Microfinance and Poverty Alleviation in the Caribbean

A Strategic Overview

Jonathan G. Lashley

Abstract: The following paper highlights the main issues that emerged from the results of a recent study into microfinance in the Eastern Caribbean (Lashley & Lord, 2002), of which the primary aim was to make recommendations for the best practice for successful microfinance provision. It appears that despite a number of operational issues that need to be addressed, the first step in realizing a successful microfinance sector in the small states of the eastern Caribbean is to first define what is meant by “success.” In other words, donors, providers, and recipients need to be cognizant and explicit in defining the aims and uses of microfinance.

The following paper draws on a recent study of microfinance in the Caribbean, which consisted of a review of existing research on Caribbean microfinance, institutional surveys of a selection of microfinance institutions (MFIs), and a survey of those institutions’ clients. Microfinance is a term that has become ingrained in the psyche of development professionals since the founding days of the Grameen Bank in Bangladesh in the early 1970s. Although the concept of microfinance predates the Grameen Bank, as seen in the Caribbean with the formation
of institutions such as the Penny Bank in Dominica in the early 1940s, the Grameen Bank did act as somewhat of a catalyst in raising awareness of the concept as a developmental and poverty alleviation tool. This concept of microfinance basically entailed providing very small amounts of capital to allow poor microentrepreneurs to reap the benefits of their labors. Since the early 1970s, microfinance has spread globally in both the developed and developing worlds as a means to both alleviate poverty and develop microenterprises. This provision of finance to those with limited access has been relatively successful, but in some circumstances, microfinance as a tool in the development machine has lost its way. Despite success in certain arenas, there have been several failures, mostly due to a lack of appreciation of context and strategic direction. If “strategic” is defined as planning to achieve a long term aim, the problem with microfinance in the Caribbean is the lack of any single overriding long term aim. MFIs, governments, and donors in the region appear to differ widely in their long-term desires for microfinance. This retards the effectiveness of microfinance; donor funding has been withdrawn at critical times, mostly due to MFIs following different missions that are forced on them by governments, especially in regard to interest rate setting. This trend was especially seen in the island of Dominica, as highlighted in a study by Lashley and Lord (2002), which will be discussed later. In the eastern Caribbean, as demonstrated from previous research on the Caribbean in general (von Stauffenberg, 2000; Wenner & Chalmers, 2001) and case studies of Barbados and Dominica (Lashley & Lord, 2002), many microfinance operators have adopted the attitude that simply providing microfinance services will be a panacea for development ills. The specific contingent circumstances of the target population and society in general are ignored.

Jonathan Lashley is a Fellow at the Sir Arthur Lewis Institute of Social and Economic Studies (SALISES) based at the University of the West Indies, Cave Hill Campus, Barbados. Email address: jlashley@uwichill.edu.bb
Ignoring Context

Recent institutional and client surveys of MFIs in the Caribbean islands of Barbados and Dominica, among others (Lashley & Lord, 2002; von Stauffenberg, 2000), demonstrate that the lack of appreciation of specific contingent circumstances that surround the delivery of microfinance is one of the main hindrances to the success of microfinance in the Caribbean. This lack of appreciation was especially noted in terms of the following factors:

- A lack of understanding of the specific nature and characteristics of poverty. In the Caribbean this is especially true where the characteristics of poverty are rural, young, and female. There is a severe lack of targeting these specific areas, as demonstrated in the discussion below.

- A high level of government intervention, especially with governments dictating interest rate setting, mostly for political gain.

- The poor repayment culture of the population (portfolio at risk, on average, noted at 39% [von Stauffenberg, 2000]), which is believed to stem from political messages that create an “ambivalence about defaulting on government-backed loans” (Morduch, 2000 p. 620).

- A high level of development of the financial sector, in terms of commercial banks and government fiscal packages, which von Stauffenberg (2000) notes are crowding out the microfinance sector and retarding its development.

- A lack of sufficient social capital and interconnectivity of population to facilitate the successful provision of microfinance, especially in relation to a lack of cooperation among businesses themselves and among support organizations in general (Lashley, 2002).

Unfortunately the Caribbean has suffered from this lack of context in the application of microfinance. This has subsequently led
to the exclusion of the poor and the scaling-up of microfinance to reach “bankable” clients, a lack of autonomy (and, therefore, ability of microfinance institutions to target effectively), poor repayment records, the loss of creditworthy clients to the commercial banking sector, and a lack of cooperation among support organizations that should act as part of the social safety net.

In addressing these issues, the root of the problem appears to lie at the very basic mission level. Governments, MFIs, and especially donors in the Caribbean appear to lack an explicit mission for microfinance. “Microfinance” is a term that appears to mean lending small amounts of money for enterprise development, with the ultimate aim of achieving a sustainable rise in incomes above the poverty line. However, these stakeholders need to understand what poverty truly means. Poverty is more than just lack of funds; it also relates to vulnerability, defenselessness, and dependency (Bhatt & Tang, 2001).

The only way to address these issues is to fully understand the different levels of poverty and the different needs of the various subgroups. While microfinance by itself may address the needs of persons just below the poverty line, those lower down the poverty scale may need microfinance in conjunction with other human resource development measures, skills training, and the like. Stakeholders in the Caribbean are not appreciative of this multidimensional view. There the majority of MFIs are minimalist (providing credit services alone), and this approach is encouraged by donors who are determined that the institutions that they fund achieve sustainability in as short a time period as possible. This view occurs despite the fact that the externality of educational provision requires subsidization for those on the lower end of the poverty scale.

**Differing Stakeholder Goals**

Aside from this issue of understanding the characteristics of the various groups within the “poor” category, the microfinance stakeholders need to explicitly define their goals for microfinance.
Currently, there appears to be three separate, though not distinct, direct goals for microfinance in the Caribbean.

First, on the institutional side there is a concerted drive toward self-sufficiency in the medium to short run. It is clear that if this is the main aim, the poor will suffer and, as seen so often in these small states, a scaling-up of services to reach more reliable, "bankable," clients will result.

The second apparent goal for microfinance is microenterprise development. MFIs seek to encourage enterprises to grow, thereby acting as a poverty prevention measure rather than strictly a poverty alleviating measure. It can thus be seen that a primary goal of microenterprise development does not necessarily relate to poverty alleviation.

The third apparent goal for microfinance, however, appears to be to alleviate poverty directly. Although directly targeting poverty through microfinance necessarily involves microenterprise development (highlighted above as the second apparent goal of microfinance), efficiency may not be a consideration in awarding finance to alleviate poverty, as it is with the goal of microenterprise development.

This is the point where the picture becomes clouded and "success" needs to be defined explicitly by governments, MFIs, and donors. Is the goal of microfinance to create sustainable MFIs, develop the microenterprise sector, or alleviate poverty? If all three, who has which goal?

Between the stakeholders in microfinance, goals differ widely and hazardously. The recent study of microfinance in the Caribbean by Lashley and Lord (2002) demonstrates just how detrimental these differing goals can be to both providers and recipients. In the case of a major MFI in the eastern Caribbean, the National Development Foundation of Dominica (NDFD), a substantial amount of donor funding from USAID was lost due to conflicting interests between the NDFD, USAID, and the Government of the Commonwealth of Dominica. The funding from USAID was lost due to default
rates that were considered too high and interest rates that were considered too low. USAID determined that these occurrences were detrimental to the future sustainability of the institution and hence decided to terminate a large amount of their funding. Their mission obviously included the desire to see the fostering of sustainable microfinance in the region, a noble mission, but one not commensurate with that of the NDFD or the Government of Dominica.

Although the NDFD’s mission was to alleviate poverty through microenterprise development, opposition was met from the Government of Dominica who declared that the poor of the country could not afford high interest rates. Indeed, in a recent interview with the Prime Minister at the time, Dame Mary Eugenia Charles, it was explicitly apparent that she still held to the belief that if interest rates were too high, nobody was going to borrow (Charles, 2002). This is contrary to evidence from MFIs in Latin America and Southeast Asia. However, in the Caribbean, the specific contingent circumstances and orientation of governments has led to a lack of self-sufficiency among the region’s MFIs. The NDFD, was pressured to charge lower interest rates to placate the government so that the NDFD could retain certain privileges.

To further complicate the situation, the NDFD, seeking some form of sustainability, was at one point in time charging interest on grant funding from the European Union. However, demonstrating the divergence in goals among different stakeholders, the donor did not believe that the NDFD should be earning an income from grant funding. The NDFD was subsequently instructed that they were to cease such practices, despite the fact that such interest income was being used to cover the expenses of distributing the grant to those in need.

This demonstrates the quandary in which the NDFD and Caribbean MFIs in general find themselves. Funding for poverty alleviation schemes is scarce, and the poor are suffering as they are crowded out by credit-worthy clients that see these “cheap” loans as a means to further their own fortunes.
This is a situation MFIs are forced into as a consequence of both donor instruction and government intervention. However, this particular case is not unique to the Caribbean. Coordination and cooperation is needed in explicitly defining the mission of microfinance among the main players. The defining of this mission needs to be strategic; a common goal needs to be defined. If the ultimate goal is self-sufficiency for MFIs, then there will almost certainly be a scaling-up to reach more “bankable” clients. Proponents of this approach believe that a “trickle-down” effect will be seen: by reaching more “bankable” clients, the sustainability of the MFI can be enhanced. This is expected to be followed, eventually, by an increased ability to serve the needs of the poor.

Parallels to this can be drawn from the state-led development strategies employed in the developing world that led to the economic failures in the 1980s. The implicit trickle-down nature of these state-led strategies did little for poverty alleviation. This is highlighted in a sense by Woller and Woodworth (2001), who note that although these state-led strategies were initially thought to be effective, their legacy turned out to be “reduced living standards, widespread poverty, high and persistent inflation and unemployment” (p. 268–269). In the developing economies of the Caribbean, where poverty is at high and unacceptable levels, poverty alleviation should be a primary concern (Lashley, 2001), not the potential outcome of any trickle-down development strategy.

From recent investigations (Lashley, 2003) it appears evident that microfinance programs directed specifically at poverty reduction will not be self-sufficient in the short or medium term. Maybe they won’t be self-sufficient in the long term either. This is mainly due to the time it will take to ameliorate the missions of stakeholders, reduce government intervention, and breed an enterprise culture that encourages strict financial discipline. These three factors (divergent missions of stakeholders, government intervention, and a lack of an enterprise culture) are the most important problems to overcome in
order to achieve successful microfinance provision in the Caribbean. If these problems can be overcome, MFIs may become sustainable in the Caribbean, even if they remain dependent on scarce donor funding. This can be achieved by encouraging efficiency in administration and by governments and donors realizing that strategic support is still needed. Many programs can be sustainable and may even in the long term achieve the holy grail of microfinance: the realization of poverty alleviation, successful microenterprise development, and financial self-sufficiency.

**Achieving Poverty Alleviation through Microfinance**

To achieve poverty alleviation through the provision of microfinance, a variety of measures will need to be undertaken. Especially as this goal relates to identifying the poor and their microfinance needs, as will be highlighted later. By identifying who the poor are and what their microfinance needs are, Caribbean MFIs will be able to address two important problems hindering MFI development in the Caribbean. First, the scaling-up problem, where MFIs seek out more credit-worthy/wealthier clients in order to achieve sustainability, will need to be avoided as it excludes those who are more in need to access credit.

Second, “poaching,” when commercial banks deliberately pursue more credit-worthy MFI clients must be avoided. By avoiding “poaching,” improving clients are retained until they no longer qualify for support and are ready to enter the commercial banking sector (they achieve sustainability). This is not only important for MFI as they maintain adequate loan portfolios, but also for the microentrepreneurs, to ensure that they are not enticed into the commercial banking sector before they are ready.

Commercial banks’ “poaching” of successful MFI clients is frequent in the Caribbean. However, these poached clients are the first to suffer at the hands of those commercial banks when
economic declines occur. This was one of the chief frustrations expressed by MFI managers in Lashley and Lord’s (2002) study of experiences and best practices in microfinance in the Caribbean.

Overall, if the goal is poverty alleviation through micro-enterprise development, there is an integral need to identify the following:

- Who are the poor? That is, who are the beneficiaries of microfinance to be?
- What are the main financial needs of the poor? Is it credit alone or does a multifaceted approach need to be implemented?
- How do MFIs, donors, and governments ensure that the poor benefit from microfinance?

To achieve poverty alleviation, these three points must be the foundation of any strategic microfinance initiative.

Apart from these specific poverty related issues, and in addressing the issue of context, there are several other issues in the Caribbean that the stakeholders need to be cognizant of. These points include:

1. The problem of small size in the eastern Caribbean (the Organization of Eastern Caribbean States and Barbados) and the related inability to achieve economies of scale. This is one of the main points that makes the MFI movement in the Caribbean a different creature than in Latin American and Asian microfinance. The eastern Caribbean has a population of just over 800,000 persons, dispersed across ten islands, making economies of scale in microfinance provision a virtually impossible achievement.

2. The nature of poverty in the Caribbean is rural, female, young, and undereducated, a trend seen worldwide. Caribbean MFIs that specifically address these groups are scarce. The rural poor are generally ignored due to the difficulty of monitoring their activities and the issue of seasonality in agriculture. Most programs are based in the main towns and recipients are mostly urban dwellers. Although elements of the
rural population do benefit from microfinance provision, specific targeting of this group is lacking as the Rural Development Commission in Barbados and the rural community-based Special Projects Assistance in Dominica are the only two organizations of any repute that practice specific targeting. There are no female-orientated MFI programs in the eastern Caribbean, although some NGO MFIs do include such an orientation in their mission. However, in looking at the distribution between males and females served, there appears to be little relation between males and females served, there appears to be little relation between males and females served.

3. Youth is the only group of the poor explicitly served by MFIs in the eastern Caribbean. There is a growing acceptance in several of the islands that the promotion of youth in business is a credible tool in any development strategy. This is especially seen with the growth of youth business trusts in the Caribbean. Programs such as these are up and running in Barbados, Trinidad, Jamaica, and Guyana and are overseen by Youth Business International. However, these organizations are charitable in nature and have only small portfolios, some as low as US $500,000. Related to the issue of a lack of education among the poor, MFIs in the Caribbean ignore this characteristic because microfinance programs are minimalist, providing finance alone, and do not address the training needs of this target group.

4. Caribbean governments are highly interventionist, creating market distortions by their involvement in the delivery of microfinance and in interest rate setting.

5. There is a poor repayment culture in the Caribbean. Loans are considered as handouts, and as noted by von Stauffenberg (2000) in his examination of fifteen MFIs in the region, median portfolio at risk is 39%.

6. The Caribbean is a heavily banked region unlike Latin America; this leads to the loss of creditworthy MFI clients to the commercial sector before full maturity has been achieved. Although graduation is important, premature graduation in times of prosperity does little to enable clients to cope with the pressures that occur during times of economic hardship.
7. There is a severe lack of networking among support organizations and among businesses themselves. There is a distinct need for encouraging cooperation among all parties to ensure not only more efficient allocation of financing, but also a greater amount of social capital, which has been seen to be particularly beneficial to the success of the microfinance movement (Yunus, 1998). This is shown in the case of Barbados, where a recent survey indicated that over 80% of small business persons never used the support provided by business organizations or participated in any sort of business-to-business networking (Lashley, 2002).

Summation

In essence, the nature of this complex problem lies in stakeholders not defining what is meant by successful microfinance. Unless governments, donors, and microfinance providers can explicitly and strategically define the mission of microfinance, the microfinance movement in the Caribbean will continue to flounder. What does the term “successful microfinance” mean? Is it institutional self-sufficiency, the sustainable rising of incomes above the poverty line, or a successful microenterprise sector? Indeed it may be all of these things. However, donors, governments, and MFIs need to identify their primary aim for microfinance. They must identify poverty alleviation as a primary aim, with the eventual aim of enterprise development and eventual sustainability; or they must aim at successful microenterprise development, with the desire to achieve sustainability and eventually target the poor. This study indicates that the poor need to be clearly defined and identified if microfinance is to return to its original mission and act as an effective tool in the alleviation of poverty in the Caribbean.

An important caveat here is that everyone concerned must be aware that it is the availability of finance to the poor that is important, not the cost of finance. Taking an alternative view will only result in dire consequences for the poor. Low, unsustainable interest rates will lead to the crowding out of the
“real” poor, as others who are bankable apply for these “cheap” loans. Not only will MFIs suffer if the government or donors insist on “cheap” loans for the poor, but the poor themselves will also suffer as they are forced to compete for scarce funds with the more “bankable” nonpoor.

References


Charles, M. (2002). Interview by Tracey Robinson, 12 August. Residence, Roseau, Dominica. Tape Recording. The Dame Eugenia Collection, Centre for Gender and Development Studies, University of the West Indies, Cave Hill, Barbados.


