Teaching Microfinance with the Help of Case Studies

PÉTER FUTÓ

Abstract The provision of microfinance for entrepreneurial poor people is a well-known instrument of development policy worldwide. This article describes those concepts of microfinance that are relevant to students on development courses. In particular, the following concepts are described: microfinance, microcredit (MC), micro-deposits and micro-insurance, financial illiteracy and literacy, financial inclusion, the facilitation of micro-entrepreneurship among the poor, female entrepreneurship, creditworthiness, and the sustainability of microfinance schemes. This article summarizes the educational lessons of an EU-financed project "Teaching Microcredit, 2014–2015".[1] This project created the basis for the establishment of a teaching module ("Poverty Alleviation, Social Economy and Microfinance") for students on a Joint Master's Course for Comparative Local Development. The project financed study trips to developing countries. Subsequently, it delivered high-school and university curricula, analyses of microfinance-scheme case studies, visual documents, and a documentary movie for educational purposes. The resulting teaching materials were used in educational pilot activities and disseminated.

Keywords: • microcredit • microfinance schemes • micro-entrepreneurship among the poor • "Teaching Microcredit" project • sustainability

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CORRESPONDENCE ADDRESS: Péter Futó, Ph.D., Professor, Corvinus University of Budapest, Institute of Sociology and Social Policy, Közraktár utca 4-6, H-1093 Budapest, Hungary, email: peter.futo@uni-corvinus.hu.

https://doi.org/10.4335/978-961-6842-91-4.21 ISBN 978-961-6842-91-4

1 A conceptual framework of microfinance

Approximately 200 million people around the world benefit from microcredit (Ledgerwood *et al.* 2013). Microfinance institutions (MFIs) take many profit-oriented and non-profit forms: credit and savings associations, co- operatives, NGOs, banks, and even various agencies of local and central governments. Universities and think tanks devote considerable research capacity to microfinance in the context of development economics, with special respect to local development, poverty alleviation (Banerjee and Duflo 2006), financial accessibility, financial literacy, small business development and gender equality.

One of the lessons learnt from the "Teaching Microcredit" Project was that university and high school courses devoted to microfinance should rely on a certain conceptual framework. This chapter is devoted to the identification and interpretation of the most important terms related to microfinance provision.

Microfinance is a somewhat wider term than microcredit, and is interpreted as a group of financial services that include *microcredit;* i.e., the disbursement of small-scale loans for entrepreneurial purposes. Microcredit is frequently complemented by *saving* services that are accessible to poor people, also called micro-deposit schemes. Further, the repayment of microcredit is frequently facilitated by features of micro-insurance. Additionally, typical microfinance organizations facilitate the management of microcredit by offering community-based *training and consultancy* services and by organizing self-help groups, which always aim at enhancing the financial and entrepreneurial knowledge of clients, and in some cases create networks of clients jointly responsible for the repayment of micro loans.

In teaching microcredit a suitable unit of analysis is the *microcredit scheme*, which is interpreted as the set of rules governing eligibility, guarantees, the disbursement and repayment of microcredit, and the institutional-organizational framework established for implementing these rules. A microcredit scheme is a model which may be applied by several existing and operating microfinance institutions in a particular country. Some of these schemes may be institutionalized as the financial components of agricultural, craft, trade or other sectoral development projects. Other schemes may be utilized by NGOs, banks or other financial institutions that offer small-scale loans to start-up firms, without any sectoral delimitation. The rules and implementing institutions of these schemes may be determined by governments and international organizations that provide soft loans to microfinance retailers. Finally, other microcredit schemes might be implemented by informal organizations based on local traditions of mutual financial help, such as Rotating Savings and Loan Associations or Islamic Banking.

Any particular microcredit scheme can be characterized by:

- The conditions of eligibility;
- The limitations of use of the credit (e.g. only for entrepreneurial projects);

- The average, minimum and maximum of the volume of individual credit;
- The interest rate;
- The existence and extent of securities and guarantees of repayment, with special respect to group guarantees and collateral;
- The extent and content of the accompanying business services offered to clients; and
- The policy area in which the investigated microcredit programme is used as an instrument (e.g. poverty alleviation, small business development, agricultural development, female empowerment, the empowerment of vulnerable ethnic groups or castes, etc.).

For educational purposes, it has been found useful to differentiate between two types of microcredit, namely *social and commercial* microcredit, albeit recognizing that there is a continuous spectrum between these two basic types. A series of case studies may be used to describe both types and to identify those cases where a microcredit scheme which was originally designed as an instrument of social policy has changed into a profit-oriented commercial enterprise.

Social microcredit is an innovative instrument of poverty alleviation. Social microcredit as a rule relies on the ideology that microcredit is a human right, thus society must consequently offer this opportunity to everyone, including poor people, as an act of solidarity. Social microcredit schemes are mostly operated by NGOs, by informal and formal savings associations, or by donor-driven temporary projects. These schemes usually disburse credit with a low interest rate, and do not require guarantees besides group guarantees and informal securities such as social capital, with special respect to trust. Such schemes in many cases are relatively permissive in the case of non-repaying borrowers. Theoretically, social microcredit schemes should be non-profit initiatives. In practice, their economic sustainability typically depends not only on sound management principles, but also on external grants or subsidies.

Commercial microcredit schemes are profit oriented. The declared aim of such schemes is the development of small enterprises by providing financial services to them. Most commercial microfinance schemes are economically sustainable because they apply a market-level interest rate, require various types of guarantees, and implement strict procedures in the case of defaulting borrowers. Commercial microcredit schemes are operated predominantly by financial institutes, including banks, but there are many borderline instances in which such schemes are offered by local associations, co-operatives and foundations. The typical target groups of commercial microfinance schemes are not necessarily poor people, but rather the entrepreneurial families of the middle-class.

Connections with financial policy. Governments in most countries regulate microfinance provision for the following purposes:

- To safeguard the financial stability of microfinance institutions, with special respect to ensuring the prudence of micro-deposit collection and micro-insurance;
- To establish the institutional framework for channeling government subsidies;
- To open the way to private loans / investors / donors by creating fair competition on micro-credit markets.

2 Issues under discussion

Debates about how to develop the microfinance sector exist in almost every country. Moreover, there is a growing body of professional literature which questions the relevance, usefulness and even the raison d'étre of microfinance. The educational project has inevitably been confronted by various issues that critics (Bateman and Chang 2012), apologists (Yunus 1999), and scientific investigators of microfinance have discussed over the last three decades. The teaching of microcredit must touch upon these issues, many of which have served as research questions in scientific publications and dissertations. Indeed, many students of local development have investigated microcredit provision in their respective home countries in their dissertations, tackling one or more of the research questions listed below:

- Which types of microcredit programs are economically sustainable, and which types are donor dependent?
- Some microcredit schemes ask users to pay relatively high interest rates and require guarantees/ securities: is this compatible with the principle of poverty alleviation, and can these schemes be regarded as part of the solidarity infrastructure of the particular country?
- Is group lending feasible and sustainable? Is it moral and efficient to share the responsibility for repaying microcredit among various individual debtors?
- Is it acceptable to put moral pressure on defaulting debtors by using their existing social capital and social networks to coerce them to repay microcredit?
- Is it a feasible goal to turn a wide strata of poor people into successful self-employed persons and entrepreneurs with the help of small loans accompanied by some entrepreneurial training and consultation? Alternatively, is this outcome feasible only for a narrow group of persons?
- Microfinance is only one of the possible instruments for creating jobs locally – what are the other, competitive approaches and which ones are more efficient?
- Can microcredit projects effectively alleviate and eventually reduce poverty? If yes, under what conditions?
- Is the impact of poverty alleviation measures measurable? Are the methods of randomized impact evaluation appropriate for assessing the poverty-alleviation impact of various microcredit schemes?
- Is commercial microcredit an instrument of social policy, or rather an instrument of SME development policy, or is it just a policy-independent financial product sold to entrepreneurial lower/middle-class clients?

- What is the optimal role of microcredit in financing small businesses? Should microcredit offer help only during the incubation of a business, or should working capital be periodically renewed with no defined end? In other words, should microfinance institutions avoid the long-term dependence of individual small businesses on microcredit?
- What are the specialties of microcredit provision in different cultures? In other words, how may we take into consideration cultural differences and informal and formal traditions of credit provision?
- Is it rational to compare the microcredit markets of a developing country with the microcredit market of a developed country?
- Is it rational to compare a social, non-profit microcredit scheme with a commercial, profit-oriented microcredit scheme?

3 How may we compare microcredit markets and schemes?

Case studies are excellent educational instruments for highlighting, demonstrating and illustrating the above concepts and theories of microfinance. The project described in the introduction identified rich empirical material for comparing different types of microcredit schemes.

Microcredit schemes can be compared according to certain criteria, such as by:

- Identifying the beneficiary (or client) sectors, which are predominantly agriculture, crafts, and trade;
- Identifying the types or legal forms of targeted organizations, which are predominantly small enterprises, social enterprises and farming families;
- Identifying the typical parameters of MC provision; i.e. the sources of refinancing, the interest rate, the maximum and average interest rate;
- Describing the rules for guarantees; i.e., trust, social capital (e.g. group guarantees) or physical securities pledged as loan collateral (e.g. a house, or household objects);
- Describing the services that accompany microcredit provision, such as entrepreneurial training and consultancy, the organization of self-help groups, business facilitation by authorities (e.g. legal / administrative help in obtaining permits or complying with tax rules);
- Describing the policy interventions implemented to improve the entrepreneurial environment, such as the issue of microfinance regulations which enable microfinance organizations to collect deposits and sell insurance policies.

4 The case-study schemes

The following two archetypal schemes were investigated in a North African country. Both schemes serve hundreds of thousands of families, farms and small enterprises.

In the North African country under investigation, the tradition of microcredit provision dates back a quarter of century. State intervention strengthened in the 1970s and 1980s with the establishment of state-sponsored regional development programs and urban development programs which assisted with employment creation through the promotion of handicraft and small-scale trading. Subsidized credit was the main mechanism of these intervention programs. In the 1990s, a series of regulations were issued specifically to establish and support the institutional framework of microcredit provision. By the year 2010, the country had developed a large microcredit market. The country is now host to a wide range of microcredit organizations which offer various types of microcredit schemes. The following paragraphs compare the two biggest of these. Micro- and family businesses in the country play an important role in the national economy with special respect to employment generation. The country is predominantly agricultural, therefore most businesspeople are farmers, but traders and artisans also play a significant role in the social fabric of settlements. The contribution of informal small businesses to employment creation and income creation is substantial in international comparison.

However, despite the combined efforts of the state and the private sector, the penetration of the microcredit sector remains limited and most of the target customers are excluded from funding. Despite the growth in the number of microcredit associations and their full territorial coverage of all the administrative districts of the country, the majority of micro-entrepreneurs eligible for micro- credit are still excluded from funding and suffer from problems with accessing finance.

"Microcredit Scheme A" functions according to the principles of social microcredit, which were enshrined into a microcredit law issued at the end of the 1990s. At the same time, a big state-owned bank and a guarantee fund were created from budgetary sources: these institutions guarantee the financial sustainability of this system. Loans are offered by a wide range of local associations, and a network of local offices covers the whole country. The refinancing of these associations by the above-mentioned state-owned bank occurs at preferential, subsidized interest rates. Additionally, the maximum interest rate for microloans has been fixed at 5%; i.e., at a rate much lower than the market interest rate, and the maximum size of loan permitted was also fixed per government decree. Microcredit associations are politicized in the sense that the members of the steering committees need to have the support of regional and local authorities. Microcredit associations have become a vehicle for promoting social harmony through maintaining subsidized interest rates. The beneficiaries of the scheme are predominantly agricultural farmers and artisans, and preference is given to start-ups. The scheme also supports social enterprises, entrepreneurs who create workplaces, and the generally financially under-privileged strata of society. Women represent almost half of the of clients of Scheme A. Women micro-entrepreneurs are considered more creditworthy, thus their funding requests are more readily accepted. As to the regional distribution of funds, applicants in less developed regions are more likely to receive micro-credit from microcredit associations than those in developed ones. Microcredit is frequently offered to families located in the vulnerable strata of society and also for projects that combat desertification.

"Microfinance Scheme B" started as an international NGO in the early 1990s, but was exempted from the stipulations of the microcredit law; i.e., it was not constrained by the official ceiling on interest rates (5%). Scheme B has benefited from a special permit which has allowed it to provide small loans by charging a high enough interest rate to cover its costs. Consequently, the scheme was able to borrow money both from international development organizations and commercial banks. In the early 2000s, due to the development of the regulatory framework, its legal form was changed into a limited liability company. Today it is the biggest of the microfinance institutions in the country. The interest rates applied by Scheme B go up to 25%, huge compared to those of Scheme A (maximum of 5%). Nevertheless, the repayment rate of Scheme B is almost 100%. Each time that a borrower repays their debt, they become eligible for new credit of a somewhat higher volume. Most borrowers want to maintain use of this scheme and use the loans without collateral offered by Scheme B as a source of working capital. Scheme B pays VAT and other taxes to the state. Scheme B has hundreds of thousands of borrowers, predominantly small businesses active in retailing and handicraft. The clients of Scheme B are predominantly female borrowers. The loan officers of Scheme B visit regularly clients and advise them on financial management issues related to their firms. The renewal of the loans may depend on whether the clients follow this advice.

In the investigated country there is wide consensus about the ultimate goal of microfinance: to develop a countrywide network of sustainable financial services for micro-entrepreneurs that enables them to better integrate into their socioeconomic environment. In spite of this consensus, there is still a very lively debate about the development of the sector. The inevitable shift towards commercialization has significantly increased the divergence of views about the microfinance industry and microfinance policy.

Due to some overlap of their target groups, the two schemes compete with each other. Since financial regulations regarding microfinance change frequently, the conflict between commercial and social microcredit organizations is demonstrated in their respective lobbying activity. Representatives of social microfinance have accused commercial schemes of being profit oriented and operating outside the "solidarity infrastructure" of the country. On the other hand, representatives of the leading commercial microcredit scheme have accused the incumbent social microcredit schemes of being donor-dependent, bureaucratic, and occasionally becoming instruments of local power policies. At the time of the educational project (described earlier) there was a strong and unsatisfied demand for microfinance products that microcredit associations based on the social microcredit model were unable to meet, and the commercial microcredit scheme was considered to be more successful and better disseminated than the social microcredit scheme.

5 Conclusions and recommendations

The provision of microfinance to enterprising poor people, if properly done, is a widespread and efficient instrument for international development which is worthy of analysis and study at various levels of educational institutions. The visibility and acceptance of microfinance in schools and universities can be enhanced by analyses of the microfinance schemes of various developing countries based on professional literature and on fact-finding interviews with experts from microfinance institutions and their beneficiaries. The respective teaching activities should rely on specially trained trainers, curricula, textbooks, online sources and visual resources.

The examples of commercial microcredit schemes investigated herein support the hypothesis that commercial microcredit can be sustainable, and even profitable, but the target group is predominantly not the poorest stratum of society. On the other hand, the project could not find any social microcredit schemes that were not donor-dependent. Both types of schemes are efficient at creating jobs for the self-employed and, to some degree, additional, sustainable workplaces. The associated social cost per workplace created is relatively low, therefore microfinance schemes contribute to local development.

Both social and commercial microcredit schemes are legitimate and useful, because they:

- Improve the chance of self-employment for the poor;
- Promote local development and gender equality;
- Replace usury (moneylending);
- Fulfil a huge demand for both types of lending.

For the above-described reasons, the deliverables of the project advocate sustaining both types of microcredit schemes as efficient, parallel and overlapping instruments of poverty alleviation and small enterprise development. The microfinance markets of Europe and those of developing countries are comparable. The structure, dynamics and causes of poverty in Africa, Asia and the developed world are analogous to a large extent. A global development strategy for poverty alleviation that uses microfinance provision as an instrument makes sense and is feasible. Local poverty alleviation strategies should follow international recipes and national best practices in an adaptive but locally innovative way.

Notes:

[1] The “Teaching Microcredit” Project was sponsored by the "Development Education" programme of the EU Commission, implemented by a consortium of European universities and NGOs. Italy: Gruppo di Volontariato Civile (consortium leader); University of Bologna; Bolzano Autonomous Province. Hungary: Hungarian Baptist Aid; Corvinus University of Budapest. Spain: Loyola University Andalusia, Fundación ETEA para la Cooperación y el Desarrollo; Asociación Consorcio de Cooperación, Cordoba.

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