Conference Presentations

Microfinance: Flavour of the Month or Practical Development Alternative?

Gord Cunningham
***Program Staff*, Coady International Institute, St. Francis Xavier University**

Presented at the Yukon Economic Forum: "Ideas Summit," March 25th, 2000
Whitehorse, YT

Introduction

I understand that this section of the Yukon Economic Forum is called the Ideas Summit. I hope you will not be disappointed when I tell you that I have traveled from about as far from Whitehorse as one can in this country, not to talk about an idea of mine, but about an idea of yours. Last week in Whitehorse a new initiative was launched. It is called the Yukon Micro Loan Program, and while it was conceived here in the Yukon it joins a membership of more than 7,000 organizations and programs around the world. These organizations are part of a worldwide "microfinance" movement that provides crucial financial services to more than 20 million people who were not deemed bankable by mainstream institutions.

The title of my presentation is "Microfinance—Flavour of the Month or Practical Development Alternative?" What I'd like to do is tell you a bit about the microfinance movement worldwide and particularly my experiences with it here in Canada. Hopefully this broader perspective will give you a sense of both the challenges and the potential for the Yukon Micro Loan Program. Ultimately, you will determine whether it is just another community economic development "fad" or is here to stay.

What is Microfinance?

First of all, when I use the term "microfinance," what am I talking about? Microfinance generally refers to the provision of small-scale savings, credit, insurance, and any other financial services, to those who cannot access them from formal financial institutions.

The History of Microfinance[1]

Microfinance is a relatively new term. But most societies and cultures have a long and rich history of traditional or informal savings and credit arrangements. The "susus" and "tontines" of West Africa, the "chit funds" in India, the "tandas" in Mexico or the legion of savings clubs and burial societies found in all parts of the world have operated for centuries (probably since the introduction of currency). In the late-19thcentury, various types of larger and more formal savings and credit organizations emerged in Europe and were organized primarily amongst the rural and urban poor. These institutions were known variably as People's Banks, Credit Unions, and Savings and Credit Co-operatives.

In the first half of the 20th century, various adaptations of these models were promoted by colonial administrations in the countries of South. While the goal of such rural finance interventions was usually defined in terms of "modernizing the agricultural sector," there were usually two specific objectives of such initiatives: increased commercialization of the rural sector (by mobilizing "idle" savings and increasing investment through credit) and reducing oppressive feudal relations that were enforced through indebtedness. But in most cases, these new banks for the poor were not owned by the poor themselves (as they had been in Europe) but were owned by other institutions, usually government, parastatal agencies or banks. Over the years, these institutions tended towards widespread inefficiencies and abuse, such that by the 1970s, just as the development industry was gaining its stride, the field of "rural finance," as it was generally known, was quite widely discredited as a development intervention.

The late 1970s and early 1980s saw the emergence of "microenterprise lending" programs, meaning an almost exclusive focus on credit for income generating activities (in some cases accompanied by forced savings schemes) and targeting very poor (often women) borrowers. The early focus of most microenterprise lending programs was upon proving that the poor were creditworthy. Indeed, the Grameen Bank, often referred to as the "flagship" of the new microenterprise lending movement, was largely focused on credit, with savings mobilization largely seen as a means to promote discipline. The Bank's founder, Dr. Mohammed Yunus, began in the 1980s to refer to "credit as a human right." Savings were conceived of as a method to ensure repayment, rather than as a service or end in itself.

By the late 1980s, the provision of credit to the poor had re-emerged as probably the most popular and high profile of all development sectors in terms of volume of resources invested in it and the claims of poverty alleviation attributed to it. It was not until the mid-1990s that the term microenterprise lending began to be replaced by a new term that included not only credit, but also savings and other financial services. Microenterprise finance or " microfinance" emerged as the term of choice to refer to a range of financial services to the poor, that included not only credit, but also savings and other services such as insurance, and occasionally pawning, or leasing.

The 1990s have seen growing enthusiasm for promoting microfinance as a strategy for poverty alleviation. There is a global campaign underway, under the banner of the "Microcredit Summit" and led by some of the largest donor organizations in the world, to extend the reach of microfinance to 100 million of the world's poorest microentrepreneurs by 2005. This "flavour of the month" status has been largely based upon a few select success stories of microfinance institutions (Grameen, BRI/Unit Desa, BancoSol, etc.) that have reached large numbers of clients with innovative lending methodologies while providing scope for these institutions to reach financial sustainability. It should be noted, however, that out of the roughly 7,000 microfinance organizations or programs worldwide there are less than one hundred that could claim to be financially self-sufficient.

The History of Microfinance in Canada

I'm not a historian but I would hazard a guess that the history of microfinance in Canada probably begins in the late 1800's with the Alfonse and Doriene Desjardin's lobbying efforts against usury and their search for alternative credit models. In France and Italy they saw examples of the first people's banks (referred to earlier) and set about creating the first *caisse populaire* in Canada in 1901. In the early part of the 20th century, the Fr. Moses Coady and his colleagues in the Antigonish Movement began establishing small savings and credit cooperatives in northeast Nova Scotia (many of them starting with just a handful of people sitting around a kitchen table). Before long the credit union movement was firmly established in both French and English Canada. I see from the Yukon Economic Forums website that Kenton Eggleston has already given you a more detailed history of the credit union movement in Canada.

As the credit union movement matured (amalgamations and federations) it had a tendency to "move up with its members." Where once credit unions appealed to those without access to (non-usurious) credit we now see them competing for the business of their members. To retain their members they have to offer all the same services as the chartered banks (credit cards, debit cards, telephone banking, online banking, mutual funds, etc.). Part of the price the credit union movement has paid for joining the big leagues is that they have moved away from providing credit to the very smallest of businesses. There are no doubt exceptions to this trend—one notable example is VanCity Credit Union in the lower mainland of BC, which has created a "development banking" arm and is actively promoting microfinance today.

But the overall trend of credit unions away from microfinance really is a problem because Canada's banks have never been interested in making small loans. The main reason is cost. It costs the banks as much to make a $1,000 as a $100,000 fixed term loan. Quite simply, small loans do not generate enough revenue to cover the assessing, processing and administration costs (never mind bad debt). That is why for years banks have been getting customers to put small loans (say under $5,000) on operating lines, overdrafts or even credit cards—much lower cost facilities that generate higher revenue. Rather than look for innovative low-cost ways of making micro business loans (for example, the way Wells Fargo has in the US) the Big Six in Canada have, by and large, ignored this sector. A notable exception here is the Royal Bank, which is supporting two significant microfinance initiatives in Atlantic Canada.

In the post-war period, governments filled the credit void for micro and small business through a bevy of grant and loan programs. Unfortunately for many of the loan programs, borrowers often confused the concepts of "loans" and "grants." While these programs were not particularly successful they did provide access to credit for many people shut off from conventional sources and the state was able to absorb the high loan losses and operating costs. That all changed in the 1980s with the debt/credit crunch. The state started retreating from the lending business.

At the same time, Canada was experiencing a dramatic increase in self-employment. Government and corporate downsizing in response to the debt issue overlapped with the more gradual shift that was taking place from a goods producing to a service economy and created a situation where many more people than ever before were willing to risk self-employment. This situation was reinforced by the movement of the baby boom generation though existing organizational structures (David Foote's description of a rectangle trying to fit into a triangle), which led many boomers to look for alternative ways to satisfy their career aspirations. A severance package or the presence of a working spouse coupled with a preference for being your own boss made self-employment an attractive option for many people whom a decade earlier would not have considered it.

In the US, a similar series of trends (made worse by the "redlining" of certain inner city neighborhoods by banks) led to the creation of the Neighborhood Reinvestment Act (legislation that compels banks to lend locally in proportion to the amount on deposit locally). Indirectly this resulted in the creation of a large number of community-based microenterprise lending organizations that were willing to act as financial intermediaries between the banks and microentrepreneurs. At the same time, a couple of innovative microfinance organizations that had considerable experience with micro-lending methodologies in the developing world began setting up shop in the US. The most notable of these is ACCION, which set up organizations in several US cities. Other homegrown initiatives, like the Good Faith Fund in Arkansas or the Women's Self-Employment Project in Chicago, were actually catalyzed by Shorebank-a Chicago-based bank that has set the standard for progressive and profitable lending to low-income neighborhoods.

The Modern Era of Microfinance in Canada

In Canada, most of the early microfinance efforts were undertaken by an organization known as Calmeadow. In the mid-1980s, Calmeadow had been studying the success of international microenterprise lending initiatives in places like Bangladesh and Bolivia, and they decided to look at the feasibility of microenterprise lending here in Canada. In particular, Calmeadow wanted to work with First Nations communities that had been complaining for years about lack of access to bank credit.

In 1987, I was hired to visit several First Nations and learn about the nature and extent of small-scale self-employment in these communities. I was blown away by what I found. On average, one in every three households was engaged in some form of home-based, cash generating activity. Even in communities with official unemployment rates as high as 70% and very few visible businesses (often only one or two), there was an astounding rate of self-employment. These small businesses were invisible to outsiders, not because they had anything to hide, but because everyone locally knew what they produced or sold. Everyone knew where to go to get your television fixed, or some fresh bread or a quart of milk. Sometimes the only way for an outsider to know something commercial was taking place in a house was to look for a well-worn path in the snow or mud.

Where did these folks get credit? In many cases they didn't-other than from family and friends. If they received institutional credit it was because they had established track records with suppliers or they lived close enough to a non-native community where there was a finance company-or even a department store or hardware store that offered a credit card.

Based on this information, Calmeadow began working with three First Nations in the Great Lakes region to set up experimental micro-loan funds. In the fall of 1987, these became the first group-lending operations in North America.

Group-lending, which the Yukon Micro Loan Program employs, and which was developed in Asia and Latin America, basically turns the borrowers into bankers. Prospective borrowers form themselves into groups, knowing that their own access to future loans depends on the repayment record of the other members in the group, rather than on collateral. Group members assess and approve (or reject) each other's loans, and if there are problems with any of the loans, the whole group is responsible for repayment.

I will try and sketch out the main variations on this theme for you so that you can better understand the group lending process:

1. Village banking/one large group/savings led/matching funds from external support organization
2. Groups of groups/access to future credit is dependent on each member of the group repaying/usually some form of pressure from the other groups as well (there may be a community-level emergency fund)
3. Solidarity groups/legal obligation to repay other members loans/joint and several guarantees

Calmeadow's rural initiatives (the First Peoples Fund and Calmeadow Nova Scotia) were closest to the "groups of groups" approach, although there was an element of the village banking structure involved:

- The money for loans came from a nearby bank branch and was partially guaranteed by the local community and by Calmeadow
- A local organization was formed to administer the loan fund or this function was "piggybacked" onto an existing organization
- Administration of the loan fund consisted largely of "social intermediation" between the bank, Calmeadow and the borrowers
- A local loan fund coordinator would be recruited/selected by the local organization and trained by Calmeadow to orient new groups, process loan applications (in some cases actually handle loan repayments) and follow up on any delinquency
- Calmeadow contributed to the local operating costs of the loan fund (stipend for local loan fund coordinator, initial promotion, administration costs and the loan guarantee at the bank) on a three-year declining basis after which the local organization would be responsible for all costs
- Calmeadow assisted the local organization in a business planning process to ensure that their costs and revenues were on a sustainable track

Experience has shown that a rural, community-based microfinance model can work in Canada[2]. What were some of the positive impacts?

Impacts of loans

- Increased incomes
- New or expanded businesses-new jobs and new goods and services available in the community (less leakage)
- Individuals can develop a positive credit history and this can lead to "graduation" or additional credit sources-i.e., trade credit
- New opportunities for young people to stay in the community
- Positive role models for young people

Impacts of group membership

- "Mutual support." Being self-employed, particularly home-based self-employment, can often be very isolating. Many people want and need to be able to occasionally share the ups and downs of business with others in the same boat.
- Once people begin trusting each other, they start talking about the real issues facing their businesses. Often, new opportunities and ideas emerge from this process. For example, you may find out that one of your group member's brothers is a truck driver who travels back and forth every two weeks to the same town where your main supplier is located. He turns out to be willing to regularly pick them up for you, saving you time and money.
- Sometimes this networking turns into new economic activity. I can recall several craftspeople from the same borrowing group in Shelburne, Nova Scotia coming together to set up a gift shop on the main street. Or a home-based seamstress and a woman who sold Christian gift items from her home, getting together to create a store in Lockeport, Nova Scotia called "Bibles and Bobbins." Or two furniture makers from different borrowing groups who met at an annual meeting of all the groups, coming up with the idea of renting out an empty storefront together for the two months leading up to Christmas and doing extremely well. I also recall First Nations artists, who at first kept their customers pretty close to their chests, gradually agreeing to produce a joint calendar and then eventually to set up a small gallery together. Perhaps the most ambitious "value-added" activity I saw emerge from the group lending process was a group of craftspeople that produced a gift catalogue for corporate gifts. They sent it to all the top companies in Nova Scotia and some individuals received some large orders.
- Sometimes the coming together in groups leads to people pushing for (and agreeing to help with) community improvements—Christmas decorations to promote local shopping, getting the phone company to install new lines to upgrade the old "party line" system, which wasn't very good for home-based businesses (mini chamber of commerce).

It wasn't all sweetness and light. Over the years I learned a few lessons I'll never forget.

Main Lessons Learned

- Never call what you are doing a "program." People will likely view it as "here today and gone tomorrow." As a result they will either stay away or not take loan repayment seriously.
- You really need to understand whom exactly you are trying to reach. In Nova Scotia it took me several years to figure out that we really had five main categories of target borrowers—graduates of Self Employment Assistance (SEA) programs; visible minorities (immigrant communities, African Canadian communities and Mi' kmaq First Nations); Social Assistance recipients; artists and craftspeople; and, women—and we needed a distinct strategy to attract each group.

— It didn't take me quite as long to figure out that having several people with start-up businesses in the same group is a bad idea. It is too risky and they really can't give each other much more than moral support.
— What your target borrowers may actually want and need may differ from what you are offering. For example, it was clear after some time that people who continuously required working capital loans really needed small operating lines of credit. We were not in a position to be able to offer this. On the other hand, we were able to respond to the demand for larger loans and perhaps more significantly, for individual loans.
— How a microfinance initiative handles the first few "problem loans" is critical to determining how existing and future clients will perceive the loan fund. The key is to balance the need to be fair to those who "can't pay" without tolerating those who "won't pay."
— It is very difficult to reach large numbers of borrowers cost-effectively if they are scattered among many small rural communities. That said, small community-based models can work; they may not have large numbers of borrowers, but if they have local ownership (and impacts) they can be sustained.
— In order to be sustainable, there needs to be a commitment to the principle of sustainability and a planning process in place at the outset. Sustainable doesn't just mean self-financing. In rural Nova Scotia we had a half-dozen volunteer community groups willing to raise money year after year to support their local microfinance initiatives.

If microfinance initiatives are going to survive and thrive there is one lesson that is clear the world over. They need to gradually become independent of donor organizations. There is an old Bangladeshi saying that always comes back to me when I think of this issue:

"When you walk with your hand in someone else's pocket, you walk where they walk".

Thank you.

Endnotes

1. This section was adapted from a portion of a Microfinance training module entitled *An Introduction to the Principles and Practice of Microfinance*, written by Anthony Scoggins, one of my colleagues at the Coady International Institute.

2. There are now at least 32 micro-loan funds in Canada and 350 in the US. If you want to find out more about these initiatives, Calmeadow put out a directory of Canadian micro-loan funds in 1999 (available online) and the Aspen Institute in Washington sells a directory of US funds for $15 US. The only initiatives of any significant size that I am aware of are: Calmeadow Metrofund in Toronto, Calmeadow Nova Scotia, Communi-k (formerly Calmeadow West, now run by VanCity Credit Union), Women's World Finance in Sydney, Nova Scotia, the SEED Loan Fund in Wellington and Waterloo Counties in Ontario, the Start-up Loan Fund in Calgary and the Edmonton Community Loan Fund.