

where credit's due

Business leaders, **Phil Smith** and **Eric Thurman**, argue that microcredit is the world's most powerful weapon against poverty.

A microcredit loan is often the only break that can move impoverished people up the rungs of the economic ladder in their communities.

The fundamental premise of microcredit is that people can improve their incomes through hard work if given small loans to strengthen their businesses. This premise has been proven true by millions of borrowers who are now building their tiny businesses, supporting their families, and repaying their microloans so that others can have a chance at the one break they too need to succeed. These borrowers are actively changing the futures of their families instead of begging or waiting for the next instalment of charity aid, which may never come.

Sam Daley-Harris, director of the Microcredit Summit Campaign, reports in *The State of the Microcredit Summit Campaign Report 2006* that in the autumn of 2006, 3,133 microfinance institutions served 113 million families during the previous year. While that is a laudable accomplishment, more than 500 million families that would almost certainly benefit from microcredit remain impoverished, and at least another 300 million more might benefit from it. According to our best calculations, we estimate that only one out of every eight people who could benefit from microcredit currently has access to it.

As a weapon to fight poverty, microcredit is as vital as education, health, human rights, and good government and yet, as

Richard Weingarten, executive secretary of the UN Capital Development Fund, says, "The demand for microfinance services remains largely unmet, especially in Africa." Less than 1% of World Bank funding goes to microcredit.

So, why does microcredit work so well in developing countries? The reason is the economies of developing countries are different from those of developed countries, often operating on a microscale, compared to the economies of the developed world.

What may at first appear to tourists as a flea market when visiting a developing country is in fact the community's version of a mega-mall where all exchanges of goods are in cash. In place of mass-produced name-brands, the market sells homegrown produce, household goods in small quantities, such as single bars of soap or a few squares of toilet paper, and clothing – much of it locally produced – plus a limited assortment of small luxuries that only a few shoppers can afford.

Many of the vendors work from dawn to dusk for incomes that, without a little credit, often do not meet their families' basic needs. Every financial transaction has to be completed in cash, there are no banks or alternative sources for loans and no other access to financial services. A savings account is cash under the mattress or in your pocket. Accumulating enough cash to make a major purchase such as a car or a house is often impossible. ▶

The sari seller of Tamil Nadu

In Tamil Nadu, the southernmost state in India, Shanti, a 28-year-old mother of two young sons, weaves delicate silk saris to sell in her neighbourhood. Born into the extreme poverty rampant in this region, Shanti's weaving skills were hard won, and she has worked diligently since childhood just to survive. Though renowned for the quality of her saris, Shanti was earning only \$2.60 a day, barely enough to allow her to care for her

children. Desperate for the capital required to expand her business, she became indebted to a local loan shark who charged outrageous interest rates. Later, she learned about microcredit and took a loan for \$60 that she invested in her business. Her income has since increased to more than \$6 a day, and she is now free from crippling debt. Today, Shanti is able to focus on growing her business and creating a better life for her family.





Poor people don't need to be told about business opportunities. They just need a little working capital.

Local markets can be the equivalent of mega-malls.
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Panos

▶ Investing is too cumbersome to imagine, so there is no stock market; companies that require investment capital to start up would never get off the ground. It's difficult to expand sales for a tiny enterprise, because your inventory of clothes, produce, or basic household items is limited to what your meagre profit will buy. You cannot borrow to buy, repair, or replace equipment, and, since you have no reserves, small emergencies turn into disasters. Yet more than half the world's population operates in this type of cash-only, informal economy.

Intricate banking and finance systems fuel the economies of developed countries by providing loans and other financial services to creditworthy customers and working capital for potentially profitable businesses. In contrast with a cash-only economy, developed countries are moving toward a cashless society.

In developing countries, government regulations, when they exist, often obstruct rather than support business. Laws, when enforced, are complex and regressive. They seldom protect individual property rights. Virtually no formal banking or financing services are available except for wealthy clients in the big cities. Few salaried or full-time hourly jobs exist. *The Economist* reported that nearly 60% of nonagricultural employment in Latin America and 67% in Africa is in the informal sector. In India, nine out of ten workers are in the informal sector, contributing 60% of net domestic product and 70% of income. Informal businesses are typically the only viable employment options for the poor. The one positive aspect of this type of business is that all workers can be self-employed provided they are clever enough, work hard, have inventory and a market, and keep their prices competitive.

In developing countries, most poor people do not have access to financial services. Either credit is not available from any source or only from unscrupulous lenders. Their interest demands are so exorbitant that no matter how good the business and no matter how hardworking the entrepreneur, it is impossible to get ahead. Yet, with just a tiny amount of fair credit, people are able to open and expand businesses by adding inventory or equipment, implementing a competitive advantage, or seizing a market opportunity.

With subsequent larger loans, businesses can grow, moving these families further up the economic ladder. This is real progress, perhaps the first progress some families have seen in generations and parents can ensure that their children will not suffer as they have. For this privilege they readily sign their names on the legal papers for microloans and work hard to reimburse their lenders.

Microenterprises are small-scale versions of the same types of businesses found in developed countries. Twenty hens and a coop constructed from scrap material become a poultry enterprise. A greengrocer's may be a rickety wooden cart piled with mangos picked that morning by the driver or purchased from a local farmer. Hives, bees, and a collection of mismatched used jars are a honey factory. A 40-year-old truck is used to transport both goods for sale and paying passengers. A pedal powered sewing machine is the local equivalent of a clothing factory. An outdoor clay oven is the village bakery. With a microloan providing working capital, these businesses can support families and boost the grassroots economy for the whole community.

Being creative and turning every available resource into a business is vital to improving the lives of those in poverty.

The Ukrainian entrepreneur

The Mikhayloynas were struggling in Ukraine. They were living in an unheated, half-built house that they could not afford to finish, and their government pension barely covered the cost of their food. With no money for medicine or other necessities, Galina Mikhayloyna started selling milk in jars at the local outdoor market where vendors sell everything from hand-knitted socks to home-baked bread. She soon was able to add grain to her merchandise, but did not have enough money to build up her supply or to stock other products. Galina obtained a \$400 microloan, which she used to increase and diversify her inventory with a variety of popular household products. Sale of these additional products produced enough extra income for the Mikhayloynas to be able to finish their house. Subsequent loans helped Galina move up to the best selling place in the market. She now has many customers and is known throughout the market as a strong businesswoman and savvy entrepreneur.

In the Caribbean, a young man used a microloan to buy a used TV and VCR. He has turned his two-room tenement flat into a cinema. He rents a new video every day, charges neighbours the equivalent of 15 cents to watch the movie, and sells snacks from his four-shelf grocery shop. In Asian villages with no electricity, 'phone ladies' buy mobile phones with microloans and make their livelihoods by serving as their villages' pay telephones. A man in India with a laundry business was not making enough money to survive. Washing his customers' clothes in a nearby stream was not the problem; giving them a fresh-pressed appearance afterwards was. A microloan of \$50 was all he needed to acquire an iron and an electrical outlet, bringing his business to the next level.

Poor people don't need to be told about business opportunities. They are keenly aware of opportunities to start or grow a microenterprise – usually they just need a little working capital.

Years ago in a shantytown in Managua, Nicaragua, before the opening of a community microcredit bank, all the homes were made of scrap wood, plastic sheeting, and cardboard, and the local schoolteacher lamented that youngsters were working or begging instead of attending school. At an orientation meeting to introduce the concept of a microcredit bank, few residents took an active interest – many people had given up hope of changing their situation.

In that same neighbourhood, two years after the programme opened, cement blockhouses stood among the shanties, and the community's teacher was excited that ▶



Russian babushkas (grandmothers) bake bread at home and then sell it on the high street. Microloans enable them able to make as much as they can sell.

▶ more children were attending school. The borrowers were proud of their businesses and home improvements. At one weekly meeting, the members celebrated successfully lobbying government officials to have electricity brought to the area. Some borrowers volunteered to dig holes for the utility poles, and others to provide refreshments. They concluded the meeting with a discussion of how electricity would improve their businesses. One woman planned to use her next loan to buy a refrigerator so she could sell milk and meat in addition to bread and soap. A carpenter predicted that he could more than double his production with a power saw.

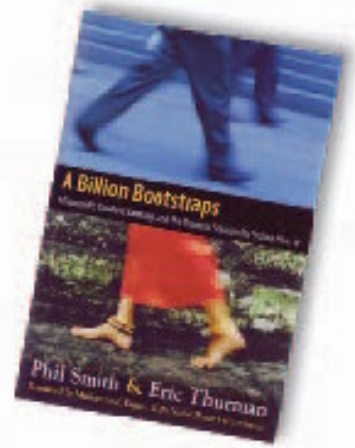
These successful borrowers had made the decision to improve their lives but until the power of credit came along, they would not have dared to approach a government official for the electricity service they were entitled to receive.

Over two years the people in that microcredit programme made the mental move into the middle class. They still did not have running water, and most of floors remained packed earth but progress was

unmistakable. Today most of the children go to school, which is a solid middle-class achievement by local standards.

In *The World Is Flat*, Thomas L. Friedman observes that when people have hope, they are in the middle class. “They have a pathway out of poverty or lower-income status toward a higher standard of living and a better future for their kids. You can be middle-class in your head whether you make \$2 a day or \$200, if you believe in social mobility – that your kids have a chance to live better than you do – and that hard work and playing by the rules of your society will get you where you want to go.”

Some of the most crucial benefits of microcredit are far more than financial and cannot be measured on a balance sheet. The true benefits are dignity and self-esteem, along with respect for family and community. Microcredit should not be seen as charity but rather as the opportunity poor people need to build a decent life. Through microcredit, donors can become true partners in progress with the people of the developing world.



MORE INFORMATION

This is an edited extract from *A Billion Bootstraps: Microcredit, Barefoot Banking and the Business Solution for Ending Poverty*, by Phil Smith and Eric Thurman.

Millions of miracles

2007 Nobel Peace Prize Laureate **Professor Muhammad Yunus** explains why social business enterprises are critical to ending poverty.

Despite many advances global poverty persists. Models that rely on government action or capitalism narrowly defined as maximization of financial profit are limited in their ability to put poverty where it belongs – in a museum. The key missing links are grassroots, private sector approaches that focus on the poorest of the poor, but in a way that is businesslike and allows for preservation of investor capital and financial sustainability over time. The potential of ‘social business enterprises’ formed along these lines can make a major impact on the global poverty crisis.

The Grameen Bank project, a for-profit, member-owned bank since 1983, shows that providing microcredit to the poor can be done in a successful and profitable manner. Today we have more than seven million borrowers, and 58% of them have already crossed the poverty line and most of the rest are heading in that direction. They have done this through their own efforts, supported by microcredit, microsavings, microinsurances, and a social development programme guided by the ‘16 Decisions’ that our clients developed in 1984. The Grameen Bank is profitable and can

expand in Bangladesh with savings provided by the poor (and formerly poor) borrowers and other savers. While the Grameen Bank does not need additional support, other programmes in other countries will benefit from support, and Bangladesh can benefit from additional social business investments that improve the lives of the poor.

One example of a social business investment is the joint venture with the Danone Group of France (famous for its yogurt products) that will produce and sell fortified yoghurt especially formulated for malnourished children in Bangladesh. Another is the eye care hospitals that will bring world-class eye care to all levels of the Bangladeshi population with the poor paying less and the richer paying more for identical high-quality services.

I have always maintained that poverty was not created by the poor, but by society’s institutions that became a ‘disabling environment’ for them. The Grameen Bank became an ‘enabling environment’ that led to millions of small miracles which, collectively, provide an example of what can be done globally.

That the Nobel Prize was awarded this year half to me and half to the Grameen Bank to recognise our progress, makes us more committed to reaching new poverty-reduction milestones in the years ahead.

Professor Muhammad Yunus, from his foreword to *A Billion Bootstraps*

