Plastic Bags and Bamboo Stools

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Marriott Student Review is a student journal created and published as a project for the Writing for Business Communications course at Brigham Young University (BYU). The views expressed in Marriott Student Review are not necessarily endorsed by BYU or The Church of Jesus Christ of Latter-day Saints.

Recommended Citation
Available at: https://scholarsarchive.byu.edu/marriottstudentreview/vol3/iss2/10

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Cover Page Footnote

This article is available in Marriott Student Review: https://scholarsarchive.byu.edu/marriottstudentreview/vol3/iss2/10
My Introduction to Microcredit

When I was 12, my mother read me an article from a magazine about a poor woman in South America who was given a loan of less than $100 to start a business.

The woman found a way to take grocery bags picked from the trash and weave them into purses to sell to tourists. In doing so, she lifted herself and her family out of poverty in an eco-friendly manner. The article took place about five years after the woman had started the business. It showed a glossy picture of her smiling with colorful purses. It also showed her children eating food purchased with their mother’s profits. Her business had grown to the point that her husband had quit his job as a laborer to help her weave purses all day. The author of the article emphasized repeatedly that the children could now afford to attend school, which would allow them to escape the poverty that had ruled their parent’s lives. My mother and I were amazed by this woman, but we were even more amazed by the concept of microfinance - the idea that just a little bit of capital could deliver someone from poverty. However, the reality of microfinance is much more nuanced. While microfinance is an amazing tool with huge potential to address the poverty problem, it’s a complex and limited economic system with a track record of both successes and failures.

Life Without Credit

In the modern world, access to capital is what allows most individuals to progress financially. Most Americans have benefitted from a loan to purchase a house, a car, or an education at some point in their lives. Imagine trying to progress financially without access to loans in order to receive an education or buy a house.

This is the reality the poor face every day. Often, they lack the capital required as collateral for loans. While the poor could take out a loan, most lack the ability to build credit to qualify. In addition, commercial banks work on too large a scale to meet the smaller needs many poor individuals have. They need small loans and would never be capable of paying back the larger loans available from banks. For banks, giving small loans is both high-risk and low-pay. Poor individuals do not have capital and commercial banks are unable to give it, leaving these poor individuals unable to invest in the future through education, real estate, or business endeavors.
**The Grameen Bank**

The birth of modern microfinance came when Dr. Mohamed Yunus studied poverty in Bangladesh. Dr. Yunus met a group of women who made bamboo stools for a living, and he learned that these women existed in a cycle of debt with local merchants. They borrowed money to make the stools, then sold them for a price barely higher than the raw materials. They would pay the merchants back for the materials every night, only to borrow from the merchants again in the morning. The merchants charged high interest, leaving these women with low profits and high risk for debt.1

Dr. Yunus was shocked to learn that all it would take to free this group of more than 40 women from debt was the equivalent of $27, but these women did not have access to $27. As an experiment Dr. Yunus provided the $27 himself, hoping that it would break the cycle. His experiment was a success, leading him to believe microloans could lift individuals out of poverty.2

Through trial and error, he found a structure for the bank that addressed the high default rates common among the poor. First, the bank gives loans almost exclusively to women. Women had a much lower rate of default and were more likely to use their loans in business ventures. Second, the bank lent to groups. The groups would meet weekly to make a payment and if one woman defaulted, all the women would pay the merchants back for the materials every night, only to borrow from the merchants again in the morning. The merchants charged high interest, leaving these women with low profits and high risk for debt.3

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They are much more involved than the average bank official.7

The most important success of microfinance is the way in which it improves the lives of borrowers. Many of the poor in developing countries benefit greatly from just enough capital to buy bamboo, install lights, or purchase an oven. Microfinance offers a way for those who couldn't afford it, to innovate and create.8

Microfinance is not without controversy. In 2010, over 200 residents of the Indian village Andhra Pradesh committed suicide, and the government incriminated microfinance companies in the investigations. Microfinance frenzy based on unrealistic expectations drove many individuals to over indebtedness, social isolation, and suicide. While suicide is an extreme example, microfinance can cause other cultural issues like domestic abuse.9

Microfinance gives loans to women to increase their social power and well-being, this often upsets cultural norm and has been linked to increased domestic abuse. Women participating in microcredit institutions are much more likely to be the victims of violence perpetrated by a loved one.10

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**Failures of Microfinance**

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**Outcomes**

Microfinance outcomes While microfinance certainly makes a difference, sometimes that difference is not as long-lasting as we assume. The structure and endurance of these microcredit businesses is also nuanced. Most microcredit businesses never grow past a single employee, find stability, or last more than a few years. One study in Mexico showed 15% of those living on less than a dollar a day had a business. In a follow-up study three years later, only 41% of those remained open.14 In Indonesia, only about two-thirds of businesses stayed open for more than five years, and very few ever had an employee, suggesting that these microenterprises are more stable than hoped for.

**Successes of Microfinance**

The structure of microfinance institutions has proven to be incredibly successful. Most have a rate of over 95% repayment, likely due to the group model. To not pay back your loan is to risk social scorn and exclusion which provides more security than most credit agencies are capable of supplying. In addition, microfinance officials are deeply embedded in the community and work closely with loan recipients. They help improve financial literacy.15

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Other times loved ones put individuals under so much pressure that they will give up food, borrow money from lenders, and sacrifice school to make their payments. While microloans provide needed credit, when used poorly, they can push a family further into poverty.

Another issue is the effect on local economies. While micro endeavors should theoretically grow the market, loans are approved for specific purposes screened by bank officers. As a result, many endeavors, such as fattening cows or raising chickens, are repeated. This can saturate local economies because most local villages only have room for a few chicken farms before there is no longer a demand for chickens.19

Because of the limited scope of microloans, many women still don't have the capital needed for their endeavors. Many women in one village felt the best way to increase their income was to rent land, but because real estate loans were prohibited by bank officials, they would lie about the purpose.20 Some operate under specific premises, such as providing loans only for water projects, yet not providing investments for livestock or small business ideas.

Other critics suggest that those living in poverty are not the underprivileged entrepreneurs we would believe. Many of the poor open micro enterprises as a last desperate resort when they cannot find another job.21 While there are success stories, many of these enterprises, like plastic-bag-refurbishing businesses, contribute much less income and stability than hoped for.
likely to change someone's year than someone's life.11

One reason these businesses don’t help as much as it seems they should is the difference between marginal and overall return. Marginal return is return per dollar, and overall return is the total profit. While marginal returns for microfinance are high, very few microenterprises can scale large enough for a significant overall return.10

Economists Esther Duflo and Banerjee, while evaluating microinstitutions in a randomized control trial found that those with loans were more likely to have started businesses, consumed less, and saved more. There was no difference in education, health, and women’s status overall. In addition, these businesses often did not greatly increase the family’s income. However, participants had better direction, plans, and goals to lift themselves from poverty.18

DOES MICROFINANCE MAKE A DIFFERENCE?

While I now understand that refurbishing grocery bags is not a one-size-fits-all answer, I still think that it is a solution worth considering. Despite extensive googling, I was never able to find out what happened to the woman with the bag business. I sincerely hope her children went to college, she continued to make a profit, and her entire family found financial peace. However, the data is against that happening. I’m afraid that, like most other microfinance cases, her experience with microfinance helped her for a while, but failed to bring lasting change. The people who benefitted most from her story may not have been her family, but the tourists who bought the bags; and the humanitarians from America who congratulated themselves on changing her life.

Often when we try to do good internationally, people in poverty become one large entity for us. We feel that starving children in Africa are all the same, and even worse, we assume every child in Africa is starving. It’s tempting to assume that if we just invest in a business or education, we will change someone’s life; however, we fail to consider the political and economic systems that created these lives in the first place. Microfinance will allow some individuals to improve their financial status, but it’s not right for everyone, and when done incorrectly, there will be a high opportunity cost. The way to make change is not to have big emotional experiences with individuals; it’s to invest in government and infrastructure. Often times, we don’t do this because there is no emotional experience, and it takes the starving orphans we so dearly love out of the picture.

When individuals participate in microenterprises, it takes away from their time and their resources. It prevents them from getting other jobs, using their money on other supplies, and even enjoying their time. It can also distract from more important problems. Sometimes, instead of microfinance programs, what people really need is safety, political change, or health. While I once assumed that microfinance was the answer, it has a role to play. Whether or not the bag woman’s business lasted, it gave her, at least, a few good years. Having reasonable expectations and being culturally conscious will help us improve the system. While microfinance is not a perfect solution, it breaks cycles of debt, provides entrepreneurship, and gives hope. While refurbishing grocery bags won’t eradicate poverty, microfinance is essential in the fight. I don’t believe that microfinance is the answer, but it has a role to play. Whether or not the bag woman’s business lasted, it gave her, at least, a few good years. Having reasonable expectations and being culturally conscious will help us improve the system. While microfinance is not a perfect solution, it breaks cycles of debt, creates entrepreneurs, and gives hope. While refurbishing grocery bags won’t eradicate poverty, microfinance is essential in the fight. I don’t believe that microfinance is the answer, but it has a role to play. Whether or not the bag woman’s business lasted, it gave her, at least, a few good years. Having reasonable expectations and being culturally conscious will help us improve the system. While microfinance is still flawed, it still provides smart and hardworking individuals with the opportunities they’ve been waiting for.

While we should be realistic about the limitation of microfinance, it’s important not to give up hope. It’s better to do something than nothing. Maybe a small loan isn’t going to break a cycle of poverty, but if it keeps a family afloat for a while longer it’s still worth it.