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MICROFINANCE AND SOCIAL TIES

by

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June 13th, 2002
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Overview

For the past twenty years in developing countries, microfinance institutions have offered those who have been excluded from the traditional banking system, the opportunity to save or to borrow very modest sums of money and thereby to get started on the road towards economic development. Since social ties are often the principal source of wealth for the very poor, these institutions try to reinforce these links, in particular by creating solidarity groups which help to secure their loans. However, there is a price to pay for the development of social ties and their cost is not accounted for in traditional indicators of financial performance. Caught between the need to generate revenues in order to become independent of international public aid which is becoming increasingly scarce, and the desire not to betray their initial objective, namely the fight against poverty, microfinance has to make a choice between these two goals.

TALK : Renée CHAO BÉROFF

I am an economist by training and have worked for the past twenty-five years at the *Centre international de développement et de recherche* (CIDR : International Centre for Development and Research), a non-governmental organisation which is principally concerned with economic development in developing countries and in particular countries in Africa. The CIDR is made up of three departments : a training department, a study and research department, and a department for carrying out projects. The last department carries out projects in four areas : microfinance, health insurance, small companies involved in production and sales, and local development and decentralisation. It is this last department which naturally provides the basic material for studies carried out by the research department of which I am the head.

My primary area of research is microfinance. This is a sector with which I have been involved for about twenty years. Apart from studying projects carried out by the CIDR which has given me a solid knowledge of the field, I have also been asked to take part in a certain number of committees on behalf of the World Bank, the United Nations, French, American, Canadian, German and Swiss donors, and I therefore have a good insight into the development of this sector on an international scale.

Before I start to tackle the problem of the role of social ties in microfinance, I will first of all remind you of what is meant by microfinance.

A tool in the fight against poverty

Microfinance is most widely known as a result of the work of the Grameen Bank, created by Professor Yunus in Bangladesh twenty years ago. It is firstly (and this is essential) a tool in the fight against poverty. It is not for poor people in general but for poor people who are considered to be economically active, in other words, those who carry out activities which generate revenues which in turn allow them to cover their needs and those of their families, even if these revenues are low and precarious. Microfinance offers to help them get started by giving them access to financial services from which they are generally excluded (including savings and credit facilities, insurance and fund transfers), and in ways that are suited to their economic and management skills.

The amounts of money lent are modest. The amount of the loan varies from one country to another, but the generally accepted norm is that it should not exceed 50 % of the GNP per capita of the country in question. For example, in Mali, which is one of the poorest countries in West Africa, the GNP per capita is two hundred and fifty Euros. The loans granted by microfinance institutions therefore will not exceed one hundred and twenty-five Euros.

The second characteristic is that these loans are short-term since the people concerned should start by learning to manage funds on the basis of a three or four month period at the most.

The payment instalments should be close and should involve small amounts in order to be compatible with the type of activity and revenue of the people concerned. For example, there are weekly or bi-weekly due dates with sums of a few Euros.

In the same way, as far as savings are concerned, an MFI (a microfinance institution) should be capable of collecting very small sums, such as one Euro or even fifty Euro-centimes per week. Clients can therefore accumulate a small amount of savings which, at the end of a few months, will become a sum of money sufficiently important to allow them, for example, to face up to an unexpected difficulty.

The MFIs can take part in the development of their clients and move from financing funds of one hundred Euros to one thousand Euros, and from three month credits to credits lasting one year, and also from weekly repayments to monthly repayments, and so on.

Since their clients cannot formally guarantee their loans, the MFIs ask them to organise themselves into groups of five people, for example, which, thanks to mutual backing and social pressure generated by the group, allows them to bring a form of guarantee to the institution.

A true-life example

How does microfinance enable people to escape poverty ? With a loan of one hundred Euros, for example, an African woman living in an urban environment can buy and sell vegetables or cereals at a market . Trade is generally the first activity which is accessible to people who have no education. With the need to repay one’s credit, this woman can then project herself into the future, whereas until then, she lived from day to day. In addition, she knows that if she repays her loan, she will be able to have access once again to credit and even with the passage of time to increasingly large sums of money.

She will therefore be able to develop an economic strategy. For example, if she manages to save one Euro per week and she takes a credit of fifty Euros, she will be able to develop a new activity and move from an activity where the aim is solely to survive to one which is truly entrepreneurial.

Thus a woman from Mopti, who had started out as a retailer, was able after a short time to get a loan to buy a dugout canoe. She employed a canoeist and while he went fishing, she sold the fish he had caught. She therefore created an accumulation cycle and became owner of a consumer durable asset, the dugout, and her activity started to generate employment for others.

A real industry

In twenty years, microfinance has seen a spectacular increase throughout the World, not only in developing countries but also in Eastern Europe. The growth rate of the sector, which reached 50 % per annum at the end of the 1980’s, is still today between 10 % and 20 % per annum.

From the 1990’s onward, after an initial phase of experimental projects financed by donors, and some success stories, a certain number of people in the microfinance sector thought that it was time to transform these projects into sustainable and autonomous microfinance institutions. In order to offer durable services, they had to become independent of the donors and find more commercial resources. In addition, microfinance had a duty to match up to the challenge of the fight against poverty and therefore could not be satisfied with just being available to a tiny group of poor people, nor relying on the generosity of private or public donors which were limited.

To achieve their aim, the MFIs had to operate like profitable companies in the framework of a market economy. Subsequently, we witnessed the beginnings of what we can call a microfinance industry.

Today, there are about ten thousand MFIs throughout the World, servicing twenty-five million clients, in an estimated market of six hundred million people, which therefore has great development potential. These clients are distributed unequally : eighteen million are in Asia, five million in Africa, one million eight hundred thousand in South America and two hundred thousand in Eastern Europe where microfinance has only just got started. A single MFI has on average between ten and twelve thousand clients, but certain concentrations have already come to light, namely that the five biggest MFIs, of which four are in Asia, cover 50 % of the total market. The total money involved is six billion Euros, of which about 50 % comes out of savings and not from donors’ money.

Four major challenges

Today, MFIs are faced with four major challenges. The first is to get closer to their clients. This might appear strange as in its very concept, microfinance involves an attempt to approach people who have been excluded from the traditional banking system. For a number of years, there were only a few microfinance institutions and therefore they constituted a monopoly in certain regions. Their aim was to be in contact with the greatest number of people and for this reason they were satisfied offering very standardised products which could be put in place very quickly. Today, the increasing number of MFIs has led to competition and standard financial products are being rejected by clients. Some MFIs have lost 40 % to 50 % of their clients each year and all their efforts to attract new clients are foiled since they have to renew their client portfolio every year. They therefore have to offer quality products which are more suited to the demand and the needs of their clients, and all this at a lower cost.

The second challenge is to improve their skills. Knowing how to manage a project is one thing ; knowing how to manage an institution in a sustainable way which will last a long time is another. Social workers or developers who are take part in the establishment of MFIs should acquire the organisational and financial management skills which will allow them to ensure the institutions' permanent renewal. In addition, MFIs should get hold of information and management tools which will enable them to follow a savings and credit portfolio at any given time.

The third challenge is to improve their efficiency in order to lower interest rates for loans. Managing a credit of one hundred thousand Euros or five hundred Euros requires roughly the same effort, and the overhead costs of MFIs are therefore very high. This is why it is not unusual to come across interest rates of 30 % or 40 %. This may seem very high, but as these interest rates are repaid by small weekly repayments, the borrowers concerned can manage this. All the same, this is not a reason not to try to be efficient in order to bring down the Euro lending rate and therefore to make it accessible to an even greater proportion of the population.

The last challenge of microfinance is to become truly profitable, and therefore totally independent of financial allocations, while at the same time maintaining the aim of fighting poverty thereby helping underprivileged populations. The danger is that in order to become profitable, one has to progressively abandon the poorest sectors of the population and turn to the richer sectors, which are able to borrow larger sums of money while offering more guarantees at the same time.

Social ties and solidarity

This brings me to the relationship between microfinance and social ties. Social ties is the name given to relationships which exist between individuals and between groups of individuals. These relationships can either be vertical, in other words innate and compulsory, as in the case of relationships within a family, a clan or a religious group, or they can be horizontal, in other words, freely chosen by the individual according to his aims and interests.

In what way are social ties relevant to the fight against poverty ? In order to understand this, we can look at the way in which Africans define wealth and poverty. In a survey concerning 'wealth rating', members of a village had to say who in the village was rich and who was poor. To the surprise of the interviewers who thought that the rich would be judged to be those who had big granary lofts or lots of animals, they replied 'The rich people are those who know how to share things out and the poor people are those who keep everything for themselves.' Since the poor people are selfish, they have few social ties with others and in times of misfortune, they find themselves alone.

This definition is surprising but even in Western countries we know that the worst kind of poverty is exclusion, in other words being alone and isolated. In countries which lack systems of social security, the relationship between poverty and exclusion is even closer, since exclusion signifies that the individual will be deprived of relationships of mutual aid and of solidarity generated by social ties which could help protect him against poverty.

Social ties and social capital

There is a second relationship between the lack of social ties and poverty. Social ties have the specific quality of creating social capital. This term signifies all the skills which an individual or a group has at their disposal in order to achieve certain objectives. On the individual level, social capital represents the person's ability to fit in and to act within a group and this starts with his own self confidence and self esteem. On a group level, social capital represents the ability of the group to organise itself, to define a project, to negotiate, to participate in the life of the city by bringing forward ideas, and so on.

People who have been excluded see their social capital rapidly decrease. They lose self confidence and self esteem and therefore their ability to enter into relationships with others and to fit into society.

The mutual support group which MFIs ask their clients to form in this respect fulfils a second and equally essential function. Within the group, one can talk about one's difficulties, learn about one's rights, regain self confidence, boost one's courage to undertake personal initiatives or to contact an institution collectively, in order to build up both individual and group social capital.

If microfinance is closely interested in social ties, it is because they create social capital which in itself is an essential part of the process of economic development, whether at an individual or group level, or even at the level of a bigger organisation.

For example, in Mopti, several groups of women got together in order to ask the mayor of the town for a programme of social housing. The fact that they organised themselves collectively gave them weight in society and contributed to its economic development.

Social ties : a cost or a gain ?

The development and strengthening of social ties and social capital constitute therefore an essential aspect of the fight against poverty.

However, there is a price to pay. In order to develop and strengthen social ties, an MFI should firstly know what were the social ties which existed before, in other words, the underlying potential on which it will try to create social capital. It should, then, devise products, services, and tools which will encourage social ties and social capital. In order to do this, these elements have to be perfectly matched to the target population, regardless of whether it is made up of men, women, children, small enterprises, country or urban dwellers, and so on. In fact, as far as social ties are concerned, everything is connected. The size of the groups, the homogeneity of the activities of the members of the group, the physical distance between them, the quality of leadership, and the type of non-financial services put forward by the institution are some of the criteria which can have an important impact on the development of social ties within the group, and consequently on the strengthening of individual or group social capital. In order to be in a position to adjust all these variables, the MFI should finally ensure the monitoring of the impact of its activity on the pre-existing social ties and on those which it helped create.

Clearly, the question is to know whether these costs are compatible with the other challenges with which microfinance is faced, notably efficiency and profitability.

In answer to this question, many MFIs today say that the strengthening of social ties also represents a certain number of gains for the institution. These include economies of scale, since the institution addresses itself to a group and not to each individual separately ; the guarantee of repayment of credit thanks to the social control exerted by the groups ;

undertaking a part of the work of management and monitoring by the groups ; securing loyal clients, who stay with the institution in order to continue taking part in these groups. As a result of this loyalty, the clients may deposit a larger amount of savings at the institution, which means generating resources at a lower cost for the MFI. It is even possible for the institution to be taken over by its clients by buying shares, which increases the institution's equity capital and strengthens its permanence.

Encouraging finance of solidarity

The main problem comes from the fact that during the process of creation and development of the MFI, the investments linked to the development of social ties should be made immediately, whereas the gains can only be apparent in the long term. In the meantime, the MFIs are subject to market pressures which encourage the instant profitability of the institution to the detriment of its social mission.

In order to encourage them to take into account social ties in their methodology and in their development, one might envisage the creation of a quality label for "finance of solidarity", which would distinguish those MFIs which take into account social ties and social capital from those which have a purely commercial purpose.

There are already MFI rating bodies which use financial performance indicators inspired by banking techniques. If these rating bodies included indicators which took into account social ties and social capital in their ratings, this could influence the behaviour of donors who want to invest in MFIs, or even allow 'labelled' MFIs to enjoy fiscal advantages or access to more favourable borrowing rates with regards to the financial markets.

However, the development of this type of indicator naturally presents huge problems. This is the challenge which awaits microfinance in the coming years.

DISCUSSION

Making a fortune out of the poor

Question : *Experience shows that contrary to what we may think, the poorer people are, the better they repay their debts. In order to make a fortune in property, it is better to build council flats rather than luxury apartments. The American company Capital One has made billions of dollars by lending money at excessively high rates to poor people. Asking for repayments of one rupee per week over a period of ten years, you reach excessive interest rates, and the poor don't realise because they are used to repaying ! Ultimately, it is an extremely profitable business.*

Renée Chao Béroff : Every time that a new sector of activity develops, there is always a negative side. Microfinance, in the beginning, intended to offer financial resources to poor people who were economically active in order to help them start an activity. There are criminal organisations which use the methods of microfinance in order to grant consumer credit, but this does not take anything away from the legitimacy of the original project of microfinance.

A hint of neo-colonialism ?

Q. : *I was a bit surprised that you did not mention tontines, which already existed a long time before microfinance, and I sense a slight hint of neo-colonialism in your description. The poor people with whom they are involved had already invented their own financial structures long before the MFIs arrived on the scene. Furthermore, you explained that your target population are the poor who are economically active, in other words, the 'good' poor people and not those who fall between delinquency and alcoholism. However, these 'good' poor* *people already knew how to be thrifty, how to manage to feed their children, and to present a united front with their neighbours. In fact, microfinance exploits the virtues which already existed before it arrived !*

R. C. B. : Of course ! To say that in order to succeed microfinance needs to rely on social ties and the social capital of its clients, is nothing less than saying that it relies on existing virtues. The practice of tontines is part of the social capital of these populations, as well as a huge number of moral values. It is not because one is poor that one does not have any values.

Respecting the money lenders

Q. : *You mentioned interest rates of between 30 and 40 % in some MFIs, but when we compare them to rates of between 100 and 150 % practised by certain traditional money lenders, it is nevertheless an improvement.*

R. C. B. : Indeed. Having said that, and despite all the bad things that we say about them, the money lender are at least a positive factor for the poor people in that they will always be there, whereas if an MFI is badly managed then it runs the risk of folding. When one asks someone to leave his money lender to become a client of an MFI, one is asking him to take an important risk. In any case, everyone knows this very well and in general they still keep borrowing a small amount of money from the money lender in order not to break off their contact with him !

The rise in exclusion

Q. : *You talked about the link between poverty and exclusion. I understand it as far as France is concerned, but I find it hard to imagine that in Africa there are people who are really excluded.*

R. C. B. : Unfortunately that is the case. Even to be part of a tontine, one has to put a small sum of money every week into a kitty and some people cannot even manage that. Because of urbanisation, there are more and more people who are genuinely destitute, who have to beg for a living, and are not part of any group. One can even find homeless old people, a situation which would have been inconceivable twenty or thirty years ago.

Q. : *What can we do in this case ?*

R. C. B. : Constitute a group of all those who are excluded and try, little by little, out of nothing, to create a social tie and social capital in order to get them out of this situation ! Of course, it is not easy.

What is the success rate ?

Q. : *Can you put a number on the percentage of clients of an MFI who manage to make it work and how many fail ?*

R. C. B. : It all depends on what you mean by “making it work” : is it repaying one’s loan and having something to eat while managing to survive ? Or is it paying back one’s loan, covering one’s needs and starting to save in order to face up to unpredictable situations ? Is it developing one’s activities, diversifying them and starting to invest ? We should adopt the point of view of our clients and respect the objectives that they have set themselves. Not all the women in Mopti want to become *mamas Benz ;* some only want to be able to help their family live, look after their children when they are ill, and if possible send some of them to school. We should not put ourselves in their place and set them aims which they do not have. It is in this spirit that most MFIs function.

A threat to social ties ?

Q. : *If we believe the very attractive definition of wealth and poverty given by the African villagers, won't the client of an MFI, who becomes involved in a loan system and is therefore concerned about paying back his loan, share things less and become less attentive to others for whom he has less time ? As a result, doesn't he run the risk of becoming poor in the African sense of the term ?*

R. C. B. : There is a big debate about this within the circle of those who practise microfinance. In fact, the question is to know whether by accelerating economic development of the poor, one is not also rushing them towards an individualistic and self-centred society similar to ours in the West. There would also be a kind of fatality, and this virtuous circle which I described where social ties and economic development strengthen themselves mutually would only be an ideal and illusory vision. As far as I am concerned, as a campaigner for microfinance and social ties, it would be a real catastrophe having worked for so many years to end up like this ! I believe that this evolution follows cycles, with periods when social ties are very strong, periods of economic development when they become less prominent, and periods when they have become so weak that a crisis breaks out and leads to attempts to create new ties. Moreover, it is perhaps this type of crisis which we are currently experiencing in the West.

The additional costs of microfinance

Q. : *You talked about the additional costs for an MFI involving the management of all the little sums of credit or savings by comparison with a traditional bank. I imagine that there are other additional costs associated with the illiteracy of the clients ?*

R. C. B. : You're right. Each time we work with the poor, there are additional costs. For example, before working with an illiterate person, you have to teach him to read or write or use numbers if you want him to be able to take part in the management of the system. Other additional costs appear in rural environments and in remote regions without an infrastructure in terms of roads or communication. To install an information or management system, for example, you need electricity and therefore you have to buy a generator.

The real question is to decide who should pay for these additional costs. In France, we have a redistribution system called town and country planning. However, this is not the case in Africa and it is the populations themselves who have to pay for all the additional costs of the services which are brought to them.

The tools for the development of social capital

Q. : *What are the tools for the development of social capital ?*

R. C. B. : Training naturally plays an essential role, but it should always be carried out bearing in mind its impact on social ties. For example, it may appear simpler and more economical to train just the leader of a group, but he runs the risk afterwards of taking control of the group and of thereby causing crises within the group which would destroy the social ties. On the other hand, if you provide training for all members of the group, then the group can establish a rota taking it in turns to make decisions. This will strengthen the individual social capital of each group member and tighten the social ties.

The reduction of public aid ?

Q. : *The advocates of the economy of solidarity in France consider that one of the characteristics of this economy is the hybridisation of resources, in other words, resorting both to private and public resources, as in the case of the associative sector whose finances rely on public aid (53 %) and private initiative (47 %). I am surprised that the aim of microfinance is to become completely independent of public aid, since despite everything this effectively puts a halt to the commercial downturn which you fear.*

R. C. B. : One can indeed imagine that mixed private and public financing would be likely to reduce the pressure on the MFIs and give them the time necessary to do quality work, bearing in mind social ties. This work could moreover be placed in the domain of public property whose costs should be paid collectively. Unfortunately, public aid for development has been decreasing from year to year. The developed countries are a long way from reaching the objective they set themselves of 0,7 % of their GNP. If we want to be rational in terms of durability, we have to take into account this growing shortage of public aid and therefore to move forward in terms of profitability, efficiency and adaptation of services.

Q. : *In any case, we hope that the development of microfinance will teach a lesson to all the donors, and that it will have shown them that it is better to support small projects than big projects, as was the case in the past.*

R. C. B. : What has really changed in microfinance is that aid which was given directly to the government has been replaced by aid brought directly to those in need. Therefore one could easily see what was not distributed to those for whom it was intended. From this point of view, microfinance certainly contributes to a more positive form of co-operation with these countries.

The profile of the microfinanciers

Q. : *What is the profile of the executives of microfinance institutions ?*

R. C. B. : Currently, we can clearly distinguish two contrasting profiles : on the one hand, the developers and the social workers who were the instigators of microfinance and whom we refer to today as the visionaries ; and on the other hand, a new generation of bankers who even though they know nothing about it, think that they will professionalise this sector thanks to their managerial talents. Personally, I hope we will see, emerging from these countries, a new generation of entrepreneurs who will interest themselves in this very specific niche and who will be able to understand that it is a profession in itself, in which one succeeds neither by applying traditional banking techniques nor by just carrying out some form of social action.

Q. : *Competition with the world of politics and the business world must be tough in order to find this type of skill !*

R. C. B. : For this sort of professional profile, the private sector pays salaries about ten times more than that which an MFI can offer without putting its survival at risk. However, I tell myself that in France one can see young people give up jobs in consultancies or in banks, where they earn six or seven thousand Euros a month, to go to work for an NGO (non-governmental organisation) for one thousand five hundred Euros per month, there is no reason why the same spirit should not exist in developing countries. The case of Yunus, in Bangladesh, is quite typical : he is someone who wanted to help the development of his country by offering his professional skills. I think that that can be found everywhere.

Q. : *Is it not easier to find this type of profile in Asia rather than in Africa ?*

R. C. B. : Often Africa is a bit behind but the trend exists. One can see a generation of African executives emerging in microfinance. These people have real skills and are starting to take over. It is more difficult in Africa than in India for example, where there are many more people with degrees, who accept relatively low salaries more easily. When I was a student, people said the same thing about India : *"Those people will never succeed ! How much longer will they let themselves die of hunger ?"* In fact, in thirty or forty years, things have changed a lot and I think that Africa is in the process of following the same path as Asia and Latin America.

Presentation of the speaker :

Renée Chao Béroff : PhD in economics and finance. She has been in charge of the study and research department at the *Centre international de développement et de recherche* (CIDR) since 1982.
She devised and perfected the methodology and the process of implementation of the project for the *Caisses villageoises et de crédit autogérées* (CVECA : Village Savings and Credit Association), which developed successfully in several regions of Africa. She has carried out numerous studies of identification and feasibility. She has also undertaken projects for monitoring and consultancy, as well as evaluations of microfinance and rural finance in more than twenty countries in Africa and Asia. She has organised and run workshops for the exchange of experiences, both in developed and in developing countries. She has been a speaker at university and specialist conferences on these topics. She has been an instructor at the SYDEC since 1995. She sat as a member of the Policy Advisory Group of the CGAP (Consultative Group to Assist the Poorest) from 1995 to 1999.

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