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THE ROLE OF FORMAL ACADEMICIAN IN PROMOTION OF MICRO-FINANCE

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ABSTRACT

Microfinance is no panacea for the alleviation of poverty in the world. The environment influences its development. Legal frameworks, monitors and supervisors, its institutions and last but not least its customers with all their commitment play a major role for the success. Due to informational asymmetries, traditional financial markets are limited or fail to include poor households. Microfinance is able to overcome these imperfections and was developed especially for poor people suffering from financial exclusion and often dependent on informal sources such as exploitative moneylenders. The different benefits, characteristics and products of microfinance will be highlighted hereafter. First a general country profile will be given with the most important economic features such as the development of GDP, economic structure, inflation and unemployment rates. The latter raises concerns, especially among young academics.

Keywords:
Alleviation of poverty, traditional financial markets, moneylenders.

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1. INTRODUCTION

Credit is more than business. Like food, credit is a human right. We believe that poverty does not belong in a civilized human society. It belongs in museums. We create a Poverty-free world "(Yunus, 2003, p. 259). Microfinance has gained importance over the last years. It is mainly thanks to Muhammad Yunus and due to the Millennium Development Goal campaign of the UN that in many developing countries microfinance programs make their contribution to alleviate poverty in the world and help poor people to grow out of their vulnerable situation. Microfinance is seen as a tool to smooth household consumptions and provide the possibility for poor people to live in dignity. While Europe and the Western World were struggling in the debt crisis, many developing countries were experiencing troubles with their microfinance sector. Even if the financial crisis had no direct effect, poor people suffered from rising food prices (Reille, 2009, p. 2). Does microfinance offer a solution here? May the world help the poor? How can they be included in financial systems? These are the main questions asked in this paper. The following text is structured in two parts, a theoretical part and a country analysis. The first part will give an overview of microfinance in general, its history with its development until today. Who offers microfinance?

Where are the customers? What are the different qualities and benefits? To answer these questions, an explanation will be offered regarding why poor people are excluded from the traditional financial market and how microfinance is able to overcome most of the problems banks face. Gender also plays a major role, as women are seen the better clients, but why is this so? What are the different lending technologies and how high are repayment rates in the microfinance sector? It is important to understand the different target groups, mostly poor people living in rural areas mainly in developing countries. These clients lack collateral and can't offer any security for their credits; operating costs for screening and monitoring are also high and discourage formal banks from operating in such areas. Microfinance institutions operate close to their customers mainly in rural areas, providing financial products and services for a higher price than banks do. The second part concerns a country analysis. I have therefore chosen a lower middle income country from North Africa, the Kingdom of Morocco, with a microfinance sector that is still young. Also the very high illiteracy rate is a major challenge for Morocco. Microcredit programs have been introduced in order to fight poverty in the Kingdom. The microfinance sector in Morocco will be highlighted in detail. First, the historical development from the early 1990s will be addressed before the legal framework in Morocco is considered including the microcredit law Dahir1 N° 18-97 adopted in 1999 by the Government, which plays an important role.

Laws, regulation and supervision of the microfinance market have a strong influence on the developments of the sector, for example on the product range or the legal form of microfinance providers. What does the law regulate? Has it been modified? Moreover, to get deeper into the developments of the microfinance market in Morocco an overview of the main actors in the microfinance sector will be given. Who are the key players in the sector? How is market shares distributed? The situation in the Kingdom of Morocco represents a unique development of the microfinance sector. It has exhibited astonishing growth in the past, but it is still too early to say for sure whether the lessons learned from the crisis will ensure today's Moroccan microfinance can grow sustainably.

DEFINITION OF MICROFINANCE

Microfinance refers to the provision of various small-scale financial products and services offered to households which do not have access to the formal financial market. It is mainly used in developing countries where people most suffer from poverty. Due to the demand for only very small amounts and the lack of collateral, traditional banks exclude these poor households (Karlan and Goldberg, 2011, p. 20). Microfinance is therefore seen as the tool to *bank the poor*, sometimes also called the bankable. There is no clear definition of microfinance (sometimes also called microcredit, however it is only one micro-product of a wide range, the different products will be explained later). Some organizations define it by asset volumes or number of employees (Ledgerwood and White, 2006 p. 30) although most organizations or microcredit programs have the same goals, their focus may differentiate from country to country.

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Karlan and Goldberg (2011) identify nine conventional features of microfinance:
1) Small transactions and minimum balances
2) Loans for entrepreneurial activity
3) Collateral-free loans
4) Group lending
5) Focus on poor clients
6) Focus on female clients
7) Simple application processes
8) Provision of services in underserved communities
9) Market-level interest rates.

The mentioned properties do not have to be present at the same time. A detailed explanation of the mentioned characteristics and the importance of microfinance will be given below. This paper focuses on the microfinance sector in Morocco, where microcredit is the core product due to the existing law.

In other countries the range of products has developed further, away from credits only (both will be described later), we should also consider the official definition from the Ministry of Economy and Finance who defines microcredits as follows: "Any loan granted to help people with limited economic resources to set up and develop their own production or service activity, with the aim of ensuring their economic.

ORIGINS AND HISTORY OF MICRO-FINANCE

The idea of microfinance is not as new as many may think. Friedrich Raiffeisen, a German village mayor, started a credit cooperative movement as early as the 1850s, providing new group-based financial services to the poor, mainly those living in rural Germany. His credit cooperatives were afterwards copied in several countries around the world and are still used today (Armendáriz and Morduch, 2007, p. 68). In the 1950s, subsidized credits for the agricultural sector within the scope of development aid were introduced without success. Later, in the 80s, state-owned development-banks and programs from international donor organizations giving credit to farmers and special groups also failed (Felder-Kuzu, 2005, p. 29). During the same period however, microcredit programs were successfully providing loans to poor households, although with a limited outreach and a small number of clients. However, the real evolution of microfinance started some year's later (Glaubitt et al., 2006, p. 213). While the origins of microfinance stretch far back in time, it was Muhammad Yunus who brought the topic to the public at large in the 1970s. In 1976 he granted his first loans to 42 people in the village of Jobra, Bangladesh, totaling 856 taka, about 27 dollars (Yunus, 2003, p. 49). He constantly developed and improved his program and finally founded the Grameen Bank in 1983 (Yunus, 2003, p. 119). The real evolution of microfinance started in the 1980s with "isolated donor-dependent microcredit programmes" (Glaubitt et al., 2006, p. 213) which evolved in a second stage in the beginning of 1990s to become sustainable and professional organizations with better integration into the finance sector and within a more regulated framework.

By the end of the 1990s networks within the microfinance sector were created and a broad range of qualified products could be offered (Glaubitt et al., 2006, p. 215). The increasing importance of Microfinance can also be observed in various well-publicized official endorsements. The United Nations (UN) for example declared 2005 the International five Year of Microcredit, elevating it from its niche market image (Year of Microcredit, 2005). Furthermore, in 2006 Muhammad Yunus and the Grameen Bank were awarded with the Nobel Peace Prize “for their efforts to create economic and social development from below” emphasizing those microcredits can help to reduce poverty in the world (Nobel Prize, 2006).

2. LITERATURE REVIEW

MICROFINANCE INSTITUTIONS

Microfinance is not only in the interest of socially oriented organizations, it can also be observed throughout different sectors and institutional bodies. So called Microfinance Institutions (MFIs) can appear in different forms: as a governmental or non-governmental organization, a credit cooperative, as private credit institute, self-help group or bank-near financial service provider (Maeser, 2008, p. 5) which can be grouped into four categories: NGOs, specialized institutions, banks and governments (Islam, 2007, p. 62). Microfinance programs operate in the formal sector, such as banks which are fully regulated, as well as in the semiformal sector as cooperatives, village banks, self-help groups etc. monitored by the government, and in the informal sector (Felder-Kuzu, 2005, p. 28). “The traditional informal finance includes: moneylenders, pawnshops, loans from friends and relatives, consumer credit in informal markets, credit unions, ROSCAs, money-guards, hire purchase stores, check cashing outlets, and NGOs” (Islam, 2007, p. 64). This sector is characterized by the absence of official regulation, monitoring or supervision. Especially in developing countries, it represents an important source of employment and hence economic growth and is essential for the rural population, which often has no other means to get money in order to start a business (Islam, 2007, p. 64).

MFIs have different motivations and intentions. Theories suggest that most MFIs have two main aims: outreach – to serve as many clients as possible – and sustainability – to cover costs and become independent from donors and subsidies (Maeser, 2008, p. 5). However, experts have different opinions, and this will therefore be further discussed in the critique. As shown in the evolution of microfinance, different approaches are implemented. Besides the fact that NGOs are no longer the only actor institutions that develop into financial intermediaries, more and more banks are showing interest in becoming microfinance service providers.

So far, four approaches can be observed: up-grading, linking, Greenfield and downscaling (Glaubitt et al., 2006, p. 216). Up-grading presents a common approach, when microfinance organizations – mostly NGOs – transform into microfinance banks. The complementary linking approach describes the connection of MFIs with the national or international banking market. On the contrary, there may be commercial banks that discover the microfinance sector as a promising investment opportunity which prompts their restructuring (downscaling approach) or use the Greenfield approach, i.e. founding a new microfinance provider (bank) which offers its services on a commercial basis (Glaubitt et al., 2006, p. 216).

QUALITIES OF MICROFINANCE

- **Benefits of microfinance**

Theories suggest that microfinance may have many different positive impacts on poor households although there is little empirical work supporting these outcomes. "Credible measurement of the impact of financial services is challenging. Correlation does not prove causality (Littlefield et al., 2003, p. 2). Moreover, most microfinance programs evoke spillover effects which are difficult to observe. Non-participants such as family members, neighbors or people of the community may be influenced in their welfare, both in a positive or in a negative way (Karlan and Goldberg, 2011, p. 49). All in all, measuring the real impact of microfinance programs is very difficult, and further impact studies need to be undertaken. Yunus (2003, p. 259) emphasizes credits to be a human right, helping people to grow out of poverty by having access to financial services. Poverty reduction is the main idea behind most microfinance programs. Many experts identify microfinance as an important tool for poor seven households to smoothen consumption. Poor people are especially exposed to vulnerabilities concerning unforeseen expenditures (bad weather, death, illness) as they have no assets or savings to rely on.

In many cases they are affected by financial problems leading to health problems because they cannot afford medical services (Ströh de Martinez, 2011, Karlan and Goldberg, 2011). The United Nations (UN) indicates that microfinance is an important instrument in reaching the Millennium Development Goals (MDGs) (Hermes and Lensink, 2007, p. 1). Microfinance may not only contribute to the first goal being reached by halving the amount of people suffering from poverty and hunger by 2015, but it also may help to improve children's education, health issues and women's empowerment in overcoming vulnerabilities to name just a few you. Additionally, Felder-Kuzu (2005, p. 62) indicates that microfinance is able to lift the living standards of people and their communities (especially in developing countries), to promote an entrepreneurial spirit, to equilibrate the global community by reducing the gap between poor and rich and to improve capital flows. "Poor households are being given hope and the possibility to improve their lives through their own labor. Access to microfinance is credited with reaching the poorest, increasing their income to have a sustainable impact in alleviating rural poverty (Islam, 2007, p. 3).

- **Collateral and Operating Costs**

One of the most important differences to the approach of traditional banks is that MFIs grant loans without collateral. The main target group is poor households and therefore most of their possible clients do not possess anything valuable that could be used as collateral. This lack of securities is solved by the group lending approach, which is the characterizing feature of most microfinance programs (Armendáriz and Morduch, 2007, p. 134). Some organizations recently shifted their requests towards a more flexible approach to collateral (mainly in the individual lending). There were eight MDGs developed and agreed in 2000 by around 150 countries and development organizations at the Summit of the General Assembly of the UN. The set of goals are to reach until 2015. The MDGs are: 1. Eradicate extreme poverty and hunger 2. Achieve universal primary education 3. Promote gender equality and empower women 4. Reduce child mortality 5. Improve maternal health 6. Comat HIV/AIDS, malaria, and other diseases 7. Ensure environmental sustainability 8. Global partnership for development (UN, 2013)

More details about the MDGs and microfinance may be found in Littlefield et al. (2003): CGAP Focus Note: Is microfinance an effective strategy to reach the Millenium Development Goals? Personal value to the borrower, or they demand financial collateral, where future borrowers first have to save a certain amount. Demonstrating the ability to save demonstrates characteristics like discipline and money management skills that correlate with being a good borrower (Armendáriz and Morduch, 2007, p. 136).

Operating costs are another reason for commercial banks to stay out of the micro-market, as they are too high to achieve profits. Offering small-scale credits (or savings) is very cost intensive, as providers have to screen the market carefully, find and reach (especially in rural areas) possible borrowers, which then must be constantly monitored and finally repayments must be ensured. It is estimated that these costs may be up to 15 – 40% of the loan size (Armendáriz and Morduch, 2007, p. 29). In other words “commercial banks will understandably avoid places where collateral is scare and operating costs are high” (Armendáriz and Morduch, 2007, p. 27).

- **Informational asymmetries**

For generations poverty has reproduced poverty and microfinance is seen as a way to break the vicious circle by reducing transaction costs and overcoming information problems (Armendáriz and Morduch, 2007, p. 8). Information about future clients is important. Usually commercial banks do not know their potential customers. They lack vital information such as the level of riskiness or behavior of their potential customers. It is very difficult and costly for banks to get this necessary information. This phenomenon is known as informational asymmetries (Armendáriz/Morduch, 2007, p. 25). MFIs or local moneylenders have a clear advantage as they operate close to their customers, and are present in their villages to observe and monitor. Agency problems caused by informational asymmetries may lead to moral hazard and adverse selection. In most cases, microfinance presents a tool to overcome these difficulties.

The Agency problem, also called the principal-agent problem, refers to a control and trust problem “whenever there is an arrangement in which one person’s welfare depends on what another person does” (Pindyck/Rubinfeld, 2012 p. 646). In the case of microfinance, the agent is the customer (borrower) seeking for a credit from the principal, the MFI (lender). Difficulties may arise, when the aims of these two parties differ and when borrowers act in their own interest, rather than in the one of the lender. Moreover, the principal does not know the agent’s intentions or behavior (in terms of riskiness) before he grants a loan (Pindyck and Rubinfeld, 2012 p. 645). The problem can be divided into three different stages prior to the contract; the lender lacks information about the borrower’s quality. It is very costly for him to screen the market for possible *safe* borrowers which can be distinguished by default risk. Safe borrowers dread risky investments and are more cautious regarding their attitude regarding their loan. The quality of the obtained information is important for determining the interest rate.

When the contract has been made and the loan granted, it is unclear with how much effort the borrower tries to repay the loan. The lender doesn’t know the borrower’s true profits, and has to trust him. Thus could be an incentive for the borrower to lie about his ability to repay. As the lender lacks important information he has no mean to enforce repayments or to impose a sanction (Armendáriz and Morduch, 2007, p. 35). Accordingly this is why commercial banks are typically not represented in villages and rural areas in most developing countries; they are too costly to operate without any enforcement mechanism or collateral. Microfinance is designed to overcome these information problems.

It entails suitable instruments to guarantee and enforce repayments. These include the group lending approach, as well as cross-reporting, a mechanism to obtain important information from other borrowers or neighbors. Participants often fear social sanctions or exclusion, so MFIs make use of it to overcome the agency problem (Armendáriz and Morduch, 2007, p. 141). Adverse selection is a hidden information problem before any purchase or loan agreements are made. It occurs when products with different quality are sold at the same price. However the buyer (or seller) lacks important information about the real quality of the product (or the client in case of microfinance), with the result that more of the low-quality products and less of the high quality products are offered. On the credit market, before the loan agreement is made, it is difficult for the bank to distinguish between risky and safe borrowers. The lender wants to cover his costs to break even, so he estimates his risk and the amount of risky and safe borrowers on the market. He will calculate his worst case scenario and therefore set quite high interest rates.

These high interest rates will not be accepted by safer borrowers, who leave the market, which in turn will raise the price for the lender further, so he will not want to offer any credit. Credit rationing occurs due to asymmetric information, which will lead to inefficiencies. The information problem results in an interest rate that does not appeal to all creditworthy borrowers. Microfinance therefore tries to reduce the inefficiency by expanding the access to the market and by improving the distribution (Pindyck and Rubinfeld, 2012 p. 634, Armendáriz and Morduch, 2007, p. 37). Moral hazard describes both an incentive and enforcement problem: “it refers to situations where lenders cannot observe either the effort made or action taken by the borrower, nor the realization of project returns” (Armendáriz and Morduch, 2007, p. 43). A distinction can hereby be made between ex ante and ex post. Ex ante moral hazard describes the information problem of the lender has after granting a loan but before benefits are made, as the efforts made by the borrower to realize his project cannot be observed. In contrast, ex post moral hazard refers to the situation after the loan was granted while the project is running, but the lender cannot observe the real profits made. The borrower could have incentives to lie about his real return or decide not to repay, against what the lender has no means to enforce repayment. MFIs have developed tools to observe returns in order to apply enforcement mechanisms. Furthermore, MFIs apply group credits with joint liability. Group members select themselves, knowing important features of one another, so the risk for the lender will be reduced (Armendáriz and Morduch, 2007, p. 43).

- **Different products of microfinance**

Based on the experiences gathered with the first programs, products have been extended from microcredit programs towards a wide range of microfinance services. Today the focus is no longer only on credits but on a wide range of different financial products and services. MFIs offer micro insurance (e.g. for life, property, crop or rainfall), pension funds, savings and deposits. Moreover, there are other services such as skills training and education or remittances services (Karlan and Goldberg, 2011, p. 24). Customers now have choice of different microproducts. Depending on the needs of the customers, one product or the other suits best. Besides access to credit, savings are important as well. They work as a complement in microfinance for poverty reduction. It is seen as essential for poor people to save in order to improve their welfare and become less vulnerable as they are then able to smooth household consumptions. The importance of savings and the ability of poor people to save were discovered during the 1980s (Ströh de Martinez, 2011 p. 10).

It presents a major challenge for poor households to save by themselves. Difficulties in saving may arise due to different personal or social reasons such as theft, husbands taking money away, or due to the lack of discipline (household budget planning to foresee necessary consumptions). Other reasons may be social commitments, for example a commitment to help neighbors in the event that one has made surpluses may prevent people from saving. Furthermore poor households need a MFI, who they can trust in, offering a saving account or plan which suits their individual needs. Different ways of saving exist e.g. postal-saving (deposit at a local post office), ROSCAs (rotating savings and credit associations work like the group-lending approach, where a group of people regularly contributes – saves – until each member once received money) or low and high-frequency saving (regular long-term, resp. short-term saving). Savings can also be profitable for MFI, as the deposits help to reduce external financing and help to become more independent and sustainable (Armendáriz/Morduch, 2007, p. 147).

In Morocco rainfall insurance was introduced as a promising pilot program. Research has shown a correlation of 60 to 80% between cereal revenue (main agricultural product in Morocco) and rainfall. This approach is seen optimistically because a wide range of businesses will benefit from this insurance such as shopkeepers, craftsmen or traders (Armendáriz and Morduch, 2007, p. 169). Due to the different needs in the respective areas or countries, the micro programs and products offered differ as well.

TARGET GROUP OF MICROFINANCE

The focus on group-lending, poor people and the provision of services in underserved communities as well as the focus on women are important features of microfinance products and clients.

- **Lending technologies and repayment**

Muhammad Yunus introduced his microcredit program and granted loans to groups of five people. Hence *solidarity groups* (or group lending, the terms are used synonymously in the following) became the classical microcredit model. In the beginning, a loan will only be given to two of the five members. If they repay without problems, the loan will be granted to the next two members, and if successfully repaid, finally the last member will gain access to credit. These or similar strategies are applied throughout the microfinance sector (Armendáriz and Morduch, 2007, p. 87). Solidarity group loans have different advantages; they help to overcome the collateral and asymmetric information problem. Group loans are characterized by their joint liability. All members are commonly responsible for the repayment of the loan, so if one defaults all members will be punished and future loans may be refused. This enforcement mechanism transfers the risk from the lender to the borrower and may give incentives to work harder (Hermes and Lensink, 2007, p. 2).

Furthermore there exists a village banking model, which works like the solidarity group lending, only with large groups of 15 to 30 people (Yunus, 2003, p. 62ff). Yunus (2003) argues that these support groups are essential for success as they enforce solidarity among participants and makes borrowers more reliable. In case of difficulties, members get support from the other group members, or the whole group may seek help from other groups in the community. Therefore groups became the target of microcredit programs, as this group lending mechanism may replace collateral and diminish the risk for the lender. These solidarity characteristics also work for monitoring and supervision, reducing the asymmetric information problem, as well lowering transaction costs. Economics of scale (in this case providing products and services to many people at once), therefore make group loans profitable and desirable for the lender (Maeser, 2008, p. 7). The composition of groups also plays an important role. “The theories that stress the positive roles of social capital and social sanctions suggest that less diverse groups will do better. Where collusion is a possibility, on the other hand, the opposite may hold: Greater diversity may aid repayments by diminishing the chance for collusion” (Armendáriz and Morduch, 2007, p.108).

Moreover, geographical proximity among group members and cultural similarity may further help to increase repayments. The real impact of social ties however remains doubtful. Results from different studies comparing self-selected groups (with social ties), and groups scheduled by the lender (or researcher) show little difference. Important are alternative options to borrow, as they may influence the success. If there are several suppliers of microfinance services there could be an incentive not to repay. All in all, it is still difficult to describe one successful outcome strategy (Armendáriz and Morduch, 2007, p. 99). Besides the group lending approach, recent developments in the microfinance sector show a shift in its lending methodology towards individual loans. Asset or credit history-based loans to individuals used to be a conventional bank feature only.

Recently however, individual loans have been adapted and introduced by MFIs. Today, MFIs apply a character-based lending method for individual microloans (Maeser, 2008, p. 7). They evaluate their customers in terms of character and skills which will influence the success of their investments. This new individual lending was introduced and customized to the needs of its borrowers. It increases flexibility in terms of loan ceilings, rules and duration according to the ability and credit history of its borrowers as well as it potentially removing possible tensions among group members (Yunus, 2003 p. 238). The increased supply of individual loans can lead to a trade off in microfinance. The so called mission drift for some institutions will be further discussed in the critique section 2.5. The change towards individual lending also influences the target group. It has shown that successful micro borrowers prefer individual loans, in other words “wealthier clients tend to seek individual loans as they move forward (Armendáriz and Morduch, 2007, p. 111).

Another important feature contributing to the great success of microfinance are public and frequent repayments. Borrowers have to start their repayments one week after the loan was granted in small installments, varying due to the season (e.g. harvest months, high-season for tourism) depending on the ability of the borrower to repay. This presents one difference to commercial banks, which would rather wait for businesses to show success, and then demand for repayment. Some MFIs require only biweekly or monthly repayments, due to the geographical location of the borrowers. Especially in rural areas beneficiaries may live far away or in places poorly accessible MFIs therefore tend to adapt their repayment systems accordingly (Yunus, 2003, p. 68). Moreover, public repayments raise repayment probabilities due to the social pressure and increases transparency of the whole procedure. As Yunus (2003 p. 65) states, it may further help solidarity and may be used as an early warning system.

These two mechanisms are often quoted as the reasons for high repayment rates in microfinance. Despite the low confidence in poor people (regarding the provision of collateral etc.), they show excellent repayment records. MFIs have much lower default rates than traditional banks. High repayment rates have therefore become one important characteristic of microfinance. In general microfinance customers present outstanding repayments of about 97% in average on a global level (MIX, 2010). These rates vary among different groups; women for example tend to have lower default rates as men. In Morocco repayment rates lay at 99% in 2007 decreasing only slightly the following years (Allaire et al., 2009, p. 16).

- **Poor Clients**

The focus on poor households is one additional feature in the description of microfinance. The definition of poor however is not that clear and depends on the local context. Some focus on the economically active poor, on people living under or just below the poverty line, others on the poorest of the poor or the extremely poor (Karlan and Goldberg, 2011, p. 22). Common for all poor people, mainly found in developing countries, is the lack access to the financial sector, and microfinance programs therefore aim to include them and are specially designed for their needs. As Morduch and Haley (2002, p. 2) point out, microfinance is beneficial for the poorest as long as programs seek to reach them with suitable product designs and the right targeting. Even if microfinance is not for everybody, as basic entrepreneurial skills are needed to be a successful microfinance customer, it has a greater effect on the very poorest.

- **Gender Aspects of Microfinance**

Some microfinance programs focus exclusively on women such as pro mujer, a leading institution providing microfinance services in Latin America to poor women (Pro mujer, 2013). The Microcredit Summit Campaign6 reported that for 2011 almost 83% of the clients were women (share of reported numbers of microfinance clients in the world). The total amount of women has steadily increased over the last years from 10.3 million in 1999 to 102.7 million at the end of 2011 (Microcredit Summit Campaign, 2011). However the focus on female customers differs by region. High rates are observed in Asia, whereas in the MENA region low female rates have been reported. In Morocco however there is a focus on women as MFIs prefer them due to their reliable and high repayment rates. In 1998 there were about 72% of female clients (Brandsma andChaouali, 1998, p. 19), declining slightly to 64% in 2008 (FNAM, 2010). The focus shift towards women in the whole microfinance sector is mainly driven by positive experiences. Women are considered as better borrowers as they are more reliable, present high repayment rates and tend to be less risky with their investments.

Additionally, there are social objectives that make women more attractive to lenders. They are more sensitive regarding other group members, and stay close to their home and do not run away in case of five. More details about the poor targed group by Hashemi (2011) in CGAP Focus Note: “Reaching the Poorest: Lessons from the Graduation Model”. The Microcredit Summit Campaign is an American NGO, founded in 1997 in Washington, DC by Muhammad Yunus (Grameen Bank), Sam Daley-Harris (President of Results), and John Hatch (founder of FINCA).

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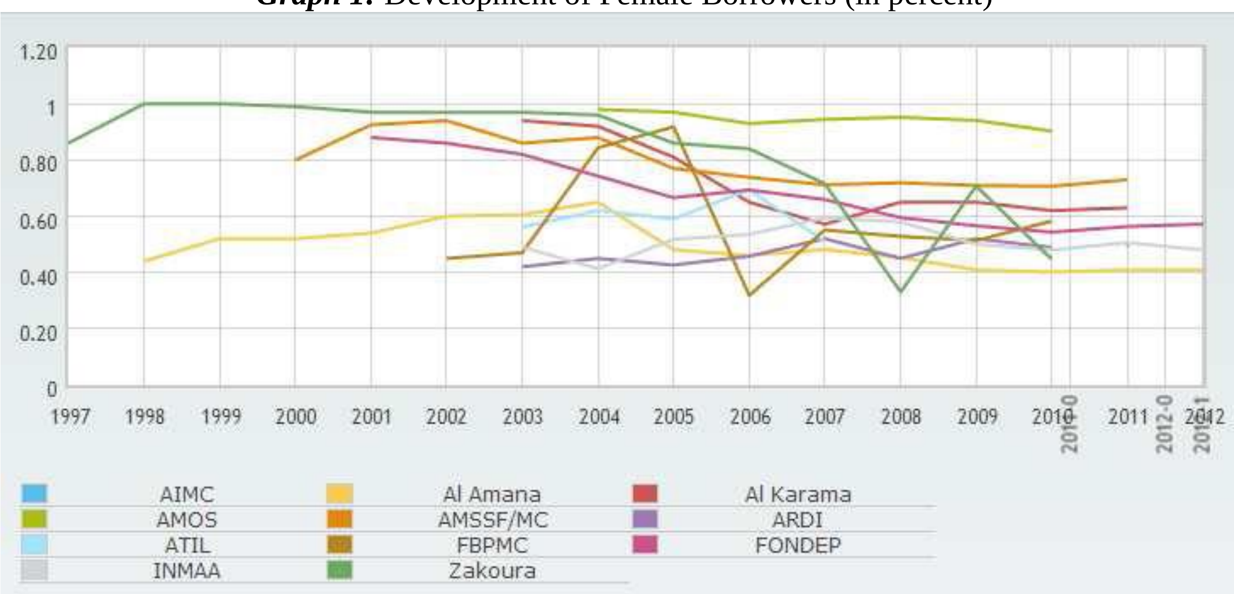
It brings together different institutions and actors involved in the microfinance sector to promote best practices, to exchange experiences and knowledge in order to reach the defined goals set by the campaign (Davis/Khosla, 2006).

Their main concern is about the children and the household (Armendáriz and Morduch, 2007, p. 183). The strong impacts women have on households are in line with findings from Khandker "a 100 percent increase in the volume of borrowing by a woman would lead to a 5 percent increase in per capita household nonfood expenditure and a 1 percent increase in per capita household food expenditure, while a 100 percent increase in borrowing by men would lead to just a 2 percent increase in nonfood expenditure and a negligible change in food expenditure" (in Armendáriz and Morduch, 2007, p. 180). The share of women among the poor has increased disproportionately. Women have to suffer more and are hit harder by crises such as famine or natural disasters. Especially in developing countries they belong to the poorest of the poor. Their access to good jobs is limited and they rely on employment in the informal sector with no or poor wages. Moreover they suffer from discrimination and cultural norms especially in the Islam world (Islam, 2007, p. 47). Microfinance can therefore help women to improve their independence and to become less financially dependent on their husbands. All in all, helping women will work as a loop: alleviating their poverty will in turn positively affect the entire household as they bear responsibility for the whole family. The Moroccan microfinance sector is dominated by female customers. However, as shown in graph 1, MFIs have a different focus, namely Zakoura or AMOS target women; whereas other MFIs like Al-Amana do no differentiate according gender, having a rate around 50%.

Graph 1: Development of Female Borrowers (in percent)



Source: MIX Market, 2013a

INTEREST RATES AND GENERAL CRITIQUE OF MICROFINANCE

A controversial characteristic of microfinance under discussion is high interest rates. While commercial banks charge 10% to 15% interest rates, MFIs charge 40% to 60% (Swope, 2010, p.

15). Only interest rates in the informal sector (e.g. moneylenders) are higher at about 180% to 240% (Helmes and Reille, 2004 p. 4). The global average interest rate for microcredits lies at 35%, but varies strongly by region and country, from Uzbekistan with over 80% to only 17% in Sri Lanka (Kneiding and Rosenberg, 2008, p. 1). Microcredit costs are high because of the greater delivery costs of tiny transactions that require face-to-face interaction and because MFIs use personal contact as a substitute for formal collateral or computerized credit scoring. In other words, the high interest rates are explained by high operating costs and labor-intensive procedures. Covering costs implies financial sustainability: a MFI that breaks even operates in a sustainable way. Access to loans and the finance sector is therefore seen as more important and justifies high interest rates (Cull et al., 2009). This is in line with CGAP (Rosenberg et al., 2009, p. 4) findings: “we do not find evidence suggesting any widespread pattern of borrower exploitation by abusive MFI interest rates.” So interest rates should be as high as needed to cover costs, but still less than the ones charged by moneylenders (Karlan/Goldberg 2011, p. 22). The debate about high interest rates has attracted the attention of many people and policy makers whose intentions were to prevent the practice of usury and who introduced interest rate caps to protect the poor**.** However, the outcome is doubtful.

It presents limitations for the development of the microfinance market, restricting the credit volume and hence the growth of the sector. “Interest rate ceilings make it difficult or impossible for formal and semi-formal micro lenders to cover their costs, driving them out of the market (or keeping them from entering in the first place). Poor clients are either left with no access to financial services or must revert to informal credit markets (such as local moneylenders), which are even more expensive. Ceilings can also lead to less transparency about the costs of credit, as lenders cope with interest rate caps by adding confusing fees to their services” (Helmes and Reille, 2004, p. 1). Studies have shown that “countries with progressive and liberal frameworks for microfinance will be able to develop stronger and larger microfinance markets” than non-liberalized financial systems (Brugger, 2006, p. 245). MFIs that do not cover their costs will further depend on subsidies. The trend towards more commercialization of microfinance plays an important but controversial role in the interest rates ceilings discussion. Some MFIs have even transformed into private commercial corporations. The critical point is possible profits gained from high interest rates which are not used for the institution itself any more, but which go directly to the private shareholders (Rosenberg et al., 2009, p.1). Profit-seeking institutions could stray from the right path, i.e. offering financial inclusion for the poor, and therefore are thought to need limits for the interest rate.

- Criticism focuses especially on these high interest rates and over indebtedness of borrowers. Some argue that poor people are exploited as they have limited options to receive loans, are vulnerable and have little bargaining power. The main arguments against microfinance, summarized by Swope (2010, p. 22).
- Despite high interest rates, most MFIs are not capable of sustainable financial operation and rely on subsidies. These subsidies distort the credit market. Some critics therefore argue that subsidized interest rates “do not reflect the real cost of money” (Roy, 2010 p. 59).
- Some see microfinance as a debt trap and a vicious circle not able to lift people out of poverty. This picture is reflected in the sad and often cited outcomes of some borrowers who saw no other option than suicide. Missing communication between MFIs (lack of a

common database) has made it possible for clients to obtain loans from different institutions, leading to cross indebtedness and exacerbating the situation.

- In order to increase their profits, some MFIs do not focus on the poorest of the poor anymore; instead *richer* clients mainly seeking individual loans are preferred. This trend is also known as mission drift because microfinance programs fail to reach their original social goal of reducing poverty (an aim which itself is sometimes questioned).
- A mission drift may occur when MFIs start with progressive lending, which means that successful active clients obtain larger loans, or in the case of cross–subsidization, when MFIs widen their outreach and include unbanked but wealthier households in order to make profits (Armendáriz and Szafarz, 2009, p. 342). Due to relatively high returns of 5.95% in 2008 and 3.1% in 2009 there has been a trend of mission drift and commercialization in microfinance. This is especially the case in Morocco (Kurze, 2013).
- Critics add that microfinance is potentially harmful to women in cases when husbands do not accept the *new financial power* of their wives. Moreover, in many cases men decide what is done with the loan even if it was granted to a woman. The impact on gender equality and empowerment in general is therefore doubted.
- Last but not least, microfinance is not universal in application. It cannot be utilized by everyone as it excludes among the target group of poor households the very young, old, sick, and handicapped people. "Though these criticisms are valid, there is ample evidence to show that the benefits of microfinance outweigh the costs" (Swope, 2010, p. 3).

3. CONCLUSION

Due to informational asymmetries, traditional financial markets fail or reach their limits, causing the exclusion of poor people. Microfinance offers the possibility for excluded households to obtain access to financial products, even if they lack collateral. Microfinance is able to overcome many problems traditional finance institutions face and is therefore seen as a tool to reduce poverty in the world and diminish vulnerabilities of the poor. Its roots go far back in history; however, its celebrity only came with Muhammad Yunus in the 1970s. Around the world NGOs and governments have since followed his example, offering different microfinance products and services. 2005 was declared the International Year of Microcredit as its sector grew further and gained importance. Today MFIs appear in many different forms such as governmental or non-governmental organizations, as credit cooperatives, as private credit institutes, self-help groups or bank-near financial service providers. Moreover it is no longer just NGOs who develop into financial intermediaries, but also the other way round: banks are showing more and more interest in becoming microfinance service providers. With the time institutions have changed, and there has been a shift in their product range too. The need for a variety of financial services beyond credits has been recognized.

Today a variety of financial products and services such as savings and deposits, micro insurance, pension funds, remittances services, and non-financial services such as skills training and education are offered. The focus hereby lies on the group-lending methodology, characterized by its joint liability, where all members are commonly responsible for the repayment of the loan. Moreover the focus on female clients is an additional important feature of microfinance. The focus shift to women was a response to experiences gathered. Women are considered as better borrowers as they are more reliable, present high repayment rates and tend to be less risky with their investments.

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