Micro-lending: Small Loans Make Big Difference

When Kevin Altomari scouts start-ups to finance, he’s not courting biotech scientists or imagining the next Microsoft. He’s looking for people with ideas for businesses that need as little as $500 to get off the ground and can be started by almost anybody.

The nonprofit company he heads, Neighborhood Business, Inc., is among an expanding cadre of financial organizations more interested in helping clients gain economic self-sufficiency than making their backers rich. By helping people build small businesses from the ground up, these organizations will be strengthening neighborhoods, cities, and eventually even nations.

Known as “micro-lenders,” businesses like Altomari’s extend credit to people either living in poverty or eking out a living. With no credit ratings, collateral, and often little if any income, these borrowers can’t turn to conventional lenders. Still they have aspirations and often ideas that, with a little leverage, can lift them to stable, productive lives.

“[We are] dealing with people for whom small amounts of money could make a difference,” says Altomari. “These loans are character-based, not collateral-based.”

Altomari is currently considering financing a start-up that needs equipment and supplies to make baked goods for a neighborhood coffee shop.

In underdeveloped nations, loans might be as little as tens of dollars to help a tenant farmer buy a few chickens or a village woman purchase a handloom.

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Although microloans also can be significantly larger — thousands of dollars in some cases — the impetus is to help people who a small amount of money is the only thing standing between them and a productive business.

Trending Towards Lending

Organizations like Altomari’s have popped up in a handful of U.S. cities in recent years, but micro-lending, in its modern incarnation, has its roots in Bangladesh. It was there that Mohammed Yunus, an economics professor devoted to alleviating poverty and empowering women in his homeland, pioneered the concept in the late 1970s. His inspiration came when he saw village women laboring to weave bamboo stools, but making only a penny profit on each because their only access to money for supplies was through loan sharks.

Yunus loaned the women $27 to buy their own materials. On that tiny grubstake they established a thriving business and Yunus developed the principles and practices for a research project that would become Grameen Bank — the world’s first financial institution focused on making unsecured loans to people living in poverty. In 2006, Yunus and Grameen were jointly awarded the Nobel Prize.

During the three decades since Yunus founded Grameen, micro-lending has spread to nearly every part of the globe and the field of microfinance has evolved to bring other financial services to people spurned by commercial banks.

Good Credit

According to The Microcredit Summit Campaign, an international organization launched in 1997 with micro-lenders from 137 countries tracking the progress of microloans, micro-lending numbers have increased to about 3,552 micro-lenders reaching nearly 155 million borrowers worldwide.

Web-based organizations, led by Kiva, have also sprung up, making it possible for individuals to lend as little as $25 to borrowers a world away.
The Microcredit Summit Campaign's latest annual report profiles numerous small borrowers who have made big improvements in their own lives, and sometimes in the lives of other people in their villages or communities as their businesses became substantial enough to employ others.

One woman in India, whose family often went without food on her husband’s 20-cent daily wage, now supports them in relative comfort, processing rice for merchants with a husker purchased on a $10 loan.

Certainly micro-lending can claim success by some measures, says Charlotte Lott, an associate professor of Economics at Chatham University and an advocate for micro-lending.

“Microcredit institutions have created a culture and practices that have led to very high repayment rates,” Lott says.

“As someone in the movement, I think the influence has been positive,” adds Lott, who lives her conviction by serving as president of the Western Pennsylvania Board of Directors for Oikocredit, an international funding source for micro-lenders.

**Credit Check**

As compelling as these stories and testimonies are, evidence of micro-lending reducing poverty or empowering women remains anecdotal. Additionally, as micro-lending has come of age, it’s done so amid controversy.

“There’s no definitive research,” Lott acknowledges. “The neutral researchers have found it very difficult to demonstrate that it is microcredit that has brought about any overall improvement in poverty or for women.”

Lott also notes that lending rates often raise eyebrows.

“Sometimes people are surprised, even shocked, at interest rates, which typically range from 35% to 50%, charged to borrowers,” she says.

The justification, she says, is high costs, not high returns for investors, which often are as little as 2%. In the web of relationships that micro-lending requires, large funding sources are in constant contact with field lenders, offering training and support. The field lenders, in turn, must take pains to educate and support individual borrowers.

Nonetheless there’s currently a tension in the micro-lending community about whether practices and economics should move more toward conventional, for-profit banking, Lott noted, citing a recent uproar over Mexico’s Banco Compartamos. Formerly a micro-lender, it had charged interest rates as high as 100% and made investors wealthy with a public stock offerings.

Simmering controversies however, don’t seem to have blunted enthusiasm among micro-lending advocates or ambitions for micro-lending expansion. Even in the face of a global economic slump, last year Kiva told *Fortune* magazine that its pool of small financiers continued to grow and that it is “doing more loans than ever.” It also said it is launching a U.S. lending program to target the estimated 30 million Americans without bank accounts and an estimated 18 million “micro-enterprises” that lack access to credit.

For his part, Altomari, who launched Neighborhood Business, Inc., in April, is quick to say his organization and its backers hope not only to raise economic prospects for individuals, but also for their communities.

“If we develop home-based businesses in struggling neighborhoods, there’s kind of the philosophy that a rising tide raises all boats,” he says. “It’s as much about changing attitudes and ideas as it is about starting businesses. Is there an expectation of a social return? Absolutely.”