Why Credit? Concrete Strategies to Address Critical Shortfalls in Microlending Models

Why Microcredit?

As a mechanism for providing loans to the impoverished, microcredit has become one of the most popular concepts in development and poverty alleviation efforts around the world. Since the 1970s when Muhammad Yunus founded the Grameen Bank in Bangladesh, enthusiasm has gradually built, culminating in the UN's International Year of Microcredit in 2005 and Yunus and the Grameen Bank's joint Nobel Peace Prize in 2006.

This growing enthusiasm has highlighted microcredit's potential as a tool for alleviating poverty, while it has also opened up more space for dialogue about the ways microcredit can most effectively work towards this goal. Many practitioners have noted that by working towards poverty alleviation through microfinance, communities will gain a number of benefits, both directly and peripherally. Indeed, there is a growing recognition that microfinance could potentially both alleviate poverty for individuals and empower communities. We believe that programs to alleviate poverty must be community-driven and multifaceted in approach, addressing a broad spectrum of community needs and assisting those in different social and economic situations. By democratizing the ability to purchase productive assets that in turn enable even those in conditions of extreme poverty to engage in entrepreneurial ventures, Microcredit can serve as a central tool within this approach. We advocate for an incorporation of microcredit into community-driven strategies for addressing poverty. Indeed, we suggest that such strategies can be flexible, addressing specific communities' needs, at the same time that they are scalable and replicable.

The Idea of Microcredit:

The proliferation of microcredit organizations has created increased opportunities for those living in poverty. Yet, in Bangladesh and increasingly in other locations that are rapidly adopting microcredit-based models of development, it is not uncommon for families to hold five or more loans from different organizations. Often these loans are procured for consumption and, subsequently, to repay other loans, rather than to purchase assets. The perceived risk associated with lending to poor, often asset-less families has driven interest rates from many lenders as high as 40%, despite claims by most microlenders of 98% repayment rates. Such realities raise the question of credit dependency and debt entrapment for the rural poor.

As debates over the pros and cons of microcredit rage and donor support encourages the rapid adoption of micro-finance strategies not just in Bangladesh but around the world, it is critical to reevaluate the impact of microcredit at a local level. The Goldin Institute has begun to do this by directly engaging the experiences and opinions of those who have the most at stake with microcredit loans: the recipients. We believe that by taking these experiences seriously, we can gain unique and critically important perspectives on the grassroots and community impacts of microcredit and, ultimately, develop programs that more directly respond to the needs of their clients.

To do this, we have employed an innovative research methodology known as Community-Based Oral Testimony. This approach, in brief, relies on training a group of community members in qualitative research methods through a series of intensive, open-ended training seminars.

Subsequently, these community members work as primary data collectors, engaging their peers and neighbors in frank, comfortable discussions to gain qualitatively different perspectives on microcredit. At the same time, this strategy strengthens the capacities of communities to articulate their own experiences with development projects and to advocate for programs that address community needs.

Initial Findings:

To date, we have completed a pilot phase of this work in Bangladesh and are pursuing parallel projects in a number of different countries around the world. Though preliminary, our results are striking and suggestive. Microcredit, as a development tool, is designed to provide small loans to those without collateral so that they can acquire productive assets that will help to break cycles of poverty. Many microcredit organizations claim that such loans additionally empower women and free villagers from the yoke of exploitative local money-lenders. Our initial results suggest that, in Bangladesh, the majority of microlending programs are failing in these core areas.

In rural Bangladesh, we have found that microcredit programs, far from breaking cycles of poverty are, frequently, reinforcing many of the social realities that they claim to transform. In the over-crowded microcredit landscape of rural Bangladesh, families frequently carry multiple loans and often take out new loans to cover old ones. In these contexts, many use the loans not to purchase productive assets, but rather to feed their families in food insecure months. The use of loans for consumption purposes is complicated by the fact that many rural services previously provided by NGOs have been replaced with microcredit programs. This is due, in part, to the relative ease in securing funding and grants for new microcredit programming from large donor organizations.

If microcredit programs are failing to meet their economic goals, they are also falling short on their social goals as well. While the potential for microcredit to empower women by placing them in economic decision making roles is much discussed, our research indicates that frequently women become conduits for credit, securing loans and subsequently passing them directly to male household members. Indeed, we heard numerous stories from and of women who were forced to take loans for family members and, subsequently, bore the financial responsibility of repaying those loans. Further, we found that the availability of microcredit has both bolstered dowry systems in rural villages in Bangladesh and inflated dowry prices.

As alarmingly, our research indicates that the incentive systems in place for fieldworks are often misaligned, leading to abusive relationships between fieldworkers and lenders. As the credit market becomes more crowded, additional pressure is placed on fieldworkers, typically in similar economic conditions as their clients, to both source new loans and collects payments. Our findings suggest that extortion; bullying; unauthorized asset repossession; threats; and verbal, physical, and sexual-abuse are not uncommon features of the microcredit landscape in Bangladesh.

Improving Microcredit Systems:

Despite these findings, it is our belief that microcredit still has the potential to dramatically improve people's lives. Indeed, the stories we heard from recipients indicate that the structure of current microcredit systems in rural areas prevents them from using their loans for productive assets. But they also indicate that there is an urgent need, as well as desire, to do so. As such, *our findings suggest that microcredit needs to be rethought from the perspective of the recipient.* In microcredit literature, sustainability has become a key-term describing the long-term prospects of microcredit lending agencies. We suggest a repositioning of "sustainability" in microcredit to focus on recipients. We believe that the promise of microcredit—that poor families to break out of cycles of debt and poverty and acquire productive assets that will allow them to compete in local, regional, and international markets—is realistic and attainable if donor communities and microcredit lending institutions (MFIs) reconsider a number of their core strategies and practices.

- **MFIs should re-evaluate their metrics for success.**
  Our findings suggest that many microcredit lenders with stated goals of poverty alleviation may have misaligned metrics for gauging success, metrics that tell more about the ongoing financial health of the institutions themselves than of loan recipeints. Again, we suggest that sustainability should be a metric applied to recipients, not to institutions. This is particularly possible in the current development climate where donor enthusiasm for microcredit projects could help to underwrite some of the ongoing costs faced by MFIs who decide not to focus on an absolute financial bottom line. Further, we question the use of repayment rates as a proxy measure for poverty alleviation. As our research shows, a focus on repayment leads to abusive relationships between recipients and fieldworkers, whose jobs depend on their collection rates. Rather, MFIs should focus on metrics, both qualitative and quantitative, linked to measuring improvements in rural livelihoods. Programs should subsequently be improved and new programs created in response to these metrics.

- **MFIs and donors interested in microcredit need to provide or ensure that critical services are available to compliment microloans.**
  We found that one of the largest barriers to using microloans for asset-accumulation was a lack of complimentary rural services. For families living on the edge, the idea of asset purchase for long-term benefit is regularly trumped by the immediate needs of feeding families, providing critical health-care, and securing school fees for children. Of these services, the issue of food security was the most critical. Indeed, most respondents identified the period of seasonal hunger in Northern Bangladesh as the time when most took out loans to sustain their families and the point where individuals were most likely to fall into cycles of debt and credit dependency.

  Again, we believe that microlenders can address these problems by bundling services, providing food banking opportunities for their borrowers, and investing in communities by supporting programs providing other complimentary services such as free medical care and education. We further believe that donors can encourage this process by looking collaboratively at a suite of community services and needs when making programming decisions, rather than funding on a project-by-project basis (e.g., the 10th MFI in a community stands to make a less significant impact on poverty alleviation than providing otherwise unavailable emergency feeding or free medical care programs). Providing such services to both recipients and non-recipients stands to dramatically impacts overall community development as it strengthens the mission of MFIs and improves the chances of successful loan-use and repayment by recipients.

- **MFIs need to bring more inputs into the borrower/lender relationship than just cash.**
  Though many of the stories we heard in our research were grim stories of failure and entrapment, we also heard stories of success. These stories suggest that those who are best able to make successful use of their loans are those who already had some additional form of input into their entrepreneurial activities, such as land, assets (such as rickshaw vans for transporting goods to market), additional capital, or education and training. This, we believe, does not mean an abandoning of the microcredit tenet of loans for those with no collateral. Microcredit lenders are in an ideal position to provide some of those inputs for recipients. This might take place in the form of training, facilitating market linkages both between rural and urban areas and between regional villages and towns, and facilitating

productive partnerships between lenders.

- **MFIs should provide insurance or partner with insurance providers to protect lenders and encourage them to take risks on new ventures**.
  Many of the respondents in our study were not only eager to use their loans for entrepreneurial ventures, but had, in the past engaged in such projects. Yet the inherently risky nature of many of these ventures, coupled with a lack of training, led to a high-level of failure. We heard numerous stories of animals dying and crops failing in floods or blights. Indeed, for many respondents, such events marked the beginning of ongoing cycles of debt-entrapment, as the financial-shock of covering the cost of those loans was something that they never fully recovered from. Coupling loans with insurance for specific assets would provide ways to both protect borrowers from unforeseen events and encourage them to engage in more potentially productive ventures.

- **MFIs should engage in sustained community dialogue to better address the needs of particular communities.**
  Our work highlights the critical need for MFIs to engage in an ongoing, sustained, and robust dialogue with communities where they work, at the same time that it suggests both the benefits of and strategies for doing so. Microcredit is a tool designed to serve poor families living in a range of different economic, agricultural, environmental, social, and political contexts. Therefore, it is critical that the models employed by MFIs be flexible enough to adapt to the ever-changing needs and contexts of the communities where they work. In our research, we found that many potential recipients frequently preferred to work with local money-lenders to secure credit. This was in part because money-lenders, despite charging high interest rates, understood local conditions and tailored repayment schedules to the needs of their clients. Local money-lenders, for example, understand that loan repayment for agricultural loans needs to be delayed until after harvest times, whereas most MFIs mandate that repayment schedules begin the week after taking a loan.

  Settings up strategies for ongoing community dialogue could help MFIs better serve recipients and strengthen community capacities to advocate for programming that addresses their specific needs. Indeed, such dialogues, we believe could ultimately help MFIs improve both their social and economic bottom lines. We believe that by working with communities to set-up ongoing evaluations, modeled after the community-based oral testimony strategy that we employed in our research, MFIs can more rapidly achieve their goals of poverty alleviation as they adapt their programs to meet cultural norms and challenges in the areas that they work.

Ultimately, while exposing many of the problems with current microcredit programs, our research also highlighted the critical and ongoing need for microcredit projects approached from a more grassroots, community-based, and, we believe, ethical perspective. While a majority of families in the regions where we conducted our research take microcredit loans, many are unable to use them to purchase productive assets that could facilitate economic mobility. The message of our research is not that microcredit cannot help to achieve these goals, but rather that by rethinking strategies for microlending, microcredit can become one strategy (used in concert with others) for radically reducing poverty in rural areas and making positive impacts on the livelihoods of rural loan recipients.