

Microfinance as an Approach to Development in Low Income Countries

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The paper examines the link between microfinance and the fight against poverty in developing countries. It explores the issues and the limits of the major approaches (welfarist and institutionalist) in microfinance and presents different forms of contract in microfinance. It further analyses the current status of microfinance in developing countries, its characteristics, and its articulation with the policies against poverty and inequality. Recent policies against poverty, advocated by both the donors and developing countries, view the microfinance sector as a key tool of public policy by establishing regulatory frameworks and framing national policies relating to microfinance.

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I. INTRODUCTION

The fight against poverty is seen as the new paradigm of international community aimed at legitimising a regression in development assistance. Indeed, the significant and prolonged decline in family incomes in developing countries since the early 1990s has changed the behaviour of individuals and social landscapes. The theme of the fight against poverty has taken, rightly, a new importance and has again become one of the main slogans of the donors. The process of conversion of debt to developing countries offers an opportunity to develop real policies against poverty. The collaborative development of strategies for the fight against poverty is also a condition for eligibility for debt relief.

Yet, the argument grounded in the "global development architecture" (Weber, 2002) is part of a new development paradigm called Post or New Washington Consensus (Stiglitz 1998, Gore 2000), which has been extended to issues of financing development. Set within a historical perspective,

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microfinance is "one of the many manifestations of financialization that has expanded and intensified during the past quarter century under pressure from neo-liberal ideologies" (Servet 2006). "Eradicating poverty through an alternative approach to capitalism," is the promise behind the emergence of microfinance which was reaffirmed by Professor Yunus in his speech to the Nobel Prize committee.

Microcredit in Bangladesh opens up many other experiences in the world. Institutions are created to provide the poor with the means to create their livelihoods and the tools to manage the risk, that is, normal financial services that are offered to the wealthier. Despite the success of the Grameen Bank, which now counts as customers more than 7 million poor in Bangladesh, in practice, it proved difficult to copy the experience. In countries where population densities are lower, it is much more difficult to meet the conditions of profitability to provide microcredit services.

In Latin America, institutions providing credit in urban areas are beginning to cover their costs without subsidy. The Bolivian NGO PRODEM (the foundation for the promotion and development of micro-enterprise), founded in 1986, decided to "spin off" its microfinance activities in the form of bank creating Banco Solario, widely known as BancoSol. It is the emergence of a "microfinance industry." Much progress has been made, but not all problems have been resolved, and the majority of the population who earns less than a dollar a day, especially in rural areas, do still have no access to the normal financial services. The microfinance sector has grown steadily to reach \$ 25 billion in 2007. It would take ten times more resources to provide the poor with the capital they need. The microfinance sector has grown substantially, so that one may have wondered if there were not a potential risk to direct so much capital into a sector that was not always properly managed. If rural and urban microfinance is not always appropriate because of intense relationships between the populations of rural and urban areas within a country, it is clear that access to financial services shows significant regional inequalities. The very high concentration of supply of microfinance in Asia, with a coverage of half of the poor of this region, hides some national disparities to the disadvantage of rural areas where yet the vast majority of the poor (about 75 per cent) live. In India, two southern states, Andhra Pradesh and Tamil Nadu, ranked among the richest states, account for nearly three quarters of the supply of microfinance. A study by CGAP (the Consultative Group to Assist the Poor) shows a negative correlation between the level of economic and social marginalisation of the state and financial services (2006). The results in Bolivia also confirm the situation.

The sectors of microcredit and microfinance often deliver services primarily by cooperative savings and credit associations, sometimes by mutual, and projects, NGO initiatives in the South or North, or are the result of bilateral or multilateral cooperation. Besides these two categories of formal structure, there are informal ones with varying degrees of sophistication (e.g. Ghana, Togo, Benin, Cameroon). Microfinance is perceived by the majority of the population as the only financing mechanism, that is, as a strategy oriented towards poverty reduction and wealth creation, because it gives hope to a group "left behind" and excluded from mainstream financial system.

The needs of the poor are enormous in terms of credit demand, that is why Attali (2007), founder of PlaNet Finance, says: "The 50 million richest people in the world (or 1% of world population) see a combined income greater than the three billion poorest people (55% of the population). These figures could lead us to a total despair into an abyss of no return! These differences are such that it seems unimaginable to redress the balance in another direction! Yet, proponents of microcredit say, it is not. They say that many countries of Asia and Africa have made dramatic progress in the fight against poverty through microcredit. PlaNet Finance offers advisory services and technical assistance to microfinance actors to improve their financial and social performance, as well as support programmes for micro-entrepreneurs. It also contributes to the improvement of knowledge in microfinance and dissemination of good practice. Thus, PlaNet Finance and its "Doing Business in suburb" invest the northern suburbs of Marseille. For ten years, PlaNet Finance facilitates access to credit for the poorest people in developing countries. In early 2007, PlaNet Finance adapts this expertise and its priority is to fight against exclusion in neighbourhoods. The programme "Business in Suburbs," which aims to stimulate the sense of initiative and responsibility in disadvantaged areas through access to microcredit, started with a simple idea of Jacques Attali, President of PlaNet Finance: the suburbs "is not a lawless zone, but a den of wasted talent." Microfinance is also a priority of the Strategic Orientation Plan of the French Agency for Development (FAD). The first intervention of French Agency for Development Microfinance was in 1988. The French Agency for Development has supported some 40 institutions (MFIs) for a total of over € 160 million, especially in Africa (IMF grants, loans and guarantees to MFIs). According to Duflo and Pariente (2009), "the development of microfinance is partly born from the observation that traditional financial institutions are unable in these countries to effectively participate in economic development and poverty alleviation." According to Lelart (2009), it is

the informal sector development as poverty and exclusion can be reduced. And it is with microfinance institutions that find ways to finance. To Nowak (2005, 1994, 1993) "Open access to credit for all economic actors promotes personal success, but also equal opportunities and preservation of capital." The Association for the Right to Economic Initiative (ADIE), founded in 1989 by Maria Nowak, finances and supports entrepreneurs who do not have access to bank credit and especially job seekers and beneficiaries of a minimal income of insertion (RMI). For a first application, the loan amount is limited to € 2,000 with an interest rate similar to that in the traditional finances (9.7 per cent excluding 5 per cent contribution to the solidarity fund of the association).

However, for sustained growth and a sustainable reduction of poverty, the anchor of development should be achieved through decentralisation of public action to the local level by regional development and regional planning for the development and mitigation of territorial imbalances and boosting local economies. In this perspective, Ehrhart (2006) explains that during the first half of the 1980s, in the context of debt crisis, the World Bank was taken to relegate the objective of poverty reduction to the background. However, in response to criticism of its social costs of adjustment programmes, the International Financial Institution has reaffirmed its commitment to fight against poverty, especially by proposing new strategies against poverty in the long term.

It further specifies that in facilitating the poor's access to markets by providing transport services and information and technological innovations adapted to small-scale farming, they will respond to economic incentives. Finally, the provision of credit to the poor through microfinance institutions, such as the Grameen Bank in Bangladesh, can help the poor to purchase assets. Thus, the alignment of national strategies (country) with local priorities (communities) and improving production conditions in rural areas should help create attractive development areas to mitigate the rural exodus of youth to urban centres. The poverty reduction also requires effective leadership to population growth and specific attention to redistribution by social class and wealth space.

In this paper Section II describes the main approaches and different forms of contract in microfinance. Section III provides the conclusion.

II. THE MAIN APPROACHES AND DIFFERENT FORMS OF CONTRACT IN MICROFINANCE: CHALLENGES AND LIMITATIONS

Today microfinance is an integral part of development policies in poor countries. In 1998, the United Nations General Assembly had proclaimed 2005

as the "International Year of Microcredit" to mark the importance of this instrument to eradicate poverty worldwide. One of the Millennium Development Goals is to halve, by 2015, poor people living below the poverty line.

The pioneering experiments in the field of microfinance have changed dramatically. There are pluralities of microfinance institutions using different legal status (foundations, cooperatives, savings and credit, public banks, corporations) whose modes of operation and objectives differ greatly. MFIs are now largely dependent on a neo-liberal discourse advocating market mechanisms and adopting a commercial approach. For institutions such as the World Bank or the United Nations, it is indeed necessary to achieve "integrated financial markets" to implement sustainable microfinance systems and benefit large numbers of poor people. They, therefore, advocate the institutionalisation of microfinance programmes, that is, the establishment of profitable microfinance institutions, responding to competitive financial markets laws and using effective governance. Because the social institutions (such as NGOs) are mostly fragile, these organisations are dependent on "subsidies" from donors and have limited ability to cope with the massive demand for microcredit. Others are anxious to remain in the service of the poor, wonder about the potential abuses of the adoption of such an approach and fear that the pursuit of profit leads to the separation of most disadvantaged clients to meet profitability criteria specific to financial markets. It should be emphasised that the open debate on how microfinance, helping to eradicate poverty in developing countries, will lead to an opposition between two contrasting schools of thought that Morduch (2000) referred to "microfinance schism." Each position differs on how to provide microfinance services (NGOs versus commercial banks), the technology to be used (or financial service approach versus minimalist approach to integrated service), and the methods of performance evaluation.

On the one hand, we have the "welfarist" consisting essentially of supportive institutions such as NGOs or cooperatives who consider microfinance as a key means to reduce poverty of the poorest. Here we find MFIs such as Grameen Bank, village banks, etc. On the other hand, we find the "Institutionalists," primarily commercial institutions, who view microfinance as a financial product aimed at strengthening the role of the financial sector of developing countries. Examples include the BancoSol in Bolivia and Bank Rakyat Indonesia (BRI).

The opposition between these two visions is designated by Morduch (2000) as the schism of microfinance to the extent these two approaches offer a different vision of the priorities and functions of microfinance institutions (Woller, Dunford and Woodworth 1999). The institutionalist approach and the welfarist

approach are opposed over the issue of financial sustainability of MFIs and the social financing granted.

Moreover, microfinance is a way to fight against poverty in developing countries, through the financing of income-generating activities for poor households. However, the best way to help the poor gain access to financial services of welfarist approach contrasts with that of the institutionalists. Although they share the goal of poverty reduction, these two approaches put microfinance in the crossroads.

According to Otero and Rhyne (1994), the future of microfinance lies precisely at the intersection of these two approaches. The welfarist approach and the institutionalist approach do not represent two models of structuring the microfinance but two stages of the development of microfinance. If the welfarist approach can lead to a process immediately by relieving the poorest, only an expansion of sources of financing made possible by the institutionalist approach allows sustainability of MFIs and a real improvement of general well-being. According to Robinson (2001), the approach adopted by the financial system aims at institutional self-reliance. This approach calls for commercial microfinance for the poor with economic activity. She believes that financial institutions, to be sustainable, should seek financial independence and be able to achieve profitability, that is, to bear their loads by applying interest rates in a position to provide sufficient margin. In addition, formal microfinance institutions carry out their duties under the supervision of the supervising bank. The approach to the poor is based on grants as funding sources for loan portfolios of microfinance to the poor. These credits must be combined with other forms of social interventions such as education, vocational training, nutrition, literacy, etc. The credits are generally available at low interest rates, well below market rates. These are subsidised loans.

The purpose of this section is to outline this debate by presenting each of the different theories or approaches.

2.1 The Welfarist Approach or the Approach of “Social Welfare”

It is also called approach of “directed credit” (Credit Directed Approach). Welfarists perceive microfinance as part of an integrated programme of fight against poverty, vulnerability and improving the welfare of the poor. In addition to providing financial services, this approach favours the granting of non-financial services such as training, technical assistance to micro entrepreneurs and literacy. The approach of social welfare (welfarist approach) argues not only

MFIs can be sustainable without being financially self-sufficient, but they should not seek self-sufficiency at any cost, because the search of financial performance would inevitably lead to a blurring their social mission. By diverting microfinance from its ideological foundations, research of financial performance would be a disincentive to innovation and poverty reduction. Social investors who fund MFIs are not necessarily motivated by personal search of financial gain, rather by the desire to contribute to poverty reduction. For example, most MFIs in Western Europe are either public (territorial authorities) or the foundation of banks or large corporations. These donors are primarily motivated to accomplish a social return which is "intrinsic" in working for the public welfare. According to Simon (1993), economic actors do not seek only to maximise financial returns, they also seek to maximise their utility function, which may involve altruistic concerns. It is this vision that prevailed in the 1980s, which resulted in gradual disappearance of many microcredit programmes. Along with these problems of poor financial performance, a revival of economic and financial thinking is characterised by a desire to liberalise financial markets. Faced with this double evolution, the "welfarist approach" was the subject of much criticism.

The aim of evaluating effectiveness of MFI programmes is to measure the impact of microcredit on the lives of the target populations. These studies assess the situation before and after joining the MFI and then explore the evolution of income levels, nutrition and education of the poor and access to health services and insurance. However, institutionalists criticise such studies as too subjective that generate excessive costs in addition to methodological difficulties they may encounter. According to the welfarist school, an individual is considered poor when he/she is below a minimum of economic well-being. The concept of wellness is closer to that utility which is understood as the satisfaction of desire of a person provided by the use or possession of goods and services. Indeed, a person is considered poor if he/she does not reach a minimum reasonable satisfaction of a "thing", i.e. a minimum of economic well-being.

The welfarist approach is practiced by the MFI-type "family." It is not confined strictly to economic efficiency rather operates within a perspective of social equity and tries to relieve the daily burden of poverty, as a first step to help customers escape from poverty in the long term. MFIs that meet these requirements are a client base of the poorest and their goal is self-employment. Loans are often reserved for women because they not only demonstrate better repayment rates but also control of income and household savings. MFIs making

poverty-lending have as the focal point of “family.” The welfarists attach particular importance to the depth or extent of poverty and achievement of MFI interventions aims at improving the immediate welfare of clients.

However, microfinance is often integrated into a strategy against poverty and vulnerability and improving well-being of the poor (Mayoux 1998). These studies seek to measure the impact of microcredit on the lives of targeted populations, that is, to measure change in terms of well-being and quality of life of beneficiaries. Mayoukou (1997, 2000) suggests that sociological analysis of target groups can provide a better understanding of the risks of failure of an individual by revealing the logic at work in the working groups and processes that lead to building social trust. Indeed, these welfarists focus on poverty levels of clients as well as on the rapid improvement of living conditions of the participants, even with extensive use of subsidies. This welfarist approach, however, resulted in reimbursement rates below 50 per cent and operating costs leading to high failure and disappearance of some MFIs. Although based on logic of subsidies and dependence of the beneficiaries, these MFIs come up against obstacles (problem of viability and sustainability) that can impede their development and their ability to help develop the people they support. Thus, the welfarist approach has been widely criticised because of its subjectivity and cost and methodological difficulties it entails (De Briey 2005). Particular interest was raised by economists and practitioners to study the effectiveness of MFIs in the fight against poverty. This paved the way for treatment effectiveness increasingly in financial and accounting terms. The welfarists are based on the theory of social responsibility vis-à-vis the customer to meet its expectations (Carroll 1979). This school of thought evaluates the performance of MFIs through the social (“outreach”) and impact analysis (“impact assessment”): it targets the poor whose incomes are 50 per cent below the poverty line (\$ 1 per day) and aims to improve their living conditions. This school emphasises the rational management of resources and does not exclude that MFIs can conduct a profitable business after a period of 5 to 12 years. We examine the institutional approach below.

2.2 The Institutional Approach or the Approach of the Financial System

Supported by international bodies such as the World Bank and the United Nations, a new approach has emerged: the institutional approach (Institutionalist Approach) or “financial market” (Woller, Dunford and Woodworth 1999). Under this approach, MFIs should not only be able to cover their operational and financial income through their own business but they should also be able to

generate profits to ensure their financial viability and sustainability. Indeed, microfinance institutions are capitalist structures like the others, one of whose aims is the search for profitability. The institutionalists believe that the unique way to reach the vast majority of the poor who lack access to financial services is to increase the microfinance movement through its integration into the formal financial system. Thus, they seek to register MFIs within a market approach focusing on the will of the establishment of sustainable microfinance systems and on the will of massification of credit (De Briey 2005). Each MFI should seek financial sustainability and maximise its efficiency and productivity. Therefore, sustainability requires financial independence. Indeed, the institutionalists believe in the need for large-scale intervention that requires financial resources beyond what can be provided by donors. But the only way to have the financial resources needed is to use private sources (savings, commercial debt, equity and venture capital). To access, strict management, transparency and efficiency are required, but mostly it takes a profitable institution. Therefore, to achieve financial self-sufficiency, the institutionalists have made substantial efforts to try to design a set of “best practices” which refer to practices that improve efficiency, such as systems management, finance and accounting, marketing, service delivery, etc. The widespread adoption of “best practices” is an essential step to achieve financial self-sufficiency on an industrial scale, access to financial markets, and reach as many customers as possible (Morduch 2000).

The institutionalist approach or sales approach focuses on economic efficiency to generate what would be economic and social development in the long run. The MFI commercial loan targeted at “not-so-poor-as-it” (not-so-poor) can start or expand their micro-enterprise, which ultimately will create employment for the very poor. The IMF puts the commercial promotion of micro enterprises in the centre of its agenda for funding. It contributes to development by improving the economic efficiency of micro-enterprises, which improves the position of the most disadvantaged. The institutionalist approach considers “one of the primary goals of microfinance is financial deepening, the creation of a separate and viable financial intermediation for the poor, their approach to microfinance is an approach to financial system, in which the future of microfinance is dominated by many institutions working on a large scale, in search of profits who provide quality financial services to large numbers of poor clients.”

In fact, these institutionalists focus on the performance evaluation from the perspective of the institution rather than from the perspective of customers. They consider financial independence as a criterion that best fulfills the social mission (Cornée 2007). They measure social impact through a proxy, profitability, then they judge the success through self-sufficiency programme (Otero and Ryhne 1994). This approach shows two major trends. On the one hand, we find the process of upgrading where some regulated MFIs are beginning to emerge in countries that provide a regulatory process of specialised microfinance institutions. These MFIs are NGOs that give rise to financial institutions which are clearly within the logic of profitability (De Briey 2005). On the other hand, we find the process of downgrading where certain traditional commercial banks that are seeking new market niches have entered the microfinance industry more recently. These banks not only have been convinced of the potential of microcredit, but they also have easier access to funds and the best marketing tools. They can directly grant credit to micro-entrepreneurs or make equity investments in MFIs. Prominent examples of these institutions are the Bank Rakyat Indonesia (BRI) and Banco Solidario (BancoSol) in Bolivia. However, this institutional approach has registered a number of criticisms. The welfarists focus on the borrower through impact studies, while institutionalists propose to integrate the microfinance sector in financial markets (Cornée 2007).

For Ghatak and Guinane (1999), the institutionalists rely instead on contract theory that considers that the incompleteness of contracts can lead to opportunistic behaviour of credit applicants. The institutionalists evaluate the performance in terms of the institution by targeting a clientele of poor households and financial sustainability of MFIs. They design a set of “best practices” to increase the effectiveness of management systems (finance and accounting, marketing, service delivery, etc.), whose adoption is an essential step to achieve financial self-sufficiency on an industrial scale and access to financial markets. They consider financial independence as a criterion that best fulfills the social mission. They are essentially financial institutions: either specialised microfinance institutions (NGOs, non-bank financial institutions and microcredit associations) that fall clearly within the realm of profitability or village banks and some commercial banks that are more traditional involved in microfinance. However, the welfarist and institutionalist approaches have a number of criticisms. The first approach faces the problem of viability and sustainability induced by subsidies, low reimbursement rates and rising operating costs, while the second approach prefers customer micro-entrepreneurs close to the poverty

line (\$ 2 per day). This "microfinance schism" (Morduch, 2000) refers to the trade off between targeting the poor and profitability.

Moreover, the "financial market" registered microcredit programmes work within a market logic. Recognising the limited capacity of donors to meet the overwhelming demand for microcredit, such initiatives work on two essential characteristics: a willingness to massification of credit and a willingness to sustainability of institutions. In order to develop sustainable MFIs, these programmes promote self-sufficiency and financial viability of institutions. The goal is not focused on improving the welfare of the poor in general, rather on improving access to financial services for the poor category. One thing is certain, the current challenge for MFIs (whether commercial or social) is to strike a balance between financial profitability and satisfactory maintenance of the social mission of the organisation which is the reason for their existence.

In light of the foregoing discussion, it should be stressed that the reasoning developed by institutionalists seems relevant and plausible in terms of stability and survival of MFIs. Indeed, in the current context where microfinance occupies a prominent place in the global economy, it must be based on the logic of sustainability and viability; it must be able to guarantee its financial autonomy by mobilising savings necessary to achieve equilibrium and without losing its social objective of helping the most vulnerable to access credit.

2.3 The Forms of Contract in Microfinance

Some approaches, the best known and most widely used in the field of microcredit, are presented in this section. According to Ledgerwood (1998), there are six major forms of microcredit:

- Individual credit;
- Credit solidarity;
- The village banks;
- The self-managed village banks;
- The Grameen Bank model
- Mutual-models.

The distinctions between different types of organisation are related to products and services offered and the way they are offered. The idea is that there is no single model (such as the Grameen Bank model) because it is necessary to take into account the local context to best meet the needs of the target population.

Except joint credit as practiced by the Grameen Bank, the six forms of microcredit are detailed below.

2.3.1 The Individual Credit

This type of credit is primarily for entrepreneurs whose firm size is large enough and are generally located in urban areas. It may also have the customers of small farmers in rural areas. This system assumes that clients have assets that can be deposited as collateral or that persons may act as guarantors of the borrower. Specifically, the typical customer is an entrepreneur in the informal sector and in need of a loan of cash or credit to invest. Client follow-up is provided by a loan officer whose client portfolio size is relatively small (between 60 and 140 customers). The agent is recruited locally, that is, from the same community as that of its customers, in order to reduce information asymmetry about their actual solvency. Demand for credit is generally subject to very careful consideration on the part of the agent and is based, in particular, on an analysis of detailed financial projections. Moreover, the amount and duration of credit are subject to negotiation between the loan officer and client. The loan amount generally varies between 100 and 3,000 USD and the duration varies between 6 months and 5 years. The interest rates are generally higher than those of traditional formal sector (banks) but remain lower than those charged by informal lenders. Finally, most microcredit institutions that build on this approach require a guarantee and/or co-signers and do not impose a mandatory savings prior to the loan. Worldwide, the Caja Municipal Peru, the Credit Agency for Private Enterprise in Senegal, the Bank Rakyat Indonesia or the Self-Employed Women's Association in India have adopted this form of organisation.

2.3.2 The Group Lending (Solidarity Credit)

This practice is based on the principle of distribution of credit to individual members of groups which consist of 4-7 people. In this type of organisation, the surety is required. The target audience is primarily urban and consists mostly of women, market vendors. These customers need very small cash loans on time. Customers are generally micro-entrepreneurs in the informal sector. The various band members have the collective guarantors of the loan repayment. Furthermore, credit is renewed only if all members have paid their credit. Repayments are weekly and are held with the agency that manages the programme. Credits are granted by agents taking between 200 and 400 clients

each and which have only a very partial knowledge of their customers. Credits are awarded based on a limited economic analysis by the credit officer who also regularly visits each member of the group. The credit is distributed equitably to all members at least for the first loan. The total amount of the loan increases gradually over time when members demonstrate their individual ability to pay more money. The amount of the first loans generally varies between \$100 and \$ 200 and there is no ceiling to the following credits. The interest rate charged is relatively high, as the filing fees are in addition to the cost of credit. Finally, a savings is often required but, rather than prior savings, it is often an amount deducted from the loan during loan disbursement. The savings thus plays a partial guarantee of the loan. The main institutions of this type are those affiliated with ACCION International (which has developed this type of credit). These are, for example, BancoSol in Bolivia, Bank Rakyat Indonesia (BRI), Asociacion Grupos Solidarios in Colombia and Guatemala and the Association for Social Progress in Bangladesh.

2.3.3 The Village Banks

Village banks are cooperatives of savings and loans that are managed by the community and are sponsored by a microfinance institution. The latter shall give an initial capital which is distributed as credit to 30 to 50 members (mostly women). All members sign the credit agreement which provides a collective guarantee of the initial capital. The amount of the latter depends on individual requests for appropriations of members of the credit. Usually, the first credits are short-term (4-6 months) and for small amounts (about \$ 50). The interest rate on these loans is close to normal commercial rates (around 1% to 3% per month).

Repayments are weekly. The amount of credit depends on the second offering (in the form of weekly deposits to the fund) that was formed during the member's first credit. This encourages members to save every credit cycle (lasting between 10 and 12 months) an amount equal to 20% of the loan amount. The funds collected internally can be lent but interest rates are much higher. Finally, meetings (weekly or monthly) are held to disburse loans, collect savings, solve problems and attend regular training seminars. Institutions of this type are best known, e.g. Foundation for International Community Assistance (FINCA) in Mexico and Costa Rica and Freedom from Hunger in Thailand, Burkina Faso, Bolivia, Mali and Ghana.

2.3.4 Self-managed Village Banks

They are both created and managed by village communities mostly rural. The aim is to support the entire village and not just a few members as in the previous cases. The creation of such institutions is based on strong social cohesion in a given geographical area (and therefore relatively limited). Members are men and women from the same village that together define the operating principles. In particular, members elect a management committee and two or three leaders. Savings mobilised in the body is in the form of individual loans in the short term. Unlike the previous system, there is no external supply of resources in the form of any subsidy. The credits are a direct result of local savings mobilised. These are also linked to the formal sector to the extent that they mediate between the formal banks (an agricultural development bank, for example) and members of the village applying for credit with them. Note that in such a system, the amount of credit given to each member is not dependent on the ability of individual savings. Individual physical safeguards are needed to get the credit but, in fact, the high repayment rates observed are due to social pressure exerted on borrowers. Leaders, also members of these organisations, receive in-depth training. The village banks in Mali, Burkina Faso and Madagascar work on this principle.

Other sources of credit are commercial banks that lend relatively high amounts, but under very restrictive terms of guarantees so that small and medium farmers have little access. For emergency loans, households may use loan sharks, which are less demanding than banks in terms of guarantees, but require prohibitively high interest rates. Interest rates charged by such lenders vary greatly from case to case, depending on the relationship between the creditor and the debtor and the type of contract established.

2.3.5 The Grameen Bank Model

Among the best known of microfinance institutions is the Grameen Bank¹ of Bangladesh. It draws in particular its reputation from its ancient origins (1976), its location in a particularly disadvantaged country and its great ability to reach, with an excellent repayment rate, largely a poor population. Following a pilot project implemented by charismatic Professor Yunus, it got a bank status in

¹Morduch (1999) considers that the experience of the Grameen Bank itself found its inspiration in the European cooperative movement of the late nineteenth century. In 1910, Raiffeisen cooperatives financed 1.4 million poor.

1983. It is the property of the poor, the bank's customers, who hold 94 per cent stake. It does not require collateral in return for loans. Grameen Bank now has 4.89 million customers, of which 96 per cent are women. It operates in 55,050 villages through 1,583 branches. Its outstanding credit in late 2005 stood at \$ 448 million. The loan recovery rate is about 99 per cent. Since its birth, the bank made profit every year except 1983, 1991 and 1992. For example, the rate of housing loans is 8%, student loans are at a rate of 5 per cent and credit to beggars is free. It also develops loan for micro-enterprises and a range of services. The average loan is just over \$ 100 with an average maturity of one year.

However, these approaches and developmental bureaucracy have failed to ensure that the poor can access state development resources. Increasing attention is now being paid to alternative institutional frameworks that have established their credibility in stimulating rural development (Chowdhury 1989, Asian Development Bank 1993, Sarker 1996, Rahman 1999, World Bank 1996). Sarker (2001) notes that most countries in the developing world have unequivocally accepted the reality that no meaningful development can take place in any country unless the standard of living of the poor is raised. This idea came to the fore because purely growth-oriented strategies failed to improve the living conditions of the majority of the people. Microfinance involves small-scale transactions in credit and savings designed to meet the needs of small and medium-scale producers and businesses. Microfinance programmes also offer skill-based training to augment productivity and support and consciousness-raising training to empower the poor (Khandker, Khalily and Khan 1995). Some scholars have raised concerns about the efficacy of the Grameen model to ensure the economic emancipation and empowerment of women (Kabeer 1995, Todd 1996, Wood 1994, Goetz and Gupta 1995). Despite such criticisms, there are clear positive impacts of Grameen intervention upon the economic as well as socio-political condition of the rural poor.

A significant aspect of Grameen intervention is the involvement of women in self-employment. Hossain's study (1988) shows that the average worker was employed for six days per month prior to joining the bank, but access to Grameen activities increased their employment to 18 days per month. Other studies corroborate this finding (Bangladesh Institute of Development Studies 1985, Todd 1996). Along with employment, productivity has also increased. Alam (1988) argues that Grameen members' increased productivity was due to their adoption of High Yield Variety crop production.

The Grameen Bank was the brainchild of Professor Muhammad Yunus. He observed that conventional banking practices had in-built constraints and were aimed only at those who were already well off. In this context, Professor Yunus contemplated an alternative institutional framework that could be used to raise the well-being of impoverished sections of society (Yunus 1994a, 1994b, 2000, Yunus and Weber 2007). After experimenting on a personal basis, he undertook a small research project in a village near the Chittagong University. The project went on to test the hypothesis that if financial resources were made available to the poor at reasonable terms and conditions, the poor could generate productive employment without external assistance. The pilot experiment was successful and the project was extended to other areas. In 1983, a government ordinance transformed the project into the Grameen Bank, a specialised financial institution for the rural poor (Yunus 1994a, Hossain 1988). The Grameen Bank is now a very distinct poverty-alleviation organisation aimed exclusively at the poor. By definition, it is purely a bank and provides banking services to the poor. Although it is a poverty alleviating organisation, it is designed to run on commercially viable terms. It extends credit to the poor to invest in productive areas such as processing and manufacturing, agriculture and forestry, livestock and fisheries, services and trade. Although its primary responsibility is to provide credit, it has involved itself in different social development activities as well.

The success was built on subsidies, investments, interest charges, the high repayment rates and the growing number of borrowers. In 1996, for example, the total subsidies were approximately US\$ 26 to 30 million (Morduch 1999). In 1997, the subsidy amount was US\$ 28.54 million and in 2010 this amount increased by 102.83 million. The overall base of the borrowing was estimated at US\$ 22.57 million in 2010. The amount of investment of the Grameen Bank in 2010 was estimated at US\$ 678.46 million. In 1998 the amount of net profit was estimated at US\$ 2.12 million; in 2010 net profit increased by US\$ 10.75 million. During 2006, interest costs were estimated at US\$ 49.65 million, with an increase of US\$ 131.1 million in 2010. The wages and other related expenses were estimated at approximately US\$ 20.51 in 1997 and wages grew to US\$ 65.9 million in 2010. The paid-up capital is estimated at US\$ 7.78 million in 2010, capital and other reserves are at approximately US\$ 96.82 million and the deposits amount was estimated at 1.492.02 million. Over the same period, the own fund and deposits percentage of loan and advances were 170 per cent. This helps explain why institutions like the Grameen Bank have not only emerged on their own as a private commercial enterprise, but also emphasises the value of

openly addressing the costs, profits, investment, wages, benefits of grant. The evaluation and management of social performance of an institution may also be beneficial in improving financial performance through customer retention and cost reduction. Donors believe that the exclusive focus of MFIs towards profitability and growth leads to growing business without worrying about the welfare of clients. Many experts noted, however, that some MFIs lacked transparency in several areas, ranging from governance structures to methods of calculating interest rates. They observe that while the MFIs had set social goals, they were content to track and report their financial results. The alignment of performance indicators on social objectives would have warned of the problems customers might encounter.

Apart from these, the Grameen Bank is distinguished from traditional banks in many ways. It deals with women in rural areas. It emphasises trust, the renegotiation of litigation, integration of social objective in the financial objective and individual human development. Its operation is based on a specific set of principles that underlie its originality (Hossain 1988):

- Small loans to individuals based on group targeted to the poorest of the rural population;
- No physical collateral or guarantors required, but use of the security group and the possibility of future loans, for the smooth repayment of loans;
- Loans repaid regularly and in small increments over one year during weekly meetings with group members and project staff;
- Compulsory savings parallel to repaying the loan and interest rates to cover operating costs to achieve long-term viable and independent system;
- Loan money, untargeted, available only for a productive activity, at the option of the borrower;
- Very gradual introduction of these loans within groups to run on a sound basis;
- Limited distance between the credit institution and borrowers to keep access costs low;
- Lending process as simple as possible.

For the Grameen Bank and similar institutions, close monitoring of customers and simplifying procedures would provide cost-effective ways of reaching small rural enterprises previously limited in scope by lack of capital.

Following the success of the Grameen Bank, many experiences in the world were inspired by its principles to develop mutual credit systems (Berenbach and Guzman 1994, Thomas 1995). The approach is to keep what is the strength and success of the Grameen Bank, in terms of matching its audience, the objects of credits, the financial and institutional arrangements, while adapting to the specific local context. The Grameen Bank model is found in Asia (Red River program; Fos Vietnam, Cambodia's rural credit; Kum Indonesia; Ikhtiar Malaysia), South America (in conjunction with ACCION International), Africa (the Project Promotion of Small Rural Credit in Burkina Faso, the Rural Credit of Guinea) and even in developed countries (Nowak 1994). But the debate continues about the limits of the "replicability" of the system in an economic, political and social environment different from Bangladesh. Indeed, the high population density, the supply of skilled labour and cost of the labour market and access to national or international funds cheaply have greatly facilitated the expansion of the Grameen Bank.

Grameen Trust (the group) has more than 40 operators that reproduce the operating principles of the Grameen Bank in Asia, Africa and Latin America. The operating principles of this type of solidarity loans are:

Loans must finance productive activities mainly short-cycle (which does not prohibit the financing of activities related to social obligations generating a daily income to cope with repayments. These are weekly and are held at a meeting where the members' attendance is mandatory. At that same meeting, members must also make a savings deposit.

Borrowers must belong to the same village and constitute a group of five persons of the same sex. These five people must not have any family relationship. Among these five, one is designated by the other four as head of group of borrowers. Before getting a credit, customers must have saved for 4 to 8 weeks. So there is both a credit and savings prior to a mandatory savings over the life of the latter.

The sequence of loans is as follows: once the group consisting of the members start by being trained (interest assessment of the investment project, in particular) by employees of the Grameen Bank, they encounter a number times in the week. As mentioned earlier, members are required to continue to save

throughout the term of the loan. A few weeks after the group's constitution, the first two members receive a loan. Repayments are weekly and are spread over a period of one year. If the first two borrowers repay regularly, a new loan is given to two other members. Finally, if everything goes well, the last one say the "leader" of the group in turn gets a loan. If a group member does not pay, no other member may borrow from the bank in the future. With the additional revenue generated by the loan, borrowers are encouraged to build up savings. Credits are awarded by an officer who manages 200 credits to 300 customers. Group members and leaders of the centre are responsible for assessing applications for credit. The staff of the agency verifies the information and makes regular visits to customers. Finally, borrowings are relatively low (100 to 300 U.S. dollars) and the annual interest rate on a credit is around 20 per cent in nominal terms. Groups are attached to larger units called "centres" at 8 groups per centre. Each week, an officer visits the Grameen Bank group to ensure that refunds do take place as well as to provide advice. According to Yunus (1997), the interest rate is 20 per cent and the reimbursement level is 2 per cent per week for fifty weeks. The first proposed contract consists of savings accounts mentioned above and borrowers are matched by a compulsory levy of 5 per cent of the total loan amount.

It is also powered by any fines imposed on borrowers who do not respect the terms of the contract. Centres manage the fund as they see fit. In particular, they are a group of funds with which borrowers can apply for a loan to meet community obligations. The second is an emergency fund designed to insure borrowers against macroeconomic shocks (natural disasters) or idiosyncratic ones (the death of a member of the group of borrowers, for example).

In fact, these two funds provide borrowers a margin of safety in the case of failure of one of their affiliates. As mentioned earlier, the purpose of loans is to finance the establishment of small productive activities, mostly micro-enterprises which require little capital investment. It should be mentioned that microcredit mainly target women for two main reasons. First, statistics show that defaults on loans to men are more frequent than on loans to women. Sociologists consider here that women are more vulnerable than men in the case of permanent exclusion of a microcredit organisation, making them de facto pay more attention to the use of borrowed funds. Second, the fact that microfinance organisations assist target women to easily reach social goals such as health or education of children.

2.3.6 The Mutualists Models

Mutualistic models are relatively old. They are inspired by movement developed in Europe or North America (Canada) in the late 19th century e.g. the Raiffeisen banks in Germany and caisses Desjardins in Canada. They include, in Africa and Latin America, a large number of networks with various names but based on common basic principles (Fournier and Ouedraogo 1996):

- Prior mobilisation of savings;
- Distribution of funds from collected savings;
- Individuals wishing to join buys a share and become members, liability of members, self-management of the fund by members;
- Organising the structure from among the elected members (Board) and employees on the technical aspects.

Discussions involve mutual constraints that impose a prior mobilisation of household savings. This client selection could indeed exclude the poorest households or in the process of capitalisation, following, for example, droughts in the Sahel. The three level structure (local branches, regional and national federation) sometimes leads to centralised decision-making and administrative burdens. A variant of mutual systems was developed later. These are the village savings and credit organisations (Chao-Beroff 1997) in Mali and Burkina Faso. They operate at the village level and self-managed by the villagers, based partly on volunteering which limits their operating costs. Maximum autonomy is left to base units. The intermediation is limited to the village or a small area; these raise funds from national banks (e.g. National Bank for Agricultural Development of Mali, National fund Credit Agricole of Burkina), which allow growing the business despite the limited resources collected locally. Credit unions and banks associations are supported through a contract with a common service that provides monitoring, advising and training. The Federation of Savings Banks and Credit Agricole Mutuel of Benin is a successful example of the mutual model in Africa.

III. CONCLUSION

Different approaches certainly point to differences over methods of financing, the role of microfinance and the procedures for granting credit to the poor, but they all converge towards a common goal to fight against poverty.

According to Guerin (2002), microfinance institutions are moving from the experimental stage to that of sustainability. This phase involves finding legal and financial mechanisms that promote a balance between the approaches mentioned and avoid two pitfalls. The first leads MFIs to forget their target markets to search for quick profits. The second pushes to neglect the fundamentals of finance, which could lead to failure of microfinance programmes.

The institutionalists emphasise the existence of a gap between financing needs and the financial resources mobilised. Indeed, microfinance institutions are mainly funded by private donors (including foundations of large companies) and by the government, through subsidies. However, these funding sources are, according to institutionalists, rare, limited and unstable. Therefore, MFIs need to rely on private sources of capital to meet their financing needs. For this, these institutions must be profitable and get closer to standards of financial performance of commercial banks. The profitability of microfinance institutions determines their self-sufficiency, which itself determines their survival and thus their contribution to poverty reduction. Only by ensuring their financial viability, these institutions would be able to raise new funds in the financial markets to increase as well as intensify their activity. A lack of financial viability of MFIs in the medium to long term could lead to failure of microfinance programmes and the demise of a new way to fight against poverty.

In the welfarist approach, altruism of the contributors of funds is the engine of an activity based not on the profit motive, but on the social utility. Altruism is considered an invariant feature of the psychology of donors for MFIs, which should ensure sustainability of these institutions. When donors do not expect a high return on their investment, the MFIs can focus on the poorest people who are also at higher risk of default. Money loaned to the poor can not only improve their standard of living, but also enable them to save more or finance new activities. In the institutional approach, MFIs need to finance priority assets of the poor. They can start their own business which will not only ensure their own activity but also to generate employment, promote economic growth and well-being (Ayayi 2007). In this context, the financial return is considered a sustainability factor of microfinance. It allows both to ensure the sustainability of MFIs against the fads or changes in economic policy and expand funding sources. For obtaining new sources of financing from investors, microfinance institutions can expand their business and thus reach a larger section of the

population. However, the need to provide investors with a minimum financial profitability could lead MFIs to rethink their way of selecting projects for funding and to approach the management methods of commercial banks.

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