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Microfinance : Microfinance Basics

What the Poor Really Need

What do the poor need to escape poverty? Good advice? Moral support? Neither, according to Nobel laureate Muhammad Yunus who says the poor really need a little capital to start climbing the economic ladder.

Grameen Bank founder and Nobel Laureate Muhammad Yunus (Photo: Reuters)

For over thirty years, Yunus and his Grameen Bank have shown that small loans can change a whole economy from the bottom up, ensuring that the poor are the first to profit.

But what is wrong with giving big money on a grand scale, such as major development projects or international aid? It seems most funds do not trickle down to the people who need them, but end up in private Swiss bank accounts.

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"The international state sector transfers 100 billion US dollars per annum in a top down manner, but has high frictional costs in allocating capital effectively", says Arthur R. Wood, senior vice president of Ashoka Social Financial Services, an international organization giving financial and community support to social entrepreneurs worldwide.

Smaller is better

"The worst example is sub-Saharan Africa where an estimated 80 percent of capital allocations have come back as flight capital in one year." In other words, if you want to give something to the poor, give it to them directly.

But it is not only dishonesty that swallows funds; it is also inefficiency. Global management consultants McKinsey & Company Inc. estimate the average cost of fair capital allocation to be between 20 to 50 percent. "The cost of capital allocation in the citizen or philanthropic sector is ten times the rate in the normal capital market," concurs Arthur Wood.

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The conclusion: in countries where anything "macro" fails through weak infrastructure, rampant corruption and inefficient administrative practice, you have to build your own system of giving money directly to those who need it (i.e. via microfinance).

Doing good requires expertise

More and more of the world´s benefactors are realizing they have to get better at doing good. That means asking professionals, and in the case of microfinance, this means consulting banks. But banks are generally not charities. They give loans, not handouts. They want an interest and expect to be paid back.

"The poor must pay back every penny they get," says Yunus, who founded Grameen Bank in the aftermath of the devastating famine of 1974 in Bangladesh, which killed 1.5 million people.

Yunus's approach is echoed by other social entrepreneurs. Give somebody a handout, they say, and he will feel and act like a helpless beggar. Give him a loan, and you treat him (or, in most cases her) as a responsible business partner.

"I see people develop a sense of self-respect, hope and confidence in themselves for the first time," says Jimmy Carter, former U.S. president and founder of the Carter Center, a philanthropic society whose mission is to "wage peace, fight disease and build hope," especially for "poor and often forgotten people."

Are poor people a bad risk?

"The poor are neither too stupid nor too passive to earn money," says Yunus. "On the contrary, having to fight continually for survival has honed their innovative skills. All they need is a small capital to get them going."

When Yunus founded the Grameen Bank, almost nobody shared his vision. "Give small loans to poor people? Everybody told me this had to go wrong!" he recalls.

But it is the skeptics who were wrong: 95 percent of Grameen's loans are paid back. Of course, loans should be given on acceptable terms, which is why banks and social entrepreneurs must work together. Banks know how to distribute money effectively - social entrepreneurs know how to distribute it justly.

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