MICROFINANCE TECHNOLOGY: IMPLICATIONS FOR NONPROFIT FINANCIAL INSTITUTIONS

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Nonprofit and for profit financial institutions around the world are promoting microfinance technology as the latest mechanism to eliminate poverty and empower people with low incomes (CGAP 2006, IDB 2006). The financial technologies offered include banking services (e.g., savings accounts, ATM cards, cellphone banking), loans (e.g., home mortgage, small business), credit cards, and insurance policies (e.g., life, health, home). Microfinance is lucrative, yielding annual returns of 15 to 35 percent.

While microfinance may prove to be a sound financial technology for some individuals, easy credit may also lead to financial ruin for others. Indeed, microfinance may be the newest form of green washing or "charity washing" in the making, whereby bankers can use microfinance as a selling point to command pricing premiums while advertising their brand as charitable.

This article describes the newest microfinance technology in the context of global capitalism. Also explored are some of the implications of growing competition between for-profit and nonprofit financial institutions to dominate microfinance. Ideas are offered on ways nonprofits might assume a leadership role in microfinance training to protect customers who have little or no education and banking experience.

The Washington Consensus

1992 marked the launching of a new experiment in global capitalism designed by what is known in political circles as the Washington Consensus, including Wall Street, Washington, and multilateral financial institutions. The experiment encouraged governments of emerging markets (i.e., developing nations) to join the global market system by opening their economies to foreign capital, selling public assets, and pegging currencies to the U.S. dollar with the promise that global capitalism would lift them out of poverty.

Today we see the impact of the experiment. Within a few years of nearly every nation joining the Washington Consensus, a financial meltdown occurred, requiring governments to borrow ever greater sums of money to make debt payments at ever higher interest rates with stricter conditions. Monetary authorities, including the Federal Reserve and the U.S. Treasury, often bailed out investors for fear that one nation's financial collapse would spread to other nations. Thus, an asymmetry emerged whereby leading private and institutional investors reaped tremendous profits while governments in emerging markets were left heavily indebted.

A critical turning point was in December of 2001, when Argentina—fearing a financial meltdown—walked away from $132 billion in debt, marking the largest default in history. Rather than assuming additional loans, Argentina stopped making payments all together and asked for time to reconsider its options. Without the influx of foreign capital, Argentines suffered from fiscal austerity, unemployment, and growing poverty for several years. In 2005, the government offered to pay 32 cents on every dollar of debt, noting that this was more than Enron shareholders received after the energy trader filed bankruptcy in 2001. Argentina slowly regained its footing and posted annual growth rates exceeding eight percent in 2004, 2005, and 2006.

Others nations are taking note. Several Latin American, Asian, and Eastern European nations are stockpiling dollars to avert future crises. Some countries are bypassing traditional lending institutions in favor of bilateral or regional partnerships. Indeed, the International Monetary Fund's outstanding credit dropped from $104 billion in 2003 to $28 billion in 2006, reflecting an increasing reluctance to do business with the Washington Consensus under the old rules of the game.

Hence, the bankers are nervous. Having lost high yielding portfolios with governments in emerging markets, new financial technologies are being marketed directly to poor people. The generic term for the newest financial technology is microfinance, which includes banking services, loans, credit cards, and insurance policies.

In Latin America, the initiative was formally launched by the Inter-American Development Bank (IDB) at a conference in June of 2006. It was noted that in Latin America, there are roughly 360 million poor people who do not have access to financial services. While most of these people live on less than $2 a day, together their purchasing power exceeds $510 billion per year (IDB 2006). The bankers want to access this previously untapped market sector that offers both profitable and attractive financial margins. The rhetoric is that the approach will allow the poor to be part of the global market place, access consumer goods, and be lifted out of poverty.

Microfinance Products and Services

Microfinance begins with bank accounts, a service currently availed by less than ten percent of low income households around the world (Women's World Banking 2005). Given that the poor have no money, relatives who work abroad are encouraged to deposit remittances into their family's local bank account. Some banks offer starter savings

accounts that require small initial sums of money (e.g., $25) and low minimum balances (e.g., $10 a month) to attract new customers.

The second step is to turn banking customers into borrowers. Bank accounts will serve as a gateway to other financial products, specifically loans and credit cards for consumption, home purchases, and/or business development. Creative methods are being developed to quantify assets (i.e., secured collateral) that can be repossessed in the event of a default (Hernando De Soto 2006).

As with every other technology humans have adopted, there is no educational component with its introduction, which raises the concern that many people may not be able to read the fine print on a bank loan or credit card application. Moreover, unlike Argentina—the third largest debtor to the IMF in 2003—individuals do not have the clout necessary to renegotiate debt if they get in over their heads. *The Economist* (2006) reports that microfinance in India has resulted in some heavily indebted individuals committing suicide because they cannot meet interest rate payments in excess of 20 percent or do not see a way out of their indebtedness.

A third microfinance technology is insurance, including life, health, and home policies. As with any gamble, some people will benefit by purchasing insurance; others will end up losing more than they wager. The key issue to consider is whether insurance will be voluntary or involuntary. Peru's Banco del Trabajo, for example, offers credit cards, consumer loans, remittance services, and mortgages to 1.4 million clients. The bank requires that its 78,000 microcredit clients purchase life insurance to cover the note in the event that the debtor dies. Can people with low-incomes afford to pay principle, interest, plus mandatory insurance on a loan? If so, what is the advantage of using a microfinance institution instead of traditional lenders?

Competition between Nonprofit and For Profit Institutions

Microfinance builds upon a history of micro-enterprise development, that is, making small amounts of capital available to people with low-incomes. Pioneers in the field include Nobel Peace Prize recipient Muhammad Yunus of the Grameen Bank in Bangladesh, Sr. Anne Marie Gardiner of Salvadoran Enterprises for Women, and others. Seed money is offered as either a non-collateralized loan (which charges interest below the market rate) or a grant (which creates no future financial obligations).

Unlike micro-enterprise development, microfinance is not necessarily charitable in nature. Bankers estimate that the return on capital of micro loans exceeds 20 percent. Funds from the March 2006 sale of Morgan Stanley's $106 million bond will be distributed to 65 microfinance institutions that loan to low-income people in increments of $100 to $500 at 15 to 35 percent interest rates (Sapp 2006). Wall Street is now a microfinance creditor because microfinance is profitable.

Hence, there is growing competition to dominate microfinance technologies that may result in new partnerships and/or mergers. One of the goals of the IDB's expansion into

microfinance is to assist "nonprofit lending organizations in transforming into for-profit, regulated financial institutions" (IDB 2006). This idea is seductive at a time when U.S.-based nonprofit organizations are modeling themselves on for-profit entities, a trend driven in large measure by the fact that over half of nonprofit revenues in the U.S. derive from fees for services.

In order to maintain a comparative advantage, nonprofit financial institutions may want to stay true to their charitable purpose by serving as an intermediary between households in emerging markets and commercial banks. Nonprofits could offer workshops on banking and finance. They might also assess local trends, financial terms, and performance of microfinance institutions as a form of public education, thus reaffirming their rationale for tax-exemption. Nonprofits could also work with governments who may be called upon to develop codes of conduct to regulate this rapidly growing market.

"Charity Washing"

The Washington Consensus is marketing microfinance as a form of financial democracy to help disadvantaged people become part of the global economy, to reduce poverty, to increase social inclusion, and to improve living conditions. While the technologies are new, the rhetoric is familiar and suggests that we may be seeing a new form of green washing or "charity washing" in the making. The risk is that microfinance technology will be mistaken as benevolence rather than simply an extension of global capitalism.

In the years to come, microfinance may prove to be a sound technology for savvy individuals who need secure mechanisms to send remittances home or financial capital to expand a small business venture. Others who obtain easy money through credit may not do as well due to a lack of education or self-restraint as we saw with many emerging market governments that received win-fall loans in the 1990s. What will happen if large numbers of individuals become overextended on credit cards or default on mortgages? Will we see debtor's prisons as in the days of yore? What cultural, legal, and social institutions will be needed to ensure that the newest financial technologies benefit society in the short and long term? Perhaps these are questions for civil society to consider moving forward.

For more information on microfinance, see Patrice Flynn's article entitled, "Microfinance: The Newest Financial Technology of the Washington Consensus" *in Challenge: The Magazine of Economic Affairs.* Vol. 50, No. 2 (March/April 2007).

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