

## **From Microcredit to Microfinance: a business perspective**

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### **ABSTRACT**

When Muhammad Yunus made a humanitarian gesture to help 42 women in Bangladesh's Jobra village by lending them 27 dollars in 1976, he did not dream of it as a business or realize its social, marketing, banking, and economic impact. As a United States trained economist, he believed in the general economic theory of fiscal and monetary policy to address society's ills. After winning the Nobel Peace Prize in 2006, Muhammad Yunus has since prepared society to re-define its view of a business and may well re-define human security, marketing concepts, banking systems, and local economies.

This paper examines microcredit as a business starting as a social inspiration and continuing as a sustainable model for microfinance. Microcredit originally started as a humanitarian and philanthropic concept, but as it matures as a business, it is raising social, political, and economic questions as well as questions about its purpose. This paper will attempt to answer some of the questions, surfaces the debate on what should be the purpose of microfinance institutions, and questions whether our society has evolved to a new level of capitalism where businesses care for and enable the poor to help themselves.

It provides insights on some of the business microcredit dimensions that may be changing society. Some of the changes may be for the better while others may still be in doubt due to concern of sustainability. Regardless, Dr. Yunus has reinvented the way society looks at a business.

Keywords: microfinance, microcredit, microlending, social business, microenterprise credit, and microcapital.

## INTRODUCTION

Traditional business roles call for transforming inputs into outputs that can be offered to consumers. The roles and responsibilities of a business entity change over time, but it must remain sustainable in order for society to continue benefiting from the efforts and creativity of entrepreneurs and governments. Recent growth in a model that is aimed at serving the poor in society has surfaced and mushroomed beyond most expectations. The model is known by such names as Microlending, Microcredit, Microfinance, Microcapital, and Social Business. This evolving concept has touched off some of the most powerful changes that are occurring in different societies throughout the world.

Microcredit originally started as a humanitarian and philanthropic concept, but as it matures as a business, it is raising many social, political, and economic questions as well as questions about its purpose. This paper will attempt to answer some of the questions, surface the debate on what should be the purpose of microfinance institutions, and questions whether our society has evolved to a new level of capitalism where businesses care for the poor.

One of the debates on its purpose strikes at the heart of the concern. The August 2010 issue of "MicroCapital Monitor," contains an editorial by Barbara Magnoni, President of EA Consultants, regarding the initial public offering (IPO) of SKS Microfinance, one of India's largest and the world's fastest-growing microfinance institution (MFI). Magnoni writes, "Is the value of microfinance its ability to alleviate poverty, promote financial inclusion or some combination of the two? If the answer is the former, are profits appropriate?" (Magnoni, 2010, p. 13). Magnoni continues by quoting SKS: "If the microfinance industry is going to provide the estimated USD 45 billion of credit needed by the poor, it must tap commercial capital markets – and that means structuring microfinance so that investors can expect a return on their investment" (p.13).

Some of the questions explored in this paper are from both the political right and left, leaving the question of whether bottom-up entrepreneurialism or collectivist regimentation will triumph. In addition, it attempts to answer the following questions: Has human security been redefined? Can new profitable markets be created? Will the extension of traditional banking credit be redefined in emerging nations? Will local economies stimulated by Microcredit expand sufficiently to improve a nation's economy? Can a social business be sustainable?

This paper examines the background of microfinance from a growth and business purpose perspective. It addresses how microfinance affects the perception of self-interest and human security, how it may change merchandising methods in emerging markets, the impact on local economies, and whether microfinancing ventures can be self-sustaining. Finally, it provides some conclusions and recommendations, but may provide more questions than answers.

## BACKGROUND

### Growth and focus.

Starting from a 27 dollar loan to 42 women by Mohammed Yunus in 1976, microcredit has grown to worldwide efforts by different organizations claiming a gross loan portfolio of over 43 billion dollars through 2009 with over five-hundred million borrowers and their families being affected (Goldsworthy, 2010; Reille, 2010; Daley-Harris, 2009). According to a publication from MIX Market, a microfinance institution (MFI) data gathering organization

founded by the Consultative Group to Assist the Poor (CGAP) in 2002 which the Bill and Melinda Gates Foundation supports, “the loan portfolio [of almost 1,400 MFIs] grew 34 percent per year on the average [between 2003 and 2008]” (Gonzalez, 2010, brief 5, ¶ 1), even though during the years of 2007 and 2008 the world experienced the worst financial crisis since the great depression of the 1930s. While traditional bank after bank became insolvent in the United States, MFIs from India to Kenya grew.

Some may claim that microfinance is nothing new. What they may mean is that the concept of helping the poor is not new. Sure, we’ve all tossed change into a panhandler’s cup or the Salvation Army cauldron. We’ve all spotted a few bucks to a friend in need, perhaps far more than 27 dollars, but such things are charity, not microfinancing. Further, while the delivery system may well be novel, the impact of microfinancing is creating a change in what may be the purpose of a business.

The concept of helping the poor has been around as long as man has walked the earth. However, as societies developed into nations, helping the poor was left to charitable institutions, churches, and for the most part, the government. As different forms of governments developed, the delivery of aid to the poor changed. Some industrialized nations induced aid to the poor of emerging nations by encouraging other governments with loans and sponsored programs such as development banks and financial institutions to eradicate poverty.

“The economic and financial crises of the 1980s, coupled with mismanagement of banks and financial institutions, have propelled the liquidation of development banks and specialized financing structures dedicated to reducing poverty. This situation has accentuated the exit of small economic operators and the rural world from classic financing structures.” (Ayayi & Sene, 2010, p. 303). As the world suffered from recessions in the early 1990s, financial meltdowns in the second half of the first decade of this century, and more recent news of excess government deficits, microcredit has become more popular as a cause and a social business.

By December 1976, Muhammad Yunus started an institution that borrowed from other banks to loan to the poor. By 1982, the institution had 28,000 members and on October 1, 1983, became an actual bank. Muhammad Yunus founded Grameen bank, with a mission statement to: “make low-interest loans to the poorest of the poor, people with no collateral or credit history” (Dalglish, 2010, p.1) in a country ravaged by war and famine. As Grameen’s success flourished, the mission and purpose became global in scope and the 1990s saw compound growth of MFIs increase by double digits.

Microcredit’s purpose was declared in 1997 to be: “a global campaign to reach 100 million of the world's poorest families, especially the women of those families, with credit for self-employment and other financial and business services by the year 2005” (Daley-Harris, 2009, p.35). By 2007, their efforts exceeded the goal of 100 million by 54 million (Daley-Harris, 2009). Further, the worldwide financial meltdown of 2007 has left exasperated governments unable to care for their impoverished by means of traditional and often exhausted government funded programs, and with few incentives for banks to loan to the poor, economic devastation plagues the globe.

Fortunately for many, microcredit organizations and institutions like the Grameen bank have taken on the plight of the poor. “Microfinance institutions and their backers — which include banks, charities, nongovernmental organizations (NGOs) and international development institutions such as the World Bank” (Hodge, 2010, p. 18) are targeting areas that will benefit from their input. Small to medium sized credit operators in countrysides and towns that had lost traditional financial structures took to microcredit to fill the gap. “Microfinance subsequently

proliferated in countries with a paucity of bank infrastructures, such as most of Africa, Asia, Latin America, and Eastern Europe. In some of these countries, less than 20 percent of the population has a bank account.” (Ayayi & Sene, 2010, p. 303). Whether the new MFI’s mission statements will honor the poor as well as benefit their shareholders is yet to be determined.

Lately, the focus is turning to the Americas. “Commitment to the concept has been particularly strong in Latin America, according to the first annual global microfinance index produced by the Economist Intelligence Unit (EIU). The region accounts for six of the top ten most suitable destinations for microfinance ranked in the EIU’s research report: Bolivia, Colombia, Ecuador, El Salvador, Nicaragua and Peru” (Sanchez, 2009 as cited by Hodge, 2010, p. 18). The index, a taxonomy of 55 countries, appears to be the first of its kind. It tightly defines MFIs as institutions that provide microcredit to those who earn less than 250 percent of the Gross National Income per Capita. Evaluations of this type are difficult to find because of weak and inconsistent data along with deficient transmission of information across countries. However, it scores and normalizes 13 indicators, reorganizing them into three broad categories: regulatory framework, investment environment, and institutional advancement (Sanchez, 2009). Sanchez further found the best ranked nations had the most favorable legal and regulatory framework followed by a moderate investment environment and a high level of institutional development.

### **The purpose of a business.**

The social purpose behind microcredit is philanthropic, yet, if it is to survive, the model will have to have not only sustainable countenance, but a continuous flow of investors who not only want their investment back but expect a profit as well. According to a recent special report by The Economist, “Microfinance has existed in many forms for decades, but has only recently garnered global attention as a commercially viable activity that can offer real opportunities for microentrepreneurs” (Sanchez, 2009, p. 4).

A great advocate of capitalism, Peter Drucker stated that the first and primary purpose of a business is to create a customer, and in its performance of this task, it fulfills its social responsibility (Drucker, 2001). While he surfaced the need for a business to have social responsibility, his focus was to point out management’s responsibility to create a sustainable competitive advantage. Earlier in his writing, he stated, “The first responsibility of business is to make enough profit to cover the costs for the future. If this social responsibility is not met, no other social responsibility can be met.” (Drucker, 1954, p. 2).

On another dimension of the philosophical continuum which sings a similar song, Muhammad Yunus believes that “Not every business should be bound to serve the single objective of profit maximization” (as cited by Engler, 2009, p.85), but rather “pursue specific social goals” (p. 86)—such as creating products and services for humanitarian reasons. However, in an interview with the president of Group Dynamics Institute, Dr. Yunus admits “[a] company can make [a] profit. That profit stays within [the] company. The profit is used to pay for expenses. Investors can take back his or her original money” (Yanagidaira, personal communication, 2009). Additionally, he believes that humans can and often do override their habits of self-interest for the benefit of others.

The glamorous social goal of ending poverty becomes a moving target because different governments, organizations, and individual champions define poverty according ever varying criteria. Its metrics become gelatinous, defined one way and then another. Whether one uses a nominal or purchasing power parity, the figures of income, assets, and supportive infrastructures

that set the defining line of what constitutes poverty will invariably change based upon opinion that may well be philosophically based. Mark Engler (2009) wrote a thought provoking article which injects such terms as Neoliberalism, Do-gooderism, Communitarian snake oil, Femino-socio-financial engineering, and Collectivist regimentation to describe the philosophical basis of microcredit of those to the left of the political spectrum.

However, some would describe these efforts as the new future of a postcapitalist society. At times, Dr. Yunus sounds like a conservative when denouncing welfare systems and promoting the mythos of self-made success via microcredit. The fact that this delivery system to the poor has had such a remarkable growth may be evident that perhaps society is ready to raise the bottom of the pyramid as suggested by C.K. Prahalad (2010). While some argue that in many cases the loans are used to sustain rather than increase the wealth and well-being of the poor, one fact remains: microcredit is putting money in the hands of consumers and providing a sense of self worth.

Perhaps the United Nations' Millennium Development Goals of preventing many forms of global poverty will bring about a new society of global peace after the Cold War by focusing on intrinsic components of well-being called "human security." In so doing, it will prevent what Heather Goldsworthy (2010) calls "cultural tribalism" (p. 451). Goldsworthy declares that microcredit may be seen as a way to "diffuse threats at the individual and community levels... At its root, human security is about protecting and empowering all people to live their best lives every day, guaranteeing basic necessities, freedoms, and dignity" (p. 452). In essence, it is providing the poor with the tools to improve their own defined quality of life with dignity and self-efficacy, and it is creating a new breed of entrepreneurs among the poor. However, behavior patterns may take generations to change and one has to look at the reality of current and dominant business practices and their rapacious appetite for profit.

Muhammad Yunus' visionary mission of a social business for the poorest of the poor may be taking root, however, it may be evolving into a system that does not operate and function as the compassionate social institution he originally intended, but rather a self-sustaining business that would lend low-cost money, yet provide a reasonable return to investors. While it appears at first glance that MFIs are gaining strength, it is apparent that they are heavily supported by government efforts in the form of non-government organizations and institutions formed by individuals under the precept of running as a charity with the added flavor of stating that at least 98 percent of the principal will be returned to the individual investor. Once the governments stop funding and lending at zero interest rates and these humanistic efforts have to compete with other charities, commercial funding dependent on the continuous flow of investors for its sustainability and growth will necessarily become the new paradigm. When this happens, the for-profit mind-set (self-interest) will force a new microfinance business model. The world may be re-defining what human security means as well as how, or whether, it can be served by a hybrid mix of altruism and capitalism. Additionally, Britta Augsburg (2010) cautions "the overwhelming drive for microfinance institutions to become financially self-sustainable...can have severe consequences, ranging from mission drift to questionable practices employed by institutions" (Augsburg, 2010, abstract).

## **Human Security**

According to Heather Goldsworthy, "[H]uman security is a concept created in response to the transformed geopolitical conditions that emerged at the end of the Cold War"

(Goldsworthy, 2010, p. 450). As state-level military conflicts fade, a new threat to society is evolving. Terrorism is often based on clannish ideology where the individual and community are threatened with civil unrest, destruction of property, and violence. Poverty and the lack of education are at the roots of civil unrest. Microcredit attempts to mitigate the fears generated by providing capital at the individual and community levels to alleviate want and accommodate education in the form of principles to erase the fear generated by ignorance. The most famous of these principles are promoted by the Grameen Bank beginning with “we are disciplined, united, courageous and workers” (Grameen Bank booklets 2010).

Bayulgen (2008) suggests that a link exists between “self-efficacy and social capital, which can be generated from a particular form of micro-credit lending where clients apply for loans as a group and share responsibility for repayment” (Bayulgen, 2008, p. abstract ). A distinction needs to be made between self-efficacy and self-esteem. Many have misunderstood, assuming that self-efficacy is the same as self-esteem, and these words are sometimes used interchangeably when the fact is that self-esteem is an effect of self-efficacy. According to Albert Bandura (1997), an expert in the field of self-efficacy, “perceived self-efficacy is concerned with judgments of personal capability, whereas self-esteem is concerned with judgments of self-worth” (p. 11). The poor feel a sense of being capable when they are able to convert natural resources or their services into the production of goods or delivery of services. Having the funding to do this will give them more confidence and lead to a feeling of self-worth once they meet their expectations through their work. Bandura explains there is “group efficacy” or “collective efficacy” (p.448) as well which increases productivity and is the strongest predictor of workplace satisfaction.

The shift on security from sovereign nation to individual and community is quickly becoming a new paradigm. Will Maslow’s theory of the Hierarchy of Needs be turned upside down in the new millennium? Can man’s primary driver of self-survival be displaced by the higher order of self-actualization? If so, can self-actualization serve the need to survive better than primal instincts? After all, this is a 21<sup>st</sup> century global village where specialization and optimization of resources renders communities better fit to provide water and basic necessities than the individual alone. As a society, it seems quite upside down to cling to the current hierarchy as if individuals are all living in isolated mud huts sharpening sticks in the hopes of gorging themselves upon a passing rodent. These questions hit at the very essence of human behavior which has long been studied by various disciplines with no definitive answers. The most cherished precept of market economics is the pursuit of self-interest and gain. The concept of subjective expected utility (SEU) has been a well established concept in the human decision-making process. Its fundamental concept is based on what is called utility-maximizing rationality.

A number of recent winners of the Nobel Prize in Economics such as Robert Aumann in 2005 and John Forbes Nash, Jr. in 1994 have searched human behavior patterns that consider group consequences in decision-making processes under the more commonly known label of game theory. Most cultures view utility-maximization from a utilitarian point of view—when making choices, what is the most good for the most people, but at the individual level, if no one thinks they can improve their position by changing their current strategy, the Nash equilibrium will prevent change and possible utility maximization. There is an enormous challenge in relieving the equilibrium that dictates the best possible position for each individual as it is based on the expected best play and position of the others in the group rather than the best possible position for the group as a whole. However, game theory illustrates that, in a non-zero-sum

game, whether cooperative or noncooperative, consideration for what most benefits the group is actually a form of rational selfishness in that it perpetuates game play and the potential for future resources that will benefit the individual better than the finite spoils of a single “win.” Put simply, losers are unable to add to the wealth of the group and gameplay eventually ends with a finite reward. Perpetual co-players, however, can add to the wealth of the group which can accumulate infinitely and gameplay can continue infinitely (Carse, 1987). Perhaps, the answer to breaking the stasis of Nash equilibrium is changing the object of the game from a finite win to the continuation of the game itself by the collective group members as has been the case in microcredit.

## Markets Created

This paper uses the definition of marketing established by USAID in 2000: “Broadly speaking, marketing for a microfinance institution (MFI) can be defined as an analytical tool to study and know the client. It addresses the questions of who are the institution’s clients, how many clients there are, which clients should the MFI target, and how many clients it hopes to capture” (Tran, 2000, p. 1) with their products and services. The products and services are financial in nature and should be designed for the poor. However, in the beginning, the product was designed by the MFI and controlled by governments or their institutions. “These products [were] created at the top and [were] inspired by an MFI’s interest in the innovation rather than in response to client demand. This motivation is different from the commercially oriented MFI, which ‘must’ be client driven in order to survive. If the market-oriented MFI fails to develop products that are tailored to customer demand, it will continually lose clients to competitors” (Brand, 1998, p.4).

In a commercially designed product, the customer’s need is always the foremost consideration in design and concept. The MFIs assert that their product design is customer driven, but in many cases, it is still producer driven. Some are need-based from an institutional or manufacturer point of view, and these products are government sponsored in the majority of cases. As the microfinance business develops commercially and becomes accountable to investors instead of governments, more sustainability will be apparent. As more and more MFIs enter the market place, it will follow the typical competitive strain on profitable deliverables until a consolidation takes place and monopolies and oligopolies emerge.

Even if the MFI has a monopoly in a given region, there is no guarantee of its success. In a study by ACCION (1998), Monica Brand concluded that “Regardless of the type of product developed, a monopoly status quo is not sustainable [long term if its marginal costs are above the average total cost]. Markets transform quickly and many MFIs are unprepared for unanticipated competitive developments” (Brand, 1998, p. 4). In the MFI conference in Bamako (2000), it revealed four concerns in Western Africa having to do with growing pains. The four concerns were:

1. Increasing competition in some markets for microfinance.
2. Slowing growth rates in certain MFIs.
3. Increasing client desertion.
4. Growing recognition that MFIs need to be more client led (Tran, 2000).

The good thing about monopolies is that they can continue to operate in less than a profit-maximization mode for a longer period of time than most firms operating in a highly competitive

market. As long as the monopolist's price exceeds its marginal variable cost, even if below the average total cost, it may continue to operate and stay in business.

History has taught MNC's marketing organizations the hazard of assuming that the products that have been successful and profitable in their developed markets can automatically be transferred to developing markets without great study, adaptation, and care. The epitome of this error, of course, is the Nestle infant formula disaster that became known as the "bottle baby disease" in the 1970s (Sokol, 1992). Baby formula was marketed to Third World countries. Poverty caused mothers to over-dilute the formula to make it go further. Dilution and insufficient clean water supplies resulted in infant deaths and disease in those Third World countries. The WHO/UNICEF International Code of Marketing of Breast Milk Substitutes subsequently adopted a new voluntary code of practice in 1981 by 118 nations. It is crucial that marketers never forget this study of how good intentions can lead to dire consequences. Hence, any marketing suggestions based upon the data and experience of developed nations must be tempered with the realization that any postulation towards future marketing must be examined in the light of study, adaptation, and care for the specifics of the new market.

Still, some basic hypotheses must be made towards the possible means for marketing microcredit to developing markets. While financial and banking institutions often have a disdain for marketing and operate with very few job titles that use the words "sales" or "marketing," it is not possible for any operation to ignore the basic marketing functions; they can only shift and rename those functions. Much of the sales function for microcredit at the Grameen bank is performed by its loan officers. When trained correctly, salespeople should only sell to those whom they believe would materially be advantaged in the long run via the purchase of their goods or services. This philosophy is not inconsistent with the traditional role of the loan officer. Grameen loan officers go out to the villages and monitor the progress of their microcredit product/service to ensure the mutual benefit of the transaction (Severino, 2009). Further, these loan officers continually educate their customers throughout the period of the arrangement with an eye towards developing their next customer. These are all sales and marketing functions. The Grameen loan officers would appear to have extremely rewarding positions that would epitomize the most positive and responsible aspects of sales.

One interesting corollary between Grameen's microcredit dissemination techniques and traditional western sales methods is the use of group selling. The basic point of difference between a western "Tupperware" style party plan and the Bangladeshi women's groups is the long term and developing nature of the group. Each member of the group awaits their turn to be the "hostess" of their entrepreneurial development meeting/party projects.

Marketing also applies to the other end of microcredit and may, given the intelligent use of resources, prove even easier than dissemination. Microcredit does not exist in a Third World vacuum, but is integrated into the global village. The global village has never been smaller or more accessible than now, due to the greatest marketing tool yet devised: the Internet. It is now commonplace for individuals from locales as diverse as China, South Africa, Colombia, Slovenia, and Ohio to communicate, discussing everything from politics to movies to any imaginable topic.

The Internet is transforming everything and microcredit is no exception. On one end is the potential for borrowers (or, more likely, their loan officers) to submit applications from the field via smart phones using internet platforms and eliminating the need for multitudinous branches or treks by borrowers to distant offices. Technology allows microcredit to be "micro" at both ends. Even now, an individual interested in following Dr. Yunus example may visit

websites such as [www.kiva.org](http://www.kiva.org) and review loan requests which are coordinated through and disbursed by microfinance banks in the appropriate areas. An individual may choose to extend a 25 dollar loan to Juana Gelsamina Maldonado of Honduras to fund her clothing business. When that loan is repaid, they might choose to keep the money in play and extend it to Batbaatar Pagam in Mongolia so he can buy the wood and supplies necessary to expand his furniture business and achieve his dream of sending his children to college.

Most of the time spent on the Internet involves social networking sites like Twitter, Facebook, and interactive gaming sites. The influence and example of celebrity is also amplified by the Internet. Imagine Ashton Kutcher tweeting to his six million followers about how he just donated 25 dollars to help a group of women fishmongers in Uganda save their business. The self-actualized among a celebrity's followers may not be able to emulate Angelina Jolie in adopting starving children or start a foundation like Bill and Melinda Gates or have the influence of Bono or a former U.S. President. They can't walk the streets of Bangladesh looking for people to help like Muhammad Yunus. But they can see the parity in purchasing power between developed countries and those overwhelmed by poverty. They can learn just how exponentially powerful that 25 dollars can be. They can scan a site for a few minutes, find a case that moves them, enter a little bit of data, and extend a life-altering loan to a fellow human being. They can help save the poorest of the poor.

### **Banking and Credit**

Banks were affected by the 2007 financial meltdown to such a level that they stopped lending to one another. They are just now recuperating by cleansing their portfolios and tightening credit extension. This has added to the misery of the poor who previously were at the end of the line in receiving credit. Suddenly, they found themselves out of the line entirely. However, the poor may yet become the new customers of banking. Change is more accepted during a crisis recovery and during this past three years changes adapted or practiced by the microfinance banks may be adopted by the traditional or formal banking system.

The banking system has to reposition its conservative stance and allow changes to take place that will offer more informal methods of creating customers. The Indian banking industry is evolving from a more formal to a less formal system using innovative methods of gaining access by its customers. "The Prime Minister of India, during the recent platinum jubilee celebrations of Reserve Bank of India, has encouraged Banks to be more innovative" (Varadharajan, 2010, ¶ 1). The finance minister is encouraging and inviting new license applications including five international banking giants. Varadharajan further declares that the keys to insure success will be investment and innovation in technology along with credit analytics to help access new customers and profitability. While his remarks are focused on India's banking system, they apply to a new world of emerging nations.

Securing customer applications through the use of mobile phones will become the norm once a secured and fast internet banking platform is established. A new interest calculation methodology is presently in development to respond more quickly to credit interest in the accounts of savers. In addition to paying the saver faster, a customized loyalty package for bank customers will encourage the use of debit cards to help minimize the cost of increased interest payment outflows. The new biometric ATMs' sensing a user's physical characteristic such as a fingerprint or palm geometry will help build more confidence in the system. Soon checks will be phased out, thus reducing the need for conventional physical instruments and the traditional use

of written language which will be securely replaced with electronic commands in the form of symbols.

In Africa in the 1990s, the banking system in four countries made changes patterned after the Grameen Bank's marketing strategy, allowing an informal method of making it convenient for the poor in rural areas to make account and savings deposits using a community-based approach called a "Susu" system. The system is composed of collectors, associations, clubs, and companies all for the purpose of making banking more convenient. Methods to overcome distances and inconveniences of travel in the rural areas of Africa have been developed. "One example is how the susu collector function was expanded in Ghana by licensed MFIs with 'Mobile Banking' services, with officers visiting rural markets on specific days" (Basu, Blavy, and Yulek, 2004, p. 8).

Another example would be the concept of group lending. It "tends to encourage self-selection and group formation among good credit risks, addressing partially the problem of imperfect information faced by the lender, and thereby lowering the overall risk of the group lending scheme" (Basu, et al., 2004, p. 8). This concept is psychologically fascinating because of the group dynamics and risk underwriting reduction since the liability is transferred to the group. It becomes much like a co-signer guarantee in traditional banking arrangements. The whole idea of community banking is being re-invented and may well support a collective society as well as an individualistic one.

An additional consideration in product design for the Microfinance business is modifying its payment schedule to accommodate an economy that may be seasonal in nature. For example, Bank Prodem in Bolivia "shifted away from ACCION International's typical practice of offering fixed amortization schedules for its products after it spun off many of its urban branches to BancoSol. Left to serve rural areas of Bolivia, Prodem was subject to seasonal fluctuations of its agricultural-driven markets, which affected the cash flow of its clients' enterprises regardless of whether they were directly involved in this sector. Accordingly, Prodem refined its loan product to tailor repayment to the seasonal nature of the economy within which its microenterprises operated" (Brand, 1998, p. 23)

Serving the poor also requires consideration of health issues when designing a product. Several MFIs are developing products such as life and disability insurance. In many cases the coverage is not optional but rather mandatory in order to mitigate the losses by the MFI in case of widespread loss of life or disability due to natural forces.

Additional insurance coverage may be provided to offset not only personal losses of human life and disability, but the destruction of the economic base by natural forces. For example, SEWA Bank in India introduced an insurance product to offset losses from cyclones, floods, and other natural disasters (Brand, 1998).

## **IMPACT ON LOCAL ECONOMIES**

When one speaks of economic impact, one thinks in financial terms. However, there are non-financial considerations as well. For an economy to experience economic growth, most economists would agree that both are needed. On the financial side, the system needs investment in private capital as well as public capital (otherwise known as infrastructure). On the non-financial side, acquired human capital (education) as well as technology is needed. If a society or a group has not acquired human capital and technology, it must be developed or sought out.

Finally, entrepreneurial spirit, property right protection, and freedom to act in a stable political environment are required to advance consistently.

All of these are necessary not only at a macro level, but also at a micro level such as a business. A business cannot function without some sort of initial financial capital which may be a private investment to allow its operational profits to sustain it. To facilitate business transactions and operations, a viable infrastructure is required at both the entity and external levels. A home base is needed as well as ease of distributing the product or service by having an infrastructure outside the business premises which is a public investment.

The microfinance business requires all of these determinants in order to have an economic impact at both the micro and macro levels. Suffice it to say, the purpose of this paper is not to cover all of these aspects of a microenterprise, but rather surface some of them when reviewing the history of microcredit and its evolving status as a microfinance business. A simplified way to look at what is happening in the microfinance arena from an economic point of view is as follows: Most economic systems, such as a local economy, have variable forces that stimulate the economy. In traditional terms, most economists speak of Land, Labor, and Capital as the basic factors of production. By land, one means raw materials and natural resources. By labor, one means the physical as well as the human capital available. By capital, one means the machinery and equipment used to produce goods and services and not financial capital as in money.

In the case of a microfinance business, these are rearranged slightly to define capital as money. Figure 1 as depicted in the Appendix may portray a simplified economic model being pursued by the microfinance business. The X-axis denotes the human labor part of the equation. In this instance, the word “group” has been added because of its importance in the labor pool. However, labor contains the important elements of capital knowledge previously discussed. The Y-axis denotes the national resources the individual and group have to work with in a particular environment. The Z-axis is the financial capital available to the individual and group.

This theoretical microfinance economic model suggests that economic growth occurs when any combination of these factors increase. In emerging countries, the abundance of labor is apparent. However, the labor force may not have the capital knowledge in terms of education and training to be as productive as business demands. Having the natural resources readily available to produce products or services is paramount and especially necessary for the poor. The poor are “the members of the community most reliant on natural resources for subsistence and income” (Goldsworthy, 2010, p. 459-460). Issuing micro loans prevents the poor from being held hostage by lenders who set their own price and take most or even all the profit from goods produced. Herein lies the story behind microlending: making money available to those who would not otherwise have access without paying high usury interest rates. The continuous expansion of microfinance, as it is becoming known, will have an economic impact not only on the individual, the household, the community, and the region, but may have an impact on a country’s economic and political stability as well (Goldsworthy, 2010; Kuhinur & Rokonzaman, 2009 ).

Some past studies suggest that the poor can be productive if given the tools to be self-sustaining at a fair cost of money (Sebstad & Chen, 1996; Woller & Parsons, 2002). As suggested by Sebstad and Chen, “productive” is defined by positive metrics on output, asset accumulation, technology, employment, enterprise management, markets, and income. Woller and Parsons suggest a multiplier formula based on population originally developed by Ullman and Dacey (1960) to measure the economic impact on the community.

Inflation is a consideration when operating a microfinance business in certain countries experiencing soaring inflation. “High inflation would spark a need for highly liquid savings products. Not surprisingly, the majority of BancoSol’s depositors keeps small balances in the most liquid types of accounts and choose the U.S. dollar option to maintain value. Other MFIs, such as Grameen Bank in Bangladesh and the Rural Finance Facility in South Africa, have responded to housing shortages in their markets by offering a Residential credit product for their customers, especially since many microentrepreneurs run their enterprises from home” (Brand, 1998, p. 23).

In Figure 2, as depicted in the Appendix, an economic concept Marginal Rate of Technical Substitutes (MRTS) explains the relationship between two factors of production: capital and labor. In this instance, capital is defined as an asset used to produce goods and services. In a sense, the funds from the MFIs may be construed as capital because they are used to produce goods and services. The MRTS figure shows the rate at which capital may be substituted for labor while maintaining the same level of output of 100 units. This inverse relationship helps explain the trade off. If a poor entrepreneur has the funds to buy equipment and machinery, she may not have to put in as much personal and physical labor in her production of the product. In fact, the machinery and equipment may produce more goods and services for the same given time and materials.

In a hypothetical situation, each individual, family, or village has limited labor per capita. However, capital, which is at the heart of every social/economic system, may be imported or bought with funds from outside creditors. Microcredit changes the nature of this financial capital allocation system. In the case of Jobra, the allocation process was shifted from a moneylender who was able to keep 42 people in quasi-indentured servitude, to a group of women that allocated the funds on the basis of satisfying opportunities and benefits for the group. Comparatively, labor shifted from human physical labor to machinery and equipment.

Sebstad and Chen (1996) studied 32 MFIs to determine the economic impact they had on their respective communities and countries. They generally found positive effects. They examined the impact of credit (usually upon a single assisted enterprise) on output, asset accumulation, technology, employment, enterprise management, markets, and income. In a single study, Project Hope in Portoviejo, Ecuador, Woller and Parsons (2002) concluded “that the presence of multiple MFIs in local developing country economies could have a significant economic impact on those communities, in many cases possibly reaching well into the millions of dollars” (p.11).

Ayayi & Sene (2010) have extended the metrics in terms of financial stability and sustainability. Their study covered 217 MFIs from 101 countries over a 9-year period from 1998 to 2006. They provide a more concrete way of measuring economic impact as well as pave the way for investors with their statistical analysis. Additionally, they found “that the client outreach of microfinance programs and the age of MFIs have a positive but lesser impact on attainment of financial sustainability” (abstract).

## **SUSTAINABILITY**

### **Financial sustainability**

According to Richard Wilcox, head of the social banking unit at Co-operative Financial Services, it is relatively simple to measure the success of microfinance projects in traditional

financial terms (Hodge, 2010). However, success or failure is greatly determined by external non-financial factors.

The Consultative Group to Assist the Poor (CGAP) developed an index to assess MFIs performance as well as provide a forum for best practices. The index “rates how well-equipped funders are to design, implement, and monitor microfinance programs. The index focuses on the part of this chain that funders can influence most directly: their own management systems” (Hodge, 2010, p. 22). The index measures six areas of effectiveness: strategic, clarity, staff capacity, results accountability, knowledge management, and the use of appropriate management instruments. Alexia Latortue from CGAP declares, “[T]he results [from the index] have shown some consistent patterns of strength and weakness” (as cited by Hodge, 2010, p. 22). Hodge further reported that “funders tended to score best on having strategic clarity and appropriate instruments. They scored most poorly on accountability. Funders' total scores ranged from 35 to 75 out of 100, with no organisation falling in either extreme of performance: ‘very good’ or ‘inadequate’ ” (p. 22).

A sample of 217 top rated microfinance institutions (MFIs) from the MIX Market database from 1998 to 2006 by Ayayi and Sene (2010) showed that a high quality credit portfolio is the most determining component of financial sustainability of MFIs, followed by the application of adequate interest rates and effective management to control personnel expenses. Further, our results show that the client outreach of microfinance programs and the age of MFIs, whose coefficients are positive and statistically significant, have a lesser influence on financial sustainability of MFIs.” (Ayayi & Sene, 2010, p. 303).

One of the financial concerns is the transactional costs and management of small loans. “Brau and Woller (2004) corroborate this hypothesis [small loans are too costly to provide, and the resulting income is insufficient to ensure profitable operations] by showing that unlike financial institutions in the formal sector; most MFIs are not financially sustainable. They add that many MFIs could not function without the subsidies they receive from governments and other funders” (as cited by Ayayi & Sene, 2010, p. 304). The way to make MFIs financially stable is to increase interest rates to adjust for such risk factors as poor collection management, loss attributed to defaults, operational costs, adverse selection practices, and perverse contagion such as that being experienced in the mortgage industry—neighbors not paying their mortgage because each believes that others are not paying theirs. Additionally, not staggering portfolio repayments to match loan demands, local and international economic recessions, government interference and regulation, and moral hazard contribute to the MFIs’ risk. However, if interest rates rise above 60 percent per annum there will be a decrease in the loans demanded, thus reducing the number and amount of loans which leads to decreases in profits (Ayayi & Sene, 2010).

Grameen is the international benchmark for the concept of microcredit. The concept of benchmarking assumes some level of production. Prahalad and Ramaswamy (2004) suggest that microcredit sustainability could not be supported by an infrastructure such as is presently found in the Congo, and might not be needed in the highly developed western countries, but would find the most fertile environment in developing nations such as India.

### **Non-financial sustainability.**

Prima fascia differences between the Congo and India clearly demonstrate the importance of environmental factors in applicability of microcredit and hence its sustainability in a particular

market. However, it is important to know the dimensions of what factors make one country capable of sustaining microcredit and another incapable.

Jon Williams, partner at PwC says that microfinance institutions also need metrics to measure the non-financial benefits of the work they fund. "Microfinance is about empowering people who would otherwise not have had the opportunity. It's about alleviating poverty, so institutions need to be able to monitor the associated effects, such as the number of children in education and the level of home ownership in the communities concerned" (As cited by Hodge, 2010, p. 22). According to Hallen (2010), microfinance contributes to a positive social impact on three different levels: personal/household level, community level, and regional level. Probably the best and most important agents to sustain a microfinance business are the impoverished intended to benefit from microfinancing. C.K. Prahalad (2010) says, "Our best allies in fighting poverty are the poor themselves. Their resilience and perseverance must inspire the courage to move forward with entrepreneurial solutions to the problem. Given bold and responsible leadership from the private sector and civil society organizations, I have no doubt that the elimination of poverty and deprivation is possible by 2020" (p.138).

## CONCLUSION AND RECOMMENDATIONS

This paper examined microcredit as a business starting as a social inspiration. The business aspect of the microcredit concept was questioned as a viable entity. It suggests that today's society might just be ready for private individual donors and private banks along with non-government organizations to accept microcredit as a sustainable business entity. Microcredit has become a microfinance business with social inferences.

The paper provided insights on some of the business microcredit dimensions that may be changing society in the marketing of financial products and financial delivery systems as well as its impact on the poor and communities. It examined what is meant by human security, explored the marketing concepts of MFIs, addressed how banking may be changing the way it does business, and looked at how MFIs are affecting local economies. It revealed that some of the changes may be for the better while others may still be in doubt because of sustainability concerns. Regardless, Dr. Yunus has reinvented the way society looks at a business. This paper also attempted to answer several social, political, and economic questions created by microfinance business ventures.

It explored capital as a variable having multiple usages. This paper investigated the nature of the factors of production created by capital. A theoretical economic model using three variables (labor/group, natural resources, and microfinance funding) graphically displayed how MFIs may impact growth in the local community. Knowing and understanding the nature of these capital variables can lead to a deeper understanding of how to maximize and grow the output of this basic model at the individual level, the family level, and the village level.

Further, the paper investigated the premise inherent in microcredit that capital decisions may often be more efficiently made at the macro level by allowing them to be made at the most micro of levels. Finally, this paper seemed to open up more questions than it answered. Further studies are needed on how collective emerging societies are changing the way the industrialized nations will conduct business in the future using microfinance. The larger question remains: Have we crossed over to a postcapitalist society as suggested by Muhammad Yunus?

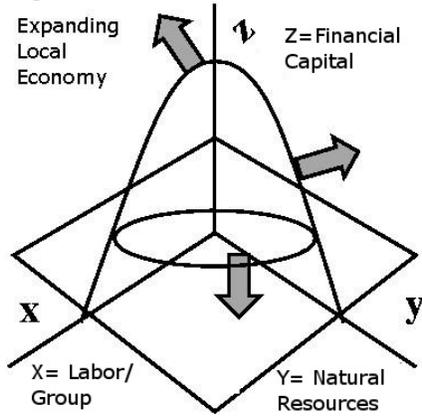
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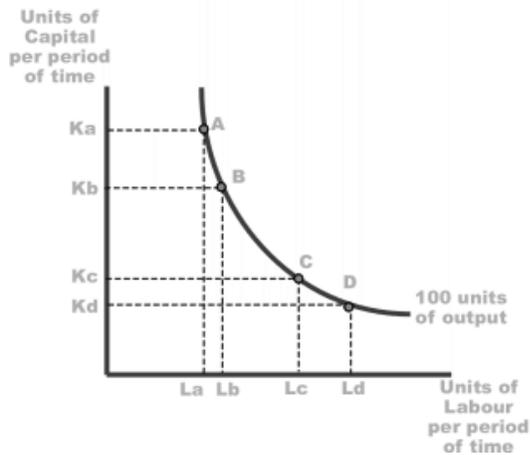
Appendix

Figure 1. Theoretical Microfinance Economic Model



Source: Valadez, R. M. and Buskirk, B. (2010)

Figure 2. Marginal Rate of Technical Substitution (MRTS)



Source: Retrieved August 13, 2010, from [http://en.wikipedia.org/wiki/File:MRTS\\_small.png](http://en.wikipedia.org/wiki/File:MRTS_small.png)