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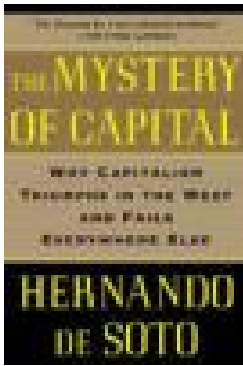
## **Microfinance: Extending financial services to the poor**

by Nicholas Santos



Marta PÈrez LÛpez of Pinar, Mexico, weaves a wool skirt while her daughter looks on. LÛpez sells the garments with the help of small loans from Alsol, a microfinance institution in Mexico. (MCT/Dallas Morning News/Jim Landers)

When the Grameen Bank in Bangladesh and its founder, Muhammad Yunus, were awarded the Nobel Peace Prize in 2006, ?microfinance? was suddenly thrust into the global limelight. Though microfinance is mostly associated with microcredit or lending, it also includes other financial services such as savings, money transfers, and even insurance provided to those at the base of the economic pyramid.



This population has mostly been denied access to financial services provided by large

banks, because of lack of collateral, as the Peruvian economist Hernando de Soto alluded to in his book *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*. Thus, the poor, who nonetheless have financial needs, are forced to use the services of a local moneylender who often charge exorbitant interest rates.

While there are varied opinions with regard to the delineation of the poorest segment in society, it suffices to describe this group in the context of microfinance as those who do not qualify to be catered to by the traditional banking system. In order to be able to extend loans to the poor, Yunus pioneered an innovative model of lending that used peer pressure as collateral. Thus, Grameen Bank would lend to a group of women who would lend to individual members of the group. Repayment rates much higher than those in the traditional banking sector -- Grameen claims to have a repayment rate of over 96 percent.

Over the last two to three decades there has been phenomenal growth of microfinance institutions across the world. For instance, the Microfinance Summit Campaign Report 2009 includes reporting over a 10-year period, 1997-2007, from over 3,500 microfinance institutions across the world serving over 154 million clients, about 83 percent of whom are women.

The increased interest in microfinance has sparked an intense debate about whether microfinance is an effective tool for poverty alleviation. A prominent critic of microfinance's claim of poverty alleviation is Aneel Karnani at the University of Michigan's Ross School of Business. In an article appearing in the summer 2007 issue of the *Stanford Social Innovation Review*, Karnani argues that flourishing enterprises offering stable jobs at reasonable wages are better able to eradicate poverty than micro-entrepreneurs.

Other criticisms of microfinance include charges of multiple borrowing, in which clients borrow from multiple microlenders, often falling into a debt trap as they borrow from one microfinancer to repay another; and critiques of increased consumption, which holds that because of the lower rates of finance availability, clients end up purchasing many things that they would not otherwise have purchased.

One concern arising in the field of microfinance is the emergence of unethical financial lenders who are attracted to the field and charge exorbitant interest rates, sometimes as high as 120 percent. If the involvement of the corporate sector in this field is truly to help the poor, then it is imperative that their efforts be based on an ethical framework. This writer's research, under Gene Laczniaak, an internationally renowned expert in marketing ethics at Marquette University in Milwaukee, has been aimed at providing such an ethical framework for companies interested in assisting impoverished populations in a fair and just manner.

What is the future of microfinance? Despite some criticisms, microfinancing will likely thrive in the coming years. There is already a growing interest in related areas such as microsavings and microinsurance. Many supporters say microfinance serves an important need, of extending financial services to the poor, and that need is far from met.

[Jesuit Fr. Nicholas Santos is a visiting professor from Pune, India, at the Markkula Center for Applied Ethics and Leavey School of Business at Santa Clara University, California. He is also the chair of the income issues work group of ?Step Up Silicon Valley,? the campaign to end poverty in Silicon Valley.]

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