



MICRO FINANCE BANKING

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Abstract

Micro finance has been provided to low income communities predominantly through traditional non-profit or government subsidized programs. In several instances, however, this service has been operated in a for-profit manner with good returns to the lender. As financial organizations look to strengthen their investment portfolio in the face of fierce competition and shrinking margins, micro finance will play an increasingly larger role driven by the sheer size of the potential market. There are many challenges to providing banking services to the poor including perceived high default risk, lack of a free market economy, underdeveloped capital markets, and low literacy levels. This paper reviews some of the initiatives used by non-traditional banks to circumvent these challenges.

The review of some existing initiatives in Brazil show a number of large commercial banks are expanding into the lower income market and a non-traditional bank in Bolivia has achieved enormous success in providing financial services to a poverty stricken country. Low-income communities exist in both developed and under-developed nations, but with several infrastructural differences. These differences are discussed alongside recommendations for successfully capturing the opportunities in each market. The paper concludes with a discussion on implementation of micro finance services by traditional financial institutions, with scenarios in each of the developed and under developed communities.

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1. Executive Summary

Microbanking is not a new topic in the sustainable/development community or the world in general. What is beginning to gain a strong footing is the idea that microbanking and micro-finance initiatives can break from traditional non-profit or government subsidized programs and become for-profit enterprises. As financial organizations look to strengthen their investment portfolios under fierce competition and low interest rates, microbank lending will play a bigger role, as that potential market is so large.

Microcredit banking has been profitable, but traditional banks invest in more developed countries in the Third World. The range of financial services provided to the “base of the pyramid” varies depending on countries and financial institutions.¹ The poor need not only “seed” money but also access to other services such as checking and saving accounts. There are many challenges in providing banking services to the poor. How to reduce the costs and risks is an important issue. The lack of a free market economy, underdeveloped capital markets, and low levels of education are some of the barriers to entry in these developing economies.

Our recommendations try to capture the opportunities in developing economies and developed economies while leveraging the existing strengths. For developing economies, we recommend financial institutions leverage the strong sense of community, develop points of presence with Automated Teller Machines (ATM), and develop low-cost loan evaluation solutions. For example, a strong sense of community helps to reduce the risk of default and keeps the high repayment rates traditional of micro-loans. The reason is that individuals feel a responsibility toward the community to repay their loans. Defaulting could mean that other community members may not get credit

¹ “Base of the Pyramid” is a socio-economic designation for the roughly 4 billion people who live primarily in developing countries and whose annual per capita incomes fall below \$1,500 (PPP). The phrase was coined in “*The Fortune at the Bottom of the Pyramid*” (Prahalad, C. and Hart, S. (2002). *strategy + business*, 26; online at: www.digitaldividend.org/pdf/bottompyramid.pdf).

opportunities from micro credit institutions. In addition, we recommend financial institutions provide greater access to ATMs for deposit and withdrawal services. Furthermore, banks could also use existing technology in voice ATM to help people who cannot read. The variable costs on these transactions are low and the banks would immediately benefit from increased profits. This system would enable poor people to get check cards and some financial services education. Financial institutions should leverage their capital to grow their loan portfolios as long as it adequately reflects the risk profile of the borrowers. The high profits generated by the loans will help to offset the costs to develop the infrastructure.

In developed economies, banks should develop checking solutions and leverage existing infrastructure and community leaders. The poor in developed economies lack access to checking products and pay high prices to obtain access to replacement services. While the poor would be weary of monthly maintenance cost for checking accounts, banks could propose accounts with transaction-based fees. We also recommend that banks leverage community leaders to promote their effort. Community leaders could initiate a dialogue between communities and financial institutions to ensure that the offering meets the needs of the targeted communities and to capture potential new opportunities. In the longer term, the poor will develop a relationship with their financial institution and build a history that may serve as a reference for future banking services. Having such a history allows the financial institution to evaluate risk and build a relationship with the borrower that may allow the bank to provide more loans and services.

2. Introduction

Microfinance banking is the provision of financial services to the poor through simplified transactions. Microcredit is defined as small loans extended to poor people for self-employment projects that generate income allowing them to provide for them and their families. This is a general decision but it may vary from country to country. Certain defining criteria relate to size and the use of the funds; whether that be a very small loan or one used for a larger entrepreneurial venture.

Microbanking is not a new topic in the sustainable/development community or in the world in general. What is beginning to gain a strong footing is the idea that microbanking and microfinance initiatives can break from traditional non-profit or government subsidized programs and become for-profit enterprises. As financial organizations look to strengthen their investment portfolios, microbank lending will play a significant role since the potential volume of business is so large. However, institutions will have to approach lending and financial services for the world's poor with an open mind as to how the endeavor "should" be undertaken.

There are "push and pull" forces that lead banks to microbanking. Economic profits, competition, and a decrease in interest rates have "pushed" banks into emerging markets. To protect their profit from fierce competition and low interest rates, banks are seeking new markets at the base of the pyramid. The base of the pyramid has mass: there are 4 billion people who earn less than \$1,500 U.S. purchasing power parity annually. There are 10 million who earn less than \$3,000 a year in the U.S. (See Exhibit 1). On the other hand, the successes of microcredit and banking services for the poor "pull" banks into these markets.

There have been many financial institutions in the microbanking area. Some of them provide a single service such as microcredit or checking/saving services for the poor, and some provide a variety of services. Some are funded by governments and some are commercial institutions. We can visualize the characteristics of the institutions, such as public and private, and the range of services they provide (See Exhibit 2). There is a continuum of services and levels of privatization in the diagram. In this paper we analyze the challenges financial institutions face when they begin microbanking and expand their services, and how they can overcome those challenges.

3. History of Microbanking

Microcredit has existed in various forms for centuries. A very early form of microcredit took place in Ireland in the 1700s where at its peak, 20% of households obtained these small loans.² Other examples have ranged from villagers collaborating by using their future crops as collateral for loans to local loan sharks lending money and charging exorbitant interest rates. In 2002, the World Bank estimated that there were more than 7000 microfinance institutions serving 16 million people in developing countries.

The modern concept of microcredit was developed in the mid-1970s by U.S.-educated professor of economics, Muhammad Yunus. In 1974, Professor Yunus' work in Bangladesh (one of the world's poorest and famine-ravaged countries), is highlighted as the first modern day use of microcredit. Yunus discovered that the smallest loan could make a huge difference to an individual's life. The first loan was for US \$27 to a woman who made bamboo furniture to support her family, which Yunus paid for from his own pocket.

In fact, 94% of all microcredit loans are made to women. The reason is that women typically undertake projects that benefit the entire family. Microcredit enables those in the developing world who rely on the informal economy to improve their lives. It prevents these people from being trapped in a poverty cycle and enables them to obtain low interest loans which can be used to improve their lives.

Professor Yunus realized that large financial institutions were unwilling to make these small loans because they perceived poor people as posing a high risk of default and viewed the costs and lack of infrastructure as barriers to entry. In 1976, Yunus opened the Grameen Bank to make small loans to poor Bangladeshis and, over a 16 year period, US \$3 billion was loaned to 2.4 million borrowers.

Despite the concerns of the large international banks, repayment rates have remained at over 95%.³ Such high repayment rates may be explained by Grameen's use of a system of 'solidarity groups.' Solidarity groups are informal groups that together apply for loans and whose members act as guarantors for the repayment of the loan. In this way, a group of people can benefit from the loan while decreasing the risk of default to the bank. The success of Grameen Bank has stimulated many similar ventures in both the developing world as well as industrialized countries such as the USA.

Historically, microcredit lending has been pioneered by non-profit organizations. As microcredit has evolved around the world, these non-profit organizations have either become profitable and economically sustainable businesses, or global banks that have made investments in consumer lending in developing countries (For more milestones, see Exhibit 3).

4. Challenges

Standardized banking practices used globally and aimed at the wealthy and educated will have to give way to regionally customized services and strategies. Here we will take a closer look at some of the human/educational, as well as technological, challenges that microbanking programs face.

"Getting the word out" is one of the biggest challenges faced by microbanking promoters. According to David Kilgour, it is necessary to demonstrate that microbanking does work and that the poor can be a good credit risk. He states, "We must find ways to adapt and replicate successful microbanking models to address poverty in a wider range of cultural and social environments."⁴ Kilgour echoes what others in our research have asserted: microbanking is not a panacea. The

² *Women and Microcredit in History: Gender in the Irish Loan Funds*. By Aidan Hollis, 1999

³ *Microcredit*; Available from <http://www.fact-index.com/m/mi/microcredit.html>

⁴ *The Challenges of Microbanking*. By Hon. David Kilgour, Canadian Secretary of State (Latin America & Africa) Paper for the Meeting of Microbanking Summit Councils, New York, NY, June 25-27, 1998; [cited 9 October 2004]; Available from <http://www.david-kilgour.com/secstate/microcdt.htm>

contributors to poverty are many and diverse. Again citing Kilgour, "The diversity of cultures, circumstances and of individuals makes the situation much more complex. [This] also presents our biggest challenge: how to replicate and adapt successful experiences with microbanking to vastly different cultural and social circumstances."⁵

In addition to demonstrating that microbanking can be a profitable business, there exists a greater challenge to replicating successful projects – justifying microbanking to stakeholders. For example, microbanking endeavors like Grameen Bank that rely on a strong sense of community for their success, may not achieve the same results in more transient neighborhoods where community ties are much weaker or seemingly non-existent. Kilgour makes an additional point that part of the intangible success of microbanking programs is the sense of empowerment experienced by their participants. A dilemma arises as more institutions with an historic need to justify the use of funds to stakeholders enter the microbanking arena. To ensure that funds are being employed effectively, the institutions feel compelled to participate in the administration, effectively undermining the empowerment of the recipients. Kilgour states, "[T]op-down structures simply don't work."⁶

Illiteracy in some of the poorest regions where microbanking initiatives are being undertaken poses another serious challenge. John Hatch, founder of FINCA (Foundation for International Community Assistance) states, "[I]f we only serve the illiterate, who will keep the books? [Our] banks are self-managed. [F]or [the system] to be self-managed, we have to go to the not-so-poor, or better-educated people in the community."⁷ Illiteracy, as a contributor and reinforce of poverty, has important implications for microbanking initiatives in terms of entering into repayment contracts and borrower identification.

To further add to the list of challenges facing microbanking, each locale has its own specific set of needs and functional environment. Muhammad Yunus explained in an interview regarding the challenges of microbanking, "The problems are those of institution-building. Money alone will not do it. You must build institutions at a slow, steady pace, so that at each step your quality of work is 100 percent guaranteed. We mean creating institutions with the particular capacity, procedures, and methods needed. [For example], [m]any countries have many languages [and] documents have to be translated into 100 or so languages. Another example is the need to develop appropriate software if you are using a computerized system for accounting practices."⁸

According to Mr. Yunus, there is another critical question: "Where does the money come from?" "For every [World Bank] dollar", he states, "some \$200 is needed to see that the administration of the program takes place."⁹ Top level support must be efficiently and appropriately communicated and translated into real action at the grassroots, country level, and this takes time.

While certainly most would agree that the funds borrowed in microbanking arrangements are primarily intended for enterprise use including family-run micro-businesses, in many cases the level of poverty is such that funds are diverted to food and other consumable items. This poses another problem that while resulting in a higher standard of living, if the borrowed funds are not invested in the business, repayment is more difficult as the investment is most likely not producing income. This effect can be compounded, strangely, in instances where there is an oversupply of microbanking. Instead of having the effect of lowering interest rates, as would be expected, there is a challenge with over-indebtedness.¹⁰

As microbanking makes the migration from non-profit to for-profit, an ongoing challenge will be, according to Nancy Natilson, "that institutions might go up-market to lend larger amounts of

⁵ *ibid*

⁶ *ibid*

⁷ *Institutional Action Plan: FINCA Faces The Summit's Challenges*; [cited 9 October 2004]; Available from <http://www.microbankingsummit.org/newsletter/action1.htm>

⁸ *The Next Steps for Microbanking: An interview with Muhammad Yunus*. From Jan/Feb 1998 issue of Share International. [cited 9 October 2004]. Available from http://www.shareintl.org/archives/economics/ec_mlnextstep.htm

⁹ *ibid*

¹⁰ *What are some of the Benefits and Challenges of Micro-Credit?*; interview with Nancy Natilson, 06 August 2004 [cited 9 October 2004]. Available from <http://www.awid.org/go.php?stid=1377>

money, [and that] for-profit institutions do not generally provide any of the additional training and integrated services that the non-profits do.”¹¹ Again echoing that microbanking is not a panacea to poverty, Natilson states, “[G]iving women access to credit does not assure them access to other things they need to turn their credit into a productive and profitable income like access to materials, access to markets, access to technology, and access to insurance.”¹²

Many of the challenges will be in the form of infrastructure. Infrastructure in terms of physical/technological – like ATMs in poor areas and credit/check card transactions – as well as in terms of legislative. Personal privacy anti-discrimination laws in the U.S. would render ineffective many of the programs that have produced results in other regions of the world. For instance, the solidarity group lending of Bangladesh would not be practical in the U.S. since group members would be legally barred from knowing the repayment history of others in the group. Therefore solutions must be community-specific in order to be effective.

As we have seen, the challenges facing microbanking are many and diverse. From widespread local knowledge, lack of necessary inputs such as training and education, low levels of literacy in the developing world coupled with the high cost of loan administration, the requirement of a financial return from stakeholders, and difficulties of technological and legal infrastructure, microbanking faces a struggle in making a successful, efficient and profitable transition from non-profit to for-profit.

5. Existing Initiatives

The investments of traditional financial institutions in emerging markets vary from private to government-funded initiatives and range from full service operations to limited product offerings. There are several examples of traditional commercial banks expanding operations in the South American markets, particularly in Brazil. These markets often represent new growth opportunities for banks. In addition, economic profits, competition, and a decrease in interest rates have “pulled” banks into emerging markets. Brazil, for instance, is the largest and most populous country in South America (population of 184 million) with a developed capital market relative to those of its neighbors. The country has a stock exchange that traded US\$24.4 billion in the month of September 2004 (or US\$1.161 billion traded per day) and with several Brazilian companies having ADR’s (American Depositary Receipts) listed on the New York Stock Exchange. However, Brazil is also a developing country often cited for wage disparities and poverty. Currently, 22% of the population, or 41 million Brazilians, live below the poverty line.¹³

Brazil: Citigroup

Citigroup, one of the largest financial institutions in the United States, has always had an international presence. In Brazil, Citigroup has traditionally focused on high-end consumers and corporate accounts, but in 2003 the bank opened CitiFinancial. CitiFinancial is a subsidiary of Citigroup and offers personal loans and mortgages to low-income Brazilians. CitiFinancial plans to have 100 branches in Brazil by 2008. They are already located in the major cities and have five branches in the major metropolitan city of São Paulo.¹⁴

Brazil: HSBC

Another example of commercial banks expanding into emerging markets is HSBC’s venture into consumer lending. In October of 2003, HSBC Holdings Plc paid \$815 million for Lloyds TSB Group Plc which included Losango Promotora de Vendas SA, a Brazilian consumer finance company.¹⁵

¹¹ *ibid*

¹² *ibid*

¹³ Central Intelligence Agency World FactBook. <http://www.cia.gov/cia/publications/factbook>

¹⁴ Michelle Guevara. Title: *Branching out – Trade Talk – Citibank’s CitiFinancial targets poor people in Brazil.* <http://findarticles.com>

¹⁵ Bloomberg. Title: *Brazil’s Banks Lend to Consumer as Economy Starts to Grow.* <http://quote.bloomberg.com/apps/news>

Losango offers loans (albeit with high interest rate and therefore profitable to the company) to low-wage earners. One example of a typical loan was one made to Lucia Ramos, a Brazilian office cleaner, who borrowed 600 reais (US \$205) to buy cement and window frames for her home. Ms. Ramos earns 600 reais a month from her cleaning job and by selling cosmetics and lingerie to friends. She repaid her loan with eight monthly installments of 115 reais, representing a return of 153% (equivalent to a simple annual interest rate of 79.5%).¹⁶

In countries where the majority of the population is living at or below the poverty line and where there is no market economy, or the local capital market is non-existent, traditional banking institutions most often form partnerships with non-governmental organizations or governments, if they even decide to make investments in that country. Barriers to entry in these markets are administrative costs, lack of local knowledge, and high default risk, among others. For this reason, banks have devised strategies to lower costs and reduce risks. Some banks, for example, have leveraged the government's postal network while others have utilized a trusted NGO with a history of operations in that particular country.

Bolivia: PRODEM Foundation

One example of a non-traditional bank is PRODEM in Bolivia. PRODEM Foundation, a foundation for the promotion and development of microenterprises, was created by a group of Bolivian businessmen and is dedicated to supporting small businesses. It began as a non-profit, then became financially sustainable after a few years of operations. Since then, PRODEM has spun-off Banco Solidario, which is the first private commercial bank in Latin America dedicated to serving microenterprises. Approximately eight years later, PRODEM formed a FFP (Private Financial Fund). As a regulated financial institution, the new PRODEM FFP offers a wide range of high-tech, non-credit services. PRODEM FFP offers savings accounts operated with smart card technology, fingerprint recognition for client validation systems, intelligent automatic teller machines (ITMs) with visual and audio features in three languages including indigenous dialects, money transfer service within Bolivia, time deposits, international remittance services, and the largest network of branches (62 in total) throughout the country.

As was mentioned earlier, some of the issues faced by financial institutions in less developed markets are low literacy rates and multiple languages being spoken in one country. To improve outreach given such obstacles, PRODEM pioneered the intelligent automatic teller machines (ITMs) in Bolivia. ITMs give Bolivia's indigenous population access to banking services. ITMs also do not discriminate against the illiterate. They have proven highly successful in increasing outreach and improving the quality of services.¹⁷ Bolivia is one of the poorest countries in South America with a total population of 8.7 million people and 70% living below the poverty line. In addition, Bolivia has a small capital market established in 1989 and is largely dependent on bail out foreign aid packages from organizations such as the International Monetary Fund and The World Bank.¹⁸ This country would not appear attractive to a traditional financial institution like Citigroup, but the PRODEM Foundation, which started as a non-profit entity, has spun-off a successful and profitable banking subsidiary.

Most major business investments undertaken by large commercial banks such as HSBC and Citigroup are limited to countries with relatively more mature capital markets, larger populations, and some infrastructure such as existing local banks in need of capital for expansion. These markets are more likely to serve as the first investment for a traditional financial institution, in less developed economies initiatives remain the focus of non-governmental organizations and publicly funded entities.

¹⁶ Bloomberg. Title: Brazil's Banks Lend to Consumer as Economy Starts to Grow.
<http://quote.bloomberg.com/apps/news>

¹⁷ Article found at <http://www.bellanet.org/partners/mfn/memberFFP.html>

¹⁸ Central Intelligence Agency World FactBook article. <http://www.cia.gov/cia/publications/factbook>

6. Recommendations

Our analysis shows important differences between developing and developed economies. Our recommendations try to capture the opportunities in each market while leveraging the existing strengths.

In developing economies:

Developing economies usually do not have an existing private banking infrastructure. Small initiatives exist but are limited in size. There is, however, a strong sense of community that leads to very high repayments rates for micro loans. Individuals feel a responsibility toward the community to repay their loans. Defaulting could mean that other community members may not get credit opportunities from micro credit institutions. Finally, we also noticed that the interest rates in this market are extremely high (in the range of 50%).

We recommend financial institutions leverage such economies by providing micro credit loans and access to Automated Teller Machines (ATM) for deposit/withdrawal services. Financial institutions will leverage their financial strength to increase the scale of operations through lower rates that still reflect the risk of these activities (for instance 35%). The high profits generated by these activities will balance the costs to develop the infrastructure. Yet the effort will be limited to opening points of presence and hiring staff. The infrastructure of a banking network will not be needed at first. The network will consist primarily in fixed costs and perform loan evaluation.

In developed economies:

We recommend a different banking approach in developed economies. As we have previously noted, poor people in developed economies lack access to checking products and pay an expensive price to get access to replacement services. Companies like Western Union charge 2% for cashing pay checks and motivate poor people into asking for cash advances. Cash advances are charged at a yearly compounded interest rate close to 60%. In the U.S., 8.4 million families earn less than \$25,000. If we assume the average to be \$6,000, the potential gross profit for cashing checks is \$1 billion. While poor people would be worried about the monthly costs of checking accounts, banks could propose accounts with transaction-based fees. Banks could also use existing technology in voice ATM to help people who cannot read. The variable costs on these transactions are low and the banks would immediately benefit from increased profits. This system would enable poor people to get check cards and some financial services education.

We also recommend that banks leverage community leaders to promote the effort. Community leaders will also engage a dialogue between communities and financial institutions to make sure that the offering answers the needs of the communities, and to capture potential new opportunities. In the longer term, poor people will develop a relationship with their financial institution and get a credit rating. This will help financial institutions provide the loans necessary for poor people to overcome challenging economic times (a month of unemployment has drastic effects on a family with no or little savings) and for people with entrepreneurial skills who want to develop their own projects.

7. Implementation Plan

In order to develop a concrete implementation plan based upon our recommendations, we will look at two scenarios – one for a developing economy and one for a developed economy. The economic, social, and environmental conditions will be explored for each scenario. Although there is a continuum of services and level of privatization that we see in Exhibit 2, our scenarios will assume we are looking at traditional financial institutions, which would place them within the right side of the diagram. An implicit differentiating factor will be that a single (or only a few) banking service(s) is (are) offered to the developing economy, while a full service institution will be depicted for the developed economy.

Developing Economy Scenario

Three aspects of microbanking that must be accounted for in the developing economy are: Building a stronger sense of community through responsibility to a group, developing points of presence for identification of customers, and creating loan solutions which favor sustainable development initiatives.

In our scenario, we find that the poor in developing economies do not have formal rights to property, including the land and dwelling where they reside. This leads to a fundamental issue of not having collateral against which a person can borrow money. One way to avoid asking for collateral is group lending. If everyone loses when one defaults, the group will deal with the defaulter. For example, agricultural decollectivization in Kyrgyzstan after independence in 1991 left farmers with as little as one hectare each and no assets to use as collateral for investment. The European Commission and other donors funded a group-lending scheme to address this problem. In one instance when a farmer defaulted, the others had him put in jail.¹⁹

To develop points of presence for the identification of customers who are not only poor, but often illiterate, we must use innovations in technology to close the gap between urban and rural economies. This can be accomplished through the design and production of easy-to-use smart card operated cash machines.

The Bolivian company PRODEM, which has been offering microcredit and other financial services for over 14 years to Bolivia's poor urban and rural population, sees the multilingual ATM as the latest step in its services to those excluded from mainstream society. Operated by the use of a smart card and a fingerprint scanner, the new machines offer an unprecedented level of security to PRODEM's clients (See Exhibit 4). "There is no possibility of fraud," commented Sergio Prudencio Tardío, national commercial manager at PRODEM. "If a customer loses their card, it is impossible for another person to use it because of the digital fingerprint." Another advantage of the smart cards is that they store customer's personal details, account numbers, a record of transactions and a fingerprint. This allows the cash dispensers to operate without a permanent network connection, a great help in remote rural areas. The machines also offer a functional simplicity of overcoming language barriers and illiteracy. The Bolivian ATM can speak instructions to clients in a choice of either Spanish or one of the two predominant indigenous languages, Aymara or Quechua. To make things even easier, clients can access the various services available by simply touching the screen.

Despite the technical advantages offered by the hardware combination of a De La Rue cash dispensing system, France's Gemplus smart card technology, and a fingerprint reader from U.S. based Digital Persona, PRODEM is building their machine for only \$15,000. This is less than half the price of a standard ATM which can cost anywhere between \$35,000 and \$40,000. PRODEM has made the smart cards available to all their account holders at a price of \$10 with a further \$7 annual operating charge applicable.²⁰

The financial institution needs to create loan solutions which favor sustainable development initiatives. One example of a successful entrepreneur is the story of Terezia Mbasera. She spent years making straw brooms in Zimbabwe, selling them for 25 cents each, ultimately putting her five children through college. As she grew older, the physical demand of making brooms was too much strain. Terezia began a new business selling yams and firewood on the roadside, but lack of capital meant slow growth and minimal profits.

In 1991, Terezia was introduced to Zambuko Trust. She applied for a loan of \$650 to purchase a small shop and buy her stock in bulk. The first loan was quickly paid off and Terezia continued to put her entrepreneurial skills to work, looking for needs in the community and filling them. She expanded her small grocery business, opened a beauty salon, barber shop, second grocery shop and a wholesale drink outlet. Terezia also manufactures and sells coffins and provides basic funeral services. Her last loan allowed her to buy a truck to transport the coffins, as well as to start a sock

¹⁹ www.fao.org, *Banking for the Poor*, 10-13 June, 2002

²⁰ BBC News website, *Smart Money Goes Multilingual*, June 13, 2001

distributing business. With each business expansion, Terezia has been able to hire more employees, creating jobs and bringing hope to many families. At last count, she employed over 30 people. The loans have made a tremendous impact in Terezia's life. Instead of poverty, she now enjoys the life of a savvy middle-class businesswoman that others look to for inspiration. Her advice was summed up in a perfect reflection of her own life. "You must be diligent," she said. "If I can do it, you can do it. And I am 78 years old."²¹

Developed Economy Scenario

For the developed economy, a different set of requirements are needed. In many cases, there is not a strong sense of community. One has to be built. To do this, local champions must be found who will be advocates for the poor of the community. Two-way communication between the poor of the community and the financial institution is a requirement for successful entry into the market. As opposed to the developing economy where there may be little infrastructure available to serve the poor, existing banking infrastructure is plentiful in developed economies. Checking solutions must be developed to gain market share against check cashing companies. This will take time to educate customers about the advantages of the established institutions over the small, sometimes predatory, check cashing companies.

When we speak of a "local champion," one example is Bruce Marks. Marks's tactics have helped the Massachusetts-based activist win truckloads of money for impoverished neighborhoods. Marks takes on the banks for refusing to lend money in low-income and minority neighborhoods. He says many of these same banks work in a conspiracy with shady loan brokers or trap unsuspecting homeowners into mortgages laced with hidden fees and high interest rates.

One of Marks's first targets was New England's largest bank, Fleet Financial Group. The bank owned a loan company accused of preying on 20,000 black homeowners in Georgia. Using sit-ins, door-to-door organizing, and publicity stunts, Marks and a coalition of consumer attorneys prompted a probe by the Georgia attorney general. After state congressional hearings, Fleet promised to come up with millions in class-action settlements and special-loan programs. The deal included \$140 million in low-cost loans for the poor funneled through the Neighborhood Assistance Corporation of America--the group Marks runs. In return, the Neighborhood Assistance Corporation agreed to leave Fleet alone. Marks has gone after other banks that he says do not live up to their end of the deal. "If we don't get the criticism, we know we're not pushing hard or far enough."²²

When it comes to two-way communication, a great example is the story of Harrison Coleman who practically grew up in his father's barbershop in Demopolis, Alabama. After his father retired, he wanted to open up a barbershop of his own. "What I wanted to do was try to offer some employment for people who probably didn't want to go to college or couldn't go to college. This would give them a way of bringing their economic level up, and hopefully would affect their families' lives as well." Harrison was finally able to get a bank loan for construction for the barbershop, but this loan did not include funds to buy the barber chairs and carpeting essential for the functioning of the shop. The bank was not willing to increase his loan amount. But at the Demopolis Federal Credit Union, Harrison was able to get the money he needed.

"The thing with the credit union is that these people are people you know, people you go to church with, people you talk to, people who share the same interests and have probably felt the blunt blow of the same things you've dealt with in your life. So when you put people like that on the credit committee, they tend to look a little deeper and they tend to look at ways of helping you, rather than ways of holding out on you. And that's a big difference between the credit union and the bank." Harrison has hired and trained a number of young men to work as barbers, some of whom have gone on to start their own shops. Coleman's Barbershop has been very successful, and Harrison is currently opening a restaurant nearby. While he is now able to approach commercial banks for his

²¹ Opportunity International Australia, *Success Stories*, <http://www.opportunity.org.au/article/articleview/99/1/30>

²² The Progressive, 'Banking terrorist' fights for poor - Bruce Marks's Neighborhood Assistance Corp. of America fights banks for loans for low-income areas, Oct., 1997

new ventures, he is still an active member of the credit union, and believes it plays an essential role in his community.²³

A major differentiator of the developed economy from the developing economy is the existing banking infrastructure. It can be quite extensive in the developed economy, utilizing the latest technology. It seems impossible that in this environment, there could be people who do not use the services of a bank – the “unbanked.” According to Federal Reserve estimates, 13.2 percent of American households do not have a checking account, and 9.5 percent have no bank account at all. More than half of “unbanked” households are nonwhite or Hispanic. The “unbanked” also tend to be disproportionately young, less educated, and earning low incomes. In other words, these citizens meet almost every criteria for social disadvantage, and their reliance on fringe financial institutions help keep them that way.

Check-cashers, for example, offer immediate access to paychecks without the sometimes-lengthy delays banks impose for check clearance. “Fringe” institutions typically offer convenient evening and weekend hours, not “bankers’ hours.” They also provide quick short-term loans, and their fees, while often relatively high, are sometimes less prohibitive than the minimum-account-balance fees charged by banks. And finally, “fringe” institutions often bundle their financial services with other essential services for low-income families, such as prepaid phone cards, money orders, and low-cost fax machines. Less rational, but still compelling reasons for using fringe institutions rather than banks include perceptions of hostility from bank employees; the personal experiences of many immigrants from countries with less stable and reliable banks; and the mistaken belief that maintaining small cash balances in bank accounts could make families ineligible for federal benefits necessary to supplement wage income.

Banks need to learn from the recent realization of many retail firms that low-income neighborhoods represent one of the few great, untapped markets in the U.S. economy. Just as banks have innovated in recent years to provide customized services for upper- and middle-class customers (from PC banking to a whole array of new savings and investment devices), they should consider customized services to attract the poor. The competition they could provide would also drive down the cost of financial services now dominated by fringe institutions.

Federal, state and local policymakers can also contribute to this effort, by (1) authorizing and funding small bank-based pilot projects to show the potential impact of banking services for the poor, (2) promoting more aggressive use of the incentives provided for low-income financial services by the federal Community Reinvestment Act, and (3) expanding public and private financial education programs to help low-income families take advantage of the best services at the best price.²⁴

²³ pbs.org, Community Development Financial Institutions, *Real Stories, Real People*

²⁴ New Democrats On-Line, *Idea of the Week: Banking the Poor*, August 3, 2001

APPENDIX:

Exhibit 1: Economic Pyramid

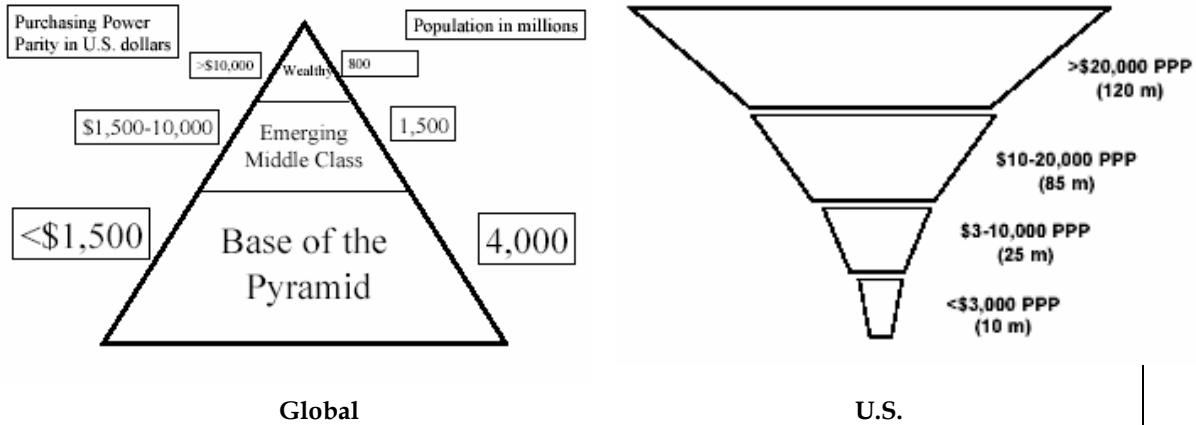


Exhibit 2: Service range / Financial Institute Characteristics Diagram

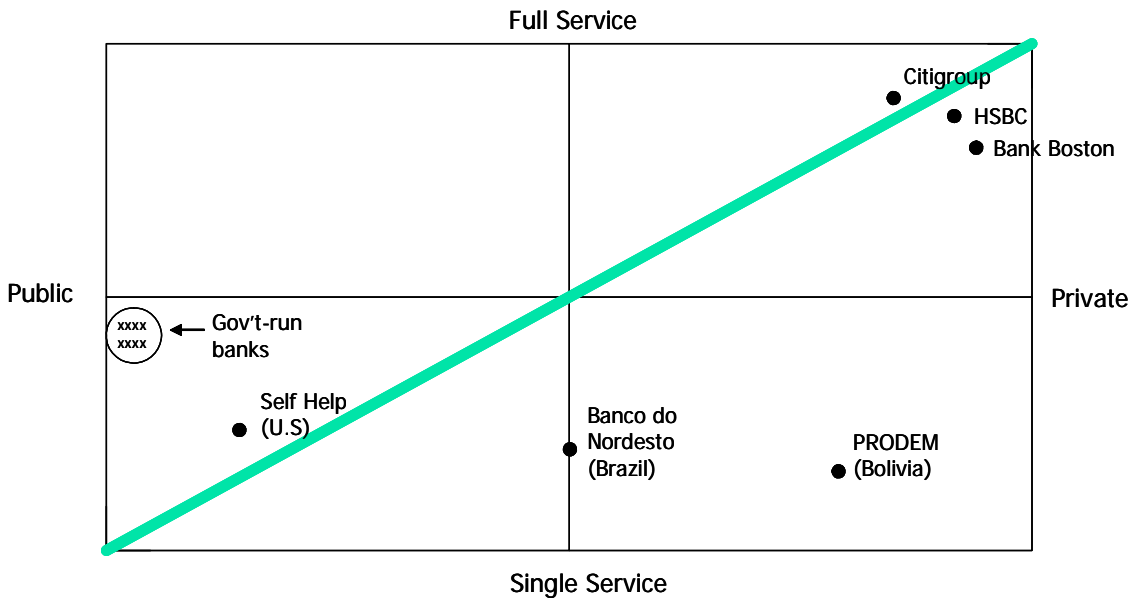


Exhibit 3: Major milestones in microfinance

- 1961- ACCION International founded
- 1973- First microloan disbursed in Recife Brazil – coined the phrase “microenterprise”
- 1976- Mohammad Yunus begins lending in Bangladesh with the Grameen Bank
- 1980’s- Decade of expansion of scale for microcredit institutions
- ACCION International expanded into 14 Latin American countries
- Grameen expands as well, implementing training programs and opening up irrigation- and fisheries-specific programs.
- 1984- FINCA founded
- 1991- ACCION USA began in Brooklyn NY, and eventually expands into regional network in 9 states in more than 30 cities and towns.
- 1992- First commercial microfinance bank founded – BancoSol in Bolivia
- 1994- BancoSol sold certificates of deposit in US financial markets – view as a viable investment
- 1995- Caja Los Andes founded in La Paz; began as a regulated financial institution.
- 2000- ACCION International expands operations to Africa and currently supports microlenders in Benin, Mozambique, Tanzania, Uganda and Zimbabwe.
- 2005- Declared Year of Microfinance by the United Nations

Exhibit 4: ATM of PRODEM



Source: BBC News website, 13 June, 2001