Is microfinance a band-aid solution to poverty?

Frederic Sautet, Senior Fellow
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What is microfinance?

- Microfinance encompasses the provision of a broad range of financial services to the poor
- Microcredit covers only the loans
- Two important aspects:
  - Small groups of borrowers get together & are financially responsible for each other (Muhammad Yunus’ Grameen bank model)
  - Absence of (physical) collateral
How is microfinance organized?

Small group of borrowers

Microfinance institutions
Reach out to the poor & deliver services & loans

Funders
20 Private foundations (eg Grameen Foundation), Development banks and organizations (eg WB), 40 Government agencies (eg USAID), 60 Private & institutional investors (eg banks)

Loans: $70 to $800
Average around $100
# of borrowers: 25m to 70m

# of MFIs: 3,000 to 5,000
30 serve more than 100,000 borrowers (68% of total)

Average grant: $100K
Total portfolio: $7b
Myriad possibilities for channeling funds through intermediaries

Mercatus Center
George Mason University
What is microfinance supposed to do?

- Poor would-be-entrepreneurs lack access to credit because:
  - They have no collateral
  - Moneylenders are sharks (>300% annual int. rate)

- Relieve poverty by helping the poor:
  - Become an entrepreneur (providing credit)
  - “Graduate” into the formal economy
Does it achieve its goal?

- Mixed results
- The Philippines — slums of Manila
  - Little or no graduation & limited entrepreneurship
  - Helps put food on the table
- Fails to achieve its graduation/entrepreneurship goals
- Does not address the root causes of poverty
Entrepreneurship is primary, financing it is secondary

Importance of institutional environment in the emergence of entrepreneurship:
- Lack of well-defined property rights
- Legal ethnic discrimination
- Lack of competition in financial sector & other government regulations
- Scope of government fuels corruption
The future of microfinance

- Add more government funds?
  - More funds do not make more entrepreneurs
- Success depends on many factors:
  - The role and quality of MFIs & funders
  - Alternative solutions: self-financing, savings club, informal financial markets
  - Systemic issues: institutions, regulations, taxes
- Goal: environment that promotes risk taking, entrepreneurship & the development of trade