University of New Mexico
UNM Digital Repository

NotiSur Latin America Digital Beat (LADB)

4-4-1998

Microcredit: Big Gain On A Small Scale

Guest Author

Follow this and additional works at: https://digitalrepository.unm.edu/notisur

Recommended Citation
Guest Author. "Microcredit: Big Gain On A Small Scale." (1998). https://digitalrepository.unm.edu/notisur/12488

This Article is brought to you for free and open access by the Latin America Digital Beat (LADB) at UNM Digital Repository. It has been accepted for inclusion in NotiSur by an authorized administrator of UNM Digital Repository. For more information, please contact amywinter@unm.edu.

LADB Article Id: 54794
ISSN: 1060-4189

Microcredit: Big Gain On A Small Scale

by Guest
Category/Department: Region
Published: 1998-04-04

[The following article by Barbara J. Fraser is reprinted with the permission of Noticias Aliadas in Lima, Peru. It first appeared in the Feb. 19, 1998, edition of the weekly publication Latinamerica Press.]

Francisca Apaza Pacco's small house on the outskirts of Juliaca, on the Peruvian altiplano, looks like those of her neighbors except for two modern knitting machines she, her husband, and one employee use to make sweaters to sell in Cusco. Apaza is one of thousands of Latin American women who have launched small businesses thanks to a microloan from a nongovernmental organization. While programs providing microcredit small, short-term loans aimed at poor people who have no fixed assets with which to guarantee a loan seem to have sprung up almost everywhere in Latin America in recent years, the concept is far from new.

Muhammad Yunus, a Bangladeshi economics professor, pioneered the idea almost by accident in 1976, when he lent small amounts of his own money to extremely poor women who used the money to raise cows or buy supplies for making handicrafts. As they sold their wares, they repaid the loans. Yunus is now managing director of the Grameen (Bangladeshi for "rural") Bank in Bangladesh, which has lent about US$2 billion to 2.3 million people, more than 90% of them poor women. While the Grameen model has been imitated worldwide, including in Latin America, even its strongest proponents admit that small loans to poor people are not a panacea for developing countries' economic woes.

Credit by itself is not the answer to development needs "Credit, in itself, can't be the centerpiece of development," says Francisco Barquero, a consultant with a loan program administered by the Nicaraguan Council of Evangelical Churches. "Giving poor people access to credit requires social and economic plans that go beyond simple microfinancing. At first, everyone talked about credit for the poor. Now, people talk about credit for poor sectors that can be financed and reactivated. The sectors that can't be reactivated need to be covered by social programs."

During the past 15 years, hyperinflation and economic structural adjustment programs imposed by creditors like the International Monetary Fund (IMF) and World Bank pushed more and more Latin Americans into poverty. Budget-cutting and privatization of government-run businesses led to massive layoffs. Those who lost their jobs began selling soft drinks and washing cars to make ends meet. Working independently but outside the system, with no stable income, benefits, or tax obligations, these people swelled the "informal economy."

By the beginning of this decade, in many countries, as much as half the economy was informal. Recognizing the development and tax potential of these small entrepreneurs, many governments began to take steps to incorporate them into the formal economy. Loans for starting or expanding a business, however, remained largely out of reach. Most informal merchants are poor. Many are

©2011 The University of New Mexico,
Latin American & Iberian Institute
All rights reserved.

LADB Article Id: 54794
ISSN: 1060-4189

street vendors, without a fixed sales location, and many either do not own a house, or do not have legal title to the property where they live. Informal lenders often charge exorbitant interest rates, and without collateral, informal merchants cannot qualify for a loan from a commercial bank.

Nongovernmental and church organizations were among the early supporters of microcredit projects, while commercial banks dragged their feet. A 1995 study of six Latin American countries by the Swiss aid organization FUNDES showed that the major problem voiced by 70% of microentrepreneurs was lack of access to credit. Only 16% of banks surveyed considered lack of access to credit the main obstacle for small businesses, naming instead a lack of organization and training on the part of microentrepreneurs, and bad economic conditions. Now, commercial banks are beginning to move into the field, encouraged by such institutions as the World Bank and Inter-American Development Bank (IDB), as well as by potential profits.

Other lenders, like Bolivia's Banco Solidario, known as BancoSol, have converted from nongovernmental programs to commercial institutions. Microenterprises account for much of the informal economy In many countries, microenterprises generally defined as businesses having 10 employees or fewer account for as much as half of all employment. In Chile, one-fourth of the labor force about 1.2 million people works in microenterprises, a figure that rises to 46% in Colombia. In Bolivia, the proportion of the urban work force in microenterprises and family businesses grew from 58% in 1992 to 63% in 1995. During that time, 90% of the new jobs created in Bolivia were in microenterprises and the informal sector.

Not all microenterprises contribute to a country's economy in the same proportion, however, and organizations offering microloans have learned to distinguish. "It isn't easy to provide credit to the poorest of the poor, because they have to have a small business for at least a year to qualify for a loan," says Gabriel Gaitan, microcredit director of Catholic Relief Services (CRS) in Nicaragua. He adds, however, that those who receive microloans from CRS "are the poorest of the poor among the microentrepreneurs."

The Grameen Bank pioneered the "solidarity group," which makes it possible for poor people to borrow money even though they have no collateral. Five or six borrowers meet regularly for mutual support. If one has trouble repaying a loan, the entire group is responsible for finding a solution. Some lenders, like Bolivia's BancoSol, use the same method. Others, like CARE in Peru, lend through revolving funds to existing women's organizations, relying on peer pressure among the women to guarantee repayment so other members can also receive credit. Although between 30% and 60% of all microenterprises in Latin America and the Caribbean are owned and operated by women, according to the IDB, women historically have had limited access to credit.

While women are barred from commercial credit, they often are favored in the microcredit world. Lenders have found that women repay their loans more conscientiously than men. Organizations that provide training programs along with their loans often stress the importance of investing wisely. If women are finding that microcredit can jump-start their earning power, rural Latin Americans are still largely excluded from the system. One study in northeastern Brazil found that 90% of small farmers had no access to credit, and a study in Mexico between 1990 and 1994 showed that fewer than 25% of rural entrepreneurs received cash loans from any source, and only about 8% received credit from commercial banks.

©2011 The University of New Mexico,
Latin American & Iberian Institute
All rights reserved.

ISSN: 1060-4189

Even microcredit programs like the one run by BancoSol in Bolivia tend to lend mostly in urban areas. Agricultural cycles, which require longer-term loans, and the geographic distances are among the factors that increase the cost of providing credit to campesinos. Some organizations are finding solutions, however.

In Nicaragua, a microcredit program run by CRS and Caritas in the city of Matagalpa is now generating income equal to about twice its cost. The organizations use the proceeds to expand the program into rural villages, offering longer-term credit. Microcredit has to be supported by government programs Lenders have realized that the many factors involved in determining a microenterprise's survival require a multifaceted approach in which governments, nongovernmental organizations, businesses, and trade unions can play roles. "In many cases, studies have shown that credit is not the most important element.

More important are other kinds of assistance, such as information about markets or technology, and in some cases machinery that can allow them to improve production quality," said Carlos Garatea, general secretary of the Latin American Association of Financial Development Institution (ALIDE). Experts point out that governments must play an important role in creating an environment in which microenterprises and small businesses can flourish. Small businesses have less protection in the marketplace against unscrupulous competitors or customers who break contracts, for example. Informal microenterprises tend to generate informal employment, usually for the entrepreneur's family, without benefits or minimum-wage standards.

In Chile, more than one- third of the people who work in microenterprises are not affiliated with a health-care provider, and 40.6% lack work contracts. "The government has to assume the role of regulating, promoting, and providing orientation," said Garatea. It must also support small businesses with infrastructure. "Because if there aren't roads, or systems to generate power, all of this is theoretical." The IDB sees education as key. According to the bank, if the average level of schooling in Latin America is increased from the present five years to 6.8 years over the next decade, sustainable economic growth would increase by at least one percentage point.

One constant problem is the high cost of providing credit to small borrowers. It costs the bank as much to process a small loan as a large loan, and the more small borrowers, the higher the administrative overhead. However, the higher interest rates associated with microcredit may not be a major problem for the borrower. "The cost of credit is not a decisive element. Much more important might be the term of the loan and adjusting the conditions of the loan to the entrepreneur's situation so the loan can be paid back," Garatea said. Although access to credit may not be the make-or-break factor for a microenterprise, it often determines whether the business will grow.

And as the businesses expand, the solidarity that made those first loans possible will continue to aid the microentrepreneur. Garatea believes that by joining with other businesses, microenterprises can enter into market niches that would otherwise be closed to them. Credit, experts say, is only a means to an end. The long-term goal is the survival and growth of the microenterprises, and their contribution to the Latin American economy. A study done between 1992 and 1994 in Chile

©2011 The University of New Mexico,
Latin American & Iberian Institute
All rights reserved.

LADB Article Id: 54794
ISSN: 1060-4189

showed a significant decline in the number of microentrepreneurs living in poverty, implying that the microenterprise is an effective means of moving out of poverty.

A key factor in long-term success is savings. Many microloan programs have incorporated savings plans, either as a requirement for obtaining credit or through forced savings during the term of the loan. "The fact that a small farmer has a cow or a chicken shows the ability to save, because he is not raising them for food, but to market them and reinvest the profits," he says. This maturing of vision on the part of lenders and borrowers alike should help give microcredit programs, which have a good track record in Latin America, an even more promising future.

-- End --

©2011 The University of New Mexico,
Latin American & Iberian Institute
All rights reserved.