Microcredit in the Developed World:

Can microcredit serve as an effective tool of poverty alleviation in the United States?

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This paper investigates the following topics:

• An overview of microcredit and microfinance as tools of poverty alleviation
• The impact and execution of microcredit in the less developed world
• The impact and execution of microcredit in the developed world
• The current state of microcredit in the United States
• The future potential of microcredit in the United States as a tool of poverty alleviation
"Give a man a fish, he'll eat for a day. Give a woman microcredit, she, her husband, her children and her extended family will eat for a lifetime." – Bono

Introduction

When she was only 8 years old, Selina was sold by her father, a blind beggar, into the Bangladeshi child labor market. By the age of 11 Selina was married and struggling through life in Bangladesh, a highly impoverished and overpopulated country (Asia). Her life changed when she got the opportunity to join a group of women and take out her first loan at the Grameen Bank, a microfinance institution (MFI) committed to serving the poor in Bangladesh. With a loan of only $60, Selina was able to buy chickens, start husking rice to sell to vendors, and put down an initial payment on a rickshaw for her husband. 10 years later, Selina lives in a three-room house, owns a cow and several rice fields, and her daughter aspires to be a doctor (Grameen Research).

Thousands of miles away in the economically flourishing European country of Denmark, Anne Los struggled to find a bank willing to issue her a small loan to start a beauty salon. Anne visited multiple banks all over her city and each one turned her down because she was not steadily employed, had no partner in the venture, and had failed in a previous business endeavor. Her business plan was well developed, but not a single traditional lending source was willing to approve her loan because she was labeled “too risky”. Without any options left, Anne decided to visit Qredits, the country’s national non-profit microcredit institution, to ask for a loan. After prudently discussing Anne’s business plan, Qredits approved her loan and she is now the proud owner of a small beauty salon (“Anne’s”).

The stories of Selina and Anne paint two very different images of microcredit, otherwise understood as the system of offering small loans. The impact microcredit has had on poverty
over the past 40 years in the less developed world is staggering\(^1\) and Selina’s story is just one of millions of success stories (Robinson). In the developed world, on the other hand, microcredit has served a different purpose. In developed countries, MFIs strive to enable the unbanked population, generally unemployed individuals fighting social exclusion and poverty, to start small businesses and rise out of poverty (Armendáriz). Nations ranging from Bangladesh to France to Indonesia to Denmark have all successfully utilized microcredit to alleviate poverty within their cultures. The United States is one country where interest in microcredit as a tool of poverty alleviation has grown in recent years, yet actual implementation has largely failed (Schreiner). This paper will evaluate success stories of microcredit in both the less developed and developed world in order to properly assess the market for microcredit in the U.S. Additionally, it will provide recommendations based on those analyses on ways to improve the implementation of microcredit in the U.S. in order to maximize its potential as a tool of poverty alleviation.

This paper assumes the overarching goal of microcredit is to alleviate poverty. The meaning and standard of the word “poor” throughout this paper will vary by country and the program of focus. Three countries and their microcredit systems will be emphasized throughout this paper. The United Nation’s Human Development Index (HDI)\(^2\) will be used to label countries as developed or less developed. Countries with a medium or low HDI will be considered less developed, while countries with a high or very high HDI will be considered developed. High human development areas are characterized by high life expectancy, a good

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1 Microfinance in Indonesia has helped reduce poverty from 40% of the Indonesian population to slightly over 10% of the population in the span of 30 years (Robinson, xxi). In Bangladesh, microfinance benefits local economies, and between the years of 1991/2 and 1998/99 helped reduce overall moderate poverty levels by 17% and by over 20% in 2 The Human Development Index is a “composite index measuring average achievement in three basic dimensions of human development—a long and healthy life, knowledge and a decent standard of living”. It takes into consideration average life expectancy at birth, mean years of schooling per citizen, expected years of schooling per citizen, and gross national income per capita. (Vroman Vroman.com, report)
education system, and high Gross National Product per capita, while low to medium human development areas struggle with high infant mortality rates, a failing education system, and widespread poverty. Bangladesh, a medium human development country, will serve as the primary example of successful execution of microcredit in a less developed country. The microcredit system operating within France, a very high human development country, will be analyzed because of its effective use of microcredit to help the poor in a developed country. Finally, this paper will conclude by considering the microcredit systems in place in the United States, also a very high human development country. As previously stated, microcredit has been ineffective in the U.S. in the past and the overarching purpose of this paper is to identify methods of better utilizing it as a tool of poverty reduction. Before delving into any specific examples of effective microcredit, it is imperative to better understand microcredit and the overarching concept of microfinance and the purpose they serve.

**What is microfinance and how does microcredit function to alleviate poverty?**

Microfinance is specialized small scale banking focused on serving the needs of the poor around the world. It utilizes a unique system to make capital and other services available to those typically excluded from normal banking systems (Ledgerwood). The original purpose of microfinance as a tool of poverty alleviation was to cultivate sustainable economic development in areas of extreme poverty, but it has since been adapted to also serve the poor in developed countries by opening doors to self-employment. The term microfinance encompasses a variety of different offerings available to those in need of financial services. Because the term microfinance...
is so broad, this paper will focus primarily on the use of microcredit as a tool of poverty alleviation.

The effectiveness of microcredit in reducing poverty stems from the severe absence of capital available to the poor in both less developed and developed countries. Capital throughout this paper refers to financial capital. Capital is incredibly difficult for the poor to acquire in areas of low development and although it is easier to access in highly developed areas, it comes at an extremely high cost to the poor. A survey in 1985 in Bangladesh showed that prior to the introduction of MFIs in their towns, women had on average 336 Taka or $10.84\(^6\) of working capital available to them. After gaining access to MFIs and microcredit, the same women had access to approximately 1,713 Taka or $55.26\(^7\). This relationship represents an 88 percent increase in available working capital per year (Hossain). In developing countries, MFIs provide financial capital to the poor so they can establish and sustain small businesses and begin a pattern of sustainable development within their communities.

In developed countries, credit is more readily available through banks and payday lenders, but the existing systems either exclude or take advantage of the poor. For example, to acquire a traditional loan from a bank, a borrower must provide documents including a credit report, a bank statement and proof of employment to prove willingness and ability to repay the loan plus interest. If approved, the borrower must pay an origination fee, which is higher for borrowers with low credit scores, and then finally they receive the loan and are required to pay it

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\(^6\) The Taka is the national currency of Bangladesh. The currency conversion is based on an exchange rate of 31 Taka per USD. That exchange rate is what was in place at the very end of 1985 and towards the middle of 1985 the exchange rate was 26 Taka to USD. This means that if anything, the dollar amount of capital would actually be higher if the conversion rate was lower at the point when the survey was taken. At that time, Bangladesh had a highly fluctuating currency, so determining an entirely accurate dollar amount for Taka is difficult (http://intl.econ.cuhk.edu.hk/exchange_rate_regime/index.php?cid=29).

\(^7\) Men had access to 1,237 Taka or $39.9 prior to the introduction of microfinance institutions. That number increased to 4,141 Taka or $133.58 after they began loaning from microfinance institutions. That relationship represents an increase in access to capital per year of 56% (Hossain).
back over a determined schedule. This system extensively excludes the poor. Not only is it unlikely that an individual in poverty would be capable of providing the required documents, but even if he or she did somehow provide them, the chances of a bank issuing the loan are incredibly low. Traditional banks have cut and dry guidelines on the type of loan they will accept and the poor rarely fall within those strict parameters. The poor in more developed countries also have access to additional lending sources with lower loaning standards such as payday lenders, but those loans come with incredibly high interest rates that take advantage of those in desperate need of money (Payday Profiteers). Because of these barriers, MFIs and microloans are incredibly valuable to the poor. Simply by increasing the accessibility of capital to the poor, microcredit works to diminish poverty, boost up communities through entrepreneurship, and empower individuals in both less developed and more developed countries.

Microloans were designed as a tool to break down the barriers the poor face in acquiring loans. They are very small loans tailored to fit the needs of the poor. They effectively eliminate barriers caused by geographic location, education levels, employment past, and many additional influencing factors that keep the poor from participating in economic activity. Generally, institutions offering microloans do not require the same documents needed to apply for a loan at a bank and they assist borrowers through the loan process. The resulting loan differs from individual to individual and especially by country because the institutions must adjust their loans to best fit the society they are serving. For example, institutions in less developed countries often focus on providing loans to women and often times require that the women form self-selected

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8 Payday loans are very accessible sources of quick cash that come accompanied by incredibly high interest rates. Payday lenders have very low standards for who they lend money to and offer cash quickly to customers. They have been criticized for taking advantage of vulnerable groups including the poor, the less educated, separated and divorced men and women, and others. The Pew Charitable Trusts article on payday loan communicated that the average borrower ends up “spending about $520 on interest with an average loan size of $375” (“Payday Lending in America.”).
groups to establish accountability for the repayment of the loan. This is due to social and economic factors apparent within these societies that will be discussed later. Additionally, institutions often focus more on individuals and require training as a condition of the loan.

In both the developed and less developed world, microcredit functions to alleviate economic poverty by creating opportunities for the poor to start their own businesses and achieve financial stability. The United Nations and those working to diminish poverty around the world now recognize that poverty cannot simply be measured by income, but that other cultural, social, and political components also contribute to poverty. It is now widely accepted that barriers to an individual’s right to education, health, freedom of expression, and freedom of cultural association are also significant contributors to poverty (Poverty). There are millions of organizations around the work devoted to opening doors to education, healthcare, political expression, or any other poverty perpetuating discrimination with the hope that something will make an impact on worldwide poverty. Microcredit is a unique answer to poverty because it focuses exclusively on the alleviation of the economic dimension of poverty with the expectation that other disadvantages will fall away once the poor achieve economic stability. When implemented well, microcredit has proven to achieve just that and positively influence the fight against poverty going on around the world (Littlefield).

**Microcredit in Less Developed Countries**

**Overview**

Microfinance organizations in less developed countries focus on mobilizing the poorest of the poor by opening up opportunities for sustainable economic development. The Millennium
Development Goals (MDGs)\(^9\) established by the UN in 2000 initiated a progressive movement to vastly better the situation of the poorest of the poor around the world (Littlefield). The initiatives range from health goals to expanding education to alleviating poverty. The objectives of the UN’s movement are strongly geared towards reducing the dilemma of the poor, but the results of the programs have been vastly affected by weak economies and infrastructures in the parts of the world where the poorest of the poor reside. Further research and evidence show that providing financial services to the poor in areas such as rural Bangladesh or Indonesia is a critical component of establishing sustainable development and creating a more nurturing environment for overall economic and social growth (Littlefield).

Muhammad Yunus, the founder of the Grameen Bank, voiced the potential of microcredit well when he stated that:

“People… were poor not because they were stupid or lazy. They worked all day long, doing complex physical tasks. They were poor because the financial institution in the country did not help them widen their economic base” (Yunus).

This quote accurately depicts Yunus’ belief that the poor are in some part capable of handling the epidemic of poverty and economic deficiencies within their countries on their own if they are simply empowered to do so through access to capital. Therefore, microcredit in less developed countries confronts the core issue of poverty and by doing so it inevitably leads to improved

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\(^9\) The eight Millenium Development goals are 1) eradicate extreme poverty and hunger 2) achieve universal primary education 3) promote gender equality and empower women 4) reduce child mortality 5) improve maternal health, 6) combat HIV/AIDS, Malaria and other diseases 7) ensure environmental sustainability and 8) establish global partnership for development.

- The most current overarching statement of the UN regarding the MDGs reads as follows: “The eight Millennium Development Goals (MDGs) – which range from halving extreme poverty rates to halting the spread of HIV/AIDS and providing universal primary education, all by the target date of 2015 – form a blueprint agreed to by all the world’s countries and all the world’s leading development institutions. They have galvanized unprecedented efforts to meet the needs of the world’s poorest. The UN is also working with governments, civil society and other partners to build on the momentum generated by the MDGs and carry on with an ambitious post-2015 development agenda.” (“We Can End Poverty”).
health and dietary conditions, higher education rates, and overall stabilization of the position of the poor (Littlefield). Microcredit is estimated to have impacted over 150 million individuals in the less developed world (Armendáriz).

Several general features characterize microcredit in the less developed world. First, interest rates of MFIs in less developed countries are relatively high in comparison to interest rates commonly seen in financial institutions in developed countries where usury laws combat exorbitant interest rates. Interest rates are high because the costs associated with providing reasonably priced small loans to the poorest of the poor in the world are extremely high (Fernando). Interest revenue from those loans is the main source of income for MFIs. Often times, high interest rates are what it takes for a MFI to sustain operations while also opening up economic opportunities to those labeled the most “risky” borrowers. MFIs actually reach more people and make a stronger impact in countries where they are free to set the interest rate based on the market and the institutional structure.¹¹

Additionally, MFIs in less developed countries tend to focus on making themselves available to the rural poor and creating alternative options to collateral. A large portion of the poor in less developed countries live in rural areas, so creating networks for them to better access the available capital is important (Hossain). MFIs also work to find alternative motivators in lieu of requiring collateral because the impoverished in less developed countries often don’t have anything to put up as security for a loan. Normally, lacking something to put up as collateral

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¹⁰ “Regulations governing the amount of interest that can be charged on a loan. Usury laws specifically target the practice of charging excessively high rates on loans by setting caps on the maximum amount of interest that can be levied. These laws are designed to protect consumers.” (Investopedia.com)  
¹¹ In regions where MFIs are free to set interest rates there is a much stronger microfinance industry. In Bangladesh 10 million people borrow from MFIs. In Cambodia over 500,000 people borrow from MFIs. Vietnam and China’s markets are much smaller because of interest rate limitations (Fernando).
would result in the exclusion of the poor from receiving credit, but MFIs open doors to economic opportunities by utilizing alternative methods.

The Grameen Bank

The Grameen Bank in Bangladesh is a prime example of an established MFI serving the poor in a less developed country. Bangladesh is a nation almost entirely bordered by India in South Asia with extremely weak economic growth and a poor infrastructure ("PovcalNet."). The economy is not strong enough to support the largely rural and impoverished Bangladesh population of which women are the most disadvantaged demographic\(^{12}\) (Esmat Ara \textit{et al.}, Khandker, 1998). The Grameen Bank in Bangladesh is one of the most established and well-known MFIs in the world. The Grameen lending format is also one of the most, if not the most, replicated microfinance models in the world.\(^{13}\) The goal of the institution is to create sustainable social and economic development in poor communities by expanding access to capital for the poor through credit ("Grameen Bank.").

Muhammad Yunus, a Bangladesh native and professor of economics, started the bank in 1983 when he began to recognize how deeply the economy was failing the poor of his country ("Grameen Bank."). He realized how valuable microloans could be to the poor when he encountered an impoverished woman struggling to retain even a hint of profit making bamboo stools in a poor and underdeveloped village in Bangladesh. The incredibly high rates of interest she had to pay to borrow supplies for her business made it impossible for her to ever get ahead. This woman was stuck in the unfortunate, yet common cycle of borrowing and poverty. Upon

\(^{12}\) "In Bangladesh like many other developing countries women’s access to positions of influence and power is limited: their occupational choices are narrower and their earning capacity is lower than those of men. Bangladeshi women face severe challenges due to their economic, social and cultural positions and the country’s physiographic conditions" (Esmat Ara \textit{et al.}).

\(^{13}\) "This lending model was developed by the Grameen Bank of Bangladesh to serve rural, landless women withing to finance income-generating activities. This model is prevalent mostly in Asia but has been replicated in other contexts. Grameen Trust has more than 40 replicators in Asia, Africa, and Latin America" (Ledgerwood).
witnessing this woman’s situation, Yunus realized how impactful a small loan with reasonable rates could be on her life. From that experience he formed the Grameen Bank, which now serves 8.29 million people in Bangladesh with a recovery rate\(^{14}\) of 97 percent, superior to any other system in the world\(^{15}\) ("Grameen Bank."). The Grameen Bank now charges 20 percent interest rates on business loans, which would be considered high in a developed country, but is low in comparison to rates available prior to the introduction of the bank ("Grameen Bank.").

The Grameen Bank was set up to be accessible and successful in rural areas of Bangladesh where the majority of the poor live. The bank now focuses almost exclusively on lending to women because they have restricted access to typical banking systems, constricted occupational options and low earning capacity, and they have proven to be consistent and dependable borrowers (Khandker, 1998). Muhammad Yunus explains why the bank focuses on loaning to women in the following quote:

“Poor women had the vision to see further and were willing to work harder to get out of poverty because they suffered the most. The women paid more attention, prepared the children to have better lives, and were more consistent in their performance than men. Money going through a woman in a household brought more benefits to the family as a whole than money entering the household through a man. On the other hand, a man had a different set of priorities which do not give the family the top position” (Yunus).

By empowering women, the Grameen Bank has redefined the social structure in Bangladesh and reduced the “social oppression and economic exploitation” facing women in many less

\(^{14}\) Recovery rate is the percentage of borrowers who pay back loans

\(^{15}\) “In Bangladesh today, Grameen has 2,564 branches, with 19,800 staff serving 8.29 million borrowers in 81,367 villages. On any working day Grameen collects an average of $1.5 million in weekly installments. Of the borrowers, 97% are women and over 97% of the loans are paid back, a recovery rate higher than any other banking system. Grameen methods are applied in projects in 58 countries, including the US, Canada, France, The Netherlands and Norway.” ("Grameen Bank.")
developed countries (Esmat Ara et al.). With the introduction of microcredit, women are now able to start and maintain small businesses and create a better life for themselves and their families.

Data also shows an economic and overall benefit to Bangladeshis not actively participating in the bank’s services, but who live in villages where the Grameen Bank has a presence in the community. That data demonstrates that microcredit is an effective tool to create sustainable development for entire communities in areas of extreme poverty. Between the years of 2000 and 2010, extreme poverty in rural Bangladesh decreased from 37.9 percent to 21.1 percent largely due to the Grameen Bank (“Bangladesh: New Life for the Rural Poor.”).

In addition to focusing on women, another distinguishing aspect of the Grameen Bank philosophy is that it requires borrowers to form groups of village members in order to apply for a loan. These groups are incredibly effective in a village society because each woman is responsible for the loan a group member who fails to make payments, which creates accountability between the members. The bank chooses this approach in lieu of requiring collateral because it fits better with the Bangladesh society. Many poor women in Bangladesh have nothing to offer as collateral and close communities make group loans effective motivators for repayment. Additionally, by eliminating the requirement for collateral, MFI s are also eliminating one of the many barriers the poor face in acquiring capital.

The Grameen Bank is one of the greatest success stories of the microfinance movement and is one of the most mimicked systems for microcredit in less developed countries. The bank services over 80,000 villages and 8.3 million people in Bangladesh. It is self-reliant and does not accept any donor or government funds (“Grameen Bank.”). 97 percent of those borrowers are

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16 “It is estimated that the average household income of Grameen Bank members is about 50 percent higher than the target group in the control village, and 25 percent higher than the target group non-members in Grameen Bank villages.” (“Grameen Bank.”)
women, which demonstrates the institution’s success in empowering women in a strongly patriarchal society (Rahman).\textsuperscript{17} By empowering women, the bank has transformed social norms as well as elevating millions of Bangladeshis out of poverty (Hossain).\textsuperscript{18}

The social and economic factors present in Bangladesh are similar to those of less developed countries in various areas of the world where MFIs function. The Grameen Foundation has now expanded to serving the poor through very similar techniques in Latin America, Asia, the Middle East, North Africa, and Sub Saharan Africa (“Grameen Foundation.”). A large amount of MFIs in the less developed world follow the Grameen structure and focus on enabling women through economic opportunity and use group techniques because of their effectiveness in rural patriarchal communities (Armendáriz).

The Grameen Foundation and other MFIs in less developed areas of the world have proven what a little capital in the hands of a capable person can do when the circumstances are right and systems are effective. In fact, microcredit in Indonesia has helped reduce poverty from 40 percent of the Indonesian population to slightly over 10 percent of the population in the span of 30 years (Robinson). Additionally, between the years of 1991/2 and 1998/99, microcredit helped reduce overall moderate poverty levels in Bangladesh by 17 percent and by over 20 percent in households who participated in the program for all seven years (Khandker, 2005). These institutions serving the poorest of poor in the poorest countries in the world are making an impact and creating sustainable development in previously destitute communities (Littlefield).

\textsuperscript{17} http://www.unicef.org/bangladesh/Women_and_girls_in_Bangladesh.pdf

\textsuperscript{18} - As early as 1985, the average borrow’s capital increased approximately 64\% per yeat when utilizing Grameen Bank’s microfinance services
- Approximately 30\% of Grameen Bank borrowers reported that they had been unemployed before borrowing
- 91\% of Bangladeshis reported feeling as though borrowing from the Grameen Bank had increased their quality of living (increased income). Statistics on income are difficult to find because borrowers didn’t keep record of their businesses (Hossain).
Microcredit in More Developed Countries

Overview

Microcredit as a tool of poverty alleviation didn't become popular in the developed world until years after it was utilized in less developed countries. Several societal differences make microcredit a much less obvious solution to the plight of the poor in developed countries as compared to less developed countries. Unlike countries such as Bangladesh and Indonesia where around 30 percent of the population lives on less than $1.25 a day\(^{19}\), the poor in the developed world suffer from a different reality of poverty. And although the poor in developed countries rarely live on less than $1.25 a day\(^ {20}\), many still struggle to exist in a world that ostracizes them, both socially and economically. All over Europe, microcredit has benefitted the poor by acting as an “effective instrument for stimulating social inclusion through the promotion of entrepreneurship” while correspondingly relieving the economic plight of the disadvantaged (Bendig).

In the United States, an individual is considered “in poverty” if he or she makes an annual income of less than $11,770 or around $32 a day ("2015 Poverty Guidelines"). The poverty line in France is set at a little under 1,000 Euro a month or $13,020 a year ($36 a day) ("Poor Getting Poorer in France."). Using $34 as the mean, a poor person in a developed country is 27 times wealthier than a poor person in a less developed country. Appropriately, that multiple strongly reflects the overall state of the economy in each of those countries. The United States’

\(^{19}\) "The poverty rates for Bangladesh are based on the PPP value of $1.25 per day in 2005. The $1.25 per day poverty line is adjusted for price changes (i.e. inflation) over time with a Basic Needs Price Index (BNPI), which has been constructed from the Bangladesh Bureau of Statistics (BBS) Household Income and Expenditure Survey (HIES)… The official poverty rates corresponding to the official upper poverty lines are: 58.8 percent for 91/92; 51.0 percent for 95/96; 48.9 percent for 2000; 40.0 percent for 2005; and 31.5 percent for 2010." ("PovcalNet.")

\(^{20}\) [http://www.indexmundi.com/facts/indicators/SI.POV.DDAY](http://www.indexmundi.com/facts/indicators/SI.POV.DDAY) - view rates in developed countries
GDP per capita is 33 times that of Bangladesh and France’s GDP per capita is 23 times that of Bangladesh\(^\text{21}\) ("Country vs country.").

These relationships accurately convey how a strong economy creates more available capital for the poor, but the main takeaway concerning microcredit is that a capital rich economy requires more capital investment for starting a business. For instance, a little capital does not go very far in a developed country like it does in a less developed country. Unlike in Bangladesh where under $100 invested in a small business can elevate an individual and family out of poverty, it takes thousands of dollars to start a small business in areas of high development.

Additionally, MFIs in developed countries want to keep interest rates reasonable for clients, but high operating expenses cause barriers to self-sustainment. For many institutions it is a constant battle between “the trade off of being financially sustainable while simultaneously issuing microloans to disadvantaged target groups” at reasonable interest rates (Bendig). The need for more capital and the struggle to become self-sustaining are just two reasons why MFIs in developed countries function differently than those in less developed countries.

There are other societal differences between less developed countries and developed countries that influence how microcredit is implemented in the developed world. Developed countries tend to have more individualistic cultures, so the group credit concept used in the Grameen Bank often fails when used in countries such as France, the United States, or Denmark. Because most loans go to individuals in these countries, MFIs in developed nations have an enhanced focus on training and mentoring services or unconventional collateral practices to stimulate repayment (Bendig).

\(^{21}\) GDP per capita in Bangladesh was $1,385, the United States GDP per capita is $45,759, and France’s is $31,161 ("Country vs country.").
Additionally, in much of the developed world, the psychological effects of poverty inherently deplete the poor’s sense of ambition and fervor for success. Simply put, they have often times given up that they can change their situation in life, which perpetuates the behaviors keeping them in poverty (Dalton). The presence of the welfare system in most developed countries also contributes to this phenomenon. The following quote accurately describes the need for additional training and support programs in developed countries:

“The lack of an entrepreneurial and aspirational culture among the low-income groups, the bureaucratic hurdles in setting up a business, and the existence of the welfare state mean that clients thinking about starting a business need support to make the leap…” (Buckland).

Training and mentoring programs are beneficial and effective in building the self-confidence of the disadvantaged who have gotten used to facing barriers to economic progress. Those with potential and skills are much more likely to see their venture succeed if they have a support system behind them. It is entirely more difficult to establish a small business in a strong economy where robust competition exists than in a less developed economy and these programs help entrepreneurs achieve their goals. Additionally, most clients of MFIs are not well versed in running a business so having a mentor to train them and walk with them through the process makes a big difference. For example, Fair Finance, a MFI based in the United Kingdom, functions in some ways like a community bank where “loan officers [deal] directly with clients and [offer] training to those creating startup businesses” (Buckland).

Because of the sizeable amount of capital needed to start an economic venture in the developed world and the strong market competition, MFIs in developed countries focus on a different segment of the disadvantaged population than MFIs in less developed countries. While
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MFIs in less developed countries mostly focus on the poorest of the poor, in the developed world they seek to serve the unbanked and socially excluded population (Armendáriz). They don’t just loan money to people begging on the streets. They loan to those with some potential or skills who are possibly homeless, currently unemployed, recently out of jail, suffering from health issues, or in other similar situations and looking for an opportunity out. All of those groups are commonly rejected not only by the financial sector, but also by society. MFIs strive to break down the barriers to both economic and social exclusion through microcredit and entrepreneurial support.

Additionally, regulations and laws are more stringent in developed countries, affecting the functionality of MFIs. In France, regulations make it hard for individuals from difficult backgrounds to start a business (Bendig). In Romania, MFIs are treated as normal banks and therefore they struggle with a multitude of constraints imposed by regulations. In Denmark, government regulations on savings create barriers to growth for MFIs. Each instance of government regulation imposed on MFIs in developed countries is another obstacle the institutions must address in order to deliver optimal opportunities to the group they are serving.

Adie:

Adie in France is a prime example of an MFI that has successfully used microcredit to open doors to economic development for the poor in the developed world. Adie in French stands for the “Association for the Right to Economic Initiative” ("Microfinance in France."). The institution has stayed true to its name since it was started in 1989 and continues to target the poor and unemployed who are generally barred from the banking sector (Bendig). The establishment of Adie was inspired by the “bank of the poor” concept originated by the Grameen Bank in Bangladesh, but the structure of the institution has evolved to best serve the economically
disadvantaged in France, a highly developed country. Adie is by far one of the oldest and largest MFIs in Europe with almost 2,000 staff members and volunteers, and an outstanding portfolio of €58 million ($63 million) currently being used to open economic doors to the disadvantaged around France ("Microfinance in France.").

France has the 6th largest economy in the world according to the International Monetary Fund ("List of Countries by GDP."). In 2012 alone, 550,000 new businesses were started, 300,000 of those businesses were registered as self-employed, and 90,000 of those entrepreneurs were unemployed prior to starting their business (Bendig). That means that in 2012 at least 90,000 previously unemployed individuals in France gained employment by starting their own business. Adie focuses on serving the unbanked of France, which includes welfare recipients, the unemployed, and others excluded from the banking sector. The institution’s hope is to improve the situation of individuals and communities through self-employment. Adie believes that providing access to capital and eliminating administrative barriers to self-employment are the two central requirements for the restoration of the right to economic initiative to the disadvantaged in France ("Microfinance in France.").

As in most developed countries, it is difficult for the poor and unemployed of France to get a standard loan from a bank. Adie closes the gap between those excluded from the banking sector who wish to borrow and actual access to capital by empowering the poor to take economic initiative. It does that through low interest small loans paired with post-loan business advice ("Microfinance in France."). Adie provides loans up to €10,000 at interest rates between 6.76 percent and 7.76 percent, a low rate in comparison to many of Adie’s European counterparts.\(^2\) Additionally, there are over a thousand volunteers Adie utilizes to provide advice and mentorship

\(^2\) PerMicro in Italy has interest rates between 8.5% and 11.75%. Fair Finance in the UK has a 20% interest rate for business loans and significantly higher for personal loans. Qredits in the Netherlands has interest rates between 9.75% and 10.75%. RoCredit in Romania has interest rates of 10% (Bendig).
on the “business management, administrative formalities, marketing, and legal” components integral to starting a business. Like MFIs in other developed countries, Adie focuses not only on providing clients access to credit, but also on supporting them throughout the start-up process so that capital ultimately results in long-term economic stability and social inclusion.

Adie views the regulatory framework in France concerning business start-ups to be a significant hinderance to the growth and impact of microcredit, as is the case in many developed countries. The institution estimates the amount of potential microentrepreneurs could be multiplied by six if regulations were simplified and access to capital increased (“Microfinance in France.”).

The scope of Adie is far fetched in France with 120 branches throughout the country, but the impact is felt the strongest in communities with severe unemployment rates (Bendig). In France, there are obvious areas of severe poverty and social exclusion in which Adie purposefully targets expansion efforts with the objective of creating economic growth and social inclusion within communities (Armendáriz). It is difficult and a complicated task to collect quantifiable data on the impact of microcredit in developed countries such as France. The research on the impact of MFIs in developed countries is significantly limited in comparison to the research conducted in less developed countries because microcredit was established much later in the developed world. Despite the lack of quantifiable data proving the impact of Adie’s use of microcredit, it can be concluded that Adie is enabling impoverished and unemployed individuals in France to take economic initiative and work towards a better life for themselves (Armendáriz).
Limitations and Concerns of Microcredit

There are dozens of potential issues that could be discussed in this section, but three main limitations and concerns will be mentioned for the sake of succinctness.

Sustainability

One significant area of interest and concern surrounding microcredit is the inability of most MFIs to become “sustainable” (Brau). In other words there is concern over whether MFIs are capable of becoming self-sufficient, not relying on donor funds and government subsidies, and the implications of that limitation. There are a few different perspectives on this issue. First, the institutionist paradigm claims that in order for a microfinance institution to be sustainable and effectively provide credit to the poor, revenues from the program must cover costs of running the program (Morduch, Woller et al.). This argument voices concerns over the innate riskiness of loaning to the poor and the need for stability and sustainability in order to best serve the needs of those lacking access to financial services.

The opposing argument is the welfarist approach, which takes a much more social perspective. Welfarists argue that financial sustainability is not necessary for MFIs because donor funds create sustainability for the institutions by serving as financial investors with intrinsic motivations (Morduch, Woller et al.). The following quote accurately describes this perspective:

“Donations serve as a form of equity, and as such, the donors can be viewed as social investors… [They] do not expect to earn monetary returns. Instead, these donor-investors realize a social, or intrinsic, return… These socially responsible fund investors are willing to accept a lower expected financial return because they also receive the intrinsic return…” (Brau).
Welfarists more strongly emphasize poverty alleviation and social metrics as measures of institutional success to a greater degree than financial metrics. To the credit of the welfarist, there is some limited evidence showing that self-sustaining MFIs tend to focus on individuals a little higher up on the poverty scale for the purpose of capturing returns (Navajas et al.) A conclusion on the best approach to microcredit has not been reached at this point, but sustainability is an important concern to consider when dealing with the future expansion of microcredit.

Commoditization of the Poor

An additional issue brought to light by Ananya Roy in her book, “Poverty Capital: Microfinance and the Making of Development”, is the criticism that microfinance and microcredit in particular turn the poor into a commodity used to make money for institutions. Roy supports the Bangladesh Consensus, which focuses on human development over the Washington Consensus, which focuses on financial benchmarking. The Bangladesh Consensus insists that microcredit should be focused on empowering the poor and not on creating profits for investors. This topic is a strong concern surrounding microcredit and MFIs making significant profits off of the poor are criticized and questioned by the rest of the microfinance community. For example, Compartamos, a Mexican MFI, has been in the center of controversy on this topic because its IPO raised $458 million of which $150 million went to individuals serving as top executives (Roy). Additionally, Compartamos makes $80 million of profit annually by serving over a million poor borrowers at interest rates over 100 percent. The MFI claims that their practices allow it to better serve the poor of Mexico, but many critics claim it is drastically taking advantage of the poor for profit. The commoditization of the poor controversy is an important
issue to continue monitoring to ensure that microcredit continues to serve as an effective tool of poverty alleviation.

**Scalability**

The scalability of microcredit is a visible concern in more developed countries where the need for significantly more capital per loan puts limitations on the breadth of microcredit outreach. Additionally, less dramatic rates of poverty in developed countries translates to smaller market sectors into which MFIs can penetrate. This issue is visible through the juxtaposition of the two examples of successful MFIs this paper has analyzed. While the Grameen Bank in Bangladesh serves over 8 million borrowers annually, Adie in France serves closer to 13,000 annually. These numbers represent the limitation of MFIs in the developed world where higher capital needs and a different realm of poverty keep institutions from reaching the impact of MFIs in less developed countries. The scalability of microcredit is important to keep in mind as the discussion of the potential of microcredit in the United States begins in the next section.

**Microcredit in the United States and Future Potential**

Now that the background and groundwork of microcredit has been laid, it is time to look into the current state of microcredit in the United States and the future potential of it as a tool of poverty alleviation. Similarly to other MFIs around the world, microcredit’s overarching goals in the United States is to “expand economic opportunities for individuals and foster community economic development” (Bernanke).

**Current State of Microcredit in the U.S.**

In comparison to MFIs in the less developed world and in some of the developed world, MFIs in the United States have failed to achieve even close to the same amount of success in utilizing microcredit as a tool of poverty alleviation (Schreiner). The main barriers to the success
of microcredit in the United States can be categorized into two main overarching segments. First, the small business sector is much smaller in the U.S. as compared to counterparts around the world, which makes it difficult for MFIs in the U.S. to utilize economies of scale. Second, the U.S. economy is structured in such a way that those trying to start small-businesses face an array of blockades and hurdles (Schreiner). Like the majority of MFIs in other developed countries, MFIs in the United States are not self-sufficient and rely on donations to operate, which brings into question their relevance in a country satiated with donor-funded not-for-profit organizations serving the poor.

The conditions of microcredit in the United States are similar to those previously discussed concerning MFIs in developed countries. The amount of capital needed to start a business is very high and therefore loans are much larger than in less developed countries (“U.S. Network.”). MFIs focus on business loans to individuals who lack access to the normal financial sector, but have some skills and potentials making them capable of running a business. The emphasis on training and mentorship is strong in the United States due to the dollar amount of the loans and the competition within the market. A large portion of the clients MFIs serve don’t have experience running a business, so training is essential to the success of the venture and the overall economic and social advancement of the individual and community in which they live.

Opposing arguments to the expansion of microcredit as a tool of poverty alleviation include several perspectives. First, opposition has argued that wage-jobs are often a more attractive option for the poor who have the skills and potential to possibly start a small business using a microloan. Starting up a small business, even with the help of a mentor or training program, takes long hours, achieves less starting pay, and a requires more risk (Schreiner, Spalter-Roth). Second, some believe that microenterprise for the poor is unlikely to achieve
success while such a strong safety net exists in the form of welfare (Schreiner). This argument has become weaker since deadlines for unemployment welfare were enacted and unemployment benefits became limited to 6 months. Third, competition between large companies is so strong in the United States that the economy is less friendly to small-businesses (Schreiner). Big retailers and manufacturers dominate the market and set low prices with which entrepreneurs are unable to compete unless introducing a new product or entering a specialty market. Finally, regulations make it incredibly difficult for MFIs to be successful in the United States. The United States has usury laws that were put in place to protect borrowers from unreasonable interest rates, but interest rate caps create significant hindrances to MFIs (Schreiner). MFIs exist to give economic opportunities to those without access to financial capital, but doing so costs a lot of money – more money than it costs to provide capital to the wealthy. Despite this, usury laws prohibit MFIs from charging more interest for the riskiness of the loans, therefore limiting the growth and impact potential of the institutions (Schreiner). Also, public opinion on interest rates creates barriers for MFIs. The American public views high interest rates charged to the poor as predatory and taking advantage of an already disadvantaged group. Whether that argument is valid or not, public opinion on interest rates still makes it difficult for MFIs to make their case as to why higher interest rates on their loans is a fair and productive practice. Additionally, regulations concerning licensing and taxes create barriers to market entry and wealth accumulation that often times discourage those utilizing MFIs (Dennis, 1998).

These limitations and the significant failure of MFIs originating in the past two decades make it clear that using microcredit as a tool of poverty alleviation is not a quick cure-all fix to poverty in the United States. But, despite these barriers, there are several MFIs that originated in the United States with the desire to make an impact on poverty and have achieved success by
implementing effective strategies tailored to the U.S. economy. One such MFI is Accion, the largest MFI in the U.S. and the organization that future microcredit in the United States should look to as an example.

The Accion organization is a broad network of microfinance institutions around the world, but the organization launched a microcredit program in the United States in the 1990s as a response to the increasing income inequality and high unemployment of the prior decade ("U.S. Network."). Accion is now the largest MFI in the United States. The network in the U.S. strives to serve “low-to-moderate income business owners through access to capital and financial education” ("U.S. Network."). Accion makes it easy for borrowers to gain access to capital through their online lending network and also offers training to borrowers through member organizations within the Accion network. Those member organizations offer loans between $200 and $300,000. Small businesses consisting of five or less employees “make up 85 percent of all businesses in the United States” and Accion believes it is a failure of the financial sector that small businesses are often excluded from accessing financial tools. It strives to fill that need through its microcredit network ("U.S. Network.")

Accion focuses on serving those barred from the normal financial sector, but with the skills and potential to start or grow a small business and repay their loan. A few of Accion’s operational practices are particularly unique and allow for the success of the network in the United States (“U.S. Network.”). First, while it somewhat increases administrative costs, Accion motivates borrowers to succeed in their ventures and pay back loans by accepting anything from furniture to cars to stereos as collateral for the loans they offer (Burrus, Bonavoglia). While the unconventional collateral they accept has little market value to them if the borrower does happen
to default, it has been shown to be an effective source of security for the institution because the collateral often holds significant value to the borrower (Bhatt).

Additionally, the Accion U.S. network emphasizes the provision of a support system to accompany loans given to new and growing businesses. The organization wants to see an impact on both the individual and community of the individual with every loan, so a strong one-on-one approach to lending is utilized to better understand the character and situation of each individual applying for a loan ("U.S. Network."). Accion’s staff is dedicated to going above and beyond to assist borrowers and ensure a smooth loan process. Personalized counseling, business strategy consultations, and other professional trainings are available through Accion and the organizations goal is to enable and empower small business owners to succeed ("U.S. Network.").

The impact of Accion has been proven through a study on over 800 program borrowers across the country. The study verified that poor borrowers who took out small loan from Accion “experienced substantial increases in profits, equity, and take-home incomes” (Bhatt, Himes). Accion also reported repayment rates over 95 percent, exceptional rates for the United States (Burrus & Stearns). Since the network was begun in 1991, Accion has made over 50,000 loans representing approximately $450 million ("U.S. Network."). Whether supporting a entrepreneur starting a beauty salon, a restaurant, or a soap making business, Accion has succeeded in making an impact on poverty by fostering “job creation, increases in family income and lasting economic vibrancy for small business owners and their communities nationwide” ("U.S. Network.").

Future Potential as a Tool of Poverty Alleviation

Going forward it is important to recognize the limitations of microcredit as a tool of poverty alleviation in the United States. By restricting the scope and recognizing the limitations
of microcredit in the U.S., MFIs can actually better realize the full potential of microcredit and better serve the disadvantaged. Microcredit is not the overarching solution to poverty in the United States, but if operated in an effective way, it can work to alleviate poverty and build economic and social growth throughout poor communities. Accion is a good example of how microcredit should work in the U.S. The target market for MFIs should be low-to-medium income individuals either wanting to start a business or looking to grow a current business, neither of which has access to normal financing options. Individuals with skills and potential to run a small-business, but who are dismissed by banks for having a weak credit history, periods of unemployment, or lacking financial capital to put up for collateral are the ideal client of MFIs in the U.S. Loans should be secured through collateral fitting the resources of the borrower and financial training services need to be offered if not required because guidance and training are incredibly important to the success of a venture. Microcredit is likely to fail if it extends beyond its capabilities and reach within the United States.

Credit unions are also a helpful tool to consider when determining the future potential of microcredit because they have been successful in delivering fair credit to target communities for decades. The purpose and operation of credit unions are very similar to MFIs, but they differ because credit unions are owned by members with a financial stake in the union. The purpose of them is to provide financial opportunity and advice to individuals in particular communities (hrcu.org). Credit unions are not profit based and strive to enhance the well being of individuals and communities, but at the same time are self-sustaining and function without government or charitable assistance. In the United States, membership in credit unions has gone beyond 100 million in the past few years ("About HRCU."). The most significant difference between MFIs and credit unions in the United States is that the overarching purpose of MFIs is to empower the
unemployed and disadvantaged groups of the country, while credit unions exist to serve particular communities. Federal credit unions “serve groups having a common bond of occupation or association, or groups within a well-defined, local neighborhood, community, or rural district” (Federal Credit Union Handbook). Credit unions therefore serve an important purpose within communities, but don’t strive to empower the poor. For this reason, microcredit remains relevant as a tool of poverty alleviation in the U.S. But, in the future MFIs should utilize both credit unions and Accion as effective examples of microlending, so they can better utilize microcredit to serve the poor and create economic development.

**Conclusion**

When I first decided to research microcredit and its potential in the United States I started off by asking myself whether microcredit had the same potential to alleviate poverty in the U.S. as it does in the less developed world. Through my research on microcredit in the less developed world, the developed world, and particularly the United States, I came to realize my question was not the one to ask. It quickly became clear that the economic and social differences between the less developed world and the developed world made the United States a much less receptive environment for microcredit. A better question I then strove to answer was whether microcredit could fulfill the need for capital within a certain subgroup in the U.S. and serve as an effective tool of poverty alleviation by doing so. My conclusion to this question is yes. I believe that by recognizing the limitations of microcredit in the U.S. and by tailoring its future operations to best serve the poor within the reach of MFIs, microcredit can serve as an effective tool of poverty alleviation. Microcredit also has the potential to create new prosperity and wealth for individuals at the brink of poverty. In closing, microcredit is not the solution to poverty in the United States, but it is an underutilized tool and its impact could burgeon if implemented effectively.
Works Cited


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