



Microfinance : Microcredit

Microcredit: Only a Romantic Notion?

Aneel Karnani at the University of Michigan's Ross School of Business says despite its growing popularity, microcredit is not the best way to help poor countries out of poverty.



Aneel Karnani is author of "Microfinance Misses the Mark," a 2007 article in the Stanford Social Innovation Review

You have said there is a gap between the hype and reality of microcredit. What do you mean?

There are millions of people getting microcredit. What the media plays up are the success stories: a woman who borrows 200 dollars, and after ten years, she has become middle-class with a big factory and lots of employees. But this is one out of a thousand or so microcredit recipients. The vast majority does not suffer or gain much from it.

Microcredit assumes that all poor people are entrepreneurs. By entrepreneur, if we mean somebody who creates value through innovation, drive, persistence, and good business skills, then I think that most people are not entrepreneurs. Even in rich countries, I think that less than ten percent are self-employed; most people have a job with a regular salary. To assume that poor people are going to somehow become entrepreneurs is a romantic notion.

But isn't promoting microcredit better than doing nothing at all?

If the choice is between doing microcredit and doing nothing, I think we should still do microcredit, but that's the wrong way to frame the choice. The alternative is not to do nothing; it is to do something different and better. The danger I see with microcredit is that if we keep doing more of it, we will get an economy that is very inefficient and fragmented.

The biggest problem with microcredit is that people who get these small loans usually start or expand a very simple business. The most common business for microcredit is simple retail - selling groceries - where there are often too many people, fierce competition, and where they don't really earn enough money to get out of poverty. We need to create more jobs, and microcredit does not help to do that yet.

Microcredit is still relatively young. Is it too early to tell what the

effects are on national development?

Microcredit has been going on in Bangladesh for decades. Grameen is over thirty years old. I don't think it's too early, but I agree that we don't have enough research on the impacts of microcredit. In my view, even if we did the research, I think the logic is still flawed. Expecting so many people to be entrepreneurs just isn't going to work.

**Microfranchising (click on image to read more)**

Not everyone has the entrepreneurial skills to lift themselves out of poverty with a loan. Read more about an alternative - microfranchising, which can help poor people profit from proven business models.

Instead of microcredit, what would you do to alleviate poverty?

My advice to philanthropic organizations is to put more money in helping the small to mid-sized enterprises. I think these are the real engines of job creation. They use more technology, more capital assets, and they increase productivity and provide stable employment.

When you look at the poor countries, you see microenterprises - one person selling groceries - or you see large companies. The middle sector is totally missing. In rich countries, the bulk of employment is in the small- to mid-size companies.

Why has this "missing middle" not yet emerged in developing countries?

In many poor countries, this middle sector suffers from all kinds of problems: it is hard to get capital; political systems tend to favor large companies; and the infrastructure is very bad, and small and medium-sized enterprises cannot survive without roads, electricity, and so on. Distribution channels and access to markets are not very good. So, small companies are at a disadvantage. Rather than putting more money into microenterprises, I think we should devote more resources to the small to mid-scale sector.

Do you see any other problems with microcredit?

The debt trap is an under-reported problem. Quite a few people invest money, their business does not make money and goes under, and they are stuck with the debt. The interest rate on this debt, even with a microcredit loan, is quite high, so some are never able to repay it. Another reason why they get into a debt trap is that, in theory, you should take a microloan to invest in the business. But in practice a lot of people use microloans for a wedding, festival, or to buy something.

A lot of these people don't know how to use debt. Even people in rich countries often don't know how to use debt. They think that once you have a credit card, you can buy anything. If you get microloans, it doesn't necessarily mean you can buy things you couldn't afford before.

Is there anything you like about microcredit?

Microcredit does some good. It can increase the income of poor people, but just not by very much. I think the biggest benefits of microcredit are the social benefits. It's clearly true that in many countries, women are discriminated against. Microcredit improves their standing in the household. The women can bring in some money, and gain a little bit of equality in the household and recognition in society. Now she has some economic independence. She goes out, meets people, has a job, and gains confidence.

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Somewhat related to that, there is a lot of research that shows that women are more responsible than men as far as taking care of the children. The future clearly lies in looking after the children. The benefit of microcredit is that it will help women, and the women will help the kids.

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