



Australian aid: Approaches to microfinance and enterprise development

MICROFINANCE AND ENTERPRISE DEVELOPMENT CAN HELP THE POOR TURN EXISTING SKILLS INTO THE OPPORTUNITY TO EARN AN INCOME. THIS CAN IMPROVE HEALTH, HOUSING AND EDUCATION OPPORTUNITIES FOR THEIR CHILDREN. IN SHORT, IT CAN HAVE A MASSIVE DIRECT EFFECT ON THEIR QUALITY OF LIVING.

THE FACTS

The majority of the world's poor live in the Asia-Pacific region. Of the 1.1 billion people in the world living on less than US\$1 a day, 700 million are located in this region. Despite this, the proportion of the population in East Asia and the Pacific who are poor fell from 29.6 per cent in 1990 to 14.9 per cent in 2000. This contrasts with sub-Saharan Africa, where in the 1990s extreme poverty rose from 47.4 to 49.0 per cent.

The major decreases in poverty in the Asia-Pacific region have been attributed largely to long and stable periods of economic growth in several major countries, including China and India. Evidence has shown that broad-based growth with low initial inequality is important in accelerating poverty reduction.

Governments have an important role in addressing inequality, as well as in creating an environment conducive to broad-based growth. Governments can do this by adopting an approach that balances the need to achieve high levels of growth against the need to ensure the benefits of growth are shared with the poor.

This kind of approach may involve, for example, eliminating conflict, maintaining macroeconomic stability, providing key infrastructure and creating an attractive investment framework and well-functioning markets. In addition, to ensure that the poor can share in the benefits of growth, barriers to their participation in the economy need to be removed. These include a lack of access to health and education, a lack of essential infrastructure and, in some cases, a lack of access to financial markets.

Microfinance attempts to address the lack of access to financial markets. It focuses on providing microcredit – small, collateral-free loans – to the very poor for self-employment. It also provides other financial services such as savings and insurance (known as microfinance). Access to microcredit can enable the poor to turn existing skills and market opportunities into income. If they lack these skills or opportunities, they may need to be developed before access to credit is appropriate.

Microfinance is not appropriate in all contexts. For extremely poor people in particular, providing essential infrastructure and basic health and education and reducing other barriers to economic participation may need to take place before microfinance has a role. Also, investment in productive infrastructure, employment programs and training in business development can help to build social capital and skill levels within communities where microfinance would be inappropriate or unsuccessful.

AUSTRALIA'S APPROACH TO MICROFINANCE AND ENTERPRISE DEVELOPMENT

Australia's approach to microfinance and enterprise development focuses on a broad range of measures to help strengthen the financial sectors in partner countries and help them work better for the poor. The approach includes:

- > creating an enabling environment by improving financial and business sector regulation
- > providing financial literacy training and supporting business skills development, and
- > meeting the financing needs of micro, small and medium size enterprises, and the need for poor households to have access to a range of financial services, including deposit facilities.

Although there have been some great success stories in microfinance, experience shows that it can achieve its full potential only in the right circumstances and as part of broader development programs. Given this, it is important that best practice principles of microfinance are promulgated among donors, developing countries and microfinance institutions.

To aid in this, Australia supports the Consultative Group to Assist the Poor (CGAP) to build a stronger worldwide microfinance industry. CGAP is a consortium of public and private development agencies that work out of the World Bank to expand access to financial services for the poor in developing countries and to build the capacity of microfinance institutions.

Examples of approaches adopted in AusAID-funded activities that have been successful or innovative in a country or regional context follow. These are preceded by best practice principles drawn from donor briefs by CGAP and from Australia's own experience in implementing microfinance activities.

CREATING AN ENABLING ENVIRONMENT

Overly restrictive enterprise laws can be a major barrier to self-employment and the development of microenterprises. Restrictive laws can increase business costs and, in some cases, lead to harassment and opportunities for corruption as entrepreneurs are forced to comply with unnecessary and burdensome regulations.

In **Vietnam** Australia worked with the United Nations Development Programme and a range of other donors to provide support for the implementation of a new Enterprise Law. The law took effect in January 2000 and simplified establishment procedures for businesses, abolished a range of sub-licences and decreased the involvement of the state in business management. Since the law took effect, 80,000 new private enterprises have been created and approximately one million new jobs generated.

Donors can assist in integrating microfinance into the financial systems of partner countries to ensure that significant numbers of poor people have access to financial services. Donor collaboration can leverage funds and increase the impact of microfinance initiatives.

In **Papua New Guinea** Australia is contributing to an activity of the Asian Development Bank that is developing microfinance and employment opportunities. The activity is helping to build the capacity of microfinance practitioners, prepare a new legal framework with the Central Bank to facilitate the development of microfinance, and pilot the broadening of operations of a number of commercial banks and financial institutions. It is also providing sustainable microfinance services to viable enterprises and the population at large.

The focus on savings is particularly important in Papua New Guinea where there is a high default rate on loans, making microcredit largely impractical. A pilot microbank established in Wau, Morobe Province, just over a year ago is already

showing signs of success. It is expected to be operationally sustainable within three years and financially sustainable within five years.

PROVIDING FINANCIAL AND BUSINESS TRAINING

Financial and business training can be an important precursor to microcredit schemes or, where these would be inappropriate, an effective means of enabling poor people to participate in the economy.

In **Fiji** Australia is supporting a program that is teaching enterprise skills to primary school children in 20 rural disadvantaged schools. The students are establishing and operating school-based enterprises using seeding grants of \$500. They receive support for researching, planning and monitoring their enterprises. Projects have included sewing, raising poultry, floriculture, aquaculture, bee farming, tie dyeing and tapa cloth making.

An evaluation of the program demonstrated that the initiatives in each school were being effectively linked to existing curriculums. The program will be expanded to include another 20 rural disadvantaged schools, with the likely inclusion of some secondary schools.

MEETING THE NEEDS OF POOR HOUSEHOLDS

Being able to earn income, save and borrow can increase the confidence and ability of poor women to participate in decision-making about priorities for family spending. Potential spin-offs of this include better health and nutrition for family members, increased participation in schooling for children and reduced fertility rates.

Australia supported an activity in Tianjin, **China**, to assist laid-off women workers in urban areas to create new economic opportunities. The activity helped to establish the Tianjin Women Business

Incubator Centre, the first of its kind for laid-off workers in China. This accelerated the growth of incubated businesses and provided re-employment and venture creation for women.

Since its establishment in 2000 the centre has helped 58 women-owned businesses that employ more than 2700 people (80 per cent women). Ten of these businesses have now 'graduated' from the incubator. They are now sustainable in their own right. The activity also provided access to microfinance services for urban laid-off women workers, and by November 2002 had delivered loans to 2586 clients.

The business incubator model has been disseminated through high-level national conferences and a series of media advocacy activities and is now funded through the World Bank. This microfinance activity receives ongoing support through the United Nations Development Programme.

Improved access to credit in rural areas can help to reduce poverty by creating opportunities for self-employment and income generation.

Australia is supporting the Microfinance Northwest Expansion Project of the **Bangladesh** Rural Advancement Committee (BRAC), which is providing access to financial services, including credit, for nearly 23,000 households in seven north-west districts. These districts make up the poorest and most food-insecure part of the country. Three-quarters of the households are landless or 'near landless', meaning their landholdings are insufficient to grow sufficient food for their families.

BRAC is the largest non-government organisation in Bangladesh, covering 60,627 villages in the 64 districts of Bangladesh. Its microfinance operation provides credit for poor women to develop income-generating activities and has already resulted in a 27 per cent increase in school attendance among borrowers' children.

BRAC operates through a number of village organisations that facilitate access to microfinance through weekly meetings with a microfinance officer. These organisations also have the broader aim of enabling the poor to participate in sustainable development. Village organisations can also be the focal point for strategies related to delivering services, building institutions, mobilising the public sector and addressing wider social issues. In some cases the organisations have addressed such issues as child marriage, polygamy, illegal divorce and domestic violence. Village organisations can also access BRAC staff to assist them with socioeconomic, legal and health issues.

Microcredit can be a valuable tool in helping to combat poverty levels exacerbated by urban migration.

In **Vietnam** Australia is supporting the Capital Aid Fund for Employment of the Poor (CEP) in its efforts to help urban migrants create work for themselves by accessing loans.

The level of urban migration has increased markedly in Vietnam in recent years. For example, it is estimated that there may be as many as 1.5 million unofficial residents of Ho Chi Minh City, many of whom have migrated from the central provinces of Vietnam in search of employment. These migrants are often among the poorest residents and tend to live in informal settlements.

Almost 80 per cent of households being assisted by CEP have per capita incomes of less than US\$0.86 per day. CEP offers loans to petty traders (repaid daily), labourers (repaid weekly) and salaried workers from low income households (repaid monthly). CEP relies on the government-sponsored labour confederations, community leaders and market managers to help identify clients, collect repayments and follow up on late payments.

Analysis has shown that the majority of income derived from the investment of CEP loans is used for purchasing food and other necessities, followed by reinvestment, children's education and household items.

CEP has established a reputation as a market leader in microfinance in Vietnam and was given a rating of B+ by Planet Rating, an independent agency that rates institutions over a range of areas from institutional capacity to financial sustainability. Planet Rating found that CEP's main strength was its ability to cover operational costs, its longstanding presence in Ho Chi Minh City, its support from the labour confederations, its strong network of local collaborators and its tested methodology.

Supporting microfinance in devastated areas is risky, as higher levels of grant funding can erode the concept of repayment, and assets of clients are destroyed. Risks can be reduced by working with experienced partners and having realistic expectations.

An Australian-supported microfinance program in **Sri Lanka** is helping people to recover from the impact of the 2004 tsunami on their livelihoods. The program is supporting loans to 2100 people (mainly women) in small-scale activities such as preparing food, making lace, fishing, selling vegetables and making bricks.

Before the tsunami, around 1700 women (and 96 men) had received assistance under a microfinance program run by the Arthacharaya Foundation based in Hikkaduwa. Repayment rates were around 97 per cent. However, the tsunami had a devastating impact on communities who had received loans under this program. Around 80 people died and over 830 families lost their housing. The ability of local members to repay their loans was seriously disrupted, as many families lost their productive assets. In the months following the tsunami, the Arthacharaya

Foundation sought and received funding from Australia to help rebuild their loan portfolio for their members hardest hit by the tsunami.

FURTHER INFORMATION AND RESOURCES

RESEARCH AND ADVICE ON MICROFINANCE

www.themfmi.org (information on management of microfinance institutions)

www.mixmarket.org (global information exchange for microfinance industry)

www.mfnetwork.org (global association of microfinance organisations)

www.microfinancegateway.org

www.planetrating.org

www.cgap.org (Consultative Group to Assist the Poorest)

www.uncdf.org (United Nations Capital Development Fund)

www.gdrc.org (Global Development Research Centre, which has a microcredit virtual library)

MICROCREDIT ORGANISATIONS

www.cep.org.vn (Capital Aid Fund for Employment of the Poor, Vietnam)

www.brac.net (Bangladesh Rural Advancement Committee, Bangladesh)

OTHER USEFUL INFORMATION

www.yearofmicrocredit.org (information on the International Year of Microcredit)



MORE INFORMATION ABOUT AUSTRALIAN AID

Further information about the Australian Government's overseas aid program is available online at www.aisaid.gov.au

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FRONT COVER IMAGE: *Hikkaduwa, Sri Lanka. Groups (mostly women) set up 'credit schemes' where they are taught to save money and use skills to make products to sell. PJ Chandrawathie used the money she saved to buy more cows, she also was taught to manage her own compost system for household waste.*

PHOTO: *Will Salter.*

BACK COVER IMAGE: *Vietnam, stall-owner and beneficiary of Capital Aid Fund for Employment of the Poor in Ho Chi Minh City.*

PHOTO: *Lorrie Graham.*

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