Charity or commerce?

The different structures of microfinance

The term microfinance is used to describe a vast range of business structures and funding mechanisms. In particular, the roles of charity and commerce within the world of microfinance vary hugely depending on the organisation and the country of operation.

Commercial microfinance

Commercial microfinance institutions structure a profitable business model around the principles of microfinance. This does not prevent them from being socially responsible, or “pro-poor” – Compartamos, a Mexican MFI and bank that is part of the ACCION network, describes itself as a “social company”, for example. Similarly, Kenya’s K-REP describes itself as a “commercial bank” with a “social mission”.

Another area in which private investment is playing an increasing role in microfinance is through the capitalisation of MFI loan books. In recent years, investors have begun to create investment funds for the microfinance sector offering a market rate of return. The first widely cited example of this was Profund, a $23m Latin American fund created by a group of investors headed by ACCION in 1995. Large, multi-national banks are also now becoming increasingly involved in this area – Citigroup and HSBC both have microfinance divisions providing services such as loan guarantee funds, operational support and commercial wholesale lending to MFIs.

Charitable, and not-for-profit microfinance

Modern microfinance has its roots in non-profit structures. Grameen Bank of Bangladesh, founded by Nobel peace prize winner Mohammad Yunus, is a community bank owned by its clients. Grameen now claims to be sustainable, in that it covers its costs from interest earned on loans, and so does not require donor funding. However, unlike commercial microfinance, profits are reinvested into the business, or what it calls a “Rehabilitation fund”, which is set up to provide support and relief in disaster situations.

Other not-for-profit microfinance institutions do receive external funding, either to support expansion or to help cover costs. These include global organisations such as FINCA, BRAC and Opportunity International (which has a UK support base), as well as UK based charities such as the MicroLoan Foundation.

Many, though not all, not-for-profit microfinance institutions aim to cover costs, and hence achieve full sustainability (ie non-reliance on donor funds). Sustainability is widely considered desirable, since it ensures that initiatives will be meaningful, scalable and long-lasting. In this model, donor funding is used to fund start-up costs or expansion as opposed to propping up a long-term business plan.

However, in many regions, notably sub-Saharan Africa, sustainability is often incompatible with universal access. For example, a rural client who needs a $50 loan and who requires basic business training to set up their first business is far more costly to serve than an urban, educated client taking a $500 loan to finance an existing business venture. At the MicroLoan Foundation, (a UK based microfinance charity operating in sub Saharan Africa) we are therefore committed to becoming sustainable in the long term, both from the interest charged on loans and from ethical trading with our clients. However, it is integral to our approach that sustainability does not come at the expense of the availability of services to those most in need.

Who's right?

There is much debate within the microfinance community regarding the ethics of making money from the world's poorest people. Some, such as eBay's Pierre Omidyar – a leading advocate of private sector involvement in microfinance – consider that private sector investment is the key to achieving scale and sustainability. He is quoted in the New Yorker as describing microfinance as "a self-sustaining, profitable model, which opens the door to reaching large numbers of people who need to be reached by this tool of access to capital." (*New Yorker, 30th October 2006*).

Many, including Grameen's founder Mohammad Yunus, disagree. In the same article he responded by commenting "Why do you want to make money off the poor people? You make money somewhere else. […] When they have enough flesh and blood in their bodies, go and suck them, no problem."

Ultimately, both charitable and commercial microfinance have important, though differing, roles to play in providing the world's unbanked with financial services. Few would question the value of commercial microfinance in circumstances where it can provide valuable services at scale. Equally, wherever this is not possible (and in many parts of the world the private sector has simply not yet proved capable of providing universal access to microfinance), charitable MFIs will continue to provide essential support (sustainably or otherwise) to people in living in extreme poverty.

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