

Are all poor people entrepreneurs?

There is a basic assumption that the poor just need capital to climb out of poverty. This presumes that all poor have business skills translatable into profitable enterprise. This assumption defies logic. Even in the USA new small businesses succeed about 10% of the time with nearly 90% ending in failure. The sad fact is that most micro-loans to the poor are used for consumption not income generation; very similar to credit card use in the USA. This may smooth cash flow, but does nothing to improve the families' overall income. In fact, it just becomes revolving debt, sometimes called micro-debt! In a rush to have a large portfolio, many MFIs show little concern whether the borrower has the skills or experience to start a business; they primarily want to expand their clientele. It is easy to imagine, if little or no profit is made, the borrower may quickly find herself or himself in debt with little hope of repayment. This can and does result in a downward spiral into deeper poverty. Just the opposite of the hype.

How does FARMS International differ with mainstream micro-lenders?

FARMS in no way resembles those in the "industry" of micro-credit. We are a ministry to the poor, with their best interest foremost in our hearts and operation. We have proven over the past 50 years, long before this new industry emerged, that with your support, we can tangibly help the poor without creating dependency and without the trap of debt.

Policy	"Best Practices" (most organizations)	FARMS International	Notes
Interest Rates	Average APR 36% and higher	Interest Free Loans	FARMS is a not for profit ministry to the poor. Loan funds are granted to the volunteer committees interest free
Solidarity Groups	Yes, group members guarantee each other's loan payments	No, family or individual loans only	Surety for another's loan is cautioned against in scripture
Gender Preference	Yes, 85% of more loans given to women	No, FARMS generally works with the head of the home	Family integrity and scriptural order is an important part of the ministry of FARMS
Consumption Loans	Yes, in practice most loans end up not being used for income generation	No, FARMS's committees screen applicants and approve only income generation projects	FARMS's goal is to see families set free from poverty through work and giving
Income Generation	Yes, this is a goal but not often achieved	Yes, a complete business plan must be presented for approval	FARMS's goal is to see families self-supported
Loan Preference	Non-discriminatory	FARMS's loans are for Christians only	Purpose of FARMS is to strengthen the local church so it can become a source of community blessing and evangelism
For Profit	Yes and no, interest income covers operation and overhead, plus profit for investors	No, a small service fee is charged on each loan to cover administration cost	All of FARMS loan committees are volunteer run. No salaries are paid.
Loan Committees	Paid staff	All volunteer: staffed by nationals	FARMS's model is volunteer run programs, greatly reducing costs
Sources of Funding	World Bank, IMF, National Banks, Investors, Government grants, Foundations, Individuals	Churches, Individuals, Foundations, Businesses	FARMS does not accept government grants. Loan funds are granted without interest or repayment
Weekly Meetings	Yes, most require weekly meetings for repayment	No	FARMS recommends monthly meetings for prayer, testimony, training and repayment
Repayment Schedule	Weekly, usually begins first week of loan cycle	Determined by the committee,	FARMS's repayment is scheduled by the type of project and is not started until adequate profit is generated
Church Empowering	Not in most cases	Yes, FARMS's ministry is designed to empower the local church	FARMS's loan recipients agree to tithe to their local church out of project profits



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Doing Good That Is Good

The newsletter of FARMS International

What is wrong with micro-credit? A look at current practices September 2011

Providing revolving entrepreneurial loans to poor Christian families - Galatians 6:10

Dear Brothers and Sisters,
Greetings in the precious name of Jesus!

I want to share with you some important insights on how the ministry of FARMS contrasts with the popular phenomenon of "micro-credit". By creating an awareness, I trust to encourage you even more in your support. You may be surprised and even shocked by what you learn, but it is very important for us to understand that **not all loan programs for the poor are the same**. To be blunt, there is a lot of hype out there that does not match reality. I have introduced some of these concerns in an earlier letter, but I feel it is time to pull back the curtain that covers the reality of "micro-credit" as practiced by most organizations today.



About six years ago, on a visit to Bangladesh, I was having a discussion with a missionary and the subject of the Grameen Bank came up. I was curious as to his personal experience with this large micro-loan organization. In just a few words this missionary confirmed my suspicions of this internationally acclaimed group. He shared how many poor families had been hurt by their practices. He had wished that I had a few more days to visit some of the individuals and to hear their personal stories. He intimated that families, many times, were worse off for being in the program. Similarly, on a recent visit to Haiti, we asked those in a FARMS's training session some questions about other micro-loan programs in their area. Their spontaneous, animated response was that these other programs were "Mean!" Recently, brave authors and investigative journalists have been exposing the dark side of micro-credit schemes as practiced by most organizations. In this report I will draw upon their research.

I opened this letter by saying, "FARMS contrasts", well that may be a great understatement. In practice the only similarity we have with these "for profit" programs, is providing loans for the poor. The similarity ends there. I know as you read this report, you will agree that FARMS is truly in a realm of its own; the biblical realm.

Blessings in Jesus,
Joseph Richter
Executive Director

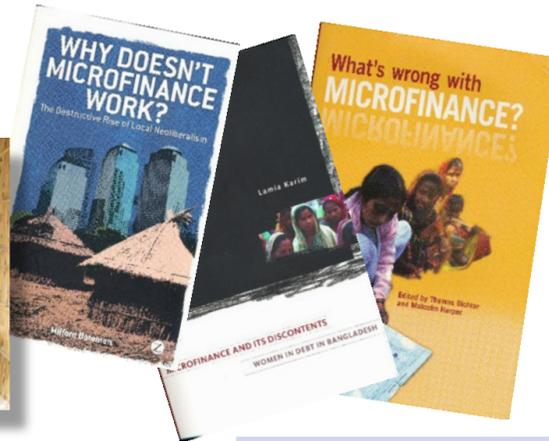


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What is wrong with micro-finance???

Put yourself in this situation. You need a loan to start a small business, so you go to your local micro-finance agency. The agent you meet greets you with a smile and then proceeds to lay out the conditions for a loan. First, you are required to join a group of other lenders from your neighborhood, usually a group of eight to ten other women. This “solidarity group” must agree to pay each other’s loan if there is a missed payment or a default in the group! Then you must agree to weekly meetings, sometimes lasting an hour or more. At these meetings you must be prepared to make a payment on the loan and probably a mandatory savings deposit. It makes no difference that your business has not generated an income or a profit, a payment must be made or you are in default. There may be a fine for a late payment and even a missed meeting. **What about interest, well, it is much lower than the “money lender rate”, but it is still 36%APR and sometimes much higher!**



Well, “I guess this is better than no loan, you ponder”. But you are further cautioned; “If you are late on your final payment, interest accrues at 1% per day or 360% APR on the total face value of your loan!” You then nervously ask, “What is the amount I can borrow?” The agent explains the max amount, which is below what you really need, but he assures you that if you stay in good standing with your group, attend all the meetings, and never miss a payment, you can borrow again and again. Reluctantly, you sign the papers for your loan because you have no other choice.

“Is this really happening?”, you might ask. Yes, millions of times over. Micro-credit, as practiced by secular and most religious based organizations follow this model, euphemistically called, “Best Practices”.

Before we go on, let me assure you that FARMS International’s loan program in no way resembles what I just described.

Let me shed some light on how these “Best Practices” of the micro-credit industry impact the life of the poor.

Micro-credit became mainstream practice in the 90’s. Models such as the Grameen Bank in Bangladesh began to be replicated. In 2006, Muhammad Yunus of Bangladesh was awarded the Nobel Peace Prize for his founding of the Grameen Bank. In a rush “to do good”, government and private donors poured millions of dollars into organizations using similar “off-the-shelf” micro-loan programs. The World Bank, the IMF and international aid agencies, such as USAID became major players. It seemed that a solution to poverty had been found! Billionaires began investing and now there are even “Micro-loan Mutual Funds”. It seemed that finally, millions of the world’s poor now had access to credit. Lending to the poor, was not only “doing good”, it meant that the investor would also “do well” by the interest earned on investments. Stories of poor entrepreneurs coming out of abject poverty filled the Internet and the pages of newsletters. Many new organizations doing micro-credit sprung up. It is now even possible through the Internet to make a loan to an entrepreneur of your own choosing. However, a more realistic and darker picture of mainstream micro-loan programs is emerging.

“Best Practices” and their dangers

Lending groups and repayment rates:

Through a photo or a video we are presented with a group of ladies sitting in a circle smiling as one of the group shares. Descriptive phrases such as **economic empowerment, empowerment of women, poor women are bankable, and social empowerment** are used. The image and the message are glowing and warm: women taking charge of their destiny and the welfare of their families! But what is really happening and why?



The “solidarity group” model is promoted as a “best practice” because of its benefit to the lending agency. With this model, **the group becomes the guarantor for loan repayment of all its members!** Due to of this practice, nearly all micro-finance institutions (MFIs) boast of a 98% or better loan repayment! These statistics seem to “prove” that the poor, especially women are “bankable”. However, it only takes a little digging to find the real basis for these claims. **Simply put, these high repayment rates are not the result of business success or because of rare defaults, they are the result of the group absorbing the bad debt of its members!** Ponder this, when one member defaults, the other members must cover that bad debt, which in turn reduces their potential earnings! Nevertheless, the MFI (micro-finance institution) can claim remarkable repayment success, but at a great cost to the poor!

Socially, the cost may be even higher. Women traditionally carry the honor of the family in poor societies. When a woman defaults, the group members and the MFI workers generally harass and shame her. In addition the husband may get angry because their family’s honor is lost! It is not hard to imagine how socially destructive this shame is.



To avoid default presents even more dangers! A woman faced with the prospect of being shamed will turn to alternative sources of funds to meet her weekly loan obligations. First she may turn to her extended family network, if this is unfruitful, she may seek out the local money lender for a small loan to meet her installment, and if this fails she may try to get another micro-loan from another agency to pay the first loan. Any of these scenarios will lead to further debt and poverty! This is the slippery slope of micro-credit and it is all too common!

Over 85% of micro-loan clients are women: Men need not apply!

Why women? The answer may seem obvious at first glance. As mothers they are seen as more caring for the family than the man. Women are also

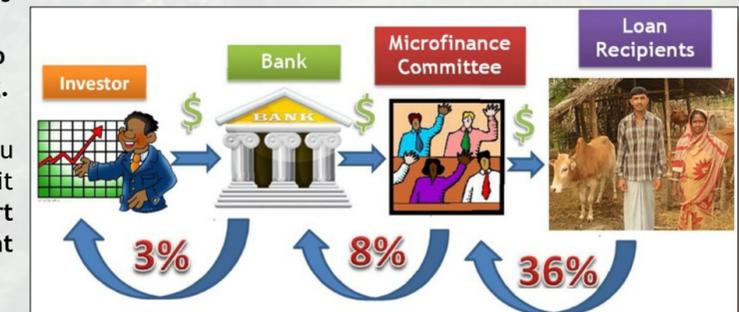
seen as economically disenfranchised. But what is the truth? The reality is women have a “**positional vulnerability**”, meaning they are more easily coerced into making repayments than men because of shame. Furthermore, studies have shown that even when a loan is given to the woman the husband still controls the money in nearly 95% of the cases. Sociologists that have studied this phenomena in patriarchal societies have coined the term “**fight or flight syndrome**”. Simply stated, the husband will either fight for control of the money or he will abandon the family, which further harms their economic condition. The real loser in this scenario is the family; stability and cohesion are lost.

Interest rates of micro-loans:

A quick review of the literature reveals industry averages for annual percentage rates (APRs) are 36% with some reaching as high as 100%! The justification for these usurious rates is explained like this: “*These rates are much lower than the local money lender rates and even though they seem high the high repayment rates shows that the poor can afford and want these loans*”. This simply is not true! In fact, the government of India recently stepped in to regulate MFIs with anti-usury laws aimed at preventing interest rates on micro-loans rising above 24% APR. This move was prompted by a rash of suicides among loan holders unable to make repayments to their MFIs. Usurious rates of 36% or more make it nearly impossible for the poor to make a profit from a business or farm. In fact, a study in India found that interest rates above 24% make it impossible for the poor have a profitable business. On the other hand, **these rates do allow MFIs to turn a profit, but at whose expense?**

MFIs justify this profit, “*because it allows them to reach more clients with loans.*” However, testimonies from poor loan recipients before the World Bank, explained it this way: “*There is a limit to how much one hungry man can feed another.*” It may surprise the reader, but even billionaire George Soros is a major investor in SKS Micro-finance, India’s largest for-profit micro-lender. **The sad truth is that the poor are seen as a group to profit from. This should be disturbing.**

I will illustrate this with a diagram. As you can see with the normal micro-credit scheme, the poor borrowers nearly support the whole system through their payment of high interest!



What are the poor saying?

From an article in the book “MICROFINANCE AND ITS DISCONTENTS” we have the following quote from a micro-loan borrower, “*Every day we think about it (our loan) and feel entrapped.*” Similarly, Manda Gawande, 45, a housewife and borrower, said this, “*It’s as though every week goes by so fast that we think we have paid our weekly installment only yesterday, and the man is back again at our doorstep to collect the installment today.*” Another woman is quoted as saying, “*It brings happiness in the beginning, but tension in the end.*”

Catholic Relief Service micro-credit worker Kim Wilson stated in dismay after a review of their large micro-finance program, “*Our power to set people back through debt, and shame was far greater than our power to bring them forward.*” Quote from the book, “*What’s wrong with MICROFINANCE?*”