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Microfinance 101

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Over the past year, Natik's partner program, **Veredas**, has engaged in some critical reflection about microfinance. As public opinion on microlending has become increasingly polarized in the past few years, it's important to us that we learn as much as possible from reports and studies as well as from our loan recipients and other loan organizations.

First, a little history

Microcredit has had an interesting path, especially in the last few decades. Muhammad Yunus is credited with inventing microfinance when he founded **Grameen Bank** in Bangladesh in 1976 (in reality, this type of lending has happened at various points in history and cannot necessarily be pinned down to such a recent start date). Grameen was hailed as a remarkable innovation in that it allowed women to take out small loans without collateral by participating in solidarity groups–circles of other women who held each other accountable for paying back their loans. For the first time, it seemed, people unable to offer any sort of collateral could have access to small loans that would help them begin small, productive businesses.

Microfinance boomed in the intervening decades, but has suffered a few significant scandals in the past few years. In 2009-2010, **microfinance clients in Nicaragua simply refused to pay back their loans**, fed up with the extortionate interest rates and harassment from loan officers. Then in the fall of 2010, microfinance reached a point of **crisis in the southern Indian state of Andhra Pradesh** when several loan clients were found to have committed suicide as a result of over-indebtedness.

So what are the primary issues?

Most criticism of microfinance can be grouped broadly into two categories. The first category includes critiques of the **implementation** of microfinance programs:

- Conflicts of interest within loan funds and microfinance institutions (MFIs) lead to a lack of transparency
- MFIs are often overly focused on profitability
- MFIs become too big and lose their ability to track clients
- Poorly trained loan officers harass clients
- Participants borrow from multiple MFIs, using each loan to pay back another

The second category includes critiques that are more **philosophical** and **fundamental:**

- The concept of microfinance itself can never reduce poverty or effectively empower women or families in the long run
- Microfinance places the onus of development and prosperity on individuals, relieving the state of its responsibility for the welfare of its citizens
- The expectation that every poor person should become an entrepreneur is unrealistic

Keeping in mind all the difficulties that the microfinance sector has seen, and acknowledging that some criticism of microfinance is nearly impossible to prove or disprove in the short term, Veredas has tried to focus on how to serve its clients best. While working in and around San Cristóbal de las Casas, Chiapas, Veredas participants and staff have encountered numerous other MFIs, many of which are larger and provide much bigger loans at very high interest rates. At the Grameen Bank branches in San Cristóbal, for example, clients take out minimum first loans of 7,000-10,000 pesos (approximately $558.00 to $797.00). In contrast, Veredas rarely lends out more than 4,000 pesos ($319.00) to an entire loan group of four to ten women.

Over the course of the past year, Veredas has renewed its commitment to providing small loans at symbolic interests rates. Veredas also focuses on encouraging an attitude of community collaboration among loan participants by facilitating initiatives that emerge from the groups, including homework help for young students, donations of books and didactic materials for a study area, and other activities that directly benefit participants, such as low-smoke stoves and **product marketing support**.

Perhaps most importantly, we believe that by maintaining strong relationships with all the women to whom we lend, we can understand their economic situations a little better, allowing us to make sure they are not over-indebted, track the progress of their business, and provide them with flexibility in terms of their repayment schedules and interest rates.

To read more about the founding and fundamental philosophy of Veredas, read our blog post **here**. To hear from a Veredas loan recipient on her own experience with microlending, see our blog post **here**.

Recommended reading:

Hugh Sinclair's 2012 book, ***Confessions of a Microfinance Heretic: How Microlending Lost Its Way and Betrayed the Poor****.* While Sinclair is deeply disappointed with the performance of the microfinance sector, he does point to particular MFIs and their clients who seem to be successful in helping to eradicate poverty, gradually and conscientiously.

If you're interested in learning more about microfinance in general, **Innovations for Poverty Action** has done extensive research on its impact in many different regions of the world. Review their past and current studies on microfinance **here**.