

# **Universität Bielefeld**

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## **Masterarbeit**

im Studiengang Interamerikanische Studien

zum Thema:

**“(Doing) Business With The Poor” – A Critical Analysis Of  
Microfinance In Peru**

vorgelegt von

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## **Abbreviations and Glossary**

|                                       |  |
|---------------------------------------|--|
| Asomif                                | Association of Peruvian MFIs   |
| BCP                                   | Banco de Crédito del Perú  |
| Caja Municipal (CMAC)                 | Regulated MFI that has been implemented by the GTZ according to the “Sparkassen” principle (its property but not its major control is in the hands of the municipal governments) and is specialized in microfinance.   |
| Caja Rural de Ahorro y Crédito (CRAC) | Regulated MFI, created in 1992 after the “Banco Agrario” went bankrupt.  |
| CEPAL                                 | “Comisión Económica para América Latina y el Caribe” (Economic Commission for Latin America, ECLA), headquartered in Chile is one of the five regional commissions of the United Nations and was founded with the purpose of contributing to the economic development of Latin America.  |
| CGAP                                  | “Consultive Group to Assist the Poorest”, found in 1995 by the World Bank with the purpose to invigorate microfinance in Latin America. The CGAP is financed by multilateral donors.   |
| COPEME                                | “El Consorcio de Organizaciones Privadas de Promoción al Desarrollo de la Pequeña y Microempresa” (Consortium of Private Institutions), a network of NGOs, promotes the development of Microbusinesses.  |
| Credit Unions                         | “Cooperativas de Crédito”, financial institutions specialized in savings and short-term credits.   |
| EDPYME                                | “Entidad de Desarrollo de la Pequeña y Microempresa” (Small Business and Microenterprise Development Institution), regulated by SBS. Consists mostly of NGOs that converted into financial institutions.   |
| FENACREP                              | “Federación Nacional de Cooperativas de Ahorro y Crédito del Perú” (National Federation of Cooperatives of Savings and Credits in Peru). An organization subordinated to SBS that supervises Cooperatives of Savings and Credits in Peru since 1993.   |
| Finca International                   | Foundation of International Community Assistance, non-profit organization, headquartered in Washington, D.C., assists and supports a network of MFIs on a global level.  |
| GDP                                   | Gross Domestic Product.  |
| GTZ                                   | “Deutsche Gesellschaft für Technische Zusammenarbeit” (German Society for Technical Cooperation), today known as GIZ (“Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH” – German Society for International Cooperation) – services delivered by GIZ focus on international cooperation on sustainable development, wealth and regional and technical expertise. |
| IDB                                   | Inter-American Development Bank.   |
| IFC                                   | International Finance Cooperation, financial arm of the World Bank, focuses on the private sector in developing countries.   |
| KfW                                   | “Kreditanstalt für Wiederaufbau” (Loan Corporation for Reconstruction), German Development Bank.   |
| Microbusiness/ Microenterprise        | “Microempresa”, small enterprises with not more than five employees  |
| Microcredit/Microloan                 | Small loans up to 20,000 PEN/USD 7,500 (as defined by the supervisory authority SBS in Peru) allocated to small businessmen_women who have no  |

access to financial services in the traditional banking industry. Microcredits are primarily invested in production, commercial enterprises, consumption or housing.

|                       |   |
|-----------------------|---|
| Microfinancial System | Comprises financial services such as small loans, savings deposits, insurance benefits and transfer of funds, particularly addressed to social classes excluded by the formal banking industry.                                 |
| MIX                   | “Microfinance Information Exchange”, most important rating- organization on Microfinance worldwide, non-profit, headquartered in Washington, D.C., provides data and analysis of microfinance performances of every country.    |
| MFIs                  | Microfinance Institutions such as formal banks, semi-formal NGOs, cooperatives and village banks as well as informal financial institutions (saving and credit groups) that focus on microfinance services.                     |
| NGO                   | Non-Governmental Organization. NGOs in Peru operate with microfinance-programs as part of their anti-poverty strategy.  |
| SBS                   | “Superintendencia de Banca, Seguros y Administradora de Fondos de Pensiones” (Supervisory Authority for Banks, Insurances and the Administration of Fonds and Pension), governmental institution that supervises banks in Peru. |

## **Definitions**

If not announced differently, in this thesis the terms informal sector, poverty and vulnerability are defined according the following definitions:

|                          |  |
|--------------------------|--|
| Currency                 | Throughout this thesis, the conversion of PEN (the Peruvian currency – Peruvian Nuevo Soles) to U.S. dollars (USD) is based on the current exchange rate published by OANDA (cf. OANDA 2012).  |
| Informal Sector          | The informal working sector generally consists of family members helping without payment, domestic staff, freelancers as well as employees and employers of small enterprises (less than 11 employees, cf. Krumwiede/Stockmann, 1992, 405 f.) Mostly, “informal workers” receive a low (irregular) income and do not pay taxes (are members of the “informal proletariat” according to the sociologist Alejandro Portes, 1985, 15). Although freelancers are perceived as “informal workers”, this definition is problematic, because small entrepreneurs may be employed occasionally as “hired hands” and thus, cannot be recorded correctly (Krumwiede/Stockmann,1992, 405 and Portes 1985, 18).  |
| Poverty                  | The definition and measurements of poverty vary substantially around the globe. The National Statistics Departement of Peru (INEI, 2012) uses a poverty line to define poverty but definitions on the term “poverty line” differ in every country, too. In Peru, individuals who fall below the poverty line do not have enough household income to satisfy their minimum needs (lack of nutrition and consumption opportunities). According to the most recent definition released by INEI in 2008, individuals with an income of less than 264 PEN per year/ USD 103 (approx. USD 0.30/day) are poor. Due to the numbers used in my field research, which are mostly based on the definition released by COPEME (Peruvian network of MFIs, cf. above, I use the term “poor” if not announced differently for persons, who have an income of less than USD 2/day. |
| Vulnerability to Poverty | Vulnerability to poverty refers to the risk of falling into poverty or into deeper poverty.  |

## **Introduction**

In 2005, the United Nations launched the “International Year of Microcredit” and former United Nations Secretary-General Kofi Anan, proudly announced at the official opening:

"A small loan, a savings account, an affordable way to send a pay cheque home can make all the difference to a poor or low-income family.

With access to microfinance, they can earn more, build up assets, and better protect themselves against unexpected setbacks and losses.

They can move beyond day-to-day survival towards planning for the future.

They can invest in better nutrition, housing, health, and education for their children. In short, they can break the vicious circle of poverty.

Microfinance has proved its value, in many countries, as a weapon against poverty and hunger. It really can change peoples' lives for the better - especially the lives of those who need it most "

(cf. UN 2004).

Finally, the international development community seemed to have found a universal instrument to combat poverty that perhaps will even consist of the potential to make the Millennium Goals, including halving the amount of people who suffer from poverty from 1990 until 2015, come true.<sup>1</sup> Since its rebirth in the 1980s, microfinance has consistently increased its popularity and has been implemented in various financial systems around the globe. However, recently, critics began to question the benefits of microfinance for the people it addressed: the so-called “Poor”.<sup>2</sup>

Interestingly, the good image of microfinance started to crack in the country of its initials – in Bangladesh - when newspapers published stories of microloan debtors who committed suicide because they were pressured or could not repay their loans. Documentaries provided pictures of microfinance clients whose living situations had not improved, but worsened. Muhammad Yunus, the leading figure of microfinance and recipient of the Nobel Peace Prize in 2006, was fired from the board of his famous and influential microfinance Grameen Bank. The ball has started rolling, and the international development community has to face increasing doubts on the success of microfinance.

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<sup>1</sup> Cf. United Nations Capital Development Fund (UNCDF) 2005, 5: “Microfinance is one of the practical development strategies and approaches that should be implemented and supported to attain the bold ambition of reducing world poverty by half.”

<sup>2</sup> Due to the different understanding and interpretation of poverty by the participants of my field research and the various authors referred to in this thesis, I use the term “the Poor” in inverted commas.

General critics, for example, question how the economic focus of microfinance (assuming that access to capital allows poor individuals to establish or expand a simple income-generating activity and an escape from poverty) correlates with the definition of poverty as a multidimensional, dynamic phenomenon. Furthermore, without entering into a discussion on the very subjective interpretation of Kofi Anan’s remarks about “changing peoples’ live for the better”, does microfinance really work in our heterogeneous world, and can it be defined as a universal tool to combat poverty?

Microfinance does take away a lot of the responsibility of the international development community and every individual state because the problem of poverty is simply transferred from the public to the private sphere.<sup>3</sup> However, in the microfinance “shark tank”, players composed of multinational and national companies and banks compete in a more or less free market, where “the fittest” are going to survive and loans are offered to “the unfittest”: people suffering from poverty who, as studies found, most often need the money to pay for their basic needs and not to start a new business. Obviously, this is problematic, especially when welfare and development aid is cut down and the most vulnerable citizens of a society can no longer count on their government but instead must depend on profit-oriented financial institutions.

Nevertheless, although microfinance is not the only existing contra-poverty strategy, it must have some potential, if it is being implemented in more and more countries around the world. Further, it seems to link perfectly to the famous “capacity building” approach, which is promoted by the majority of players involved in development policies today. Microfinance advocates even relate microfinance to the formation of a new banking segment, which keeps growing and may become a powerful, influential sector of the formal banking industry in the future (Cayo and Bravo 2009, 5 and Yunus 2010, 3ff.).

As my title has already revealed, this thesis aims to examine, how microfinance is practiced in the supposedly best-developed microfinance market across the globe (as awarded by “The Economist” in 2009, 2010 and 2011): In Peru. Like other area studies on microfinance, I seek to compare whether or not my findings in Peru underscore the common portrayal and criticism that microfinance is mostly encouraging “business with the Poor” without achieving a sustainable

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<sup>3</sup> Cf. United Nations Capital Development Fund 2005 (15):

“The report presented by the Commission on the Private Sector and Development gives microfinance and financial sector development significant roles in the growth of the private sector and its contribution to poverty alleviation and economic justice. (...)”

benefit for the people addressed. To achieve this objective, I will focus on the perception of microfinance by microfinance institutions (MFIs) and the “reality” experienced by microfinance-clients in Peru.

Although international players (cf. the Inter-American Development Bank) still refer to Peru as a “best-practice” -example for microfinance, the Peruvian microfinance market has experienced an increase in players involved and numerous transformations within the past three years. While some academic researchers have already focused on microfinance in Peru,<sup>4</sup> these developments were the basis for my choice to conduct an updated field study, allowing me to contrast my findings with the most recent critiques published and to compare the results to the assumptions of microfinance advocates as well as to the general development aim as introduced by the economist Amartya Sen in “Development as Freedom”.

Consequently, the examination of the following hypotheses provides the frame of this thesis:

#### Regarding the Contextualization of Microfinance

- If microfinance empowers “the Poor” sustainably and reduces poverty, in the countries that apply microfinance the life quality (access to health services and education) will improve and the poverty rate will decrease
- If microfinance is perceived as a tool to fight multidimensional poverty, microfinance players will cooperate with other players that release microfinance-programs and international alliances will be formed
- If microfinance is practiced around the world, microfinance systems will be distinct due to political, economic and cultural differences of nation-states

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<sup>4</sup> Cf.:

Ströh, Christiane: “How to Assess Pro-Poor Financial Sector Development: A Comprehensive Framework Applied to the Case of Peruvian Microfinance”. Doctoral thesis at the School for Business & Economics. Berlin: Free University of Berlin, 2010. - This work focuses on the conceptualization of microfinance in Peru and analyzes indicators for impact assessment of microfinance.

Pait, Sara. “The Microfinance Sector in Peru: Opportunities, Challenges and Empowerment with Gender Mainstreaming.” Oxfam, 2009. <http://www.microfinancegateway.org/p/site/m/> (accessed October 8<sup>th</sup>, 2012). – This research examines the expansion of microfinance and access of female entrepreneurs to microloans in Peru.

Portocarrero, Felipe et al.: “Microcrédito en el Perú: Quiénes Piden, quiénes dan.” Lima: Consorcio de Investigación Económica y Social (CIES), 2002. - The authors of this research analyse the players and their products on the microfinance-market in Peru as well as the clients with access to microloans.



### Regarding My Research in Peru

- If microfinance is dedicated to improving the living-conditions of “the Poor” and has a beneficial purpose, mostly clients without an occupation who do not own property and in particular women will be registered as borrowers at MFIs in Peru and MFIs will not make a lot of profit
- If interest rates are high, the demand for microloans will decrease and if the competition among MFIs is high, the interest rate will decrease
- If microloans are supposed to help clients to escape from poverty, there will be a limitation of credit-dependencies because with every new credit the likelihood of over indebtedness will increase

My thesis is divided into two main chapters: the general contextualization and theoretical background and the field study on Peru. Firstly, in the frame of contextualization, I will explain the importance of microfinance as a “new” policy in the international development community. Secondly, I will refer to Amartya Sen and present his assumptions expressed in “Development as Freedom”, in order to relate them later to microfinance when comparing my findings in Peru with his ideas. Thirdly, I present general attempts and approaches of microfinance as promoted by Muhammad Yunus and the international Microfinance Institution (IMFI) Kiva. Fourthly, I will summarize general criticism on microfinance. Fifthly, I will describe the historical and socio-economic development in Peru. In order to complete my overview, I will provide a panorama on the development of microfinance in Peru, which explains how the Peruvian microfinance market is supervised and has transformed in the past, the products and conditions microloans are based on as well as the general problems microfinance in Peru has to face.

The chapter on my field study begins with an introduction of my field study and my objectives, followed by the structure of my field research and its methodology. I will then present the participants of my research and illustrate my findings. I organized the results of my research into three categories named “Terms and Conditions of Microloans”, “Evaluation of Microfinance Players and the –System in Peru” and “Impact of Microfinance in Peru”. Each category contains subcategories on specific elements, which are presented, discussed and related to the presented assumptions as introduced in the first main chapter “Contextualization”. Finally, I will summarize my results and provide a future prospect.

In sum, this paper attempts to widen the global perspective on microfinance and to provide further ideas and stimuli in regard to how microfinance can be improved. Nevertheless, my

findings will only have a limited meaningfulness due to my area-concentration and empirical factors that will be explained in the methodology section. Furthermore, due to the limitations of the size of this thesis, I decided to contrast my results in Peru mainly with “western” critics as expressed by the British economist Milford Bateman (2010) and the German investigative journalist Gerhard Klas (2011). Thus, although I included some critics of researchers in Bangladesh, there is a discrepancy between the references of “occidental” and “oriental” perspectives. Bateman and Klas though, focus in their works on microfinance practiced around the world.

## **I. Contextualization**

### **Theoretical Framework: Development Assistance and Microfinance**

Although Muhammad Yunus is still celebrated as the inventor of microloans, the early origin of microfinance systems can be tracked to Asia in the Middle Ages (cf. Faber 2011, 256). In Europe, microfinance started in Ireland and Germany in the 18<sup>th</sup> century, when credit funds and “Sparkassen” (savings banks) were the first to offer small loans, partly without charging any interest, to help “the Poor” (ibid. and Klas 2011, 18).

However, in the 1970s the idea of microfinance was “re-freshed” in Asia and Latin America:

In Bangladesh, Yunus became the pioneer of microfinance when he founded the “Grameen Bank” to distribute group loans to poor women and the rural population. Simultaneously, the relief organization Acción Internacional handed the first microcredits to individuals in Brazil. Bank institutions such as BancoSol in Bolivia, SEWA (Self Employed Women’s Association) Bank in India and BRAC (Bangladesh Rural Advancement Committee) in Bangladesh, quickly adopted the idea of microfinance and initiated the participation of banking institutions throughout Asia and Latin America (Faber 2011, 258).

In the 1990s, microfinance was accepted as a main strategy of the new development policy ratified by the international development community. After the oil crisis in the 1970s and the related economic crisis developing countries had to suffer from in the 1980s (today referred to as the “Lost Decade”), many states implemented neoliberal programs. In 1992, the international development community also changed their policy and announced a paradigm shift at the United Nations Conference on Environment and Development (UNCED) in Rio de Janeiro. Henceforth, 172 states agreed to focus on sustainable development and on capacity building to overcome exclusion and suffering (cf. Agenda 21). Microfinance, which attempts to include the marginalized “Poor” into the formal banking industry, in order to increase “the Poor’s” self-determination and independency and to enable them to establish income-generating activities themselves, perfectly links to the desired measures on capacity building. Thus, development assistance provided by industrialized countries has increasingly been invested into microfinance worldwide since then: In 2011, approximately USD 60 billion was invested in microloans around the globe and was distributed by an estimated 70,000 MFIs (Von der Hagen 2011). Recent numbers prove that for example the German Federal Government has spent one third of the money dedicated to development assistance on microfinance in 63 countries (Hartmann 2012,

331). The German KfW (Kreditanstalt für Wiederaufbau) is even known as the largest microfinance investor worldwide (Hartmann 2012, 331 and Klas 2011, 40).

However, microfinance as promoted in the 1970s has developed and changed over time. Therefore, academic studies today differentiate between “Microfinance prior to 1995” and the so-called “new wave-Microfinance”. For example, in the transformation of the famous Grameen Bank to Grameen II (cf. Yunus 2008, 78f.), “the ‘new wave’ approach to microfinance rests its main a priori case on the claim that commercialization<sup>1</sup> will facilitate the largest possible availability of microfinance at the lowest possible cost to governments and the international donor community” (Bateman 2010, 152). Thus, the new features of the revolutionized “new wave-Microfinance” contain a greater variety of products sold to clients (eg. not only loans but also insurances). Campaigning (commercials) is used to address potential clients and flexible credit conditions are offered (eg. loan periods, payment rates and individualized loan maximum based on individual criteria of microfinance institutions/MFIs). The conversion of microfinance into a “market-led development instrument” shall reach a larger number of “poor people” (cf. Ströh 2010, 293). And as advocates may argue, “the Poor” are not one homogeneous group, but a term that refers to many different groups of people who are in some way or another barred from living the lives they want to live – thus, they need different types of financial services and kinds of products that relate to their personal needs (eg. with consideration of their profession). However, if this new product variety is based on a shift in microfinance institutions “from being a social agency first to being primarily a lending agency that wants to maximize its profit” (Arnab Mukherji, in: Gokhale, 2009) as critics such as Arnab Mukherji, a researcher at the Indian Institute of Management in Bangalore argue and make the “new wave-Microfinance” responsible for, the benefits of this transformation are highly questionable.

Although the German Ministry of Economic Cooperation and Development (BMZ) is aware of the fact that until today there are no independent academic studies who prove that microfinance has a positive impact on poverty (BMZ in Klas 2011, 48 and Faber 2011, 256), the German development minister slanders this lack and just recently reinforced Kofi Anan’s optimistic assessment: “Microcredits have proven to be an effective and economical tool to fight poverty” (quote Dirk Niebel in Klas 2011, 40).<sup>2</sup> The description of a development tool as “economical” has already earlier been picked up by critics of microfinance who argue that the principles of

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<sup>1</sup> In the context of microfinance, commercialization is understood as the move of microfinance providers towards profit-maximization far beyond cost coverage. (cf. Ströh 2010, 1).

<sup>2</sup> In the Original: „Mikrokredite haben sich als wirksames und kostengünstiges Mittel zur Armutsbekämpfung bewährt“ (Dirk Niebel, in: Klas 2011, 40).

microfinance underlay double standards. While on the one hand microcredits shall empower “the Poor”, microloans primarily allow a cheap exit of the welfare states to implement expensive social programs to help “the Poor”. In regard to the implementation of microfinance in the leading development-policy, critics conclude: “Promoting the required ideology of self-help was far more important to the international development community than whether or not microfinance actually worked for the poor (or even just better than other possible policy options)” (Bateman 2010, 205).

## **Amartya Sen: Development as Freedom**

### Significance of Sen in the Development Discourse

This chapter will introduce the development approach formulated by the economist (and Nobel Prize winner) Amartya Sen in his book “Development as Freedom”. Although he published his ideas already in 1999, they are still significant in development policies today and link to the principle of “capacity building” as agreed on by the international development community in 1992. Thus, the ideas provided by Amartya Sen also bond to the ideology of microfinance.

This chapter seeks to present Sen’s approach and discusses his widely recognized ideas, also in the frame of microfinance. Later (in “Examination: Microfinance Performed in Peru”) I will relate and discuss my findings in Peru while referencing detailed elements of Sen’s approach.

In “Development as Freedom”, Amartya Sen’s approach centers on freedom and is comparable with studies focusing on lifestyles, because he understands human development in relation to the opportunities people have to live the lives they want to live (cf. Sen 1999, 37). He investigates five different types of freedom, which help to advance the general capability of human beings: political freedoms, economic facilities, social opportunities, transparency guarantees and protective security (cf. Sen 1999 and Torres García 2009, 82). Sen’s central argument is that all of these freedoms are linked and have an effect on development and vice versa, development is the “integrated process of expansion of substantive freedoms that connect with one another” (Sen 1999, 8). He further argues, that the knowledge of how these freedoms strengthen one another allow individuals to shape their own life (cf. Sen, 1999). Within the mapping of development policies, “Sen’s concept of capabilities turned towards positive values and freedoms—what is possible for people, and thus, can also be seen as the other (positive) side of the coin of the 1970s and 1980s dependency school“ (Torres García 2009, 82).

### Sen on Poverty

In “Development as Freedom”, Sen expands economic indicators of poverty (low income and a lack of basic commodities), arguing that economic restrictions (poverty) always relate to a lack of freedom on various dimensions (Sen 1999, 51). In particular, Sen emphasizes, that poverty limits one’s self-realization and hence, curtails one’s essential freedom (Sen 1999, 32; 100 and 113). According to Sen, economic restrictions caused by a low income are connected with one’s capability in the sense that capability determines one’s income (Sen 1999, 114). Thus, Sen argues that the reinforcement of capability may also improve the productivity and capacity of human

beings to work (Sen 1999, 116).<sup>1</sup> A lack of essential capability further has an impact on other dimensions, eg. access to healthcare, education, etc. and thus, intensifies inequality. Therefore, Sen argues that inequality is also a form of bondage. As a consequence, Sen concludes that poverty must be perceived as a complex combination of discrimination patterns (Sen 1999, 128).

### Sen on Development

Sen believes, development depends on the freedom an individual has and needs to be understood as a process through which the freedom of each individual is expanded (Sen 1999, 13). He argues that development policies need to dispose of the bondages that result in poverty (Sen 1999, 47). In particular, development needs to be perceived as the freedom of choice through which individuals are empowered and freed to develop their personal capabilities (Sen 2000, 50 and 146). Through this process, institutions can then support and strengthen personal independence (therefore: capability in general, Sen 1999, 175) and achieve development due to the increased free agency of people. According to Sen, the strengthening of a democratic system is crucial in order to move forward within the development process (Sen 1999, 193). Healthcare, sufficient nutrition, a relatively high life expectancy, education and political participation become basic devices that encourage greater substantial freedom and set economic development in motion.

### Sen on Freedom

Like development, Sen defines freedom similar to development as a process that allows for independent action and decision-making, which further have a positive impact on human capabilities. Thus, freedom is the ability to live according to how members of a society collectively decide to exist (Sen 1999, 24). In this context, poverty, despotism and a lack of economic opportunities reveal a lack of freedom (Sen 1999, 13).

Individual freedom, in Sen’s perception, has a social origin and is based on the mutual relationship between social facilities that increase individual freedom and the realization that individual freedom is not only for the improvement of the personal life of human beings, but for the better and more effective arrangement of social facilities (Sen 1999, 44). As a consequence, individual capability depends on economical, political and social facilities (Sen 1999, 69).

Sen further distinguishes between constitutive and instrumental roles of freedom (Sen 1999, 36).

The constitutive role of freedom relates to the improvement of human life through fundamental

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<sup>1</sup> According to Sen, child labor for example needs to be understood as lack of economic freedom (in this case: lack of freedom to go to school, Sen 2000, 43) because a family with a low income (or: in a poor economic situation) often depends on additional income provided by their children and thus, limits the child’s capability automatically.

capabilities, such as the ability to avoid starvation, being literate and the ability to influence political decisions through participation in the political system. The purpose of the constitutive role of freedom is to determine how human beings construct their social and economic environment by human beings.

Instrumental roles of freedom are those which directly or indirectly contribute to a humans’ fundamental rights, such as political freedom (civil rights, political participation, freedom of speech, freedom of the press, etc.), the economic opportunity to develop (freedom to consume, produce and trade, right of access to the economy, distribution processes) social opportunities provided by social facilities (for education and healthcare), guarantee of transparency (elimination of corruption) and social securities that take effect in case of emergency and prevent sections of a population from becoming destitute (Sen 1999, 53f.). As described in the beginning, Sen’s concept of freedom takes a crucial position in his approach because he views freedom as the cause and purpose of development (Sen 1999, 51): “Freedom is both the primary end *and* the principal means of development” (O’Hearn 2009).

### Sen’s Development Approach and The Role of Markets

Sen analyzes development in the frame of a market economy and understands market economy as a place without any restrictions, based on trade and exchange (Sen 1999, 39). On a micro-level, he perceives markets to be legitimate means of development in the sense of enabling people to undertake mutually advantageous activities (cf. Sen 1999, 142). Consequently, on a macro-level, he believes that economic inclusion in a global market system, generally becomes the motor for economic growth and highlights the fact that a high Gross National Product (GNP) encourages a high life expectancy rate because state distributions to healthcare and poverty-elimination rise, as well (Sen 1999, 59). Sen also emphasizes that the importance of market mechanisms are underestimated (Sen 1999, 40 and 55). However, although development and economic growth are linked, Sen underlines that other connections are important as well (Sen 1999, 55).

### Discussion of Sen’s Approach

Comparable to poverty, development is a term that has many faces, which Sen analyzes on various levels. In regards to development, he stresses the importance of individual freedom, political freedom, and of economic freedom, and favors a market-orientated economic system in combination with democracy to fight inequality and enhance equality of opportunity (Sen 1999, 176). Interestingly, Sen does not include the aspect of “Otherness” (cf. Edward Said’s “Orientalism”) in his approach and instead believes that his approach is universally applicable



(Sen 1999, 292). He focuses on so-called “universal development triggers”, instead (Bateman 2010, 78). The concept of microfinance is also formulated as a universally applicable approach and, similar to Sen’s “Development as Freedom”, mainly ignores other cultural values and principles, thereby neglecting the question of how “others” are influenced and determined by whom and why. Critics refer to this as a “domination of western values” (Klas 2011, 53), because microfinance programs are perceived as tools to generate modernization according to the western depiction.

Criticism may also be placed on Sen’s positive depiction of human beings, which leaves out selfish behavior (cf. Thomas Hobbes’ Leviathan). Sen argues that he has hope that human beings can handle more freedom and may advance socially through reflection similar to governing institutions, which may operate in a well-considered manner (Sen 1999, 311).

In the frame of microfinance, basic elements of Sen’s approach seem to be put into practice. The fundamental aim of microfinance (cf. “Bank of the Poor” – Attempts, Approaches and Promotion of Microfinance”) has been to provide access to capital for “the Poor” who did not have the opportunity to borrow capital formally at banks before, due to missing securities. Thus, microfinance has enabled more economic freedom for “the Poor”, who can now borrow money formally from MFIs instead of having to depend on private debt collectors (“credit sharks”). Further, they are emboldened to use loans as starting capital for a new business that may improve their living conditions and subsequently encourage development. Consequently, microfinance advocates focus similar to Sen on the improvement of capabilities to assist “the Poor” in helping themselves. Unlike microfinance advocates though, Sen does not transfer general state responsibilities to private markets, but emphasizes the need of a state to secure basic public needs (education, health service, pensions, etc.).

## **“Bank of the Poor”: Attempts, Approaches and Promotion of Microfinance**

In general, MFIs spread the belief that microloans have the ability to reduce poverty, to increase capabilities, to support economic growth (and inclusion in the world market) and to improve the life quality of every microfinance client. This chapter will introduce general main assumptions of advocates on the relation between development and microfinance (illustrated on the approach made by the most popular microfinance advocate Muhammad Yunus) and examine how MFIs operate and promote microfinance internationally.

### Poverty and Microfinance According to Muhammad Yunus

Today the economist Muhammad Yunus, who was awarded with the Nobel Peace Prize in 2006 for supporting “bottom-up”-development through microfinance, is the leading figure of microfinance. Yunus firmly believes that MFIs operating similarly to “his” Grameen Bank contribute to poverty alleviation in any country – a general assumption, which is questioned by recent studies (cf. Bateman 2010, 67) but still agreed on by the international development community. Thus, the following overview will present Yunus’s ideas that shaped microfinance, and in particular the Grameen Bank.

#### ➔ Yunus on Poverty

According to Yunus, poverty is something placed on humans from the outside (Yunus 2010, 8). Further, Yunus argues that poverty not only causes dependencies but also takes away the control over one’s own destiny. This deprives principal human rights from people who are suffering from poverty. Yunus believes that poverty is the biggest threat human beings have to fight against, because poverty causes hopelessness, which drives poor people into actions of despair and makes them more willing to accept violence to improve their situation (Yunus 2008, 127). Similar to this one-sided perception that violent actions are mostly rooted in economic despair, Yunus argues that poverty is predominantly caused by inaccessibility to and control of capital. He emphasizes that “the Poor” mostly work to generate profits for somebody else (Yunus 2008, 139). Accordingly, he believes that microloans invested in entrepreneurship will solve poverty.

#### ➔ Yunus on Microfinance

Originally, Yunus’s idea on microfinance was based on the motivation to counteract the exploitation of poor people who had to borrow money from “credit sharks” at exorbitant interest rates, due to a lack of access to capital from banks (Yunus 2008, 43 and Yunus 2010, 7). Yunus thus defined microloans as credits offered to “the Poor”, who could use the loans without having to provide any securities for realizing business aims (Yunus 2008, 83). He argued, that “people

suffering from poverty do not need pity but access to capital” (Yunus in: Klas 2011, 24). Consequently, MFIs generally operate as including institutions for “the Poor” (Yunus 2008, 8). Nevertheless, he identified two different types of MFIs. “Type 1” belongs to any institution that aims to combat poverty and thus, provide loans without requesting high interest (max. 15 %, Yunus 2008, 83) and securities. MFIs categorized under “type 2” operate by following a profit target and request interest rates that are beyond 15 %. These MFIs do not aim predominantly to reduce poverty but need to achieve high yields for their shareholders and investors (Yunus 2008, 84).

The Grameen Bank, Yunus self-made MFI, one of the world’s largest microloan provider with more than 8 Mio. microfinance-clients (Hartmann 2012, 319) implemented Yunus’ ideas with a special focus on group-loans (Yunus 2008, 36 and 70). Further, Yunus’ MFI specifically addresses female clients who are often marginalized in developing countries and depend on their husbands (Yunus 2008, 231).

Yunus promoted his Grameen Bank as a best-practice example, arguing that, in addition to its aim to reduce poverty, Grameen’s microfinance-clients have the opportunity to influence the policy of their MFI because every client automatically becomes a shareholder, with 9 of the 13 board members elected directly by the clients (Yunus 2010, 5). According to Yunus, the Grameen Bank has proven to be a success because 64 % of Grameen’s clients have improved their living conditions and are no longer defined as “poor” (Yunus 2008, 64). He further argues that Grameen’s recent redemption rate is at 98.6 %, and the MFI has been financially independent since 1995.

Although Yunus believes that microloans generally help “the Poor”, he limits the success of his approach, stressing that microloans cannot be the only solution for every human being suffering from poverty. Instead, microloans may serve as a “stable groundwork for additional programs”<sup>1</sup> (Yunus 2008, 92). However, he uplifts the meaning of money arguing that a loan, similar to nourishment, is a human right (Yunus in: Klas 2011, 17).

#### ➔ Discussion of Yunus’ Approach

Like Sen, Yunus has been influenced by a neoliberal university-education, which both economists received in the United States, and believes that maximizing the opportunity for poor individuals helps them to escape poverty. Furthermore, both economists apply the famous U.S.-American

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<sup>1</sup> In the original: “(...) Mikrokredite schaffen ein stabiles Fundament, auf dem alle anderen Programme aufbauen können, um bessere Ergebnisse bei der Armutsbekämpfung zu erzielen” (Yunus 2008, 92).

ideology “from rags to riches” in their approaches (cf. “the neoliberal mantra”, Hartmann 2012, 255) believing that “the Poor” need to be empowered economically in order to manage their way out of poverty themselves as entrepreneurs. Yunus’s business-oriented approach has been controversially discussed in particular with regard to the shift of responsibilities in the development context and hence, the replacement of state institutions by privately owned market-driven institutions.

The professor of economics and freelance consultant Milford Bateman, for example, opines: “Yunus has many times registered his support for one of the most extreme ‘anti-poor’ demands” (Bateman 2010,158). Furthermore, Yunus’s statements regarding the Grameen Bank have been proven to not correspond with his initial ideas and the released figures: For example, although Yunus himself limits the interest of MFIs that follow a charitable purpose (type 1) to 15 %, Grameen requests 20 % (Yunus 2008, 217). Furthermore, Grameen’s board members are mostly male, although 99 % of Grameen’s clients are female, which opposes his promotion of Grameen as an MFI directed by its clients. In addition, a report by the World Bank and the Bangladesh Institute of Development Studies provided figures indicating only 5 % of the borrowers have successfully escaped from poverty, thus contradicting Yunus’s statement that 64 % of micro-clients have managed to improve their living conditions and are no longer poor (Muhammad 2009, 39). Additionally, critics reproach Yunus and the Grameen Bank for a lack of transparency, because researchers haven been offensively obstructed when requesting details on microfinance clients and aiming to visit them personally. The producer of the documentary “The Micro-Debt”, Tom Heinemann, was even threatened by Grameen during his research (cf. Heinemann in: Hartmann 2012, 343). Although the Grameen Bank clearly operates for profit, the MFI is not registered as a bank but an NGO, which enjoys tax exemption privileges (ibid., 350). Critics even assume that the profit achieved by the Grameen Bank is invested in other associated companies. If this is true, it means Grameen’s microloan clients assist in building Yunus’s company-empire (cf. ibid., 351). This assumption correlates to the reproach of Bangladesh’s minister president Sheik Hasina Wajid, who claims Yunus is a “bloodsucker of the Poor” (cf. Klas 2011, 15). The behavior of the Grameen Bank after natural catastrophes underlines this reproach. It is common practice that even microborrowers who have lost their existence need to repay their loans and interest in the planned order. Yunus justifies this practice, arguing: “The Grameen Bank has experienced many natural catastrophes in its 31 years of existence. If we cancel the debt of micro-clients because of that, they will always ask for a cancelation when, for example, their

home is burned down or something else has happened”<sup>2</sup> (Yunus 2008, 15). Therefore, it is questionable in how far this way of proceeding correlates with Yunus’ general charitable approach.

### International Microfinance Institutions: Attempts and Promotion of Microfinance

When discussing microfinance, MFIs who do not operate within the limitations of a national market, but internationally (so-called IMFIs), need to be examined as well because of their influence on local microfinance structures. They provide funds particular for NGOs, EDPYMEs and other independent supervising institutions who do not practice development according to national competition structures but because of the requirements made by their partners. Although most NGOs and EDPYMEs claim a philanthropic interest, my findings in Peru also indicate that these MFIs follow other purposes, such as operating for profits and/or conducting religious manipulation. Moreover, the financial support of an IMFI is often tied with dependency-structures that are passed to microfinance clients.

Influential IMFIs operating in Peru, such as Kiva, are IMFIs headquartered in the so-called “first world” – in industrialized countries where the money to be invested is generated (see Interview Barton F.).<sup>3</sup> They specialize in fundraising and do not lend microloans to “poor individuals” directly, but invest in partner-organizations (mostly local MFIs), for whom they collect donations with the help of Internet platforms. The following overview focusing on the IMFI Kiva exemplifies how IMFIs operate and how they promote microfinance. Although Kiva is only one example and thus, my results cannot be generalized to 100 % and assigned to the operations of other IMFIs, parallels with other IMIs are easily identified when examining their webpages.<sup>4</sup>

#### ➔ Fundraising by Kiva

On Kiva’s websites, users find information on the IMFI as well as on their cooperation with other MFIs (Kiva cooperates with 164 local MFIs, Kiva 2012) around the globe. Predominantly though, the potential “lender” is confronted with profiles of microfinance clients, who are in need of a microloan and registered at a local MFI for example in Peru. These profiles show

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<sup>2</sup> In the Original: “Die Grameen Bank hat in den 31 Jahren ihre Existenz schon mehrere Naturkatastrophen miterlebt. Aber wenn wir jetzt die Schulden streichen, dann wollen die Leute jedes Mal die Schulden erlassen bekommen, wenn ein haus gebrannt hat oder sonst etwas passiert ist” (Yunus 2008, 15).

<sup>3</sup> Critics emphasize: “By choosing these status symbols as headquarters (skyscrapers in influential cities, cf. Grameen/ note D.W.), MFIs are proclaiming their legitimacy to the regular banking industry, but they are also creating an elitist divide between their ostentatious wealth and their clients’ poverty.” (Bateman 2010, 109).

<sup>4</sup> For further information: <http://micro-ventures.eu>, <http://microvestfund.com>, <http://triplejump.eu>, <http://kiva.org>, <http://kolibrikapital.no>, <http://blueorchard.com>, <http://folade.org>, <http://fortalecer.com>, <http://microplace.com>, <http://freedomfromhunger.org>, <http://oikocredit.org>.

pictures (cf. appendix),<sup>5</sup> often the clients full name and hometown as well as their profession, education, family status and the amount of money they need to improve their business.<sup>6</sup> Users can choose a client to whom they want to lend any amount higher than USD 25. Consequently, together with other lenders, a user provides the complete amount of a loan a client needs without carrying the risk of the total loan.

Additionally for every loan provided, lending users have to pay USD 5 for the service provided by Kiva, which is transmitted as a “donation”. The users themselves do not receive any interest from the client supported nor, officially, does Kiva. Unless users investigate Kiva’s extensive website closely, they will not know<sup>7</sup> that their money will be invested in a local MFI, which generally charges interest for the loan dedicated to the client. Although Kiva argues, that profiles on their field partners contain information on their interest rate, the numbers behind the category “interest and fees are charged” often only indicate “yes”, instead of a numerical percentage (Kiva 2012).

Reports on the client’s (or “borrowers”) activity and repayment are transmitted to lenders via email. Loans are always provided for one year, after which approximately 98.96 % of Kiva’s clients have repaid their credits completely (Kiva 2012). Lenders, whose clients have not repaid still receive their money back from Kiva. Lenders only recognize the delay, because of the reports sent by Kiva on the repayment activity of the clients. After a year, lenders may withdraw their funds or invest again. So far, Kiva has made loan investments as high as USD 377,053,350 provided by 848,438 lenders and given to 917,863 borrowers (Kiva 2012, Stand November 26<sup>st</sup> 2012).

After having provided a loan to any client of the 221 countries represented on Kiva’s platform, users get a personal account and profile on Kiva’s website (they can decide if they want their profile to be hidden from others) in which their lending-activity and personal data is published. Further, lenders may become a member of a social group/team and can chat with other “lenders”. As of November 2012, there are 23,803 lending teams in existence.




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<sup>5</sup> In July, 2011 I lend 25 \$ to four different clients in Peru, which I aimed to visit during my stay in Peru. Unfortunately, Kiva did not cooperate with me and did not forward their addresses. Nevertheless, I received quarterly reports on their repayment and access to the Kiva-online-community. The profiles of the four clients I lend money to is attached to this thesis.

<sup>6</sup> See annex: Email from J.M., July 17<sup>th</sup> 2012.

<sup>7</sup> Even the GTZ verifies, that “lendings (on Kiva’s) website are less direct as it is put into the user’s mind” (see GTZ in Klas 2011, 177).

**Ranking of the Largest Kiva-Groups<sup>8</sup>**

| Social Group/<br>Lending Team  | Philosophy  | Members and<br>Loans                                   |
|--|---|--|
|   | We loan because:<br><br>We aim to decrease world suck   | 32,084 members have lent USD 1,496,300 in 49,912 loans |
| <b>Atheists, Agnostics, Skeptics, Freethinkers, ...</b><br><br> | We loan because:<br><br>We care about the suffering of human beings.  | 22,970 members have lent \$8,912,275 in 302,774 loans  |
| <b>Kiva Christians</b><br><br>                                 | We loan because:<br><br>Pure and undefiled religion before God the Father is this: to care for orphans and widows in their misfortune and to keep oneself unstained by the world. (Jam. 1:27) | 10,287 members have lent \$5,539,000 in 162,705 loans  |

➔ Kiva’s Relation to Local Partnering MFIs

Although Kiva informs the lenders about any payments corresponding field partners have to pay to Kiva, my contact person Javier Melgarejo at Microfinanzas Prisma, which whom Kiva cooperates, explains that Kiva asks their partners to pay commissions (“pequeñas comisiones”) for the transfer of money on a monthly basis (cf. Javier Melgarejo, 09.04.2012, Lima).

According to David Venegas, Executive Director of EDAPROSPO in Lima who cooperates with Kiva, in reality the lending process is different than presented on Kiva’s website. Instead, clients visit an MFI and ask for a loan, which will then be approved by the local MFI. The whole amount will be transmitted to the client within a couple of days (clients who apply for a credit usually need the money immediately<sup>9</sup> and do not have the opportunity to wait until the

<sup>8</sup> Source: Own elaboration with data from <http://kiva.org/community> (accessed November, 11th 2012).

<sup>9</sup> See also F.C., March, 28<sup>th</sup>, Arequipa.

bureaucratic process has finished). Thus, Kiva’s field partners mainly pre-finance the loans that are referred to at kiva.org.<sup>10</sup> Background information and photos of clients are taken by the local MFI after a request has been made. Then, this information is published on Kiva’s website. At that point, any user can visit the clients’ profile and make a donation that will be transferred to the MFI responsible for that client. It takes Kiva another 40 days maximum to provide the money applied for by the client and to transfer this amount to its field partners.<sup>11</sup> Due to transfer costs, MFIs receive their money as a monthly package for all the clients supervised by that MFI. Thus, clients on Kiva’s website have already received their loans and do not depend on the good will of the users who relate to a specific client. Instead the MFIs are in need of reimbursement for the money they have already distributed.<sup>12</sup> Hence, the money that is directly addressed by the lender is not directly received by the so-called “borrower” but instead covers the debts of Kiva’s field partners. It is difficult to prove, if the amounts of money as presented on kiva.org really correspond to the amount of the microloan a client “far away” has applied for. It is possible that not only is “financial power” handed to users of kiva.org, but that the clients’ profiles are fake. Furthermore, the amount credited to a client may depend on the overall financial need of the MFI rather than the clients themselves.

I questioned Kiva about how they ensure that the money provided for a specific client will be used for that specific loan. Kiva indicated their field partners “obtain a random sample of ten borrowers to conduct a verification” and ensure, “all of the funds you contribute to a loan are used to fund the borrowers that you choose”.<sup>13</sup> Sometimes, “if necessary” Kiva’s staff members visit clients in person to confirm the “borrower’s” identity and write reports for Kiva’s portfolio team to guarantee that the borrowers published on Kiva’s website are real.<sup>14</sup> Nevertheless, the frequency and number of field partners maintaining this process remained unclear.

Furthermore, Kiva obliges the so-called “field partners” to use the money generated by Kiva only for small loans (a clear definition and enumeration is not accessible by users) handed to many different micro borrowers. Kiva does not impose a restriction on the interest rate, which credit recipients are charged for by Kiva’s field partners. I asked Kiva, if field partners could charge any interest rate and Kiva replied that it would not partner with MFIs that charge an “exorbitant

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<sup>10</sup> See appendix: Email from David Venegas, July 13<sup>th</sup> 2012 and Email from Timothy Payne, July 26<sup>th</sup> 2012.

<sup>11</sup> See appendix: Email from David Venegas, July 13<sup>th</sup> 2012.

<sup>12</sup> My contact person from Finca (Ryan Markus Alexander, volunteer counselor at Finca) admitted that Finca behaves similar to Kiva in regard to how funds are transmitted to field partners and their clients and transfer-costs are not reported on their website either.

<sup>13</sup> See annex: Email from Celeste Gonda, July 24<sup>th</sup> 2012.

<sup>14</sup> See annex: Email from Celeste Gonda, July 24<sup>th</sup> 2012.



interest rate”. I wondered, how “exorbitant” is defined, but even after two different contacting-attempts this question was not answered to by Kiva.

I visited two of Kiva’s field partners in Peru: Microfinanzas Prisma and EDAPROSPO. According to kiva.org, Prisma requests an interest rate of 38.78 % and EDAPROSPO asks for 45.84 %. The findings of my field-research (cf. “Examination: Microfinance Performed in Peru”) do not correlate with these numbers. J.M. from Prisma (and COPEME reports) estimate the average interest rate to be 60 % at Prisma and D.V. from EDAPROSPO asks for an interest that ranges between 34 % and 42 %. Additionally, according to kiva.org, Prisma’s return on assets rate is – 4.46 % but COPEME identified a negative rate of 14.6 % in 2009/2010 and an even larger negative increment in 2010/2011 of -15.2 % (COPEME 2012, 36).<sup>15</sup>

#### ➔ General Criticism on Kiva’s Way of Proceeding

In addition to the irregularities already described, criticism relates to the general focus of these money-lending websites, simply because they aim to create a good feeling for the lenders and thus, do not focus on the success of the recipient (cf. Bateman 2010, 49). Furthermore, helping others is introduced in this case as a commodity: “wealthy” user can buy a good feeling. Instead of being asked to “click and buy” they are asked to “click and help”. The lending-profiles accessible by other lenders and the possibility to join a social group furthermore let the users gain recognition, because their “good will” is published and becomes measurable.

Another main issue relates to the transparency. Kiva’s website primarily provides general information. Accessing detailed information is rather difficult: Although I examined the website in detail, I had to contact Kiva several times, asking the same questions but did not receive any answers until my contact person, D.V. from EDAPROSPO handed a direct contact to me. Nevertheless, even the direct contact person answered my questions only partly and not in personalized but with general information also accessible on kiva.org. Once again, I contacted Kiva, stressing that I needed the information for my academic research. Once again, key questions remained unanswered with the excuse that, due to the high amount of questions to answer from other users as well, Kiva’s staff had a shortage on time.

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<sup>15</sup> Studies in other countries have found that many MFIs have negative return on assets rates: “Most in the microfinance industry (...) agree with the evidence showing that the bulk of MFIs are unlikely to reach financial self-sustainability. Of the 10,000 MFIs currently estimated to be operating in the world, only 3 – 5 per cent will become financially self-sustaining” (Bateman 2010, 59).

## Criticism on Microfinance

The complex way of proceeding by international MFIs such as Kiva is only one example of microfinance players who over the past 30 years have contributed to the creation of a “microfinance industry” (cf. Leleux and Constantinou 2007, 50f. and Ströh 2010, 8). Although microfinance has attained some successes, most significantly by providing wide access to capital for “the Poor” and has even resisted the global financial crisis (cf. COPEME 2012), researchers are voicing criticism. The following overview refers to general criticism as published by Gerhard Klas and Milford Bateman and aims to show the various aspects they address. Further criticism will also be picked up in “Examination: Microfinance Performed in Peru” when being directly compared to my findings.

### ➔ Conception of Man: Entrepreneurial Spirit

Microfinance is based on the assumption, that every individual has the ability to become economically successful if they have access to capital. Microfinance advocates presumptuously assume that every human being is driven by the so-called “entrepreneurial spirit”. Obviously, this generalization provokes doubts because entrepreneurial activity may not be something every male or female “Poor” wants to do or feels suited for (cf. Bateman 2010, 74).

When taking into account the role of women (with children) in developing and/or culturally patriarchal countries, further second thoughts on the “entrepreneurial spirit” are raised. Studies found that, due to their additional role as mother and wife, the self-employment-strategy as promoted by microfinance advocates forces women quite often “into the most primitive forms of self-employment” (Bateman 2010, 48 and cf. “informalization”).

### ➔ Empowerment vs. New Dependencies

Although microfinance-pioneer Muhammad Yunus argues that microfinance particularly empowers women because they no longer depend on “the wallet of their husbands” and thus reduces gender inequalities, the economic activities (cf. “informalization”) undertaken by female micro-lenders still reflect patriarchal hegemony (cf. *ibid.*, 49) and mostly go along with exploitative structures. Thus, instead of depending on their husbands,<sup>1</sup> women depend on financial institutions and members of their credit-group to whom they have to report their development and to pay interest to. As critics emphasize, especially credit groups whose members become “watch-dogs” and ensure that every group-member pays their rates on time disempower long-lasting community structures. In this context academic studies refer to the

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<sup>1</sup> In Peru, women still depend on their husbands when becoming micro-entrepreneurs, because at most MFIs they cannot request a loan without a signed agreement by their husbands (cf. A.M., Arequipa, 29.03.2012).

theory on “social capital” as defined by Robert Putnam, according to which so-called “bonding” and “bridging” mechanisms come into effect, which underline solidarity but are endangered or “destroyed by microfinance” (ibid., 108) because of the distrust that is provoked in credit-groups.

➔ Impact on Local Structures

Bateman argues that the majority of the microenterprises founded by microfinance-clients, which he examined “have almost no real growth or development potential” (Bateman 2010, 90), because “under conditions of intense poverty-push competition”<sup>2</sup> they copy mostly local enterprises and offer their traditional services more cheaply (ibid., 163). Statistics on the total volume of local businesses underpin this assumption. Although more micro-financed-enterprises enter the market, the total amount of businesses operating in a region usually does not increase (cf. ibid., 73). Instead, competition causes the wage level to descend and employees to work under exploitative conditions. Bateman emphasizes in this context, that those who benefit are not “the Poor”. Instead, “the middle classes in developing countries thus find a source of cheaper goods and services than before” (ibid., 163).

➔ Informalization

The economist M.M. Akash from Dhaka University also relates the increment of “cheap labor” to microfinance (Akash in Hartmann 2012, 367). He stresses that, for the most part, micro-financed-enterprises are opened in the informal sector – a parallel world of work in which employees often work without a contract, receive irregular income and have no access to social securities (cf. “Definitions”). The so-called “working poor” are often individuals who are marginalized due to their education, family situation, health, etc. and have difficulties to accessing work in the “first labor market”. Women and migrants are particularly likely to be employed in the internationally growing<sup>3</sup> informal sector (Carpintero 1998, 36 and Portes et al. 1986). Following this depiction, it is questionable how microfinance improves the life quality of “the Poor”. The journalist Kathrin Hartmann even compares the working conditions of “informal” micro-entrepreneurs to the exploitative labor structures known from the “sweatshops” of economic giants and denounces the absent regulation of world trade in general, which allows wage levels to drop drastically (Hartmann 2012, 281). The journalist Gerhard Klas further emphasizes the responsibility of the international development community, which consequently

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<sup>2</sup> Bateman explains that “swarms of microenterprises” have already been implemented in the areas of interest, which causes increased competition and diminishes the already low profits micro-enterprises can make (Bateman 2010, 68).

<sup>3</sup> In “Die Mikrofinanz-Industrie”, Klas refers to Jude L. Fernando, the U.S.-American professor for development policy at Clark University, who stressed that the increment of informal workers worldwide has been caused by the degradation of investments for welfare states and development and the massive rural exodus especially experienced in developing countries (in: Klas 2011, 277).

extends the number of micro-financed-entrepreneurs working under precarious conditions in the informal sector (Klas 2011, 277).

➔ Impact Assessment

After having done research on microfinance for twenty years in different countries around the world, the economist Milford Bateman concludes: “Microfinance does not work” (Bateman 2010, 1). Even the World Bank questioned the impact of microfinance in its 2008 publication “Finance for All”, writing that “more research is needed to assert whether there is a robust and positive relationship between the use of credit and household welfare, including moving out of poverty” (The World Bank 2008, 104). Bateman explains, that these statements contradict the results of most of the impact assessments carried out since 1995 because “(...) almost all microfinance impact assessments are quite seriously flawed (...) and provide only the good half of the overall economic picture” (Bateman 2010, 77). Although Bateman names various impact assessments carried out by independent studies, which concluded microfinance “had little or no impact, and in some cases negative impact” (ibid., 62), the majority of the impact assessments are carried out by “insiders” who mostly do not assess the reasons for microenterprise failures (cf. ibid., 77 and my findings in “Results of the Field Study”).

➔ Profit-Orientation of MFIs

A key issue of microfinance critics relates to the general question: is it morally acceptable for MFIs to profit from low-income/poor people (cf. ibid., 124), and if so, where is the need to draw a limit? Examples of MFIs selling ultra-expensive microloans, such as the Mexican MFI Compartamos, which requested 100 % of interest for loans, can be found in almost every country, yet few have been discussed in the worldwide press (cf. ibid., 144f). Furthermore, the profit motive of MFIs encourages them to offer more short-term, high profitable loans while longer termed loans are more likely to allow sustainable development of micro-enterprises because their owners are less pressured to make high returns in order to repay a loan quickly (cf. ibid., 95).

➔ Economization (Privatization) of Welfare

Critics often emphasize that NGOs and MFIs in particular fill the place of missing state structures (cf. Klas 2011, 57), which have been reduced during the structural adaption of globalization processes Latin-American countries had to undergo after neoliberalism was initiated

in the 1980s (cf. Hartmann 2012, 328f. and BpB 2005).<sup>4</sup> Since “(...) most MFIs are perceived to be opportunistic and uncaring” (Bateman 2010, 110), not only trust in “caring welfare-state” is lost, but hopelessness due to a more difficult exit of poverty structures and higher vulnerability to poverty is spread.

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<sup>4</sup> With the neoliberal economy-reformation, critics further underline, informal labor and marginalization of people has increased in Latin America (Fernando 2006, 14f.).

## Development and Microfinance in Peru

### Socioeconomic Information on Peru

Poverty in Peru has been caused by external circumstances as well as internal conflicts and thus, also influenced the development of microfinance structures. In particular the debt-crisis that Latin American states had to deal with at the end of the 1970s and 1980s combined with the structural changes caused by the neoliberal globalization processes at the same time, as well as the influence of the “Shining Path” (Sendero Luminoso) tremendously affected the Peruvian society and economy. The following overview provides information on Peru’s historical, sociopolitical and economic background in the past 30 years, and describes the Peruvian poverty profile and trends before referring in detail to Peruvian microfinance in the next subchapter.

#### ➔ History and Politics

The political system of the Republic of Peru (independent since 1821) has been subject to constant change and experienced major transformations in the past 25 years. After several dictatorships, democracy was implemented again in 1980, which was revolted against by Alberto Fujimori in 1993, whose government collapsed in 2000. During his governance, Fujimori implemented neoliberal structures that stopped the hyperinflation, which had affected the Peruvian economy after the debt crisis. However, the neoliberal transformation and Fujimori’s privatization-policy (in accordance with the policy of the IMF) caused large parts of the Peruvian society to drop into poverty instead (Mücke 2006, 499).

Fujimori was celebrated though, for shattering the terroristic Shining Path by imprisoning its leader, Abimael Guzmán in 1992 (Mücke 2006, 495). The Shining Path had terrorized the Peruvian society since the 1980s and had started a civil war (cf. *ibid.*, 494). During the armed conflict between activists of the “Shining Path” and military forces, which used terroristic measures themselves, approximately 70,000 mostly uninvolved Peruvians died (*ibid.*, 495). As a consequence of the civil war, a massive rural exodus took place and about 150,000 mostly indigenous peasants became international displaced persons (IDPs, cf. the CIA Fact Book 2012).<sup>1</sup> A “Truth Commission” has examined the terrible crimes and massacres during the civil war since 2001. However the memory of the atrocities remain very present in the Peruvian society. Many Peruvians are still traumatized and organize protests for compensation payments from the government,<sup>2</sup> because the executive body of the state has not been part of the criminal

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<sup>1</sup> I also accessed UNdata (data.un.org), but the most recent numbers were published at CIA Fact Book 2012).

<sup>2</sup> I attended such a (peaceful) protest carried out by a group of indigenous peasants from Ayacucho myself during my stay in Lima (on April 17th, 2012) – cf. flyer attached.

prosecution until today (cf. Mücke 2006, 496). As a consequence and because of widespread corruption, the majority of the Peruvians do not trust the government, which is perceived to be weak and only contains little room to maneuver due to the neoliberal transformation of the state in the 1990s, which put most of the federal power in private hands (ibid., 501f.).<sup>3</sup>

The Republic of Peru adopted its current constitution in 1993 under Fujimori (who had rewritten the democratic constitution from 1979) but has been changed and amended until today. Since 2001, free and secret elections are carried out in Peru. Ollanta Humala, who belongs to the Peruvian Nationalist Party (“Partido Nacionalista Peruano”) represents the Peruvian society as their president since 2011.

### ➔ Economy

Since 2002, the Peruvian economy has been growing by an average of 6.4% per year<sup>4</sup> with a stable exchange rate and low inflation.<sup>5</sup> The public debt has been reduced from 21.9 % (2010) to 19.9 % (2011). The most recent numbers by INEI (the National Statistics Department/ “Instituto Nacional de Estadística e Informática”) show an estimated economic growth of 6.9 % in 2011, which is related particularly to the high amount of private investments (14 %). Still, the non-coastal areas stay behind the general growth due to a lack of infrastructure.

The working population of Peruvians older than 14 years is mostly concentrated in services (76 %) - only 24 % work in the industry and only 0.7 % in agriculture (INEI 2012). The informal sector is not part of these statistics but still very relevant. Even the National Statistics Department recognizes most of the Peruvians are employed informally (INEI 2012). The liberalization of the economy in the 1990s has diminished the formal sector for the benefit of the informal sector (cf. Mücke 2006, 505).

The Peruvian economy depends on the export of mineral and metals and import of foodstuffs, which makes the economy susceptible to fluctuations in world prices (CIA Fact Book 2012). In 2011, Peru exported goods valued at USD 46.27 billion and imported goods valued USD at 36.97 billion. The most important trade partners of Peru are the United States (30 %), the European Union (25 %) and the Andean Pact (6%, INEI 2012). Although Peru has continued to attract

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<sup>3</sup> J.R. (09.04.2012, Lima) also underlined the problem that Peruvians do not have a lot of confidence in the state because of the past. Identification is rather based on the regional than on the national level (eg. in Arequipa the citizens invented a local passport). The geographical diversion and history complicates the development of a common identity and empowers racist groups.

<sup>4</sup> In 2011: 6.9 %, predictions for 2012 vary between 5.5% and 6% (COPEME 2012, 11).

<sup>5</sup> 4.47 % in 2011 and is estimated to not top 4.17 % in 2012 (COPEME 2012, 11).

foreign investment, critics emphasize that political disputes and protests may limit the development of some projects related to natural resource extraction (cf. protest that have been evolving on the mining project “CONGA”).<sup>6</sup>

### ➔ Poverty

Although a growing number of Peruvians shares the benefits of economic growth and for Peru, the Gini Index<sup>7</sup> has slightly improved (from 51 (2005) to 48 (2011), UNDP 2012); income inequality is still persistently high. According to the latest Human Development Index (HDI)<sup>8</sup> from 2011, Peru has experienced constant positive development since the 1980s and is ranked on place 81 (out of 169 countries analyzed). Its stage of development is slightly above the general development in Latin America and the Caribbean (0.742 to 0.731, UNDP 2012).

According to INEI, 27.8 % of the Peruvian population is classified as poor.<sup>9</sup> Compared to 2010, INEI announced an improvement in the poverty rate of 3 %. In total, 8.3 million Peruvians suffer from poverty. The regions with the highest poverty rates are Apurímac, Cajamarca, Huancavelica, Huánuco and Ayacucho, in which 53 – 57 % of the population are poor. Strategies to combat poverty have shown success in the “Selva”, where poverty has been reduced from 39.8 % (2010) to 35.2 % (2011). In the coastal region, poverty has decreased by 2 % in comparison to 2010. In regards to the occupation of “the Poor”, INEI announces that the majority works in micro-enterprises or small enterprises. According to Conger et al. (2009, 14), in Peru every third small business received microcredits in 2008.

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<sup>6</sup> During my stay in Peru, protesting miners blocked main interestates for days and caused that commodities could not be transported to or out of Lima (travelling to and from Lima was impossible at that time, too). The mining unions appeared very powerful and the mediareports supported them, underlining the problematic policy carried out by the government. With reference to these reports and different conversations, it seemed to me as if the majority of the society accepted the mining protests.

<sup>7</sup> The higher the Gini-Index (up to 100), the more unequal is the distribution of income. Compared to the German Gini-Index: 28 (UNDP 2012).

<sup>8</sup> The Human Development Report, which is published by the United Nations Development Programme once a year, focuses on multi-dimensional indicators of development and is based on Sen’s understanding of poverty. The central indicator is the Human Development Index (HDI), which includes the Life Expectancy Index, the Education Index and the Income Index.

<sup>9</sup> The numbers provided by INEI differ with those published by CIA Fact Book (2012) according to which 31.3 % of the Peruvian population to live below the poverty line. This might be due the use of different definitions on the poverty line. While INEI uses a definition (cf. “Abbreviations and Glossary”) that reduces the amount of people suffering from poverty due to the determination of a very low income (approx. USD 0.30 per day), does the World Factbook relate to the poverty line published at the World Bank: USD 1.25 per day.



## Panorama on Microfinance in Peru

The Peruvian microfinance market is barely concentrated (according to Conger et al. 2009, 14 and COPEME 2012,12: the three main institutions concentrate only 38 % of all microcredits)<sup>1</sup> and further, is perceived to be the most diverse and developed on a global level due to its constant growth and the high amount of foreign sponsors (Conger et al. 2009, 14; COPEME 2012, 12; IDB and The Worldbank in SBS 2011; The Economist 2011). The various MFIs that offer financial services and credits for the so-called “Poor” are multinational banks, IMFIs, NGOs, EDPYMEs, Credit Unions and specialized local banks (Conger et al. 2009, 13f.). According to the latest data published in December 2011, the Peruvian microfinance sector is composed of 1,555 different MFIs, which primarily concentrate in urban areas<sup>2</sup> and employ 30,000 Peruvians (cf. Barton F., 10.04.2012, Lima). MFIs that operate in less developed regions in Peru are mainly NGOs and EDPYMEs (Aguilar Andía 2011, 19).

### ➔ Supervision of MFIs in Peru

Next to the governmental supervision agency SBS various private organizations and associations exist, such as COPEME that monitor microfinance players in Peru. On a state level, SBS<sup>3</sup> supervises the MFIs operating in Peru based on a regulatory framework addressed to banks, financial institutions (“Financieras”), Cajas Municipales, Cajas Rurales and EDPYMEs as determined in the “General Law No. 26702 of the Financial System and Insurance System”.<sup>4</sup> SBS ensures the stability and solvency of financial institutions that participate in the Peruvian financial system in order to protect the funds and savings of clients, while NGOs remain unregulated by SBS. Regulated MFIs must report to SBS on monthly basis.

COPEME<sup>5</sup> evaluates regulated and unregulated MFIs, particularly NGOs and Credit Unions, who cooperate with COPEME voluntarily. In this way, MFIs that cooperate with COPEME are part of the reports on microfinance which COPEME releases quarterly for the public and for the players involved in microfinance in Peru. Numbers released by COPEME are based on official numbers provided by the MFIs themselves as well as on data published on MIX Market.

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<sup>1</sup> However, according to Ströh (2010, 11f.), estimates assume that less than 10 % of the largest MFIs serve 80 % of microfinance clients in Peru, which limits the significance of the Peruvian findings.

<sup>2</sup> 524 Cajas Municipales, 117 branches of MiBanco, 351 Financial Companies, 244 Cajas Rurales, 172 EDPYMEs and 147 NGOs (cf. COPEME 2012, 32).

<sup>3</sup> SBS = “Superintendencia de Banca, Seguros y Administradora de Fondos de Pensiones” (Supervisory Authority for Banks, Insurances and the Administration of Funds and Pension)

<sup>4</sup> Download of Law No. 26702: [www.bu.edu/bucflp/files/2012/01/General-Law-No.-26702-of-the-Financial-and-Insurance-Systems.pdf](http://www.bu.edu/bucflp/files/2012/01/General-Law-No.-26702-of-the-Financial-and-Insurance-Systems.pdf) (accessed October 29th, 2012).

<sup>5</sup> COPEME = “El Consorcio de Organizaciones Privadas de Promoción al Desarrollo de la Pequeña y Microempresa” (Consortium of Private Institutions).

MIX (Microfinance Information Exchange) Market is a non-profit rating agency evaluating MFIs around the world. The information provided by MIX may serve potential investors in deciding, which MFI to invest in. Thus, MIX Market assesses MFIs based on their credit volume and their repayment quota. Consequently, MFIs with high interest rates and high return on equity are perceived to be the most profitable (cf. MIX Market 2012, Hartmann 2012, 364 and Klas 2011, 31). The impact of microfinance on clients is not taken into account, neither their financial background, as over-indebtedness is not measured by MIX. Furthermore, MIX lacks in providing information on loan conditions of MFIs for potential clients. However, since 2006, the “Alliance for Fair Microfinance” and the global initiative “MicroFinance Transparency” fill in this gap and monitor conditions provided by MFIs, “seeking fair and transparent pricing in microfinance” (Bateman 2010, 131). Currently, the United Nations is working on an official seal of approval for MFIs which aims to reevaluate microfinance (Klas 2011, 222).

#### ➔ Transformation of the Microfinance Market in Peru

According to the most recent numbers published by SBS and COPEME, MFIs represent 16 % of all players operating in the Peruvian financial system. Therefore, microfinance is still a small segment of the Peruvian banking industry. Nevertheless, microfinance is growing in Peru. In comparison to 2010, 170 additional MFIs were found in 2011 (an increase of 11 %, COPEME 2012, 32) and 300,000 more debtors were registered (MIX Market 2012b).

Due to this constant growth of microfinance in Peru, this sector triggers a significant amount of transformation (cf. COPEME 2012, 27). Thus, MFIs are often sold, merged or transformed, particularly NGOs who try to become EDPYMES (cf. F.C., 30.03.2012, Arequipa). For an EDPYME, loan capital is less expensive than it is for NGOs. EDPYMEs therefore try to become financial companies for whom it is easier to generate foreign investments. Financial companies then attempt to increase their size and turn into banks (cf. COPEME 2011, 9). Subsequently, MFIs often merge (eg. of NGOs/EDPYMEs and Financial Companies) because a fusion allows the offering of a greater variety of credit products, particularly addressed to “microempresarios” and at a lower cost (COPEME 2012, 28 and COPEME 2011, 9).

#### ➔ Products and Conditions of Microloans in Peru

Credit products offered by various microfinance players primarily differentiate among the number of borrowers involved. Thus, MFIs offer group-lending to “grupos solidarios” of at least five different borrowers and individual lendings (“créditos individuales”), which are for those

borrowers who have securities (such as a formal employment or property) and are in need of higher lending. Members of a credit group receive funds that need to be divided among the members who secure the repayment of each member and share the risk (Carpintero 1998, 78).

In Peru, group lending is less popular, especially in urban areas. Thus, 78.9 % of microfinance-clients receive microloans as an individual lending (COPEME 2012, 53).

A recent resolution passed in July 2010 by the SBS (Res. SBS 11356-2008) classifies credits in the following categories (cf. COPEME 2012, 8):

- Corporate Credits (Créditos Corporativos)
- Credits for Large Companies (Créditos a Grandes Empresas)
- Credits for Medium Companies (Créditos a Medianas Empresas)
- Credits for Small Companies (Créditos a Pequeñas Empresas)
- Credits for Micro Companies (Créditos a Microempresas)
- Consumption Credit (Créditos de Consumo)
- Mortgage Loan (Créditos Hipotecarios para Vivienda)

According to this categorization, there is a difference between credits distributed to small and micro-companies (cf. Res. SBS 11356-2008 in COPEME 2012, 8). The distinction is made on behalf of the amount of total debt. Although both credit-types are destined for the finance of production, commercialization and provision of services, in order to be classified as loan for a small enterprise, a company already needs to have a total debt of more than 20,000 PEN (approx. USD 7480) but less than 300,000 PEN (approx. USD 112,150) in the last six months. Meanwhile, micro-companies cannot exceed a total debt of more than 20,000 PEN in the last six months – excluding mortgage loans (cf. COPEME 2012, 8).

The interest rate passed to the clients varies and depends on the product. However, the most recent chart released by SBS in July 2012 shows a high discrepancy in regard to credit-costs based on the introduced credit-categorization. For example, the interest rate a large company has to pay for a loan varies between 6.05% and 7.3% while the interest rate a small company has to cope with ranges between 14.89% and 23.73%. A micro-enterprise has to pay an interest rate of 18.93% to 39.52% on average per annum/p.a. (cf. SBS 2012 and COPEME 2012, 23). These numbers only include MFIs which are regulated by SBS; interest rates of NGOs and Credit Unions may even be higher. In general, interest rates on higher amounted loans are lower than on microloans. This is caused by transaction costs financial institutions have to cover, which are equal for every loan requested. However, due to the relation of interest rates and amount credited, the redemption amount of large loans is higher as of microloans.

The interest rate percentages a client has to pay depend on four indicators:

1. costs the MFI has to pay for the credit itself,
2. operational costs (eg. employees, rents for the offices, advertisement and transportation costs),
3. credit defaults and finally
4. profits, to increase its stock of capital and to finance its future growth

NGOs often have the highest interest rates while banks such as MiBanco and CMAC’s generally offer lower interest-rates. According to a study carried out by the IDB, this is because NGOs working in microfinance have to cope with a lower efficiency caused by their high operational costs (IDB 1994, in: Carpintero 1998, 74).

In Peru, interest rates are not regulated by SBS and can be as high as 100 % or as low as 0 %. Representatives of MFIs that I interviewed often argued that a regulation is not necessary because the competition among the different players itself reduces the interest rates to a decent percentage. Further details on interest rates will be provided in the chapter on “Examination: Microfinance Performed in Peru”. Together with a credit-product, insurances are often sold guaranteeing in case of death the payment of the outstanding credit by the MFI and thus, “after ‘Credits for the Poor’ the new slogan is ‘Insurances for the Poor’”<sup>6</sup> (Klas 2011, 291) This development will also be analyzed in “Examination: Microfinance Performed in Peru”.

#### ➔ Problematic Tendencies of Microfinance in Peru

A general problem identified by COPEME is that the Peruvian microfinance-industry has to deal with the increasing occurrence of over-indebtedness of microfinance clients. Although in 2011, the main MFIs operating in Peru have had more exclusive clients than those who received loans from various institutions at the same time<sup>7</sup> and those who with more than four microloans at the same time averaged between 0.8% and 2.4 % (cf. appendix, Table 14), the number of parallel loans increases constantly and at the same time as the risk of over-indebtedness (detailed discussion in “Examination: Microfinance Performed in Peru”).

Another problem is the morbidity increment. Although the sensitivity for savings is overall growing, most clients are not aware of its importance (COPEME 2012, 27 and 99: “Si a todo

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<sup>6</sup> Original quote: “Nach Kredite für die Armen heißt das Motto also Versicherungen für die Armen” (Klas 2011, 291).

<sup>7</sup> Only EDPYMES had less exclusive clients than those with multi-loans.

esto se suma la poca cultura de ahorro en el Perú (...). Only a few clients see the need to save money on their bank account, which is also caused by the fact, that banks often charge high commissions for every cash withdrawal and the maintenance of those bank accounts (cf. interview with COPEME).

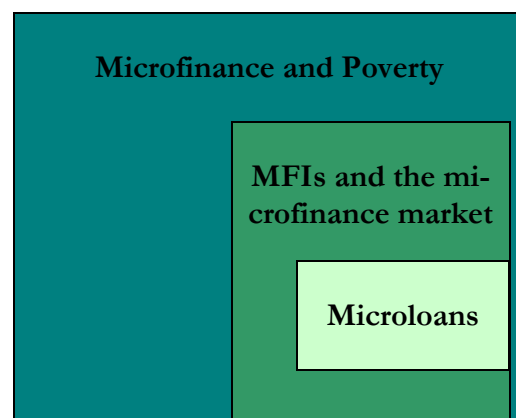
## **II. Field Research: Microfinance in Peru**

### **Introduction**

#### **Aims and Structure**

In order to fulfill the demands of the complex field of microfinance and to bring my field study into a treatable format, I identified three general dimensions of microfinance based on the hypotheses referred to earlier that I decided to focus on:

- 1) Microloans as financial commodities,
- 2) MFIs and the microfinance market as operating players and finally,
- 3) the mutual connection of microfinance and poverty (effects of microfinance on poverty and vice versa).



The following chapters will concentrate on terms and conditions of microloans in Peru, evaluate the different players and the Peruvian microfinance system, and examine how effects of poverty in relation to microfinance are determined and valued in Peru. Each of these chapters begins with a presentation of answers provided by the participants of my research. In a secondary step, the results will be analyzed and discussed, compared to general criticism on microfinance as formulated by Klas and Bateman, and linked to Sen’s concept of development.

After a brief presentation of the MFIs, the MFI-representatives, and the clients that participated in my field study, the section on “Terms and Conditions of Microloans” aims to find out how microloans are framed in Peru. Consequently, the following central questions will be answered:

- Who has access to microloans? Who is addressed? What securities are necessary to take out a loan?
- What credit products are offered and which amounts are credited? For what purposes can loans be requested? What limitations do exist? Are microloans used as a quick stimulus with a short or long-term duration and dependency (duration of microloans)?
- How are payment conditions framed? On what terms are microloans provided (interest rates), and what consequences do clients have to fear when it comes to payment delays?

The chapter “Evaluation of Microfinance Players and the Microfinance System in Peru” examines characteristics of the MFIs operating in Peru and the structural elements of microfinance, focusing on the subsequent aspects:

- How do MFIs compete in Peru? How do MFIs use commercials to promote their work?
- How are regulation and supervision of microfinance put into practice in Peru? Are there any obvious lacks in the Peruvian microfinance system?

The “Effects of Microfinance in Peru” are tackled in the chapter of the same name, which questions:

- What sustainable effects can be measured in Peru?
- How do clients and the involved players evaluate microfinance in Peru?

## **Methodology**

### Preparation of My Field Study

In March and April 2012, I conducted a qualitative field research in Peru with the purpose of receiving detailed information on how microfinance is practiced and perceived in a country known for having the most developed microfinance system in the world. I decided to carry out qualitative interviews because this method offers the opportunity to receive detailed subjective information from individuals involved in the microfinance system; plus, questions are less likely to be answered arbitrarily in qualitative versus quantitative studies (cf. Diekmann 2007, 439 and 444).

The interviews with MFI representatives followed a focused, guideline-based structure (cf. appendix: Questionnaire 1). I used guiding questions instead of a narrative interview because microfinance in Peru is based on different parameters, which I aspire to analyze in detail. Thus, information would have been difficult to gather with a narrative interview, in which the person questioned answers mainly general questions in a detailed, subjective manner. The focused, guideline based interview developed by Merton and Kendall in 1946 grounds on pre-formulated assumptions which provide the content structure and are verified or falsified during the interview by the subjective experience of the person questioned. This interview format allows unexpected responses and new points of view or aspects to be included in further analysis (Diekmann 2007, 439). Therefore, I developed partly standardized questionnaires with individual questions concerning the background of the person questioned or the MFI the person has worked for. Addi-

tionally, I created questions spontaneously whenever the participants of my research addressed additional interesting topics. I did not use any closed-questions but open questions focusing on attitude and opinion as well as one rating-question to ensure that answers were not provided within a certain category but could be arranged “outside the box” of my pre-defined assumptions (cf. Diekmann 2007, 477).

Due to the fact that I did not have any contact information for microcredit clients, nor the chance to arrange any meetings with microcredit clients in advance, I visited them spontaneously during their work hours. Therefore, I had to adapt my interview-strategy to these circumstances and developed a problem-oriented interview in which qualitative and quantitative elements were combined (Diekmann 2007, 543). This short guideline-based interview consisted of open questions (cf. appendix: Questionnaire 2), which the clients answered verbally and/or filled out by hand. Both questionnaires, the one answered by MFI representatives as well as the one handed to microfinance clients were arranged in a similar order and started with so-called “warm up” questions followed by specific questions and finished with more general questions (cf. the “suspense curve”).<sup>1</sup>

### Selection of The Persons Questioned

To arrange “face-to-face” interviews, I contacted MFI representatives in Arequipa and Lima,<sup>2</sup> the two Peruvian cities in which the majority of MFIs are located (COPEME 2012, 105) and attempted to talk to representatives of structurally different MFIs operating in Peru. I sent emails to employees of banks, NGOs and EDPYMES and paid particular attention to those who work in cooperation with other MFIs and IMFIs, so as to not exclude any external influences. Unfortunately, a lot of emails remained unanswered (cf. Table 2), but after arriving in Peru, I profited from the “network” of the MFI-community and was able to talk to representatives of five MFIs and two monitoring organizations (cf. Table 3).

In general, I interviewed MFI representatives in their personal office or the MFI’s conference room. Only the interview with A.M. took place in public – at a local coffee bar. Every interview I held was personal and without third-person influence. All of the persons questioned answered every question raised and were willing to answer any additional question via email.

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<sup>1</sup> According to the “suspense curve” will the attention of the person questioned climb up in the beginning and drop with the time passed during the interview (cf. Diekmann 2007, 484 and König 2005, 91).

<sup>2</sup> Lima is the economic, financial and political capital of Peru. The headquarters of the most influential banks and MFIs are located here. The microfinance-market in Arequipa is perceived to be one of the best-developed in Peru (cf. Ströh 2010, 36).



I had hoped to arrange meetings with microcredit clients after having talked to the MFI representatives in order to juxtapose the information provided, but unfortunately, all of them denied to hand contact information to me or to arrange any meetings with their clients, by referring to their privacy protection policy. Only D.V. from EDAPROSPO offered to take me to a group meeting of EDAPROSPO’s clients, which is arranged once a



month. However, the earliest visiting-date possible would have been after I had returned to Germany. As a consequence, I went to the center of Lima (“El centro”), a famous district for street hawkers, simple kiosks, fast-food stands, petty services and the printing industry. There, I talked to approximately 30 different people, yet surprisingly, most of them had never heard about microcredits (“microcréditos”/”micropréstamos”). However, I did meet four microfinance-clients who accepted my invitation to be part of my research and answered my questionnaire.

Later, I went to “Polvos Azules” which is a giant marketplace, popular for a variety of commodities and food-shops. “Polvos Azules” is situated in Lima’s poorest district:

“La Victoria”. Therefore, I assumed that entrepreneurs who use microcredits to build up a business would choose to do so in “La Victoria”. Again, I discovered microcredits are not as common as I had expected them to be, and although many shop owners and their employees had heard of microfinance, only a few of them admitted to financing their business with the help of a microloan. In the end, three entrepreneurs answered my questions at “Polvos Azules”. Since I attempted to include clients with many different



professions, I further visited “Gamarra”, a popular district also located in “La Victoria”, where clothes are manufactured and sold. Three entrepreneurs agreed to fill out my questionnaire there.

### Limitations of My Research

Limitations of my research regard two aspects:

1) The likelihood that answers given during my interviews may be distorted or adulterated cannot be eliminated completely due to the following influencing factors. In general (with one excep-

tion), my interviews were held in Spanish, my competence of the Spanish language being at the European level “B2”. Consequently, differences in language constructs (in regard to the use of language and the definition of words according to one’s cultural background, cf. König 2005, 85f: “principle of strangeness”) may have caused a divergent understanding of the questions raised and/or questions may have simply been misunderstood. Furthermore, the person questioned may have answered dishonestly because of memory errors (Diekmann 2007, 449), or when feeling uncomfortable with sensitive questions asked, answers may have been a compromise between reality and the general desired social behavior (according to their perception). I tried to eliminate this so-called “social desirability effect” (Diekmann 2007, 448) by asking mostly neutral questions and introducing those, which provoke sensitive and revealing answers as if the deviant behavior was normal (eg. question on corruption).<sup>3</sup>

2) The group of clients I interviewed consisted of nine male and only one female “microempresarios” in the end, which unfortunately excludes a close analysis of microfinance in regard to gender. Although I talked to many female employees at the different locations that I visited, most of them did not identify themselves as owners of the shop and again only a few of them knew the term “microcrédito”/“micropréstamo”. All clients questioned received payments as individual lenders, which does not enable me to discuss group lending in my field-research. Moreover, only two clients questioned obtained credits from an MFI that has been part of my qualitative research (MiBanco). Thus, it is impossible to contrast opinions of other microclients questioned with the statements given by the MFI-representatives of my qualitative research. Additionally, owing to the fact that only ten clients and eight employees and/or experts of MFIs were questioned in total, this study’s representativeness is limited.

Nevertheless, the limitations of my study do not outweigh the benefits. The answers given by the participants of my field study provided important information on microfinance in Peru, which will be presented and discussed in the next chapter.

### Evaluation of My Research

I analyzed the responses of the persons interviewed (as well as additional information received from websites, photos, flyers and my own observations) following the “grounded theory” method of content analysis, which provided a systematic and objective evaluation of my data (Diekmann 2007, 577) and thus contributed to more accurate and less biased results. Primarily, I transcribed my interviews and used codes for every sentence to reduce the complexity of my material

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<sup>3</sup> This strategy is also known as the asking of “opposite suggestive questions” (Diekmann 2007, 449).

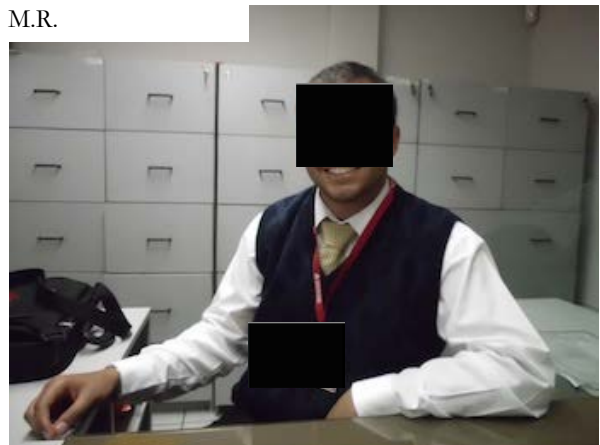
and to further develop categories (Mayring 2000, 76) which helped me to order and contrast the statements given by every participant of my research. Subsequently, I created a hierarchal order of categories, which consisted of main- and subcategories that assisted in filtering and rating the statements given according to the amount of codes assigned to a specific category. The categories were created and defined in relation to my research questions, which I introduced in “Introduction of Field Study – Aims and Structure”, and thus allowed for a “rule-guided” interpretation (Mayring 2000, 603). Since I evaluated my research by myself and used codes and categories according to my perception, it may be argued that the objectivity of my research is limited and the principle of “Inter-Koderreliabilität” (Mayring 2000, 604) is not fulfilled. Although the high amount of information provided in the interviews (cf. transcriptions) bar detailed analysis of every sentence said, I included most of them and therefore examined as many aspects and parameters as possible during the evaluation process.

### Participants of My Field Study

The following introduction of the MFIs that participated in my field research will provide information on their sizes<sup>4</sup> and positions within the microfinance market in Peru, as well as on their programs and allies. Later, the persons interviewed will be presented.

The “Cajas Municipales” (CMACs) were established by an initiative of the German government and the GTZ in 1983, following the approach that credits should be democratized in Peru and be controlled by a regulated (regional not state-run) financial system (Cayo and Bravo 2009, 9). Following this idea, the Caja Municipal Arequipa (CMAC Arequipa) is noted as the leading “Caja Municipal” in Peru due

M.R.



to its number of clients (among them about 208,000 microloan-clients, the total number of clients in 2011 was 227,287, cf. MIX 2012e.) and branches (more than 50) in Peru (COPEME 2012, 57). About 2,500 Peruvians are employed at CMACs. In general, Cajas Municipales do not cooperate with other MFIs, but they receive funds from other banks such as the “Banco Continental” and “Banco de Crédito”. Although CMAC Arequipa provides all types of loans as defined at SBS, their main business focuses on microloans because the majority of their clients request microcredits. I interviewed M.R. at a CMAC Arequipa branch office in Cayma, Arequipa.

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<sup>4</sup> The Rankingtable 15 “Investments of the MFIs” is placed in the appendix.

M.R. works as an analyst for CMAC Arequipa since 2011. His work primarily consists in promoting credits, recruiting, evaluating and presenting clients within the banks’ committee.

Today MiBanco, a former NGO called “Acción Comunitaria del Perú” that became the first and only Peruvian microfinance bank in 1998, has more than 110 branches throughout the country, employs about 3,000 laborers (cf. B.F., 10.04.2012, Lima), and supported 488,721 clients in 2011 (cf. MIX 2012f.). MiBanco (similar to Bancosol, the first microfinance institution in Bolivia) exclusively operates in microfinance and aims to provide small, short time loans that are mainly used as working capital (Carpintero 1998, 76 and Cayo and Bravo 2009, 10), yet also offers other long-term credit products, such as mortgages and leasing loans. MiBanco allies with MiBanco in Brazil and Mexico. I interviewed M.E. who started to work for MiBanco as an analyst in February 2011. She studied law, administration, and economics, and after graduating started to work for different banks, among them “Caja Rural”.<sup>5</sup> Two of MiBanco’s (exclusive) clients that I talked to during my field research in Lima are Kenny Rosales Canchari and Jhony. It is important to note that information provided during my interviews with MiBanco and MiBanco’s clients only relate to conditions MiBanco offers in Lima because products differ throughout the country (M.E., 12.04.2012, Lima).

The NGO Paz Peru, headquartered in Arequipa, is responsible for 1,700 clients. The Swiss pastor Friedhelm Krieger initiated its founding when opening an outpatients’ clinic in Cayma, Arequipa in 1993 that became known as Paz Peru. Today, the NGO manages two outpatients’ clinics and other social projects, such as the program “Sonrisa” (smile) which attempts to improve the life quality of Peruvians who suffer from poverty. Paz Peru maintains its own clothing workshop and children’s home, in which children and adolescents who have experienced different forms of abuse are taught and cared for. These programs are financed through profits made of the outpatients’ clinic, the clothing workshop and Paz Peru’s microfinance program.

The microfinance program was implemented in 2008 and pre-financed by a loan Paz Peru itself received from the Swiss foundation of the same



<sup>5</sup> The “Cajas Rurales de Ahorro y Crédito” (CRAC) were founded in 1992 after the “Banco Agrario” had disappeared from the market (Cayo and Bravo 2009, 9).

name. The interest-rate of the loan is “low” (according to F.C. who is the person responsible for coordination and supervision of the microloan program) and has the purpose of supporting “a responsible development of Paz Peru, to learn to achieve auto-sustainability and to develop strategies that permit them to grow”. I interviewed F.C. who started to work for Paz Peru in 2008 and thus, shaped Paz Peru’s microfinance program from its beginnings.

EDAPROSPO (Equipo de Educación y Autogestión Social) was founded in 1978 and today is an NGO that concentrates on education and social self-management of local regions, following the principle to build a democratic “cultit-solidari” society. Women belong to EDAPROSPO’s target group and the NGO maintains projects that promote education, training and work especially in rural areas. EDAPROSPO has different projects and programs, among them the microfinance program “Prosperidad” (prosperity) with whom the NGO wants to instigate decentralized microfinance based on “socioactividad”. EDAPROSPO already started with microfinance on a small basis in 1997/98, and the extensive program “Prosperidad” was found in 2003/04. In 2011, EDAPROSPO supported 5,369 borrowers in Peru (cf. MIX 2012c.). Group lendings accounts for 80 – 85 % of the loans provided by EDAPROSPO and are given to clients in and around Lima. EDAPROSPO cooperates with Kiva (since 2008) and other MFIs from whom they receive funds to finance themselves. I spoke with D.V., the executive director of EDAPROSPO who has been working for EDAPROSPO since 1994/1995.



J.R.

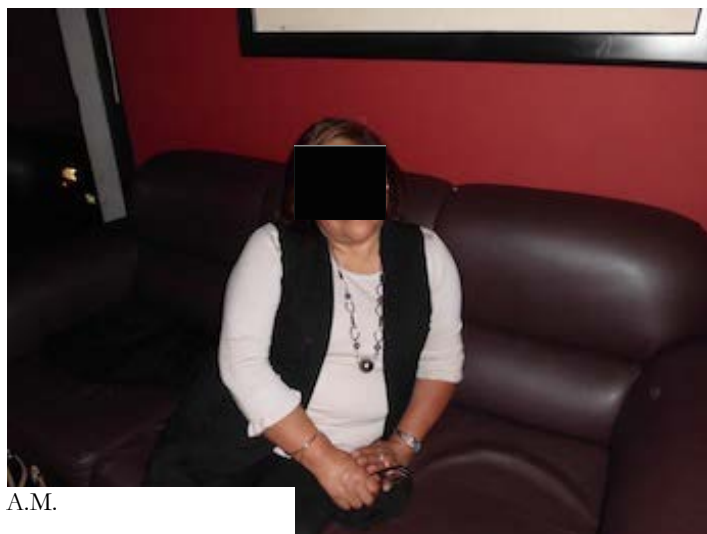
The NGO Prisma, found in 1987 and headquartered in Lima, focuses on the development of local structures, the improvement of education, and inclusion of marginalized Peruvians. In addition to their programs on “family and community empowerment” they run a microfinance program named “Microfinanzas Prisma” which, similar to EDAPROSPO, mostly provides group lending and also receives funds from Kiva (since 2007) on a monthly basis.

In 2011, Prisma lent loans to 18,194 clients in Peru (cf. MIX 2012d.). I interviewed J.R., an economist with 25 years of working experience in the Peruvian finance sector. In the past nine years he primarily focused on microfinance and is a lecturer on this field at the “Universidad del Pacífico” in Lima. He began to work for Prisma in February 2010 and quit

in June 2012. Today, he works for “Caja Rural”, but during our meeting was still employed at Prisma.

PeruCámaras is a non-profit association in which elected representatives of entrepreneurs working in trade, production and services meet to exchange experiences, to work on bilateral contracts with the government and to develop common strategies to improve the situation of entrepreneurs working in these fields. PeruCámaras supervises 70 sub-Cámaras located in different provinces in Peru. The main focus of PeruCámaras is the development of regional industries in rural areas.

I met with A.M., the former president of PeruCámaras, executive director of “La Cámara de Industria, Comercio, Artesanía de la Pequeña y Microempresas de Arequipa en la Región Sur” (Chamber for Industry, Trade, Handicrafts of small- and microbusinesses in Arequipa, in the South) and the president and founder of “La Asociación Peruana de Mujeres Industriales del Perú” (Peruvian Association of Women working in Industries in Peru).



A.M.

The non-profit association COPEME (“El Consorcio de Organizaciones Privadas de Promoción al Desarrollo de la Pequeña y Microempresa” - Consortium of Private Institutions) was founded in 1990 and is headquartered in Lima. COPEME evaluates and advises MFIs in Peru and provides a quarterly report on microfinance in Peru, which is financially supported by international and national GOs and NGOs, such as USAID and OIKO Credit. Further, COPEME finances itself through the financial training offered to Peruvian MFIs. I interviewed B.F., a former GTZ-agent who helped to develop the Cajas in Peru in the 1990s. He has been employed at COPEME as an advisor for more than 10 years and is teaching Peruvian advisors working for COPEME.



B.F.



As financial arm of the World Bank, the International Finance Cooperation (IFC) specializes on the private sector in developing countries. The IFC was found in






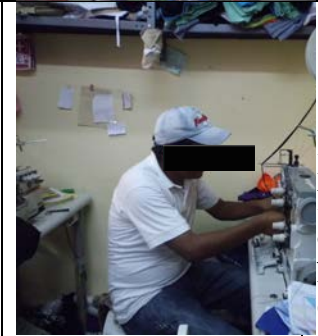

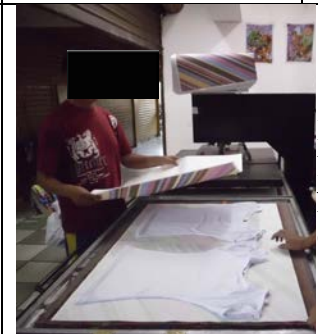
1956 and is headquartered in Washington D.C. but has a branch in Lima, Peru. It is owned by 184 member countries and works in more than 100 developing countries with the intention to “create jobs, generate tax revenues, improve corporate governance and environmental performance, and contribute to their local communities” (IFC 2012). Its vision is to reduce poverty and improve the quality of life.

I interviewed the operative officer at IFC and leading Peruvian microfinance-expert F.P., who inter alla wrote the CEPAL report on microfinance in Peru in 2005.

The micro-entrepreneurs that were willing to participate in my field study further received loans from MFIs such as Banco Continental Banco Internacional, BCP, Caja Pirva, HSBC, Interbank, MiBanco and Scotiabank but as mentioned in the chapter “Methodology”, with exception of MiBanco the other MFIs are not included in my examination. Unfortunately, none of the clients interviewed received a loan from any other MFI than banks. Therefore, it is impossible to juxtapose detailed information provided by NGOs in this study with the clients’ perspective.

The following overview provides information on the clients’ family-status, profession, number of microloans and their loan-lending MFI. Further information on the clients are interlinked and directly contrasted with the information provided by MFI representatives in the following chapters.

|   |  |  |   |
|---|--|--|---|
|  | <p><b>R.J.</b><br/>Family-Status: Single<br/>Profession: Distributor<br/>Number of Microloans: 2<br/>Client at Scotiabank,<br/>Interbank</p> |  | <p><b>J.</b><br/>Family-Status: Single<br/>Profession: Shop-Owner<br/>Number of Microloans: 1<br/>Client at MiBanco</p> |
|---|--|--|---|

|   |   |  |  |
|---|---|--|--|
|    | <p style="text-align: center;"><b>D.J.</b></p> <p>Family-Status: Single<br/>         Profession: Metalworker<br/>         Number of Microloans: 1<br/>         Client at Banco Continental</p>  |    | <p style="text-align: center;"><b>H.Q.</b></p> <p>Family-Status: Separated<br/>         Profession: Graphic artist, Printer<br/>         Number of Microloans: 2<br/>         Client at Banco de Crédito del Perú (BCP), Interbank</p> |
|   | <p style="text-align: center;"><b>C.C.</b></p> <p>Family-Status: Single<br/>         Profession: Distributor<br/>         Number of Microloans: 4<br/>         Client at Scotiabank, Interbank, Banco de Crédito del Perú (BCP),<sup>6</sup> HSBC</p> |   | <p style="text-align: center;"><b>O.M.</b></p> <p>Family-Status: Married<br/>         Profession: Runs an internet café and a grocery store<br/>         Number of Microloans: 1<br/>         Client at Banco Internacional</p>        |
|  | <p style="text-align: center;"><b>F.R.<br/>(at the right)</b></p> <p>Family-Status: Married<br/>         Profession: Administrator<br/>         Number of Microloans: 1<br/>         Client at Banco de Crédito del Perú (BCP)</p>                    |  | <p style="text-align: center;"><b>E.C.</b></p> <p>Family-Status: Married<br/>         Profession: Produces clothes<br/>         Number of Microloans: 1<br/>         Client at Caja Pirva</p>  |
|  | <p style="text-align: center;"><b>J.M.</b></p> <p>Family-Status: Married<br/>         Profession: Ing.-Mechanic<br/>         Number of Microloans: 1<br/>         Client at Banco de Crédito del Perú (BCP)</p>                                       |  | <p style="text-align: center;"><b>K.R.</b></p> <p>Family-Status: Single<br/>         Profession: Sales clothes<br/>         Number of Microloans: 1<br/>         Client at MiBanco</p>   |

<sup>6</sup> BCP is the main private and commercial bank in Peru (Conger et al. 2009, 9).



## Examination: Microfinance Performed in Peru

As explained in “Aims and Structure” of my research, in the following chapters I will present and discuss the findings of my field study in Peru. Firstly, I will refer to microloans as financial commodities, secondly I will focus on MFIs and the microfinance market as operating players and finally, I will examine the mutual connection of microfinance and poverty (effects of microfinance on poverty and vice versa).

### Terms and Conditions of Microloans

#### Access and Preconditions

J.R. (09.04.2012, Lima) from Prisma estimates that 70 – 80 % of the economic active part of the society works as micro- or small-entrepreneurs. Some of them already use micro- or small loans - many of them have the potential to become micro- or small-credit lenders.

| MFI                  | CMAC Arequipa  | MiBanco   | EDAPROSPRO   | Paz Peru  | Prisma   |
|----------------------|--|---|--|---|--|
| <b>Gender</b>        | Mostly female clients  | Equal distribution of female and male clients   | 80 % are female clients  | Equal distribution of female and male clients   | 60 % female clients                                  |
| <b>Age</b>           | Most clients request their first loan between 20 and 35 years of age.                        | Most of the clients are 34/35 years old.  | The average age is 40 years.   | Many clients are around 29 and 52 years old.  | Most of the clients are between 35 and 45 years old. |
| <b>Work field</b>    | Most of the clients have a little shop, only few work in sectors of production and services. | The majority of the clients work in the informal sector.  | 70 % work in trade, 20 % in services and 10 % work in production.  | Many clients work in the informal sector.   | / <sup>1</sup>                                       |
| <b>Preconditions</b> | Run a business for at least 6 months, own property   | 9 months of working experience, ID Card, receipt of electricity or water, for loans higher than 7,500 PEN/USD 2,900 documentation of their own property | Verification of their home, good record at EQUIFAX, clients need to have an economic initiative and know-how on the financial system | Receipt of water and electricity, verification of their business, documentation where they live, no negative record (over-indebtedness and/or outstanding loans) at SBS | Business experience, Ownership of a house property   |

The overview provided by the MFI representatives of my field research (cf. Table 1: Who has access to microloans?) draws a rather consistent picture on the characteristics of micro-credit clients in

**Table 1: Who has access to microloans?<sup>2</sup>**

<sup>1</sup> This question was not raised during the interview with J.R. (09.04.2012, Lima).

<sup>2</sup> Source: Own elaboration.

Peru. When relating microfinance distribution to gender, only MiBanco and Paz Peru have equal female and male borrowers while female borrowers clearly dominate at CMAC Arequipa and at the NGOs Prisma and EDAPROSPO.

M.R. from CMAC Arequipa explains the greater number of female clients occurs because “women are less likely to find regular work in Peru”, especially as single-mother. Women often start their own business close to or at the family’s home. D.V. from EDAPROSPO, on the other hand, has experienced that only 25 % of EDAPROSPO’s female clients (80%) are “jefe de familia” and raise their children without a spouse. Another common argument underlined by statistics claims that female clients are more responsible than male clients (see Interview with Barton F. and cf. Hartmann 2012, 319), and consequently, women are preferred clients of MFIs, who even invent microfinance programs particularly for them. F.C. disagrees with this depiction and refers to her experience at Paz Peru, which shows that the repayment of loans and the regular repayment of the interest rate does not depend on a clients’ gender. As M.R. (CMAC Arequipa) points out, in general, there are less microfinance borrowers with family than those without – an assumption that can be enhanced by the results of my research on microfinance clients as well: The majority of the clients I interviewed responded to as “single”<sup>3</sup> or “separated”,<sup>4</sup> while four out of ten clients responded as “married”.<sup>5</sup>

In regard to the clients’ age, at every MFI that participated in this study, clients need to be of age in order to request a loan. Thus, the youngest clients at CMAC Arequipa are 18 to 19 years old while at MiBanco the youngest clients are aged 23 to 24. At MiBanco and at the NGOs Prisma and EDAPROSPO clients have a similar average age and are between 35 to 45 years old. Clients at CMAC Arequipa and Paz Peru are mostly younger and between 20 to 35 years old, yet at Paz Peru the clients’ age mostly circulates around 29 and 52. While clients at CMAC Arequipa are mostly younger, the MFI also provides loans to clients as old as 70 (the oldest age mentioned during the field research).

Microfinance-clients who work in the fields of production are often dressmakers or work in agriculture. In the work field of services, clients who have a car often become taxi-drivers. The MFI representatives I interviewed agreed that most of the micro-borrowers have small businesses dedicated to trade. Few clients work in production and even fewer clients in agriculture. This appraisal correlates with the outcomes of the interviews I had with different microloan clients.

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<sup>3</sup> C.C., R.J., D.J., J. K.R.

<sup>4</sup> H.Q.

<sup>5</sup> J.M., O.M. F.R. E.C.

Out of ten clients I talked to, five named their profession to be “shopkeeper”<sup>6</sup> and thus, are trading goods. Four clients work in other professions as a mechanic (J.M.), metallurgical (D.J.), graphic artist (H.Q.), and dressmaker (E.C.) and also run their own shop. Only one client is employed at a fabrics shop (K.R.). Interestingly enough, none of the clients I talked to described their economic situation as “poor”<sup>7</sup>: Six of them described their economic situation to be “Medium”,<sup>8</sup> one chose “Regular” (D.J.) and another “Stable” (H.Q.) while one client even described his situation to be “Good” (C.C.) and another to be “Average-High” (J.).

This impression correlates with the preconditions microfinance clients in Peru have to fulfill in order to receive a microloan: Out of five, three MFIs I interviewed demand the documentation of a clients’ property as a security. Furthermore, MiBanco and Paz Peru double-check the water and/or electricity receipts in order to verify the clients’ address. All MFIs require business experience of differing duration, and Paz Peru, as well as EDAPROSPO, examines a clients’ record at SBS and EQUIFAX, which provide information on the debt-status of a client and outstanding loan-repayments. At MiBanco clients who apply for a credit of 7,500 PEN/approx. USD 3,000 are required to show a list/diary of how much they sell and how much money they need to invest. For loans higher than 7,500 PEN, clients need to own property and have to provide legal documentation of ownership. If a client owns her\_his workplace (eg. restaurant or bar) MiBanco can provide loans as high as 50,000 PEN/approx. USD 19,600. Prisma even visits the home of a client and the clients’ business and decides to allow the credit request when nothing negative has been detected. According to Barton F. (10.04.2012, Lima) from COPEME, visiting a clients’ home is very important, because analysts can easily detect if someone is orderly and clean or chaotic. In his opinion, the situation at home and at the clients’ workplace show, if someone has a sense of duty. Further, analysts who visit a clients’ home see, how many family members create an income or need to be financed by the potential client.

### Discussion: Access and Preconditions

Three out of five MFIs provide more loans to female clients, which makes it seem like access to microloans is easier for female clients to achieve than for male clients. The different reasons that

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<sup>6</sup> C.C., R.J., O.M., J., F.R.

<sup>7</sup> My questionnaires did not state a definition of poverty to avoid stigmatizing the participants of my research and to not make some of them feel uncomfortable. Thus, the adjective “poor“ was used by the clients interviewed according to their own sentiments. Therefore, unambiguous interpretation and assignment is not possible with the answers given.

<sup>8</sup> J.M., R.J., O.M., F.R., E.C., K.R.

were mentioned during the interviews<sup>9</sup> explaining this distribution are questionable (there are no studies that prove the relations stated) and hence, have to be classified as potential indicators but cannot be seen as the larger reason for why some MFIs have more female clients than others. Furthermore, my research on microfinance clients in Lima draws a different picture, in which very few women own their workplace and even less have heard about and/or requested a microloan. The majority of clients I interviewed were male but it is important to keep the limitations of my study (eg. in terms of number of clients interviewed and locations) in mind as expressed in chapter “Methodology”, which denies drawing generalized conclusions on this aspect.

In terms of age, all MFIs have clients of almost every age. Nevertheless, the variations of their clients’ average age indicate that different cohorts are addressed. This might be caused by the variety of loan products or special commercials and further depend on the MFIs’ interest on exclusive and experienced clients. Especially clients of older age are more likely to have credit experience and may be more reliable in terms of repayment. On the other hand, due to their experience, they are less likely to request a loan with a high interest-rate, which obviously provides more profit to an MFI. Since clients usually keep requesting loans after they have repaid the old loan, young clients – if they can be bound to an MFI as exclusive clients – who might have a higher risk potential, instead become long-lasting clients.

Though microfinance clients operate in different work fields, microloans seem to be less demanded/distributed in the fields of production and agriculture yet very likely to be used for trade. This may be caused by the structure of microloans and in particular the need to repay an interest rate and a percentage of the loan regularly (see Table 4: Payment Conditions, Interest Rate). Agricultural harvests, which are easily affected by unpredictable factors (eg. natural disasters), do not match the static model for microfinance. In the work field of production, the purchase of machines can be very risky due to extraordinary costs and the necessity of high loans and thus, also contradict the system of microfinance, which primarily attempts to provide small amounts that improve a business without a lot of risk. Clients who trade different goods are flexible and may change their product repertoire simply due to low acquisition costs and therefore adapt to the market demand. In addition, generally the rent of their shop is the highest expense they have. As a consequence, for MFIs risks are lower especially when clients have

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<sup>9</sup> On the one hand, women are perceived to be more reliable in terms of repayment and thus, are preferred clients of MFIs and on the other hand, the need for women to request a microloan may be higher than for male clients, because there are more single mothers than single fathers in Peru who need to work close to the families home in order to provide childcare at the same time and further, women appear less likely to find regular work.

accounts that show a regular profit. Nevertheless, although risks are reduced for an MFI, the small shop owners themselves and their families do not only depend on the shop's profit but also secure the loan with their property (cf. Table 1: Who has access to microfinance?). As informal workers they have no steady income, neither a regular working time nor health insurance and do not pay taxes (F.C., 30.03.2012, Arequipa). All in all, it seems obvious that microloans are particularly addressed to clients who trade products and work in the informal sector whose growth is directly supported by microfinance. The growth of the informal sector is inconsistent with the attempt to achieve sustainable improvements of the clients' life quality and to secure the elimination of poverty thus contradicting Yunus' attempt to end any form of exploitation of “the Poor” (Yunus 2008, 43 and Yunus 2010, 7) and the demands of development policies formulated by Sen (the need to dispose the bondages that result in poverty, cf. Sen 1999, 47).

In regard to the clients addressed by microfinance, Peru is no exception: On a global level, studies concluded that the majority of microfinance clients is working in trade but as critics such as Bateman emphasize, these investments in the trade sector already contradict to the desired effect of microfinance because they diminish the long-term development of a country's industry and thus “underpin an import-dependency dynamic” (Bateman 2010, 107), which complicates a self-determined development of a nation and its citizens. Bateman even concludes that microfinance generally supports a progressive deindustrialization and leads to “infantilization” of Asian, African and Latin American developing countries (Bateman 2010, 95ff.). In the case of Peru, further research would be needed to clarify if his general assumption is correct.

However, after analyzing the preconditions a client has to fulfill when requesting a microloan at the MFIs that were part of my field research, it is even questionable that the addressees of microfinance in Peru are “the Poor”. If they are living according to the standard definition of poverty of USD 2 a day, then they would be very unlikely to own their own property and to be as content with their economic situation as the clients I interviewed were. The common practice of home visits to examine how many family members contribute financially to a clients' household and/or are financed with the requested loan seems plausible. However, it is questionable whether analysts who judge on the “neatness” of a clients' household and relate it to the sense of duty a client has (cf. Barton F., 10.04.2012, Lima) have the ability to generate the desired information and moreover behave morally correct.

Microloans, as promoted by Muhammad Yunus, should provide the opportunity to start a new business. If MFIs in Peru mostly expect borrowers to have a six to nine months of business experience, microloans, will not be invested in new businesses of “the Poor” but instead will only improve already existing businesses, a fact that is even confirmed by CMAC Arequipa: Mauricio Rodriguez argues that microloans, which are invested in “future businesses”, are too risky, because the clients have no experience. As a consequence, CMAC Arequipa mostly invests in existing businesses and only finances business-startups when clients want to buy a car to become a cab driver, which is perceived to be a secure profession.

### Products

Although group lending is less popular in Peru, all MFIs participating in my field research offer individual and group lending products (except CMAC Arequipa, who does not offer group-lendings at all). In general (and as described in “Panorama”) most of the Peruvian microfinance clients are individual lenders. This fact correlates with my field research on microfinance clients: Out of the ten clients I interviewed and chose randomly, ten (= 100 %) have been customers of individual lending.

According to A.M. (29.03.2012, Arequipa) microloans are generally dedicated to the development of businesses in Peru. In fact, CMAC Arequipa allocates microloans that are, without exception, business-related. MiBanco, Paz Peru, EDAPROSPO and Prisma also approve microcredits that follow an educational, health or even consumption purpose (cf. MiBanco). Nevertheless, the majority (seven out of ten) of the clients interviewed requested a loan for their business. Two clients received a consumption-related loan and used it to buy a car and to renovate the house; one client needed the loan to pay off another loan. Further, one client confessed to being an unofficial borrower (D.J.), whose relative signed the credit agreement for him. The amounts credited are based on different procedures the MFIs of my research apply. CMAC Arequipa, for example, evaluates the clients’ solvency and then decides about the credit amount they can offer.<sup>10</sup> At MiBanco, analysts take a look at the loan experience a client has. Hence, if a client has already successfully repaid a loan, the conditions for the new loan will be better (at MiBanco this also counts for experience with credit cards).

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<sup>10</sup> Female borrowers who are married further have to verify their husbands’ income and need to present the signature of their husbands in order to request a loan. This is procedure is common at other MFIs as well (according to A.M.) but among the MFIs that participated in this study it was only applied at CMAC Arequipa.

| <b>MFI</b>                             | <b>CMAC Arequipa</b>  | <b>MiBanco</b>   | <b>EDAPROPO</b>   | <b>Paz Peru</b>  | <b>Prisma</b>   |
|--|---|--|---|--|---|
| <b>Products</b>                        | Offers individual loans with a business related purpose.  | Offers individual and group-loans with purposes regarding business, education, health and consumption (products vary and depend on the location of MiBanco’s offices). | Offers individual and group-loans with purposes regarding business, education, health, and consumption.                   | Offers individual and group-loans with purposes regarding business, education, health and consumption. | Offers individual and group-loans with purposes regarding business, education, health and consumption.                  |
| <b>Minimum amount credited</b>         | The amount credited depends on the clients’ request and his/her payment capacity (evaluation of the clients’ solvency).         | 1,000 PEN (approx. USD 390)  | 100 PEN (approx. USD 38)  | 300 PEN (approx. USD 114)  | 1,000 PEN (approx. USD 390)   |
| <b>Maximum amount credited</b>         |   | 90,000 PEN (approx. USD 35,260)  | 3,500 PEN (approx. USD 1,350)   | 15,000 PEN (approx. USD 5,750, exceptions up to 20,000 PEN = USD 7,655)                                | 5,000 PEN (approx. USD 1,960)   |
| <b>Average duration of a loan</b>      | Maximum duration 48 months.   | Maximum duration 48 months (only credits for housing may last longer).   | The duration of an individual loan is flexible. Group loans have a duration of four months.                               | The duration of a loan is always flexible.   | At the beginning, clients have to repay their loans within 6 months. Later, this time may be increased until 10 months. |
| <b>Limitations of loans/total debt</b> | No limitations, as long as the total debt is evaluated to not exceed the client’s repayment ability.                            | Maximum 4 loans from different MFIs including MiBanco.   | Clients who have more than 3 other loans are not accepted. Neither are those, whose debt-capacity is already on the edge. | / <sup>11</sup>  | Maximum 3 loans from different MFIs, including Prisma. Maximum debt of 20,000 PEN (approx. USD 7,840).                  |
| <b>Insurances</b>                      | Obligatory - Insurances that repay the loan in case of mortality are automatically added to interest rates a client has to pay. | Obligatory - Microloans always go with micro-insurances from MiBancos insurance agency ACP that covers every risk – death, robbery, etc.                               | Does not offer insurances.  | Voluntary  | Voluntary   |

**Table 2: Credit Products and Limitations<sup>12</sup>**

A client who borrows her\_his first loan only receives 1,000 PEN and will receive more money when applying for another loan. The maximum amount credited by MiBanco does not exceed

<sup>11</sup> Question was not raised during the interview with F.C. (30.03.2012, Arequipa).

<sup>12</sup> Source: Own elaboration.

90,000 PEN (approx. USD 35,260). EDAPROSPO on the other hand uses a scale according to which loans are distributed to clients. Thus, clients always start off with small loans that range between 100 and 500 PEN (approx. USD 38 – USD 190). After the first loan has been successfully repaid, the second loan may range up to 1,000 PEN (approx. USD 380). The highest amount credited by EDAPROSPO does not go beyond 3,500 PEN (approx. USD 1,350). Group lending follows the same structure: thus, some members may have already proven to be trustworthy with their repayment and therefore, receive a higher amount credited compared to other members of the same group. Yet the team as a whole secures the total amount credited to that group. At Paz Peru clients start with a loan of 300 PEN (approx. USD 114). If clients prove their willingness to repay the loan they can request another loan that will be provided as a parallel loan with a higher amount credited. Prisma, which mostly provides individual loans, offers minimum loans of 1,000 PEN (approx. USD 390) and maximum loans of 5,000 PEN (approx. USD 1,960). The average loan that 90 % of Prisma’s clients receive is about 1,600 PEN (approx. USD 610).

| Client | Purpose of the Loan    | Amount of Loan                   | Number of Loans | Loan duration   |
|--------|------------------------|----------------------------------|-----------------|-----------------|
| C.C.   | Business-related       | 127,475 PEN (approx. USD 50,000) | 4               | / <sup>13</sup> |
| J.M.   | Business-related       | 40,000 PEN (approx. USD 15,690)  | 1               | 4 years         |
| R.J.   | Consumption            | 27,000 PEN (approx. USD 10,600)  | 2               | 3 years         |
| K.R.   | Business-related       | 20,000 PEN (approx. USD 7,850)   | 1               | 1 year          |
| O.M.   | Business-related       | 15,000 PEN (approx. USD 5,890)   | 1               | 10 months       |
| H.Q.   | To pay off other loans | About 12,750 PEN (USD 5,000)     | 2               | 18 months       |
| D.J.   | Business-related       | 10,000 PEN (approx. USD 3,930)   | 1               | 2 years         |
| J.     | Business-related       | 10,000 PEN (approx. USD 3,930)   | 1               | 1 year          |
| F.R.   | Consumption            | 6,000 PEN (approx. USD 2,350)    | 1               | 6 months        |
| E.C.   | Business-related       | 5,000 PEN (approx. USD 1,960)    | 1               | 3 years         |

**Table 3: Loans of the Interv. Clients<sup>14</sup>**

<sup>13</sup> The client did not answer this question.

<sup>14</sup> Source: Own elaboration.



Seven of the ten clients participating in my field research are classified as micro-entrepreneurs (max. debt of 20,000 PEN), following the distinction made by SBS in Resolution 11356-2008. The remaining three borrowers’ debt ranges between 27,000 PEN and 127,475 PEN, and hence, according to SBS’s categorization, these clients are small-entrepreneurs (max. debt of 300,000 PEN). The duration of loan agreements differs similar to the amounts credited. Therefore, at Prisma, first time-borrowers have to repay the loan within 6 months. This time can be expanded up to 10 months after the first loan has been successfully repaid. At CMAC Arequipa and MiBanco the maximum duration of a loan is 48 months while at EDAPROSPO (except group loans, which always have a duration of four months)<sup>15</sup> and Paz Peru the duration of loans are always adjusted individually and without a minimum or maximum duration. The duration of loan-agreements as described by the clients interviewed varies between six months and four years. Only one micro-entrepreneur and two of the small-entrepreneurs have to pay back their loans within three to four years while four of the seven micro-entrepreneurs have loan agreements that end after one year.

Since over-indebtedness of clients has become an issue in the Peruvian microfinance market (also affected one of the clients interviewed, who needed a new loan to repay a previous loan agreement), more and more MFIs respond with limitations not only in regard to the amount credited but also in terms of how many parallel credits a client is allowed to have. Only one micro-client of my research has had two loan agreements whereas the other micro-entrepreneurs obtained just one loan. Two of the small-entrepreneurs have to fulfill more than one credit demand; one small-entrepreneur-client has to pay off four parallel loans.

At MiBanco, clients with three loan agreements can still apply for a fourth credit while at Prisma and EDAPROSPO clients may not maintain more than three different loans (including the new one requested at EDAPROSPO or Prisma). Further, EDAPROSPO evaluates a clients’ pre-debt situation and denies loans to those who are already struggling with other repayments that they have to fulfill. CMAC Arequipa decides whether a client may obtain a loan “only” depending on her\_his general debt situation. Hence, if the client’s repayment ability is questioned, in theory CMAC Arequipa will not provide a new loan to this client.

If a client has not repaid her\_his credit and passes away, in Peru insurances often cover the remaining demands and thus, reduce the risks of family members or the MFI itself having to

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<sup>15</sup> Than, after these four months, a subsequent loan with a higher amount credited can be requested from the same group in a similar or changed constellation.

cover outstanding rates. As a consequence, at CMAC Arequipa and MiBanco every loan is sold together with insurances. Insurances that repay the loan in case of mortality are obligatory at CMAC Arequipa and MiBanco, but MiBanco further sells a set of micro-insurances that covers the loan in case of mortality, as well as when a client loses her\_his property through external influences. The insurance rates depend on the total amount credited and are automatically added to the interest rate a client has to pay for her\_his loan.<sup>16</sup>

At the NGOs Paz Peru and Prisma, insurances can become part of the credit agreement: however most clients search for external insurance agencies. Prisma offers insurance with a fee that does not depend on the loan nor the income of a client but is sold as a “flat” rate with a monthly amount of 3 PEN (approx. USD 1,20). If clients pass away and do not own an insurance certificate, at Prisma the relatives of the client have to pay outstanding rates whereas at Paz Peru, the NGO itself covers for the remaining amount. EDAPROSPO does not offer insurances at all, but the NGO assesses options to add insurances to their products. Since most of the insurance agencies EDAPROSPO cooperates with offer obligatory insurances for every client and 20 – 30 % of EDAPROSPO’s clients already have external insurances. The NGO has to face the risk of losing clients when selling obligatory insurances with every loan. On the other hand, if EDAPROSPO establishes its own agency, as D.V., EDAPROSPO’s executive director explains (10.04.2012, Lima), this has to be financed and adapted to the legal frame and may turn out to be costly. Until now, EDAPROSPO and the remaining members of a group (in case of group-lendings) share the outstanding payments if a client passes away.

### Discussion: Products

As the results of my field research have shown, the purpose for which microloans are offered at MFIs and requested from clients may differ, but in Peru microloans are primarily used and consumed to improve a business. Nevertheless, a clear distinction can be made in regard to the amounts credited: While banks such as CMAC Arequipa and MiBanco offer microloans (as characterized at the resolution by SBS named earlier) and small loans up to 90,000 PEN, the NGOs that were examined in this study exclusively sell microloans up to 20,000 PEN. This dissimilarity is probably caused by the different structure of banks and NGOs. While banks are

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<sup>16</sup> Although my interview partner M.E. at MiBanco (12.04.2012, Lima) tried to explain the composition of total rates a client has to repay monthly – including insurances, I did not receive clear information on the percentage added to loans for insurance fees in general. In her example, she generally assumed that a client with a loan of 1,000 PEN (approx. 390 USD) has to pay 103 PEN (approx. 40 USD) every month just for the loan, but 110 PEN (approx. 43 USD) with insurances. As will be described in the chapter on “Payment Conditions”, it is very unlikely that a microloan bears an interest-rate of 3 % - especially because according to my interview partner herself interest rates at MiBanco vary between 11 and 18 %. Further, I could not follow her explanation on why she added exactly 7 PEN for the insurances – perhaps because of content misunderstandings or maybe because there is no clear percentage that she knew of.

primarily financial actors who follow a profit-orientation strategy,<sup>17</sup> NGOs are set on the social surplus. But, sometimes and in the case of EDAPROSPO a complex field of power relations (in particular the question: Who benefits how and why?) is accompanied with this surplus, which is exemplified by the fact that, at EDAPROSPO, group members who borrow a loan together can request different amounts credited but have to secure the total group-loan. Consequently, hierarchical order and inequality is inflicted.

The findings of this study make clear that microfinance players proceed on the assumption that handling money is a learned behavior. As a consequence, all of the MFIs that participated in this study explained that, among other factors, amounts credited are related to a clients' experience with loans. Thus, clients usually start with small loans and have to pay a high interest-rate due to the risk factors. After having repaid their first loan or the first rates on time they can apply for a higher loan or parallel loans.<sup>18</sup> Interestingly, none of the MFIs interviewed offer any classes or teachings on how finances need to be organized and what different financial terms mean in reality. Instead, clients are purposely unprepared and are expected to learn from their own experience. D.V. (10.04.2012, Lima) from EDAPROSPO explained that group loans and the exchange of information within the groups support the clients in their financial dealings. He further argued that teachings offered by MFIs themselves might be perceived negatively as paternalistic. However, J.R. from Prisma (9.4.2012, Lima) argued financial education is a key for successful dealings with microloans. Nevertheless, Prisma also does not offer any classes. In its place, according to M.M., clients are expected to search for and attend classes voluntarily. Obviously, it is questionable, that clients who are not obliged by MFIs do so, since generally have limited time to even visit MFIs (cf. M.R., 28.03.2012, Arequipa) and classes are usually not for free. In particular clients who do not live in urban areas are very unlikely to find courses on financial management close by.

Parallel loans on the other hand contain, as F.C. explained, the opportunity to pay off an old loan with high interests, to cover outstanding demands or to generate more money even with little financial experience. My field research though shows that remarkably small loan clients are more likely to sign parallel loan agreements than micro-entrepreneurs, although those clients already have an easier access to capital. This might result again in the differences in structures of MFIs.

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<sup>17</sup> According to B.F. (10.04.2012, Lima) registers CMAC Arequipa a profit of 14 Mio. PEN (approx. USD 5,5 Mio.) every two months.

<sup>18</sup> Critics argue, that this behavior of MFIs empowers the start of a “credit-spiral” (Conger et al. 2009, 13f.). Clients learn to depend on the loans provided and after having reached a level, in which they can apply for high loans due to their financial experience the risk of a personal collapse increases and in the end, clients are very likely to be left with high loans they cannot cover, consequently have to sell their property and are confronted with poverty again.

At banks, parallel loans are less limited than at NGOs (at MiBanco clients can request up to four loans at different MFIs, at CMAC Arequipa it does not even matter at all, how many loans a client has, only the total debt is important). On the other hand, the NGOs questioned in this study accept a maximum of three parallel loans when taking the total debt into consideration. Still, none of the MFIs interviewed use a standardized evaluation on an acceptable and non-acceptable credit-debt. It is always decided individually if a client is over-indebted or not. Recognizably, this provides space for misjudgments and perhaps even corruption. Additionally, as B.F. explained (10.04.2012, Lima), clients who manage more than one microloan, perhaps even at more than one MFI, are less reliable than clients with few loans and, in particular, exclusive clients (who do not work with more than one MFI).

This realization relates to the latest scientific findings according to which the microfinance-clients caught in the “debt-circle” are the ones who keep taking loans (cf. microfinance specialist Paul Rippey, in: Bateman 2010, 37). Frequently, these clients even request new loans although their business activity has already failed and no longer exists (Bateman 2010, 74). As a consequence, “the poor are often powerless to stop their descent into a nightmare world of debt” (Bateman 2010, 37) and cannot exit the “downward spiral into deep poverty” (Bateman 2010, 36). According to Gerhard Klas, the over-indebtedness of microfinance clients does not only cause, that “the Poor” to slide into even worse poverty, but often leads to an increase in child labor. Children become responsible subjects for the family’s financial “Handlungsspielraum”. Critical studies thus emphasize, that instead of providing an exit of poverty, microfinance increases the pressure on families, to gain a specific amount of money in a limited frame of time (cf. Hartmann 2012, 336 and Klas 2011, 39, 109).

Differences between micro- and small-loan clients are also visible in regard to the duration of loans. The small entrepreneurs in this study have longer repayment rates than micro-entrepreneurs, who usually repay their loans within a year. This fact is mirrored again in the conditions provided by banks and NGOs: At CMAC Arequipa and MiBanco loans can last up to 48 months while at the NGO EDAPROSPO loans need to be repaid after 4 months, at Prisma after 6 months and only at Paz Peru individual terms are offered. Consequently, it seems that microloans need to be perceived as short-time stimuli, while small-credits are built on development of a longer term.

The rise of insurances on the microfinance market relates to the general expansion of micro- and small loan products. As such, the growth of players and the increase of clients interested in loans

might create more potential and perhaps even a different distribution of power within the financial system, but continuing the developing complexity of this field also includes risks and the danger of collapse. Consequently, MFIs try to secure themselves and their profits against credit defaults with insurances. Thus, insurance companies turn into new players who enter the microfinance sector. Banks such as MiBanco and CMAC Arequipa work with insurance agencies and require that clients take out insurances with every loan request.<sup>19</sup> It seems, that NGOs have not “set their feet on this trail” so far. Some of them cooperate with insurance agencies and offer packages on a voluntary basis for clients (eg. Prisma’s insurance flat) while others still have to overcome structural transformations (eg. EDAPROSPO). In general, insurances primarily take away responsibility of MFIs and, depending on their coverage, even of clients and their relatives. Yet so far, no detailed research has been published on their efficiency and effects on the Peruvian microfinance market.

As described earlier, the new microfinance products relate to the transformation of microfinance since 1995. Since then, “new-wave microfinance” (cf. “Theoretical Framework: Development Assistance and Microfinance”), with its focus on commercialization the microfinance industry, has increased and, as my findings in Peru indicate, even more MFIs expanded their products. Thus, it is going to be a question of time until the majority of the Peruvian NGOs will include insurances in order to stay competitive (cf. “Competition and Promotion of MFIs”). Those who decide to not establish their own insurance company will cause that in addition to the microfinance segment a new micro-insurance-segment to be found. This development correlates with Sen’s approach and proves that market mechanisms cause transformation (cf. Sen 1999, 39). This transformation is often not enhanced voluntarily, but in the frame of dependencies – in this case the need to stay competitive. The plurality of players though, also empowers microfinance clients to choose – put in Sen’s wording: they provide the freedom of choice (Sen 2000, 146).

### Payment Conditions

Although the interest rate an MFI offers is the most obvious distinction clients can discern when comparing different MFIs (cf. Table 8: Why do clients choose an MFI?), payment terms can turn into an important factor for the “loan-repayment-likelihood”, depending on the type of business

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<sup>19</sup> At MiBanco, M.E. (12.04.2012, Lima) argued very much in favor of insurances and exemplified their usefulness on a case, in which a client lost his shop during a fire in Lima’s center, for which he had a loan agreement about 15,000 PEN. MiBanco’s insurance covered everything and consequently, he was able to reconstruct his shop from the money he received from the insurance (maximum amount = credit amount) and did not lose his livelihood. Although this is clearly a positive example, it is questionable how other insurances might have dealt with this situation – in particular Prisma’s insurance flat with a cost of 3 PEN per month does not appear very trustworthy in my opinion. But further research would be needed to draw a final conclusion.

a client has. The MFIs questioned in this study predominantly offer repayment terms on a monthly basis. Only CMAC Arequipa provides more flexible repayment terms that can be agreed on individually. As David Venegas (10.04.2012, Lima) pointed out, clients usually attempt to repay the total amount of a loan before Christmas, in order to request a new loan during Christmas season.

At EDAPROSPO loans are repaid monthly and members of the borrowing-group meet on that repayment day to cover their rates, exchange experiences, and talk to their analyst, who takes care of about 30 different groups.

| MFI                                    | CMAC Arequipa  | MiBanco   | EDAPROSPO  | Paz Peru  | Prisma  |
|--|--|---|--|---|---|
| <b>Payment - terms</b>                 | Monthly, every two/three weeks, every four months, every six months                                | Monthly   | Monthly  | / <sup>20</sup>   | Monthly   |
| <b>Interest – rates</b>                | Depend on risk factors (qualification, property). The highest interest rate at CMAC is about 56 %. | Depend on the products. Differ between 11 % and 18 %. | Depend on the products. Differ between 34% and 42 %. | Depend on punctuality and reliability. Differ between 8.4 % and 12 %. | Depend on a clients’ age. Average around 60 %.      |
| <b>- percentages nominal/effective</b> | Clients are informed about effective interest-rate.  | Clients are informed about effective interest-rate.   | Clients are informed about effective interest-rate.  | Clients are informed about effective interest-rate.                   | Clients are informed about effective interest-rate. |

**Table 4: Payment Conditions<sup>21</sup>**

The interest rates of the MFIs offered to the participants of my field research either depend on risk factors or the products sold. Since interest-rates are not regulated at SBS, they are balanced through the competition among MFIs. Thus, at CMAC Arequipa the highest interest rate may range up to 56 % and at the NGO Prisma up to 60 % (always p.a.). At MiBanco, depending on the products, clients have to pay an interest fee of 11-18 % of the loan.<sup>22</sup> Paz Peru offers the lowest interest rate that ranges between 8.4 and 12 %. Numbers published in the recent report by COPEME estimate the average interest rates for microloans requested at NGOs to be 38 %, at EDPYMES and Financial Agencies to be 32 %, at MiBanco to be 25 % and at CMAC’s to be the lowest at 24 % (cf. B.F., 10.04.2012, Lima and COPEME 2012, 48).

Although interest fees are published in flyers, on websites and even on posters, a general problem identified by all participants of my research relates to the missing transparency of the total costs a

<sup>20</sup> Question was not raised during the interview with F.C. (30.03.2012, Arequipa).

<sup>21</sup> Source: Own elaboration.

<sup>22</sup> M.E. (12.04.2012, Lima) further explained that MiBanco attempts to keep the interest rates constant and as such it has been constant for 5 years. Unfortunately, in my previous interviews this aspect was not part of my questionnaire and hence, it is not possible to point out differences or similarities on this aspect between the MFIs included in this research.

client has to deal with when receiving a microloan. Often, quite a lot of extra-commissions are added to the interest rates, as D.V. (10.04.2012, Lima) explains: “Although some banks publish on their websites that they only take 7 %, they sometimes request 200 %. The banks profit more from commissions than from interest-rates.” SBS already reacted and clarified 200 different commissions to be illegal. But as B.F. (10.04.2012) also pointed out, experience has shown that banks (who primarily use commissions) find loopholes. B.F. underscored this with the following example: Although SBS has asked banks to inform them about extra-commissions that are charged whenever a client uses the ATM, they only publish a note saying that extra-commissions may be levied when withdrawing money, without saying how much. Thus, following the example provided by Barton F., if a client moves 10 PEN, some banks will request up to 6 PEN for that movement, while others may only charge a few “centavos” (= cents). The clients do not know the difference because the extra-fee is not put into numbers.

The interest rates the clients of my field study have to pay differ between 6 % and 51 % p.a. In general, the rates were perceived as fair/okay by 50 % of the clients questioned. One client (the one with the lowest interest rate of 6 %) assessed the interest rates in Peru to be good. Thus, four clients (the minority) evaluated the interest rates in Peru to be unreasonable: Two clients (with interest rates of 24 % and 51 %) judged them to be unfair, one opined that the interest rates had improved but were still higher than international standard, and one client (having to pay an interest of 27 %) expressed that the interest rates are too high.

| Client | Interest Rate   | Opinion on Interest Rate   |
|--------|-----------------|--|
| C.C.   | / <sup>23</sup> | “The interest rates have improved in Peru although we are still far from international standards.” |
| J.M.   | 10 %            | “The percentage of the interest rates is fair.”  |
| R.J.   | 24 %            | “The percentage of the interest rate is not reasonable.”   |
| K.R.   | / <sup>24</sup> | “The percentage of the interest rates is fair.”  |
| O.M.   | 41 %            | “The percentage of the interest rates is fair.”  |
| H.Q.   | approx. 51 %    | “The percentage of the interest rate is not reasonable.”   |
| D.J.   | 20 %            | “The percentage of the interest rates is fair.”  |
| J.     | 27 %            | “The percentage of the interest rates is very high.”   |
| F.R.   | 20 %            | “The percentage of the interest rates is more or less okay.”                                       |
| E.C.   | 6 %             | “The percentage of the interest rate is good.”   |

**Table 5: Clients on Interest Rates<sup>25</sup>**

<sup>23</sup> The client did not answer this question.

<sup>24</sup> The client did not answer this question.

When it comes to payment delays, all MFIs interviewed differ in their reactions between clients who do not pay their rates on purpose and those who are affected by social factors. Consequently, Paz Peru for example initially tries to contact the client and find out the reason for the payment delay. If a client has been unable to work because of illness or loss of business due to external circumstances such as a fire or robbery, Paz Peru will not inform SBS but develop a new payment plan with the client. CMAC Arequipa, MiBanco and Prisma deal similarly with such situations. They reprogram the loan and diminish the amount a client has to pay each month. At EDAPROSPO every payment delay is firstly discussed within the borrowing group and in “heavy cases” (eg. a client has to stay in hospital or a family member died) the group covers half of the outstanding money as well as EDAPROSPO or rates are paused until a client can overcome the problem.

| MFI  | CMAC Arequipa  | MiBanco  | EDAPROSPO   | Paz Peru  | Prisma  |
|--|--|--|---|---|---|
| <b>Consequences at payment delays (social factors)</b> | Development of a new payment plan (reduction of monthly rates)   | Development of a new payment plan (reduction of monthly rates)   | Other group members and EDAPROSPO cover outstanding money. Reduction of loan capital and elimination of interest rates.   | Development of a new payment plan (reduction of monthly rates)  | (The question was not raised during the interview.) |
| <b>Consequences at payment delays (on purpose)</b>     | First, analyst visit and calls client. After 40 days the delay is announced at the recovery department. Until day 60, they visit the client and send letters, report the client to SBS and Cámara de Comercio. After 60 days a juridical trial is initiated. | After 6 days, an extra commission is raised (every 8 days 20 PEN more), the client is called and visited by the analyst. Between day 15 and 30 different employees of MiBanco visit the client. After 30 days a group of employees visits the client and requests the outstanding money. | The group discusses the problem with the client firstly. If the clients remain not paying, EDAPROSPO gets involved. Usually trials are only used in case of frauds because the costs are expensive. | Clients who do not pay in time are reported to SBS but first the client is visited and/or called and asked for the reason of the delay. | (The question was not raised during the interview.) |

**Table 6: Dealings with Payment Delays<sup>26</sup>**

If a client does not pay the rates on purpose, juridical trials and reports to SBS will be the heaviest consequence a client has to fear. But in general, MFIs try to prevent juridical trials because they often last for years and cause costs that are excessive in comparison to the

<sup>25</sup> Source: Own elaboration.

<sup>26</sup> Source: Own elaboration.



outstanding amount of money (cf. M.R., 28.03.2012, Arequipa and F.C., 30.03.2012, Arequipa). Thus, MFIs use different steps to collect the remaining debt a client has.

At CMAC Arequipa and MiBanco, during the first days of delay, the analyst who sold the credit is responsible for the process. They visit the client and phone her\_him to reinforce the need to pay. After this step has been without success, at CMAC Arequipa the client is called on the telephone until day 39. After 40 days of delay, the responsible analyst will report the delay to the recovery department at CMAC, which specializes in those dealings. Consequently, between 40 and 60 days of delay they visit the clients, send letters and inform the clients that they will be reported to SBS and the Chamber of Commerce (“ La Cámara de Comercio”). If a client does not start to repay the loan again after 60 days, CMAC Arequipa sues the client. At MiBanco, in addition to the analyst who keeps calling the client after six days of payment delay, a commission is charged (every eight days the client has to pay an additional 20 PEN more). The first 15 days of the delay, the client is only in contact with employees of MiBanco. After the 15th day, letters are sent and delivered personally by other (for the client unknown) employees of MiBanco. Between day 15 and day 30, MiBanco keeps calling and visiting the client. After 30 days of delay another commission is charged and a group of MiBanco employers visits the client, requesting the payments again and trying to cause public attention, so that neighbors will be informed about the payment delays, too. A compromise is offered containing the option to reduce the extra commissions if the client pays immediately. M.E. (12.04.2012, Lima) explains that the majority pays at this point. Paz Peru has not had any experience with payment delays so far (according to F.C., 30.03.2012, Arequipa and flyers published by Paz Peru) but in theory would visit the client, ask for the reason of the delay, and if the client does not want to pay, the client will be reported and a trial will be initiated. At EDAPROSPO, if a client does not want to pay, this will also be discussed within the borrowing-group at the beginning and later, pressure of the group and carried out by EDAPROSPO comes into effect. EDAPROSPO usually does not use trials because of their costs. They only sue clients who commit frauds.

Four of the ten clients questioned admitted to having repaid a rate late, and all of them experienced the consequences described earlier by the MFIs interviewed: They were called (already after a four day delay) and had to pay either a higher interest or extra commissions. Two of them felt pressured to repay the outstanding rate. Reasons mentioned for the delay were a lack of money, outstanding bills by own clients, and illness. Two of the clients were able to repay the rate and commissions with the help of friends, while the other two managed to pay themselves (one received more time from the MFI).

| Client | Did you ever pay a rate late (why?)?                    | How did the MFI react?   | How did you manage to pay the rate?                      | Did you feel pressured?       |
|--------|---|--|--|-------------------------------|
| C.C.   | No  | /  | /  | /                             |
| J.M.   | Yes, 4 days delay, didn't have the money                | They called me.  | I paid it after I had generated income with my business. | No.                           |
| R.J.   | No  | /  | /  | /                             |
| K.R.   | Yes, I was 5 days late one time.                        | They requested me to pay soon.                                   | We asked a friend to help us.                            | No, they did not pressure me. |
| O.M.   | No  | /  | /  | /                             |
| H.Q.   | Yes.  | They called me. Usually they also charge more interests.         | Because they gave me more time.                          | Yes                           |
| D.J.   | No, I just started to pay off my first rate.            | /  | /  | /                             |
| J.     | Yes, because one of my clients did not pay me my money. | They raised an extra commission.                                 | With the help of friends.                                | Yes.                          |
| F.R.   | Yes, because of illness and other costs.                | They called me and increased the percentage of my interest rate. | Through work.  | Yes.                          |
| E.C.   | No, I am always punctual.                               | /  | /  | /                             |

**Table 7: Clients on Payment Delays<sup>27</sup>**

Discussion: Payment Conditions

In regard to payment terms of microloans, CMAC Arequipa appears to be the most flexible. This might depend on the financial independency, its size in comparison to NGOs and further on the heterogeneity of its clients. CMAC Arequipa mostly has branches in urbanized areas but also in some smaller villages. Surprisingly MiBanco, which has even more clients and branches than CMAC Arequipa, operates similar to NGOs, and offers static repayment terms. These inflexible terms mirror MiBanco’s orientation around urban areas, where agriculture is less widespread. Unexpectedly, this is also valid for the NGOs questioned, although it is a common assumption in Peru that NGOs in particular will offer flexible microloans and are willing to support clients in rural areas, where less profit but a greater social surplus may be achieved (cf. J.R., 9.4.2012, Lima and B.F., 10.04.2012, Lima). Less flexible loans obviously make it more difficult for micro-entrepreneurs to build up their businesses, because they are pressured to repay their loans within a fixed time frame and cannot take as much time to adapt their business to the existing market structure. All in all and corresponding to the results of my field study, small business loans seem to have a greater impact, because they are more flexible in regard to their conditions (cf. Bateman 2010, 37), but in Peru, they are more difficult to access for micro-entrepreneurs.

<sup>27</sup> Source: Own elaboration.

The interest rates at the MFIs interviewed depend on the products sold and the repayment risks of a client. No clear distinction between banks and NGOs can be made, because CMAC Arequipa charges an interest almost as high as Prisma, while Paz Peru offers lower interest rates than even MiBanco. According to B.F. (10.04.2012, Lima), NGOs receive funds for an interest that varies between 8 and 9 %, the Cajas have to pay 6 % for external funds and MiBanco only has to pay 4.4 %. This underlines the obvious profit orientation not only CMAC Arequipa and MiBanco but also of NGOs such as Prisma (60 % in comparison to 8-9 %) and necessitates the question of why NGOs charge such high interests and how this correlates with their charitable foundation. D.V. from EDAPROSPO (10.04.2012, Lima) argued that interest rates are important not only to cover expenses but also to clarify the value of the loan for a client: “Lo que no cuesta no tiene valor”.<sup>28</sup> This might be a (questionable) reason but does not relate to the excessively high interest rates charged, since any interest already indicates a greater value of a loan. In general, high interest rates always diminish the minimal margins realized in microenterprises, which prevent “the Poor” from quickly improving their living situation. Bateman (2010, 55) concludes: “This is why, whenever asked, the poor overwhelmingly argue that they should not be subject to market-based interest rates, because they will simply not be able to generate a decent surplus”. MFIs, on the other hand, also justify high interest rates arguing that they need to generate significant profits in order to expand and to disburse more microloans to other potential clients who suffer from poverty. Thinking this argument through the end, it remains quite questionable if it is plausible to expect individuals fitting in the category of “the Poor” (as clients who are supposedly primarily addressed by microfinance) to not only facilitate their own economic progress, but to help other potential clients suffering from poverty, too (cf. Bateman 2010, 56).

With reference to Sen’s development approach, this shift of responsibility contradicts his assumption that economic growth in general encourages a state to invest in healthcare and poverty-elimination (cf. Sen 1999, 59) and further leads to even further exclusion of “the Poor”, who then become an independent fragment of the state and society. Obviously, this development is strongly encouraged by the growth of the informal sector (cf. Aguilar Andía 2011, 8). The state does not earn money from the implementation of new micro-businesses because they do not receive taxes from them and therefore cannot redistribute the additional tax-money in welfare programs.

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<sup>28</sup> “Something that doesn’t cost, hasn’t got any value neither.”

In Peru, extra commissions charged for withdrawals and payment delays add to the issue of interest rates. As my interviews show, commissions are often not transparent, appear unfair, and its regulation needs to be improved. Although all of the MFIs interviewed did not see the need for a regulation of the interest rates by SBS and argued instead, that the competition on the Peruvian market has constantly reduced the rate itself,<sup>29</sup> it is clear that the existing limitations of SBS on commissions do not prevent MFIs from violating them (cf. B.F., 10.04.2012, Lima). Consequently, in Peru, more control is needed and might even be expanded on the interest rate some day. On a global level, strong regulations and controls are also lacking, which is why Bateman links microfinance to the exploitation of “the Poor”, claiming that “with so much prior encouragement to deploy Wall Street-style methodologies and tactics, it seems that too many profit-seeking commercialized MFIs are all too often willing to hoodwink and abuse their poor clients” (Bateman 2010, 130). The use of commissions is not an exclusive problem of Peruvian microfinance but also common practice in Bangladesh. Similar to Peruvian microfinance clients, in Bangladesh costs and fees are often imposed without a client’s knowledge (cf. Bateman 2010, 135). With reference to the decline of interest rates caused by competition, on a global level Bateman draws a different conclusion than the MFI representatives interviewed. On a global level, “there is surprisingly little comment on the important fact that one of the most widely stated benefits of commercialization – lower interest rates – is not actually expected to transpire. In fact, commercialization is now seen as militating against this positive development” (Bateman 2010, 147f.).

Although the majority of the clients described the amount of interest they have to pay to be reasonable, only one client (unsurprisingly the one with the lowest interest-rate) evaluated the rate to be good and the one with the highest to be unfair. As will be stressed later in the next chapter, when it comes to improvement suggestions, the majority of the clients demands that the interest rates need to be reduced. Thus, interest rates are clearly an issue in Peru.

Although all of the MFIs questioned in the field study provide information on the effective interest rate, according to critics on global microfinance, it is a common practice that MFIs use nominal rates to tempt clients (cf. Klas 2011, 30). In countries with high illiteracy rates researchers have found that MFIs use false information to attract clients who are pressured to sign contracts which they cannot read (ibid.)

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<sup>29</sup> Although the interest-rate on microloans has been constantly reduced in the past, this development has not been identified in the business with credit cards. Credit cards are very popular in Lima and there is a lot of competition on this segment of the financial market as well, but as J.R. (09.04.2012, Lima) from Prisma pointed out, the interest rates range between 100 – 120 % per year and have not been reduced in the past years.

The reactions of MFIs on payment delays appear to be fair on first sight, since all of them “only” call and visit clients who are late with their payments. Nevertheless, some statements imply that other reactions are not unfamiliar. M.R. (28.03.2012, Arequipa) from CMAC Arequipa for example said: “In comparison to other MFIs the Caja is soft in this sense”.<sup>30</sup> This statement clearly implies that other MFIs do not only call and visit their clients. Further, M.E. (12.04.2012, Lima) from MiBanco explained without having second doubts that it is not unusual to cause a “little scandal” in front of a client’s neighbors to pressure the client to repay outstanding loans. This public shaming, such as tying a client on the whipping post, is extremely outdated, highly unprofessional and does not go along with the protection of human dignity. Interestingly, similar to the statement made by Maria Elena Saldarriaga Alvarado (12.04.2012, Lima), Bateman’s research found “many MFIs choose to hire and train male employees to ensure that high repayment is maintained” (Bateman, 2010, 45).

Nevertheless, in Peru only two of the four clients who admitted to having repaid a rate too late felt pressured by the reaction of the MFI. Interestingly, the 40 % of the clients questioned that paid a rate late consisted of three micro-entrepreneurs and only one small entrepreneur. This proves that, although the rates for micro-loans in total are lower than for small-loans, micro-entrepreneurs undergo more financial struggling. Only one of the micro-entrepreneurs managed to repay the outstanding rates by himself, while the other two had to receive help from friends, which underlines the difficulty of the situation.

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<sup>30</sup> In the original: “En comparación con otras entidades la Caja es un poco suave en este sentido” (M.R., 28.03.2012, Arequipa).

## Evaluation of Microfinance Players and the –System in Peru

### Competition and Promotion of MFIs

When walking through the urban centers of Peru or the different districts of Lima, Peru’s capital, it is almost impossible not to see the advertisements (posters and videos) promoting microfinance and headlining: “I am a Peruvian who moves forward the country. I am work – The microbusiness, the engine of Peru” (MiBanco)<sup>1</sup> or: “We convert your dreams into wealth”<sup>2</sup> (CMAC Arequipa).



This obvious sign of competition among the Peruvian MFIs occurs because MFIs strive to fulfill two different purposes:

1. Depending on the number of clients, they can transform their structure and become an EDPYME, financial agency, or bank
2. Depending on their structure they can generate more funds and improve the conditions offered to clients and consequently, attract more clients (cf. J.R., 09.04.2012, Lima).



Thus, commercials have become a tool to generate new clients and increase the influence an MFI has on the microfinance market (cf. D.V., 10.04.2012, Lima). Every MFI representative questioned and especially F.C. (30.03.2012, Arequipa) stressed that like the number of Peruvians interested in microfinance, competition has increased enormously among the different

operating MFIs in Peru during the past few years. Therefore, aggressive commercials (even personalized postcards offering credits with a concrete amount written on the cards) as well as advertisements on TV and on the radio have become very popular. According to A.M. (29.03.2012, Arequipa) the strategy of the MFIs’ advertising works because clients are driven in

<sup>1</sup> In the original: “Yo soy un Peruano que mueve el país. Yo soy trabajo – La microempresa, el motor del Perú.”

<sup>2</sup> In the original: “Convertimos tus sueños en riqueza.”

by commercials and marketing strategies. Quite often, “clients are caught because of the ‘nice picture’ drawn by promoters of MFIs”.<sup>3</sup> Nevertheless, F.C. (29.03.2012, Arequipa) as well as the other MFI representatives conclude that generally it is the interest rate that attracts clients or not.

The interviews with microfinance clients in Peru support these assumptions: Three out of ten clients choose to request a microloan at a specific MFI due to its advertisement (one client mentioned personalized advertisement: a phone call). Four out of ten clients chose their particular MFI because of the interest-rate offered.

Only one client was interested in the background of the MFI, which later fulfilled his loan requests. The decision was based on two aspects: trustworthiness and guarantees of the MFI. CMAC Arequipa published a poster that precisely links to this selection criterion, stating: “Caja Municipal Arequipa. Leader in Microfinance.”



| Client | Why did you choose to borrow money at MFI XY?   |
|--------|---|
| C.C.   | Because of its trustworthiness and guarantees.  |
| J.M.   | Because I received preferential treatment (lower interest-rate) due to the fact that I work for a subgroup of the bank. |
| R.J.   | Because I was called on the phone (commercials).  |
| K.R.   | Because of commercials and a low interest-rate.   |
| O.M.   | Because it was recommended by a relative.   |
| H.Q.   | Because of commercials.   |
| D.J.   | Because the interest-rate is low and it was recommended by a relative.  |
| J.     | Because it was recommended by friends and relatives.  |
| F.R.   | Because the interest-rates are low and a colleague recommended the MFI.   |
| E.C.   | Because it was recommended by relatives.  |

**Table 8: Why do clients choose an MFI?<sup>4</sup>**

In the perception of M.E. (12.04.2012, Lima) from MiBanco, for clients, the duration between the credit request and the approval matters a lot. As a consequence, MiBanco invested in special software that accelerates the process and time until a request can be fulfilled. J.R. (09.04.2012, Lima) from Prisma added that clients also decide where to request a loan depending on the preconditions he\_she needs to fulfill and because of recommendation provided by family members or promoters.

The results of my field study on microfinance clients even imply that recommendations are the main reasons why clients choose one MFI over another: Half of the clients questioned named

<sup>3</sup> In the original: “(...) hay entidades financieras que llegan a los clientes porque (...) digamos lo pintan de una manera muy bonita por ejemplo que te dan un crédito, que te ayudan, que te exoneran, (...)”.

<sup>4</sup> Source: Own elaboration.

recommendations by friends and family members as the cause of their credit request at a particular MFI. MiBanco has already adapted this idea and created a recommendation program called “Mi Amigo”, assuring clients a bonus when friends or relatives request a loan at MiBanco. In addition, MiBanco wants their clients “to feel special”, according to M.E. (12.04.2012, Lima), and offers meetings with tombola and a personal attendant 24 hours a day (every analyst carries a mobile phone with her\_him, on which clients who have questions, doubts, or problems can call at any time of day).

Another clear competitive advantage of CMAC Arequipa and MiBanco is their high number of branches in urban areas. Thus, if a client is searching for an MFI, a CMAC and MiBanco branch is more likely to be close than branches of other MFIs. Consequently, those without time do not search for other MFI offices, but instead try to request a loan at MiBanco or CMAC (cf. J.R., 09.04.2012, Lima). MFIs, such as EDAPROSPO, who cannot keep pace with the competition in conurbations like Lima, often choose to expand their working area (“Debemos abrírnos”, cf. D.V., 10.04.2012, Lima). D.V. added that a lot of MFI-NGOs fear the competition in urban areas: “Many predicted that NGOs would disappear because of influential institutions such as MiBanco, but it was to our advantage that they have not shown a lot of presence in rural areas so far.”<sup>5</sup> Hence, instead of working only in Lima as EDAPROSPO did six years ago, they also run projects in rural areas today. However, the majority of EDAPROSPO’s clients are still located in Lima (approx. 4,000 clients) and “only” 1,500 clients are supported in Lima’s suburbs. J.R. (09.04.2012, Lima) further argues that due to the high concentration of banks in Lima, it is difficult for NGOs to find capable clients because banks generally offer better conditions than every other MFI and usually attract those clients.

In contrast to the MFIs interviewed, Paz Peru does not invest any money in advertisements. Instead, the NGO uses its profits to lower the interest rate, improve its service and to hasten the process of a credit request as F.C. (30.03.2012, Arequipa) explained. In addition, Paz Peru’s client capacity is limited – another reason why Paz Peru does not do any promotion or commercials. This might change though in the future, if Paz Peru’s transformation to an EDPYME is successful.

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<sup>5</sup> In the original: “Al principio decían Bueno, las ONGs van a desaparecer.’ (...) Entonces eso ya, es decir, ahora yo digo eso: Ahora eso es una fortaleza, porque no no salen.”



### Discussion: Competition and Promotion of MFIs

In Peru, the variety of public advertisements provided by MFIs on their products show, that MFIs believe that there is large number of consumers that can potentially be acquired. However, my research on microfinance clients has shown that many (particularly female) Peruvian entrepreneurs have not heard nor taken advantage of microfinance.

In their advertisements, MFIs address clients following two different principles: On an individual level, they promote that work and wealth can be generated through microfinance; on a collective level, they emphasize that microfinance clients contribute through their work to the Peruvian economy (cf. those of CMAC Arequipa and MiBanco). As such, microfinance commercials usually do not focus on interest rates despite being a deciding factor. Rather, they want potential clients to visit their offices in person. Obviously, MFIs follow this strategy because interest rates are individualized and they cannot promote a fixed interest rate to every potential client.

Still, MFIs promote their products in personalized commercials, too. It is interesting how MFIs receive data on potential clients to whom they can offer loans of a certain amount with fixed conditions. This is not the only aspect that questions the belief that microloans are primarily used as a tool to encourage sustainable development. The clients and MFI representatives interviewed stated that, particularly during the holiday season, microfinance promoters contact potential clients and increase their advertisements (cf. M.E., 12.04.2012, Lima and K.R.). MFIs following this marketing strategy primarily motivate clients to consume commodities and to use microloans for consumption, knowing that consumption is often a pressuring factor for “the Poor” who want to participate in community life and prevent social exclusion (cf. Sen 2000, 113).

At Christmas, when everybody feels the need to buy gifts, MFIs see their time to promote their products. Not only profit-oriented banks, such as MiBanco, but also NGOs, like EDAPROSPO, openly support clients who are using their loans not for their business but for personal consumption (cf. M.E., 12.04.2012, Lima and D.V., 10.04.2012, Lima): At MiBanco, it is a common practice for clients to pay off their loans in November and ask for a new loan in December in order to increase the amount credited. EDAPROSPO even knows in advance that they need more funds in December, assuming that their clients will request more parallel loans during this month. Thus, it is not only the “nice picture created” (cf. A.M., 29.03.2012, Arequipa) in MFI commercials that often turns out to be fake, but also implies that the widespread portrayal of microloans, which are primarily and mostly used for development is incomplete. Although poster-commercials emphasize the business relation of microloans, it seems that the

personal advertisement strategies of some MFIs (especially those who send promoters once a month to their clients, offering parallel loans – cf. experience of O.M., J. E.C. and K.R.<sup>6</sup>) even increase the risk of over-indebtedness and hence, endanger any development of microfinance clients.

Although one might believe that the use of microloans for consumption was primarily encouraged with the transformation of microfinance into “new wave” microfinance and may not be a general issue in microfinance worldwide, studies in Bangladesh carried out in the 1990s by Aminur Rahman for the Grameen Bank (!) found, that 70 % of microloans were used for non-business related purposes (cf. Bateman 2010, 29). This implies that even in the beginning, microfinance has promoted exclusively income-generating activities. In addition, various studies (of “microfinance insiders”)<sup>7</sup> focusing on different areas discovered consumption is encouraged by microfinance. A study carried out by Rutherford et al. on microfinance in Uganda and Tanzania in 2003, for example, illustrates: “The main reason for borrowing money is to buy food. Thereafter, funerals, school fees, and medical expenses become the most pressing needs” (Rutherford et al., in: Bateman 2010, 30). The evaluation of a microfinance industry that primarily serves as distributor of consumption loans juxtaposes and tremendously damages the picture of microfinance as a tool for poverty alleviation. Thus, as Bateman and Klas conclude, those who actually benefit from microfinance are powerful multinational enterprises that increase the selling of their products (Klass 2011, 56). “It is markets which are being empowered here (...)” (Bateman 2010, 49).

Focusing again on Peru, another risky aspect that is empowered through unregulated competition relates to the general behavior of clients and any financial institution. Clients naturally cooperate with MFIs who offer good conditions and low interest rates. At the same time, MFIs try to reduce their risks in order to offer low interest rates and ask their clients to show proof of certain preconditions. Clients, who know that, due to their documented reputation their loan request will not be approved, contact a different MFI. As my field research has shown, NGOs in general demand less preconditions to be fulfilled than banks and therefore, attract clients who are not accepted at banks. As a consequence of the higher risk potential NGOs have to increase their interest rates but simultaneously, even less “capable” clients will be attracted because of the high amount of interest they would have to pay (cf. Prisma). Consequently, as long as risks are

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<sup>6</sup> K.R. even testified that his analyst only visits him when the MFI is running a campaign (Original: “La analista nos visita en situación de Campañas.”).

<sup>7</sup> John Hatch, the founder of FINCA International and supposedly the “true founder of microfinance“ and opponent of Muhammad Yunus even admitted publicly, that estimated 90 % of microfinance is used for consumption purposes rather than for income-generating-activities (Bateman 2010, 30).

transferred into the percentage of interest rates and a minimum of preconditions is not defined, clients as well as MFIs have to face over-indebtedness and bankruptcy. Although Sen perceived markets as legitimate frames of development in the sense of enabling people to undertake mutually advantageous activities (cf. Sen 1999, 142), my findings in Peru prove, that this interpretation on the benefits of unregulated markets endangers development on the long-run.

As D.V. explained, MFIs do not primarily operate in rural areas because of the poverty alleviation potential but rather due to the competition MFIs have to deal with when being (exclusively) located in urban areas. Christiane Ströh (2010, 252) also stated in her dissertation on microfinance in Peru, that “(...) nearly all branches of banks and finance companies within the larger cities (are/note D.W.) located in the more developed areas.” The concentration of MFIs in urban areas does not correlate with the poverty distribution in Peru, because the majority (54.2 %) of the people suffering from poverty in Peru live in rural areas (according to the most recent numbers available from 2010, UN Statistics 2012). Thus, those who are supposed to be addressed with microfinance again are not reached. As a contrast the findings by Ströh and the results of my study, Bateman, referring to studies on microfinance in Africa and Asia, found MFIs prefer to operate in agriculture because they know “that repayment could be eventually secured by many factors other than the success of the individual dairy unit” (Bateman 2010, 89), such as land titles.

Nevertheless, in regard to the “aggressive competition” of MFIs discovered in Peru, Bateman also observed this competition to be constantly increasing worldwide, not only due to the increment of players operating in microfinance but also because there is a “growing number (of clients/note D.W.) voluntarily choosing not to take on any new microloan” (Bateman 2010, 52). This competition also weakens the working conditions of MFI employees, who are expected to work more for less salary (cf. Klas 2011, 208). Bateman explains, because of the bad image MFIs increasingly have to suffer from, so-called client “drop outs” occur more frequently, which causes “MFIs everywhere to be increasingly caught up in a desperate struggle to find new clients.” Therefore, MFIs often “hide the true cost of the microloan they wish to sell” and pressure clients to take out parallel loans (Bateman, 2010, 52f.). Again, this practice intensifies the danger of over-indebtedness of clients and MFIs, but critics also stress the likelihood of a “major credit bubble” that might grow in microfinance, too (cf. Bateman 2010, 54 and Klas 2011, 48).

### Regulation, Supervision and Lacks of the Microfinance System

In the perception of the participants interviewed, the microfinance market in Peru is very liberal and mainly unregulated. The Inter-American Development Bank and SBS have implemented a regulatory framework, according to which loans are categorized. Further, SBS provides public information on regulated/supervised MFIs such as banks, financial agencies and EDPYMES. All MFIs questioned agreed that, next to SBS, the IDB is one of the most influential players in terms of framing microfinance in Peru, yet can only operate within limitations. “Although the Inter-American Development Bank tries to improve everything, it cannot control everything”<sup>8</sup> (cf. A.M., 29.03.2012, Arequipa). As mentioned earlier this paper, in Peru not every MFI is supervised by SBS, and can participate in the evaluation program of SBS on a volunteer basis. As a consequence, interest rates, especially of NGOs are very high and may reach 80 % because they do not fear any blaming in SBS’s persistent reports. B.F. from COPEME justified this lack of regulation: “The main task of SBS is to make sure, that the financial system remains stable and the dilatoriness-rate is not overdrawn but not interfere in business policy. That’s a difference.”<sup>9</sup>As J.R. (09.04.2012, Lima) from Prisma explained further, transparencies provided by SBS’s reports, as well as by INDECOPI (the Peruvian consumer protection), promote MFIs who follow a good practice, blame those who do not, and help to lower the average interest-rate. He also argued that SBS makes a great effort to control data provided by regulated MFIs of SBS, double-checks their accounts, and punishes those with fines who violate SBS’s transparency system. In addition, in Melgarejo’s opinion, SBS has passed a law, which makes it easier for clients to enter a caveat against MFIs. He concluded: “If there is a regulation it always needs to be adapted to the system”.<sup>10</sup> All MFIs participating in my field research (except Paz Peru) cooperate with COPEME and are evaluated by MIX Market.

Problems identified by MFI representatives and clients interviewed relate to four different issues that will be presented in the following: 1. corruption, 2. over-indebtedness of clients, 3. power-discrepancy between MFIs and clients, 4. handling of microfinance.

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<sup>8</sup> In the original: “El Banco Interamericano es un cooperante muy importante en el Perú. Sí. Ellos quieren hacer las cosas bien pero lamentablemente no lo pueden controlar todo, ¿no?”

<sup>9</sup> In the original: “Aber das ist wie bei uns, die Bankenaufsicht in Deutschland auch, die muss sicherstellen, dass das Finanzsystem stabil ist und nicht zusammenbricht. Das heißt, die guckt, dass die Mora nicht überzogen ist. Die guckt, dass die Evaluierung der Kredite nach Gesetz in Ordnung läuft, aber sie greift nicht ein, in die Geschäftspolitik. Ich muss schon trennen.”

<sup>10</sup> In the original: “Existe un nivel creciente de corrupción en las microfinanzas, sea por clientes o por propios colaboradores. (...) Entonces tiene que estar en ... en permanente relación con lo que pase en el mercado. Entonces, ahorita, no ... una regulación está muy central en las temas de gestionar bien el riesgo de crédito. Luego es de, en la otra preocupación es fortalecente, no, patrimonial.”

➔ Corruption

According to the MFI representatives’ participating in this field research, corruption is “common practice” (cf. B.F., 10.04.2012, Lima) and carried out by promoters, analysts and clients: Clients pay promoters/analysts for not reporting fake identification and documents, promoters fake documents for clients in order to sell credit contracts in higher amounts of loans. Analysts, who further take advantage of clients with payment delays, accept gifts for not reporting them for the lengthening of their payment duration.

However, as the analyst M.R. (28.03.2012, Arequipa) from CMAC Arequipa says, promoters and clients are more likely to be involved in corruption than analysts because analysts (at CMAC Arequipa and MiBanco) receive a fixed salary and have to present their cases to other colleagues, which complicates the manipulation of clients’ data. Promoters, on the other hand, are paid on a commissioner basis. In the case of CMAC Arequipa, they are not directly employed at CMAC Arequipa but work for a sub-business called “El Riachi”.

J.R. (09.04.2012, Lima) from Prisma does not see any difference in the likelihood of clients, analysts, or promoters to be involved in corruption and even emphasizes: “It is the analyst, who dies for the money”.<sup>11</sup> Although analysts generally receive a fixed income, they also get a bonus for every new credit sold. At MiBanco, additional commissions received by analysts depend on three factors that try to eliminate corruption on behalf of analysts: number of new clients acquired, amount of credit loans sold, and payment delays of clients. Thus, analysts clearly profit from “good clients”. Nevertheless, MiBanco’s analyst M.E. (12.04.2012, Lima) admits that corruption is a topic at MiBanco and that there have been cases of analysts who changed documents or took money in order to wave through a credit request which normally could not have been fulfilled. A rather moderate form of corruption is especially likely to occur during holiday seasons, when clients bring their agricultural products or homemade cookies and try to establish a friendship with the analysts. “It is difficult to say no in these cases in order to not embarrass the clients”<sup>12</sup> (cf. M.E., 12.04.2012, Lima).

D.V. (cf. 10.04.2012, Lima) from EDAPROSPO confirmed J.R.’s appraisal and added that most of the analysts just want to generate profits, and are willing to accept risky clients and therefore do not care, if a client loses her\_his livelihood because of over-indebtedness.

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<sup>11</sup> In the original: “Es la analista, se muere por el dinero.” (cf. J.R., 09.04.2012, Lima).

<sup>12</sup> In the original: “(...) vienen con sus manzanas, ¿no? Es una vez, yo no quiero, gracias. Claro que ellos reciben. Gracias, no. A veces (unintelligible) Si todos los señoritas no le vas a botarlo, porque se ofenden.”

➔ Over-Indebtedness of Clients

Over-Indebtedness of clients is an issue that J.R. (09.04.2012, Lima) mainly holds MFIs responsible for. He clearly states it as a problem that clients continue requesting credits after they have successfully repaid others and become over-indebted after a while because they overestimate their capacity. He emphasizes that this development relates to the wish of many MFIs to sell more credits: “Whenever a client repays a loan successfully, they (MFIs) increase the amount given and hence, their own profit.” A.M. (29.03.2012, Arequipa) further stresses that instead of stirring up the risk that clients lose their houses in order to repay loans, MFIs could simply extend the time a client has to reimburse the loan. F.C. (30.03.2012) demands a strict categorization developed and published by SBS and believes that a table in which different amounts of income are listed and a maximum of debt is related to the specific income levels (which need to be taken into account by every MFI), would help to decrease the numbers of over-indebted clients.

➔ Power discrepancy between MFIs and Clients

B.F. (10.04.2012, Lima) from COPEME moreover criticizes the power-discrepancy between MFIs and clients. He explained that foreign investors and banks in particular have a lot of power. Thus, if a client wants to sue a bank, the likelihood to win a trial against a bank will be low, because banks use their money and influence to corrupt the juridical system in Peru. B.F., who used to work for GTZ when the German government implemented CMACs in Peru, further experienced personally that GTZ paid SBS in order to push certain laws through and to hasten the implementation process.

The power discrepancy as described by B.F. was also mentioned by A.M. (29.03.2012, Arequipa) from PeruCámaras, who demands more control and regulation be provided by the Peruvian government. Besides, she sees the need of laws in favor of microclients, which support and help micro-entrepreneurs. Although the majority of the clients interviewed<sup>13</sup> wish the reduction of interest rates, it was also mentioned by one client that better regulation and more laws provided by the Peruvian state are necessary to avoid violations and to provide better information for clients to counteract the hegemonial position of the MFIs and empower clients.

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<sup>13</sup> Five of seven clients who answered the question on what improvements are necessary on the microfinance market in Peru.

| Client | How can microfinance be improved in Peru?  |
|--------|--|
| C.C.   | Conditions need to be on a more equal level.   |
| J.M.   | Microfinance clients need to be better informed before they request a loan. Microfinance should be more regulated to avoid abuses. |
| R.J.   | The interest-rates need to be reduced.   |
| K.R.   | The interest-rates need to be reduced and there should be more variety in regard to the amount credited.                           |
| O.M.   | / <sup>14</sup>  |
| H.Q.   | Yes, the total cost of a loan needs to be reduced.   |
| D.J.   | Yes. (note D.W.: Question seemed not to be understood properly.)   |
| J.     | The interest-rates need to be reduced.   |
| F.R.   | The interest-rates need to be reduced.   |
| E.C.   | No. (note D.W.: Question seemed not to be understood properly.)  |

**Table 9: Clients on MF improvements<sup>15</sup>**

➔ Handling of Microfinance

A major lack of the microfinance market in Peru identified by B.F. from COPEME, A.M. from PeruCámaras, as well as from MFI representatives J.R. (Prisma) and F.C. (Paz Peru) relates to the use of microloans by and their allocation to clients. As B.F. (10.04.2012, Lima) points out, approximately 50 % of clients who request a microloan do so because an entrepreneurial spirit drives them, while the other 50 % apply for microloans because of economic distress. Quite often those clients need money immediately because they do not know how to pay their bills nor to feed their families. If these clients receive access to capital via microloans, they will also need advice on how to invest it sustainably, explained F.C. (30.03.2012, Arequipa). In her opinion, MFIs should not only focus on their economic growth but also need to offer advice for inexperienced clients in order to prevent them from being caught up in credit-spirals and over-indebtedness. B.F. does not suggest financial training provided by MFIs because in his opinion it is simply not the business of banks to educate. J.R. also replied that clients are supposed to learn from their own experience, which is particularly intended with group loans, because it is assumed that members share their skills and knowledge with each other.

B.F. further believes, that any client who requests microloans because of economic distress and does not have a relatively secure business should not become a microfinance client at all. Thus, in his opinion someone who has a little food-stall at a street corner, which might easily be destroyed by fire, is too risky for any MFI. Instead, B.F. opines these clients need money to be given to them as a gift: “Credits can only be handed to those who are able to repay it. Therefore, it is

<sup>14</sup> The client did not answer this question.

<sup>15</sup> Source: Own elaboration.

necessary that clients understand how to save money and after they have successfully saved money they have a feeling that it is necessary to repay loans”<sup>16</sup> (cf. B.F., 10.04.2012, Lima).

### Discussion: Regulation, Supervision and Lacks of the Microfinance System

According to the participants of my field study, SBS und the IDB are the major players framing microfinance in Peru. The World Bank and in particular the programs of the IFC were not mentioned by any MFI representative (except F.P., the operative officer at IFC). Interestingly enough, most of the interview partners mentioned that SBS and IDB lack control of the microfinance market in Peru, but did not indicate this to be negative. Instead, only two out of eight MFI representatives urged SBS to increase the regulation of the microfinance market while  $\frac{3}{4}$  of them did not see any need for more regulation. Thus, although the MFIs interviewed have different backgrounds, all of them argue in favor of free competition and perhaps because of Peru’s political past (cf. the last dictatorship of Fujimori) approve a rather liberal structure of microfinance in Peru.

Regulation and supervision of microfinance is perceived differently between MFI representatives and microfinance clients. Whereas clients demand regulation of interest rates by SBS, the majority of MFI representatives argued against any regulatory framework released by SBS that influences competition in the market. Participants of my field research reasoned mostly according to their own benefit.

In sum, when following the general idea of SBS to secure the stability of the financial system, it appears to be questionable, that a missing regulation of the interest rates will not contradict SBS’s purpose, especially when keeping in mind the reasons for the financial crisis in 2007. Although up to now the dilatoriness-rate of 4 % does not cause concerns (cf. B.F., 10.04.2012, Lima), the rising popularity of parallel loans causes more and more clients to find themselves caught in a credit-spiral which ends with over-indebtedness and bankruptcy and may have a devastating effect on MFIs and perhaps even on the Peruvian microfinance market in general.

As international studies found, it is a widespread phenomenon that microfinance clients around the globe use parallel loans to repay other loans (cf. Bateman 2010, 58), which creates fear of a “microfinance credit bubble”. Although experts opine the dilatoriness-rate in Peru does not cause doubts, experience in neighboring Bolivia shows that “even though it was well known that many poor individuals were accessing multiple loans from different MFIs (...) default rates began to rise rapidly” after a large number of poor borrowers could no longer repay their debts (Bateman

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<sup>16</sup> In the original: “Ich kann Kredite doch nur geben an Leute, die das auch zurückzahlen können. (...) Erst muss ich das Gefühl kriegen, wo kommt das Geld her. Ich sag mal Spargelder. Und ich muss dem Sparer ja auch sicherstellen, dass er das Geld wiederkriegt (...)”



2010, 120). Further, it needs to be discussed in how far any regulation on or limitation of interest rates and the amount of parallel loans can be judged as interference in “business policies” (cf. B.F., 10.04.2012, Lima) or might be situated in a (colloquial) “grey area”. Klas (2011, 13) found in his research that most microfinance advocates refuse any interest rate ceiling and restriction on the amount of parallel loans a microfinance client may request, arguing these state-interferences would lead to competitive distortion and reduce the interest of private initiatives to participate in microfinance. This explanation strongly underpins the general criticism often addressed to NGOs and development agencies, reducing their work to operations following their own interest and securing their self-preservation and jobs (cf. Klas 2011, 53).

Among microfinance players the occurrence of corruption is not denied as all MFI representatives interviewed admitted its existence. Its description as “common practice” (cf. B.F., 10.04.2012, Lima) even shows its popularity and perhaps even implies an acceptance. Nevertheless, corruption<sup>17</sup> seems to be a noun used for a variety of different phenomena: In the answers given, the term was not only used to explain how people in power are bribed, but was also related to analysts/promoters faking documents in order to receive a bonus, to clients who show their gratitude for the assistance and care provided by analysts as well as to the conspiracy to defraud of clients and analysts/promoters. Particularly the faking of documents by clients may not only relate to financial greed but mostly emphasizes distress of clients, who risk being reported and receiving an entry at SBS (similar to an entry at the German Society for the Securing of Loans, Schufa).<sup>18</sup>

Although obviously M.R. (cf. 28.03.2012, Arequipa) intended to defend his profession when arguing that promoters are more likely to be involved in corruption than analysts, consequences analysts have to fear are clearly heavier than those of promoters. For example, if an analyst is convicted of corruption, she\_he will be reported, lose her\_his job and theoretically not be to work in the banking industry ever again; whereas a promoter may change the field she\_he is in more easily. Nevertheless, a bad image of analysts dominated the responses of the MFI representatives when referring to analysts whose main motivation is monetary gain and are willing to risk a clients’ livelihood for their own benefits. Bateman also found that “loan officers (analysts/note D.W.) (...) are generally more willing to do whatever it takes to bring in new

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<sup>17</sup> According to the definition of corruption by Transparency International is corruption “the abuse of entrusted power for private gain”. Transparency International further classifies corruption “as grand, petty and political, depending on the amounts of money lost and the sector where it occurs”. (Transparency International, 2012).

<sup>18</sup> Credit information of every citizen are registered in Germany at a service provider called “Schufa”.

clients and help existing clients into possibly unwanted debt, thereby earning their bonuses” (Bateman, 2010, 54).

Although at MiBanco measures are already implemented to eliminate corruption on behalf of analysts, the three factors described by M.E. (12.04.2012, Lima: 1. number of new clients acquired, 2. amount of credit loans sold and 3. payment delays of clients) do not necessarily have an equal influence on the bonus of an analyst and hence, cannot eradicate doubts on the occurrence of corruption at MiBanco completely but may be seen as a step in the right direction.

Although only a few participants of my field study referred to the problem of over-indebtedness of clients, those who did demanded more regulation by SBS to counteract the capriciousness of MFIs, who are selling their credits to clients who are already caught in credit spirals. Interestingly, the problem of over-indebtedness in general was almost exclusively perceived as being caused by MFIs and in particular banks, who keep supplying loans to already over-indebted clients. Thus, J.R. (09.04.2012, Lima) from Prisma pointed out that “creditors who cannot repay have basically been poorly evaluated”<sup>19</sup> but also added that clients who keep consuming and do not reduce their expenses despite being in crisis enhance this problem as well.

All in all, none of the representatives draw a negative picture of their clients (eg. judged clients to be lazy, foolish, greedy, etc.) but instead reinforced the capitalistic picture of certain MFIs. However, the juridical system and Peruvian government were also criticized from the participants interviewed. In this way, the influence of foreign investors (cf. B.F. 10.04.2012) and banks who hold a lot of power clearly undermine patterns founded on the rule of law, which further lead to inequality and power discrepancy.

Criticism concerning the handling of microfinance is especially related to the selection of clients and allocation of loans. In addition to the missing financial experience and education many microfinance clients have the allocation of microloans to clients who suffer from poverty and choose a microloan in order to prevent having to beg for money on the street was questioned by B.F. (10.04.2012, Lima). Obviously, these clients cannot use the “tool” microloan in the intended manner and often do not see the continuing costs of microloans, which they cannot repay in the long term. B.F. opines, these clients should rather receive money as a gift, and be considered in welfare programs. His view leads again to the questions raised earlier (“Terms and Conditions of Microloans”: Who is addressed by microfinance in Peru?) and the influence of neoliberal

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<sup>19</sup> In the Original: “Los créditos que se caen (...) significa que el no fue bien evaluado”.

structures (cf. “Panorama”). Therefore, critics arguing that microloans are not a tool to eliminate poverty completely, because it is not addressed to “the Poorest of the Poorest” and cannot fill the place of missing welfare structures are re-empowered and reinforce B.F.’s statement: “Poverty alleviation is one thing, the business with loans is another thing. You should not mix it”<sup>20</sup> (cf. B.F., 10.04.2012, Lima).

Interestingly, these statements indicate that the MFI representatives in Peru have already realized that microfinance does not work as a development-tool for the real “poor” people (and as already has been found earlier, cannot be accessed by “the Poor” referred to by Kofi Annan nor Muhammad Yunus). Neither do the microfinance institutions referred to in Peru operate according to Sen’s approach: They do not increase the opportunities of “the Poor” to participate in labor structures, which “help to generate personal abundance as well as public resources for social facilities” (Sen 1999, 11). And in 2010, The World Bank (2010, 33) realized: “(...) tiny loans usually provided under microcredit schemes do not seem to lift large numbers of people out of poverty. Poor people need credit that enables them to go beyond meeting immediate consumption needs and build permanent assets.”

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<sup>20</sup> In the Original: “Und Armutsbekämpfung ist das eine, Kredit ist was anderes. Das darf man nicht vermischen.”

## Impact of Microfinance in Peru

Critics of microfinance often emphasize the missing evaluation verifying that microloans cause a positive social impact and question sustainable effects in terms of poverty alleviation. Although modern impact assessment tools exist today<sup>1</sup> the MFI representatives I met could not present any assessments based on statistics of their clients because most of them do not measure the effect of microloans on a clients' life.

EDAPROSPO for example does not carry out objective evaluation because of the necessary expenses. Instead, they employ volunteers who do random checks using elements of the PPI because the complete use of the patented tool is too expensive. Nevertheless, according to their research on 150 clients, which is not “profundo” as D.V. explained himself, EDAPROSPO's microloan clients had improved their income and life quality (in regard to the construction of their housings, business, education of their children etc.). Furthermore, EDAPROSPO always holds an evaluation chat after a loan has been repaid and asks how everything has worked out, how the loan has helped, and if the client wants to request a new loan.

After a client has repaid her\_his loan, at Paz Peru, evaluation talks are only scheduled if the client requests another loan. Similar to Paz Peru, MiBanco does not question the effects of their microloans provided to clients and only evaluate a clients' life situation in case of a new credit request. Neither Paz Peru nor MiBanco use other evaluation measures.

CMAC Arequipa gleans from new loan requests made by clients that microcredits have a positive effect because every new loan application is examined and related to a clients' background. Thus, if clients are able to receive a new, higher amount loan they must have learned how to deal with money and consequently, the first microloan presumably has not had a negative effect, reasoned Mauricio Rodriguez (28.03.2012, Arequipa) as well as J.R. (09.04.2012, Lima) from Prisma. Further, at CMAC Arequipa clients are interviewed after they have repaid their loan and “our experience has shown that their level of life has improved mostly” (cf. Mauricio Rodriguez, 28.03.2012, Arequipa).

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<sup>1</sup> Eg. Randomized Control Trials – RCTs, the Progress out of Poverty Index – PPI, a software that calculates the progress a client has made and thus, links to the sustainability of microfinance. According to J.R. (09.04.2012, Lima), the PPI was developed because the poverty line and measurements on consumption are too general to use when evaluating the effects of microloans. The PPI on the other hand, questions different parameters at the moment when a loan is given to a client and after a client has repaid her\_his loan. A general problem assigned to the PPI by J.R. relates to the data. He explains, that MFIs can easily lie with the information put into the system as well as the employers who collect the data from clients in the first place.

Prisma, who cooperated with the Grameen Foundation in the development of the PPI<sup>2</sup> does not use the PPI but maintains a rather simple statistic in which a clients’ days of payment delay are recorded.<sup>3</sup> This statistic does not have the ability to measure the social impact of microloans, but is used as an indicator for future loans. The general influence of the loan will only be questioned at Prisma, if a client applies for a new loan.

The responses given by MFI representatives relating to the final rating question (“On a scale that ranges between 0 and 10 (0 = poor, 10 = good), how do you evaluate the influence microloans have in order to reduce poverty and improve the development in Peru?”) of my questionnaire were quite different. M.R. (28.03.2012, Arequipa) from CMAC Arequipa and B.F. (10.04.2012, Lima) from COPEME assigned a 9 and 10 and argued that microloans definitely reduce poverty and improve one’s standard of living. B.F. further explained that in his opinion the microfinance segment is well developed and efficient in Peru and although improvements are always possible, within the overall context, he believes that Peru does very well. His only critique is that Peru has too many different institutions leading to an overbanked country, yet emphasizes that the competition among the MFIs helps to improve the whole system. Nevertheless, B.F. does not believe that microfinance will eliminate poverty. In his perception of human nature, some people always depend on others because of their missing capabilities. MiBanco’s analyst M.E. (12.04.2012, Lima) also perceives microfinance positively and argues, that microloans help to make dreams come true and to improve the living situation of a client.

The representatives of NGOs also concluded that microloans are positive, with limitations. Thus, D.V. (10.04.2012, Lima) from EDAPROSPO opines microloans help in all ways, as long as the attitude of the involved players is reasonable. Hence, if a client receives a loan of 1,500 PEN from EDAPROSPO, she\_he could take the money to MiBanco and ask there for a loan of 30,000 PEN. Over-indebtedness and a repay deficit would be a likely consequence. According to D.V., analysts also endanger the positive effects of microloans if they do not evaluate clients properly, but instead try to sell as many loans as possible in order to receive more bonus payments.

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<sup>2</sup> The development of the PPI was initiated by Grameen Foundation and in cooperation with CGAP, the Ford Foundation and different NGOs (among them Prisma and Oikocredit) released as an impact assessment tool of microfinance in 2009 (cf. PPI 2012).

<sup>3</sup> If a client is late with her\_his repayments, her\_his reliability will decrease constantly. When a loan has been repaid completely, Prisma calculates the median based on the payment delay. The median is used as an indicator for future loans and influences the conditions offered to a client.

J.R. (09.04.2012, Lima) from Prisma summarizes positively that the Peruvian microfinance market is very sophisticated and liberal: “That is the reason why Peru is the leading country in microfinance the third year in row according to Mix Market.” Additionally, he believes that microfinance is needed because it causes that consumption increases and helps families to grow. Still, he assigns a “6 or 7” to the Peruvian microfinance system, arguing that concrete measurements are missing and not every client (“3 out of 4/5”) succeeds with microloans. Furthermore, J.R. emphasizes that access to microfinance is not provided equally in Peru, and especially Peruvians living in “underdeveloped” regions located in the Andes (the “sierra”) are still excluded from microfinance.

At Paz Peru, F.C. (30.03.2012, Arequipa) emphasized that microfinance still provides access to capital for those who have been excluded in the past decades and thus, also supports the growth of the state. With the help of micro-entrepreneurs, a new demand on products develops. Nonetheless, F.C. worries about the competition among MFIs. Furthermore, she underscores that many MFIs (especially financial institutions) lack their social responsibility. All in all though, F.C. believes microloans have already helped many people improve their personal situation and increase their businesses.

The only absolute negative opinion on microfinance in Peru was expressed by A.M. (29.03.2012, Arequipa) from PeruCámaras. She argued that the Peruvian microfinance sector is only praised because of the number of different MFIs involved and the permeability of the system. But in her appraisal, the problems are often underestimated. In regard to poverty alleviation, A.M. says that, on a scale of 0 to 10, MFIs have an effect of 2 to 3 because, although they provide access to capital, microloans also promote “the informality slightly”.<sup>4</sup>

The clients interviewed responded unanimously that microloans improve the living situation of the clients. Eight out of ten clients interviewed further perceived microloans to be a useful instrument to reduce poverty worldwide. Two clients limited the positive effects of microloans and argued that other circumstances may decrease their results.

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<sup>4</sup> Original: “(...) ellos están un poco promoviendo también la informalidad”.

| Client | Do microcredits improve one’s living situation?  | Are microcredits an useful instrument to reduce poverty worldwide?  |
|--------|--|---|
| C.C.   | They are very helpful in regard to one’s progress.   | Definitely.   |
| J.M.   | Yes, microloans have improved my life.   | Yes, they are. With a reasonable interest-rate they may help to reduce poverty. But access to microloans needs to be increased for poor people. |
| R.J.   | Yes, they help.  | Yes.  |
| K.R.   | Yes, because of them I was able to buy a new machine for my textiles and was able to do better manufactures. | At occasions – depends on the situation in which microloans may help and on how they are invested.  |
| O.M.   | Yes, they help.  | Yes, of course.   |
| H.Q.   | Yes.   | Yes.  |
| D.J.   | Yes, they help a lot.  | Yes.  |
| J.     | Yes, they are a good alternative, but the interest-rates do not encourage many people.                       | I believe so, because microloans help at a moment when you need money the most.   |
| F.R.   | Yes, because they respond to the need of the clients.  | It depends.   |
| E.C.   | Yes.   | Yes.  |

Table 10: Clients on MF and Poverty<sup>5</sup>

### Discussion: Impact of Microfinance in Peru

Sustainable effects of microfinance have been difficult to measure in the past and, although an improvement of the poverty line, the Gini-Index and the HDI may support the positive appraisal of microloans. It is important to keep in mind that none of these instruments measures how microfinance influenced any improvements concretely. While some MFIs use different measurements to analyze how microloans have enhanced the living situation of their clients, the most popular evaluation tools are released by microfinance advocates (e.g. CGAP Poverty Assessment Tool/PAT) and MFIs like Grameen (Progress out of Poverty Index/PPI), FINCA (FINCA Client Assessment Tool/FCAT) and USAID (Assessing the Impact of Microenterprise Services/AIMS). It is very likely that an impact assessment tool developed by microfinance “insiders” primarily serves them, focusing on results they can benefit from in their future work.<sup>6</sup> Thus, it is questionable, if impact assessment tools such as the PPI examine the reality of microfinance<sup>7</sup> and the involved players, or only focus on certain parameters.<sup>8</sup>

Interestingly though, most of the MFI representatives interviewed revealed that after a credit has been successfully repaid, an evaluation is not generally envisaged. Consequently, the MFIs provide access to capital and promote microloans without measuring the effects or questioning their positive influences. Especially at NGOs, who define themselves as charitable and whose

<sup>5</sup> Source: Own elaboration.

<sup>6</sup> Bateman (2010, 77) criticizes the mostly one-sided evaluation carried out by MFIs with reference to parallel loans: Generally, MFIs assume that someone who has been willing to repay a loan and proven a sense of responsibility, won’t have any difficulties to repay parallel loans. In this context, Bateman concludes: “Because they do not factor in the important aspects of microenterprise failure, and instead provide only half – the good half – of the overall economic picture, almost all microfinance impact assessments are quite seriously flawed” (Bateman, 2010, 77).

<sup>7</sup> Due to the limit of space of this thesis, the question on impact assessment of microfinance and an examination of evaluation tools will be part of a future work.

<sup>8</sup> Cf. Bateman, 2010, 35: “You do not bite the hand (...) that feeds you.”

employees mostly follow a philanthropic desire, it is not understandable that results remain unmonitored and will be analyzed only if a subsequent loan is requested. In this context, critics who believe that NGOs only work for their own existence will be empowered. Although monitoring and evaluation measures (M&E) cause costs that add to other expenses and may influence the total cost of loans, it is not known why most MFIs interviewed invest in transparency reports and advertisements (as described in “commercials”) but only two out of five MFIs interviewed wonder about the effects of their work in general. Only D.V. mentioned that concrete studies to measure the effects of microfinance are still missing. Critics of microfinance such as Gerhard Klas and Milford Bateman refer to global studies on microfinance estimating that overall only five to ten percent of microfinance clients profit from microloans (Bateman, 2010, 62; Klas, 2011, 239).<sup>9</sup> Bateman and Klas even point out, that in some cases microloans have had negative impacts on debtors and require more long-term evaluation: “(...) one would think that examination of client failure should be a fairly high priority of the longer-term impact of microfinance, but it is not” (Bateman, 2010, 62 and 77; Klas, 2011, 53).

Nevertheless, most of the MFI representatives and microfinance clients interviewed consider microfinance in Peru positively and therefore correspond to the perception of “The Economist” and IDB mentioned earlier (“Introduction of Field Study – Panorama”). Criticism relates to issues discussed beforehand, such as dilatoriness of repayment rates and over-indebtedness of clients, which both clients and analysts are made responsible for. Interestingly enough, the assumption that MFIs overvalue a clients’ securities (property) on purpose in order to make clients lose their properties to the banks as stated by A.M. seems to be a common prejudice, which was also remarked on in conversations I had with other Peruvians I met during my stay in Peru. Further research would be needed though, to verify or falsify this belief.

Most importantly though, the participants of my field research seem certain that microfinance in general helps to reduce but not to eliminate poverty, and as A.M. stressed, it is necessary to question how microfinance stimulates an increment of informal labor and increases the vulnerability to poverty. Microfinance critic Gerhard Klas describes this relation to microfinance to be visible around the globe and caused by the ideological shift which expects “the Poor” to achieve development themselves and expects microfinance to be a tool that “helps poor people to help themselves” (= capacity building): “Instead of job contracts (...)more and more credit

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<sup>9</sup> “Unsere Studien und die anderer Wirtschaftswissenschaftler haben ergeben, dass etwa fünf bis zehn Prozent der Kreditnehmerinnen von den Mikrokrediten profitiert haben.” (Klas 2011, 239).



contracts take in place” – regular employment that is subject to social insurance diminishes (Klas 2011, 187, 207 and 277).<sup>10</sup>

The acceptance and encouragement of informal work by the microfinance advocates sees Bateman (2010, 91) to be proven correct because of the high amount of informally working, self-employed traders who are accepted as microfinance clients. In his opinion, this shows that “(...) microfinance is (...) intimately associated with the legitimization and support of the informal sector.” An increment of informal work, which is linked to “a lack of self-respect and humiliation” (Bateman, 2010, 39), cannot be an aim of the international development community, but in the context of microfinance is clearly supported. Interestingly though, only a few critics relate the rise of informal microenterprises in Latin America since the 1980s (cf. Portes) to the implementation of microfinance. Perhaps because of the missing long-term assessments do insiders such as A.M. “only assume” that microfinance stimulates informal work. Nevertheless, an increment of informal work contains major risks for a society: Because of its declining effects on wages and the increasing impoverishment and inequality (cf. Klas, 2011, 228), informal work can turn into a threat to social peace and - as history has shown - to domestic security - “The creeping informalization of the economy in both developing and transition countries is seen as responsible for a great many antisocial developments” (cf. Bateman, 2010, 91f.). This dimensioning juxtaposes the understanding of microloans as a tool of political and social pacification (cf. Klas, 2011, 69). Bateman further emphasizes, that the increase of an “unprotected informal sector” has often exacerbated ethno religious differentiation, sectarian violence, and ethnic exclusion (2010, 93). The experience of Barton F. who participated at a microfinance group meeting, which was predominantly framed in a religious ceremony and supposedly organized by an MFI with relations to the Pentecostal Movement (this will be discussed in detail in “Conclusion”), correlates with this observation made by Bateman.

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<sup>10</sup> “An die Stelle des Arbeitsvertrages – bisher Grundlage für den Verkauf der ‘Ware’ Arbeitskraft – tritt in den Ländern, in denen reguläre, sozialversicherungspflichtige Beschäftigung noch einigermaßen weit verbreitet ist, zunehmend der Kreditvertrag.”

## **Conclusion**

The hopes on microfinance as an innovate tool to reduce poverty, to generate new employment and to increase incomes, thus, to empower “the Poor” and to cause sustainable “bottom up” development might not need to be completely disappointed but my findings in Peru and those of other researchers around the world indicate, that microfinance may only be able to achieve these goals with limitations.

Although Bateman declared that “microfinance does not work” (Bateman 2010, 1), I am still a little more optimistic that microfinance can have a positive impact on development, to some degree. My research has shown that criticism can successfully be placed on several dimensions but always depends on one’s perspective and understanding of reality. However, to me the unequivocal opinion of the microfinance clients who I met in Peru stating that microfinance has helped them, weighs a lot.

Obviously, their opinion on microfinance is influenced by their social surroundings and the state system in which they live. Therefore, critics on capitalism argue in favor of the transformation of state- and market systems to encourage sustainable development and equality but although alternatives to capitalism are publicly thought of nowadays, the interdependence of states and markets in our globalized world makes a change rather difficult. Furthermore, for those who currently suffer from poverty, help is urgent – but this is not an excuse for implementing unconsidered development programs. Instead, development players especially in microfinance need to be pressured more, to question their measures and to evaluate impacts of their work.

This is not only the case in Peru but as Bateman, Klas and other researchers have found: everywhere. The heterogeneity of people, cultures and countries contradict to every generalized development tool and thus, require that microfinance is adapted to local structures (cf. Faber 2011, 257). Considering multi-angle perspectives, consequently the development-success depends on how the involved players transform microfinance and how they meet the needs of the clients addressed. To put in Sen’s wording: Similar to development, microfinance needs to be seen as a process that allows for independent action and decision-making but whether its impact is perceived positively or negatively depends on the different experiences of and multiple perspectives on reality by the individuals involved.

The increasing interest in microfinance from public and private actors had become my motivation to examine microfinance in Peru. And although it is rather complicated to define the Peruvian microfinance as “the best developed” in the world (as explained earlier), I wanted to find out in how far it can be seen as a “good-practice” example. Therefore, before discussing

“Future Prospects” I will present the results of my findings with reference to my hypotheses (cf. “Introduction”).

## Results

- If microfinance empowers “the Poor” sustainably and reduces poverty, in the countries that apply microfinance the life quality (access to health services and education) will improve and the poverty rate will decrease

Firstly, “the Poor” as a heterogeneous group are not empowered equally. As shown in Peru for example, the distribution of microloans differs regionally and although more loans are designed for female clients, they can often only request a loan with a written permission of their husbands. Thus, not the whole group is empowered, but only some of them. Secondly, those who are addressed are not necessarily the very poor “Poor” one thinks of. Thirdly, long-term impact assessments on microfinance do not exist until today in any country. Hence, critics only speculate that microfinance does not enable the majority of “the Poor” to improve their living-conditions over the long haul (cf. “Informal Sector”). However, although microfinance may allow empowerment of some microfinance clients, clients are often caught in credit-spirals and face deeper poverty than experienced before. Thus, microfinance increases the vulnerability to poverty due to the popular distribution of parallel loans and high interest rates, which also cause that many clients lose their property.

Although the poverty rate in Peru has constantly decreased as well as in other countries that apply microfinance, it is not possible to correlate this success exclusively to microfinance, because poverty affiliation may be caused by other factors and additional programs as well. On the other hand though, it may be possible to assume that the countries that do apply microfinance do not experience an increase of poverty. But further research would be needed to prove this assumption.

Following Sen’s understanding of development and Yunus’ interpretation, it is very likely that “poor” families who used to work for someone else have had less income than those who run their own business. Thus, with an own business the family income increases and child labor decreases. Consequently, children are more likely to go to school. As researchers found in Bangladesh, Bolivia and India, clients who are caught in credit spirals depend on the financial support of their children who then carry out child labor again instead of attending classes in schools.

- If microfinance is perceived as a tool to fight multidimensional poverty, microfinance players will cooperate with other players that release microfinance-programs and international alliances will be formed

MFIs cooperate with other (international) players but as the excursus on the IMFI “Kiva” has shown, predominantly they do so in order to raise funds. My research and other studies found that the majority of MFIs only focuses on the distribution of capital to combat poverty and recently, the distribution of insurances increases. However, there are no studies on microfinance players who cooperate with development players that perhaps focus on education or health. In Peru, the NGO Paz Peru might be an exception, because microfinance is only one of their programs. Next to school education they also run a medical clinic but Paz Peru does not cooperate with other development players neither. In spite of the predominant financial focus, microfinance players clearly cooperate with other microfinance players. Paz Peru for example cooperates with the Swiss foundation of the same name, COPEME with Kiva, KfW partners with local MFIs.

- If microfinance is practiced around the world, microfinance systems will be distinct due to political, economic and cultural differences of nation-states

As discussed earlier, it is advantageous to take local factors into consideration when applying microfinance. Microfinance is generally practiced similarly around the world and critical studies focusing on different regions often correlate in their findings. Thus, similar to the transformation of microfinance “prior to 1995” into “commercialized microfinance”, which was experienced by every microfinance market around the globe, micro-insurances have become a popular trend in different microfinance markets, too. Nevertheless, my findings do not allow me to verify or falsify this hypothesis as further research in other countries is needed.

- If microfinance is dedicated to improving the living-conditions of “the Poor” and has a beneficial purpose, mostly clients without an occupation who do not own property and in particular women will be registered as borrowers at MFIs in Peru and MFIs will not make a lot of profit

The interviews with MFI representatives and microfinance clients have shown that in Peru microfinance is mostly exclusively accessible by those who have securities. I could not find evidence, that “the Poor” referred to in my hypothesis have access to this capital for whom microcredits have predominantly been designed. Nevertheless, at some MFIs women are preferred clients (cf. CMAG Arequipa and EDAPROSPO). On the other hand though, during my research on microfinance clients it seemed as if only very few women knew of microfinance.

Furthermore, none of the clients interviewed defined their living situation as “bad”. Thus, it is very questionable if in Peru those who live from less than USD 2 a day are addressed by microfinance.

For MFIs in Peru (and as other studies confirmed: for MFIs around the world) microloans are a profitable investment. Numbers provided by B. F. (10.04.2012, Lima) reveal that for example CMAC Arequipa’s profit is about 14 Mio. PEN (approx. USD 5,5 Mio.) every two months. Although it is difficult to find out about the profit margins of MFIs and some MFIs (e.g. Microfinanzas Prisma) clearly have a negative default rate, increased investments by public and private actors as well as the constant increment of MFIs operating in the field indicate profitability. Thus, some MFIs make a lot of profit but still follow a beneficial purpose.

- If interest rates are high, the demand for microloans will decrease and if the competition among MFIs is high, the interest rate will decrease

Although the perception of “high” interest rates may vary, my findings in Peru show that the demand for microloans has constantly increased in the past although microloans are costly. Further, MFIs with high interest rates in comparison to other market offerings still experience an increment of clients (cf. Prisma) although microfinance clients decide predominantly on the interest rates where they request a loan. As explained earlier (cf. “Discussion: Competition and Promotion of MFIs”), MFIs with high interest rates often accept clients who have fewer/worse securities and are denied at MFIs with lower interest. The greater risk thus, adds to the increase of interest. All in all, although 100 % of the clients interviewed wish an improvement of interest rates, only two described interest rates to be “unfair”. Nevertheless, as Ströh found during her research in Peru, some MFIs offer microfinance in a profit-maximizing manner. Consequently, “a few institutions take usurious interest rates from the poor - far above cost coverage – making the loans very costly to the clients” (Ströh 2010, 293). In general, it is important to distinct between for-profit and non-profit MFIs, who usually have to offer loans that are more expensive while at pro-profit institutions microloans are often sold with other products. Further, often the total cost of microloans is unclear due to not transparent interest rates (nominal vs. effective) and extra commissions charged.

MFIs use more and more customer incentives and microfinance advertisement as tools to compete. Taking the numbers of advertisements and MFIs operating in Peru into account, competition is very high and as the representatives interviewed stated this competition causes that interest rates decrease. Nevertheless, in contrast to the MFI representatives who fear that state regulation will cut down private investments, the clients interviewed favor a regulation of

interest rates by the state, because they still find them too high, especially in comparison to other countries. Furthermore, although clients benefit from the competition of MFIs and the many different players offering microfinance (eg. have more “freedom of choice”), the advertisements (and special offerings at Christmas) also cause, that already indebted clients are attracted and request other loans at different MFIs, often leading to over-indebtedness. Sometimes, parallel loans become a tool to pay off other more expensive loans, but recent trends indicate that parallel loans are especially used for increased consumption. The aggressive campaigns (phone-calls, personalized letters, etc.) result in the high level of competition, because especially in urban areas, MFIs are concentrated.

- If microloans are supposed to help clients to escape from poverty, there will be a limitation of credit-dependencies because with every new credit the likelihood of over-indebtedness will increase

Microfinance clients in Peru have the opportunity to request a loan with different durations. Although microloan durations range between 4 months and 48 months (depending on the MFI, cf. “Table 2: Credit Products and Limitations”), most of the MFIs offer their clients to apply for a parallel loan in order to pay off the old loan and thus, extending the duration until they have to pay back the complete amount borrowed. As explained earlier, this method contains also risks of over-indebtedness, because clients may use the loans for unprofitable. However, as my findings have shown, microloans are often used for non-business-related purposes.

As a consequence, many MFIs limit the amount of micro-loans and the total debt a client may have when requesting for a new loan. These measurements can be perceived as a step in the right direction, from which not only clients but also MFIs benefit because risks are reduced.

## Future Prospects

As experienced in Bolivia (“one of the jewels in the crown of microenterprise finance”, cf. Bateman 2010, 118), the “good-practice”-example of microfinance in the 2000s the commercialization-driven expansion of microfinance contains major risks, which if not taken seriously by involved players will cause that microfinance systems collapse. In Bolivia, microloan over-indebtedness is huge and thus, microfinance has caused that “the Poor” are caught in even more dependencies and left with less financial resources than before (ibid.). Consequently, the privately owned commercial microfinance sector is affected, too – having lost trust, financial investments and potential clients (cf. Bateman 2010, 141).

India has started to experience a microfinance crisis (“India’s asset bubble” called by critics) in 2010. Experts see the cause of the crisis in the rapid and uncontrolled growth of MFIs in India and their profit maximizing behavior at the clients’ expense. Similar to Bolivia, in India many microfinance clients are caught in credit spirals, are over-indebted and cannot repay their loans. The Indian government is currently developing a regulatory body that will put restrictions on MFIs and develop integrated software to allow loan tracking across multiple MFIs, in order to oversee the clients’ credit history (Kuts 2011).

The development of microfinance in Bolivia and India shows that the opportunistic behavior of all involved players may destroy the market as such.

In Peru, a similar negative prospect will be avoided if new transparency laws are passed. Although the dilatoriness-rate in Peru still does not cause great concerns, the increasing over-indebtedness of clients needs to be faced and counteracted – for example through state regulation. If SBS releases new restrictions that limit interest rates and the amount of credits (and the total credit amount) offered to clients, risks of over-indebtedness will be reduced directly. Obviously, it is complicated to restrict the amount of credits because microfinance clients have different prerequisites. Thus, the microfinance players need to decide on individual basis but if they do so in cooperation with other MFIs, with which a client already has loan contracts, an assessment of the clients’ background will be more complete. Further, MFIs should assist their clients in how to invest a microloan sustainably and to deal with accounting and taxation issues. Most importantly though, it is necessary to assess possible side effects of microfinance (eg. increment of informal labor, effects on culture) and to evaluate in how far “the Poor” really benefit from microfinance.

In order to meet the widespread exaggerated expectations of microfinance, the idea of the “Bank of the Poor” needs to be coordinated with other existing strategies to combat poverty and development programs. Then, a greater benefit for “the Poor” will more likely be achieved.

## Final Words

During my interview with the COPEME-representative B.F., a new issue with reference to microfinance was raised: It was described how a group meeting of microfinance clients that B.F. had attended was carried out by the responsible MFI as a religious ceremony similar to those of the Pentecostal Movement. Interestingly, the MFI he referred to, operates in other Latin American countries as well and has its roots in the United States. Unfortunately, the MFI did not respond to my phone-calls and emails, thus, I was not able to question them in person or to attend any of these meetings myself. Nevertheless, Barton F.’s experience indicates that perhaps the Pentecostal Movement uses microfinance to do missionary work.

Until now, the Pentecostal Movement has not been related to microfinance in academic research but studies on the Pentecostal Movement’s way of proceeding support my assumption:

- Members of the Pentecostal Movement are often “the Poor”

According to a study by C. Lalive d’Epinay the Pentecostal Movement addresses primarily members of the dispossessed classes and who are further often employers of the informal sector and belong to marginalized groups (in: Bergunder 2000, 9 and Sepúlveda 2000, 84). Further, sociological studies prove that the typical clientele of the Pentecostal Movement has not been included in the main society and often been imposed by structural changes they could not influence, e.g. the massive migration from the country to the cities and the insufficient integration in the developing urban, industrial structure (Sepúlveda 2000, 84). As a consequence, many people have become part of a social class that lives from the production of craftwork and street sale, temporal occupation or begging (ibid.).

As a result of the missing access to normal working conditions and a lack of participation opportunities within the society “poor people” often feel excluded and the Pentecostal Movement addresses their longing for (their inclusion in a) community (Sepúlveda 2000, 84f). Members of the informal sector, who cannot rely on a fixed employment relationship, often develop the illusion to be the only ones responsible for their lives and consequently believe their social situation to be caused by their own responsibility or lack of responsibility. Therefore, they do not believe to be oppressed but to be “poor” because of their own culpability or destiny (Sepúlveda 2000, 85). These characteristics may be combined within a life-attitude that is mainly



pessimistic and hopeless and get along with feelings of guilt. Being in this state, “the Poor” do not expect to receive anything good from society but instead the society promotes their feeling of failure and insignificance which is picked up by the Pentecostal Movement and their preaching of a new spiritual purpose in life (ibid.).

Thus, some analysts perceive the Pentecostal Movement as a mass movement for “people in transition” who try to contradict the existing class structures with the help of their own empowering communities (Self 2000, 78).

- Role of Women

Similar to the popular assumption spread by MFIs that poor (especially male) clients are more likely to spend their money on alcoholics than women relies the Pentecostal Movement on a puritan ethic, which emphasizes the rule to not spend any money on alcoholics, tobacco products, gambling, etc. Instead, the spare cash shall, according to the ideology of the Pentecostal Movement, be invested into the social advancement such as education (Bergunder 2000, 10). Parallel to the freedom of action provided to women provided by MFIs when providing access to capital for women, the Pentecostal Movement also provides new social positions for women whose actions in the patriarchal system before were limited within their role as housewives (Bergunder 2000, 14).

- Influence of the Pentecostal Movement in Latin America

The Pentecostal Movement has got one of its centers in Latin America and its memberships are constantly increasing (Tovar and Köhrsen 2010). Citing the decline of memberships in Catholic unions, it seems to be very likely that in the future Catholics will not be the major religious group anymore (Bergunder 2000, 7) but instead Protestant (and Pentecostal) churches will fill their position (Brooks 1999, 67).

Many MFIs (cf. Kiva and Finca) already emphasize that their commitment to combat poverty is based on their religious beliefs and also, the advertisement of MFIs in Peru underline typical religious motives, arguing that microfinance encourages those, who want to work and to improve their lives and the lives of their community (cf. “Competition and Promotion of MFIs”).

Further research (perhaps in a doctoral thesis) will be necessary to substantiate my accusation.



## **Appendix**

### **Questionnaire 1)**

#### **Entrevista a empleados de IMF en el Perú**

| <b>Preguntas básicas</b>  | <b>Preguntas en detalles</b>   | <b>Respuestas</b> |
|---|--|-------------------|
| Para empezar la entrevista, presentense por favor y puede describir su profesión y sus laborales por favor? | ¿Para que organización está trabajando y por cuantos años está trabajando allí?  |                   |
| ¿Qué condiciones previas los prestatarios tienen que cumplir para recibir un microcrédito de su IMF?        | <p>¿Qué requisitos son necesarios para recibir un microcrédito? (¿Cómo evalúan estos requisitos y que es mejor la habilidad del cliente o el aval?)</p> <p>¿Es posible prestarse un microcrédito solo para empezar una empresa o también es posible prestarse por otros motivos (como la educación o la salud)?</p> <p>¿La IMF acepta prestatarios quienes ya reciben un microcrédito de otros IMF? Si no, cómo se aseguran que no existe otra dependencia entre un prestatario y otra IMF?</p> <p>¿Hay criterios predefinidos los cuales necesitan ser cumplidos antes de prestarse un microcrédito? (por ej. necesitan una cuenta bancaria? Cuanto cuesta el mantenimiento de la cuenta y cada transacción?)</p> |                   |
| ¿Cómo se decide sobre la cantidad del microcrédito?   |  |                   |
| ¿Por favor, puede describir el fondo social de la mayoría de sus clientes?                                  | <p>¿Tiene más prestatarias femeninas? Por qué?</p> <p>¿Aproximadamente, cual es el promedio de edad de sus clientes?</p> <p>¿En que sector trabaja la mayoría de sus clientes?</p>   |                   |
| ¿Qué porcentaje de intereses es obligatorio para los prestatarios?  | <p>¿Puede variar este porcentaje? ¿Cómo calculan los intereses en general?</p> <p>¿Están los intereses incluidos en las letras mensuales o tienen que pagarlos de manera separada (en el último caso: cuándo tienen que pagar)?</p> <p>¿Reciben los prestatarios información sobre los intereses nominales o efectivos?</p>  |                   |

|   |  |  |
|---|--|--|
| ¿Qué facilidades de pago ofrecen a sus clientes (un pago semanal o mensual)?  | ¿Ofrecen créditos de grupo y de manera individual?   |  |
| ¿Qué medias toman si un prestatario no paga su letra a tiempo?  | <p>¿En el caso del golpe del destino personal, ¿es posible por un cliente cortar el pago de la letra y por cuanto tiempo al máximo?</p> <p>¿Piensa que hay muchos clientes quienes prestan parte de su propio préstamo a otras personas?</p> <p>¿Cómo evalúan la corrupción en el sector de las microfinanzas?</p> |  |
| ¿Desde su punto de vista, por qué un cliente se decide por una IMF u otra?  |  |  |
| ¿Cómo evalúa la competencia entre las IMF diferentes?   | ¿Cómo se financia la IMF? ¿Recibe fondos de bancos comerciales o de inversores estatales?  |  |
| ¿La IMF trabaja en cooperación con otras IMF (internacionales)?   | <p>¿En que sectores trabajan en cooperación y cómo? (¿Tienen que pagar algún interés a la IIMF? ¿Cuanto es?)</p> <p>¿De qué tamaño es la responsabilidad de la IMF local con la IMF transnacional?)</p> <p>¿Sabe el prestatario que existe esta cooperación?</p> <p>¿Afecta al prestatario? ¿Cómo?</p>             |  |
| ¿Qué importancia tiene la ubicación de la MFI aquí?   | <p>¿Piensa que es difícil encontrar inversionistas de otros países porque el Perú es un país en vías de desarrollo?</p> <p>¿Entonces, piensa que es más fácil para una IMF que tiene una ubicación en un país industrial encontrar inversionistas?</p>   |  |
| ¿Qué medidas de ajuste nacionales e internacionales existen para quienes tienen una influencia en las microfinanzas en el Perú? | <p>¿Qué influencia tienen las instituciones internacionales en la industria de las microfinanzas en el Perú?</p> <p>¿Cuál es la función del banco de desarrollo interamericano en las microfinanzas en el Perú?</p>  |  |

|  |   |  |
|--|---|--|
|  | ¿Tienen que informar a un departamento del gobierno sobre su trabajo?   |  |
| ¿Tienen la impresión que hay una relación entre las medidas de ajuste/la deregulación de las microfinanzas y la globalización? |   |  |
| ¿Cómo evalúan el trabajo de la IMF?  | <p>¿Hay una conversación al culminar el crédito entre el analista y el cliente?</p> <p>¿Cómo garantizan transparencia en su trabajo?</p> <p>En la IMF, ¿reciben los empleados un pago de gratificación o un salario lo que depende del número de los microcréditos cuales han otorgado?</p> |  |
| ¿Tienen la impresión que en los años pasados aumentó la obtención de beneficios en el sector de las microfinanzas?             |   |  |
| ¿En que caso piensa la IMF que el préstamo de un crédito fue un éxito?   | ¿En su opinión, que es el porcentaje de los clientes quienes sacan provecho de los microcréditos en una manera a largo plazo generalmente?  |  |
| ¿Cómo evalúan los instrumentos diferentes (por ejemplo el PPI) para averiguar la eficiencia de los microcréditos?              | Cuales son los ventajas del PPI en comparación con otros instrumentos?  |  |
| ¿También ofrecen microseguros, por ejemplo seguros de la salud o seguros cuales ayudan en el caso del muerte de un cliente?    |   |  |
| ¿Qué piensa sobre una regulación estatal de la tasa de interes?  |   |  |

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|---|---|--|
| <p>¿En una escala de 0 a 10 (0 es lo peor y 10 lo mejor) cómo evalúan la influencia de los microcréditos para reducir la pobreza/aumentar el desarrollo en el Perú?</p> | <p>¿Qué aspectos tienen que mejorar en el futuro?</p> <p>¿En su opinión, que sectores han mejorado en el Perú en comparación a otros países y que sectores falta mejorar?</p> |  |
|---|---|--|

## Questionnaire 2)

### Entrevista a l@s clientes

| Preguntas básicas   | Preguntas en detalles   | Respuestas |
|---|---|------------|
| <p>Para empezar la entrevista, presentese por favor y describe su profesión y también su estado civil por favor.</p>  |   |            |
| <p>¿Cual es el nombre de la IMF que le ayuda?</p> <p>¿Que informacion tienen sobre la IMF que le ayuda?</p> <p>(por ejemplo: tiene las tasas de interés más bajas o es bien conocido en el Perú por su trabajo profesional ...)</p> | <p>¿Por qué seleccionó esta IMF? ¿Fue recomendada por familiares o amigos?</p> <p>¿Quién le proporcionó el crédito a usted?</p> <p>¿Sabien si la IMF que le ayuda a usted tiene una alianza con otras IMF?</p> <p>¿Sabien si la IMF que le ayuda está regulada por el gobierno?</p>   |            |
| <p>¿Cómo evalúan su situación personal?</p>   |   |            |
| <p>¿Por qué (y para que) prestaron un microcrédito del banco y en que ayuda el préstamo?</p>  | <p>¿Cual es la suma total del crédito?</p> <p>¿Es un crédito individual o grupal?</p> <p>¿Cuales son las condiciones del banco? (¿cuanto tiempo tienen para devolver el préstamo?)</p> <p>¿Tienen un tipo de interés nominal o efectivo?</p> <p>¿Cuales fueron los requisitos para que el banco les preste el dinero (una casa, un contrato del trabajo, etc.)?</p> |            |
| <p>¿Le ha pasado que no ha podido pagar una letra al banco?</p>   | <p>¿Por qué?</p> <p>¿Cómo reaccionó la IMF? (¿Hubo condiciones antes en el contrato que entraron en vigencia?)</p> <p>¿La IMF lo presionó para pagar la letra (lo antes</p>   |            |

|   |  |  |
|---|--|--|
|   | posible)?<br>¿Cómo fue posible pagar la letra? ¿Recibieron ayuda de familiares?<br><br>(¿En su perspectiva darle una coima al analista para alargar el plazo para pagar la letra?) |  |
| ¿Qué piensa sobre el uso de los microcréditos en general? ¿Ha ayudado el crédito a usted y a su situación de vida actual? |  |  |
| ¿En una escala de 0 a 10 (cero = peor, 10 = mejor), está satisfecho con su IMF?   |  |  |
| ¿Tiene recomendaciones para mejorar este instrumento?   |  |  |
| ¿Piensa que los microcréditos son instrumentos útiles, para reducir la pobreza en el mundo?                               |  |  |

**Table 11: MFI-representatives interviewed**

| MFI  | Representative | Position   | Date and duration of the interview    |
|--|----------------|--|---------------------------------------|
| Caja Municipal Arequipa (CMAC)   | M.R.           | Customer service officer and analyst             | March, 28 <sup>th</sup><br>36 minutes |
| La Cámara Nacional de Comercio, Producción y Servicios (PERUCAMARAS) and<br>La Asociación de Mujeres Industriales, Empresarias y Profesionales (MISUR) | A.C.           | Founder and president                            | March, 29 <sup>th</sup><br>34 minutes |
| PAZ Peru   | F.C.           | Director of microfinance program                 | March, 30 <sup>th</sup><br>51 minutes |
| Microfinanzas Prisma, Lima   | J.M.           | Economist  | April, 9 <sup>th</sup><br>72 minutes  |
| El Consorcio de Organizaciones Privadas de Promoción al Desarrollo de la Pequeña y Microempresa (COPEME)   | B.F.           | Counselor, former GTZ-employee                   | April, 10 <sup>th</sup><br>83 minutes |
| Equipo de Educación y Autogestión Social (EDAPROSPO)   | D.V.           | Secretary and executive director                 | April, 10 <sup>th</sup><br>89 minutes |
| Corporación Financiera Internacional (IFC) – Grupo Banco Mundial   | F.P.           | Officer of operations (“Oficial de Operaciones”) | April, 10 <sup>th</sup><br>66 minutes |
| MiBanco  | M.S.           | Executive senior analyst                         | April, 12 <sup>th</sup><br>51 minutes |

**Table 12: Clients interviewed**

| <b>Name</b> | <b>Gender</b> | <b>Profession</b>                         | <b>MFI responsible for credit</b>  |
|-------------|---------------|---|--|
| C.C.        | Male          | Distributor                               | Scotiabank, Interbank, Banco de Crédito del Perú (BCP) <sup>1</sup> , HSBC     |
| J.M.        | Male          | Ing. - Mechanic                           | Banco de Crédito del Per (BCP)   |
| R.J.        | Female        | Distributor                               | Banco Scotiabank, Interbank  |
| O.M.        | Male          | Runs an internet café and a grocery store | Banco Internacional  |
| D.J.        | Male          | Metalworker                               | Banco Continental (He has to pay the interest but the credit is on a relative) |
| H.Q.        | Male          | Graphic artist, Printer                   | Banco de Crédito del Perú (BCP, Interbank)                                     |
| J.          | Male          | Owner of a business                       | MiBanco  |
| F.R.        | Male          | Administrator                             | Banco de Crédito del Perú (BCP)  |
| E.C.        | Male          | Produces clothes                          | Caja Pirva   |
| K.R.        | Male          | Sales clothes                             | MiBanco  |

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<sup>1</sup> BCP is the main private and commercial bank in Peru (Conger et al. 2009, 9).



**Table 13: Distribution of exclusive clients and clients with more than one credit in regard to the main MFIs operating in Peru**

| MFI                        | Exclusive Clients in 2011 | Clients with more than 1 credit in 2011 |                   |                  |                  |
|----------------------------|---------------------------|---|-------------------|------------------|------------------|
| <b>Credit Unions</b>       | 81,813 (64%)              | 46,179 (36%)                            |                   |                  |                  |
|                            |                           | 1 MFI                                   | 2 MFIs            | 3 MFIs           | 4 and more MFIs  |
|                            |                           | 31,469<br>(68.1%)                       | 10,788<br>(23.4%) | 3,131<br>(6.8%)  | 791<br>(1.7%)    |
| <b>Cajas Rurales</b>       | 157,011 (55.8%)           | 124,394 (44.2%)                         |                   |                  |                  |
|                            |                           | 1 MFI                                   | 2 MFIs            | 3 MFIs           | 4 and more MFIs  |
|                            |                           | 80,433<br>(64.7%)                       | 33,357<br>(26.8%) | 8,955<br>(7.2%)  | 1,649<br>(1.3%)  |
| <b>CMAC Arequipa</b>       | 114,048 (54.9%)           | 93,872 (45.1%)                          |                   |                  |                  |
|                            |                           | 1 MFI                                   | 2 MFIs            | 3 MFIs           | 4 and more MFIs  |
|                            |                           | 62,402<br>(66.5%)                       | 23,760<br>(25.3%) | 6,381<br>(6.8%)  | 1,329<br>(1.4%)  |
| <b>EDPYMEs</b>             | 110,949 (49.4%)           | 113,437 (50.6%)                         |                   |                  |                  |
|                            |                           | 1 MFI                                   | 2 MFIs            | 3 MFIs           | 4 and more MFIs  |
|                            |                           | 71,770<br>(63.3%)                       | 31,447<br>(27.7%) | 8,529<br>(7.5%)  | 1,691<br>(1.5%)  |
| <b>Financial Companies</b> | 916,333 (67.5%)           | 441,960 (32.5%)                         |                   |                  |                  |
|                            |                           | 1 MFI                                   | 2 MFIs            | 3 MFIs           | 4 and more MFIs  |
|                            |                           | 321,534<br>(72.8 %)                     | 96,536<br>(21.8%) | 20,566<br>(4.7%) | 3,324<br>(0.8 %) |
| <b>MiBanco</b>             | 221,284 (52.1%)           | 203,665 (47.9%)                         |                   |                  |                  |
|                            |                           | 1 MFI                                   | 2 MFIs            | 3 MFIs           | 4 and more MFIs  |
|                            |                           | 135,555                                 | 53,490            | 12,438           | 2,182            |

|             |                 |                   |                   |                 |                 |
|-------------|-----------------|-------------------|-------------------|-----------------|-----------------|
|             |                 | (66.6%)           | (26.2%)           | (6.1%)          | (1%)            |
| <b>NGOs</b> | 107,492 (60.4%) | 70,460 (39.6%)    |                   |                 |                 |
|             |                 | 1 MFI             | 2 MFIs            | 3 MFIs          | 4 and more MFIs |
|             |                 | 44,463<br>(63.1%) | 17,832<br>(25.3%) | 6,461<br>(9.2%) | 1,704<br>(2.4%) |

(Source: Own elaboration with data from COPEME 2012, 57)

**Table 15: Investment in Micro-Enterprises (Ranking)**

|                           | Investitionen in MF (2011) in PEN | Investitionen in MF (2011) in USD |
|---------------------------|-----------------------------------|-----------------------------------|
| 1. MiBanco                | 1198 Mio. PEN                     | approx. USD 449 Mio.              |
| (...)<br>4. CMAC Arequipa | 621 Mio. PEN                      | approx. USD 233 Mio.              |
| (...)<br>33. Prisma       | 27 Mio. PEN                       | approx. USD 10 Mio.               |
| (...)<br>48. EDAPROSPO    | 4 Mio. PEN                        | approx. USD 1,7 Mio.              |

(out of 57 estimated, data from COPEME 2012, 38)

\* Paz Peru was not included in the ranking.

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