

IRDIP	Integrated Rural Development Program (India)
MBB	<i>Microbanking Bulletin</i>
MFI	microfinance institutions
NGO	nongovernmental organization
PROGRESA	Programa de Educación, Salud y Alimentación (Mexico)
RBI	Reserve Bank of India
ROSCAs	rotating savings and credit associations
SEWA	Self-Employed Women's Association (Ahmedabad, India)
UNDP	United Nations Development Program
USAID	United States Agency for International Development

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Rethinking Banking

1.1 Introduction

Every day about a hundred people go to work in an unassuming brick office building in the Mohammedpur neighborhood of Dhaka, the main office of ASA—the Bengali word for hope and the acronym of the Association for Social Advancement. ASA is a nongovernmental organization (NGO) that at the end of 2003 provided banking services to nearly 2.3 million customers in Bangladesh. Unlike many commercial banks, ASA's present headquarters contains no marble floors and no plush rugs. Accounting procedures are so streamlined that the accounting department is housed in a single room where thirteen staff members keep an eye on the numbers for the entire operation. If the headquarters is surprising, the clients are even more so. Target clients are the wives and mothers of landless laborers and small-scale farmers with average monthly incomes around \$50, borrowing on average around \$120 per loan. Traditional commercial banks avoid this population. First, the loans are so small that profits are typically hard to find, and, second, lending seems risky since the borrowers are too poor to offer much in the way of collateral. But in 2003 ASA reported loan recovery rates of 99.9 percent, and their reported revenues have fully covered costs in every year since 1993.¹

ASA and institutions like it challenge decades of thinking about markets and social policy in low-income communities. For many observers, microfinance—a collection of banking practices built around providing small loans (typically without collateral) and accepting tiny savings deposits—is nothing short of a revolution or a paradigm shift (Robinson 2001). To others, microfinance is still to be fully developed and tested by time. Few will disagree, though, that microfinance has already shaken up the world of international development. One of the

most striking elements is that the pioneering models grew out of experiments in low-income countries like Bolivia and Bangladesh—rather than from adaptations of standard banking models in richer countries.

Entrepreneurs, academics, social activists, and development experts from around the world have been drawn to microbanks and NGOs like ASA. They are attracted by the lessons about retail banking through microfinance, as well as by the promise that banks like ASA hold for getting much-needed resources to underserved populations.² Scores of doctoral dissertations, master's theses, and academic studies have now been written on microfinance. Some focus on the nontraditional contracts used to compensate for risks and to address information problems faced by the microlenders. Others focus on microfinance as a way to better understand the nature of markets in low-income economies—with possible lessons for how to supply insurance, water, and electricity through markets rather than through inefficient state-owned companies. Still others focus on the ways that microfinance promises to reduce poverty, fight gender inequality, and strengthen communities. This book provides a critical guide to some of the most important new ideas.

The ideas give reasons for hope. Banks and NGOs like ASA are flourishing at a time when the effectiveness of foreign aid to ease the burdens of the world's poor faces fundamental questions (e.g., Boone 1996; Easterly 2001). Governments around the world routinely face criticism for at times being corrupt, bloated, and uninterested in reform. Against this background, banks and NGOs like ASA offer innovative, cost-effective paths to poverty reduction and social change.

ASA is not the only microlender flourishing in rural Bangladesh. ASA's management could learn from the experiences of the pioneering Grameen Bank and from BRAC (formerly the Bangladesh Rural Advancement Committee), now Bangladesh's largest microlender. By the end of 2003, Grameen had 3.1 million members and BRAC had 3.9 million. In Bangladesh, microlenders collectively serve roughly 10–12 million clients, nearly all of which had been written off by commercial banks as being “unbankable.”³

The institutions anchor a movement that is global and growing. Microfinance programs have created new opportunities in contexts as diverse as villages along the Amazon, inner-city Los Angeles, and war-ravaged Bosnia. Programs are well-established in Bolivia, Bangladesh, and Indonesia, and momentum is gaining in Mexico, China, and India.

Table 1.1
Growth of microfinance coverage as reported to the Microcredit Summit Campaign, 1997–2001

End of year	Total number of institutions	Total number of clients reached (millions)	Number of “poorest” clients reported (millions)
1997	618	13.5	7.6
1998	925	20.9	12.2
1999	1,065	23.6	13.8
2000	1,567	30.7	19.3
2001	2,186	54.9	26.8
2002	2,572	67.6	41.6

Source: Daley-Harris 2003, Table 1.

Table 1.1 shows the results of a survey conducted by the Microcredit Summit Campaign. By the end of 2002, the campaign had reports of 67.6 million microfinance clients served worldwide by over 2,500 microfinance institutions. Of these clients, 41.6 million were in the bottom half of those living below their nation's poverty line (defined as “the poorest”; Microcredit Summit 2003). Between 1997 and 2002, the numbers grew on average by about 40 percent per year, and the movement's leaders expect to continue expanding as credit unions, commercial banks, and others enter the market.

Microfinance presents a series of exciting possibilities for extending markets, reducing poverty, and fostering social change. But it also presents a series of puzzles, many of which have not yet been widely discussed. One aim of this book is to describe the innovations that have created the movement. Another aim is to address and clarify the puzzles, debates, and assumptions that guide conversations but that are too often overlooked. Debates include whether the poorest are best served by loans or by better ways to save, whether subsidies are a help or a hindrance, whether providing credit without training and other complements is enough, and which aspects of lending mechanisms have driven successful performances. Many of the insights from the microfinance experience can be seen fruitfully through the lens of recent innovations in economics (especially the economics of information, contract theory, and the mechanism design approach). Other microfinance insights point to areas where new research is needed, especially around possibilities and constraints for saving by the poor and for estimating social impacts.

