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Microloans, Macro Impact

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Introduction

- Nearly half of today's population is living in poverty, meaning that they are living on less than \$2.50 a day
- Microcredit and Microfinance refer to the opportunity to obtain banking services and financial products to individuals who are typically considered "non-bankable"
 - Subprime or Risky Borrowers
- Traditional Banking typically requires a borrower to prove they are credit worthy and have collateral before they can obtain a loan
 - A credit score indicates the past borrowing history of an individual
 - An individual who cannot prove their credit worthiness will pay higher premiums
- Microfinance Institutions are Non-Traditional Lenders
 - Do Not Require a form of security or collateral
- Access to a loan gives individuals the ability to create sustainable income producing businesses to consistently earn an income and payback the loan in comparison to a one time charitable gift

Muhammad Yunus and The Grameen Bank

- Nobel Peace Prize 2006 for "creating economic and social development from below"
 - Does creditworthy mean trustworthy?
 - The wealthy can always get access to loans, which implies more money, while the poor cannot obtain loans
 - Yunus believes that Credit is a human right
- Believes that anyone, given the skills and the chance to borrow money, can manage their finances with a high repayment success
- The loans are used to start sustainable businesses to create reliable incomes

Analysis of Micro Lending

- High interest rates means high cost of borrowing for the borrower
 - Interest Rates are the Cost of Money
- Riskier investments require higher returns on investments for the lender
 - Risk vs. Reward
- **Income from Loans =**
 - + Cost of Funds:
 - + Cost of Debt and Equity to fund the upfront capital
 - + Loan Loss Expense:
 - + Reserve for others missed Loan Payments
 - + Operating Expense:
 - + Employment Compensation, Cost of Implementing Loan Management Activities and Lessons, Firm Assets
 - + Profit

Other Interest Rate Determinants

- Risk Free Rate
- Currency Risk
- Political Risk
- Specific to Micro Lending: Peer Groups for support and availability of funds

Benefits of Microfinance

- Confidence of having money in the bank
- Creates successful entrepreneurs and not objects of charity
- The Multiplier Effect in practice

Implications of Microfinance

- Subprime lending is expensive for both the borrower and lender
- Difficult to ensure that the money is going towards the intended purpose
- Micro Finance Payback Support Groups structure can limit another's ability to obtain a loan

Discussion

- Business vs. Charity?
 - Loans are Costly for Subprime Borrowers
 - High Interest Rates
 - Nature of the services and risks associated with Micro Lending
 - For Profit Businesses Require a Profit Premium
 - Is profiting from people in poverty ethical?
- Money Management lessons and security of a safe place to hold money is worth the expense of high interest payments
- Reduce severity of poverty and increase quality of life

Impact of Microcredit in Bangladesh:

- Group Method or "peer pressure" encourages a 90% repayment success rate with a 15% drop out rate
- For every 100 taka, household consumption increases:
 - 18 taka for Women
 - 11 taka for Men
- Poverty falls by 15% for the moderate poor and 25% for the ultra poor when they borrow a loan for up to 3 years
- In Grameen Bank Villages, individuals with one or no loans have a poverty rate of 76% while those borrowing five or more loans have a 57% poverty rate

Micro Finance in the US

- Welfare
 - Implement a payback program or keep as is?
- J.P. Morgan
 - Small Business Forward Movement
 - Encouraging local, small business owners to hire other members of the community to reduce unemployment

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