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Tesi di laurea

Il settore del microcredito: dalla missione sociale alla commercializzazione

The microfinance sector: the shift towards commercialization and the original social mission

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Abstract

Nel seguente elaborato si presenta un'analisi del microcredito allo scopo di comprendere il ruolo della commercializzazione e dell'originaria missione sociale nel futuro del settore. Lo studio si basa su di un campione di 346 istituzioni microfinanziarie e rivela profonde differenze tra le organizzazioni a scopo di lucro e non: le prime hanno una profittabilità in media superiore, effettuano prestiti dal valore più elevato e, quindi, hanno costi e tassi di interesse inferiori; le seconde, invece, utilizzano più sussidi, ma riescono a raggiungere un numero maggiore di donne e di persone bisognose. Oltre la metà delle istituzioni che persegue obiettivi unicamente sociali riesce ugualmente a coprire i costi. Il business sociale nel microcredito, quindi, non sembra destinato ad essere superato da quello meramente commerciale: al contrario, la missione sociale del microfinanziamento, iniziata con Yunus e concretizzata nella *Grameen Bank* e in tutti i successivi progetti nei vari Paesi del mondo, sembra portare i suoi frutti in termini di miglioramento delle condizioni di vita delle persone maggiormente disagiate. Il modello dell'impresa con obiettivi sociali è, infatti, estremamente moderno e di ampia applicabilità; l'impresa sociale è al giorno d'oggi una grande opportunità sia per i paesi in via di sviluppo che per quelli sviluppati.

Introduction. Microfinance as a poverty reduction tool: should it be profitable?

The term “microfinance” refers to a range of financial services (primarily, loans) offered to low-income and non-bankable customers: making use of self-help resources, it aims at releasing the productivity of cash-starved small entrepreneurs, while raising their incomes above poverty lines. In this way microfinance can let poor people develop basic financial capabilities (deal with emergencies, handle cash flows and invest for the future) and it could play an important role in breaking gender-based barriers, empowering women through financial independence.

Microfinance began its evolution at the start of the 1970s, thanks to great minds such as Muhammad Yunus, with a particular focus on poor farmers in developing countries. This first attempt was not successful: agricultural lending was too risky (because of agriculture vulnerability to the unpredictable changes of weather and crop prices) and the incentives of institutions were misaligned; as a consequence, the first microfinance institutions were costly and inefficient. During the 1980s, the focus shifted: microfinance pioneers began addressing people in villages running small enterprises (e.g. making handicrafts, livestock raising). Although no collateral or credit history was asked, repayment rates were really high. This success created concrete basis for extending access to loans to billions of low-income people previously left out from formal financial services.

With the continuing of the development and growth of the sector, in the 1980s and 1990s policymakers started arguing that the new microfinance institutions (MFIs) should look for profits in order to be “financially sustainable”. The supporters of profit-seeking microfinance believe in a “win-win” opportunity: they can give a service to the poor while making profits with a little trade-off between the social and commercial objectives. They support their convictions with three arguments. First of all, they affirm that access to finance is more important than its price: small loans are costly to manage and, consequently, high interest rates are charged to poor households; but, since the only other option to have cash is given by usurers who charge even higher interest rates, what is offered by profitable MFIs is anyway a benefit. Actually, their claim that the existence of moneylenders implies the insensitivity of most borrowers to interest rates should not be taken for granted. In fact, moneylenders and microfinance answer to different needs: while moneylenders’ loans are usually used for very short periods (less than a month) for compelling consumption needs, microfinance loans are used for longer periods (at least several months) for business investments. Secondly, the supporters of the financially sustainable microfinance state that subsidies in nonprofit MFIs can reduce initiatives of innovation and cost cutting: also in this case, there is no evidence to support this assertion. Finally, they also argue that only commercialization can let microfinance spread extensively. The problem is that commercialized institutions rarely reach the very poor; furthermore, the long-term interest of private investors in this sector is in doubt.

This debate about the "business model" of microfinance has been strongly revived in April 2007 thanks to the *Banco Compartamos of Mexico* (an example of prosperous commercialized microfinance institution) Initial Public Offering. The IPO was very successful: insiders sold 30% of their holdings and the sale was oversubscribed by 13 times (*Compartamos* was soon worth $1.6 billion). This achievement was due to the extraordinary growth the bank experienced between 2000 and 2007 (from 60,000 customers to over 800,000), the high interest rates (e.g. 94% per year on loans in 2007) and the consequent high profits (nearly one quarter of the bank's interest revenues went to profit). This information caused opposite reactions. On the one hand Yunus (the founder of *Grameen Bank*) and the ones who believe in the social mission of microfinance were shocked by the IPO; for them the high interest rates and large profits were unacceptable: *Compartamos* could have reduced interest and profit rates and expanded at a slower pace, without subtracting so much money from Mexico's poor citizens. On the other hand, the supporters of a profit-driven model of microfinance were in favor of this IPO: in their view, it indicated the freedom of microfinance from donor-supported initiatives, substituted by investments from the private sector. Moreover, they sustain that, if *Compartamos* had not achieved high profits, hundreds of thousands of poor customers would have been left out of microfinance opportunities, remaining with the only option of turning to usurers (as stated before, they consider access to finance more important than its price). Anyway, all sides agree on the vastness of the demand for reliable financial services and on the help they could give to low-income people.

1. A portrait of the microfinance industry: types of institutions and customers

In their work "Microfinance Meets the Market" (2009), Cull, Demirgüç-Kunt, and Morduch realize an analysis of the microfinance industry in order to understand whether for-profit could replace nonprofit microfinance institutions. Using a dataset from the *Microfinance Information Exchange*, they analyze the types of institutions (with a particular focus on banks, for-profit status, and nongovernmental organizations, not-for-profit status), the interest rates they charge, their clients and their risk of insolvency.

1.1 Data used for the analysis of the microfinance industry: limits, strengths and robustness

The dataset used for the analysis of institutions and customers is not publicly available; it is taken from the *Microfinance Information Exchange* (*MIX*), a not-for-profit organization that collects data on microfinance institutions and whose goal is to promote information exchange in the microfinance industry. The dataset covers 346 institutions with nearly 18 million active microfinance borrowers and a total of $25.3 billion in assets (in purchase power parity terms) during the period from 2002 to 2004. Outreach and impact data, financial data, audited financial statements and general information on specific microfinance institutions are included. A problem is given by the lack of direct measure of outreach to the poor. However, the dataset includes indicators (e.g. average loan size, fraction of borrowers that are women) which are correlated with self-reported measures of household poverty. In this way, it is still possible to distinguish between MFIs serving the very poor versus those serving low-income people. Although participating institutions have been selected on their ability to deliver quality data, participation in the sample is voluntary: so it is not representative of all microfinance institutions. As an example, *Grameen Bank* decided not to participate during this period.

In order to address the limits of the dataset, Cull et al. (2009) make comparisons with the parallel work of Gonzalez and Rosenberg (2006); they also analyze *MIX* data, but merged with two broader datasets (the *Microcredit Summit Database* and a larger database from the *MIX*). For the most part, the comparison shows consistency. On the other hand, an important strength of the dataset is its adjustment to account not only for explicit, but also for hidden subsidies. MFIs could obtain capital from social investors at a price that is below the market interest rate: the difference in interest rates consists in an implicit subsidy. So the adjustment is based on estimates of the alternative cost of capital that the MFI would have had to pay if it had obtained the capital in the market rather than from social investors. The alternative cost of capital must account for the perceived risk of investing in microfinance institutions (the loan portfolio could deteriorate and there is no collateral) and the political or exchange rate risk that may affect net returns. So, the choice of the alternative cost of capital is determinative; in this case, the *MIX* uses a country's deposit rate (taken from the *International Monetary Fund*'s database), that is a relatively low cost of capital. As a test of robustness, Cull et al. (2009) re-run profit calculations with a higher alternative cost of capital: the prime interest rate (the price for capital that banks charge to their most reliable customers, also taken from the *IMF*'s database) incremented by 2% in order to account for the risk of lending to microfinance institutions. Predictably, this adjustment increases the value of implicit subsidies and reduces profits.

1.2 Distribution of microfinance institutions by institutional type

The sample analyzed represents a various group of MFIs, as shown in Table 1. The most important are nongovernmental organizations, nonbank financial institutions and banks (other types of institutions included in the sample, but not deeply analyzed, are rural banks and credit unions). Nongovernmental organizations (NGOs) are the majority (45% of 346 institutions): NGO is any nonprofit, citizen-based group, that functions independently from governments. The nonprofit status doesn't necessarily imply the absence of profits; it means that, if revenues are higher than costs, the profits must be re-invested in the organization to further social missions and can't be distributed. Nonbank financial institutions (NBFIs) represent 30% of all institutions; they are in a large category which includes both for-profits and nonprofits. Banks represent only 10% of the total number of institutions; they have for-profit status (they can do what they wish with after tax profits).

Although banks represent a minority in the sample, they account for over half of all the assets (mainly loan portfolios) of the institutions of the dataset. NGOs account for only 21% of total assets, but they serve 9 million clients, half of the total borrowers in the sample. Instead banks serve only a quarter of total customers. These figures have an important implication: if banks have the majority of assets (they lend in greater volume than others), but serve substantially fewer customers, it means that they are doing on average larger loans per borrower than NGOs. In addition, NGOs are serving more female borrowers (but only 290 institutions report on their coverage on women and only 281 on their use of subsidies): they serve 8.76 million women, 73% of all the female clients in the sample, against 16% served by NBFIs and only 6% served by banks. On the other hand, NGOs are the institutions that are absorbing more subsidies: 61% of all the $2.6 billion of subsidized funds used in the sample come from NGOs, while the same percentage (18%) come from banks and NBFIs. NGOs have a share of subsidies that is not proportionate to their assets: they use almost $1.6 billion of subsidies for $5.3 billion of assets; banks, on the contrary, use less than $0.5 billion of subsidies for almost $14 billion of assets.

Table 1. Distribution of microfinance institutions by institutional type

	% of institutions	***% of assets***	***% of borrowers***	***% of female borrowers***	***% of subsidized funds***
Bank	10	55	25	6	18
Nongovernmental organization (NGO)	45	21	51	73	61
Nonbank financial institution (NBFI)	30	19	17	16	18
Credit union	10	4	6	4	3
Rural bank	5	1	1	1	0
	100	100	100	100	100
Numbers total	***346 institutions***	***$25.3 billion***	***18 million***	***12 million***	***$2.6 billion***

(*Note*: the sample includes 346 institutions. Data on assets are available for 276 institutions; on borrowers for 346; on female borrowers for 290 and on subsidized funds for 281)

Source: Cull et al. (2009)

1.3 Interest rate diversity across institutions: the explanation given by cost structure

The various types of microfinance institutions in the sample also differ for the interest rates they charge. The unexpected fact is that NGOs (not-for-profit organizations with an explicit social mission) charge higher interest rates than banks (focused on profits): in fact, as shown in the first item of Table 2, while the median NGO has a real portfolio yield (average interest rate adjusted for inflation) of 25% per year, the median bank charge an average interest rate of 13%; a quarter of NGOs charge even more than 37%. Why are the highest fees being charged by the institutions most focused on social mission? Cost structures explain these patterns.

Table 2. Nongovernmental organizations versus nonbank financial institutions and banks

	Nongovernmental Organizations	***Nonbank financial Institutions***	***Banks***
1) Real portfolio yield (%)			
25th	15	12	9
Median	25	20	13
75th	37	26	19
2) Operating cost as a percent of loan value			
25th	15	13	7
Median	26	17	12
75th	38	24	21
3) ***Average loan size as a percentage of income at 20th percentile***			
25th	27	71	110
Median	48	160	224
75th	135	247	510
4) Women as a percentage of all borrowers			
25th	63	47	23
Median	85	66	52
75th	100	94	58
5) Portfolio at risk, 30 days (%)			
25th	0.74	0.91	0.39*
Median	3.54	2.06	2.43*
75th	7.59	6.91	5.23*

*Based on fewer than 10 observations

Source: Cull et al. (2009)

Figure 1 shows that, when the value of the average loan size (as a percentage of the income at the 20th percentile of the national income distribution) increases, the operating costs (as a percentage of the value of the loan portfolio) decreases. Cull et al. (2009) underline how this result doesn't change after controlling for institutions' age, inflation, country-level governance, GDP growth, region and lending method.

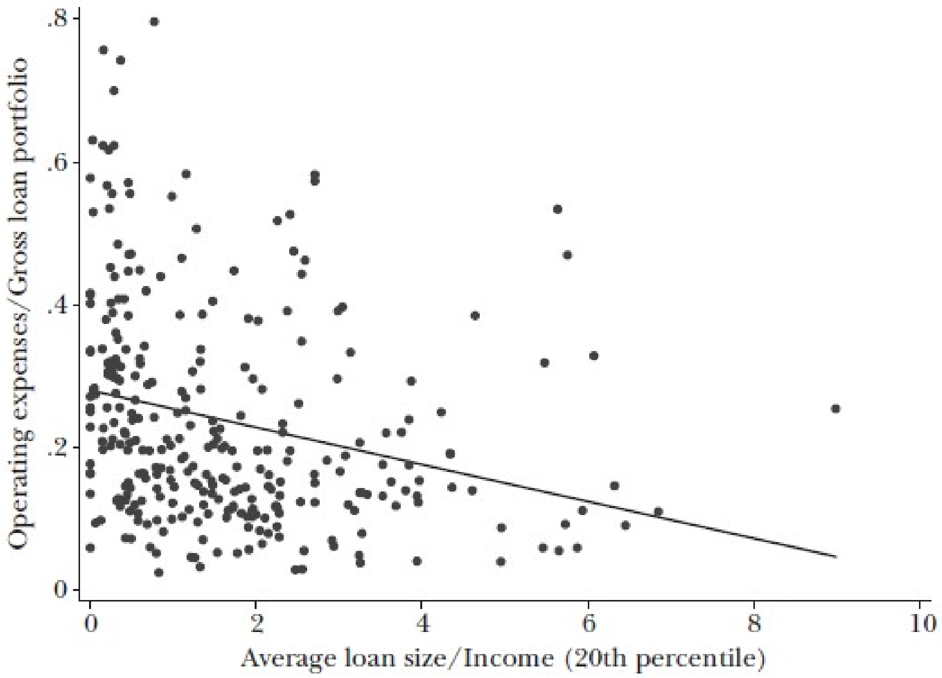

Figure 1. Average costs per dollar lent falls as loans get larger
Source: Cull et al. (2009)

Operating costs are the ones that make the difference in total costs among various MFIs. Moreover, broadening the customer base brings no economies of scale: Gonzales (2007) finds that returns of scale disappear after reaching about 2,000 customers.

We already demonstrated that banks make larger loans than NGOs: these larger loans translate into lower costs per dollar lent, as seen in the second item of Table 2. The median NGO has an operating cost that represents 26% of the value of the loan (26 cents per dollar lent), while for the median bank it's less than half (12 cents per dollar lent). The median NBFI has a cost of 17 cents per dollar lent. So, although NGOs try to keep costs down (even giving lower quality services), they can't recoup the diseconomies of transacting small loans: this is the reason why they charge higher interest rates.

1.4 Customers served by different types of microfinance institutions

Customers of NGOs, banks and NBFIs are analyzed based on their income and the percentage of women. Cull et al. (2009) assume the loan size as a proxy for the poverty of customers (the poorer the customer the smaller the loan). As an evidence of the link between the loan size and the borrowers' poverty, they use Gonzalez and Rosenberg's (2006) work: in their data institutions are asked to self-report on the percentage of poor borrowers among customers and on the percentage of small loans they make. They find that, if the fraction of small loans increases by 10%, the self-reported amount of poor clients increases by 9%: this suggests a rather strong correlation between smaller loans and greater outreach to the poor.

As the third item in Table 2 shows, in order to make comparisons across institutions in different countries, Cull et al. (2009) consider the average loan size as a percentage of the income at the 20th percentile of the income distribution in the given country (they consider the average loan given by the MFI divided by the income at the 20th percentile of the distribution in the country where the institution is situated). For half of the banks the average loan size is more than 224% of per capita household income at the 20th percentile, meaning that their average customer gets a loan that is more than twice the income of the poorest fifth of the national population. For NGOs, instead, the median average loan size is only 48% (they are giving loans that are half the income of poor people). NBFIs are in the middle with a percentage of 160%. Moreover, a quarter of banks give an average loan that is more than 5 times the 20th percentile income. These large loans given by banks demonstrate that their customers are substantially better off than NGOs' clients: nongovernmental organizations are more likely to serve the poorest of the country in which they are. So, these results suggest that there could be a trade-off between pursuing profits and reaching the very poor. Nevertheless, it's important to remember that the evidence does not come from direct measures, but from proxy indicators of customers' incomes.

The NGOs of the sample also serve a higher percentage of women: at least 25% of these not commercialized institutions serve exclusively women and only one out of four NGOs has a percentage of female customers below 63%. On the contrary, 25% of banks serve less than 23 women every 100 customers and for the median bank women represent 52% of all borrowers. Nonbank financial institutions are again in a middle position: for the median NBFI female clients represent 66% of all borrowers. In this case, we could also notice that there are no data about the number of women asking for a loan to NGOs versus those asking to banks and the amount of them approved by the two types of institutions: the difference between the capability of the two types of institutions in reaching female customers could be given by the refusal of banks to serve women (maybe because they are very poor and could ask for very little loans), but also by the fact that women prefer turning to NGOs rather than to banks.

1.5 Portfolio at risk: are all customers able to repay their loans?

In order to study the risk of insolvency, Cull et al. (2009) consider three different lending methods: individual, solidarity group and village bank. Individual lending consists in the usual lending relationship between the bank and individual customers; this method is usually applied in growing markets with larger loan size. In fact, two thirds of the banks in the sample lend through this method. Solidarity groups are appropriate for poorer households: they are group contracts (made famous by *Grameen Bank*) in which customers are asked to associate into small groups and are required to guarantee all other members' loan repayments. In this way the MFI can ensure that clients' incentives are aligned. Usually, when a person of the group defaults, the entire group is denied access to future loans. Also "village banks" are based on group responsibility for loan repayments: this method is generally applied to serve the poorest customers, the ones so costly to reach that are usually excluded from any other form of financial services. In the sample 75% of NGOs lend through one of these two group methods.

The interesting result from the dataset is that the lending method, notwithstanding the different targets associated, doesn't seem to affect the repayment of the loan. In order to appreciate the risk of insolvency, Cull et al. (2009) consider the percentage of outstanding balance of loans for which installments are more than 30 days overdue on the total value of loans outstanding. Referring to the fifth item in Table 2, banks are slightly less at risk than NGOs: for the median bank 2.43% of the total value of loans is more than 30 days overdue, while for the median NGO the percentage rises to 3.54% (an important specification is that data about banks are based on fewer than 10 observations). Obviously this is a static analysis: the data cannot reveal what would happen to loan repayment rates if an institution suddenly switched to a different lending method. So, the measures suggest that, although loans may not be repaid in full, the risk of insolvency is kept under control by all types of institutions. This result confirms the great achievement that is acknowledged to microfinance: microfinance demonstrates that poor "unbankable" customers are actually able to pay back their loans, even in the absence of collateral.

2. Financial sustainability of microfinance institutions

In the first chapter microfinance institutions and their customers have been analyzed, finding remarkable differences between banks and nongovernmental organizations. This second chapter will deal with the financial self-sufficiency of MFIs, with a particular focus on profitability, subsidies and the possibility of attracting private investors. The important results that nonprofit organizations demonstrate also in the financial field will bring to the conclusion that commercialized institutions cannot completely substitute social organizations in the future of microfinance.

2.1 Profitability of for-profit versus nonprofit microfinance institutions

We could expect that commercial organizations seeking for profits have higher profitability than nonprofit organizations pursuing social goals. This trend is confirmed in Figure 2, based on a sample taken from the *MicroBanking Bulletin* (2005).

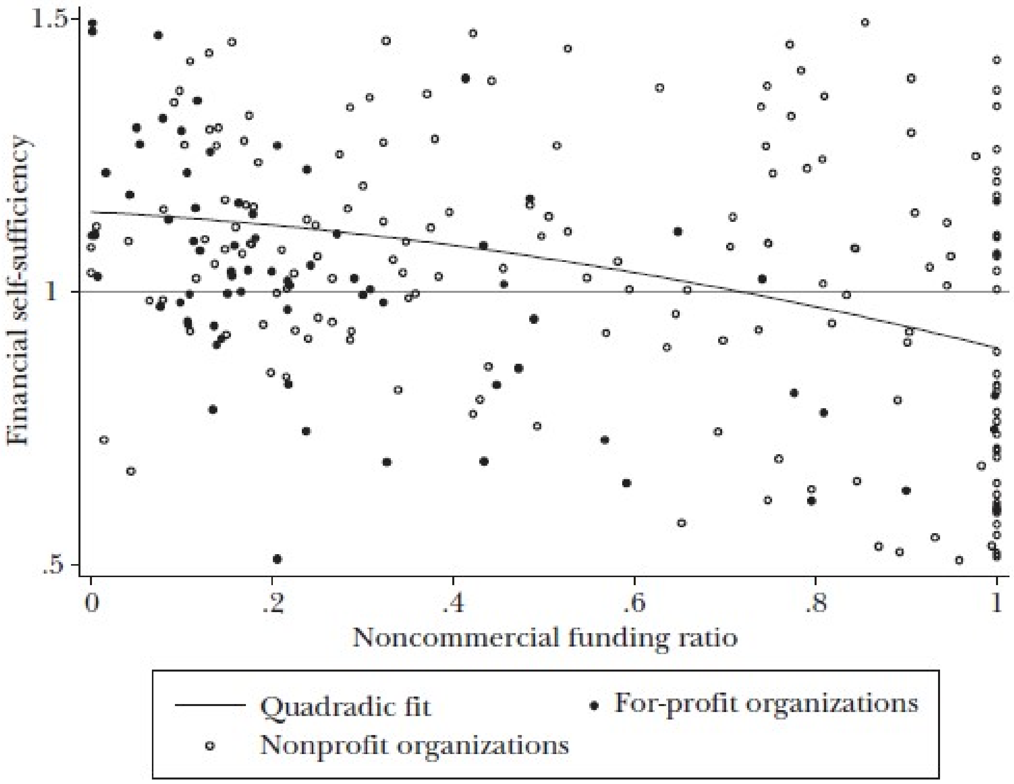

Figure 2. Profitability versus noncommercial funding

Source: Cull et al. (2009)

Profitability is the institution's ability to generate sufficient revenues to cover its costs, with no need for subsidies; it is indicated on the vertical axis by the financial self-sufficiency ratio (if it is below 1, the institution needs subsidies). In order to understand whether an organization is commercialized, the horizontal axis gives the "noncommercial funding ratio" (the sum of donations plus noncommercial borrowing plus equity, divided by total funds): when it is zero, funding comes exclusively from deposits and commercial borrowing; when it is one, the institution is fully dependent on donations, borrowing at below market rates or equity. The quadratic fit confirms the logical intuition: there is a link (although weak) between higher profitability and smaller reliance on donations and noncommercial funding.

The scatter plot of data points is also very interesting: each point represents a microfinance institution (empty circles stand for nonprofit organizations; solid circles represent for-profits). What banks and commercial MFIs are searching for is to be in the north-west area of the graph with high profitability and low reliance on donations. So, the for-profits tend to cluster in this zone; on the other hand, nonprofit organizations can be found in every part of the graph, including the profitable range. Nonprofits can be so successful thanks to social investors, such as international financial institutions (e.g. the *World Bank's International Finance Corporation*) or individuals who invest small amounts of money asking no financial return. These social investors and the subsidies they permit access to are really important for the future of nonprofits.

Going more in depth in the analysis of the sample taken from the *MicroBanking Bulletin*, as Table 3 shows, banks are more likely to be profitable (self-sufficiency ratio higher than 1) than others: 73% of institutions are profitable and about 3.7 million out of 4.1 million bank customers are served by profitable banks. On the other hand, profitable NGOs serve 8 million customers, twice the number of profitable banks. However, a notable remark is that the sample is mainly composed of nongovernmental organizations (NGOs are 148, more than four times banks) and some of them are really large: the immediate implication is that profitable NGOs can serve more clients than profitable banks. About nonbank financial institutions, 60% of them are profitable, but they serve the lowest amount of customers overall and on a profitable basis: they have 2.6 million customers and only 75% of them (about 2 million) are served by profitable NBFIs. Overall, 57% of MFIs in the sample are profitable and they serve 14 million clients out of 16.1 million. This analysis about profitability reiterates that nonprofit nongovernmental organizations are not marginal: they serve more borrowers overall and on a profit-making basis.

Table 3. Profitability of microfinance institutions

	Institutions		***Active borrowers***	
Institution type	Number in sample	Percent profitable	Number in sample (million)	Percent served by profitable institutions
Bank	30	73%	4.1	92%
Nongovernmental organizations	148	54%	8.9	91%
Nonbank financial institutions	94	60%	2.6	75%
Credit union	30	53%	0.5	57%
Total	302	57%	16.1	87%

Source: Cull et al. (2009)

2.2 Private investors: could they be attracted by this level of profits?

In the sample taken from the *MicroBanking Bulletin*, 57% of MFIs are profitable; this is a good result, but it also means that there are still lots of unprofitable institutions. In addition to this, Cull et al. (2009) analyze the profitability of institutions in the dataset from the *MIX*. As shown in Table 4, at the 25th percentile NGOs' self-sufficiency ratio falls to 0.78, against 0.99 of banks and 0.86 of NBFIs. This demonstrates that a quarter of NGOs cannot autonomously cover a large part of their costs. But an indicator of profitability that private investors usually look at is the Return On Equity: the ROE of MFIs in the sample is very various. 25% of NGOs and NBFIs have a negative return on equity (below -10.5 for NGOs and -7.9 for NBFIs). The median of both these types of institutions has a ROE higher than 3%. At the 75th percentile, NGOs reach a ROE of 13.8%, while nonbank financial institutions have a return on equity of 17.8%. Banks have the best performance: the median bank has a ROE of 10%, while a quarter of the banks in the sample have a ROE higher than 22.9%. Considering only profitable institutions, things become better: the median profitable NGO still has the lowest return on equity (11.4%), but the median profitable NBFI has a ROE of 14.4% and the median profitable bank has a ROE of 15.1%. The real question is to understand whether these returns are high enough to attract private investors who have no concerns with social impact.

Although these figures are impressive, the majority of MFIs cannot be appealing for profit-maximizing investors. As a term of comparison, Cull et al. (2009) use *Banco Compartamos of Mexico*: in 2004 (three years before its IPO) it had a ROE of above 50%. This suggests that only the best-performing microfinance institutions could attract private investors; the majority of organizations, on the contrary, should continue relying on social investors.

Table 4. Financial results and funding of different institutions

	Nongovernmental organizations		***Nonbank financial institutions***		***Banks***	
	For different percentiles for this variable	Median if profitable	For different percentiles for this variable	Median if profitable	For different percentiles for this variable	Median if profitable
1) *Financial self-sufficiency ratio*						
25th	0.78		0.86		0.99	
Median	1.03	1.14	1.04	1.16	1.04	1.10
75th	1.17		1.22		1.15	
2) Return on equity (%)						
25th	-10.5		-7.9		1.6	
Median	3.4	11.4	3.6	14.4	10.0	15.1
75th	13.8		17.8		22.9	
3) Subsidy per borrower (PPP$)						
25th	72		0		0	
Median	233	199	32	8	0	0
75th	659		747		136	

Source: Cull et al. (2009)

2.3 The relevance of subsidies and composition of funding across microfinance institutions

In the analysis of *MIX* data, subsidies have been evaluated as subsidy per borrower in purchasing power parity equivalents (see the third item in Table 4). Nongovernmental organizations are the ones absorbing the greatest amount of subsidies: the median NGO receives $233 per borrower and a quarter of NGOs receive subsidies per borrower greater than $659. Half of the banks, on the contrary, receive no subsidy at all. Nonbank financial institutions are, as usual, in a middle range: a quarter of them receive no subsidy, while the median NBFI absorbs $32 per borrower and at the 75th percentile they are even more subsidized than NGOs with $747 per borrower. Also conditioning on profitability, things are exactly what we could expect according to the previous analysis of the outreach to poor customers: the median profitable bank uses no subsidy while the median profitable nongovernmental organization needs a subsidy per borrower of $199 (slightly lower than the median NGO when unprofitable organizations are included). So, although there are many profitable NGOs, the subsidization still plays a notable role also for profit-making nongovernmental organizations.

Cull et al. (2009) go a step further into the analysis of the sample, reasoning on the types of funding and their shares in different institutions: they find that, on average, only 16% of the total funding of banks is given by noncommercial funds (donations, equity, borrowing at below-market interest rates) against the average of 63% of nongovernmental organizations. So, NGOs do have higher operating costs- as demonstrated in the previous chapter- and do need greater subsidization than commercialized organizations. This does not necessarily imply a reduction in efficiency, as stated by the supporters of the profit-driven model of microfinance. Many nonprofit organizations will need the economic support of social investors also in the future in order to face the costs to reach the very poor: proving the broad impact that microfinance can have on social outcomes is crucial to ensure their economic support.

2.4 The future of microfinance: the false choice between the profit-seeking and social-driven models and their development

At the end of 2006 microfinance customers were 133 million (Daley-Harris, 2007); even if only one person per family gets a loan, the entire family will be positively affected. Considering the average family as composed of 5 members, about 665 million poor and low-income people were reached by microfinance worldwide. There is no doubt that these figures will continue growing in the future and microfinance will expand further. But using which of the two models? Is the profit-driven model the only way to the future? Cull et al. (2009) don't believe that commercialization can be embraced as the single way to the future: their analysis shows that nonprofit nongovernmental organizations play an essential role in serving the very poor, especially women, that cannot be completely replaced by commercial banks. Social-driven institutions like NGOs are still indispensable to the cause of microfinance; the two models can survive together. In general, Cull et al. (2009) see the private sector as capable of innovating, growing and adapting; this brings benefits to low-income people (even if not the poorest) and it is anyway important to contribute to demolish barriers to financial access. Moreover, commercial banks are essential tools of savings: by taking deposits, they not only ensure themselves funds for the loan activity, but they also give customers a safe way to accumulate.

An interesting challenge for the future of both commercialized and social microfinance institutions will be finding ways to reduce costs of financial transactions (above all, to keep expenses for managing small deposits low). Technology could result very helpful in this: mobile banking, for example, can reduce costs, increment efficiency and increase the quality of services even in poor communities; it is showing first successes in the Philippines, South Africa and Kenya. Obviously, to harness the potential of technology and make it reach also very poor villages, large investments on new infrastructure (such as electricity and coverage) are needed. MFIs should not underestimate the risks connected to the development of such innovations.

Probably, in the future, microfinance should rethink the principles of lending: today microcredit focuses mainly on funding small businesses which need cash, but the demand for loans goes beyond this urgency. Loans are often asked for other reasons, like paying for school fees or coping with health emergencies. Johnston and Morduch (2008), for example, find that 50% of recent loans given to poor households in Indonesia were not used for purposes related to business. In addition, Rutherford (2006) studies a sample of *Grameen Bank* borrowers, observing that many loans, although labeled as business loans, were used for different purposes.

3. The original social mission: Yunus and his idea

The main problem about commercialization highlighted in the analysis of the previous chapters is the decline of the original social mission intrinsic to microfinance: Yunus came up with the idea of microfinance to help the very poor, after having talked with them and having touched with hands their needs and problems. It was a bottom-up process, that, from local projects and experiments, resulted in the foundation of an autonomous bank under a special law: the *Grameen Bank*. In this chapter the whole process will be summarized, focusing on the effectiveness of microfinance in reaching its social goals. But Yunus's idea is not confined into the boundaries of microfinance: today more and more private companies with explicit social missions are arising and the eventuality of earning profits while positively impacting the society seems always more desirable.

3.1 Yunus's first attempts: finding out the poverty cycle and the solution to break it

Muhammad Yunus was born in Chittagong (Bangladesh) in 1940; he graduated at Chittagong University and, after a Ph. D at the University of Vanderbilt in Nashville (US), he started teaching at Middle Tennessee University. After the Bangladesh Liberation War from Pakistan (1971), he returned to Bangladesh and he became head of the Economics Department at Chittagong University.

The War of Liberation and a devastating series of natural disasters in those years caused a terrible famine in Bangladesh: Yunus was perturbed by this and in 1974 he started acting. What shocked him the most was the fact that, while people died of starvation, fields around the university were not cultivated: so, he created a program called *CURDP (Chittagong University Rural Development Project*) through which he encouraged students to go with him into the village and find ways to improve day-to-day life.

In 1975, in order to alleviate hunger, he focused his attention on solving the problem of irrigation to raise an additional crop in Jobra (a village near the Chittagong University) during the winter unproductive dry season. He called a meeting of local farmers and sharecroppers to propose a new type of agricultural cooperative called the *Nabajug* (New Era) T*hree Share Farm*: during the dry season, landowners would let sharecroppers cultivate their land, using tube-well, seeds, fertilizer and technical know-how provided by Yunus. In exchange each of the three parties would share one third of the harvest. The project, although some farmers gave Yunus less than agreed (causing him a loss), achieved its goal: rice was cultivated and harvested during the normally unproductive season. But following all phases of agricultural production during this experiment, Yunus understood that sharecroppers were not the poorest and, in turn, they were exploiting poorer people, as destitute women who separate the rice from the dry straw ten hours a day for 40 cents. He realized that his recent project had only made things worse for these women. At this point, it was important to distinguish between the very poor and the marginal farmers: the wealthier the farmer (the more he earned from the project), the smaller was the share of the exploited very poor. This convinced him to address only the poorest in his future programs, otherwise the non-poor would reap all the benefits.

Yunus started analyzing the life of the landless poor (day laborers, craft workers or beggars) in order to go at the root of the problem. He talked to women who threshed rice or made bamboo stools and he understood the problem was not the lack of effort (they were really hard workers), but their lack of cash to buy the raw materials: this forced them to buy raw materials from the usurer and sell back the final products to him, earning not more than what was sufficient to keep them alive. In this way the cycle of poverty was almost impossible to end. But there was a way: lending people the small amount of money they needed for the raw materials so that they could sell their handicrafts at fair prices. At this point, Yunus felt the urgency to create an institutional answer for these people to rely on: he went to *Janata Bank*, a government bank located in the Campus University and one of the largest in the country. After talking to the local and regional managers, he managed to convince them to borrow to poor illiterate people if there was a guarantor, Yunus himself, to act on behalf of the borrowers. After six months, in December 1976, Yunus succeeded in taking out a loan from the *Janata Bank* and giving it to the poor of Jobra. More than 98% of the loans were repaid: the poor knew this was their only chance to break the poverty circle.

3.2 The arduous birth of Grameen Bank and its mode of operation

Although this success, traditional bankers did not change their mind about lending to the poor: they still believed the poor were not credit-worthy, since they had no credit history or collateral to offer and, being illiterate, they could not even fill out the necessary paperwork. Moreover, they were not interested in such tiny loans. Finally, in 1977, the managing director of the *Bangladesh Krishi (Agriculture) Bank* agreed to have a special bank branch created in Jobra to test the idea of lending to the poor: this project was called the *Experimental Grameen* (which means “of the village”) *Branch* of the *Agricultural Bank*. In order not to force the poor to deal with large sums, Yunus decided to institute a daily payment program, soon substituted by a weekly one, trying to keep each procedure as simple as possible. Yunus and his collaborators (among whom many students) also discovered the importance of support groups: group membership creates support and a sense of intragroup and intergroup competition. Association should be spontaneous and when 5 poor people have formed a group, they can request a loan to the *Grameen Branch*. After that, prospective borrowers must participate in a training about the duties and responsibilities of a *Grameen Bank*'s member of at least 7 days with a final individual test; if only one of the 5 doesn't pass the test, the entire group cannot obtain the loan. Today the procedure is still the same and it is summarized in the *Grameen Guidelines*. If an individual is unable or unwilling to pay back the loan, the group could become ineligible for larger loans in subsequent years until the repayment problem is brought under control.

Grameen also encourages savings: initially all borrowers were required to deposit 5% of each loan in a group fund; any borrower could take an interest free loan from the group fund (not more than half of it), given all the other members' approval (then, under *Grameen II*, group fund will be replaced by individual savings). About clients, this experimental project had a particular goal: at least 50% of customers should be women. There are several explanations for this: first of all, women were almost completely excluded by the traditional banking system; secondly, lending to women brings more benefits to the entire family. In fact, while men are usually focused on themselves, women focus on their children and the household, bringing more welfare to the entire family. But, integrating women in the project was very difficult, because of socio-cultural customs and religious beliefs. It took more than 6 years to achieve the goal. Also in this case, repayment rates were nearly perfect.

In 1979, the Central Bank promoted the expansion of the experiment: Yunus joined the two-year *Grameen Bank Project* in the District of Tangail. The objective was to demonstrate that the success of *Grameen Bank* was not due to Yunus's personality, reputation and personal involvement, but was replicable on a large scale. At the end of this second experiment, managing directors of the Central Bank were not convinced yet. Yunus made another proposal to demonstrate it: the experiment would have been extended to five very poor areas on a national level, with no costs for the Central Bank. He obtained a guarantee fund of $800,000 from Ford Foundation and a loan of $3.4 million from the International Fund for Agricultural Development (IFAD), based in Rome. In 1982 the expansion program started. But this was not enough: in 1983 Yunus, thanks to the Ministry of Finance Muhith, managed to convert the project into an autonomous bank under a separate law created especially for the purpose: *Grameen Bank*, the bank for the poor, was born.

During the 1980s, *Grameen* expansion program created approximately 100 new branches every year. Responsibility for setting up new local branches is given to young managers. These new young workers receive on-the-job-training: they have a two-day briefing and then they go to various branches to observe the reality of *Grameen* for 6 months. In this way they are immersed in the culture of the poor, learning how to appreciate the unexplored potential of the destitute. At the end of the period of training, they have a debate to criticize what they have seen in the branches and to make their own proposal of improvement. Afterwards, each of them chooses the general location of the future office; they have to draw a map of the area and write reports on the village's history, culture, economy and poverty situation; then, they organize a "projection meeting" inviting all the people in nearby villages, including village leaders, religious leaders, teachers and government officials. The meeting aims at explaining *Grameen*'s procedure and regulations in detail: then the village chooses whether to accept the presence of this bank on its territory or not. At first, convincing people to trust *Grameen* can be an arduous battle.

Yunus's idea had been inspiring for many new projects outside Bangladesh in both developing countries (such as Malaysia and the Philippines) and developed ones (such as in US- the *Good Faith Fund* in Arkansas and the *Lakota Fund* in South Dakota are some examples- and in Europe- e.g. in Poland and Norway, where microcredit was promoted as a tool for social integration and an effective means of giving new meaning to people's lives).

In 2001 *Grameen Bank* launched a program to convert its operational methodology into a newer version called the *Grameen Generalized System* (or *Grameen Bank II*): the main innovations are the possibility of getting flexible loans, a pension savings account and a loan insurance program in the eventuality the borrower dies. Today Grameen Bank is self-reliant, receiving no donation: all loans are paid using deposits. Ever since it came into being, it has made profit every year (except in 1983, 1991, and 1992), but it is not a commercial bank; borrowers own 94% of the bank, the government the remaining 6%. It has 2,568 branches in 81,392 villages, with a total of 8.8 million members (96.5% of which are women). Since inception, it has disbursed $19 million with a repayment rate of 98%, providing not only microenterprise loans, but also housing loans (697,395 houses were built thanks to these loans), education loans (helping 53,453 students) and others. Each borrower has a savings account and every year the bank's profits are returned to the borrowers in the form of dividends. Since its foundation, *Grameen Bank* continued fighting against poverty trying to answer to all needs and shortages of the poor through new *Grameen Companies*. Today the *Grameen* Family is made up of 25 *Grameen Companies*, each of them with a specific goal, as reported in Table 5.

Table 5. *Grameen* Companies

Company Name	Founded	Purpose
Grameen Bank	1983	Financial services for the poor
Grameen Trust	1989	Training, technical assistance, and financial support for MFIs around the world
Grameen Krishi (Agriculture) Foundation	1991	Experimentation and training to improve agricultural practices and output
Grameen Uddog (Enterprise)	1994	Export of *Grameen* Check hand-loom fabrics
Grameen Fund	1994	Social venture capital funding for entrepreneurial start-ups
Grameen Motsho O Pashusampad (Fisheries and Livestock) Foundation	1994	Fish pond and livestock breeding programs
Grameen Telecom	1995	Telecommunications services for the poor
Grameen Shamogree (Products)	1996	Domestic sales of *Grameen* Check hand-loom fabrics, handicrafts and products
Grameen Cybernet	1996	Internet service provider
Grameen Shakti (Energy)	1996	Renewable energy sources for rural Bangladesh
Grameen Phone	1996	Cell-phone service
Grameen Kalyan (Welfare)	1996	Health and welfare services for members and staff of Grameen Bank
Grameen Shikkha (Education)	1997	Scholarship and other assistance to students of poor families
Grameen Communications	1997	Internet service provider and data processing services

Grameen Knitwear	1997	Manufacture of knitted fabrics for export
Grameen Capital Management	1998	Investment Management
Grameen Solutions	1999	Development of IT solutions for business
Grameen IT Park	2001	Development of high-tech office facilities in Dhaka
Grameen Byabosa Bikash (Business Promotion)	2001	Provision of small business loan guarantees
Grameen Information Highway Ltd.	2001	Data connectivity and Internet access provider
Grameen Star Education	2002	Information technology training
Grameen Bitek	2002	Manufacture of electronic products
Grameen Helthcare Trust	2006	Funding for *Grameen* Health Care Services
Grameen Healthcare Services	2006	Health care services for the poor
Grameen Danone	2006	Affordable, nutritious foods for the poor
Grameen Veolia	2008	Safe drinking water for Bangladeshi villages

Source: Yunus, Muhammad, and Karl Weber. Creating a World without Poverty: Social Business and the Future of Capitalism. New York: PublicAffairs, 2007

3.3 Poverty reduction: is the social mission achieved?

Not everyone agrees that microfinance is capable of improving the poor's conditions. Bateman and Chang (2012), for example, even affirm that microfinance can make things worse, since, supporting microenterprises, it goes against the concept of efficiency deriving from economies of scale, it causes de-industrialization of the local economy and it fails to connect with the rest of the enterprise sector. Many others, such as Armendáriz de Aghion and Morduch (2005) and World Bank (2007), consider inconclusive the results of the existing studies on the effect of microfinance on global poverty. In his work, Beck (2015) shows moderate but not transformative effects of microcredit, with outcomes being conditional on individuals' characteristics. In general, critics often argue that microcredit does not contribute to the economic development of a country. But it all depends on the definition of this development: effective results on aggregate figures could be hard to find, but the immediate benefits in the poor's lives are rather evident in the majority of the cases.

Many microfinance organizations (such as *SHARE* in India, *CARD* in the Philippines and *LAPO* in Nigeria) report evidence of material change about food, water and housing: poor people experience fewer months of food shortage, eat more nutritious food and can improve the size of house and the durability of materials. They also report evidence of a positive cognitive change, with more people knowing how to read and /or write and experiencing more self-esteem and confidence about the future. Improvements have been seen also in group dynamics (e.g. more trust, more use of discussion and consensus to take group decisions), community participation and participation in politics. As an example, Yunus reports that in 1997 over 1,750 *Grameen* members (1,485 women and 268 men) and 1,570 members of *Grameen* borrowers' families were elected to local offices in Bangladesh. These achievements demonstrate how poor people can escape social alienation and, thanks to the re-gained self-esteem, they can express their opinion and actively participate in the life of their State.

In addition, microfinance can really produce positive behavioral changes. First of all, the life of poor women (who are the main target of socially oriented organizations) can be improved: especially in developing countries, women can be subjected to many forms of violence, among which economic violence. World Bank (2015) defines economic violence on two levels: "acts perpetrated by systems and structures, as well as by individuals. At the interpersonal level, economic abuse is defined as making or attempting to make an individual financially dependent by maintaining total control over financial resources, withholding one's access to money, or forbidding one's attendance at school or employment. At the structural and institutional level, women might experience economic violence as limited access to funds and credit; controlling access to health care, employment, or education; discriminatory traditional laws on inheritance and property rights; and unequal remuneration for work." Microfinance is aimed at eliminating economic violence. Moreover, if it is connected to empowerment initiatives, microfinance can be particularly useful in reducing also intimate partner violence against women (an example is given by the *IMAGE* "Sisters in life" Study in South Africa). Furthermore, after having increased their incomes through self-employment, *Grameen* female borrowers show a remarkable determination to have fewer children and educate the ones they have.

Microfinance institutions can also educate clients, facilitate access to public and private providers, provide health financing options (such as loans and savings) and even directly deliver clinical care. This improves the health of poor borrowers. According to Leatherman et al. (2010), in Dominican Republic, South Africa and Bangladesh the impact of microfinance combined with health education has proven to have positive results in reproductive health, preventive and primary health care for children, child nutrition, breastfeeding, child diarrhea, HIV prevention, sexually transmitted disease and malaria. Furthermore, Odell (2015) shows preliminary findings about the increase in the use of health care due to basic health insurance products.

Ayyagari et al. (2016), using two complementary datasets, are the first to formally establish that increased access to finance results in increased job growth in developing countries, especially among micro, small and medium enterprises.

These results, although they are mainly self-reported by the organizations that have achieved them, are certainly meaningful and cannot be ignored: microfinance is giving a concrete help in improving the poor's lives.

3.4 Business and social mission beyond microfinance: the social company

Yunus's idea of microfinance is a great example of a player in a "new sector" of the economy: the social-consciousness-driven private sector. Social companies are private-owned companies that have a social impact: they are a new category of entrepreneurs and financiers who have taken a different approach in the last few years, showing that it is possible to create social wellbeing and make a profit. They are different from both profit-maximizing companies and donation-dependent nonprofits. In this perspective, a new model of for-profit corporation was legally created: the Benefit Corporation. The main difference from the other types of companies is in its double bottom line: the B-Corporation must not only return profits to shareholders, but it is also obliged to pursue public benefits. Stecker (2016) even talks about a "triple bottom-line", related to people, planet and profits. This new business structure is fundamental for empowering socially-oriented commercial organizations. The values of shareholders will give the company its moral legitimacy.

Today social companies can act to solve the problems of both developed and developing countries. Government of developed countries are going to face enormous difficulties as the population gets old (more retired people, larger needs for health assistance, fewer young working people) and the market saturates; social companies can help in addressing these challenges through new and innovative approaches. First of all, they can substitute the government in providing public goods efficiently and profitably. An example is given by the *Centro Medico Sant'Agostino*, in Italy: it is a completely private organization and it is capable of offering high-quality and efficient health care services, at the same price (sometimes even lower) of public health care structures. Its main partner is *Oltre Venture:* it is the first Italian social venture capital which helps creative entrepreneurs realizing their project through impact investing. Social impact investing consists in providing finance to organizations which are trying to give an answer to social needs with the explicit expectation of a measurable social (as well as financial) return. This is a second way of answering the needs of developed economies: new businesses, enterprises and organizations are a very strong regenerating force, capable of effectively fighting unemployment and creating a prosperous economy.

Another interesting tool for helping people through private enterprises is given by the "social impact bond" (SIB), a form of payment by results. In a SIB, companies with a social mission receive funding from private investors to make actions in order to produce social outcomes. If these programs actually produce better social conditions, it results in savings to government (which must not give services to needy individuals): part of these savings will be given back to the investors. So, as an example, the government will pay for every person the company manages to keep out of prison, for every child it enrolls at school or for every homeless person that it houses, but it will spend nothing for unsuccessful projects: the risk of social results is shifted to private investors, while the government bears no risk. A great model is given by *MHSA (Massachusetts Housing and Shelter Alliance) Boston*, which is an independent nonprofit organization dedicated to ending homelessness in Massachusetts.

On the other hand, in developing countries many people are left out of the market and even their basic needs remain unanswered. In this case social companies and commercial enterprises which have also social goals are fundamental to take those opportunities that profit-driven companies can't even see. An example is given by *Unilever* that, collaborating with *Oxfam, Population Services International (PSI), Save the Children, UNICEF* and the *World Food Programme*, is taking concrete action to improve life conditions in destitute community in the poorest areas of the world. Many others, such as *Danone* and *Veolia* are collaborating with social organizations to solve developing countries' more urgent problems and, in addition, more and more organizations which pursue only social goals are arising. A mention deserves *StreetwiZe mobile school*, an organization including 50,000 activities in Africa, Asia, South America and Europe. Its objective is to bring a "Mobile School" to street children: each school cart has over 300 games designed not only to teach children how to read and write, but also to develop their talent in their environment. The project has been financed through a business strategy course based on street children's lives, in which top managers of companies such as *Ikea* and *Nike* can learn how to take a positive view and make quick and effective decisions as street children are able to do.

Conclusion

In this work the microfinance sector has been analyzed, using a dataset from the *MIX* (data refer to the period 2002-2004), comparing commercialized and not commercialized institutions: nonprofits are the majority in the sample, they serve more borrowers, more women and even more clients on a profitable basis than for-profits, but they have less assets and absorb more subsidies; commercialized institutions, on the other hand, serve less poor customers, give larger loans, are more likely to be profitable and charge lower interest rates (since their loans are larger, their operating costs per dollar spent are lower). Anyway, only top institutions with very high ROE could attract private investors. Because of all these differences and since half social-driven institutions usually completely recover their costs, commercialization of microfinance is a way to the future, but not the only one. On the contrary, the social mission that gave birth to microfinance is a really present concern.

Microfinance was born thanks to Yunus's idea: he saw poverty in Bangladesh and talked to the very poor in order to understand the reasons behind that misery. It was not their lack of skills: usually they were hard workers. It was the lack of money to buy raw materials for their businesses: all they needed were few dollars to initiate their activities and sell their products at fair prices. After several local experiments, the *Grameen Bank* was founded: it is a private institution with the specific social mission of letting people escape poverty. Lots of similar microfinance institutions were born all over the world: it seems that they are reaching their social goal and many men and women are enjoying better life conditions. This is the reason why the "social business model" of microfinance should not succumb. Actually, many other social companies are arising for providing public goods or helping disadvantaged people in both developed and developing countries.

This work suggests that it is possible for organizations to focus on a social mission, while remaining efficient and even making a conscious profit: it enriches the entire community, not just the shareholders. It's a sustainable way of doing business: it produces wealth and, as in the case of microcredit, it can produce new business, with a regenerating force that makes the economy prosperous. As people continue to strengthen their social conscience, companies driven by social missions will continue to develop and play an essential role in the future economies.

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