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After microcredit comes microinsurance. Lately, the idea of microinsurance has caught the attention of researchers, NGOs, donor agencies, policy makers, and social scientists involved in tackling poverty. The optimism that accompanies microinsurance stems mainly from two different sources: (1) the success of microcredit programs in ameliorating the conditions of the poor in different parts of the world by enabling them through asset and/or skill formation to generate sustained income (Morduch, 1999a), and (2) the growing recognition of the role that risk plays in the lives of the poor, and hence the need to increase the ability of the poor to cope with their various risks. Improving the risk management capacity of
the poor has come to be viewed as an integral part of any poverty alleviation program (Holzmann & Jorgensen, 1999).³

Although the empirical literature on the impact of microinsurance schemes is limited, the available research suggests that microinsurance, if properly designed and implemented, can provide an effective mechanism for meeting the health care challenges of the poor. Microinsurance schemes meet these challenges by reducing out-of-pocket health expenses of poor households and improving their access to health care services.⁴

The potential upscaling, extending, and expanding of microinsurance programs crucially depends crucially on affordability, that is, to what extent resources for meeting health care costs can be mobilized by the people themselves.⁵ Limited reach and the coverage of the existing microinsurance programs alone are not sufficient reasons for the poor to question the affordability of premium, and hence justify their need for subsidizing premium. In this paper we explore the issue of affordability and demonstrate with the help of a simple analytical device how institutional rigidities, in particular credit or borrowing constraint, suppress low-income households' demand for insurance, households that could otherwise afford to pay for insurance, and how households without insurance become vulnerable, forcing them into the poverty trap.⁶

This paper is organized in the following manner. In the next section we give a brief overview of microinsurance and highlight the importance of the affordability issue in the context of community-based health insurance schemes. After that we show with the help of a simple analytical device how easing credit constraint could potentially increase demand for microinsurance, thereby decreasing the risk of poor households falling into the poverty trap. In the following section we review appropriate government intervention in the light of our analysis. The last section concludes the paper.

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Overview: Health Risks, Microinsurance, and Affordability

Insurance is not the only way to deal with risks, and not all risks are insurable. However, health risks such as those relating to illness, injury, disability, maternity, and the like are considered to be eminently insurable, as these risks are mostly independent or idiosyncratic (i.e., not correlated among community members). Moreover, among the several risks that face poor households, health risks are considered to be crucial as they have destabilizing effects on household finances—directly, by forcing health expenditure and indirectly, by affecting the income earning capacity of households (Asfaw, von Braun, Admassie, & Jutting, 2002). Hence the need for a two-pronged strategy: (1) an aim at improving the health status of the poor, and (2) an aim at protecting the poor from the financial consequences of illness of other medical problems. For this reason, microinsurance that essentially protects households against the financial consequences of illness is regarded as a complement to, not as a substitute for, other health interventions.

Amidst shrinking government budgets, the failure of markets to reach the poor, and the widespread criticism of levying user charges, community based arrangements have aroused much interest and hope that health care challenges facing the poor can be met. Microinsurance is considered to be an important financing tool to protect the poor from adverse financial consequences in the event of sicknesses or ill health. While the out-of-pocket expenditure on health care payments imposes great financial hardships on the poor, community based health insurance is an effective way to finance health care costs. Health insurance that is determined by pooling the risks of members participating in health insurance lessens the financial burden of members affected by illness. Indeed, several types of community based health insurance schemes have emerged in sub-Saharan Africa (Wiesmann & Jütting, 2000; Atim, 1998), Asia (Krause, 2000) and other regions (Bennett, Creese, & Monash, 1998; Jakab & Krishnan, 2001). Some of these
schemes are community based, while others are based on membership in a particular group. In this paper these community based and member based arrangements are collectively referred to as community financing schemes. In some cases, a health insurance feature is embedded in the other types of functions that community or member based organizations provide. In fact, some microfinance programs have successfully introduced insurance on a limited scale (Morduch, 1999b).

Community health care financing schemes are usually based on the following characteristics: voluntary membership, nonprofit objective, link to a health care provider (often a hospital in the area), risk pooling, and reliance on an ethic of mutual aid/solidarity. These finance schemes have an advantage in their ability to reach low-income people in rural areas who work in the informal sector and are otherwise difficult to reach and their ability to exploit social capital to bring about greater awareness, correct for adverse selection and moral hazard problems, encourage preventive measures, and increase access to health care. But community based schemes also have certain weaknesses, such as a low capital base, a low level of revenue mobilization, frequent exclusion of the poorest of the poor, small size of risk pool, limited management capacity, and isolation from more comprehensive benefits.

However, the reach of existing microinsurance schemes is still limited although attempts are continually being made to involve more and more people by upscaling, extending and replicating the schemes. In extending the reach of microinsurance, demand side and supply side factors and other factors relating to design and development of schemes are important (Dror & Jacquier, 1999; Wiesmann & Jütting, 2000; Siegel, Always, & Canagarajah, 2001). However, this paper focuses only on the demand side factors, in particular on the issue of affordability.

By and large the literature on demand side factors is limited. A few microlevel studies that have tried to estimate demand for health insurance based on the willingness and the ability to pay for it have had positive findings. A survey-based study on willingness
to pay, even in the case of Ethiopia—one of the poorest countries in sub-Saharan Africa—shows that the poor are willing to pay up to 5% of their monthly income (Asfaw et al., 2002) to have a scheme that can take care of their illness costs. Jakab and Krishnan’s (2001) review of existing schemes highlights that (a) microinsurance schemes can raise substantial resources but must obtain additional funds from donor agencies, the state, or health care providers, and (b) the poorest of the poor in a community are often excluded from microinsurance schemes. In order to increase this group’s access to microinsurance, some schemes have developed mechanisms that lower entrance barriers for the poorest (e.g., flexibility in premium collection and exemption mechanisms).

One of the common perceptions about the poor is that they are too poor to either save or buy insurance. In other words, the poor are too poor to have insurance. While this may be true for the poorest of the poor who struggle to survive every day, it is not necessarily true for those living close to the poverty line (Martin, Hulme, & Rutherford, 1999; Zeller & Sharma, 1998). For people living close to the poverty line, their apparent inability to join insurance schemes may not be the result of affordability per se, but it may be the result of institutional rigidities such as credit constraint that prevent their latent demand from translating into effective demand for health insurance. In such situations, easing credit constraint rather than subsidizing premium may help improve the reach of microinsurance schemes. The manner in which borrowing constraint impinges on poor households’ demand for insurance is demonstrated in the next section.

**Insurance Demand**

In this section we first analyze how borrowing constraint may affect the demand for insurance in general, and then we show how it influences insurance demand in the case of poor households.

**The General Case**

For this study, we used a two-period model in which a typical risk averse individual (or household) faces no uncertainty in
the first period and therefore has a fixed given income \((y)\). In the second period, however, the individual has a random income. For simplicity we assume that there are only two possible states of nature: (1) a good state in which individual income is \(y + z\) and (2) a bad state in which individual income is \(y - z\). The bad state in this context refers to the state of the individual becoming sick.¹⁹ The probability of the bad state, denoted as \(p\), is assumed to be 0.5. The risk averse behavior is captured by the restriction on the utility function, \(U\), that is, by its strict concavity \((U' > 0 \text{ and } U'' < 0)\). Expected utility of the individual in the absence of insurance is given as

\[
EU = U(y) + 1/2 \{U(y - z) + (y + z)\}
\]

Notice that the income loss suffered by the individual in period 2, if the bad state occurs, is \(2z\), and the discount factor is assumed to be 1 (unity).²⁰

We first consider a case where the individual faces no borrowing constraint. Furthermore, we assume that the individual can buy as much insurance coverage as wanted at actuarially fair price.²¹ According to existing insurance literature, at an actuarially fair price, the utility maximizing individual would demand full insurance coverage (see Mas-Colell, Whinston, & Green, 1995, pp. 187–188). If \(D\) represents demand for insurance, full coverage implies \(D^* = 2z\). The utility of the individual after the maximization would be

\[
EU = U(y - z + B) + U(y + z - B)
\]

where \(B\) represents borrowings by the individual. Since we have assumed no borrowing constraint, the optimal borrowing is one that would equalize income in both periods. This occurs when \(B^* = z\). Substituting \(B^*\) in the above condition equation yields \(EU^* = 2U(y)\).

If the individual faces a borrowing constraint (i.e., \(B' < z\)), his demand for insurance would be partial. For example, suppose that the individual cannot borrow at all. If the individual still demands full insurance, his utility would be \(U(y - z) + U(y + z)\),
which is lower than his initial utility \((U(y) + 1/2\{U(y - z) + U(y + z)\})\), suggesting that he would demand partial and not full insurance. Now, if we allow for some borrowing but the borrowing falls short of the optimal level, the demand for insurance would continue to be partial.

Basically, from a point where the individual demands partial or no insurance and faces a borrowing constraint, the individual’s demand for insurance increases as borrowing constraint is relaxed. This result is formally stated and proved in the proposition given in Appendix 1 to this paper.

**Demand for Insurance by the Poor**

Since the paper deals specifically with the poor’s demand for insurance, we characterize the poor by assuming that they are at (or close to) their subsistence level in the current period (i.e., period 1), and face credit constraint (a well known fact about the poor in the developing world). An important implication of this assumption is that the poor cannot spare much, if anything, from their current income to insure their future. Let \(c\) denote the minimum consumption needed by the individual to remain at the subsistence level. In the above construct, let the relationship between \(c\), \(y\), and \(z\) be defined by the condition, \(y - z < c = y\). This condition implies that the individual is only able to meet his minimum consumption (defined by \(c\)) in period 1. In period 2, the individual runs the risk of falling below his subsistence level (or the poverty line), in the case that the bad state (illness) occurs. In this case, if the individual cannot borrow at all, he will not demand any insurance. However, if the individual can borrow, he will demand full insurance, yielding utility \(EU^* = 2U(y)\). Thus, the individual is able to stay above the poverty line (i.e., the individual is able to meet minimum consumption needs in both periods). This example is specifically constructed to highlight the importance of subsistence consumption that creates constraints on the individual’s demand for insurance. If the poor individual is allowed to borrow against his future income, his demand for insurance will go up. This is the situation in which the poor are
aware of the benefits of purchasing insurance but cannot set aside any money from their current income for the purpose. In reality, borrowing for insurance need not necessarily take the form of actually taking credit at the prevailing interest rate. In fact, many schemes are designed to compensate for this fact. For example, a flexible premium option is one of the ways to address this issue. Another way to address this issue is to create a common pool of funds that can be used to give soft loans to group members. Although there is not a lot of literature on microinsurance, there is already some evidence available that illustrates this effect. In fact, many microfinance organizations dealing with savings and credit have been successful in introducing and running microinsurance schemes.

Although in the above construct we equate consumption with income \((c = y)\), it is not crucial for the result. To show this, assume that \(c < y\), that is, the subsistence constraint is not rigidly defined. Assume further that the individual cannot borrow at all. In the normal case (in the case of the nonpoor), we noted that in the absence of any borrowing facility, the individual would demand partial insurance. Let this partial coverage be denoted by \(z^o\). Now in the case of the poor individual, who is faced with constrained subsistence, it may not be possible to buy even this partial coverage. This would be the case when \(\{y - (z^o/2)\} < c < y\), that is, when the amount over and above the individual’s subsistence consumption is insufficient to pay the premium required for this coverage. In this situation, his demand for insurance would be lower than \(z^o\), and allowing for borrowing would then increase this demand level.

To show that the above analysis is not a unique case, we also performed some robustness tests. In particular, we checked how the lack of access to credit affects demand for insurance under two different income scenarios (i.e., different combinations of present and future income). This is shown in Appendix 2 where we illustrate that the above result is also applicable to alternate income scenarios, and is not due to the specific example constructed above.
Thus, in the above analysis we show how subsistence constraint faced by the poor who can otherwise afford insurance interferes with their purchase decision, and how access to credit can mitigate the effect of subsistence constraint.

It must be stressed that the setting we outlined above is not applicable to the poorest of the poor for whom affordability is indeed the major issue, leaving them dependent on public subsidy.\(^{25}\) The setting outlined in our study is applicable to those who, though currently living above or on the poverty line, are likely to fall into the poverty trap in the event of any unexpected major health issue.\(^{26}\) If such people have access to credit, their need for health insurance may get translated into terms of effective demand for insurance; this translation fails due to their subsistence constraint. However through purchase of insurance, the poor may be able to protect themselves against the risk of falling into the poverty trap.

The existing literature points to the circularity between poverty and vulnerability: poor people are more vulnerable (exposed to risk), and their vulnerability is the cause of their poverty. In other words, the link runs both ways (Martin et al., 1999). The above analysis shows how the presence of credit constraint might reinforce this circularity, and how this cycle can be interrupted by easing such constraint. Another aspect where the above analysis can be useful is in understanding the order of priority between savings and credit on the one hand and insurance on the other. Whereas the importance of financial services (savings, insurance, and credit) in risk management literature is well recognized, it is not clear how to prioritize the allocation of public funding and effort between savings and insurance. This confusion occurs in the question of whether access to voluntary, flexible withdrawal of savings and credit should receive a higher priority over insurance or whether insurance should be assigned a higher priority than savings and credit. The above analysis indicates that savings and credit functions should at least be undertaken concurrently with insurance, if not before insurance. Perhaps it is appropriate to embed microinsurance
functions in microcredit schemes that already exist—a suggestion about which there is some mention in the current literature (Sadoulet, 2001).

The Role of Public Intervention

There is no doubt that the poor living in developing countries need public health intervention. Where affordability is the issue, government subsidy is clearly needed and an important policy issue here is the extent and the appropriate form that the subsidy should take. Our deceptively simple model is powerful enough to highlight several aspects dealing with this issue.

First, public intervention has an important role in upscaling, extending, and replicating microinsurance schemes that have emerged as promising routes for health care financing. One important role that public intervention plays is in the removing of present institutional rigidities (e.g., in labor, credit, and product markets). These rigidities may take the form of pre-existing patron-client relationships, interlinking of wage and credit contracts, various government controls, and so on.27 The presence of such rigidities prevents the poor from fully participating in market opportunities. The above analysis shows that removing these rigidities, in particular, easing credit constraint, may be an appropriate way to translate latent demand for insurance into effective demand. However, this channel is likely to work mainly for the poor who are currently able to meet their basic needs but face the risk of falling into the poverty trap in the future. For people who could afford premium except for the institutional rigidities, subsidizing premium may not be an appropriate strategy. In fact, subsidizing premiums bears the disadvantage of potentially aggravating associated moral hazard problems.

Second, for the poorest of the poor who are already below the poverty line, easing of credit is unlikely to generate insurance demand. If credit is made available to them, it will in all probability be used to meet their current basic needs instead of for protection against future risks. The poorest of the poor need direct public support to meet their health care needs. These
needs can be met either directly through free access to public health care services or indirectly by integrating them into microinsurance schemes and subsidizing premium. The idea behind integrating the poorest of the poor into microinsurance schemes is to enlarge the risk pool and thereby make the existing schemes more stable. Without subsidizing premiums, the poorest of the poor cannot be integrated into such schemes, since no resource pooling (distinct from risk pooling) can be effected by selling insurance to them. How can these people be integrated into microinsurance schemes? Suppose that a microinsurance agency already offers insurance to members of a village community in which some members are too poor to afford insurance. If the government has a policy of subsidizing the premium for these poorest members, then the insuring agency can, for example, collect premium from the government after submitting proof of providing insurance to the poorest of the poor, who can be well identified.

Third, some inferences can be drawn from the design and development of microinsurance schemes. For example, schemes that allow flexibility in payment of premium (small amounts collected more often; allowing premium in kind as well as monetarily) are more likely to succeed, because such flexibility can actually serve in the role of credit.28 Perhaps a credit facility could be built into the schemes by having a separate pool that can be used for paying premiums of members who are unable to make premium payments on time. Also, linking credit exclusively for the payment of premiums may also counterbalance its dissipation in meeting other less urgent needs.

In a broader sense, public intervention can play an important role in risk reduction activities such as improved sanitation, preventive health care, and controlling for communicable diseases. The burden of these shocks falls inequitably on the poor. Public intervention can contribute to the success of microinsurance schemes by insuring against the covariate risks that undermine microinsurance arrangements against uncorrelated shocks. Moreover, public intervention can also make microinsurance programs viable at least in the early stages of their formation.
when these programs may have difficulty in breaking even because of limited risk pooling capacity and low capital base. Public intervention could also create a greater awareness among the people about protection through insurance.29

Reinsurance, a mechanism designed to guarantee the solvency of institutions that provide insurance, is one of the ways in which public intervention could contribute to the viability of microinsurance schemes (Dror & Prekar, 2002).30 Because microinsurance is generally offered to a targeted population living in close proximity, the risk pool is not well diversified across geography, occupation, age, etc. Hence, there is a greater need to parcel out risk by transferring (also called ceding) it to a specialized agency (reinsurer) that insures the primary insurers. Just as the poor have no access to insurance, microinsurance institutions typically have no access to reinsurance as well.

**Conclusion**

In the context of the discussion on extending the reach of microinsurance schemes, which hold promise for reducing health related shocks facing poor households, it is essential to make a distinction between those who can afford health insurance and those who cannot. A lack of demand for insurance need not necessarily be the result of affordability, thereby justifying the need of government subsidy, but may be the result of other institutional rigidities, such as borrowing or credit constraint. This would mean that it is probably wise for donor agencies to look for potential ways to embed microinsurance in existing microcredit schemes rather than creating microinsurance schemes from scratch. Further research should test this hypothesis in an empirical setting by analyzing if microinsurance schemes have fared better in an environment where credit is less binding or where credit facility is built into such schemes than in an environment in which availability of credit is more restricted.
Appendix 1

Proposition: If the credit available to the credit-constrained individual is increased, demand for insurance will also increase.

Proof: The individual has the following objective function:

\[
\text{Max } EU = U(y - 0.5D + B) + 1/2 \{U(y - z + D - B) + U(y + z - B)\}
\]

\{D\}

The first order condition (where \(D^*\) denotes the optimal coverage) would be

\[
(-0.5)U'(y - 0.5D^* + B) + 0.5U'(y - z + D^* - B) = 0
\]

or

\[
U'(y - 0.5D^* + B) = -U'(y - z + D^* - B)
\]

The above condition implies \((y - 0.5D^* + B) = (y - z + D^* - B)\), which yields \(D^* = (2B + z)/1.5\). In the unconstrained case, we mentioned that \(B^* = z\). Substituting this in the above equation confirms that optimal insurance in the unconstrained case is \(D^* = 2z\). However, if the individual is credit constrained (i.e., \(B^* < z\)), demand for insurance is constrained as well (i.e., \(D^* < 2z\)).

To see how \(D^*(B)\) changes with \(B\), we differentiate the f.o.c total with respect to \(B\). It yields:

\[
(-0.5)U''(y - 0.5D^* + B) (-0.5 dD^*/dB + 1) + 0.5U''(y - z + D^* - B) (dD^*/dB - 1) = 0
\]

\[
dD^*/dB = \{U''(y - 0.5D^* + B) + U''(y - z + D^* - B)\} / \{0.5U''(y - 0.5D^* + B) + U''(y - z + D^* - B)\} dD^*/dB > 0
\]

implying demand for insurance would increase as credit constraint is relaxed.

Appendix 2

We consider two different income scenarios (i.e., different combinations of present and future income), and each scenario
has two cases, depending on the assumption about the subsistence constraint.

Income Scenario (a): If \( EU = U(y) + 1/2\{U(y) + U(y - z)\} \). In this scenario, while first period income continues to be \( y \), it is the second period income which now becomes different—it could be \( y \) or \( (y - z) \) each with probability of .5.

Case (i): \( \{y - (z/2)\} < c < y \). In this case, the individual will only demand partial insurance, because with full insurance, first period income will fall below subsistence consumption (the expression \( \{y - (z/2)\} \) denotes income less insurance premium for full loss coverage).

Case (ii): \( c < \{y - (z/2)\} \). In this case, the individual will demand full insurance, because with full insurance, the individual gets the highest utility \( (U(y - z/2) + U(y)) \), compared to the case of either no insurance or partial insurance.

Income Scenario (b): If \( EU = U(y) + 1/2\{U(y) + U(y + z)\} \). In this scenario also, income in the first period remains \( y \), but the second period income now could be \( y \) or \( (y + z) \), each with probability of .5.

Case (iii): \( \{y - (z/2)\} < c < y \). In this case, the individual will demand only partial insurance, because subsistence constraint becomes binding before the individual reaches full insurance level.

Case (iv): \( c < \{y - (z/2)\} \). In this case, the individual may still demand full insurance.

In the context of the results of this paper, the relevant cases are (i) and (iii), because it is in these cases that subsistence constraint becomes binding, which can be eased by having access to credit.31 Note that in the above cases we have deliberately omitted the possibility of \( y < c \), because this is applicable only to those who cannot meet even their subsistence consumption (i.e., the poorest of the poor).

Notes

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1. We do not state this in any pejorative sense. We state this to illustrate the order in which research has proceeded and also to hint at the order (between credit and insurance) that we suggest in the paper.

2. Although credit and insurance are two very different concepts (for the difference between the two, see Siegel et al., 2001), it is believed that the success of microcredit shows how the impediments posed by informational asymmetries (giving rise to the moral hazard and adverse selection problems) and those relating to high transaction costs that prevent formal providers of financial services from catering to the low-income section of a society can be overcome.

3. According to Prekar et al. (2001), motivation for the provision of health insurance also comes from the failure of the public sector to provide health care at reasonable cost.

4. See Jakab and Krishnan (2001) and Prekar et al. (2001) for a summary of different case studies on the impact of community based health insurance schemes.

5. Unlike microcredit, where transfer in the first instance takes place from the credit provider to the poor, in the case of insurance, a reverse transfer takes place (i.e., from the poor to the insurance provider, for a promise of covering the loss resulting from a particular event). Therefore, in the context of insurance, affordability becomes an important issue.

6. The effects of borrowing constraint on the technology adoption by poor farmers, as well as on the risk preference of the poor, have been explored by Eswaran and Kotwal (1989, 1990) and Morduch (1994). The effect of borrowing constraints on saving behavior has also been well covered in current literature (see Besley 1995).

7. Depending on an individual’s response to dealing with risks, the literature classifies all risk management practices into three broad groups: (1) risk reduction (RR), (2) risk mitigation (RM), (3) strategies and risk coping (RC). The first two strategies are ex ante risk management strategies (i.e., used before a risky event takes place) whereas the last strategy is an ex post strategy (i.e., used after a risky event takes place). Insurance, similar to savings and borrowings, is a part of risk mitigation strategy (Brown & Churchill, 1999; Holzmann & Joergensen, 2000).

8. Insurability of risks depends on the characteristics of the particular risk. Literature on risk management approach classifies risks along several lines (e.g., depending on the nature of risks—whether risk is independent vs. correlated, high frequency low cost vs. low frequency high costs—or depending on the appropriate agency handling risks). On insurability of risks, see Jütting (2002), Brown and Churchill (1999), and Siegel and Alwang (1999).
9. Unlike many health risks, political, social, and institutional risks are often covariate in nature (Weinberger & Jütting, 2000).

10. The current literature recognizes that improvement in health status is not just the result of higher incomes but is also an input for generating higher incomes, especially for the poor. This linkage has been recently demonstrated in the work of the Commission on Macroeconomics and Health of the WHO (CMH, 2001).

11. Four models of microinsurance have been discussed in the literature. In the partner-agent model, insurers, health care providers, and organizers of the scheme decide on the insurance-cum-health care package. In a community based insurance model, policyholders are owners and managers of all aspects of insurance operations. The full-service model is similar to formal sector insurance provision, and finally, the provider model where the health care provider and insurer are the same party in terms of insurance coverage is restricted to the services provided by the health care provider (Siegel et al., 2001). These arrangements should not be confused with other community schemes that merely subsidize the cost of health care for poor sick people. Such schemes are devoid of any risk pooling.

12. For example, the main objective of the Self-Employed Women’s Association (SEWA) in Gujarat, India, is to help the poor generate their own income. Since 1992, SEWA has also provided medical insurance to its members (for more information on SEWA, see Ranson, 2001).

13. Both of these problems arise due to informational asymmetry between the seller and the buyer of insurance. Generally, the buyer of insurance is more informed about his health status and care level. While adverse selection problems tend to reduce the size of membership, the moral hazard problem leads to over consumption of benefits covered under the scheme.

14. This classification is only for the sake of simplicity. In reality, it is expected that these factors are interdependent. For example, weak supply of health care services may be the result as well as the cause of poor demand. Similarly, if the design of a health insurance scheme is poor, it may fail to attract households (see Dror & Jacquier, 1999).

15. This is not to deny the role of other demand side factors, such as the social and cultural milieu in which the poor live, access to other risk management instruments, and so on. To illustrate how social-cultural factors pose a barrier to demand for insurance, take for instance the belief in some societies that to think about the consequences of ill health or death is to wish upon yourself the same. Similarly, in some societies people interpret ill health as the wish of the gods or they link ill health to fate and hence refuse any medical treatment, turning to a religious leader (Wiesmann & Jütting, 2000).
Too Poor to Demand Health Insurance?

16. Much of the existing literature on microinsurance focuses on supply and institutional issues (Siegel et al., 2001). In the words of Brown and McCord (2000), “The limited understanding of households’ needs, preferences, and expectations will have to be deepened, if future experiments in micro-insurance are to be ‘demand-driven.’

17. Demand for insurance, which is mandated by the providers of credit to the poor, needs to be distinguished from the demand for insurance that is necessitated purely by health considerations. In the former case, insurance protects the creditor’s interest against the risk of default in the event that the borrower falls ill. In the latter case, insurance protects the financial interest of the borrower in the event of illness. Furthermore, in the former case, the premium is deducted from the credit extended to a borrower, and in the latter case, timings and mode of premium collection are important determinants of demand for health insurance. In this section we analyze the latter case.

18. See Eswaran and Kotwal (1989, 1990) for more information on how borrowing constraint affects adoption of technology by farmers, as well as on how such constraints shape their risk preference (also see Morduch (1994). See Besley (1995) on the effect of borrowing constraints on saving behavior.

19. In the case of illness, the individual not only suffers income loss but also loss on account of having to bear the cost of illness (i.e., the cost of medicines etc.). In our model we do not distinguish between these two costs and treat the entire loss to be insurable.

20. This is a simplifying assumption that implies that the future is as valuable to the individual as the present is.

21. Actuarially fair price is the price at which the insurance company selling insurance is expected to make no profit. This condition characterizes the competitive insurance market. In the absence of zero transaction costs, the actuarially fair price is the same as the probability of the bad state occurring.

22. This follows directly from the definition of risk aversion, which yields $U(y) > (1/2)\{U(y - z) + U(y + z)\}$.

23. The authors visited a microinsurance experiment in T. Narsipur region of Karnataka, India, where soft loans among members of self-help groups are common. The loan can be used for any purpose, including to pay insurance premiums.

24. A recent ILO compendium of microinsurance schemes in India shows that about one-third of insurance schemes are initiated by microfinance organizations.

25. The poorest of the poor would not buy insurance even if some credit was made available to them. According to Dror and Jacquier (1999), the needs of the excluded (the poorest of the poor) are often not structured in terms of “solvent demand.”
26. According to Holzmann (2001), the group of poor that moves in and out of poverty is strikingly large when compared to the group that is always poor (poor at all dates). In fact, the poor who move in and out of the poverty could be further divided, depending on their income prospects.

27. These controls may, for example, take the form of preventing free movement of agricultural produce. The rigidity may also take the form of local government not being responsive to the needs of local people.

28. Allowing flexibility in paying premium is similar, in effect, to extending credit facility to the individual who buys insurance for the purpose of paying premium. The credit gets returned when the individual actually pays the premium amount.

29. In this context it is also important to recognize what public intervention should not do, because some interventions may actually have a negative impact on the functioning of community financing schemes (Hsiao, 2001).

30. Reinsurance in the context of microinsurance is also known by the name of Social Re

31. If $c < y$, and if there are some (fixed) transaction costs (say $T$) up front in buying insurance, the individual may be tempted to self-insure by setting aside (or saving, $s$) the excess of income over consumption ($s = y - c$) in the first period (i.e., saving in physical or financial form) rather than buying (partial) insurance. If the transaction costs are greater than the excess of income over consumption in the first period ($T > y - c$), the individual would not be able to buy insurance even if the desire or need existed.

References


Too Poor to Demand Health Insurance?


Community-Based Savings and Credit Cooperatives in Nepal

A Sustainable Means for Microfinance Delivery?

Chris D. Gingrich

Abstract: Savings and credit cooperatives (SCCs) provide a variety of microfinance services to households in three of Nepal’s distinct regions—the Hills, Terai, and Kathmandu Valley. Nearly all Nepali SCCs are self-funded using member savings and equity. Most Nepali SCCs are also profitable, including those located in poor, remote areas of the Hills region. Key reasons for the SCCs’ strong financial performance include reliance on member savings and control of administration costs. High-profit SCCs also show superior interest earnings on loans compared to low-profit SCCs. Nepali SCCs do not need concessionary funds, because they are already profitable and able to mobilize member savings. While savings-led microfinance in Nepali SCCs is a slow process, there is significant long-term outreach potential in local communities. The government and donors should pursue institution-building strategies to strengthen Nepali SCCs and should not provide concessionary funding.

By most indicators, the outlook for economic development and poverty alleviation in Nepal is bleak. Living standards in the country are among the lowest in the world and are declining in many categories. The country’s difficult topography poses challenges for market development and
limits agricultural investment options. The country is currently plagued by political instability, including a Maoist insurgency. In addition, formal financial markets fail to reach most poor households. According to one recent estimate (CECI, 2001), only 10% of rural households can access formal financial markets. Many government and nongovernment agencies implement a variety of microfinance programs to increase poor households’ access to financial services (Bhatta, 2001).

Nepal’s geography influences the nature of microfinance programs. The Himalayan mountains cover the northern third of Nepal. Sparse population and few business activities are found in this region. The middle third of Nepal—known as the Hills—contains roughly 40% of the country’s population. In Hills communities subsistence agriculture is the primary way of life. Hills topography consists of steep peaks and valleys between 500 and 3,000 meters above sea level. Many Hills communities are far removed from modern amenities and infrastructure. The Terai comprises the southern third of Nepal and features flat, fertile, and densely populated landscapes. In the geographical center of Nepal lies the Kathmandu Valley, the heart of government and business activities. Existing microfinance programs are mostly concentrated in the Terai and the Kathmandu Valley (Bhatta, 2001), though some organizations are expanding their activities to the Hills (CECI, 2001).

In general, there is much debate regarding the financial sustainability of microfinance institutions (MFIs). Critics argue that most MFIs can only cover operating costs under the most optimistic conditions (Hassan, 2002; Morduch, 1999). Sustainability is especially challenging in Nepal’s Hills. Poor communication and transportation infrastructures increase administration costs and complicate routine tasks such as savings and loan collection. Poverty is widespread in the Hills, so the requirements for clients’ savings and loan amounts are small. Limited access to urban markets suggests that microentrepreneurs in this region

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have few options for developing new products. Consequently, the conventional wisdom among Nepal’s microfinance community is that MFIs in the Terai and Kathmandu Valley find it comparatively easier to achieve sustainability than MFIs in the Hills. However, there is no available evidence that either supports or refutes this claim.

One popular type of MFI in Nepal is the community-based savings and credit organization. Organizations of this type range from informal dhikuti groups (Seibel & Shrestha, 1988) to legally recognized savings and credit cooperatives (SCCs). Nepali SCCs provide financial intermediation between cash-surplus and cash-deficit households. They differ from other MFIs because they are locally owned and managed. To paraphrase Ashe and Parrott (2002), Nepali SCCs resemble village banks without the external funds and structural rigidity typically imposed by donors. There are presently more than 1,300 SCCs in Nepal (CECI, 2001). Because these organizations are locally owned and managed, there is some suggestion that they can provide sustainable microfinance services for Nepal’s poorest rural communities (CECI, 1998). However, these institutions’ financial status and potential for sustainability is unknown.

This paper examines the financial performance of community-based SCCs in Nepal and their ability to provide sustainable microfinance services under various conditions. Special attention is devoted to comparing the SCC performance of Nepal’s distinct geographic regions—the Hills, Terai, and Kathmandu Valley. Some factors affecting SCC profitability are also identified. The following section briefly reviews the literature on MFI sustainability and SCC performance. The section after that describes the data and methods used in this study. Then Nepali SCCs’ financial performance is examined and some of the factors affecting profitability are identified. The next section discusses the implications for policy makers and the donor community and assesses Nepali SCCs’ outreach potential. The final section summarizes the paper’s findings.
Review of the Literature

Although microfinance programs promote poverty alleviation and community development (Khandker, 2003; Pitt & Khandker, 1998; Amin, Becker, & Bayes, 1998), there is growing concern regarding MFIs’ financial sustainability. A recent survey of seventy-two MFIs shows that only half are profitable even though all report a “commitment” to financial sustainability (Microbanking Bulletin, 1998). Morduch (1999) cautions that these results should not be extrapolated and that, in reality, a much smaller fraction of MFIs are financially sustainable. Many “profitable” MFIs also receive concessionary funds and do not include client training and development costs in their profit calculations (Hassan, 2002; Yaron, 1994). Bennett, Goldberg, and Hunte (1996), Schmidt and Zeitinger (1996A), and Basix and Ramola (1996) provide further examples of MFIs that fail to achieve financial sustainability.

Many factors affect MFI financial sustainability. The MFI’s orientation and philosophy, for example, play an important role. Some authors argue that most nongovernment organizations (NGOs) are not well suited for sustainability because of their social orientation (Schmidt & Zeitinger, 1996B; Dichter, 1996). Microfinance donors are also guilty of ignoring sustainability issues with their NGO partners (Von Pischke, 1996). The MFI’s orientation toward profitability affects loan repayment, efficiency, and staff productivity (Yaron, 1994; Schmidt and Zeitinger, 1996A).

There is also a growing awareness that client ownership and participation greatly affect MFI performance and sustainability (Rajasekhar, 1996; Morduch, 1999; Hassan, 2002). Bennett et al. (1996) cite evidence from five South Asian MFIs to show how reliance on member savings improves loan repayment and compels management to control costs. Ashe and Parrott (2002) find that women’s groups in Nepal’s Terai are sustainable because they are completely financed using member savings. Matthews and Ali (2002) report similar results for remote communities in Bangladesh using savings-led microfinance schemes.
Gender is another potential factor affecting MFI sustainability. Among the challenges for women’s MFIs are that women generally grow more subsistence crops than men and operate smaller businesses with low profit margins (Holt & Ribe, 1991). One study found that women’s SCCs in Nepal generally lack important inputs such as management systems, organizational visions, and networks with government and other agencies (CECI, 1998). On the other hand, women’s groups in Grameen-type programs typically show superior loan repayment and are more efficient (Hassan, 2002; Hassan & Tuft, 2001).

The evidence is mixed regarding SCC performance and financial sustainability (Huppi & Feder, 1990; Schmidt & Zeitinger, 1996a). Results from several countries show that SCCs promote member savings and client-owned structures. SCCs can also provide accurate information to management about borrowers. However, inefficiency, concentrated investment portfolios, and inadequate savings mobilization from deficit households are problems frequently found in SCCs. Moral hazard is another concern since default by a few borrowers encourages widespread default, and because local communities may hesitate to penalize delinquent borrowers.

**Data Description**

The Nepal Federation of Savings and Credit Unions (NEFSCUN) is an apex institution for Nepali SCCs. NEFSCUN’s primary tasks are SCC advocacy and the provision of development services to member institutions. There are presently 219 active NEFSCUN members.¹ These SCCs submit annual audited financial statements and membership data to NEFSCUN. Since this study examines community-based SCCs and their ability to implement microfinance activities, district-level SCCs and SCCs heavily involved in nonfinance activities (such as merchandise trading) are excluded from the sample. The latter group is defined as any SCC that earns less than 20% of its total revenue from loan interest and fees. Table 1 describes the sample SCCs used in this study. The extent to which the sample
fairly represents all Nepali SCCs is unknown, though NEFS-CUN membership privileges may lead to members’ improved financial performance over nonmembers. The most motivated and committed SCCs are also those most likely to join NEFS-CUN. Nonetheless, the sample NEFS-CUN SCCs are assumed to represent all of Nepal’s community-based SCCs.

Nepali SCCs have an average membership of 178 people, making them larger than Ashe and Parrott’s (2002) Terai-based women’s groups (roughly 20 members each) but much smaller than most MFIs worldwide. Average total assets are approximately

Table 1. Description of NEFSCUN member SCCs: grouped by region

<table>
<thead>
<tr>
<th>Variable</th>
<th>All regions</th>
<th>Hills</th>
<th>Terai</th>
<th>Kathmandu Valley</th>
<th>F-test for equality of means across regions (df=2,184)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active NEFSCUN SCCs</td>
<td>219</td>
<td>89</td>
<td>61</td>
<td>69</td>
<td></td>
</tr>
<tr>
<td>SCCs with missing or unreliable data</td>
<td>7</td>
<td>4</td>
<td>2</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>District-level SCCs</td>
<td>14</td>
<td>8</td>
<td>5</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>SCCs receiving less than 20% of their revenue from loan interest and fees</td>
<td>13</td>
<td>3</td>
<td>5</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Number of SCCs in data set</td>
<td>185</td>
<td>74</td>
<td>49</td>
<td>62</td>
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</table>

Measns (Standard deviation in parentheses)

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<tr>
<td>Age,a years</td>
<td>4.9</td>
<td>5.1</td>
<td>4.3</td>
<td>5.2</td>
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<td>(2.4)</td>
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<tr>
<td>Total assets,b US$1,000</td>
<td>25.8</td>
<td>23.1</td>
<td>19.6</td>
<td>30.9</td>
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<tr>
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<td>178.1</td>
<td>186.6</td>
<td>199.6</td>
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<tr>
<td>(312.8)</td>
<td>(312.0)</td>
<td>(431.7)</td>
<td>(175.3)</td>
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</tr>
<tr>
<td>Savings per memberb US$</td>
<td>98.9</td>
<td>72.1</td>
<td>86.1</td>
<td>140.9</td>
</tr>
<tr>
<td>(112.2)</td>
<td>(82.3)</td>
<td>(121.5)</td>
<td>(124.2)</td>
<td></td>
</tr>
<tr>
<td>Savings / total assets as %</td>
<td>72.3%</td>
<td>69.3%</td>
<td>70.8%</td>
<td>77.2%</td>
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<td>(18.9)</td>
<td>(16.3)</td>
<td>(14.1)</td>
<td></td>
</tr>
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</table>

Variable definition provided in Appendix.

Data originally measured in Nepali rupees: US$1 at 78 Nepali rupees

Reject null hypothesis of equal means at the 95% confidence level.
US$26,000, though total assets for 40% of the SCCs are less than US$6,500. Average SCC age is five years. The mean values for membership, assets, and age are not statistically different between the Hills, Terai, and Kathmandu Valley. SCCs in all three regions finance the bulk of their assets from member savings. Kathmandu SCCs are the most dependent on savings (77.2% of total assets), and Hills SCCs the least dependent (69.3% of total assets). The mean per-member savings in Hills SCCs (approximately US $72) is half that in Kathmandu SCCs, suggesting that Hills SCCs are located in Nepal’s poorest communities.

Because each SCC is locally managed, it is impossible to provide a general description of financial policies and procedures. However, discussions with SCC managers reveal several common characteristics. Unlike many MFIs, Nepali SCCs typically provide loans to individuals, not peer groups. Some SCCs provide consumption loans, while others restrict borrowing to income-generating activities. Membership in the form of equity shares is usually required to use SCC services. Many SCCs also require members to participate in a regular savings plan. Maximum loan amounts are typically calculated in proportion to individuals’ established savings.

Data limitations prevent any analysis beyond the SCCs’ financial status. Detailed loan data such as delinquency, size, and duration are unavailable for most SCCs. No data are available regarding SCC clients’ socioeconomic status. Transportation and communication infrastructures and other characteristics of the SCC communities are unknown.

Financial Performance of Nepali SCCs

Nepali SCCs earn strong profits (see Table 2). The mean rate of return on assets is 3.5%, which exceeds the 2 to 3% recommendation for MFIs from Yaron, McDonald, and Charitonenko (1998). Profitability is highest for Hills SCCs (4.4%) and lowest for Kathmandu SCCs (2.2%). Figure 1 further reveals that all sample SCCs from the Hills earn positive profits, while only about 85% of SCCs from the Terai and Kathmandu Valley are
profitable. Mean dividend yields on member shares are 19.6%, which easily exceed the current 5 to 6% yield on commercial savings accounts (NRB, 2001–2003a). There is no statistical difference in mean dividend yields between regions.

The fact that Hills SCCs are generally more profitable than SCCs in the Terai and Kathmandu Valley regions is counter

**Table 2. Profitability of Nepali SCCs: means grouped by region**

<table>
<thead>
<tr>
<th>Variable</th>
<th>All regions</th>
<th>Hills</th>
<th>Terai</th>
<th>Kathmandu Valley</th>
<th>F-test for equality of means across regions (df=2,184)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit as %</td>
<td>3.5%</td>
<td>4.4%</td>
<td>3.6%</td>
<td>2.2%</td>
<td>5.85</td>
</tr>
<tr>
<td></td>
<td>(3.9)(^b)</td>
<td>(3.2)</td>
<td>(5.2)</td>
<td>(3.1)</td>
<td></td>
</tr>
<tr>
<td>Dividend yield as %</td>
<td>19.6%</td>
<td>23.3%</td>
<td>15.3%</td>
<td>18.6%</td>
<td>0.70</td>
</tr>
<tr>
<td></td>
<td>(37.4)</td>
<td>(31.3)</td>
<td>(20.8)</td>
<td>(51.7)</td>
<td></td>
</tr>
</tbody>
</table>

Note. Variable definitions provided in Appendix.

\(^a\)Reject null hypothesis of equal means at the 95% confidence level.

\(^b\)Standard deviation in parentheses

**Figure 1. Profitability of Nepali SCCs: Distribution grouped by region**

\(^a\)Variable definition provided in Appendix.
intuitive in light of the widespread poverty and difficult geography in the Hills. One possible explanation is that Hills communities may be more committed to their local SCC. First, many Hills communities remain isolated and ethnically homogeneous, whereas Terai and Kathmandu communities contain significant immigrant populations. Common language and cultural practices in Hills communities facilitate progress toward a shared goal. Second, Hills SCCs were more likely conceived independent of donor or government programs, which creates an increased sense of member ownership. Third, there are simply fewer MFI alternatives available to poor households in the Hills. Members realize that no alternative for financial services is available if the local SCC fails.

Skeptics should rightly ask whether positive profits for Nepali SCCs are merely the result of widespread subsidies. Profit alone does not imply financial sustainability, since MFI financial statements do not necessarily reveal subsidies (Yaron, 1994; Hassan, 2002). If Nepali SCCs are financially sustainable and not just operationally sustainable, they must show independence from subsidies (Morduch, 1999). Using external loans as a possible subsidy indicator shows that most Nepali SCCs are self-reliant since the mean external loan-to-asset ratio is only 5% (see Table 3). Though this ratio is slightly higher for Hills and Terai SCCs (5.8% compared to 3.5% for Kathmandu SCCs), use of external funds is still minimal. Figure 2 reveals that over 60% of all SCCs do not use external loans, and only 15% of all SCCs have external loans exceeding 20% of their total assets. Furthermore, external loans are not widely subsidized, since mean capital costs, including the interest rate paid on loans, do not decline for SCCs with higher external loan-to-asset ratios (see Figure 2).

Mean profits for women’s and mixed gender SCCs are not statistically different (see Table 4). If women’s SCCs received disproportionate subsidies, it would nullify this result, but mean external loans and capital costs are not statistically different between each gender category. This finding supports Ashe and
Parrott’s (2002) conclusions regarding women’s savings and credit groups in the Terai. It also follows evidence found in other countries that women’s microfinance programs perform at least as well as men’s and mixed gender programs (Hassan & Tufte, 2001; Holt & Ribe, 1991).

Table 3. Nepali SCCs’ reliance on external loans: Means grouped by region

<table>
<thead>
<tr>
<th>Variable</th>
<th>All regions</th>
<th>Hills</th>
<th>Terai</th>
<th>Kathmandu Valley</th>
<th>F−test for equality of means across regions (df=2,184)</th>
</tr>
</thead>
<tbody>
<tr>
<td>External loans payable / total assets as %</td>
<td>5.0%</td>
<td>5.8%</td>
<td>5.8%</td>
<td>3.5%</td>
<td>6.20^</td>
</tr>
<tr>
<td></td>
<td>(11.5)^b</td>
<td>(12.2)</td>
<td>(11.4)</td>
<td>(10.8)</td>
<td></td>
</tr>
</tbody>
</table>

^Reject null hypothesis of equal means at the 95% confidence level.
^bStandard deviation.

Figure 2. Nepali SCCs’ reliance on external loans, including mean capital costs: Distribution grouped by region

<table>
<thead>
<tr>
<th>Distribution</th>
<th>Hills</th>
<th>Terai</th>
<th>Kathmandu Valley</th>
</tr>
</thead>
<tbody>
<tr>
<td>External loans payable/ total assets [mean capital costs]</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>above 20% [8.3%]</td>
<td>10 to 20% [7.5%]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 to 10% [8.6%]</td>
<td>0 to 5% [7.2%]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>no loans [7.0%]</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

^Variable definition provided in Appendix.
Several other factors may be associated with variations in SCC profit. Factors such as size and age are exogenous to the SCCs. Large SCCs possibly incur lower per-unit costs for marketing, rent, and other items and obtain easier access to financial markets. However, large SCCs may find it difficult to manage information, and members may experience a reduced sense of ownership. Older SCCs may earn higher profits due to positive learning-by-doing effects, while SCCs with inadequate policies and low member participation may experience decreased profits over time.

Other potential profit factors such as interest rates, administration costs, and reliance on member savings are endogenous to management decisions. High interest rates on loans receivable should increase revenue and profit, provided loan demand is price inelastic. While increased capital costs reduce profit, SCCs must pay a sufficiently high yield on savings to attract member deposits. Most importantly, the spread between the effective interest rate on loans receivable and capital costs must be sufficiently large to cover administration costs. Member savings provide incentives for increased member ownership and participation and reduced loan delinquency. Savings-led SCCs also have greater incentive to control administration costs. However,
because other funds, such as member equity or concessionary loans, may be less expensive, the a priori relationship between savings and profit is ambiguous. To investigate the above effects, the sample SCCs are grouped into profit quartiles and mean factor values are derived for each quartile (see Table 5).

Table 5 suggests that several factors are not associated with varying profit levels. Although the most profitable SCCs are relatively small, the mean asset values between quartiles are not statistically different. Mean cooperative age also does not differ statistically between quartiles. These findings for Nepali SCCs resemble those for the Grameen Bank, where neither age nor size affect efficiency (Hassan & Tufte, 2001). Similarly, there is no significant difference between mean quartile values for administration costs, capital costs, and external loans. It is especially noteworthy that high profits are not associated with increased external loans or concessionary funds. Nepali SCCs’ mean administration costs are 5% of total assets, which compares favorably with the 3 to 13% range that Yaron (1994) reports for other MFIs. This result is surprising since small loan size in poor communities and difficult topography in the Hills presumably increase per-unit administration costs. Thus, it appears that SCCs’ reliance on member savings provides strong incentives for cost control. Many SCCs also rely on volunteer labor.

For the remaining factors, there are statistically significant differences between mean quartile values. Member savings are the primary source of funds for SCCs in all quartiles, though there are some slight differences. Mean savings-to-asset ratios exceed 70% in all quartiles, except for the top quartile, at 64.7%. On average, SCCs in the first three quartiles finance at least 100% of their loans receivable using member savings; however, this share declines to 78.9% for the top quartile. In comparison, Richardson (2001) recommends that SCCs maintain a savings-to-asset ratio between 70 and 80%, and Yaron (1994) finds savings-to-loan ratios in five successful MFIs ranging from 31 to 110%. Slightly lower savings occur in the most profitable SCCs due to increased equity financing. The mean equity-to-asset ratio is almost 30%
Table 5. Potential SCC profit factors: Mean values grouped by profit quartiles

<table>
<thead>
<tr>
<th>Variable</th>
<th>All profit levels</th>
<th>Bottom quartile</th>
<th>Second quartile</th>
<th>Third quartile</th>
<th>Top quartile</th>
<th>F-statistic for equal means across quartiles (df = 3,184)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age, a years</td>
<td>4.9 (2.4)</td>
<td>5.0 (2.5)</td>
<td>5.3 (2.6)</td>
<td>5.2 (2.4)</td>
<td>4.2 (1.9)</td>
<td>2.29</td>
</tr>
<tr>
<td>Total assets, US$1,000</td>
<td>24.8 (52.0)</td>
<td>29.7 (53.7)</td>
<td>36.8 (81.4)</td>
<td>23.7 (30.7)</td>
<td>9.1 (10.9)</td>
<td>2.49</td>
</tr>
<tr>
<td>Effective interest rate earned on loans, as %</td>
<td>15.2 (6.2)</td>
<td>13.7 (5.2)</td>
<td>13.6 (3.7)</td>
<td>17.3 (8.8)</td>
<td>16.1 (5.0)</td>
<td>4.38&lt;sup&gt;c&lt;/sup&gt;</td>
</tr>
<tr>
<td>Capital costs, as %</td>
<td>7.3 (3.1)</td>
<td>7.6 (3.9)</td>
<td>6.9 (1.9)</td>
<td>8.0 (3.6)</td>
<td>6.7 (2.5)</td>
<td>1.75</td>
</tr>
<tr>
<td>Savings / total assets, as %</td>
<td>72.3% (17.0)</td>
<td>72.6% (19.1)</td>
<td>78.7% (13.5)</td>
<td>73.3% (14.9)</td>
<td>64.7% (17.3)</td>
<td>5.87&lt;sup&gt;c&lt;/sup&gt;</td>
</tr>
<tr>
<td>Savings / loans receivable, as %</td>
<td>97.8% (38.3)</td>
<td>108.4% (57.5)</td>
<td>103.9% (26.2)</td>
<td>100.4% (32.4)</td>
<td>78.9% (19.3)</td>
<td>6.01&lt;sup&gt;c&lt;/sup&gt;</td>
</tr>
<tr>
<td>External loans, payable / total assets, as %</td>
<td>5.0% (2.2)</td>
<td>8.6% (15.1)</td>
<td>3.0% (10.2)</td>
<td>4.4% (10.8)</td>
<td>4.0% (8.5)</td>
<td>2.20</td>
</tr>
<tr>
<td>Interest paid / total assets, as %</td>
<td>5.6% (2.4)</td>
<td>6.2% (3.2)</td>
<td>5.6% (1.5)</td>
<td>6.1% (2.3)</td>
<td>4.6% (1.9)</td>
<td>4.37&lt;sup&gt;c&lt;/sup&gt;</td>
</tr>
<tr>
<td>Administration costs / total assets, as %</td>
<td>5.0% (4.3)</td>
<td>6.2% (5.7)</td>
<td>4.6% (3.0)</td>
<td>4.4% (3.9)</td>
<td>4.8% (4.0)</td>
<td>1.75</td>
</tr>
<tr>
<td>Equity / total assets, as %</td>
<td>20.1% (11.7)</td>
<td>15.7% (10.5)</td>
<td>15.8% (7.8)</td>
<td>19.4% (8.1)</td>
<td>29.5% (13.6)</td>
<td>18.98&lt;sup&gt;c&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

<sup>a</sup> Variable definition provided in Appendix

<sup>b</sup> Data originally measured in Nepali rupees: US$1 at 78 Nepali rupees

<sup>c</sup> Reject null hypothesis of equal means at the 95% confidence level.

<sup>d</sup> Standard deviation
for the top quartile and between 15 and 20% for the bottom three quartiles. The advantage to SCCs of equity financing is reduced interest expenditures: top quartile SCCs have a mean interest paid-to-asset ratio of 4.6% compared to 6.2% for the least profitable SCCs. In addition, equity financing provides similar incentives as savings for member participation and ownership.

There is a clear relationship between profit and the interest earned on loans. High profit SCCs earn 3 to 4 percentage points more on loans than low profit SCCs. Whether the difference is due to higher nominal rates, improved loan repayment, or some combination of the two is impossible to know. Given Nepal’s inflation rate of 2 to 4% (NRB, 2001–2003b), high profit SCCs’ real loan earnings are approximately 12 to 15%, which resemble the upper range in other successful MFIs (Yaron, 1994).

### Discussion and Implications

Nepali SCCs are profitable and show evidence of financial sustainability, while most MFIs worldwide struggle in these areas. There are several possible explanations. First, nearly all Nepali SCCs depend on member savings. Savings create incentives for member participation in SCC activities and decisions. Similarly, because funds are generated within the local community (which Bennett et al. [1996] describe as “hot” money), borrowers are motivated to repay loans, and managers to control costs. Second, because the SCCs are community-based organizations, there are internal loan-monitoring and enforcement mechanisms. Third, many Nepali SCCs operated for years as informal savings groups before obtaining formal cooperative status. Hence, members are familiar with the principles and challenges of group savings programs.

An important question is whether Nepali SCCs sacrifice client outreach to achieve financial sustainability. Hassan (2002) and Navajas, Schreiner, Meyers, and Gonzalez-Vega (2000) suggest four possible MFI outreach categories: (1) breadth of outreach refers to the number of clients reached; (2) depth of outreach is the clients’ socio-economic status; (3) scope of outreach includes
the variety and relevance of microfinance services offered; and (4) outreach length measures the number of years an MFI provides financial services.

Nepali SCCs do face serious challenges regarding their breadth and depth of outreach. While savings mobilization in poor communities is a slow process, MFIs that use external funds can quickly provide credit to a large number of clients. Internally-financed SCCs must also charge sufficiently high interest on loans to cover all costs, which may deter poor households from borrowing. The problem is exacerbated if SCCs link clients’ credit availability to their established savings (Rajasekhar, 1996). Despite these concerns, it is unclear whether Nepali SCCs’ ability to serve poor households greatly differs from other MFIs. There is broad consensus that interest rates are only one of many costs affecting poor households’ demand for credit (Morduch, 1999). In addition, an assessment of outreach depth should also consider the number of poor households with access to savings accounts (Paxton, 2002). Nepali SCCs are strong in this regard. Finally, many Nepali SCCs serve isolated communities that are not accessed by other MFIs, thereby expanding both the breadth and depth of microfinance outreach.

Nepali SCCs’ scope and length of outreach are also quite strong. The SCCs are significantly ahead of most MFIs in recognizing poor households’ need for convenient savings instruments (Morduch, 1999). Their strong financial position may enable expanded client services, such as life and health insurance, in the future. They should also be able to serve their communities for many years. In contrast, MFIs that give insufficient priority to sustainability implicitly assume that poor households need only a one-time injection of cheap credit (Schmidt & Zeitinger, 1996B).

Findings from this study support the suggestion from Yaron (1994) and Bennett et al. (1996) that governments and donors adopt institution-building strategies to promote microfinance sustainability. There is no evidence that Nepali SCCs need external funding, since they can effectively mobilize local savings even
in poor, remote communities. Donors should instead provide support programs through a network organization—such as NEFSCUN—to easily access a large number of SCCs. As part of these programs NEFSCUN should establish regional service centers to increase its outreach and effectiveness.

Several specific institution-building strategies stem directly from this study’s findings. Such programs should emphasize (1) interest-rate management, (2) record keeping and information systems, (3) the importance of internal funding, and (4) the development of new financial products and services. SCC managers need to understand the relationship between interest rates and profits uncovered in this study. SCCs that perform poorly should be encouraged to adopt interest-rate policies that increase profit and savings mobilization. Information systems must be easy to implement and provide useful information. For rural Nepali SCCs, this means using manual, double-entry systems, since the infrastructure for computers is inadequate. However, donors should help devise improved systems that allow up-to-date loan monitoring. SCCs should be urged to effectively mobilize and manage internal funds, since external funds provide no advantages in financial performance. SCCs that pursue external funds divert attention away from internal management issues. Donors that offer concessionary funds exacerbate this problem. SCCs with strong financial performance should be encouraged to provide expanded financial services, such as insurance and flexible savings plans. SCCs will need technical assistance in these areas.

**Summary and Conclusion**

Nepali SCCs earn strong profits and show significant potential as sustainable microfinance institutions. This is true for all regions of Nepal, including the Hills. Nepali SCCs are almost entirely financed via member savings and equity. The rate of interest earned on loans is a key factor affecting SCC profitability. Nepali SCCs incur low administration costs and generate significant member savings even in poor, remote
In light of these findings, the government and donors should adopt microfinance support strategies that build on SCCs’ ability to mobilize member savings. The government and donors should give attention to microfinance institution building and should not provide concessionary funding. While Nepali SCCs may sacrifice short-term growth and outreach to achieve financial sustainability, they serve thousands of poor households in remote areas and provide a variety of microfinance services for the long term.

Appendix

Variable definitions

<table>
<thead>
<tr>
<th>Variable</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>number of years between the SCC’s most recent financial statement and its legal cooperative registration</td>
</tr>
<tr>
<td>Profit</td>
<td>(predividend surplus of revenue - expenditures / total assets)</td>
</tr>
<tr>
<td>Dividend yield(^a)</td>
<td>(profit x 25%) / member equity</td>
</tr>
<tr>
<td>Capital costs</td>
<td>(interest paid on member savings + interest paid on external loans) / (member savings + external loans)</td>
</tr>
<tr>
<td>Effective interest earned on loans</td>
<td>(interest earned on loans receivable + service earned on loans + fees earned + penalty and other fees) / loans receivable</td>
</tr>
<tr>
<td>Equity / total assets</td>
<td>(total member equity + reserve funds) / total assets</td>
</tr>
<tr>
<td>Administration costs / total assets</td>
<td>annual noninterest expenses such as rent, salaries, supplies, etc. / total assets</td>
</tr>
<tr>
<td>Interest paid / total assets</td>
<td>(annual interest paid on member savings + total annual interest paid on external loans) / total assets</td>
</tr>
</tbody>
</table>

\(^a\)Nepali cooperative law permits a maximum of 25% of annual profits to be distributed as dividends to members.

Notes

The author thanks the entire staff of the Nepal Federation of Savings and Credit Unions for their cooperation. Lynn Bennett, Carolyn Heggen, Richard Heggen, Ulrich Wehnert, Richard Yoder, and an anonymous reviewer provided valuable comments. Avinaya Shah assisted with data compilation. The author prepared this study while working for the United Mission to Nepal, Kathmandu.

1. This number does not include SCCs that are inactive but have not officially closed or cancelled their NEFSCUN membership.
2. SCCs should monitor the effective interest rate earned on loans and not merely the nominal rate. If there are service fees, penalty charges, or high loan delinquency rates, the nominal and effective rates could differ substantially. Nominal loan rates are unavailable for the sample SCCs.

3. Before 1992, the number of legally registered SCCs in Nepal was negligible. The Cooperative Act of 1992 simplified the registration process, and many informal savings groups became legal cooperatives (CECI, 2001).

References


Community-Based Savings and Credit Cooperatives in Nepal


Financial Performance of Microfinance Institutions

A Comparison to Performance of Regional Commercial Banks by Geographic Regions

Michael Tucker and Gerard Miles

Abstract: The number of microfinance institutions (MFIs) making small loans to the developing world’s poor has grown to over 7,000. With growth has come increasing competition for scarce funding. Few MFIs have reached self-sufficiency, and fewer still have made the transition to regulated financial institutions. Comparing the performance of MFIs that have attained self-sufficiency with those that have not and comparing both to regional commercial banks in developing countries on selected financial ratios reveals self-sufficient MFIs are strong performers on ROA and ROE. The majority of MFIs, however, are very weak and in need of continued subsidies. Providing financial services to the poor is an expensive proposition and may mean numerous MFIs will not reach self-sufficiency.

In the middle ground between wholly subsidized and regulated institutions, a growing number of microfinance institutions (MFIs) have attained sustainability without yet achieving regulated status. Many of these institutions are working on the time-consuming process of meeting requirements to apply to become regulated institutions. The greater levels of equity capital required to attain the status of a regulated institution are
available only to those MFIs with a high degree of reporting transparency and increased efficiency in business practices. Even for those MFIs not yet considered sustainable, an avowed goal of at least improving operational efficiency has become an important criteria expected by many organizations willing to provide capital. Comparing financial ratios and other operating data of the subsidized and the sustainable MFIs with each other and with regional commercial banks can provide insight into the progress MFIs have or have not made toward sustainability. Comparing performance with the commercial sector also points out where differences exist. These comparisons are made by matching regionalized aggregate data of MFIs as self-reported to the *Microbanking Bulletin* with data reported by commercial banks by region. Aggregate data on sustainable MFIs worldwide and aggregate developing-world commercial banks are also compared for this purpose.

**Sustainability**

Sustainability is defined as “a program’s capacity to remain financially viable in the absence of domestic subsidies or foreign support” (Woolcock, 1999). Financial self-sufficiency requires the ability to cover at least 99.5% of expenses exclusive of subsidies or grants (Microbanking, 2001). By definition, sustainability includes generating sufficient profit to cover expenses while eliminating all subsidies, even those less-obvious subsidies, such as loans made in hard currency with repayment in local currency.

**Paradox of Sustainable Microfinance Institutions**

The poverty alleviation/self-sufficiency paradox underscores the trade-off between effective service leading to poverty

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reduction and financial self-sufficiency. Focusing on sustainability and profitability might lead MFIs to seek to make larger loans to better-off clients in order to gain economies of scale that would both minimize expenses per loan and increase the probability of repayment. Such a strategy, while moving an MFI toward sustainability, would once again leave the poor with limited access to capital. A balance between larger, more likely to be repaid loans and the continuance of smaller loans to the poor can serve both goals. The balance will be difficult to attain, but a financially sustainable MFI will be able to increase borrowing in private-capital markets, adding to its ability to loan money (Gibbons and Meehan, 1999). Without sustainability, MFIs are not a going concern, making the goal of poverty alleviation unreachable (Otero, 1999).

Since MFIs have only been able to reach several million of the many million poor, there is constant pressure to expand. Expanding to service more of the poor and, increasingly, the less able to repay, necessitates more capital. At the margin, added capital is more difficult to obtain, requiring higher levels of financial sustainability and all the associated reporting requirements that entails. One avenue to attain operating sustainability, although not necessarily without elimination of all subsidies, is to increase profits by raising interest rates, fees, or both. However this method shuts out those least able to repay and increases default rates.

The strategy of extending loan services to more people in order to achieve economies of scale can lead to increasing bad debts if not done properly (Gulli, 1998). Overall, through economies of scale attained by judicious expansion and loan diversification, the larger MFIs that reach more people tend to move closer toward sustainability.

**Financial Sustainability**

As the number of MFIs has dramatically increased, their main source of funds, nongovernmental organizations (NGOs), has gained leverage in demanding more transparent accounting, audits, and, in some cases, clear plans to attain financial sustainability.
Most of the estimated 7,000 MFIs have fewer than 3,000 clients and less than a 95% repayment record (Garber, 1997). Many of these organizations have been unable to control administrative costs. For some MFIs, high administrative costs are simply a way of doing business that enables staff members to earn a living through the generosity of NGO subsidies. Job creation in the MFI itself was not the original goal, though for some, job sustainability may have become more important than minimizing expenses. This is no longer a viable strategy. Competitiveness in the market for funds is prompting a return to the original MFI mission motivated by a need for continuing access to capital.

The possibility of comparing publicly available audited statements of a significant number of MFIs with any MFI seeking funding may inspire some MFIs to alter financial figures to reflect a more robust performance than actual (Woolcock, 1999). Lack of transparency or even outright dishonesty creates difficulties for NGOs seeking to determine which MFIs can best use funding. Increasingly, NGOs require MFIs to adapt standard accounting practices to ease comparisons. Accion Camel has been adopted by a growing number of MFIs to report a variety of financial measures, such as capital adequacy, asset quality, management, earnings, and liquidity management (Saltzman & Salinger, 1998). Accion Camel is a modification of the Camel system used by U.S. commercial lenders. Using the same principles applied to commercial banks, Accion Camel adjusts some of the figures to account for differences between commercial lending and MFI practices. The result of an Accion Camel audit is a rating on a scale of one to five, providing a basis for comparing MFIs’ performances. Adaptation of Camel to MFIs is useful but imperfect. Benchmarks are useful when standardized commercial banks are being compared is but they can be less helpful when comparing far more diverse MFIs, which differ by region, client base, size, and culture. A specific MFI could have few comparable institutions to be benchmarked against. The cost of the Accion Camel system also effectively limits such an audit to the more successful MFIs.
Many MFIs have avoided audits or the more expensive Accion Camel for lack of funds or expertise or because of a desire to limit outside examination. Moving the process of formalized financial reporting to a greater level of transparency inevitably will be up to the NGOs that supply capital. In some cases, it may be necessary to subsidize audits.

The lack of widely used comparable accounting standards makes comparing MFIs difficult. The data contained in the Microbanking Bulletin, released by the Microbanking Standards Project, which this study examines and many NGOs have relied on, is self-reported. The vast majority of MFIs do not submit data, which creates selection bias. Those who do provide data tend to be more successful. Any conclusions from the proceeding analysis will therefore be somewhat limited. That has been the nature of MFI analysis—limited data followed by limited conclusions. Nevertheless, continuing to examine the financial information that is available establishes benchmarks that funding organizations can refer to and perhaps use as leverage to encourage greater transparency and more participation in reporting.

Aggregate MFI financial data is segmented by region while MFIs identified as sustainable cut across all regions, with no indication of how many of these elite institutions are from any particular region. Within regions there can be large economic and demographic disparities. For example, Sri Lanka and Bangladesh are in the same region but differ greatly in population density and levels of poverty. Commercial bank data is combined by region for comparison to regional MFIs and aggregated across all developing countries for comparison to sustainable MFIs. Commercial banks are by no means immune to mixed levels of prosperity and business practices within the same region. Africa includes institutions from such diverse countries as South Africa, Morocco, Kenya, and Zimbabwe. An additional problem is that within regions, commercial banks reporting may be from countries different from those of reporting MFIs. Since there is no way of knowing the specific
countries due to the anonymity of MFI reporting, regional comparisons will be broadly assumed.

**Methodology**

Five financial ratios from three different categories are the basis for the comparisons. In the first category, the ratio of operating expenses to assets measures efficiency. The second category, gauging profitability, includes the return on assets (net income divided by total assets), return on equity (net income divided by total equity), and net profit margin (net profit divided by sales). The final category, measuring leverage, is represented by the debt-to-equity ratio (total debt divided by total equity).

Commercial bank data is obtained from FISonline, covering four geographic regions: Africa (14 banks), Asia (61 banks), eastern Europe (10 banks), and Latin America (72 banks). The information obtained is most often from 2001 filings, with earlier fiscal years used when they are the most recent available. Banks from South Africa, Zimbabwe, Kenya, Ghana, and Morocco represent Africa. Sri Lanka, Malaysia, India, and Thailand represent Asia. Eastern Europe is represented by the Czech Republic, Poland, Croatia, and Latvia. Representing Latin America are Brazil, Venezuela, Bolivia, and Colombia.

The second and third data series are as reported by the Microbanking Standards Project (MSP). All of the data in this set comes from the November 2001 issue of the Microbanking Bulletin (MBB). MFIs submitted information dated from March 1999 to March 2001, with most of the information dated December 2000. The second series is an aggregated group of 57 financially self-sufficient MFIs.

The data series includes aggregated information from all regions of the world and consists of average ratios by region for all MFIs and globally for all self-sufficient MFIs. Standard deviations across all self-sufficient MFIs are provided, but regional standard deviations are not given, precluding statistical tests.
Of the 148 reported MFIs, 57 are self-sufficient. The total includes 59 from Latin America, 36 from Africa, 29 from Asia, and 24 from eastern Europe. Because the MSP’s policy is not to release information on individual banks, in order to protect privacy, it releases information on an aggregate basis. The MSP uses subcategories such as cooperatives and institution size within a geographic area. To obtain the aggregate data for one particular region, an average consisting of the individual components is calculated. Ratios and intermediary data not directly reported in MFI data are calculated on the basis of reported information.

**Total**

It is also necessary to derive one ratio for commercial banks as well. Both assets and equity are taken as reported at the end of the reporting period for both MFIs and commercial banks. Since assets and equity can vary during the course of a year, taking quarterly averages would provide more accurate ratio calculations. Such an adjustment, while possible for some of the commercial banks reporting, was not possible for the annual data available for MFIs and was therefore not done for any of the data. The practice of using end-of-year balance-sheet figures to calculate ratios is widespread and should not greatly affect the results since it is done consistently.

MBB adjusts raw MFI data for inflation, subsidies, and loan-loss provisions in order to standardize information. MFIs submit data by completing a questionnaire on accounting practices and auditing to aid in the elimination and minimization of any data that might be suspect. Accounting standards may vary by region.

**Analysis**

Table 1 compares self-sufficient MFIs with commercial banks. On both return on assets and return on equity, self-sufficient MFIs are statistically significantly superior to commercial banks from comparable countries. MFIs likely have smaller equity and asset bases than commercial banks, in part explaining their superior performance. Smaller equity bases magnify
the impact of profitability. The origin of MFI equity is also typically quite different from equity invested in commercial institutions. More often than not, MFI equity is donated. Equity in commercial banks is invested or represents retained earnings. MFI equity donors may initially expect social returns but likely reach a point where they want to see the MFI become self-sufficient. The MFIs that achieve self-sufficiency, such as those in the sample compared with commercial banks, are making financial profits and are achieving positive ROE. Therefore, the MFI sample of those that have attained self-sufficiency is likely biased toward more profitable MFIs, whereas the commercial bank sample does not eliminate banks that are losing money.

There is the possibility that self-sufficient MFIs with positive ROEs may be attaining those results by reducing levels of services to the poorest of the poor—those with the greater needs. The cost of servicing the poorest with smaller loans can reduce financial-profit margins. There is a trade-off between financial ROE and social returns. Increased pressure to attain self-sufficiency, even from initial equity donors, could have motivated some MFIs to make larger, more profitable loans to more viable clients, reducing servicing costs. Self-sufficient MFIs are likely to have been operating for a longer period of time and benefit from repeat borrowers who have both a track record of repayment and a basic understanding of the loan process.
Operating expense as a percentage of assets is considerably higher for self-sufficient MFIs than for commercial banks, though not statistically significant. It is also true that the mission of MFIs is quite different from that of commercial banks and often includes borrower education, which significantly increases operating expenses. Commercial banks also have a larger asset base than MFIs, which would also tend to make this ratio appear more favorable for them.

MFIs have higher profit margins than commercial banks, though not statistically significant, in part because they charge higher interest rates. In conjunction with lower operating profits to assets ratio, this seems to indicate that it is in fact the smaller asset base that is the major factor leading to better operating to assets ratio for commercial banks. Superior net profit margins for MFIs shows that expenses, though they are higher relative to assets, are more than adequately covered most likely due to higher interest rates charged by MFIs than commercial banks.

It is not surprising that commercial banks, with historically greater access to capital, use their larger equity (and asset bases) to gain greater leverage, as represented by the higher debt and equity ratios. What is interesting is that the difference is so small and not statistically significant. MFIs are borrowing approximately at the same rate, adjusted for their smaller equity base. Excluding subsidies, it is also quite likely that MFIs borrow at a higher interest rate while still achieving stronger profit margins. Commercial banks can obtain broader equity investment and borrow more against that equity at lower interest rates, lowering their operating-expense-to-assets ratio, but they are apparently less efficient in generating profits than self-sufficient MFIs. Commercial banks likely have higher salary structures and appear to have overall greater operating costs than self-sufficient MFIs even though it is well known that smaller MFI loans are more costly to service. As suggested before, self-sufficient MFIs may have migrated toward larger, less costly loans and, problematically to their mission, away from loans to the poorest.
Superior ROA for self-sufficient MFIs further illustrates how well MFIs use their smaller asset base. The difference in ROA is the only measure that is statistically significant, at the 1% level. This difference further demonstrates that the lower operating-expenses-to-assets ratio achieved by banks is largely due to a larger asset base. Self-sufficient MFIs, which have smaller assets, are able to employ them more efficiently.

When the data is taken in the aggregate by region as reported by MBB, the superiority shown by self-sufficient MFIs is overwhelmed by both the greater number of MFIs that have not reached self-sufficiency and their poorer performance. One factor that could explain some of the large performance gap is that MBB requires MFIs to report expenses for training not directly related to lending. This inclusion seems appropriate since it is important to educate first-time borrowers, but it makes comparisons with profit-seeking commercial banks somewhat more difficult because commercial banks have no social obligation to serve the poor. Such expenses dampen profits and even more so for MFIs that have not attained self-sufficiency. The superiority of commercial banks to MFIs overall also points to the fact that self-sufficient MFIs are quite different institutions from MFIs in the aggregate. Self-sufficient MFIs may have moved away from the more expensive mission of servicing the poorest of the poor.

Both ROA and ROE, so favorable for self-sufficient MFIs, are negative for aggregate MFIs across all regions. Since the 57 self-sufficient MFIs of the 148 reporting performed so strongly on ROE and ROA, the other MFIs are necessarily performing quite poorly to have reduced the ratios to such a degree. Negative profit margins across all regions emphasize the gap between all MFIs and the subsample of self-sufficient MFIs. Without subsidies most MFIs would cease to exist.

African commercial banks are the strongest, with the lowest operating expenses as a percentage of assets, just 2%, considerably ahead of the second best performer, eastern Europe, at 8%. Some of the African commercial bank superiority may be
because this sample includes South African banks with large amounts of assets. African MFIs are also the strongest regionally on the same measure, though they are quite comparable to MFIs in eastern Europe and Latin America. The weakest region is Asia, both for commercial banks and MFIs. This could reflect the financial damage done by the Asian economic crisis, which may have left both banks and MFIs with lower levels of assets because of still-weakened currencies. These lower levels of assets would magnify operating costs as a percentage of assets. Other factors contributing to differences across regions could be government regulations and the extent of competition, including the presence or absence of foreign-owned banks.

African MFIs are the weakest on profit margin, with considerable losses that would make them clearly unsustainable without subsidies. Asian MFIs are the strongest on profit margin, though still losing money. Asian commercial banks are the weakest compared with other regional commercial banks, possibly somewhat due to continued write-downs of losses from prior years. It may be that Asian MFIs weathered the Asian currency crisis better than their commercial counterparts, possibly because of maintaining loans in only local currency while retaining the ability to obtain hard-cash infusions from NGOs. MFI loans are also short-term unlike commercial loans, which are still at risk of default for years after an economy recovers. Asian commercial banks have yet to recover from the reduction
in the value of their assets; recovery will make ROA stronger if there are more than meager profits. The fact that Asian MFIs have the best ROA and the weakest profit margin, both negative, indicates their asset bases are also small.

The strength of African and eastern-European commercial bank profit margins compared to very negative performances by African MFIs and negative figures by eastern-European MFIs points out the type of market segmentation discussed earlier. Commercial banks focus on highly profitable loans while MFIs service the poor. Although self-sufficient MFIs did very well matched against commercial banks, when combined with MFIs that are not self-sufficient, overall profits are impacted greatly by the need to spend money to support and educate borrowers. Even with higher interest rates, most MFIs are not covering expenses. It may be that the majority of MFIs cannot attain profitability without radically altering their operations through cutting expenses and the cost of servicing loans. Doing so, however, would preclude loans to the poorest clientele, who incur the highest costs.

Commercial banks in eastern Europe have the highest debt-to-equity ratio among banks while eastern-European MFIs have the lowest debt-to-equity ratio among MFIs. It could be that eastern-European MFIs are attracting more equity in the form of donations than MFIs in other regions. Also, it is likely considerably easier for commercial banks in eastern Europe to borrow from the developed world, and certainly Europe, the region their efforts are focused on. In Asia, MFIs have greater leverage than commercial banks. This could be due to the more rapidly shrinking equity base likely to be denominated in local currency versus the commercial banking sector’s substantial portion of debt obligations in foreign currency. African and Latin American MFIs also have higher debt and equity ratios than commercial banks. One explanation for this could be a shift from outright grants to MFIs to greater reliance on market-based or subsidized loans.
Conclusion

In the aggregate sample, MFIs in every region are unprofitable and far worse performers than their geographic commercial peers. It is encouraging that the 57 self-sufficient MFIs are profitable and even performing better than developing-world commercial banks in the sample. These MFIs can stand on their own and survive. However, the larger universe of MFIs, including the thousands who do not report to MBB, are likely doing considerably worse than even the aggregate MBB sample, which itself is well below the self-sufficient MFIs.

Would the poor be better served if efforts and funds were concentrated on the self-sufficient MFIs? Without detailed data it is difficult to answer this question; however, it is likely that the self-sufficient MFIs are “skimming” the best clientele as well as operating more efficiently. They may not be servicing the smallest and costliest loans to the poor.

If it is the goal of MFIs to become more like commercial banks, then the sample of self-sufficient MFIs indicates they are progressing toward that aim. However, if MFIs are to continue to service the poor and to expand that service to the even larger multitudes that have not yet had any access to capital, profitability will necessarily be elusive. The market economy cannot impose market-based efficiencies on all MFIs and expect the poor to have access to capital. Some, if not the large majority of MFIs, will continue to require subsidies since their mission is not just to provide capital to be repaid with interest but also to service and educate the borrowers in managing that capital. Without this additional service, only providing loans to the poor would not succeed in improving their lives. This does not mean that MFIs should get a free ride and not be subject to financial scrutiny. Allocation of scarce capital by NGOs to the most successful MFIs should be a priority, but allocation cannot be solely based on profitability of recipient institutions. Wider social criteria should be included, some of which are part of the Accion Camel analysis. A first step to attaining
transparency and the most efficient allocation of capital would be mandatory reporting of financial data to MBB with the assistance of supporting NGOs. Included with the standard financial data should be some standardized reporting to demonstrate the attainment of social goals.

Notes

1. Microbanking Bulletin is now part of MIX Market, a much more accessible database of MFI information. MFI comparisons can be made using a variety of financial data of 133 MFIs worldwide by using various screening and search criteria. MIX Market also includes information on sources of funding information.

2. Since this analysis, the creation of MIX Market cited above allows for different aggregations of data, which makes possible more specific regional combinations of MFIs and may enable more elaborate analysis.

References


Microcredit in Rural Bangladesh

Is It Reaching the Poorest?

Dipankar Datta

Abstract: During the last decade microcredit has exploded in Bangladesh, as well as in a large part of the third world. Empirical studies give strong evidence that microcredit has had positive effects on two vital areas of national development; namely, the alleviation of poverty and the empowerment of women. Despite these positive impacts, some critics question the efficacy of microcredit in reaching the extreme poor. Some argue that while microcredit has contributed positively to the well-being of the poor in general, it has failed to reach the poorest of the poor. This paper explores the reasons why microcredit programs rarely reach the poorest of the poor in rural Bangladesh. The reasons have been divided into five categories: (1) supply, (2) demand, (3) NGDOs’ norms and social issues, (4) voluntary and involuntary dropouts, and (5) sustainable financial services. This paper also argues that microcredit alone is not necessarily the best way to help the poorest of the poor.

Microcredit, also known as microfinance, has emerged in Bangladesh as the newest darling of the aid community. Most of the enthusiasm springs from the reputations of a few of the best-known nongovernmental development organizations (NGDOs). These include BRAC (Bangladesh Rural Advancement Committee), Grameen Bank, Proshika—A Center
for Human Development, and ASA (Association for Social Advancement). These organizations reach millions of depositors and borrowers, most of them poor women. Although microcredit has claimed more and more of these organizations’ aid budgets (Buckley, 1997; Rogaly, 1996), this paper argues that the NGDOs in Bangladesh currently fail to reach the poorest of the poor and that microcredit may not be the most effective way of reaching the extreme poor of the nation.

Figure 1 shows that microcredit has grown at a rapid pace in Bangladesh, particularly during the 1990s. Both private and public sector organizations are involved in microcredit. The constituents of the sector include NGDOs, some nationalized commercial banks, the Bangladesh Rural Development Board (BRDB), and other government organizations. The NGDOs are, however, the leading players in this field. More than thirteen million people in Bangladesh participate in microcredit programs—more than 10% of the country’s total population. Of these, 81% are female and 19% are male (Rahman, 2000). Around nine million (more than 7% of the total population) of those participants are enrolled in NGDO programs. There are around fifteen thousand registered NGDOs in Bangladesh. Of these, nearly one thousand deal with microcredit and are commonly known as microfinance NGDOs. In 1999, microfinance NGDOs alone disbursed around US$400 million as credit, showing the significant role that microfinance NGDOs play in Bangladesh (Abed, 2000).

Empirical studies give strong evidence that microcredit has had positive effects on two vital areas of national development; namely, the alleviation of poverty and the empowerment of women. Microcredit has generated considerable hope and expectations among academics, government policymakers, multi-lateral and bilateral donors, NGDO leaders, and other development advocates in Bangladesh (Abed, 2000). Mohammad Yunus, founder of the Grameen Bank, speaks of the emergence of a virtuous circle: “...low income, more credit, more investment, more...

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income” (as cited by Roth, 1997, p. 7). Accordingly, the North has been promoting microcredit increasingly throughout the South (including Bangladesh) as an effective tool to reduce poverty (Simanowitz, Nkuna, & Kasim, 2000). World Bank President James Wolfensohn labeled microcredit as a “particularly effective way of reaching women.” The UN Secretary General calls it “a critical anti-poverty tool for the poorest, especially women.” And Hillary Rodham Clinton views microcredit as a tool that will help poor women “survive globalization” (Scully, 2000).

Despite these positive evidences, some critics question the efficacy of microcredit in reaching the extreme poor. Some argue that while microcredit has contributed positively to the well-being of the poor in general, it has failed to reach the poorest of the poor. According to Wright, “the poorest of the poor has become a catchphrase that has been rendered essentially meaningless by abuse and repetition. Realistically, the poorest of the poor are rarely served by microfinance institutions even by
the people that use the catchphrase so often. It is increasingly clear and accepted, that the majority of MFIs world-wide are not reaching the poorest of the poor even in the more microfinance-friendly and population-dense environments such as Bangladesh” (Wright & Dondo, 2001, p. 4). Hulme and Mosely (1996, p. 116) discuss the trend of many microfinance institutions to exclude the poorest of the poor, despite the many “lip services” given to them. In addition, many commentators argue that donors and advocates consistently exaggerate the power of microcredit and related assistance, while ignoring key structural issues that are far more pertinent to the long term problems of poverty and of poor people, especially women (Scully, 2000). In response to these beliefs regarding microfinance, this paper explores the reasons why microcredit programs rarely reach the poorest of the poor in rural Bangladesh and argues that microcredit alone is not always the best way to help the poorest of poor.

This paper is organized into four sections. The first section focuses on the sources of data used for the preparation of this paper. The second section categorizes the rural poor in order to explore the status of the extreme poor. The third section discusses the reasons why the extreme poor are excluded from development intervention. The fourth section focuses on the possible policy options to reach the extreme poor.

Sources of Data

Along with secondary information, this paper uses two sets of primary data collected from two different studies. The first study conducted in 1999 by the World Bank as a part of the study titled *Voices of the Poor*. It was conducted in eight rural and two urban locations of Bangladesh (Nabi et. al., 1999). The second study, by Concern Bangladesh, studied two rural and five urban locations from 1999 through 2000, as a part of the expansion strategy of its development program in the poverty-stricken areas of Bangladesh. It was titled *Listening to the Poor*. The author of this paper was directly involved in both of these studies.
In both of these studies, detailed fieldwork reports were created for all study locations. Because this paper focuses on the NGDOs’ microcredit involvement in rural areas, only the field reports of the rural locations are analyzed here. The rural locations investigated under the first study are Charfession (Chakraborty, 1999a), Dewanganj (Chakraborty, 1999b), Gowainghat (Datta, 1999a), Khaliajuri (Datta, 1999b), Dhamrai (Nabi, 1999a), Madaripur (Nabi, 1999b), Nachol (Nabi, 1999c), and Ulipur (Nabi, 1999d). The rural locations investigated under the second study are Dimla (Datta, 1999c) and Itna (Datta, 2000). The findings of these field reports have been complemented by the findings of the participatory impact assessment study of Proshika (Kar, Datta, Habib, Cima, Begum, Biswas, & Naser, 1997) and the participatory assessment of village reconstruction work by Concern Bangladesh in Itna and Khaliajuri (Miyazaki, 1999). Each of those studies produced several case studies, some of which were used by this author in organizing his analysis (for example, the case presented in the next section). In addition, analysis of the study findings have been guided by the author’s significant field experience in working with local, national, and international microfinance NGDOs.

All the studies mentioned above used the participatory technique, commonly known as PRA (Participatory Rural Appraisal). PRA employs a wide range of methods that enable people to participate in studies by expressing and sharing their opinions and information; these methods also stimulate discussion and analysis. Many of the methods are visually based, appealing to the creativity of the local people (IDS, 1996).

One such method uses social maps to show the positions of households in the study villages, as well as the locations of important local features (i.e. landmarks and resources such as water, forests, schools, and other services). Social mapping was particularly important in this study in locating the poorest households in the communities.

Another such method involves “well-being groups.” Well-being grouping exercises categorize the people of the community
into groups of economic status. There are usually between three and six economic categories. The clearly-set criteria for each category allows these exercises to identify the exact number of households belonging to each category by considering the financial well-being of the households. The criteria set to define the categories are not merely confined to the financial well-being of the households, but also include socioeconomic aspects related to the overall quality of life; some exercises often include criteria like happiness, the ability to provide a good upbringing for the children, trustworthiness, respect, etc., in carrying out well-being analyses.

Seasonal calendars are another method of encouraging participation in studies. These calendars show how availability, of food, workload, family health, prices, wages, and other important aspects of livelihood vary during the year.

Although each of the independent location studies followed the basic principles of the PRA, consolidating the data taken from the diverse locations was difficult. Drawing a common bond among the ten locations without sacrificing the diversity of the location-specific findings could not be done due to the vast spread between the communities. In order to combine the data, it was necessary to determine the common findings among the locations, as well as the unique.

**The Extreme Poor: Profile and Targeting**

*Profile of the Extreme Poor*

From the well-being grouping exercises carried out in the study locations, researchers found a maximum of five well-being categories. There was an average of four categories. Along with establishing a nomenclature for each category, villagers set different criteria for each category. Participants generally referred to the top two categories as the nonpoor, labeling them the rich and the middle. Villagers referred to the bottom three categories as the poor, labeling them as the better-off poor, moderate poor, and extreme poor. All the groups used some common indicators to show the distinct characteristics of each category. These indicators
included food security; land holding status; housing status; moveable assets like cattle, poultry, utensils, etc.; status of clothing; number of working male family members; access to credit market; respect in the society; and occupational status.

The better-off poor were largely characterized by food deficit and their ability to provide two regular meals for themselves during lean seasons. The amount of land they held could meet the family’s needs for a maximum of two months. They diversified their livelihood, usually combining sharecropping with wage labor. They were trustworthy in the community and could borrow from neighbors as well as from other financial institutions. They were allowed to express opinion on community affairs but could not take leadership.

The moderate poor were generally landless; many of them did not own homesteads. Wage labor was their main source of livelihood. At times, adult male members of the family went to other districts in search of work. Due to the low wage rate in the lean seasons, a day’s wage of a male member of the family was not sufficient to provide a balanced meal for each of his family members. To cope with this type of situation, female family members and children also worked as day laborers. They lived without health care and education; cost of both was beyond their means. They did not have the means to entertain guests. Financial institutions and neighbors would not easily give them loans, and loans they did receive rarely satisfied their needs.

The extreme poor owned neither arable land nor homesteads and therefore built their houses on the land belonging to other people. More distinctly, this type of household was headed by women or elderly men, neither of which could work sufficiently to provide for their families. Small children were an immediate burden to the extreme poor families. However, older children (aged eight and up) were important assets to their families. Instead of going to school, these children were engaged in paid labor or household care. These families had low interaction with other social groups. In Dimla, the community labeled them as the beggar class. The study team in Nachol also noted
that the extreme poor were clearly identifiable by their poor clothing and dejected faces. Nowhere did these families have access to loans—institutional or noninstitutional. They were screened out of NGDOs’ membership, which ruled out their last possibility of receiving any financial assistance.

The causes that contributed the most to the extreme poor category’s vulnerability were sickness and natural disaster. If the earning family member failed to work due to sickness, the household’s income flow was immediately affected; there was no money coming in and what money there was had to be spent on medical treatment. Though natural disaster shocked the livelihood of the whole community, it affected the extreme poor households faster than the households of other well-being categories. Natural disasters reduced the scope of employment for the agriculture wage laborers, drastically reducing the employment opportunities for the extreme poor.

Though low income could be considered an outcome of crisis, the extreme poor participants qualified low income as a cause of crisis in Charfession, Dewanganj, Gowainghat, Madaripur, Ulipur, and Dimla. According to those questioned, the sources of low income sprang from factors such as seasonal unemployment, intense competition in the labor market, and discrimination towards women. A typical working woman still earned less than half as much as a typical working man. For example, in Ulipur and Dimla (located in northern Bangladesh), women were not usually paid in cash but rather were paid in kind. For women, it was not only the unemployment but also the low and unjust wages that contributed to their crisis.

The extreme poor in the study locations have had very little capacity to maintain a sustainable livelihood. During periods of crisis, they made many adjustments to reduce the impacts of the crisis. Common mechanisms of coping with crises included reducing consumption of food or other essential goods, purchasing inferior substitutes (e.g., low quality food), increasing work efforts of other household members (in most cases, children), asking neighbors and relatives for help (e.g., borrowing money,
community fund-raising), postponing debt repayment, and selling moveable assets (e.g., poultry). Those who managed to receive small loans from neighbors or relatives were always very careful to repay their loans; full repayment was very important to receiving loans again in the future. Saving money by starving themselves was also a common strategy in repaying their loans.

Jobeda’s Tale: A Member of the Extreme Poor Class

Jobeda Begum was the youngest of five children—four sisters and one brother. Her father, Egbar Ali, was a financially stable man. They had good clothes, a nice home, a decent amount of land, cattle, etc. Yet when her father died when Jobeda was only two years old, her brother took responsibility over the family. When she was only ten, her brother died, leaving her family to the care of her paternal uncle.

At the age of twelve, Jobeda’s uncle had her marry a fifty-year-old man. She became a widow after nine years of marriage. At that time, she had a two-year-old son and was pregnant with her second. Not long after her second son’s birth, her husband’s older brother took her property from her and turned her out of her own house. She took shelter in the home of a neighbor and lives there to this day. She began to work as a day laborer in agricultural field while trying to rear her two young sons. Sadly, her oldest son died of small pox at the age of twelve. And when her remaining son was eight, she learned that he was mentally handicapped.

Jobeda is now fifty-five. She feels helpless; to have reached the end of her life. Few show any interest in providing her with work because of her weakened physical capacity. Regardless, she continues to work very hard. Because of her low earnings, she can barely manage one square meal a day for her family. If she manages to find work, her family can eat; otherwise, the family starves. Ironically, she does not qualify for loans. As she was unable to deposit money into a savings fund, she did not receive a membership to the Proshika, the only NGDO working in that particular village at that time.
Jobeda shows little hope for the future. “I have already forgotten the feelings of happiness. I do not want it any more, because I will die within a few years. However, I feel helpless when I think about the future of my son. Who will take care of him?” (Datta, 1999b)

**Targeting the Extreme Poor**

The open-ended well-being analysis allowed participants to divide their community into as many categories as they wanted. Because of the variation in the number of categories across the ten study locations, it was very difficult to quantify the findings into one single format.

A few PRA experts suggested choosing one location as a standard. This “standard location” would have a maximum number of well-being categories, and all other locations would be adjusted to match. This technique is commonly known as the super-imposed technique (Kar et. al., 1997). According to this suggestion, the Ulipur location was chosen as a standard to represent all the other locations. The sets of criteria for each category were reviewed and compared with that of Ulipur. The categories that matched those of Ulipur were merged as appropriate. While this process obviously discounted some diversity, it nevertheless served the purpose of allowing comparisons despite the diversity of the different study locations.

Table 1 shows that about eleven hundred households were directly involved with the NGDOs, yet only 12% belonged to the extreme poor category. In addition, focused group discussions within the extreme poor category clearly indicated that although 12% of extreme poor families were affiliated with NGDOs, their level of involvement with those NGDOs was less functional in comparison to the involvement of other categories. This observation implies that even when included in an NGDO, the extreme poor still may not receive loans. For example, the more affluent members of the NGDO group often encouraged or even pushed the extreme poor to participate in the adult literacy program (ALP) or consciousness raising.
Well-being analysis clearly revealed that the two most important criteria that determined the well-being of the poor were their productivity and possession of land and their access to credit. Those who had already become landless (or had only homestead land) depended largely on casual labor and other manual labor intensive activities like earthwork, cart pulling, agricultural labor, etc. Cash income from the sale of manual labor again depended on agricultural activities, which was further determined by the frequency of rain and floods, the availability of irrigation, and other factors. A longer duration of floodwater retention inversely affected the availability of labor-selling opportunities for the landless. A prolonged flood or similar situation, which stopped job opportunities for the landless or seasonal agricultural laborers, triggered the process of transformation from poor to extreme poor. In situations without any guarantee that the loan amount would be used to create tangible assets, the NGDOs were again responsible to determine whether or not to select an extremely poor person as member of a group to receive microcredit support (Kar & Datta, 1999).

Therefore, although many NGDOs talk about their pro-poor development strategy, it is evident from the exercises

<table>
<thead>
<tr>
<th>Classification of households</th>
<th>Distribution of total households living in the study locations</th>
<th>Distribution of NGDO member households in the study locations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>%</td>
</tr>
<tr>
<td>Rich</td>
<td>112</td>
<td>5.3%</td>
</tr>
<tr>
<td>Middle</td>
<td>223</td>
<td>10.6%</td>
</tr>
<tr>
<td>Better off Poor</td>
<td>664</td>
<td>31.5%</td>
</tr>
<tr>
<td>Moderate Poor</td>
<td>488</td>
<td>23.2%</td>
</tr>
<tr>
<td>Extreme Poor</td>
<td>620</td>
<td>29.4%</td>
</tr>
<tr>
<td>Total Household</td>
<td>2107</td>
<td>100.0%</td>
</tr>
</tbody>
</table>
of social mapping and well-being grouping in the study villages that generally the better-off poor and to some extent the moderate poor receive the maximum benefit of obtaining microcredit from the NGDOs’ development interventions.

**Why Are the Poorest Excluded?**

The reasons behind the exclusion of the extreme poor can be categorized in five ways: (1) supply side factors, (2) demand factors, (3) factors related to NGDOs’ norms and social issues, (4) factors related to voluntary and involuntary dropouts, and (5) factors related to sustainable financial services.

**Supply Side Factors**

Until recently, the NGDOs did not seem to have the vision to reach the extreme poor. The fact that the poor are differentiated by income and socioeconomic status has been recognized only recently. Field-level investigation reveals that the extreme poor have not been targeted specifically. The very few such households that have participated in these programs have been included accidentally rather than systematically. In addition, other social programs of NGDOs are unavailable to the extreme poor because microcredit and most of the social programs of NGDOs are highly interrelated and often inseparable.

During the field studies, it was found that BRAC’s NFPE (Non Formal Primary Education) program and Concern Bangladesh’s Earthwork Program were indeed available to all poor, whereas all other programs were credit oriented. However, in relation to the Earthwork program, Miyazaki (1999) documented:

A number of people do not participate simply because they cannot. The majority of The Very Poor families who do not participate belong to this category. These families are mostly headed by women, disabled people, elderly persons, and ill-health persons. A female household head, even if she is healthy, often finds it impossible to participate in the earthwork when she has a small baby and when she has no one but herself to take care of the baby.
Clearly, the extreme poor cannot always participate in development programs, even when they give equal opportunity to the less poor and the extreme poor to participate. This indicates a need for a special focus on the extreme poor to ensure their effective participation in the programs.

There are some other selection criteria that are used by NGDOs to target households. Some examples of these include permanent settlement and residence of members, which bar the extreme poor from being benefited from the programs. It was found that some members of ASA and ActionAid in Dewanganj lost their membership not because of their failure to pay the installments, but because they lost their houses due to riverbank erosion. The selection criteria used by Concern Bangladesh to target households in Gowainghat, Khaliajuri, and Dimla included stability in the settlement, age below 45, and regular savings requirement, all of which bar the extreme poor from benefiting from the programs. Regular savings is also mandatory to become a member of Grammen Bank, BRAC, and Proshika. This has been found at three study locations, namely Dhamrai, Nachol, and Madaripur. Additionally in Dewanganj, study participants have severely criticized the selection criteria of beneficiaries in CARE’s Road Maintenance Program.

The key selection criteria of the Road Maintenance program are as follows: the candidates must be (1) permanent residents of the respective unions, (2) aged between 18 and 35, and (3) physically sound and capable of doing the work that road maintenance requires. The first criterion specifically excludes the extreme poor who don’t have a permanent address (e.g., the extreme poor who have lost their homeland due to riverbank erosion and now live in the embankment). The second and third criteria exclude the extremely poor who are subject to old age vulnerabilities.

In most cases, NGDOs do not reach areas where infrastructural facilities are less developed. Due to time consuming communication and transportation systems, the issue of extending aid programs to these areas is usually avoided. For
example, char areas (land emerged from the river through the deposition of sand and silt from upstream) of Dimla and Dewanganj are always affected by flood and riverbank erosion. Charfession is a cyclone prone area. Flash flood and village erosion is common in Khaliajuri. These disaster prone areas are invariably inhabited by a large number of extreme poor, yet the NGDO interventions are not sufficiently available. Instead, they are more abundant in the highway sides and more developed areas, such as Dhamrai, which is located near the Dhaka Export Processing Zone (EPZ). NGDOs also consider the presence of local security because of the cash-handling that is involved in microfinance activities.

Since the more prosperous members of the groups shoulder joint responsibility of repayment, NGDOs likewise prefer members from more prosperous areas, again excluding the extreme poor. In some cases, boys and girls between the ages of eight and twelve from better-off families were included as group members by one of their family members. This was done intentionally to gain stronger hold in the group. Unfortunately, such irregularities also contributed to marginalizing the less-powerful members of the group, and resulted in larger amounts of loan amassed to some families.

Finally, it is important to mention the existence of a contradiction between the macro and micro objectives of the programs. At the macro level, NGDOs want to alleviate poverty among the extreme poor, with a recovery rate close to 100%. But at the micro level, the demanding target of fulfilling this recovery rate becomes the most important issue facing NGDO field officers. Consequently, the field-level staff hesitates to extend loans to the extreme poor for fear that the loans will not be repaid. As a result, field officers form groups with the more affluent members within the poor populations, thereby providing themselves with more assurance of recovering the funds while still choosing borrowers that fit within the definition of "the poor."

**Demand Side Factors**

The extreme poor do not have the ability to take risks, which is a key factor in becoming successful entrepreneurs. A large
majority of these poor do not initially want microcredit because they fear that they would be unable to repay the loans and would therefore be saddled with debt that would eventually force them to sell what few possessions they do have (Hashemi, 1997). Their ability and willingness to make profitable investments of the funds would generate the demand for microcredit. The question, therefore, is whether the ability and willingness to receive microcredit is indeed weaker among the extreme poor households when compared to the less poor, and if so, why?

In finding the answers to these questions, it is important to understand the operational basis of microcredit financing enterprises. Such enterprises use supplementary resources owned by the families. A larger family labor force makes that household more suitable for microcredit. More than one working family member ensures a higher amount of total labor input into the enterprise, thus generating a higher return on the capital. In such multiworker families, part of the loan can be repaid from the earnings of several members. Therefore, families with a low ratio of workers to dependants will be less enthusiastic about obtaining microcredit.

Households headed by women, usually found in the poorest category, also face constraints utilizing microcredit. These households often lack male members of working age who can perform marketing functions. They also have a lower ratio of working family members to dependants, and thus lack supplementary income to make loan repayments.

It is no secret that current interest rates in microcredit programs are extremely high and that they increase every year. For example, Proshika’s interest rate increased from 13% in 1995–96 to 20% in 2000–01. This increase indicates a 7% increase in the interest rate (implying a 54% increase in the volume of money collected as interest) in only six years (CDF, 2001). Larger national NGDOs take on an average 18 to 24% interest using the declining method (e.g., Proshika, Grameen Bank), or 15% using the flat method (e.g., BRAC, ASA). Most local NGDOs take 20 to 30% interest (flat method). In the study locations, participants from the extreme poor households said
that they rarely found any sector that could realize such a high return on its investment (FACET, 2000, p. 2).

Along with high interest rates, weekly repayment procedures also highly discourage extreme poor households from accepting NGDO loans. These households find difficulties repaying the loans in weekly installments with the high interest rates. While some study findings in Dhamrai show that some of these types of households do have interest in receiving seasonal loans (for cattle-fattening projects), most of these households cannot take the risks associated with borrowing. Since their ability to repay relies heavily on the health of the cattle, sick animals mean no income—a great risk. In addition, these households fear a weekly repayment installment plan, as these weekly obligations would be possible only after the income earned from the sale of the cows.

Factors Related to NGDOs’ Norms and Social Issues

Often the extreme poor fail to join the groups because they are not able to comply with NGDO norms. These difficult standards include the regular savings requirement, declared or undeclared minimum floor of loan size, and the requirement of weekly installments (Alamgir, 1997; Rahman, 1998).

In areas such as Gowainghat, where religious conservatism is very high, women of extreme poor families do not join groups because of social and religious sanctions. These sanctions dictate that joining credit programs and leaving the home for meetings with other men is inappropriate.

Sometimes extremely poor women fail to join groups because other group members feel that their inclusion involves high risks. Part of this fear lies in the fact that some of the husbands of these women are public gamblers and may waste loaned money. Group members also hesitate to allow the extreme poor to participate for fear that they lack money-management skills; they are often transient families, moving in and out of villages looking for work.

Factors Related to Voluntary and Involuntary Dropouts

NGDOs’ failure to serve the extreme poor may result from dropout from membership, a problem as serious as exclusion
from membership. Dropouts occur when borrowers do not or cannot make suitable investments with the borrowed funds. Dropouts are also associated with loan default, both voluntary as well as involuntary. Failure to generate an adequate return on the investment of borrowed funds inevitably results in failure to repay the loan. This inability to generate adequate return on investments may be due to low marginal product of capital, illness of working members, natural calamity, or mere lack of initiative and enthusiasm, etc. Once a borrower decides to dropout, he/she has no incentive to repay the loan. Since repayment is a precondition for obtaining a repeated loan, the opportunity will likely never come again for the borrower.

In addition to the financial reasons, dropout may occur due to an inability to comply with group discipline. Such discipline includes regular group meetings and memorizing the basic principles (e.g., sixteen decisions of Grameen Bank).

In the study locations, dropouts were found even in BRAC’s IGVGD and Agro Forestry programs, which were specifically designed to reach the extreme poor. In IGVGD, women dropped out due to a variety of factors that arise from a lack of entrepreneurial capacity, including morbidity, physical inability, and the risks associated with credit. Additionally, some members were expelled for not observing organizational discipline such as timely repayment of loans. Finally, many destitute farmers could not participate in BRAC’s Agro Forestry program because of the intensive physical labor required in the initial stage of developing the land for productive purposes.

**Factors Related to Sustainable Financial Services**

Presently, the NGDO’s financial viability is the forefront consideration in deciding whether or not to offer sustainable financial services to the poor. Financial viability refers to NGDOs’ ability to recover the full cost of operations of microcredit programs, as well as to gradually accumulate surpluses to create their own capital. This issue deals with two aspects: (1) enhancing income, and (2) reducing costs to facilitate the full recovery of expenditures
(Abels, 1993; Abels, 2001). Generating adequate income to cover the full cost of operations requires a minimum level of scale of operations in terms of the number of borrowers, loan amount disbursed, and interest rate charged by the NGDOs. Since the interest rate has settled between 20 and 30%, the only way to enhance total income is to increase disbursement for a given size of operation. Most NGDOs, big and small, follow this strategy (Abels, 2001).

To achieve a greater volume of disbursement, NGDOs disburse increasingly larger amounts of loans per member. In order for borrowers to manage the larger amounts, a higher capacity is needed, as well as better economic opportunities in rural areas. This forces loan providers’ field workers to select better-off members, those with higher loan-absorption capacity. Members of the groups also select their comembers from better-off sections with the hopes that loan installments can be paid regularly, and the risks of default and bad debt can be reduced. Costs of operation go down as income increases, promising more productive loans for field workers. Higher investment in general requires areas having relatively better infrastructures, a process that automatically excludes remote areas.

**Policy Options for Reaching the Poorest**

The previous sections have made it clear that because of various policies and institutional structures, present microcredit programs rarely reach the poorest of the poor. In order to reach the poorest of the poor, research shows that programs with different mandates, policies, institutional structures, as well as more support from external sources, both governmental and nongovernmental are required. The following are the major policy interventions requisite to making these changes.

NGDOs need to meticulously examine the efficacy of their own activities, specifically examining the increasing gap between their stated philosophical objectives and the actual strategies that they have adopted to reach them. Each organization should introspectively examine the outcomes of their
efforts in order to determine whether or not they are indeed meeting their objectives.

There is no doubt that until recently, NGDOs did not have any vision about the sustainable development of the extreme poor, as they thought that this group would automatically benefit from their programs. There should now be a radical change in this understanding; NGDOs’ social programs should be redesigned to target the poorest of the poor. NGDOs should take measures to make social programs independent of credit programs, as such programs should not influence the selection of social program beneficiaries. This invisible link between the two types of programs should be erased, thereby ending discrimination against the poor nonmembers in receiving services of the social programs (Cohen & Sebstad, 1999).

The financial services provided by most NGDOs fail to reach the extreme poor because the nature of their credit is mostly for promotion, not survival or protection. Loans for promotional measures allow the better-off poor to expand their business. But as the poorest of the poor are constantly vulnerable to income loss as a result of unforeseen events, they badly need credit for protection and survival. This will help the extreme poor to meet not only their physiological needs, but also their other social needs while they confront the unexpected challenges of life (Eigen, 1992; Tomecko & Kolshorn, 1996). NGDOs need to adopt policies of advancing small and flexible loans that suit the extreme poor, as well as longer, more flexible repayment plans and closer supervision; and they should consider linking microcredit to safety net programs like skills training and food aid (Rahman, 1998).

Basically, microcredit needs to be complemented with other interventions to bring the poorest of the poor out of the vicious circle of poverty. Some of the national NGDOs in Bangladesh have already begun doing so. For example, BRAC’s IGVGD program caters to the needs of the most destitute rural women for whom conventional credit programs are not the answer. This program gives wheat-relief rations to women on a
monthly basis, provides training in homestead poultry rearing, and progressively offers flexible loans with a monthly (instead of weekly) repayment requirement. These members are gradually absorbed into the mainstream Rural Development Program and are then offered larger loans. This mechanism is designed to facilitate the entry of the poorest into regular credit programs and acts as a transition from a relief program to a longer-term development program (Zaman, 1999; Sattar, Chowdhury, & Hossain, 1999). The Grameen Bank project is experimenting with different ways of ensuring access to the poorest such as the “goat lease” program. Rather than directly providing credit, the bank workers give each woman a goat to raise as their own. These women repay the debt by giving one goat from the first two sets of offspring. This has been very successful in providing assets to the most destitute. Attendance at weekly meetings and participation in weekly savings will potentially help these women develop the necessary confidence to eventually participate in regular credit programs.

Effective GO-NGDO cooperation is necessary to reach the extreme poor. Large NGDOs should try to establish branches in economically depressed areas and attempt to cover the most remote villages within such areas. There should also be attempts to interact with government departments to establish projects for infrastructure development in these areas. NGDOs can work closely with the government food aid programs, such as Food For Work (FFW), Vulnerable Group Development (VGD), Test Relief, and Special Test Relief. During the operation of food aid programs, NGDOs should try to build awareness, motivate participants, and teach development skills among the extreme poor.

Conclusion

There are significant variations among the ranks of the poor. The poor can be classified as better-off poor, moderate poor, and extreme poor. NGDOs in Bangladesh have tended to serve mostly the better-off and the moderate poor, often neglecting
the poorest of the poor. Successful microcredit programs require strict screening to ensure that borrowed money can feasibly be repaid. NGDO staff and group leaders are extremely careful to screen out potential risks. Poor recoveries reflect on overall group performance and the performance of NGDO staff. Consequently, households that already have assets or a steady income are more encouraged to join. The problem of “self exclusion” is also widely prevalent, and membership regulations (such as rigidity in meeting attendance and obligatory savings) aggravate the “fears and timidities” of the extreme poor.

Before designing a program for the extreme poor, however, the theory that all poor are reached by microcredit should be tested. In terms of coverage, every poor man and woman cannot possibly be reached with microcredit. Similarly, microcredit may not be a program that is suitable for every segment of society. Every poor man and woman may not be able to become an entrepreneur. For example, it may be more difficult for the elderly or those who are mentally and/or physically handicapped to function as active entrepreneurs.

Proponents of the credit-alone approach argue that the extreme poor need capital, and if capital is provided, the poor will be able to take advantage of self-employment to improve their economic status. This argument, however, ignores the fact that there are many other factors that are equally important for poverty alleviation. Even when microcredit does reach the poorest, it may not increase their income as much as is required for smooth consumption, and may not sufficiently diversify their income either (Mosley & Hulme, 1998; Morduch, 1998). Critics of self-employment initiatives claim that the emphasis on informal sector economic enhancements overlooks the structural factors that cause the economic marginalization of the extreme poor. Microcredit programs define poverty as a temporary and easily remediable cash flow problem, instead of one which indicates relations of inequality and their institutionalization in broader economic policy (White, 1991). The credit-alone approach is something like applying ointment to an open
wound while neglecting the root of the problem, which may lie in the blood (Kar & Datta, 2000). Livelihoods of the extreme poor cannot be sectionalized and addressed through only one dimension. Social development is also necessary as a precondition for realizing the full potential of credit and financial interventions (Wood & Sharif, 1997).

The debate between various concepts of sustainability—particularly with regard to the sustainability of NGDOs and beneficiaries—needs to be addressed properly. A proper balance needs to exist between the two. The implementation of the policies mentioned above is indeed difficult for NGDOs because the financial implications of implementing a combined strategy of microcredit and social development are quite heavy (Abed, 2000). Such policies make it more difficult for NGDOs to reach financial sustainability. When the aspirations for financial sustainability and the objectives of serving the poorest contradict each other, it is likely that the latter objectives will be sacrificed, especially when the donor’s goal is to achieve sustainability. As noted in Goetz and Gupta (1996), donors’ interests in seeking the development of financial, self-sustaining, rural development institutions have resulted in a preoccupation with cost recovery to such an extent that loan repayment rates have become the primary indicators of success. Consequently, the important issue of loan quality goes widely unaddressed. Donors must apply their leverages effectively in order to make NGDOs refocus their guiding principles and restructure the credit operation system, which will bring the extreme poor members under their credit network, hopefully helping them to benefit from the social development programs as well.

Notes

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Microcredit in Rural Bangladesh

1. Bangladesh is one of the world’s poorest, most densely populated, and most environmentally vulnerable countries of the world. It has a total land area of 147,960 sq km. According to the 1999 estimate, the GNP per capita is US$370. The total population is 128 million, which is equivalent to 981 people per sq km. The average annual growth rate of GNP in 1998–99 was 3.3% (World Bank, 2000). Despite the country’s uncertain climate, agriculture remains the backbone of the economy. About 75% of the population depends, directly or indirectly, on agriculture for its livelihood.

2. For the last decade, NGDOs in Bangladesh have emerged as efficient partners in development. Their efficiency has been shown in disaster management, self-employment creation, human development, infrastructural development within specific geographical areas, and rebuilding of social and institutional cohesion. Significant contribution of NGDOs has also been noted in education, health, and environmental protection. Originally designed by Grameen Bank, most NGDOs are engaged in group organization at the grass roots level, conducting “conscientization” training to build the awareness and confidence of the poor, coupling these efforts with skill training and the provision of microcredit services for income generation. Many NGDOs are now engaged in policy advocacy with the government and donors to redress the policies that negatively affect the poor (Nabi, Datta, Chakraborty, Begum, & Chaudhury, 1999, World Bank, 1996).

3. Professor Yunus, the founder-philosopher of the Grameen Bank, consistently insists that the Grameen Bank should be considered as a bank, not an NGDO, because its principal mission is to challenge the traditional concept of banking based on collateral. Collateral-based banking is designed to be used by elite beneficiaries, thereby prohibiting the overwhelming majority of the productive sections of the population from participation in these intermediaries of artificially cheap institutional capital. But these collateral-based banks could have played the role of “life-blood” for the capital-starved producers who are fighting for survival in the poorer strata of the population, considered by the traditional banks as “unbankable” because of their inability to provide “good collateral” (Islam, 1999).

4. The three key structural issues are (1) agrarian reform, (2) programs favoring export production over subsistence crops, and (3) trade agreements structured in the interests of transnational corporations.

5. Average size of land per capita is very small (0.25 acres) and the size decreases every decade with no scope for expanding the cultivable frontier. Moreover, the inequality in landholding is striking: only 10% of all rural households own about 50% of the cultivable land, with half of the rural population being landless (Nabi et. al., 1999).
6. Concern Bangladesh is running the Food for Work program for village reconstruction in Khaliajuri and Itna, with food assistance from World Food Program. Food for Work is commonly known as the Earthwork Program, which is open to all categories of poor.

7. The Government of Bangladesh introduced the VGD (Vulnerable Group Development) programs in 1975 with the support of the WFP. Through this program each VGD cardholder draws 30 kg of wheat per month for free for a period of 18 months. BRAC developed the IGVD (Income Generating VGD) program to create a pathway of sustainable livelihoods for the VGD women. The program supports these women through a development package consisting of start-up support, skills training, credit, and other inputs. The Agro Forestry program of BRAC attempts to compensate for the growing deforestation in the country and at the same time create a new avenue of income generation for the extreme poor. BRAC started this program on unused plots of land, degraded due to continuous monocropping and soil erosion. Many people, particularly the affluent farmers, kept their land uncultivated as it was not considered to be productive enough. BRAC arranged long-term lease of these lands from the private owners and allotted this land to poor female farmers.

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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.

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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 microenterprise 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 mission and practice.

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.


Abstract: Microenterprises constitute the vast majority of business firms in low- and middle-income developing countries. In Latin America, the sector contributes significantly to employment and gross domestic product. Recently, the expansion of microlending programs has been viewed as an effective means of developing the microenterprise sector and alleviating poverty. However, the nexus between microenterprise development and environmental degradation has remained largely unexplored. It is suspected that the pervasive informality of the microenterprise sector, its sheer size, and the high incidence of poverty in the sector contribute to cumulative environmental degradation and low standards of occupational safety. This paper highlights commonly observed patterns of pollution and occupational safety risks in the sector and examines feasible ways of promoting improved environmental management and occupational safety. The main recommendations are that microfinance institutions should not be excessively regulated and that environmental and occupational safety issues in the sector should be confronted directly through a combination of private and public actions. In addition, microfinance institutions can and should begin to take steps to promote environmental awareness and eco-efficiency among clients and limit their own exposure to lending risks due to environmental and occupational safety problems.
Protecting the environment and reducing poverty have emerged as key policy goals in the developing world. Nonetheless, there are challenges inherent in the simultaneous pursuit of the two goals. Dating back to the Brundtland Report of 1987, the conventional wisdom has viewed poverty as one of the primary causes of environmental degradation. Succeeding studies and reports have substantiated the basic correlation between poverty and the deterioration of the environment (Falconer & Arnold, 1989; Falconer, 1990; Dasgupta & Goran Maler, 1994). In short, the poor, motivated by the need for immediate survival, are often likely to resort to occupational activities that degrade the environment. In the case of the microenterprise sector, the question is, does a trade-off exist between helping low-income microentrepreneurs and safeguarding the environment? The majority of owner-operators and workers in the microenterprise sector rank among the poor or the near poor (Remenyi, 1998; Ledgerwood, 1999; Orlando & Pollack, 2000). Do microentrepreneurs represent a new environmental threat? If some, or many common microenterprise activities impact the environment adversely, what should be done?

The Importance of the Microenterprise Sector and the Policy Dilemma

Microenterprise, a sector consisting of firms employing less than 10 employees, is estimated to constitute the majority of business firms in low-income, developing countries and to contribute significantly to employment and share of gross domestic product. For example, in Latin America and the Caribbean, microenterprise...
constitutes 80–90% of all businesses, accounts for more than 50% of employment, and generates upward of 30% of GDP in some countries (Poyo, Parker, & Golden-Vasquez, 1996; International Labour Organization, 1999; Economic Commission for Latin America and the Caribbean, 2000). The Economic Commission for Latin America and the Caribbean (ECLAC) further estimates that there are 65 million urban micro-enterprises providing employment to 110 million people in the region. When this number is combined with small-scale farmers and rural, nonfarm entrepreneurs, the total size of the sector is massive relative to a 2000 estimate of economically active workforce of 219 million. In sub-Saharan Africa and South and Southeast Asia, the extrapolated estimates are equal or greater.

In addition to the sheer size of the sector, most micro-enterprises are informal, meaning that they are, at best, in partial compliance with existing government regulations governing business registration, taxes, zoning, minimum wage and social security provisions, and environmental protection. This informality combined with the marked weaknesses of environmental protection agencies in developing countries to effectively enforce environmental statutes and regulations creates the possibility for environmental harm. Furthermore, while each individual microentrepreneur may not be very detrimental to the environment, cumulatively the potential damage can be significant. Due to the informality of microenterprise, microfinance can provide a valuable interface to address environmental concerns. This could be an important strategy since it can potentially help address environmental issues in the largest segment of the developing world’s economy.

Since the 1970s public awareness about environmental pollution and degradation has increased and, consequently, raised the demand for more environmental regulations and stricter enforcement of them. Environmental activism started in the richer, more industrialized countries but has spread to middle- and low-income countries. There are three main areas of concern in environmental protection: unsustainable use of natural resources,
emission of effluents (air, water, and solid waste), and occupational health and safety risks. However, effective environmental protection is difficult to achieve in developing countries for a number of reasons. In developing countries legal and legislative frameworks are inadequate and environmental enforcement authorities are weak. Because poverty is more prevalent, citizens are forced to discount environmental amenities vis-à-vis immediate priories of sustenance and income growth. Citizens in these countries are also relatively uneducated about environmental safety, including remedial techniques, alternative clean technologies, and cost-effective occupational safety standards.

In recent years, national policy makers and international donor organizations have seen the promotion of microfinance programs as an efficacious anti-poverty instrument. In 1997, the organizers of the Microcredit Summit called upon world governments, businesses, and multilateral lending institutions to raise U. S. $21.6 billion to provide microcredit to 100 million of the world’s poorest families by 2005. However, the active promotion of microcredit and business development services targeting microentrepreneurs raises questions about environmental impact and appropriate remedial measures due to the sheer size of the microenterprise sector. It may be best to prevent large-scale environmental degradation and avoid major health risks now than to remediate after damage has occurred. Thus, policy makers face a difficult dilemma. On the one hand, avoiding environmental regulation may maximize short-term income and employment growth, but at an expensive long-term cost to the natural environment and future economic sustainability. On the other hand, overly strict environmental regulation may have a positive effect on the environment but also hamper the formalization and growth of the microenterprise sector and its ability to reduce poverty. In short, policymakers must either ignore the environmental consequences of microenterprise activities in an effort to promote short-term growth or craft cost-effective and practical mitigation strategies.
Clearly, those strategies that move people out of economic deprivation while maintaining their environmental quality are preferred. Crafting such strategies, however, requires an understanding of the economic and environmental impact of microenterprise in developing countries as well as the institutional context in which regulation and enforcement occur.

The Environmental Footprint of the Microenterprise Sector: A Survey of Latin America

While the economic impact of microenterprise in developing countries is substantial, what is less clear is how to deal with their environmental impact. Examining these issues in the Latin American context provides insights useful to other developing regions.

Most urban microentrepreneurs in Latin America are concentrated in commerce and service sectors and do not leave a heavy environmental footprint (see Table 1). They are food and produce vendors, seamstresses, hairdressers, tailors, shoe repairers, tire repairers, auto mechanics, and trash recyclers. The commerce

<table>
<thead>
<tr>
<th>Country</th>
<th>Agriculture</th>
<th>Industry</th>
<th>Commerce</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chile</td>
<td>13.5%</td>
<td>6.2%</td>
<td>41.5%</td>
<td>38.8%</td>
</tr>
<tr>
<td>Argentina</td>
<td>8.8%</td>
<td>57.9%</td>
<td>33.3%</td>
<td></td>
</tr>
<tr>
<td>Columbia</td>
<td>12.3%</td>
<td>81.7%</td>
<td>6.0%</td>
<td></td>
</tr>
<tr>
<td>Costa Rica</td>
<td>17.6%</td>
<td>55.5%</td>
<td>26.9%</td>
<td></td>
</tr>
<tr>
<td>El Salvador</td>
<td>24.8%</td>
<td>42.2%</td>
<td>33.0%</td>
<td></td>
</tr>
<tr>
<td>Guatemala</td>
<td>24.0%</td>
<td>45.0%</td>
<td>31.0%</td>
<td></td>
</tr>
<tr>
<td>Honduras</td>
<td>32.5%</td>
<td>43.5%</td>
<td>24.0%</td>
<td></td>
</tr>
<tr>
<td>Nicaragua</td>
<td>20.0%</td>
<td>47.0%</td>
<td>33.0%</td>
<td></td>
</tr>
<tr>
<td>Panama</td>
<td>23.1%</td>
<td>33.5%</td>
<td>43.4%</td>
<td></td>
</tr>
</tbody>
</table>

Note. Data on agriculture, forestry, and fishery sector unavailable for countries other than Chile. Lloréns, van der Host, and Isusi (1999).
and service activities that the majority of urban micro-entrepreneurs engage in may produce noise, congestion, and litter, but not heavy pollution. However, in areas where there is poor waste management infrastructure, refuse and litter from small businesses can be a significant environmental concern. Some urban businesses also encroach on and convert urban greenspaces (e.g., parks) and bodies of water for their own use. This impact is of concern due to the already very limited amount of urban greenspaces and other such amenities in developing country cities. The sector that is most pollution intensive—industry—is a distant third in concentration in most countries where data are available.

Furthermore, most environmental degradation caused by industrial activities operated by microentrepreneurs comes from the clustering of small-scale, pollution intensive industries near population centers. These industries include brick making, electroplating, and leather tanning, among others. These types of firms can have adverse effects on sewage systems, bodies of water, and the health of workers and inhabitants through the release of smoke, dust, and harmful chemicals.

In rural areas, empirical information on the intensity of industrial pollution is scarce. However, many small-scale farmers, fishermen, and miners do engage in unsustainable resource use patterns. In Latin America, a sizeable proportion of small-scale agriculture occurs on steeply sloped hillsides or fragile flat lands without appropriate soil and water conservation investments. The result is a loss of soil fertility on the farm plot and the elevated sedimentation of nearby streams, rivers, lakes, reefs, and dams due to high rates of water runoff and attendant soil erosion. There are also concerns about inappropriate use, storage, and disposal of chemicals and fertilizers by small-scale farmers. One common pollution problem associated with fertilizer use is excessive nutrient runoff into water bodies. That nutrient runoff degrades water quality for downstream users and negatively affects some forms of aquatic life. Another common problem is the improper use of agricultural pesticides, which leads to the contamination of drinking water.
Cattle grazing can also impact the environment negatively. Cattle grazing affects soil quality by compacting the soil and reducing vegetation cover, which leaves soil exposed to wind and water erosion. It also impacts biodiversity by altering the species composition and vegetation quality on grazing lands and in other natural areas (Taddese, Mohamed Saleem, Abyie, & Wagnew, 2002).

Lastly, in areas where an agricultural frontier exists, farmer colonization of previously untouched rainforest ecosystems often leads to deforestation, loss of biodiversity, and soil erosion. For the last several decades, some Latin American countries have recorded some of the highest annual rates of deforestation in the world.

The rural poor, and to a lesser extent, urban traders, tend to rely heavily on collection and trade in natural products (medicinal plants, wild game, building materials, fuel wood, fodder, and inputs for basket-weaving and other artisan products) to meet consumption and income needs. In some cases exploitation of those natural products has adverse environmental consequences (Tictin, Nantel, Ramirez, & Johns, 2002). Trade in wild game, or bushmeat, has become a central environmental concern in many developing regions, particularly in central and west Africa. Much of the trade is informal, and occurs in both urban and rural areas (Rosser & Mainka, 2002; Rao & McGowan, 2002).

Thus, small-scale rural producers may pose a greater environmental threat than urban microentrepreneurs do. However, the total value of damage caused to the natural resource base by urban and rural small-scale entrepreneurs is largely unavailable at national and regional levels.

**What Microenterprise Activities Are Pollution Intensive?**

Notwithstanding the generally low levels of pollution caused by small- and microentrepreneurs, there are several particular industries where clear evidence of high levels of pollution per unit of output exists. The industries are considered to have
pronounced adverse environmental impacts (Bartone & Benavides, 1993; Kent, 1991; Pallen, 1997).

Pollution Intensive Activities and Related Impact

Leather tanning
Tanning is a large sector in most developing countries. The major effluents consist of heavy metals, organic compounds, and liquid detergents, which are typically discharged into sewer systems, streams, and rivers.

Brick and tile manufacturing
Brick, tile, and ceramic manufacturing can be a major source of air and water pollution (particulates and sediments) as well as land degradation. The extent of pollution in this industry is largely a function of population density; the closer the kilns are to cities and crowded neighborhoods, the worse the pollution is. Often, the situation is aggravated by the burning of “dirty fuels” (scrap wood with varnish on it, tires, plastics, used motor oil, and solvents) as a low-cost alternative to clean wood or propane gas. Depending on where the materials used to make bricks are extracted, soil erosion and subsidence can also occur.

Chemical-intensive agriculture and aquaculture
In the quest to increase yields and incomes, many small-scale farmers with little understanding of associated environmental and health consequences use large amounts of pesticide, herbicide, and fertilizer without safeguards. In the case of aquaculture, the main environmental problems are the loss of biodiversity due to high conversion rates of wetlands and mangroves to fish ponds; water pollution caused by the improper disposal of blood and offal; the escape of water, soil erosion, and salinization because of poor pond construction practices; and the elimination of other species in the ecosystem due to the increasing use of extremely toxic chemicals such as aldrin and dieldrin to control predator and competitor fish species.
Environmental Protection

**Metalworking and electroplating**
Many metalworking enterprises are cottage industries discharge heavy metals in sewer systems and result in biological magnification in aquatic life, which in turn poses threats to humans who consume contaminated fish.

**Small-scale mining**
Small-scale mining tends to be associated with a number of serious environmental impacts, including land degradation and chemical pollution (Gavin, 2002). Mining operations move significant amounts of rock and soil that change the surrounding landscape significantly. Alluvial mining operations result in erosion, riverbank destruction, and dam siltation. The processing of ore, especially gold, results in the release of significant quantities of mercury and cyanide. When these chemicals enter water streams they affect aquatic life.

**Painting and printing**
Painting and printing involve a number of toxic substances. The improper disposal of pigments, inks, paper waste, and solvents can contaminate soil and water with heavy metals.

**Automobile and motor repair**
Auto repair firms contaminate the environment through the inappropriate disposal of oil, battery acid, and engine sludge into sewer systems and bodies of water.

**Wood processing and metal finishing**
The processing and finishing of wood and metal products involves the use of glues, paints, and solvents, the improper disposal of which can degrade soil and water resources. In addition, depending on location and market conditions, the increased demand for wood, coupled with outdated technology and inadequate regulation, may lead to high waste rates and contribute to unsustainable logging practices.
Charcoal making
The production of charcoal can contribute to deforestation and air pollution.

Textile dyeing
The dyeing of textiles can lead to large discharges of particulates, such as alkaline, into local water sources.

Food processing
Food processing plants can discharge significant amounts of untreated wastewater and offal into rivers and streams. This leads to degraded water quality with negative consequences for aquatic life and downstream communities. Also, when the wastewater is trapped in stagnant pools, it can be highly odorous and serves as a breeding area for mosquitoes.

What Are the Patterns of Occupational Health and Safety Risk?
A related form of environmental risk focuses on health and safety risks in the microenterprise industry. Again, data is quite limited on occupational health and safety issues in the microenterprise sector, but existing data and anecdotal evidence seem to suggest that the majority of small-scale entrepreneurs do not engage in practices to safeguard the well-being of workers and family members. Less than full compliance with established safety norms is due to low income, fear of not being able to compete with others who do not adopt safe practices, and lack of education about safe environmental practice (Pallen, 1997; Hiba, 2000). Many entrepreneurs believe that appropriate safety equipment is too expensive and unaffordable. For example, safety glasses and fire retardant work overalls cost more than regular clothing and no goggles. Due to low levels of income, many prefer to allocate income to higher priorities, such as food or schooling expenses. Also many do not know the long-term health consequences of unsafe practices or practical remedies for these consequences. Health problems...
<table>
<thead>
<tr>
<th>Economic Activity/Sector</th>
<th>Unsafe Work Conditions</th>
<th>Associate Health Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>Exposure to pesticides, herbicides, fungicides and moving parts and blades in machinery.</td>
<td>Chemical poisoning due to unsafe handling. Cuts and loss of limbs due to improper operation of machinery or failure to use safeguards.</td>
</tr>
<tr>
<td>Brick making</td>
<td>Exposure to particulates (smoke, dust, fumes), oxides of sulfur, nitric oxide, hydrocarbons, and carbon monoxide.</td>
<td>Skin irritation, allergic reactions, and chronic lung disease.</td>
</tr>
<tr>
<td>Ceramics, pottery, and glazing</td>
<td>Exposure to glazes containing lead, cadmium, chrome, zinc, asbestos, silica, uranium oxides, and deadly gases and metal fumes released during kiln firing.</td>
<td>Skin irritation, allergic reactions, chronic lung disease, and metal poisoning.</td>
</tr>
<tr>
<td>Enameling</td>
<td>Exposure to corrosive acids and silver solder containing cadmium.</td>
<td>Acid burns, chronic lung disease, and metal poisoning.</td>
</tr>
<tr>
<td>Food processing</td>
<td>Exposure to noise, humidity, machinery with sharp blades or grinders, and bones.</td>
<td>Repetitive use injuries, cuts, skin irritation, and bacterial disease.</td>
</tr>
<tr>
<td>Glass manufacture and glass blowing</td>
<td>Exposure to highly toxic gases and corrosive acids.</td>
<td>Heat stress, eye damage, acid burns, and carbon monoxide and metal poisoning.</td>
</tr>
<tr>
<td>Economic Activity/Sector</td>
<td>Unsafe Work Conditions</td>
<td>Associate Health Risks</td>
</tr>
<tr>
<td>---------------------------------------------</td>
<td>----------------------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Leather tanning</td>
<td>Exposure to toxic dyes and gases and chromium.</td>
<td>Skin irritation, intoxication, and damage to vital organs and allergic reactions.</td>
</tr>
<tr>
<td>Metal soldering, casting, welding, and forging</td>
<td>Exposure to toxic gases, silica, and asbestos.</td>
<td>Damage to the nervous system, heat stress, burns cuts, electrical shock, and chronic lung disease.</td>
</tr>
<tr>
<td>Mining</td>
<td>Exposure to mercury (in the case of gold mining).</td>
<td>Damage to organs.</td>
</tr>
<tr>
<td>Painting</td>
<td>Exposure to pigments containing heavy metals, toxic solvents, asbestos, and possibly carcinogens.</td>
<td>Skin irritation, intoxication, metal poisoning, and chronic lung disease.</td>
</tr>
<tr>
<td>Print making</td>
<td>Exposure to pigments containing cadmium, cobalt, zinc, asbestos, toxic and flammable solvents, and possibly carcinogens.</td>
<td>Skin irritation, intoxication, metal poisoning and chronic lung disease.</td>
</tr>
<tr>
<td>Textiles, dyes, batik</td>
<td>Exposure to poisonous solvents, corrosive vat and acid dyes, poisonous wax dyes, and possibly carcinogens.</td>
<td>Allergic reactions and chronic lung disease.</td>
</tr>
<tr>
<td>Wood processing</td>
<td>Exposure to toxic glues, paints, strippers, finishers, solvents and noise.</td>
<td>Skin irritation, intoxication, damage to vital organs, allergic reactions, and possibly hearing impairment.</td>
</tr>
</tbody>
</table>

due to exposure to smoke and solvents and injury due to repetitive tasks done without proper protective and ergonomic equipment may not become a problem for years, creating a sense of complacency in entrepreneurs (Hogstedt, 2000).

Table 2 lists some of the health and occupational hazards for a selected number of economic activities that small-scale entrepreneurs are involved in. According to the International Labour Organization (ILO), two-thirds of the workers in less developed countries do not meet minimum safety standards. In low-income countries a major part of the workforce is involved in agriculture, services, and cottage industries, characterized by heavy workloads and multiple tasks for each worker. Family members of the entrepreneurs are also exposed to health risks because the home and work environment are often one and the same. Furthermore, occupational risks are magnified by poor hygiene, sanitation, and nutrition, and parasitic and infectious diseases (Hogstedt, 2000).

**What Should Be Done: Institutional Context and Potential Approaches**

To improve environmental protection and occupational safety in the microenterprise sector, a careful and differentiated approach is needed in Latin America as well as other developing regions. To review, the threat of urban pollution exists from a few “dirty industries,” and with waste management in some commerce and services, but not for the majority of microenterprise activities. In rural areas the situation is more heterogeneous and does not permit generalizations. Depending on agricultural production conditions, management practices, and the ecosystems in question, natural resource degradation may or may not be a threat. Context specific information is needed before a judgment can be made for rural activities. In the area of occupational health and safety, the most serious life-threatening health risks arise from exposure to chemical agents, which seem to be concentrated in a few activities. However, work capacity risks such as workplace injuries and
repetitive use problems seem to be widespread and warrant some attention (Hogstedt, 2000).

The challenge becomes how to craft a response in this complex setting marked with such varied ecological and economic considerations. In general, there are three main approaches to mitigating impacts: command-and-control, economic incentives, and increased lender liability. Each approach has its strengths and weaknesses, and in the context of developing countries with limited scientific knowledge, low human capital, and weak enforcement capabilities, each must be used carefully to be effective.

Traditional command-and-control approaches to environmental protection and occupational safety are largely ineffective due to lack of enforcement capability, inadequate legislative frameworks, pervasive informality, high rates of poverty, and limited human capital in most developing countries. They tend to place a heavy burden on governmental enforcement agencies that have limited human and financial resources. In such a context, the best remedy would be to focus limited resources on the most egregious and threatening sources of pollution, degradation, and occupational risk (World Bank, 2000). Following this principle would entail environmental protection authorities focusing on pollution intensive manufacturing industries and largely ignoring small- and micro-scale entrepreneurial activities.

The newer economic incentive approach that has started to take hold in United States and the European Union, using tools such as “tradable emissions permits” and subsidies for the adoption of “clean technologies,” is not currently transferable to developing countries. This approach requires a preexisting base of extensive scientific field data, the ability to model financial and pollution interactions fairly accurately in order to design the permit and subsidy programs, the availability of affordable technological solutions, and the resources to bear the fiscal costs of the subsidies. In the context of developing countries, subsidies for cleaner technologies and training appear to be necessary and unavoidable. The question is how
to allocate limited resources judiciously to achieve the greatest results with a limited budget.

A third and, as yet, incipient approach is to use financial intermediaries to support environmental protection agencies and occupational health and safety authorities in enforcing relevant regulations. This approach appears to be an inviting solution, since financial institutions interact closely with the small businesses and provide opportunities to positively influence their clients’ environmental performance. However, one concern is that this shifts the administrative and enforcement burden from governments to financial institutions. Careful analysis shows that without adequate government support, this approach can have undesirable side effects when applied in a developing country context, particularly with microfinance. Principal among these side effects is an expensive administrative function requiring either additional dedicated personnel or an expansion of current team members’ training and duties. Great attention must be paid to the issue of raising costs in an industry where garnering sufficiently high returns to achieve sustainability is a concern.

This approach has, however, shown clear efficacy in the industrialized nations where a growing number of financial intermediaries are engaging in active environmental screening (Smith, 1995; UNEP 1998). Commercial banks review environmental impact assessments (EIAs), conduct environmental audits, and explicitly consider environmental risks in loan decisions (Vaughan, 1994). In developing countries, private commercial banks frequently have less incentive to be concerned about the environment, and therefore do not engage in the same degree of environmental screening as their counterparts in industrialized countries. The exceptions are with larger projects, or projects with obvious risks, such as dams, pipelines, or petrochemical factories (Smith, 1995; UNEP 1998).

Why is this the case? Because most banks in industrialized countries are being pushed to adopt more rigorous environmental standards out of fear of economic losses in projects with catastrophic environmental risks due to private lawsuits.
or government mandates. For example, in the case of the United States a series of laws, court cases, and regulations have established and defined the extent of lender liability for environmental damage. Essentially, lenders are responsible for environmental standards if they participate in management of a company and have the ability to influence treatment of hazardous waste. This makes banks that foreclose on pollution intensive clients extremely vulnerable.

In addition to facing liability for environmental disasters, a lender is also at risk of decreased cash flows due to unforeseen environmental costs faced by the borrower. These costs might include compliance with costly environmental regulations, fines for noncompliance, clean up costs, lost revenue from damaged reputation, production limitation or termination, and so on. These penalties damage a borrower’s profitability and thus hamper their ability to repay loans (Beanlands, 1999; Padden, 1996; Coulson & Dixon, 1995).

Further, banks in more developed countries are sensitive to community group criticism that can result in tarnished institutional reputations and lower profits (Smith, 1995). A handful of European banks, such as Triodos, view the environment as a “bankable” concept and are actively looking for and financing projects that involve clean technologies and sustainable resource uses, such as the production of building materials made with a high percentage of recycled materials, wind and solar power generation, and organic agriculture.

However, in many developing regions this is not the case. Countries in these regions have unclear environmental laws and less strident environmental advocacy from civil groups. Environmental legislation does not clearly address lender liability. No single provision squarely imposes liability on lenders and no provision clearly exempts or defines safe harbors (Gracer, 2000). This ambiguity in the law opens the door to private suits for environmental damage against parties with deep pockets, including banks.

In the financial services sector in Latin America, increased corporate responsibility tends to come not from environmental
regulation or advocacy but from contractual requirements in line of credit, guarantee, and grant operations funded by international donor organizations. For example, in the case of the Inter-American Development Bank there is a clear mandate to protect the environment in all project financing as described in the “Report on the Eighth General Increase in the Resources of the Inter-American Development Bank” (1994).\(^5\) The Inter-American Development Bank recently approved a formal statement mandating environmental protection called Guidelines for Environmental and Social Due Diligence for IDB Microenterprise Operations. Similar mandates exist for the World Bank, the International Finance Corporation, and some bilateral donor agencies. Furthermore, some organizations, such as Conservation International, have dedicated funds to be used for creating ventures that showcase and protect the natural environment, such as the Eco Maya project in Guatemala.

While such policies exist among many donor agencies, most of the environmental strictures created to protect the environment through sub-loans in Latin America are largely “unoperationalized,” and if applied, have been cumbersome and have met with some resistance (Taborga & Wenner, 1997; COFIDE/OACA/Ecolab, 1998; Zuccetti & Alegre, 1999). However, this may soon change as more tailored, sectorally targeted, and flexible operational guidelines are developed.

In addition to donor pressure, which is of critical importance, the other incentive for microfinance institutions to adopt environmental management policies is to avoid the risk of not getting repaid because of environmental problems with borrowers. For example, Beanlands (1999) relates a story of how the majority of a village in Vietnam rose up against a brickmaker who had located his factory in a densely populated area. He was forced to move the factory to a remote site at great cost. Such clients have a higher risk of defaulting on their loans. While brickmakers tend to be larger enterprises, this example demonstrates the financial risks associated with environmental damage in rural areas.
Many of the constraining factors listed previously—weak government, poverty, informality, lack of education, and lack of alternative technology—make implementing these mandates via financial institutions more challenging. For example, the traditional use of very rigorous environmental audits and environmental impact assessments (EIA) to screen and rank loan applicants is not applicable to most microenterprise projects in developing countries. The small size of loans demanded essentially negates the applicability of traditional EIAs. The cost of the EIA is likely to be more than the typical $50–$1,000 microloan granted in Latin America. Likewise, an exhaustive environmental audit may identify a number of glaring problem areas, but in the absence of effective infrastructure (e.g., regular waste collection) and readily accessible alternative technologies, appropriate training in new management, and production techniques, it has limited operational value. The audit may help in establishing a baseline, but by itself does not solve the problem of environmental degradation or unsafe working conditions. Moreover, the additional transaction costs entailed in using traditional instruments would increase the break-even interest rate to be charged, making microcredit even more expensive than it is already.

**Possible Solutions**

Given the dual objectives of poverty reduction and environmentally sound operations, two alternative courses of action exist. The first option is to increase the environmental awareness of microcredit clients and promote voluntary compliance rather than enforcement. The main incentives for clients of microfinance institutions to adhere to sound environmental management are perceived profit, health benefits, and sustainability of their resource inputs. A voluntary approach would build upon these incentives. For example, educating microcredit clients that well aligned and sharpened saws can minimize wood wastage and result in better selling products is one way to increase both profits and environmental soundness. Another
example would be for a microfinance institution to link one client whose waste byproduct (e.g., sawdust) could be the input of another client (e.g., packing filler or combustible fuel). Similarly, in rural agricultural settings improved environmental practices such as soil and water conservation create a win-win situation from both an ecological and a business standpoint (Barbier, 2000). In such cases, the objectives of poverty reduction and environmentally sound business are compatible.

The second option is for microfinance institutions to use simplified environmental assessment tools to identify a businesses’ environmental impact, eliminate or require mitigation from the riskiest businesses, and, depending on the scope of the impacts, choose a mitigation strategy. In the short run, an effective and feasible means of environmental screening would be to develop a list of entrepreneurial activities that are known unequivocally to pose serious environmental and occupational safety risks without the presence of mitigation plans. This would essentially eliminate the problem providing incentive for an entrepreneur to adopt cleaner technology that may not be readily affordable, as well as eliminate the transaction costs burden on the microfinance institution of having to train and monitor potential offenders. Interestingly, from an environmental perspective the “dirty industries” also tend to be the ones with the gravest occupational safety risks, so a list would be the simplest tool to use. Both approaches have unique advantages and can even be used in tandem.

Figure 1 contains a scheme that could be used for microfinance institutions. It is important to underscore the point that the cutoff loan amount for triggering more detailed environmental due diligence must be high enough not to generate excessive transaction costs. Furthermore, the measures of environmental due diligence would probably have to be more commonsensical and less scientifically rigorous than the traditional instruments used in developed countries.

In Figure 1, a proposed microloan screening procedure is diagramed. The microfinance lender would have a preestablished
Figure 1. Proposed schema to introduce environmental considerations in microfinance operations

- **Project is on exclusion list and no mitigation plan**
  - Yes: Reject
  - No: Continue

- **Projects has no or little environmental risk**
  - Yes: Process
  - No: Continue

- **Loan amount is less than cutoff or is for less than six month term**
  - Yes: Process
  - No: Continue

- **Conduct environmental due diligence (EDD)**
  - Yes: EDD report is considered in loan evaluation
  - No: Continue

- **Monitoring and evaluation system**
list of the most environmentally damaging economic activities, which would not be financed. If a project were not on the exclusion list and had little environmental or occupational safety risk, such as commerce, the loan could be processed according to standard credit-worthiness criteria. To economize on transaction costs if a project had some environmental risk, a cutoff loan amount or term should be set based on typical loan demand patterns and the level of economic development in the given country. Obviously, the higher the income and cost of living in the particular country, the higher the cutoff will be set.

For example, pig raising has some environmental risk, such as the runoff of pig manure into streams. However, if the amount lent for a pig-raising operation were small, only a few animals could be financed at a given time and thus the impact of manure runoff would be negligible. If the environmental risk level were medium to high and the loan amount requested passed a cutoff amount implying larger scale of operations, then some environmental due diligence or assessment is proposed (see Appendix). The due diligence would entail a site visit and an assessment of the amount of pollution or occupational safety risk proposed, the adequacy of existing mitigation systems, or likely effectiveness of proposed ones. The due diligence report supplements other credit risk assessments. To close the system and to help improve future screening procedures and financial product development, all the loans should be minimally monitored for environmental impact. Field officers should enter information on a selected number of environmental and occupational health and safety variables. This system implies that credit officers be given some minimal training in environmental risk assessment and management.

Conclusions and Recommendations

Microenterprise constitutes the majority of business firms in the developing world. While many microenterprise firms do not threaten the environment, some particular activities create pollution, impact biodiversity and other natural resources, and
generate occupational health and safety concerns. Despite the data problems and some uncertainty surrounding economic and ecological relationships, some pragmatic steps can be taken in this sector to mitigate existing damage and to protect the environment for both current and future generations.

The temptation to completely outsource environmental protection to financial intermediaries should be avoided. The main approach should be to directly help microentrepreneurs educate themselves about the environment, adapt more environmentally sound production technologies, and improve occupational safety standards. Instead of hectoring, the approach should be to convince microentrepreneurs of the private economic and health benefits of environmentally friendly practices (eco-efficiency). Focus should be on interventions that result in increased profits and productivity. Specific assistance could consist of loans and grants to increase environmental and occupational safety awareness, develop and diffuse environmentally friendly technology, improve environmental and occupational safety health data collection, processing, and analysis, and strengthen the public sector’s and community’s capacity to enforce standards. Partnerships will have to be forged between government, community, trade associations, and financial intermediaries to work jointly toward the goal of improved environmental protection and improved occupational safety and health. This latter area is the most fertile for quick, short-term solutions to problems as additional profits are developed that counteract program costs. The example of how brickmakers, environmental activists, and local government coordinated efforts and worked constructively to handle the pollution caused by traditional kilns in northern Mexico can be instructive (Blackman, 2000).

Pressuring microfinance intermediaries to better protect the environment by conditioning loans, however, should be done cautiously and carefully. Commercially oriented microfinance institutions are profit-oriented and dedicated to attaining financial self-sufficiency (Otero & Rhyne, 1994; Christen
et. al, 1995). The microcredit technologies that these successful institutions developed minimize transaction costs. Therefore, the incorporation of environmental concerns should be consistent with the dictates of financial viability and avoid reducing the competitiveness of such institutions if they are to meet the dual goals of poverty reduction and sustainable development. Clearly, initiatives should be streamlined and cost effective. Such interventions should serve to minimize repayment risks caused by unsound environmental and occupational health and safety practices (Beanlands, 1999). Further, financial intermediaries should actively adopt a forward-looking approach that views sustainable production processes as viable investment opportunities and begin to engage in “green financing” (e.g., micro drip irrigation, small-scale solar, organic agriculture, agroforestry, catalytic converters, etc.) where feasible.

In the shortrun, the primary focus of microfinance institutions should be to increase the level of awareness of both their staff and clients and recommend clients to qualified third parties for assistance in environmental management. With the exception of certain high-pollution activities lacking mitigation plans, microfinance institutions should be permitted to lend to all types of enterprises. Excessive environmental regulation runs the risk of introducing distortions and inefficiencies, namely, raising transaction costs without corresponding environmental benefits, reducing access to credit by poor microentrepreneurs, and encouraging more environmental degradation by severely credit constrained entrepreneurs who may be excluded from loans. The model should continually improve over time. Because environmental management in microfinance institutions is a relatively new topic, interventions should be closely monitored and evaluated.

Appendix

Environmental Assessments (EA) are used by a wide range of institutions to systematically identify environmental concerns, examine alternatives for impact mitigation, and report on expected

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impacts of projects activities. Applying EA to microenterprise requires making adjustments due to the scale and nature of microenterprise and the needs of MFIs.

In 2002, World Vision (WV) Canada began using EA and conducted staff trainings on environmental impacts of microenterprise at a regional workshop in Serbia. The EA tool was designed to be streamlined for quick analysis and ranking of the environmental impact of various types of business activities. An EA allowed for ranking sectoral impacts on the following: soils, land use, vegetation, wildlife, water quality, air quality, energy, health, and safety. Given the demands placed on microfinance staff, this rapid approach was appropriate for evaluating the level of environmental risk posed by each type of business activity.

Once the risks and impacts were identified WV staff were able to screen out certain high-risk businesses. WV trained staff on mitigation strategies involving proper waste and byproduct disposal. The trainers also encouraged MFI staff to identify and support environmentally friendly sectors such as recycling and waste management.

Similarly in Tanzania and Romania in 2002, MEDA provided environmental management training to its loan officers. Loan officers were trained to integrate environmental risk analysis into their loan review process. MEDA’s program also identified high-risk loans and devised strategies specifically for those loans. Other forms of environmental management were applied on a case-by-case basis. Source: Green Microfinance, 2003

Notes

The opinions expressed herein do not necessarily represent the official views of the Inter-American Development Bank, Brigham Young University Hawaii, the American University of Sharjah, and Green Microfinance. All errors and omissions are the sole responsibility of the authors.


2. An estimated 250 million accidental injuries with more than 300,000 fatal-
160 million new cases of occupational disease occur among the global work force each year. Poor occupational health and reduced working capacity may cause economic loss of between 10–20% of GNP. In developing countries the situation is worse. Only 5–10% of workers have access to adequate occupational health services in developing countries compared to 20–50% of workers in industrial countries. Source: Hogstedt, 2000.


4. For example, in Brazil, Law No 9.605 (February 1998) establishes broad civil and criminal liability for environmental violations. In Chile, La Ley de Bases (Framework Law) states in article 52 that “every person that intentionally or negligently causes environmental harm shall be responsible for such harm.” In Argentina, Federal hazardous waste law includes broad liability provisions, including the “owner and guardian of hazardous waste” (article 47). Under Law 24.051, a bank that forecloses on property and takes action to cause pollution could be deemed to have “utilized” the hazardous wastes in violation of the law.

5. In the case of the Inter-American Development Bank, there is a clear mandate to protect the environment in all financing projects in the “Report on the Eighth General Increase in the Resources of the Inter-American Bank,” (AB-1163) p. 42, paragraph 2.42. Similar mandates exist for the World Bank, the International Finance Corporation, and bilateral donor agencies. Recently, the Inter-American Bank approved Guidelines for Environmental and Social Due Diligence for IDB Microenterprise Operations (July 2003).

6. Other microfinance institutions can be poverty-oriented and place more emphasis on serving very poor and marginal clients. These types of institutions tend to be more subsidy dependent and long-term permanence and stability may be less certain; stability is largely a function of marketing and maintaining access to donor or social investor funds. The paper takes the perspective of commercially oriented microfinance institutions.

7. The risks, levels of investments needed, and the payoff streams of “green projects” are typically quite different from traditional microfinance activities aimed at commerce. Many “green projects” require large and lumpy investments at the start, face more marketing risks, involve higher cost of production, and may have lagged benefit streams (i.e., waste minimization, energy savings, increased soil fertility). Nonetheless, there seems to be very profitable niches to be explored in garbage recycling, organic agriculture, energy conservation, eco-tourism, etc.
References


Book Review

Building Businesses with Small Producers: Successful Business Development Services in Africa, Asia, and Latin America
Edited by Sunita Kapila and Donald Mead

Elizabeth Porter

The success of microcredit and microfinance in poverty reduction and income generation is responsible for the continual analysis of the growing role of business development services in the microenterprise and small business sectors of developing countries. Business development services offer a compliment, and sometimes an alternative, to lending for entrepreneurs who need assistance to establish small enterprises, expand production capacity, or improve product quality.

What is sometimes forgotten in the field of microenterprise development is that a majority of microenterprises and small businesses in developing countries do not yet have access to microcredit. Even where microfinance is available, it is not always a lack of financing that keeps businesses from expanding. As Building Businesses with Small Producers highlights, those in the field of microenterprise development are increasingly recognizing that “credit alone is not enough to result in sustainable increases in productivity and income.” Business development services traditionally assist with business startup,
product development, and market assessment and development and offer technical assistance and training in management, marketing, finance, and accounting. But what has the overall impact of business development services on microenterprise development been? Compared to microfinance and other income generation initiatives, are business development services cost effective?

Building Businesses with Small Producers presents the findings of a research project conducted in 1998 by the International Development Research Center of Canada and five major NGOs. Seven case studies of business development services projects are reviewed and compared, with a focus on analyzing the “design and delivery” of each of the business development services. The goal of the research project was to identify success factors among the seven case studies, with an emphasis on cost effectiveness, economic impact, and sustainability.

In the introductory chapter, the editors review the emerging role of business development services in the field of microenterprise development and give an overview of the seven case studies. The following chapters present the case studies in detail, which include a food processing project in Bangladesh, an export market project for small farmers in Bolivia, a light-engineering project in Zimbabwe, an edible oil project in Zimbabwe, an ornamental fish project in Sri Lanka, a grain marketing project in Ghana, and a smallholder coffee project in El Salvador. Five of the projects in these case studies are focused on establishing small agricultural enterprises and expanding the production of agricultural products. Only the light-engineering project in Zimbabwe and the ornamental fish project in Sri Lanka are not focused on agriculture. The case studies cover both local and export market development, with the analysis of the food processing project in Bangladesh serving as an example of developing products for a local market.

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The final chapter of the book presents some “good practice principles for the design and delivery of business development services” based on the findings of the research project. The editors suggest that the success of business development services is determined by factors such as the “scale of intervention,” “diversification in the delivery of services,” and “the key role of the implementing agency.” The editors then present suggestions for the development of commercial business development services and for the changing roles and evolution of established business development services. The editors also propose recommendations derived from the seven case studies on assessing impact, cost effectiveness, and sustainability of business development services.

In each of the case studies presented in the book, business development services were offered to subsectors rather than to individual participants, and the projects focused specifically on promoting microenterprise development among the rural poor. Because these projects focused on the rural poor, many of the clients were illiterate and located in rural areas; therefore the design of services didn’t necessarily include high levels of client participation. Also, in each of the case studies, NGOs played a key role in the project, and clients received a package of business development services, which included microfinance in several cases.

Overall, *Building Businesses with Small Producers* offers readers a comprehensive review of the factors that are essential to the design and implementation of successful business development services. Although the findings might not be entirely relevant to urban microenterprise development projects or business development services targeting small business or medium-scale enterprises, the book does offer lessons to microenterprise development practitioners and those in the microfinance sector.

The Miracles of Barefoot Capitalism makes a compelling case for microfinance by relating the experiences of microfinance recipients. The authors tell how these “barefoot capitalists” have made miracles in their lives and economies by using loans for as little as $35 to start microenterprises. The authors traveled to Africa, Asia, Latin America, and Europe to learn the stories of the microentrepreneurs featured in this book.

This book does not focus on training microfinance practitioners or teaching or researching microfinance, as much of microfinance literature does. Rather, it focuses on the stakeholders of microfinance (i.e., the poor), on whose shoulders the success of the microfinance movement remains. The authors have used a social anthropological approach in their writing, but the journalistic and philanthropic background of the authors has added to the value and readability of this book. The authors also raise microfinance issues in a global perspective and include dialogue from those that they interviewed.
The book consists of 15 chapters and includes a useful list of potential donors and supporters of microfinance in the appendix. The first chapter introduces microfinance. It reports that throughout the world, more than 2,000 microfinance institutions provide services to nearly 40 million microentrepreneurs, a majority of whom are women. If the family members of clients are included in the count, then nearly 150 million people have benefited from microfinance. But microfinance has yet to reach nearly a billion more people who live in poverty.

Microfinance projects have contributed significantly to changing the role of women in the economy. The second chapter discusses the effect that microfinance has had in empowering women. The authors state: “If a social evangelist had a choice of picking one tool, one movement with the goal of emancipating the poorest women on earth, the microcredit phenomenon wins without serious competition” (p. 26).

In the third chapter, the authors present a compelling argument for the responsibility of developed countries, especially the United States, to support microfinance. The authors remind readers that every year, nearly 10 million children die from diseases that could have been prevented, more than 100 million children are not able to attend school because their parents cannot afford it, and approximately 2 billion people do not have access to financial services to meet their consumption needs, let alone start microenterprises. The authors’ rationale for their appeal to the United States to fund microfinance projects is that the poverty of others may be a threat to our prosperity.

In the fourth chapter, the authors narrate the struggles Professor Muhammad Yunus faced while developing the microfinance movement, comparing him with Amadeo Peter Giannini, the founder of the Bank of America, and Curt Carlson, the founder of Carlson Companies. Born and raised in a poor family, but with some educational exposure in the

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United States, Muhammad Yunus, a Professor of Economics at Chittagong University of Bangladesh, initiated the microfinance movement in the mid-1970s with group lending among poor women in a village near the university. With an act of the Bangladesh Government, his project, called the Grameen Project, became the Grameen Bank in the early 1980s, and gradually the microfinance movement spread worldwide.

The book is an attempt to make people aware of microfinance’s potential to change the lives of the poor. Microfinance cannot solve every problem related to poverty, but it has become an important intervention for generating employment, alleviating poverty, improving the health, education, and livelihood of the poor, and building social capital. In several chapters of the book, the authors have included case studies from their fieldwork that illustrate these positive effects of microfinance. One such case study details the AIDS Widows Orphans Family Support (AWOFS) program, a service provided by the Nysamba hospital in Kampala, Uganda. This program houses victims of AIDS and uses small grants and loans to generate income in order to provide orphans of AIDS victims with education and training so they can obtain jobs that will allow their younger siblings to stay together. Pro Mujer in La Paz, Bolivia, is another small microcredit organization through which loans are provided to poor women, and women achieve greater empowerment in their male dominated society.

Several case studies illustrate how one individual can make a difference in the lives of many, such as Swithern Tumwimne of Kampala, Uganda. When Tumwimne was a child, he witnessed the murder of men and women in his village who were suspected to be opponents of the Idi Amin ideology. He managed to escape this fate, received education, and became the supervisor of a microcredit project in Kampala. He eventually became Executive Director of the African-originated microcredit group called UGAFODE (Uganda for Development).

A chapter is devoted to the microfinance initiatives in Nepal that have changed the lives of the poor in Nepal. In the
last chapter, the authors relate the popular case of the mobile phone service operated by 20,000 women who are members of the Grameen Bank. This chapter also reflects on the early struggles Professor Yunus faced in convincing bankers to provide loans to poor women.

The microfinance movement cannot reach every poor family in the world without the support of philanthropists, international funding, and development agencies. The seventh, ninth, and thirteen chapters detail the roles that philanthropists and agencies such as ACCION, FINCA, Women’s World Banking, Opportunity International, CGAP, USAID, and IFAD have played in the growth of the microfinance sector. In another chapter Wilkes makes an emotional appeal to philanthropists to support worldwide microfinance:

I am mother. I am a Harvard educated professional with a husband whom I adore, a big house we’ve made a home, books to read, and food on the table every day. I have a good life. But my conscience won’t let me sleep when I read about the plight of millions of families, fathers, mothers, children around the world. The last time I came home from Nepal and Tibet, I could hardly bear to go to our grocery store, overflowing with every kind of food imaginable while people are starving. (p. 125)

Because of the responsibility the authors feel toward the poor, they have established the Miracles of Microcredit Fund, under the Minneapolis Foundation, to receive contributions from individuals who wish to help the ambitious poor.

The Miracles of Barefoot Capitalism is not merely a review of existing literature on microfinance. The authors have spent time and resources with poor people, learning about their joys, pains, and successes. The book will interest scholars, policy makers, practitioners, and students of microfinance, as well as a general audience.

EDITOR: Deborah Eade, Oxfam GB

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