Eradicating world poverty is within the reach of each one of us. Microfinance has started a global movement. Almost fifty million of the world’s poorest families now put microloans to work. There are more than a hundred programs that use the Grameen model to break through poverty. However, with three billion people living on less than two dollars a day, the untapped market for microfinance remains vast. Microfinance is an effective anti-poverty strategy that can create an impact that lasts well beyond the original investment.

1. Poverty: A Global Epidemic

As the divide between the wealthy and poor nations becomes increasingly wider, an ever-increasing number of people feel the effects of poverty. Many agencies attempt to quantify poverty as a measure of income, typically as one to two dollars a day. The Office of the United Nations High Commissioner for Human Rights (2002) expresses poverty in a more tangible fashion as “a human condition characterized by the sustained or chronic deprivation of the resources, capabilities, choices, security and power necessary for the enjoyment of an adequate standard of living and other civil, cultural, economic, political and social rights.”

The global statistics for poverty are staggering. In their quantification of poverty, Eichfeld and Wendt (2006) stated that in 2001, 2.7 billion people were attempting to survive on less than $2.15 per day and one billion of those people were actually making less than $1.08 per day. While we live in relative comfort here in the United States and the Western world, over 47% of the population of the world struggles to survive. The problem of poverty affects basic human conditions. Since the 1980’s, the increasing void between rich and poor has also been contributing to this problem.

Causes of Poverty

Direct causes of poverty vary by region in specificity but on a general level, there are common causes. The geography can determine the wealth of a people by determining their accessibility to natural resources for food or economic output in the form of mineral wealth or oil. Political situations can cause unequal distribution of wealth where a disproportionate minority controls a great majority of the economic wealth of a region (Lokollo, 2006).

Globalization is an additional contributing factor to the increasing number of rural poor in the world. Industrialized nations are getting wealthier and poorer nations are marginally improving. A common misconception of poor people is that they lack a desire to save money and want to spend all that they earn. Research shows that this is not true. The poor do show a strong desire to save for the same things that others save for, such as, emergencies, investment, sickness, disability, education, future consumption, and retirement. Typically, when there is a lack of safe investment in areas with high levels of poverty, jeweler and livestock become typical forms of savings. In addition to the lack of quality savings, the rural poor do in fact have a high demand for credit. Common sources of credit for the poor are larger financial institutions that typically deal in large loan amounts which are out of reach to people with poor collateral and therefore high credit risks, and smaller lenders that charge exorbitant interests rates. These factors make obtaining credit very difficult to people in overwhelmingly poor areas. The cycle of poverty becomes self-perpetuating (Lokollo, 2006).

Failures of common remedies

Through the mid to late twentieth century, the favored approach to alleviating the situation of
poverty in the world was a top-down approach. Governments and charity organizations would invest large sums of money and resources in large-scale projects meant to give employment and provide a benefit to the poor but more typically, wind up benefiting the corrupt governments run by the elite minorities (Eichfeld & Wendt, 2006).

Microfinancing

A young economist from Bangladesh while leading his students on a field trip in 1976 observed a typical example of the cycle of poverty. A woman making bamboo stools had been utilizing a typical means of financing her business endeavor. She had been making mere pennies per stool due to the terms of her loans of raw materials from a trader. The trader would dictate a purchase price for the final product. Again, this was placing Sufiya Begum, the stool maker, in a cycle of perpetual poverty. She could not be in business without the support of the trader but because of the terms of her loan, she would never make enough profit to be able to expand her business and have a more comfortable lifestyle. The analysis of this situation by Dr. Yunus led him to develop and experiment with a new concept called Microfinancing. With just $27 from his own pocket, Dr. Yunus had made loans to forty-two basket weavers in Bangladesh. This very small infusion of capital allowed these basket weavers to prosper, become more self-sufficient, and eventually brings them out of extreme poverty (Eichfeld & Wendt, 2006).

This experiment and other research led Dr. Yunus to theorize that the primary target for these micro-loans should be women. The systems that he developed to ensure a higher rate of return are to loan money based on social networks of support. These networks are more effective when they comprise mostly of women. The poverty rate among women is typically higher than that of men due to social discriminations. Women are also more likely to repay the loans and invest their profits towards the benefit of their families and businesses (Eichfeld & Wendt, 2006).

Over the next several years, Dr. Yunus expanded his successful experiment in to the creation of Grameen Bank in 1983, which has become enormously successful in its mission of helping overcome extreme poverty. The successes of Grameen Bank and other organizations that have used this formula have earned Dr. Yunus numerous awards, including the Nobel Peace Prize, which was shared by Grameen Bank.

2. Microfinance Institutions (MFIs)

A microfinance institution is the lender that directly supplies a loan, credit, or other financial service to a borrower. In most cases, the lender tends to be a bank, credit union or other financial organization. Borrowers work with the microfinancing institutions (MFIs) directly, but there may also be another organization that also interacts with the MFI. These intermediaries can be private donors or government, non-government (NGO), and global organizations that assist with funding, setting up and overseeing programs, or offering advice.

According to World Bank Statistics, there are approximately 7,000 microfinance institutions worldwide and they only reach 4 percent of the people in need of assistance. Most microfinance institutions will lend out funds to borrowers with a certain interest rate. Some institutions have interest rates that vary according to what the funds are going towards. For example, Grameen Bank charges 20% interest on any funds that generate income for the borrower. For student loans, Grameen Bank only charges 5% interest and 8% interest for housing loans (Grameen, 2007).

Lending out finances to individuals without any collateral is high risk and commercial banks tend to stay away from this type of practice. Data from the Micro Banking Bulletin reported that 63 of the world’s top microfinancing institution had an average rate of return of 2.5% of its total asset. This does compare favorably to that of commercial banks and will hopefully entice them to create microfinancing projects (UNCDF, 2007).

United Nations
The United Nations has a branch called the United Nations Development Program (UNDP), which is their global development network. This is the world’s largest multilateral source of development (Wikipedia, 2007). The UNDP is set-up to connect least developed countries (LDCs) to knowledge, resources, and experience to assist them in living a better lifestyle. By providing microfinance assistance to people (mostly women) in developing countries, the UNDP is helping them attain two of the Millennium Development Goals, eradicating poverty, and promoting gender equality.

The United Nations also developed a fund, which offers a unique combination of investment capital, capacity building, and technical advisory services to promote microfinance in the LDCs called the United Nations Capital Development Fund (UNCDF, 2007). Prior to microfinancing, there was no means of acquiring any sort of financing from commercial banks. As stated earlier, the borrower having no collateral and the risk of non-payment was too risky for a commercial lender. The UNCDF focuses its microfinance development on the development of an inclusive financial sector that will have financial institutions competing for business by offering a variety of financial services to borrowers (UNCDF, 2007). The goal is for people in rural areas, women, individual entrepreneurs, and small businesses that are already established to have access to microfinancing institutions and the services they provide. These MFIs will be local and include all types of services, so traveling to different cities or villages for different needs will not be necessary.

An Investment Committee decides where to disperse grants and credits, gained from donations, based on proposals by microfinancing institutions. In this type of scenario, the United Nations strategy is to create an environment in which individuals and businesses can utilize the services financial institutions offer to customers in more developed countries (UNCDF, 2007).

**Grameen Bank**

The Grameen Bank was inspired by the Bangladesh Famine of 1974. The founder, Muhammad Yunus thought that by issuing small loans under $30 to a number of families that they could manufacture and sell products in order to get themselves out of poverty. With the success of these first few loans, distributed to people in the village of Jobra, he broadened the scope to the entire country of Bangladesh. In 1983, the project became a formal bank under special law and the Grameen Bank was born.

The Grameen Bank is an actual microfinancing institution where as the United Nations was the driver that enabled MFIs to be accessible to borrowers in LDCs. The United Nations did not actually distribute any loans or other financial services directly to individuals or businesses. The Grameen Bank offers loans to people without any collateral but there are a few stipulations. First, borrowers must be in a group of five. The first two individuals are offered loans and if they make their payments on time, the other two receive their loans, and if all four are compliant, then the fifth person receives their loan (Grameen, 2007). The Grameen Bank is successful for a number of reasons. First, they are quite selective with which individuals and projects they choose to loan funds to. Second, each individual in the group of five is confronted with peer pressure to make sure they make their payments and don’t default. If someone defaults, the group doesn’t have to make the payment, but it looks bad for the other four. In the beginning of the process, if either of the first two borrowers defaults, the others are denied their loans. Women have especially been successful in this program, not only for repayments, but also for the ability to identify potential entrepreneurial opportunities and take advantage of them. Women have become less dependent on their husbands and incredibly account for 97 percent of all borrowers (Grameen, 2007). The success follows the philosophy that by injecting credit into the economy, “there will be investment, more income, more savings, more investment, and more income”. They also incorporate a set of values in their banking system called the 16 Decisions. These decisions are all self-help values that are to be used to improve one’s standard of living. They include ideas such as
prosperity, strong work ethic, efficient and effective farming, and living in sanitary conditions.

Since the conception of the project back in 1976, The Grameen Bank has become the model of a successful microfinance institution. The total number of borrowers is now over 7 million and it has disbursed over $6 billion, $5.4 billion of which has been repaid. In the past year, Grameen Bank has disbursed over $730 million, which equates to $61 million per month. The Grameen Bank is entirely self-sustained and in 1995, it decided it didn’t need anymore external donations or funding. In 2005, Grameen Bank made a profit of $15 million and transferred it all to a Rehabilitation Fund to cope with disaster situations. In return, the company is exempt from paying corporate income tax. The borrowers own 94 percent of the bank and the government of Bangladesh owns the remaining 6 percent (Grameen, 2007).

The Grameen Bank continues to grow, as there are now over 2,300 branches and 21,000 employees worldwide. It has also expanded into over two dozen enterprises represented by the Grameen Family of Enterprises (Grameen, 2007). The Grameen Bank system is copied by other institutions worldwide because of their success and is called the Grameen Foundation (Grameen, 2007). In 2006, the Grameen Bank and its founder Muhammad Yunus were jointly awarded the Nobel Peace prize for their microfinancing concept.

Kiva.org

Kiva is the world’s first person to person microfinance lending marketplace. Through the Kiva.org website, potential lender can sponsor a business of their choosing. Kiva is not a microfinancing institution. It is a non-government organization (NGO) that works with existing MFIs to gain access to entrepreneurs from LDCs.

The concept originated from Matthew and Jessica Flannery in the spring of 2004. They were both working in Africa when they realized the success of hundreds of small business, which were started by the Village Enterprise Fund (VEF), and the impact they had on their communities (Kiva, 2007). They were fascinated by the success stories of these entrepreneurs and impressed with their hard work and entrepreneurial spirit. The couple wanted to find a way in which individuals could directly assist a business or business ideas from people in LDCs. In March 2005, Kiva began to raise loans for seven businesses in Uganda and from there it took off. Kiva now utilizes PayPal for the transfer of funds to and from the actual MFIs.

Kiva relies on their partnership with their 40 MFIs to find entrepreneurs and handle the dispersal of funds and repayment. Kiva doesn’t charge interest on their loan to the borrower, but the MFI does. The borrower repays the MFI in monthly installments and once the total loan amount is repaid, the MFI sends one lump sum back to the lenders account. The lender can then either cash out or lend out the money again.

Currently, Kiva has over 50,000 users that have lent out to almost 8,000 entrepreneurs. On the Kiva website, a user can pick from many different businesses and entrepreneurs. The total loan amount each borrower is requesting along with the amount they’ve currently received is there with the description of each entrepreneur.

Kiva has a repayment rate of 100 percent. They are a non-profit organization, but do receive financial support from investors and corporate sponsors to cover operating costs. In 2007, Kiva will charge the MFIs they work with a 2 percent interest rate to cover these costs.

3. Operational Aspects of Microfinancing

Microfinancing is practical and successful at providing opportunity to poor communities. It is becoming an accepted form of revitalization in countries that suffer from poverty. However, microfinancing is not a one size-fits-all system that is useful in all cases. According to the Consultative Group to Assist the Poor (CGAP), microfinancing is not always the answer, because it is not the best tool for everyone or every situation. People in extreme poverty, with no income or means of repayment, need other types of support before they enter into a
repayment program. In some cases, other alternatives could work better to alleviate poverty. For these reasons, when deciding if microfinancing is the correct procedure, many elements should be considered to assure successful and fruitful results (CGAP.org, 2003)

The MF project should contribute to the long-term development of helping communities. This is not a temporary measure. Certain regions have people that are too poor or they have incomes that are too undependable to enter MF’s. These extremely poor people are living below the poverty line. They require safety-net programs that can help with basic needs. Grants, scholarships, employment-training programs and infrastructure improvements are solutions that can work to accommodate some of these impoverished beneficiaries.

However, once it is established that the community is a candidate for MF, there are other factors to consider. The economic environment itself needs to be receptive to the Microfinancing concept. Barriers to entry, free and fair competition and mechanisms to address market failure, are necessary components to a successful MF plan. Governments that are unstable or regions that will not support the goals of MF cannot be successful, therefore should not be pursued. In addition, populations that are geographically dispersed, have a high incidence of disease, or use a barter system rather than cash payments are not suitable for the Microfinancing project (CGAP.org, 2003).

Subsequently, when the suggested guidelines are met, the effort to move ahead with Microfinancing is encouraged. One of the major components for a successful Microfinancing project is the ongoing commitment that the lender must make to the poor. The financial institution is advised to revisit their MF business plan as it relates to their mission of serving the poor. When the community is offered the MF project, teaching skills to manage money, asset building and community-wide improvements must be followed by extensive training and support. Lenders should monitor both the growth potential of the individual and the quality of their management team. The organization previously mentioned, CGAP.org, is a good reference for lenders to use for the guidelines and key principals of Microfinancing.

The objective of MF is simple and relies on collaboration from both the lender and the client. It is the principal of Microfinancing that access to financial services will open the possibilities to create a better life for the poor. For this reason, the most important principal of Microfinancing is to encourage asset building. It is important to remember that poor people save differently than those with disposable income. Saving techniques must be adapted to meet the poor’s particular cash flow needs (CGAP.org, 2003). Teaching the proper way to save with Microfinancing projects will result in asset creation and the empowerment of the poor, particularly for women. When people are encouraged to save properly, the accumulation of assets will help them in times of strife.

Assets are items and a state of mind that poor people can acquire to improve the quality of their life. The rationale behind the emphasis for acquiring assets is to benefit the family and the community as a whole. Healthy drinking water, sanitary latrines, and adequate clothing are all the things that escape the reach of the poor. Basic necessities that many people take for granted would become easier for the poor to obtain once they rely on the assets that they have built. There are many different types of assets that people can work to obtain. The goal is for the poor people to have something to fall back in times of need. Physical assets are land, housing, supplies and equipment. In addition, animals that can be used as trade for items are also considered physical assets. Financial assets are also important and necessary to grow a business in order to provide a greater chance for success. Financial capital such as a small savings account, teaches responsibility and prepares people to save for the unexpected. On the other hand, human assets help to aid in the improvement of the entire family unit. The human asset will be measured by the ability of the children to receive an education and the ability of all family members to receive quality
healthcare. Finally, there is the social asset component. Each community participating in MF is expected to enrich the community and work hand and hand to build friendships with similar networks to achieve successful results. Global poverty exists because people are deprived of opportunity and the methods of saving. Most people are willing to work hard to obtain the necessary assets to help their families and their community. When poverty-stricken people have the knowledge and the support to acquire assets, their lives can be changed for the better. The asset-building model helps to empower the people. It brings personal freedom in order to make significant changes in their life and consequently the lives of their families.

In the beginning of the project, members are set with goals to help them move toward a positive and successful experience. In order to assure progress with the MF program, lenders must be willing to perform yearly evaluations to judge if the community is truly climbing out of poverty. The members of the MF project are considered to have moved out of poverty if the family fulfills the following criteria (Grameen, 2007):

- Each member of the family is able to sleep off the floor
- Family members drink pure water and uses sanitary latrine
- Children over the age of six years are going to school
- Family members have adequate clothing for every day use
- Families can afford to take all necessary steps to seek adequate healthcare

The Microfinancing goals are ongoing and will take years of follow-up and re-investment in the community. The eradication of poverty will not be achieved overnight by providing the poor with financial opportunities. However, by extending Microfinancing help to those in need, poverty can at least be significantly reduced.

4. Success Stories

The struggle against global poverty can seem daunting and even overwhelming. The many success microfinance stories really prove that Microfinance is an effective anti-poverty strategy. Microfinance helps lift the world’s poorest people out of poverty with dignity. These small loans from the microfinance organizations help the poor start self-sustaining businesses to escape poverty. Microfinance has proven itself as a powerful force in village-based development around the world. It empowers the villagers, especially women, bringing economic success to once impoverished families. Successful microfinance operations in many countries have proved that financial services can be an effective and powerful instrument for poverty reduction by enhancing the ability of poor people to increase incomes, build assets, and reduce their vulnerability in times of economic stress. During our research, we discovered numerous examples of success stories throughout the globe. Microfinance now reaches the world’s poorest people across four continents. Tremendous progress has been made since its creation. Indeed, microfinance has grown into a powerful force for social change. We have highlighted some examples from countries in Latin America, Middle East/North Africa, South Asia, and Sub-Saharan Africa.

**Latin America and the Caribbean**

We looked at Mexico for a success story. The need for microfinance is huge in Mexico. Mexico is Latin America’s second most populous country. This country faces serious poverty and income issues with nearly 10 million people living on less than $1 a day. While Mexico is one of the largest economies in the region, microfinance has only recently begun to make inroads in Mexico and outreach is still limited. The supply of microcredit is estimated to be less than eight percent of demand. Esmerelda Espinoza is one of many microfinance success stories in Mexico.

**Esmerelda Espinoza** is on her first loan of 1,000 pesos ($91) and she hopes to take out a loan of 10,000 pesos ($914) one day as her investment capacity grows. Esmerelda sells small items such as hair accessories and costume jewelry. She also makes
decorative flowers out of soda bottles. Esmerelda sells these goods on foot by going to markets in nearby towns.

**Middle East/North Africa**

Poverty remains a critical problem in the Middle East and North Africa. It is estimated that 75 million people in the region live on less than $2 a day, of which 10-20 million barely survive on less than $1 per day. In addition, it is also estimated that only 10 percent of the region’s potential microfinance market is currently being served. Egypt is the second most populous country in Africa and the most populous in the Arab World. Egypt has a population of approximately 76 million people. Where microfinance is available in Egypt, there is evidence that women are slowly moving their families out of poverty. The following success story is an example of a grandmother that finds hope after devastation.

**Hoda’s story:** Hoda, a widow, is raising her grandson whose parents both passed away. At first she could not afford to send him to school because she was dependent on the income he brought in. After taking a microloan from Grameen Foundation partner Al Tadamun, she is now able to send him to school. Hoda is diversifying her products by reselling women’s apparel as well as by selling food she makes in her own home. She is known for her delicious chickpea soup.

**South Asia**

South Asia consists of Pakistan, India and Bangladesh. In these countries one third of the population, this is approximately 440 million people that live on less than $1 a day. Even though there are many obstacles that exist in reaching such a large number of people who have no access to financial services, microfinance has made an incredible difference. Because of its sheer size of the population living in poverty, India is strategically significant in the global efforts to alleviate poverty. India is said to be the home of one third of the world’s poor. The demand for microcredit has been estimated at up to $30 billion and the supply is less than $2.2 billion combined by all involved in the sector. The story of a woman named Ellevva is truly inspirational. She was a day laborer that turned micro-businesswoman.

**Ellevva’s story:** Ellevva and her husband live in a small, one room house made of mud and sticks. Before taking a loan from SHARE, both worked as day laborers for meager wages. Usually Ellevva worked for 20rs per day and her husband worked for 40rs per day. They struggled to make ends meet. With her first loan, Ellevva purchased a buffalo that recently gave birth to a calf. It will now produce milk that Ellevva can sell in the market. With a second loan, she purchased tow goats and some vegetables. It has only been eight months since her first loan; Ellevva can see the difference it has made in her life.

**Sub-Saharan Africa**

It is truly amazing to know that 34 of the world’s 48 poorest countries are in Africa and more than 300 million of the continent’s 725 million people are estimated to live on less than a $1 a day. The percentage of Africans living in poverty is more than 40 percent. We took noticed of the hundreds of MFIs operating as savings and credit cooperatives across the country of Rwanda. Rwanda has a huge need for microfinance with its 52 percent of the population living on less than $1 a day. The life expectancy is only 39 years old and health issues include AIDS and malaria. The microfinance industry in Rwanda contributes significantly to the provision of basic financial services. The remarkable story of Marie-Claire is giving way to Rwanda rising above the odds.

**Marie-Claire story** Life has not been easy for Marie-Claire. She had a son 17 years ago and then took in her brother’s two children when he was killed in the 1994 genocide. Her husband died in 203 of unknown cause. She remarried and had a daughter. After learning that her new husband drank too much, she left him. She then discovered that she had HIV. Marie-Claire decided to start a business and took a 20,000 franc ($40) loan from Village Phone microfinance to open the Isimb food restaurant. The profits form the restaurant help support the four children in her household and pay school fees.
Microfinance has changed her life. Marie-Claire is optimistic about her children’s future. Marie-Claire talks about her present and future with a smile on her face. When a customer of her restaurant wants to make a phone call, she proudly takes them to a separate, private room where she has set up her Village Phone. Business turned out to be profitable enough for her to pay her phone loan off in 5 months. In addition to paying school fees for her children, she was able to buy land and the foundation for her new home with the profits from her Village Phone.

5. Successful Global Results

The World Bank commissioned a comprehensive study of microfinance in the early 1990s. They focused on three of the largest programs in Bangladesh: Grameen Bank, BRAC, and RD-12. The results of this study showed that the women who were clients of these three institutions increased their household consumption by 18 percent and that by borrowing and participating in microfinance programs, 5 percent of clients escaped poverty each year. Further research done, showed that clients of the MFI Zambuko Trust in Zimbabwe were found to have higher average monthly household incomes and lower poverty rates than non-clients. The results from Peru were also favorable. The results from Peru showed that clients of MIFI’ earned $266 more per household member per year than non-clients. Furthermore, in the Philippines, 22 percent of the MFI ASHI’s clients escaped poverty altogether, as opposed to two percent of non-clients. It is important to point out that MFIs have been found to generate another important benefit. Microfinance creates social capital by promoting horizontal and vertical networks of workers within a community. It also establishes new norms of behavior and fosters a new level of social trust.

In conclusion, eradicating world poverty is within the reach of each one of us. Microfinance has started a global movement. Almost fifty million of the world’s poorest families now put microloans to work. There are more than a hundred programs that use the Grameen model to break through poverty. However, with three billion people living on less than two dollars a day, the untapped market for microfinance remains vast. Microfinance is an effective anti-poverty strategy that can create an impact that lasts well beyond the original investment. Do you realize that the change in our pockets is what people will survive on? Each one of us can help eradicate world poverty by being a banker to the poor.

References


Mehdi Hojjat is an Associate Professor of International Business and Finance at Neumann College in Aston, Pennsylvania. This paper was partly prepared by his students in the global economy and business courses. Hojjat has been the Director of International Trade Center at Lehigh University and a Budget Director/CFO for a telecommunication company.