposits 2011:	\$1.2 billion
Assets 2011:	\$6.8 billion
Number of depositors 2011:	14 million

Source: <http://www.mixmarket.org/mfi/region/South%20Asia#ixzz2CJNGrjBY>

South Asia mainly India & Bangladesh

Table 1: South Asia: 10 million loans averaging about \$145 in South Asia in 2011 for a total of \$1.4 billion in loans (Mixmarket).

Country	# MFIs	Active Borrowers*	Total Loans* (thousands)	Average Loan
Afghanistan	1	11	3,359	298
Bangladesh	3	5,840	730,333	125
India	15	3,542	592,066	167
Nepal	9	350	79,121	226
Pakistan	2	245	38,342	157
Sri Lanka	1	39	6,270	159
Total Average	31	10,027	1,449,492	145

Source: MIX Market Regional Profile <http://www.mixmarket.org/mfi/region/South%20Asia#ixzz1xjrnZDVe>

Table 2: Mix Market Data Reports 10.4 million loans averaging \$1150 in Latin American in 2011 (total of \$12 billion)

Country	# MFIs	Active Borrowers*	Total Loans* *thousands	Average Loan
Argentina	2	1.1	1,892	1,714
Bolivia	7	351	839,830	2,392
Brazil	4	1,838	1,655,205	900
Chile	2	230	1,624,709	7,058
Colombia	16	2,214	4,979,697	2,250
Costa Rica	1	3.5	4,074	1,178
Dominican Republic	4	278	286,431	1,031
Ecuador	6	243	415,866	1,712
El Salvador	5	91	320,273	3,532
Guatemala	6	254	144,285	568
Haiti	2	22	36,921	1,706
Honduras	9	114	158,955	1,389
Mexico	41	6,020	1,864,996	310
Nicaragua	10	227	224,389	987
Paraguay	5	498	985,149	1,977
Peru	50	3,607	8,734,089	2,421
Uruguay	1	2	7,324	3,466
Venezuela	1	45	120,928	2,699
totals/average	108	10,400	11,936,876	1,148

Latin American Microfinance growing pains and new developments...

1. Mission drift: Compartamos in Mexico and ADOPEM in DR become very successful and profitable banks, but charge high interest rates 70% plus

2. Competition from large banks– new mobile banking regulations favor established banks: but may not benefit rural poor... key technology upgrade challenge for MFIs.

3. Challenges of mobile banking and transfers: Africa far ahead in this area M-PESA: new regulations remittances

4. New technologies and financial regulations in U.S. impact remittances: Dodd-Frank has new regulations for remittance transfers– some “alternative financial services” (AFS) firms will exit market

Asian, Latin and African Microfinance models converging on financial access, savings

- 1. Asian model becomes more Latin in late 1990s... Grameen II switches from group lending to individual lend lending + savings still small loans: generally less than 25% interest rates... but Compartamos in Mexico and and SKS India, have similar image and (See Ananda Roy, on Grameen Private vs. public transcript.*
- 2. Bangladesh-Asian model comes to LatAm?** MFI embedded in broader safety net in BGD: in U.S. too, welfare payments out of reach of creditors... Grameen I, India village self-help groups.
- 3 Learning from Africa: new technologies, cell phone based mobile remittance transfer technologies: Hybrid** models combine micro-saving and financial access via MPSA for example: Rutherford's [SafeSave](#) ; and [P9](#) experiments....
- 4. Experiments in Mexico combine microfinance, remittances and mobile banking for Oportunidades recipients...**

Ananya Roy's Bangladesh Consensus*

1. **Access to credit is a human right** (with or w/o interest rate cap?)
safe savings vs. borrowing
2. **Microfinance key component of a broader social safety net...**
examples ASA, BRAC and Grameen (also Nidan in India) +
development strategy.
3. **Public vs. Private transcript: presentation of BGD MFIs as self-financing and profitable, but this is basically wrong— private transcript** microfinance as part of larger safety-net... parallels to U.S. policy regarding creditor access to transfers.
4. **The subsidy component of Microfinance runs about 30%: but**
about 70% operations self financed (Morduch , 1998).
5. **Grameen II moves toward Accion model** from group to
individual lending& savings sans high market interest rates....

*See Ananya Roy, 2010, *Poverty Capital* [pp. 93-132](#).

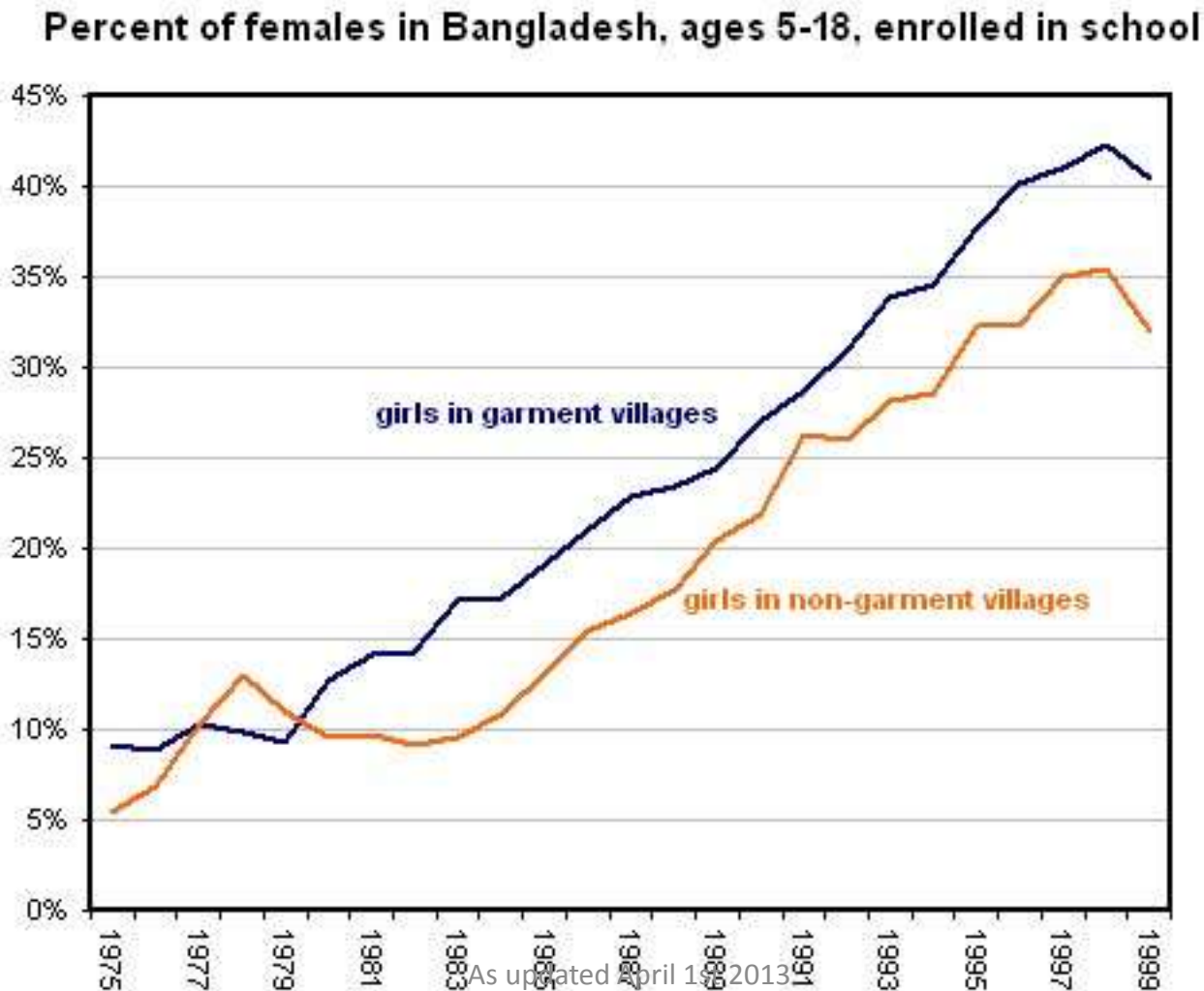
Microfinance gains credibility as part of Mohammed Yunus' Bangladesh miracle

1. **Empower women** education, birth control & health programs (NGOs +UNICEF+WB-NARI)
2. **Microfinance** + NGO form shadow government (Grameen, BRAC, ASA)
3. Garment exports; **women's jobs** college educated entrepreneurs...?? (UNDP unleashing entrepreneurship report)
4. NGOs/**social entrepreneurship**: mobile Phones Grameen phone, Grameen Yogurt

*Missing from this list: Migration & remittances. Kerala secret *See also Poverty Capital [pp. 93-132](#) first 10 minutes of this video.*

But is MFI central to or role player in the BGD miracle? Would comparing villages with & w/o microfinance or a Grameen/Brac office yield a picture like this? perhaps

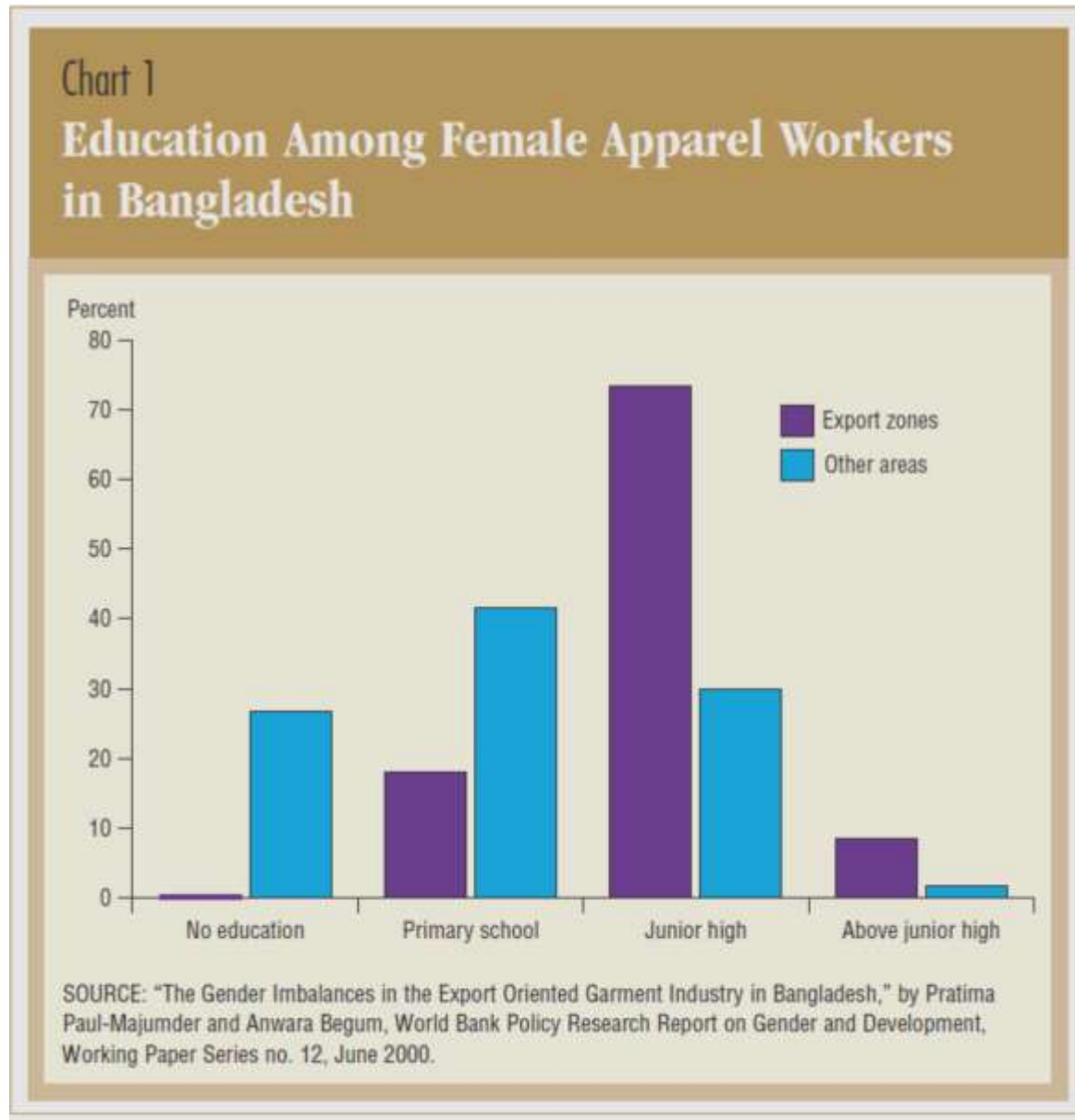
[\(source Vikas, NY Times, 2010\)](#)



Is MFI central to or part of the BGD miracle?

Would comparing employment in sectors w/o microfinance or a Grameen/Brac office yield a picture like this? Perhaps...

(source: [Gruben & McLeod, 2006](#), Apparel Exports and Education, how developing nations encourage women's schooling, *Economic Letter: insights from the Federal reserve bank of Dalla*, volume 1, no. 3, March



Banerjee & Duflo, 2011 argue a predictable flow of wages associated with a factory job is what makes families act middle class...

“Once such a job does materialize, it can make a tremendous difference in the lives of the people who get it. The middle class spends much more on health and education than the poor. Of course, in principle, it may be that patient, industrious people, inclined to invest in the future of their children, are better able to hang on to good jobs. But we suspect that this is not the entire explanation, and that this spending pattern has something to do with the fact that parents in better-off households have steady jobs: A stable job can, by itself, change people’s outlook on life in decisive ways. A study of the height of Mexican children whose mothers worked in maquiladoras (export factories) in Mexico dramatically illustrates the power of a good job. Maquiladoras generally have the reputation of being exploitative and paying poor wages. However, for many women without a high school education, the establishment of the maquiladoras offers the prospect of a better job than the jobs in retail, food services, or transportation that would otherwise be their lot—the hourly wages are not much higher, but they work longer hours and with more regularity. David Atkin, from Yale University, compared the heights of children born to mothers who lived in a town where a maquiladora opened when the woman was sixteen years old to that of children of mothers who did not have this opportunity. The children whose mother’s town had a maquiladora were much taller than those born to similar women in different towns. This effect is so large that it can bridge the entire gap in height between a poor Mexican child and the “norm” for a well-fed American child.

*Furthermore, Atkin shows that the effect of a job in a maquiladora on the level of family income is nowhere near large enough to explain the entire increase in height. Perhaps the sense of control over the future that people get from knowing there will be an income coming in every month—and not just the income itself—is what allows these women to focus on building their own careers and those of their children. Perhaps this idea that there is a future is what makes the difference between the poor and the middle class. The title of Atkin’s study, “Working for the Future,” sums it up nicely.” Banerjee, Abhijit; Duflo, Esther (2012-03-27). *Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty* (p. 229). Perseus Books Group. Kindle Edition.*

What is it that jobs, remittances and microfinance provide the poor?

The argument of B&D, 2010, p. 229 is that two equal streams of income, one from wage employment and one from self employment can make a family “middle class” or not depending on how smooth the income flow is, raises the question of whether adequate financial services can make self employment more like the regular income of a factory job? This is indeed the basic argument of Stark and Lucas, 1988 on reason households migrate to diversify (smooth) their incomes, this implies families with remittances should also exhibit more middle class behavior. This also implies that migration and microfinance may play a complementary role in making the income of households more predictable, hence making parents more willing & able to invest in their children’s education and health care. If this is the case, their children should “shoot up” in height as well, just as happened with the Mexican Maquila mothers... in fact we know this does happen from the literature on social remittances, however this literature attributes this effect to information passed by the migrant by relatives abroad. If B&D 2011 are correct it is also the smoothing or confidence about future income that matters (not just information from migrant family members).

High interest rates for and against

For high market interest rates:

1. **Efficiency:** costs for small loans are higher than large loans: loan fees... local moneylenders charge/ hurt more (Sopranos);
2. **private capital attracted by high returns** to small lending, competition should drive down rates; high rates screen borrowers.
3. Subsidized lending leads to corruption & rationing of credit.
4. K&Z 2008 evidence shows even 200% loans in South Africa help the working poor
5. **High risk: the** poor lack collateral which makes lending risky Hernando de Soto
6. **Social justice:** access to credit is a “human right” rate caps restrict access... high rates help assure supply of funds when needed.
7. Supply: Nominal interest rates caps do not consider inflation, high cost to savers (rates should be high in poor countries, because of high subjective discount rate).
8. Profits accepted in cell phones, other goods, why not lending?

Against high interest rates

1. **Social justice:** high rates can make poorest poorer... the poor likely to pay back lenders high rates leads to a redistribution from poor to rich
2. **Public image:** lower rates <25% make improve public/government attitudes toward lenders
3. High rates lead to **adverse selection:** attract risky borrowers, **moral hazard** & time consistency problems reduced but still there, borrowers feel they are working for lender, not themselves.
4. Micro lending should be subsidized. Still has better **incentive effects** than cash aid: a hand up, not a hand out.
5. The poor **lack legal protection** against predatory lending by banks/money lenders regulations/caps needed , we use rate caps, why not the poor?
Asymmetric information problems reduced by credit reporting, better regulation, works better for MFIs too.

For high interest rates

1. Costs of small loans is high, high rates help assure supply of funds when needed.
2. Moneylender rates even higher
3. Subsidies and caps reduce supply & lead to corruption & rationing.
4. Risk is high, poor lack collateral, high default rates lead to higher lending rates.
5. Even very high 200% interest rate loans can reduce poverty
[\(Karlan & Zinman, 2008\)](#)
6. If credit a “human right” caps may restrict access... ‘
7. High rates signal value of loans to poor borrowers, but also should restrict access to loans (high rates, high risk)
8. Inflation may raise interest rates & lender’s costs
9. If high profits OK for cell phones, bicycles, tec. why not loans and savings accounts

Against high MFI interest rates

1. Ethical issues: high rates can make poorest poorer... the poor likely to repay so high interest rates lead to a redistribution from poor to rich
2. Reputation lower rates <25% make improve public/government attitudes toward lenders
3. High rates lead to adverse selection: attract risky borrowers, moral hazard & time consistency problems reduced but still there, borrowers feel they are working for lender, not themselves.
4. Micro lending should be subsidized had better incentive effects than other forms of aid
5. The poor lack legal protection against predatory lending by banks or money lenders regulations/caps needed to protect them, we have interest rate caps, why not the poor? Asymmetric information problems can be addressed by credit reporting, better public sector regulation, increases flow of information

Adverse selection: normal not poor borrowers (A&M, 2010, chapter 2)

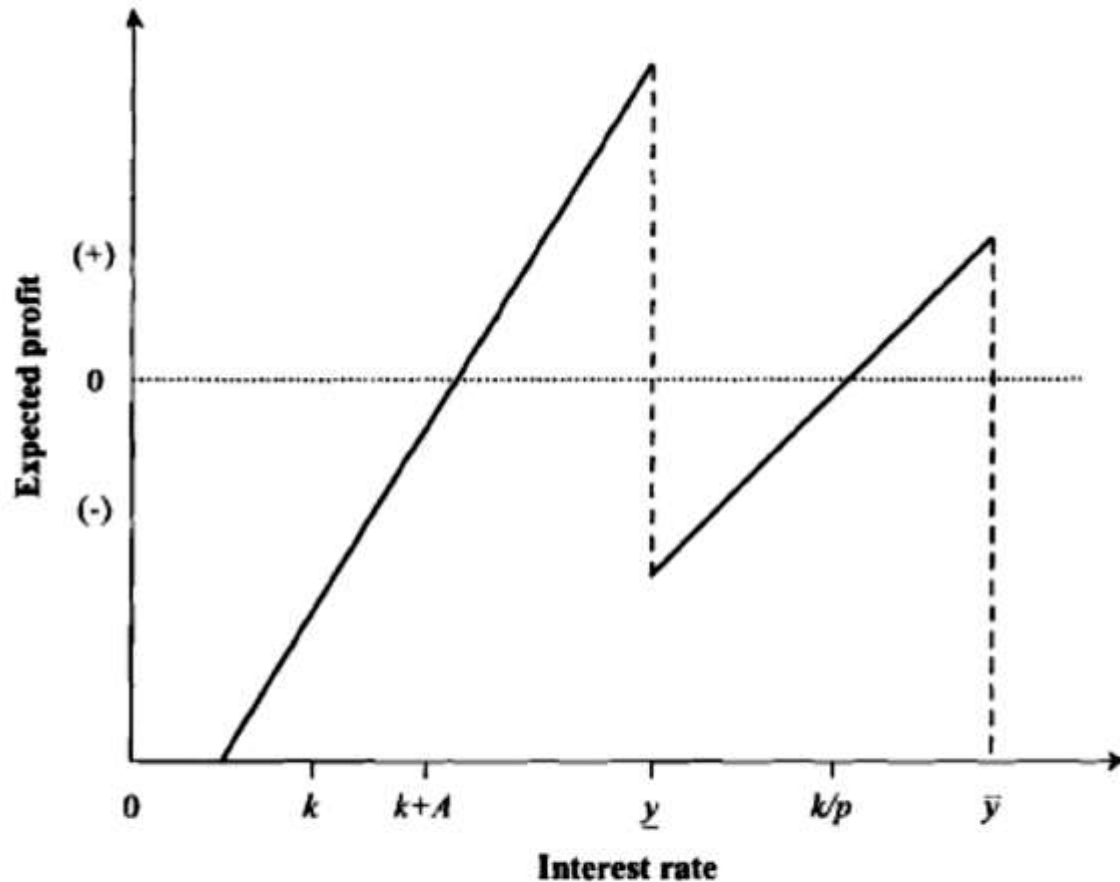


Figure 2.1

Adverse selection example (a). At gross interest rates between $k + A$ and \underline{y} the bank earns a profit and both safe and risky types want to borrow. Safe types leave the market once interest rates rise above \underline{y} , and the bank loses money. Once gross interest rates are pushed up to k/p , the bank can again earn profit, while serving only risky borrowers. At gross interest rates above \bar{y} even the risky borrowers leave the market.

Poor all high risk borrowers A&M, 2010, Chapter 2, only high rates work....

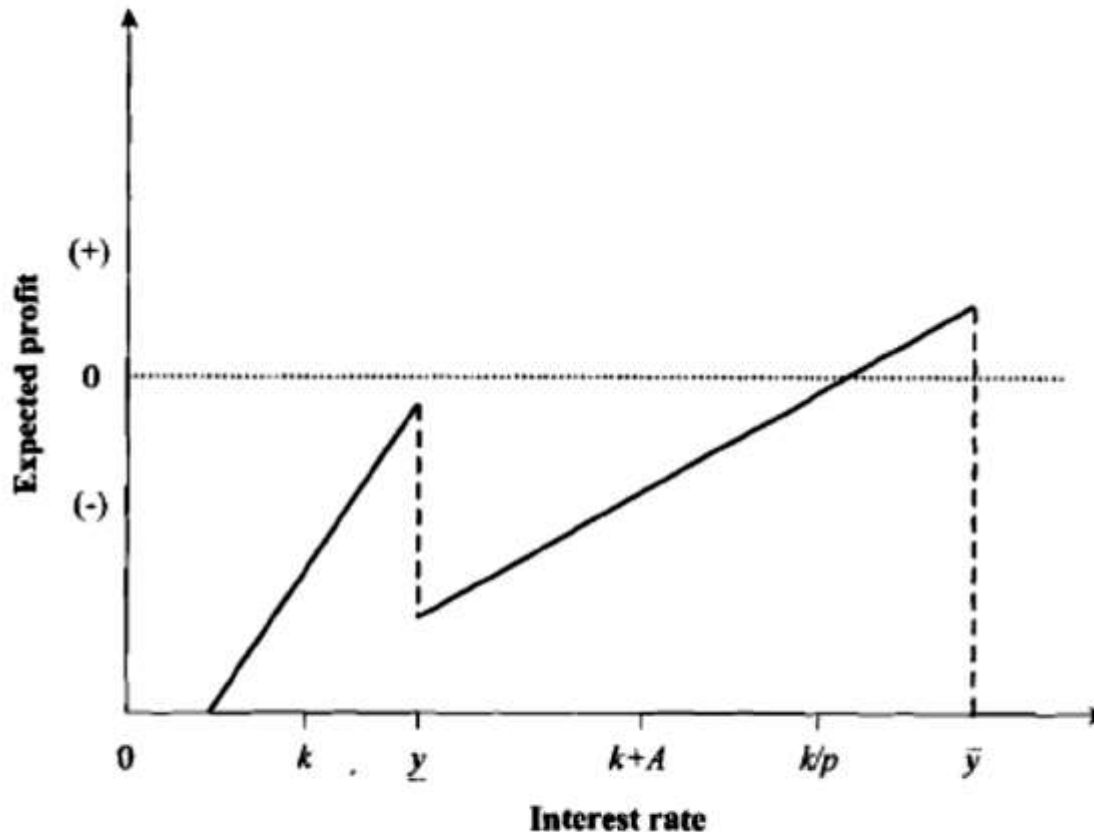


Figure 2.2

Adverse selection example (b). Here, the "risky" types are riskier than in example (a) in figure 2.1. Now the "safe" types can never be served by a bank aiming to break even (since profit is negative even at interest rate y). The bank must raise gross rates to k/p to earn profit, at which price the bank will only attract risky borrowers. At gross interest rates above \bar{y} , the risky borrowers leave the market.

How to reduce cost of small loans?

1. Caps problematic lead to credit rationing ([see Economist](#)) hard to enforce, interest relabeled fees, hidden “overdraft” charges cap on spread cap better, but hard to explain and enforce .
2. Reduce asymmetric information: credit reports, APR , prevents multiple loans....
3. Increase competition in loan market : new entry, banks, mobile or branchless banking....
4. Give/find poor’s collateral (Hernando De Soto’s idea, tyranny of collateral– see Rajan and Zingales Saving Capitalism) Make debt collection easier? (French vs. Spanish legal system)
5. Subsidize lending or guarantee loans (Fannie Mae) but then how to target? Tie to other forms of assistance?
- 6. Best but not easiest way: encourage savings, financial literacy legal aid, transparency (APR) : market rate is return to savings... (opportunity cost) and or,**

Or introduce new savings technologies, or raise return to poor's businesses

1. Larger markets: new technologies (sewing machines, tractors, tube wells.
2. Mobile money, branchless banking, the end of a dangerous [cash economy](#)... remittances costly and lumpy... less so with mobile phones– see the [economics of M-PESA](#)
3. **New BoP products:** mobile phones, (Grameen yogurt) water purifying solar power, large corporations do not block access in developing countries... See Stuart Hart Capitalism at the crossroads...

The case for high vs. low interest rates, again: with or without safety net?

For high interest rates:

1. credit when you need it most: everyone needs credit, especially the poor– a human right?
2. Small loans mean high costs, high interest rates?
3. Informal moneylenders worse; see Sopranos pilot
4. Lenders have agency problems: asymmetric information
5. No collateral + limited liability = high default rates....

For low interests rates

1. Social Justice caps make repayment more likely...
2. Less adverse selection, not just risky borrowers (mission drift)
3. Use NGO's to monitor, provide implicit subsidy, NEDAN video

The IPA-JPAL* critique of MFI's & other Aid:

1. The poor are must not be hungry because they do not spend extra income on calories (Banerjee & Duflo chapter 2, “A billion hungry people?”) – but there are millions of underweight and stunted children?
2. Without randomized trials (RTS) we do not know what really works to reduce poverty, malnutrition, illiteracy, etc. (example: microfinance), they are the “gold standard”
3. Traditional economic analysis of aid and credit and malnutrition needs to take into account corruption and irrationality– people do not always do what is good for them or their children, and this applies even more to the poor (harder to make good choices)

*[Abdul Latif Jameel Poverty Action lab or JPAL](#)

RCTs not Gold Standard, Deaton, 2009 recent experiments flawed (even J-Pal - DFID).

“in ideal circumstances, randomized evaluations of projects are useful for obtaining a convincing estimate of the average effect of a program or project. The price for this success is a focus that is too narrow to tell us “what works” in development, to design policy, or to advance scientific knowledge about development processes. Project evaluation using RCTs is unlikely to discover the elusive keys to development, nor to be the basis for a cumulative research program that might progressively lead to a better understanding of development.” [Angus Deaton, 2009, Randomization in the tropics, and the search for the elusive keys to economic Development, Princeton University,](#)

[See also DFID 2010 Review](#) evidence positive or negative is not strong

Problems with microfinance or direct lending as at Kiva.org or wholeplanet.org:

1. In most randomized trials microfinance does not reduce poverty much (Hyderabad, J-PAL experiments see pages 72-79 in Karlan and Appel, 2011)
2. Mohammed Yunus: interest rates are too high, moneylenders replaced with money lenders.
3. People use funds for consumption not investment. If people cannot afford to save, they cannot afford to borrow either.
4. Kiva.org can mislead regarding direct lending, goes to agency see KA, 2011, p. 15-16, 75, 139.

*Abdul Latif Jameel Poverty Action lab or JPAL

In Defense of microfinance, direct lending :

1. There is some econometric evidence from Bangladesh that microfinance works (BGD is doing well, 10 million borrowers can't be wrong) see [Pitt's reply to Roodman and Morduch](#).
2. Ananya Roy: Social protection + microlending works best private transcript: part of social protection system... ASA, BRAC & Grameen all part of social protection scheme (not real banks).
3. Even at high interest rates, loans reduce Poverty (South Africa experiment, see Karlan and Abel, 2011, p. 44-51, 64-66)
4. Individual lending (Grameen II) is more reliable ROSCAs (rotating savings and credit associations) Tandas, KA, 2011 p. 92-98.
5. Strong evidence that MFIs smooth consumption over time (A&M, 2010 Chapter 9) even if they do not reduce poverty(wrong measure of poverty, vulnerability reduced)
6. But what about Micro Savings?

Compare CCTs to Microfinance: or should we combine them?([World Bank](#))



Growing demand for social safety nets

Demand for well-designed safety net programs to assist poor families is growing across the developing world, as 2009 develops into a year of tough economic challenges.

Governments are concerned that the financial crisis could turn into a humanitarian one, especially for poor households already hit by the recent food and fuel crises.

Not for smoothing income.... During crises hard to scale up... though does protect poorest reducing child labor

CCTs at Glance (World Bank)

Conditional cash transfer (CCT) programs

CCT programs offer qualifying families cash in exchange for commitments such as taking babies to health clinics regularly or sending children to school.

These programs, now found in over two dozen countries, can reduce poverty both in the short and long term, particularly when supported by better public services.

CCTs at Glance (World Bank)

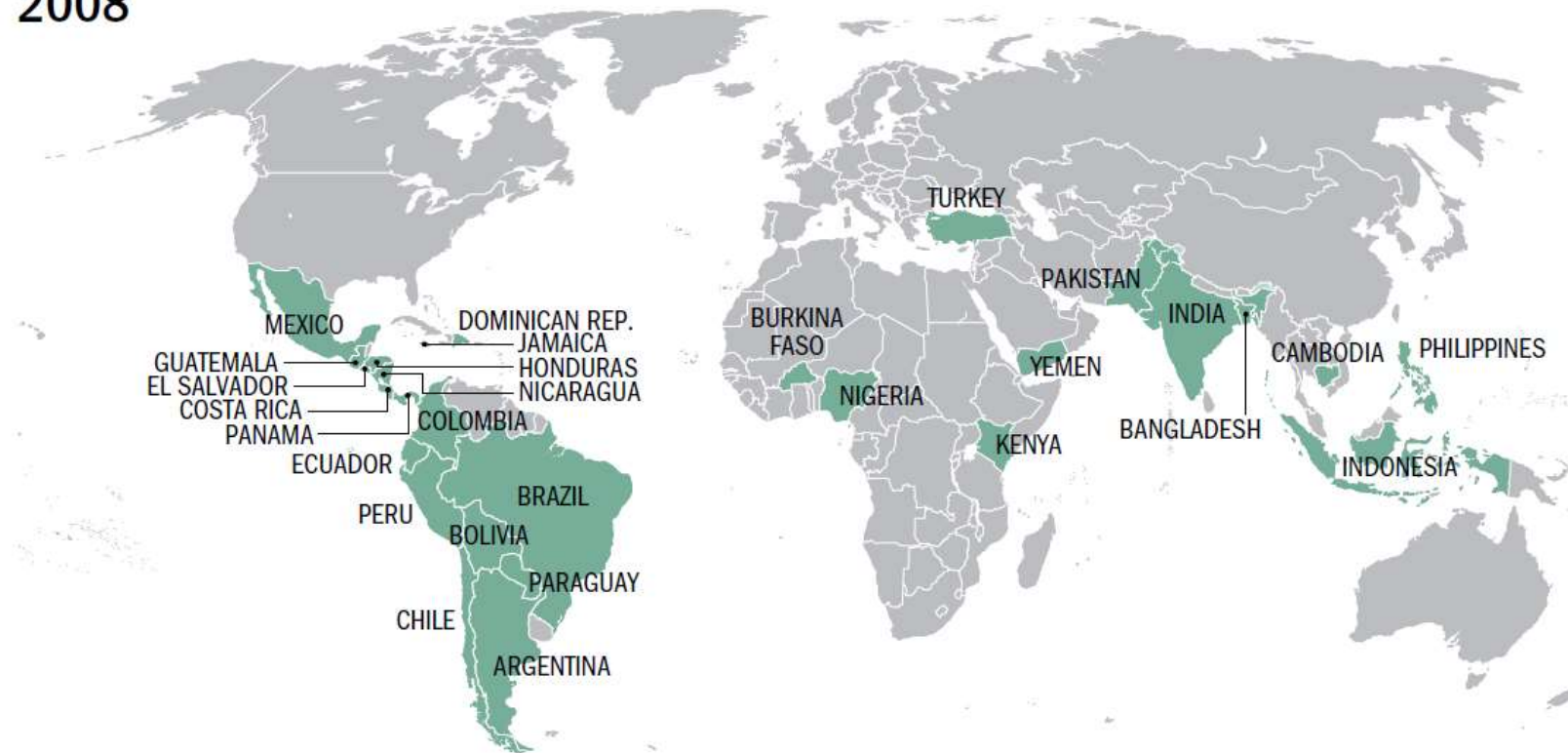
Figure 1 CCTs in the World, 1997 and 2008

1997



CCTs at Glance (World Bank)

2008



Source: World Bank.

Microcredit video

- http://www.youtube.com/my_videos_timedtext?video_id=hdbd7zxpj1o&feature=vm#
- <http://www.fordham.edu/economics/mcleod/microcredit.mp4>

References:

Stark, Oded 2009, [“Reasons for Remitting”](#) World Economics, v10:3, July-September, 147-157

MFI's with health loans.... Freedom from Hunger

<http://www.youtube.com/watch?v=zJ652vEa4Ko>

<http://www.nytimes.com/2012/04/24/business/global/in-bangladesh-strong-promise-of-economic-growth.html?pagewanted=all>