



Microfinance : Microfinance Basics

Financial Services for the 'Not Bankable'

Microfinance links longterm development targets and economic thinking. Find out about the details.



Although loans are one of the most important services offered by MFIs, there are many other services under the umbrella of microfinance. (Photo: Adam Rogers/UNCDF)

Imagine you are a villager somewhere in rural Bangladesh. You have an idea for a small business. If realized, that business could bring some extra income to your family, enable you send your child to school, and possibly even create a few jobs for the community.

You have the time and energy to build up this business, but you still need some money to get started. That's where the problem starts. Until now your only option was a local moneylender who was sure to charge astronomical interest rates on loans. Now there is another option - microfinance.

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Microfinance is generally defined as specialized financial tools - such as small loans, savings accounts and insurance policies - available to poor households and small businesses that do not typically have access to financial services.

Inclusive financial services are now recognized as one way to empower individuals and communities to lift themselves out of poverty. As has been demonstrated since the first experiments with microfinance, many people living in poverty can improve their livelihoods when given the opportunity to save, invest and insure.

There are now over 3,000 microfinance institutions (MFIs) operating throughout the world. The spectrum of organizations involved in microfinance is vast: most are small local NGOs, but an increasing number of international organizations, banks, charities, and the world's largest private financial institutions (such as Citigroup, ING Group and Allianz) are now providing or helping to provide microfinance products.

More than loans

Microfinance means more than giving out small loans. Although loans are one of the most important services offered by MFIs, there are many other services under the umbrella of microfinance. Microloans are typically smaller than the loans offered by banks in the developed world. But even a few hundred dollars can often allow a small business in a rural village get off the ground.

Secure savings accounts are another essential service, allowing households to accrue interest and save for the expected and unexpected turns in their family's future, such as school, marriage, illness, old age and death. Savings accounts without a minimum balance have been extraordinarily popular in the developing world. Bank Rakyat of Indonesia (BRI), for example, has around 30 million micro-savings accounts.

Other important microfinance services include affordable wire transfers and remittances, both of which allow people to direct across long distances and national borders.



MDG Picture Gallery (click on the image to start)

Find out about the UN Development Goals to reduce poverty (Photo: Reuters)

But microfinance also includes giving people a way to manage risks to their lives, health, families and livelihoods. Micro-insurance has therefore become a popular product in the developing world, particularly for people working in hazardous industries or living in environmentally vulnerable regions.

"Insurance is an indispensable financial service," says Vipin Sharma who directs the microfinance program at CARE India. CARE International and Allianz announced a partnership in July 2006 that will provide micro-insurance policies to over 75,000 fisherman and agricultural workers in the tsunami-stricken southern Indian state of Tamil Nadu.

"The goal is to ensure that the tsunami survivors can overcome the setback they faced as a result of the disaster and to secure the means by which they can insulate themselves against further shocks and insecurity through appropriate insurance coverage," Sharma told Allianz.com News in July.

Not charity

Projects and organizations have been experimenting with microfinance services for over thirty years. Some of the pioneering microfinance projects, such as Muhammad Yunus's early microcredit experiments in Bangladesh and ACCION International's microlending program in Brazil, took place as early as the mid-1970s.

ACCION International and Yunus's Grameen Bank have stayed on the cutting edge of microfinance, and both are among the leading organizations in the field. Other organizations with large numbers of clients include BRI, BancoSol and Opportunity International. The United

Nations - through the UN Development Programme (UNDP) and Capital Development Fund (UNCDF) - has also initiated projects, as have government branches, such as the German Agency for Technical Cooperation (GTZ).

Although alleviating poverty is a goal shared by many of these organizations, another motivation often lures financial institutions into the microfinance business - profit. By providing services for the traditionally "not bankable" or "not credit-worthy," banks and insurance companies create new markets and make money by charging interest on loans. Indeed, some experts consider profit an essential part of microfinance because it enables the expansion of financial services to poor communities all over the world.

Connected goals and solutions

Even though experts hesitate to call microfinance a catch-all solution, microfinance still has great potential to alleviate not only poverty, but also other problems that afflict the developing world. Arun Kashyap of the UNDP sees inclusive financial services as "a glue" that holds together integrated network of solutions to elusive development problems.

"The Millennium Development Goals include gender equity, improving the quality of life of children, environmental protection, addressing HIV/AIDS and other health concerns," says Kashyap. "In all these cases a key is providing more access to the goods and services for the people who need them."

"That means creating livelihoods and cash flow at that level, as well as things like access to water sanitation, energy, health services and even some kind of insurance or safety-net mechanism," adds Kashyap. "To do all of that, you need an inclusive financial system."

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