Microfinance

Microfinance has evolved beyond simple microloans to include the provision of various small-scale financial services. While many of Asia's poor remain without access to any formal financial services, Asia is also home to some of the largest, most innovative microfinance markets in the world. These innovations include advances toward meeting a triple bottom line of "profits, people, and planet" that explicitly includes environmental sustainability as a core commitment.

Microfinance, defined as the provision of small-scale financial services to the world's poor, originated in Asia. Many of the best microfinance institutions by any measure of performance are still located there today. Pioneers of the movement, the most well known being the joint recipients of the 2006 Nobel Peace Prize, Muhammad Yunus and the Grameen Bank in Bangladesh, inspired a movement that has spread around the world.

In 1976, Yunus, then a professor of economics at Chittagong University, made one of the first-ever microloans: $27 from his own pocket to a group of poor women in the village of Jobra, near his university. This experiment prompted Yunus to volunteer to serve as the guarantor of a larger loan made to the poor by a traditional bank. The repayment rates were high, higher than at any of the other traditional commercial banks in Bangladesh, which violated the accepted economic theory of the time, that the poor were not reliable borrowers. What became known as the Grameen Project eventually launched a revolution in the way financial services are administered to the poor.

As of 2012, microfinance institutions serve an estimated 175 million people around the globe (Maes and Reed 2012). At the same time, an estimated 2.7 billion people remain without access to formal financial services (CGAP and World Bank 2010). China and India, the two most populous countries in the world and home to most of the world's poor, illustrate this dichotomy. India is one of the largest and most innovative microfinance markets in the world. In China, microfinance is still a nascent industry, with services mostly limited to traditional microcredit.

When most people think of microfinance, the image that comes to mind is usually something similar to the original Grameen Bank model: small loans to groups of female microentrepreneurs who take loans individually but agree to share joint liability for each member's repayment. But since the launching of the microfinance revolution, the microfinance industry has continued to innovate. Microfinance increasingly serves men as well as women, and microfinance institutions increasingly offer clients the option of individual loan contracts—not necessarily just for business investments—with flexible repayment plans rather than only group lending programs with rigid repayment schedules.

And microfinance is no longer just about loans. One of the most significant innovations has been the acknowledgement that the poor need more than just credit. The poor face not just low income, but highly variable income. In that regard they have even more need than the rich for financial services that go beyond microcredit and include services, such as savings, which will allow them to manage their limited cash flow and to become a little less vulnerable to unexpected shocks like illness and natural disasters. Recognition of this need has inspired many microfinance institutions to move beyond the traditional provision of microcredit to include microsavings and even more sophisticated financial services, such as insurance and pensions.

Information technology is also transforming microfinance. The success of Kenya's mobile phone–based money transfer service, M-PESA, has raised hopes that mobile banking may be a low-cost way to reach the majority of those who today remain without access to financial services. In Asia, mobile-banking initiatives such as FINO (Financial Information Network & Operations Ltd.) in India and Smart Money in the Philippines now have more active clients than the largest "brick and mortar" microfinance institution in those countries (CGAP 2010). Bangladesh has capped the interest rates that microfinance institutions can charge, and officials in the natural-disaster-prone Indian state of Andhra Pradesh have passed a series of new regulations on microfinance institutions after an alarming spate of suicides by over-indebted poor, some of them clients of microfinance institutions.

Double Bottom Line

Part of the attraction of microfinance is the promise of "doing well by doing good," that is to say, the notion that microfinance can be profitable. In some cases, the profits in the industry have attracted private sector commercial banks like Indonesia's Bank Tabungan Pensiunan Nasional (BTPN), which reported a 14 percent net interest rate margin on its microloans in 2011. Another Indonesian example, the famous Bank Rakyat Indonesia (BRI), today one of the world's largest and most profitable microfinance institutions, started out as a government bank. In other cases, microfinance institutions that started out as small nonprofit organizations "commercialize" and become for-profit institutions pursuing the double bottom line of social objectives and financial sustainability simultaneously. In 2010 India's largest microlender, SKS, which had started out as an nongovernmental organization (NGO) twelve years earlier, raised $350 million by selling a 21.6 percent stake in an initial public offering (IPO) that was thirteen times oversubscribed. Other microfinance institutions, like the Khushhali Bank in Pakistan, now skip the initial NGO phase and start out with a clear vision as a commercial bank.

This trend toward profitability has brought on a heated debate about the pros and cons of commercialization in microfinance. This debate has raged since the 1990s. But in the early 2000s the governments of Bangladesh and India, the largest microfinance markets in the world, seem to be siding with those who believe that the cons of commercialization (the danger that a focus on profits will lead microfinance institutions down the path of "mission drift," from which they forget their original social mission), outweigh the pros of commercialization (faster growth and outreach to more clients).

Triple Bottom Line

Even as the debate of financial sustainability continues to rage, the microfinance industry focuses increasing attention to environmental sustainability as well. For some microfinance institutions like ACLEDA in Cambodia, which reports on environmental performance in addition to social and economic performance, the triple bottom line of "profits, people, and planet"—maintaining financial sustainability while advancing the original social mission of microfinance *and* protecting the environment—has become an institutional commitment.

Why? Even though the scale of the microenterprises targeted by microfinance are small, meaning that individually they have little impact on the environment, collectively they contribute to environmental damage, at a minimum through pollution and unsustainable use of natural resources.

For some microfinance institutions, policies to mitigate this damage may be consistent with their core mission and seem simply the right thing to do. Others may join the movement for image or branding incentives, or because institutions that finance microfinance, including private institutions such as the Calvert Foundation, Triodos, and the Bill and Melinda Gates Foundation, increasingly value environmental sustainability and include environmental criteria in their funding decisions. Responding to this trend, microfinance-rating agencies such as M-Cril, MicroFinanza, and Planet Rating have all defined some environmental indicators to include in their assessments.

Other immediate reasons exist for microfinance institutions to get involved in protecting the environment. Microenterprises are not only agents of environmental damage; they are victims of it. As policy makers from poor countries often point out, poor countries have the right to develop, and that requires energy. But the poor cannot simply dismiss the negative effects of environmental degradation as a problem of the rich world. The impact of climate change is predicted to fall disproportionately in tropical regions—home to many of the world's poor countries. Within those countries, the costs of environmental degradation will fall disproportionately on the poor. The poor are often more dependent on natural resources for their livelihoods. They are more likely to succumb to illness or reduced productivity due to pollution or inadequate waste disposal. The extreme weather conditions resulting from climate change tend to hurt the poor more—for example by destroying their homes and livelihoods—and the poor have fewer options to financially cushion themselves from these events. Because the costs of environmental degradation will disproportionately affect their clients, even microfinance institutions that place human security squarely above environmental concerns cannot ignore completely the question of environmental sustainability.

Environmentally Sustainable Microfinance

Microfinance institutions are responding to this environmental sustainability challenge in a variety of innovative ways. Many microfinance institutions, like XacBank in Mongolia, may start by including the environment in their mission statement and working to reduce their own ecological footprint. Often, this environmentally oriented mission influences the activities they choose to support. Some microfinance institutions, like ACLEDA in Cambodia or KASHF in Pakistan, have created an exclusion list of microentrepreneurial activities that are not environmentally sustainable, which they will not finance. Other microfinance institutions may not go so far, but at least limit the percentage of their portfolio allocated to "A list" industries that are particularly damaging to the environment.

Other microfinance institutions provide "green microcredit" to promote environmentally friendly activities or green technologies. For example, Ningxia CEPA in China and BASIX in India provide green microcredit to renewable energy solutions. In India, the Self-Employed Women's Association (SEWA) has partnered with SELCO, a supplier of solar panels, to bring solar energy systems into the homes of the poor and set up training programs for smokeless home stoves. Also in India, Wesco Credit has partnered with Green Microfinance to provide a solution to waste management and disease control with biogas plants that use biodegradable waste to provide renewable energy (and, as a side product, organic fertilizer) for home stoves. In Bangladesh, a developmental organization called BRAC (affiliated with BRAC University), and Grameen Shakti (part of the Grameen family) are involved in similar green microfinance, extending loans to households for the purchase of home solar energy systems, biogas plants, and improved cook stoves, while the NGO Proshika has had a successful experiment using microfinance to motivate poor households to participate in reforestation.

Outlook

Looking forward, these kinds of environmentally sustainable innovations in the field of microfinance will continue to expand. In the past thirty years microfinance has evolved to a scale and level of sophistication that few would have imagined when Muhammad Yunus made his first microloan to a poor woman in Bangladesh. Although many of world's poor remain without access to any formal financial services, the field of microfinance now serves an estimated 175 million people and includes a wide variety of financial instruments such as savings and even pensions and insurance.

The success of some microfinance institutions in meeting the so-called double bottom line of profitability and social objectives has contributed to a trend of commercialization in the industry. This shift includes large commercial banks downscaling to include microfinance in their portfolio of services, and small, nonprofit organizations transforming into licensed, regulated, financial institutions. This trend and recent tragic events in the Indian state of Andhra Pradesh have renewed a heated debate about the pros and cons of commercialization in microfinance.

Even if responses to the events in Andhra Pradesh mean that growth in the microfinance industry plateaus or even reverses in the next few years, it is likely that innovations in green microfinance will continue. Microfinance institutions must increasingly embrace a triple bottom line of "profits, people, and planet" that includes environmental sustainability. Assessment and access to financing for microfinance institutions is increasingly dependent upon environmental criteria in addition to social objectives and financial performance. The main clients of microfinance institutions, the poor, are also the main victims of environmental degradation. The poor rely more upon natural resources for their livelihoods. They are more vulnerable to illnesses and lowered productivity as a result of environmental damage. They tend to live in areas that are more susceptible to extreme weather conditions and they are less able to cushion themselves financially from the damage of natural disasters. For all these reasons, in the coming years microfinance will be one of the industries at the forefront of environmental sustainability.

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See also Climate Change Migration (India); Corporate Accountability (China); Education, Female; Five-Year Plans; Gender Equality; Green Collar Jobs; Information and Communication Technologies (ICT); Labor; Nongovernmental Organizations (NGOs); Outsourcing and Offshoring; Public Health; Public Transportation; Public-Private Partnerships; Rural Development; Rural Livelihoods; White Revolution of India

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