

## **The Microfinance Revolution: Sustainable finance for the poor**

By Marguerite Robinson

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Revolutionaries are not noted for the modesty of their aims, or their claims. Nevertheless, it is certainly true that microfinance – the provision of very small loans and deposit services to predominantly poor, under-served, rural, mostly women borrowers and savers – has captured the imagination of policy-makers, development practitioners, and researchers in ways that few other programs have. Aid grants and financing have flowed to support microfinance programs, NGOs have incorporated microfinance in their health or education or gender equity programs, Bangladesh's Grameen Bank is now almost as famous as the World Bank, and the UN General Assembly has declared 2005 as the International Year of Microcredit. This volume, the first in what is to be a three-volume series, tries to recount important parts of the story of that revolution. Subsequent volumes are to present an in-depth case study of Indonesia, whose microfinance institutions Robinson is most familiar with, and draw lessons from 'best practices' for a prospective look at the likely evolution of microfinance over the next quarter century.

The timing of this book is excellent – it has few close substitutes in terms of its sweeping overview of the terrain, and the revolution is now so advanced that the time is right for a history, or at least a retrospective. As with any revolution, however, splits have emerged within the movement. On one side are those who argue that the way forward is to require microfinance institutions to meet the test of financial 'sustainability' – essentially, requiring these institutions to cover their costs, even if this means that the very poorest of the poor remain under-served. Against this, the 'poverty lending' approach emphasizes the importance of outreach, especially to the very poorest borrowers, as a poverty-fighting approach.

Readers looking for a balanced characterization of this debate, which the book begins by describing in chapter 1, are likely to be disappointed. This is a work of advocacy, rather than assessment. The main argument made here is that microfinance programs should be subsidy-free, since in the long run, donors and governments will reduce funding for subsidized programs, in the same way that they turned against the heavily-subsidized loss-making government-run rural credit programs of three or four decades ago. Chapter 2 clubs these programs under the rubric of the 'old paradigm', and contrasts it with the 'new paradigm' in which financial services can be provided in a cost-efficient manner even to low-income households who were previously reliant on the informal sector. But this is attacking a straw man. Few policy-makers or practitioners advocate a return to the 'old paradigm' that failed so signally. Rather, there is universal acceptance of the importance of financial transparency, increasing efficiency, maintaining some link between the shadow cost of credit and the interest rate, mobilizing savings, and providing appropriate incentives for managers. The disagreement is over whether, and why, financial sustainability should be the sole or predominant criterion by which to judge a microfinance program. If a microfinance program achieves the funding agency's objectives (whether that is reducing poverty, empowering women, or improving child

health and education), then surely it should be judged by the same criteria as, for example, a project that directly subsidizes health or education services for the target population. So long as public funding for effective social welfare programs is available, then one has to explain why an effective, albeit subsidized, microfinance program with the same social rate of return should be more likely to be wound up. This is a much harder case to make, and this book does not make it at all.

Chapter 3 makes the case for microfinance, from the viewpoint of program participants. Chapters 4-7 provide an overview of the theoretical background, starting with a more detailed discussion of the 'old paradigm' in chapter 4, and moving on to a discussion of asymmetric information models in chapter 5, informal credit markets in chapter 6, and savings in chapter 7, which concludes.

Throughout, the book relies heavily on case studies drawn from Indonesia, chiefly of the Bank Rakyat Indonesia (BRI). Robinson does an excellent job of emphasizing and detailing BRI's success in mobilizing savings (long considered the 'forgotten half' of rural finance), even from very small depositors. But the reliance on one or two Indonesian case studies to draw more general lessons has obvious shortcomings. For example, the barriers to collecting savings have at least as much to do with prudential regulation of deposit-taking activity as with lowering transaction costs. BRI's institutional status as a bank allowed it to cross these regulatory hurdles, but absent significant regulatory changes, most microfinance institutions are unlikely to be able to collect deposits. While the book lists public supervision as a desirable goal, there is no sense of the difficulties of providing it, especially in underdeveloped financial markets, where the central bank's capacity for oversight is limited. Similarly, in focusing so closely on the BRI, the book misses important parts of the larger picture. There is no discussion of the relative merits of different contractual structures or institutional forms – for example, group-based versus individual lending. If groups, what should the group size be? How much monitoring responsibility should be devolved to the groups? What are the tradeoffs in combining credit/savings services with other 'social' objectives, such as education? How important is "progressive lending", where borrowers receive larger loans as they repay their earlier loans, or interest rebates for prompt repayment? Why do so many microfinance programs use inflexible repayment schedules – for example, weekly installments, beginning immediately on receipt of the loan amount? For a work that lays out so many lessons to be learnt, it is surprising that there is no serious discussion of these and other issues.

The editing warrants mention, even in a brief review. Prefatory material – the contents, introduction, acknowledgments, preface, etc. - goes on till page xlvii, taxing the reader's knowledge of Roman numerals (not to speak of his patience). The book is needlessly repetitive in places. At the same time, an assertion that BRI's microbanking division "... has been profitable each year since 1986 and independent of subsidy since 1987" (p. 34) passes without explanation or elaboration.

For academic economists, perhaps the greatest use of this volume will be as a survey of the practitioner literature, and as an introductory case study of Indonesian microfinance.

For a more analytical overview, the researcher can learn more, and more efficiently, by reading recent surveys such as the one by Jonathan Morduch in this journal (“The microfinance promise”, JEL, Dec 1999). For practitioners, policy-makers, and students coming to this field afresh, this book provides an accessible introduction, and conveys some of the enthusiasm of the microfinance ‘community’ for this promising tool. The discussion is non-technical and accessible, even for readers without much training in economics, and would be appropriate reading for undergraduate students.

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