How to apply microfinance activities in the developed world

- a case study in New York City

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Abstract

This study strives to examine how microfinance activities can be successfully applied in the developed world. This is done through a field study in New York City. Throughout interviews and observations with three of the largest actors in New York: Acción USA, Grameen America and Project Enterprise, as well as interviews with their clients, the lending processes and key characteristics of the organizations have been mapped. Furthermore, the Federal Reserve Bank of New York has been interviewed on the general opinion of microfinance in the US.

Previous theory elaborates on some of the major challenges with implementing microfinance activities in the developed world, such as lack of funding and cultural differences hindering the lending processes to be carried out as they are in the developing world. Henceforth, problems regarding regulation, awareness and outreach are discussed. Throughout the observation of the institutions we can confirm that some of the challenges brought up in theory actually are apparent. We do, however, question the criticism towards the use of group-based lending programs in the developed world. Our study does, in contrast to previous research, imply that the concept does work as well in the US as it does in developing countries.

Since this is a case study based on the observations of only a few organizations, it is precarious to draw any general conclusions based upon the findings. Indications of key success factors are, though, group-based lending programs, non-financial services, creating awareness, financial sustainability, savings as funding, standardized regulations and increased transparency. Finally we advocate focus on job creation to obtain acknowledgement.
Acknowledgments

It is our great hope that this study will contribute to a deeper understanding for microfinance and provide the reader with an increased knowledge regarding the social and economical effects that occur while implementing the concept into the developed world. Since this is a fairly new area of the economic development field, we hope and urge for more research within the area to make the industry get more efficient, helping even more poor people out of poverty.

We want to show our big appreciation and gratitude to the microfinance institutions in New York City, who have let us into their businesses and given us invaluable insight and knowledge about microfinance programs. Thanks to Grameen America, Project Enterprise and Acción USA for helping us throughout this study. In addition we have got the opportunity to have deep and interesting conversations with clients of the institutions. Thank you so much for sharing your experiences with us, our study would not have been the possible without you.

Further, The Federal Reserve Bank of New York has helped us understand the regulation and the future for microfinance in the US. Thank you for taking your time.

Last, but not least, a great thanks to our supervisor Han-Suck Song, who has guided us throughout the work and given us support and inspiration. Thanks also to Inga-Lill Söderberg, who as a journalist helped us form the interview guides.

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Sofia Bredberg  Sara Ek
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1 Introduction

“A world where you need a dollar to catch a dollar” – So does 2006 years’ Nobel Peace Prize laureate, Muhammad Yunus, describe today’s financial system. Yunus are one of the strongest profiles in the microfinance world and his creation, Grameen Bank in Bangladesh, is often used as an example of microfinance success. Today, Yunus set his focus towards a new challenge, proving the creditworthiness of the poor people in the US, a market where microfinance is a relatively new phenomenon and where the surroundings highly deviate from those in Bangladesh.

Microfinance, in terms of microcredit without collateral and targeted to the poor, started in some developing countries in the early 1970’s with a couple of thousand of clients, and has now become a phenomena dispersed over the world with over 190 million clients (Lucarelli, 2005, Microcredit Summit Campaign 2011). Microfinance has been viewed as a powerful tool in reducing poverty and the industry has developed and grown substantially since the early pioneers (Hermes & Lensink, 2007).

The increased interest in the microfinance business has led to a shift in the industry and there is now a trend towards greater focus on the commercial aspects of microfinance (Rhyne & Christen, 1999). There is, however, an ongoing debate regarding whether this shift is good or not. Some argues that commercialization is an essential step for microfinance institutions (MFIs) in order to become financially viable (Christen & Drake, 2001), while others argue that commercialization leads to a “mission drift” where the very poor are omitted (Bhatt & Tang, 2001), (McIntosh & Wydick, 2005), (Mersland et. al, 2010).

Today, the supply for serving the poorest is far too small to meet the demand, and only the financial market, argues Meehan (2004), has the possibility to fill this supply-demand gap. Mersland and Ström (2009) and Hermes and Lensink (2007) argue that since the costs of lending to the poorest are high, due to high transaction costs, the striving towards commercialization tends to overtake the original aim of helping the poorest. Marr (2002) takes this one step further and stresses that microfinance not only misses its mark, but can create even more poverty. Meanwhile, Hermes et al (2008) emphasize that sustainability and outreach, in the sense of serving the poorest, can be compatible under certain conditions.

Microfinance has proven success in helping the poorest and the phenomenon has grown significantly, not only in the developing world, but also in many industrialized countries. The wide spread of microfinance has mainly happened through replication of the first
microfinance programs in Bangladesh, India and Bolivia, where the repayment rates for well-established MFIs have been up to 97% (Bhatt & Tang, 2001). Microfinance has lately taken a part of the financial market for the poor in the US, and some of the pioneering actors from the developing world have entered the market. In previous studies it has, however, been suggested that the microfinance concept has had varied success in both social and economical terms and needs to be adjusted to different communities, since there are disparities in for example social capital and legal structures. Gomez and Santor (2001) clarify that the lack of social capital is one of the main reasons for microfinance not having as high repayment rates in the inner-cities of the US as it has in the rural areas overseas.

There are economical differences between poor people in the developing and the developed world, and there is a lack of research regarding the social and economical effects in developed countries. As Bhatt and Tang (2001) emphasize, there is vague knowledge about social, financial and administrative intermediary within microfinance in the US. Even Painter and Tang (2001) stress that microfinance programs in industrialized countries are separated from the programs in the third world and are not comparable.

1.1 Purpose and problem formulation

The purpose of this study is to identify key factors required for establishing and running a microfinance business in a developed country. By observing three microfinance institutions in the US, well-known, Acción USA and Grameen America, as well as the Grameen Foundation partner Project Enterprise, our aim is to scrutinize how microfinance can be carried out in a new market area; the industrialized world. Furthermore, the study aims to clarify whether or not the original purpose of microfinance, i.e. serving the poorest, is fulfilled, and to identify the factors that have a potential impact on this goal.

It can be stated that microfinance has had positive social and economical effects on many poor people worldwide, but the world is still consisting of 1.4 billion people that are considered the very poorest¹, out of which only a small part have access to financial services (Faiola, 2008). There is thus a great need for microfinance to be improved and adjusted to a more commercialized and competitive market, where the original focus on the poorest is remained unchanged.

The implementation of microfinance activities in developed countries have been challenging because of social, economical and legal differences in comparison to developing countries. It is thus critical to fully examine these problems since it can lead to a questioning of the

¹ The very poorest is defined as those living on less than $1.25 a day according to World Bank 2008
institutions in the microfinance industry. The skepticism towards the real impact of the industry is crucial and can, if not disproved, lead to a situation in which investors or donors withdraw from the industry, leaving the poor excluded from the financial system once again. The microfinance entry into developed countries has increased the need to examine the real effects further. There are differences in running microfinance businesses in developed countries compared to developing countries, and these differences need to be properly addressed in order to establish a sound microfinance industry. Previous research from the US shows that it is not just to apply the models from the developing world into developed countries. Being poor in Bangladesh or Bolivia differs a lot from being poor in the US, and there are also big social differences that limit the outcome of the models. An important issue is therefore to clarify how microfinance can be successfully applied in developed countries. In addition, some of the main challenges for the industry, such as capture the right target group, attract investors and achieve positive media attention, will be further discussed.

To clarify, the primary aim of this study is to identify the key factors for implementing microfinance activities in the developed world.

1.2 Outline

In an initial stage an overview over existing literature is presented in order to point out key issues and concepts that constitute the foundation for the forthcoming empirical study. The literature review also serves to identify gaps in previous research. The empirical study was executed through a case study in New York City, where three microfinance institutions, Acción USA, Grameen America and Project Enterprise, were observed. We have, by conducting interviews with employees and clients, tried to identify how microfinance can be effectively run in the US in terms of social and economical goals.

The field studies in New York served as a platform for mapping the lending processes and internal work of the institutions. The interviews were performed face-to-face and based on interview guides with open-ended questions. Two note-taking interviewers were present throughout the interviews, which were in addition recorded. The results from the case study has been analyzed leading to a concluding section were our general implications are presented. Lastly this study contains a discussion in which important insights from this study are brought up, together with a reflection over future research areas.
1.3 Scope

This study is a case study based on interviews and observations from three microfinance actors in the United States. Findings from this study can therefore not be used in order to draw any general conclusions on the developed world as a whole. The study can, however, serve as a tool to find key characteristics of successful implementation of microfinance in the US. Furthermore this study is only focused on MFIs in New York City and the results do not, if not especially mentioned, represent other parts of the US. The main focus of this study is the underlying mechanisms that can make microfinance implementation successful. Potential differences between the studied objects will therefore not be scrutinized unless they clearly affect the success of the organizations. Neither is this study examining microfinance institutions other than in the US, nor microfinance implementations in other developed countries.
2 Theory

2.1 Microfinance – a definition

The Consultative Group to Assist the Poor (CGAP) defines microfinance as follows: “Microfinance offers poor people access to basic financial services” (CGAP, 2010) This definition is widely used, but the term has somewhat different meanings, even though the original definition is that microfinance means financial services to the poor people that would otherwise be excluded from the formal financial sector (Murdoch, 1999). Organizations providing the financial services are called microfinance institutions (MFIs) and there are a variety of different kinds of organizations, including Non-Governmental Organizations (NGOs), credit unions, specialized banks, commercial banks, and more (van Greuning et al. 1998). The term microcredit refers to the actual loan that is given to the borrowers.

Microfinance activities started in the developing world in the 1970’s and today some of the institutions, as Grameen Bank in Bangladesh and BancoSol in Bolivia, serve a huge number of poor people efficiently. As a side-effect microfinance in these countries started to affect not only the economy for the poor households, but also the social capital and the empowerment of the borrowers, especially women, since the small loans were targeted mainly to female borrowers (Anderson & Locker, 2002). During the last 15 years, even the US and UK have had a rapid growth of microcredit programs (Schreiner & Woller, 2003).

In 2009 the Microcredit Summit Campaign reported that they have reached out to over 190 million clients, whereof 67% considered the poorest (Microcredit Summit Campaign, 2011). However, there are still 3 billion people around the world living beyond the poverty line, to be put in relation to the 190 million people served, thus there is a huge supply-demand gap.

2.2 An introduction to microfinance activities

2.2.1 Microfinance programs

Microfinance programs differ between organizations and countries but there are two main orientations by which the lending is performed: individual lending and group-based lending. The group-based lending is by far the most well-known process and a majority of the microfinance borrowers participate in group-based programs (Hermes & Lensink 2007). There is a tendency for commercial MFIs to focus more on individual lending while non-profit organizations focus on group-based lending (Baydas et al, 1997).

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2 Poverty line is defined as living on less than $2 a day according to CGAP 2011
The underlying mechanism for group-based programs is the joint liability for repayment. The joint liability creates incentives for the group members to screen and monitor each other, leading to higher repayment rates and also lower transaction costs for the MFIs, since there is no need for the organization to carry out extensive screening processes. On the other hand, a group-based lending can lead to a moral hazard problem where some group members take advantage of the joint liability and act as a free-rider, as the other members will make up for the borrower. By establishing a direct relationship between the bank and the borrower, as the case of the individual lending process, the free-rider problem can be avoided and it also increases the flexibility of the loan structure (Giné et al. 2006). Individual lending processes, however, result in bigger need for screening and monitoring by the bank and thus higher transaction costs.

Brau and Woller (2004), states that the group-based lending approach can be viewed as a method for MFIs to establish some kind of social collateral. By making the group mutually responsible for repayment, the group members are likely to put in more effort in repaying the loan since it would affect their social standing if they failed to do so. In developing countries, group-based lending programs make up a large proportion of the total number of microfinance programs and those programs tend to be successful. The success in using group-based lending techniques in developing countries is likely to depend on the relatively high degree of social capital within these surroundings. The group members are often part of a neighborhood characterized by homogeneity and strong interaction that all add to the social capital (Gomez & Santor, 2001). The theory is supported also by Hung (2003), who states that group-based lending work better in smaller cities and more rural areas, where the group members are more likely to be part of a neighborhood community.

2.2.2 Lending in practice

As mentioned earlier, group-based lending is the most common approach in developing countries (Hermes & Lensink 2007). The group consists of approximately 5-10 members and the group members are responsible for the first screening process and inviting new members to the group. There are usually some requirements that the potential borrowers must meet in order to become a member. Grameen Bank, for example, requires that the applicant is a permanent inhabitant in the neighborhood and that he or she does not have any family relationship with any other group member. Furthermore, Grameen Bank has an income limit for its potential borrowers. In order to ensure that the actual target group is captured, Grameen Bank dismisses loan applicants that have an income above 55 dollars per month (Bredberg &
Disbursements and repayments of loans are usually performed at group- or centre meetings held every week.

2.2.3 Products
MFI’s product range in developing countries does not only consist of credit services but also other traditional financial services such as savings and insurance. Savings are widely used by MFIs and a large proportion of savings facilitated are so called forced savings that impose borrowers to save a minimum amount each week in order to get a loan (Brau & Woller, 2004). An MFI’s total deposit amount is often several times larger than the outstanding loan balance, thus deposits can make up an additional source for funding of loans (Cull et al. 2008). Even non-financial services, such as education, business development and health advice, are used by many MFIs and there is evidence that the impact on reducing poverty is higher if financial and non-financial services are combined (Zaman, 1999).

2.2.4 Interest rates
The field of microfinance has always been surrounded by a debate regarding the true means of the business. Many of the critics question if poverty reduction really is the main objective for the organizations operating in the industry. One of the most frequently debated questions is the appropriateness of the interest rate levels. MFIs usually charge substantially higher interest rates than traditional banks; this is partly explained by the fact that the organizations face higher transaction costs and thus higher costs per dollar lent, than traditional banks (Helms & Reille, 2004; Cull et al, 2008). There are, however, significant variations in interest rate levels between different MFIs, with 80% in Uzbekistan as the extreme. The global average in 2008 was approximately 35% (Kneiding & Rosenberg, 2008). Rosenberg et al. (2009) states that the interest rate levels set by MFIs are likely to be higher than those set by traditional banks even in the future, due to the higher transaction costs and higher risk faced by MFIs. They argue, however, that a reduction in the rates is to be expected since the industry is now facing more competition, forcing the organizations to compete with lower interest rates.

2.3 Measures of success
The success for microfinance can be viewed from two perspectives; the MFIs’ and the borrowers’. Moreover there are different ways of measuring the success and it is important to distinguish between the different meanings of success. The probability of succeeding with all
measures is rare and there is an ongoing debate whether or not these factors actually can be combined.

2.3.1 The MFI perspective
Regarding the lenders’ perspective, the most commonly discussed measures in research are outreach, sustainability and repayment rates. Outreach aims to capture the actual target group for microfinance; the very poor people. Mersland and Ström (2009) define the term as the average loan size, but also take into consideration the extent of lending in rural communities, lending to women and the group lending process. It is thus a complex measurement, but many researchers, such as Marr (2002), argue that profit-making institutions will not succeed economically by focusing on this group of people, which makes it an important success factor to be measured while analyzing the market for microfinance. Without the outreach, microfinance fails to fulfill its original aim.

Moreover, the sustainability issue has grown substantially lately. Hermes and Lensink (2007) state that the new objective for the microfinance institutions is to become financially sustainable, but MFIss have high transaction costs and many are dependent on donor subsidies. Cull et al (2008) argue that these subsidies can be seen as an obstacle for innovations and initiatives, and that a commercial approach is needed for an effective microfinance market. The sustainability of the MFIs is therefore also an important measure for the success of microfinance, and it seems to be a trade-off between the outreach and sustainability. Brau and Woller (2004) state that the program revenues for the MFIs must fully cover its operating and financial costs in order to consider them financial sustainable.

The third and most easily applied factor of success is the repayment rate, which indicate how large percentage of the outstanding loan balance that is paid on time. These numbers are used by both Acción and Grameen Bank as a measurement of their success (Bhatt & Tang 2001).

2.3.2 The borrower perspective
Through the borrowers’ perspective primarily two success factors are discussed in the research; social capital and an improved economical situation for the household. Anderson and Locker (2002) define social capital as a measurement of the poor households change in production and consumption through microfinance, which generates as a side-effect of the original aim of microfinance. Gomez and Santor (2001) explain social capital as the borrower being member of a civil society, which enables individual action through social relations. The
effect of this is a stronger social status in the society. Another aspect of social capital is the female empowerment. Women are, in poor countries, often seen as less creditworthy, since they are generally poorer and have less access to collaterals in comparison to men (Burjorjee et al 2002). De Mel et al (2008) argue that women, because of this, have a desire of strengthening their status and be more involved in the households’ economy, which is an explanation to why women constitute a majority of the borrowers in the developing world. There is a lack of research on measuring the improved economical situation that has been generated only through the use of microfinance services, but this is still an important success factor since it represents the main objective of microfinance: reducing poverty.

2.4 Microfinance – demand and adaption to the US

Since the amount of immigrants is considerably large in the US in general, and in New York in particular, the new market area of microfinance is not that far away from where it once started, why the implementation of microfinance in the US is not unexpected. The phenomenon has also been planted in a few countries in Europe, including Sweden, but is still in an initial phase why results cannot be withdrawn from these countries. Even though differences between countries exist, the US can, however, serve as an example of how and if microfinance services can work in the developed world in general.

The US is considered a wealthy and highly developed country, yet, a relatively large part of the population lives below the poverty line. In 2009, 42.9 million Americans had an income below the poverty level, corresponding to 14.3%, which was an increase from 2008 and also the highest poverty rate since 1994 (US Census Bureau, 2011). The poverty level in the US is set to an income of $11,000 per year for one person and $22,025 for a family of four (Grameen America, 2011). With this background it can be stated that there is a great need for microcredit even in the developed world.

The development of microfinance in the US began in a small scale over 30 years ago. In the beginning of the 1970’s communities around the US did an attempt to serve untapped markets; the market of the poor people lacking collaterals and credit records. An operation in Chicago started offering investment capital to businesses denied by the regular banking market, focusing on female entrepreneurs. The concept grew and in the early 1980’s it was shown that not only credit is needed for the unbanked, but also business advising and affordable housing loans. In addition, policies for microfinance emerged and college courses on the subject were launched. In 1991, Acción began its activities in Brooklyn, New York,
meanwhile The Aspen Institute started its work with documentation and research on micro lending programs. In 1997, the same institution expanded its engagement in the industry by tracking outcomes and investing in innovative ideas. During the 21st century the microfinance field has grown substantially; in 2008, Grameen America, with its world-famous concept, was established in Queens, New York. (Opportunity Fund, 2011) Today, after the financial crisis, the demand for microfinance is even bigger, and new challenges have emerged within the field (The Federal Reserve Bank, 2011).

2.5 Major challenges for implementation in the developed world
Microfinance has been faced by several new challenges while expanding the industry into developed countries. For the microfinance business to survive and fulfill its mission of being poverty alleviating two major areas can be circumscribed; financial sustainability and social impact. There is an ongoing debate whether or not there is a trade-off between the two concepts. This section will elaborate on how these two areas challenges the implementation of microfinance in the US and will serve as a platform for the forthcoming study. Since the dispersal of microfinance over the world, new challenges have been faced within the framing of the programs. What works good in the developing world, might not work as good in the US, which is verified by Schreiner & Woller (2003), Bhatt & Tang (2001) and Gomez & Santor (2001).

2.5.1 Financial sustainability
While many MFIs are still highly dependent on donor subsidies, some institutions have proven to be financially viable and profitable without donors, leading to a greater emphasis and pressure on MFIs to become financially sustainable (Cull et. al, 2009). The shift towards commercialization is thus anticipated, but what does microfinance commercialization means in reality? Christen and Drake (2001) states that commercialization in its most basic form means “to manage on a business basis” but there is a variety of different definitions to microfinance commercialization. Cull et al. (2009) define it as MFIs that are profit-seeking, while Christen and Drake (2001) argues that commercial MFIs can still be non-profit organizations and that microfinance commercialization basically stands for the movement towards financial sustainability. Campion (2002) propose yet another definition; according to her, microfinance commercialization is the “application of market-based principles to providing financial services to the poor”. In this paper microfinance commercialization is seen as the approach where MFIs try to manage their activities on a “business basis” and strive towards financial sustainability. It is here important to clarify that this is not the same as using
a for-profit approach. While a financially sustainable for-profit organization distribute any surplus to its shareholders, a non-profit organization can still be financially sustainable but uses any surplus for their business operations. In the following sections some of the major implications from microfinance commercialization are presented.

**Funding**

Commercialization of the microfinance industry is by many viewed as the only way to make the industry viable in the long-run and Christen and Drake (2001) show evidence that those MFIs that use a more business-oriented approach are the leading organizations in local markets. Commercialization means moving away from donor subsidies are limited and sensitive to market fluctuations (Cull et al, 2009),(Servon, 2006). Being dependent on donor subsidies also prevent organizations from growing, and according to Christen and Drake (2001), commercialization is the only way for MFIs to grow exponentially.

There is a great difference between the US and the Third World in terms of the perception of self-sustainability. In the Third World, most organizations strive towards becoming self-sustainable, and many have already succeeded in doing so. In the US on the other hand, there are not the same focus on self-sustainability and many MFIs do not even intend to become financially viable in the long run. This attitude towards the importance of self-sustainability constitutes a threat for the future expansions of the US MFIs as the organizations do not have the incentives to increase efficiency and innovation (Schreiner & Morduch, 2001). As mentioned earlier, deposits have been used by some MFIs in the developing world as funding for the loans (Bredberg & Ek, 2009). To facilitate savings is, however, more difficult in the developed world as there are higher costs and more regulation associated with depository organizations (Fiebig et al. 1999).

In order to become financially sustainable, there is hence a need for commercial sources of capital, according to Meehan (2004). She argues that turning to the traditional financial markets are the only dependable option for microfinance financing in the long-run. But, it can be difficult for MFIs to attract such capital unless they can lower operating costs and increase efficiency (Campion, 2002). A study by Hermes et al. (2011) though, states that more efficient institutions tend to have lower degrees of outreach, which indicates that commercial investors may hinder the strive to reach the poorest. This conclusion is also supported by Hoque et al. (2011), who state that leverage tends to decrease outreach. Attracting investors is
further obstructed by the lack of transparency portraying the microfinance industry. Investors typically require a high degree of transparency in order to invest which jeopardizes the possibility that the need for capital will be met (Meehan, 2004). Alongside the lack of transparency, Servon (2006) argues that investors might also be discouraged by the lack of accreditation and standardization regarding both numerical data and actions by the MFIs.

Many of the MFIs trying on a commercial approach started as NGOs with social missions, they are therefore unlikely to have the management capacity to run a commercial business (Campion, 2002), (Roodman & Qureshi, 2006). MFIs are in many cases built around and dependent on charismatic founders which may cause problems when the organization is transformed into a commercial institution (Christen & Drake, 2001). This issue is also stressed by Schreiner and Woller (2003); they argue that even if the underlying mission is of social nature, it is of great importance that the management has the capacity to operate the MFI as a financial sustainable organization.

**Competition**

Transformation towards commercialization has led to an increase in attention from traditional banks. Their involvement in the microfinance business is promising since they already have an established organization and more resources than NGOs (Meehan, 2004). Another important aspect of microfinance commercialization is that it increases the competition among MFIs, generating both positive and negative effects. According to Rhyne and Christen (1999), competition pushes MFIs to improve service quality and provide a broader range of services. An increase in the number of services provided is likely, since commercial institutions are allowed to facilitate more services than for example NGOs (Christen & Drake, 2001). Competition also causes MFIs to compete with lower interest rates, thus, forcing the organizations to become more efficient and focus on reducing costs, evidently commercial organizations have proven to drive the technological innovations within microfinance (Christen & Drake, 2001).

Competition is, however, the cause for some of the challenges faced by the microfinance commercialization process. The increase in the number of actors might thwart the sharing of information between lenders and thereby render the possibility for some impatient borrowers to take loans from more than one organization, resulting in over indebtedness and lower repayment rates (McIntosh & Wydick, 2005). In a competitive setting, the MFIs are likely to push the boundaries and become eager to attract clients. It might lead to a too aggressive price
setting or a wide product range, or that less effort is put in the screening process. Accordingly, it can lead to an overall riskier behavior (Rhyne & Christen, 1999).

**Regulation**

Microfinance commercialization is hampered by today’s regulation and supervision; in particular the developing countries suffer from lack of a sufficient regulatory framework (Campion, 2002). There is clearly a need for a more suitable legislation but this is challenged by the fact that MFI’s in the process of becoming regulated institutions face numerous costs (Christen & Drake, 2001). Today’s regulation is inappropriate since it does not address the issues corresponding to microfinance, but rather general financial issues. One important aspect left out of the regulation is transparency; microfinance regulation does not require sufficient levels of transparency (van Greuning et al, 1998). In the microfinance case there is a need to improve transparency in two ways, according to Jansson (2001). First, there is a need for more availability of information, and second, the quality of the information needs to be improved. A study by Meehan (2004) argues that the inadequate regulation might even be a barrier, hindering the industry from growing. Another issue on the subject is that in the US the regulation regarding taxes and self-owned businesses hinders some types of home-based firms, which diminishes the incentives of self-employment. The entrepreneurs in the third world are not facing the same challenges regarding regulation, why self-employment can be more easily facilitated.

**2.5.2 Social impact**

**Poverty alleviation**

A lot of positive effects are often highlighted while discussing microfinance. Lucarelli (2005), however, is questioning this positivism and wonders if it really has a lasting impact on poverty alleviation for the poorest of the poor, if it reduces gender discrimination and if most of the projects in reality can be self-financing and sustainable in the long run. He suggests that even though microfinance might be a useful instrument for stimulating social empowerment, a more comprehensive framework is needed for poverty alleviation and he criticizes the statement that microfinance has a positive effect on gender discrimination, since a significant proportion of women’s loan are controlled by male relatives (Bredberg & Ek, 2011). Lucarelli (2005) argues that there is a risk that so much focus is put on the benefits of the microcredit programs, that the original aim of poverty alleviation might be missed. Even Marr (2002) agrees with microfinance proponents being too naive. Mainly she criticizes that microfinance
can be a market solution for a failed credit market and questions if solidarity amongst group-members exist. Through empirical studies in Peru, Marr (2002) demonstrates that microfinance organizations fail screening with severe sanctions as a result to get high repayment rates. This, stresses Marr, tend to affect the poorest harder, creating even more poverty. Painter and Tang (2001) underlines that in order to alleviate poverty, the microcredit programs in the US need to improve efficiency and outreach to become financial sustainable.

Another issue, brought up by Hermes and Lensink (2007), is that MFI's using individual-based lending generates more profit compared to the group-based MFI's, but are not as focused on the really poor. Since the group-based technique does not seem to work in parts of the US, it is important for the microfinance market to find alternative solutions to the individual based lending programs, to not miss its mark.

**Outreach**

The number of self-employed in the US is smaller than in the Third World, making the size of the microenterprise sector much smaller in the US. Thus, reaching the same number of borrowers generates much higher transaction costs in the US (Schreiner & Morduch, 2001).

Moreover, the presence of large retailers constitutes a large threat, not seen in the developing countries. For microenterprises in the US, it is hard to actually succeed as a self-employed. There is not the same type of demand for small enterprise goods in the US. Agriculture, for example, is a large proportion of all microenterprises in developing countries, but would not be beneficial as a self-employing business in the US. Henceforth, Schreiner and Woller (2003) argue that the public safety-net and minimum wage jobs in the US decrease the incentives for poor people to start their own businesses, contrasting the developing world, where no safety-net exists. In addition, the microfinance legal structures in the developing world is characterized by an informal setting in which regulation to some degree is absent. Another issue is that poor people in the US have greater access to the formal financial sector, mainly in the form of credit cards, than poor people in the developing countries that usually have to search for additionally financing through informal moneylenders (Schreiner & Morduch, 2003).

MFIs in the US have strived to increase their lending and a study by Aspen Institute elaborates on numerous areas that need to be considered in order to do so. Firstly, they state that the MFIs need to carry out careful market research to become more demand-driven and develop more diverse products to meet the demand. Furthermore, the study suggests that the
institutions need to invest in infrastructure and use a combination of effective staff and technology. (Edgecomb et al. 2010)

**Implications of group-based lending programs**

Anderson and Locker (2002), stress that the group-based lending technique enhances the possibility to change household production and consumption, and has been used successfully in the third world. However, these group-based lending programs have not been as successful in the US since there have been difficulties with managing the groups, stress Schreiner and Morduch (2001). The borrowers are dependent on the behavior of the other members of the group, claims Anthony (2005), which makes social capital crucial in this sense. Moreover group members in the industrialized world seem to lack social capital, which makes the effect of the whole peer pressure concept almost non-existent, with low repayment rates as a result. The borrowers are not tied together to a village and they do not know each other good enough to do appropriate screening or to enforce the repayment among group members. This is also due to the American culture of individualism. The group lending approach is further more costly for the borrowers in the US. Unlike the women in developing countries that consider weekly centre meetings a social event, the American female borrowers already have social arenas and see the centre meetings as an event that is time-consuming, takes time from the business and generates an additional transportation cost (Schreiner & Morduch, 2001).

Schreiner and Woller (2003) refer to the possibility of the poor people with a good credit record to get a loan anyhow as another factor for the failure of the group-lending techniques in the US. In addition, Hung (2003) argues that many rules are set in the microcredit programs in the US, and points out some of them as highly relevant for the loan performance; payoff rules and the context of borrowers, determining the credit risks.

Anderson and Locker (2002), argue that the common techniques of microfinance, such as the group lending technique, enhance the possibility to change household production and consumption. They state that there is a connection between microfinance and the effects of the common resources, which can be identified by measuring the poor households change in production and consumption caused by microfinance. Many microfinance organizations has intentionally linked there financial services to environmental objectives and even more organizations get unintended side effects. Henceforth, Anthony (2005), has studied group cooperation and its effects on both the loan and the repayment, focusing on identity, sanctions and mutuality, where he concludes that they all stimulates borrowing through higher loans,
but only mutuality has an effect of the lifetime of the group. Mutuality has shown to be a very important factor for decreasing the loan delinquency. In addition, Gomez and Santor (2001), state that social capital facilitates entrepreneurship and that the role of the neighborhood is to improve social capital.

2.5.3 Microfinance in the future

Servon (2006) argues that if not something drastic is made within the field, microfinance will neither uphold itself, nor fulfill its original mission. Changes proposed by Servon are reforming the field, encourage innovations, create an accreditation process and implement standards. Many of the programs are not improving but deteriorate when it comes to fulfilling new challenges. Henceforth, Servon (2006) criticizes the microenterprise programs to set up social and business goals that off-set each other, which is not necessary. The programs are challenged to look for “both/and” solutions, to be able to fulfill its original aim. In addition, Bhatt and Tang (2001) recommend different microcredit programs for different needs, that is, differences should exist between communities. If peer borrowing does not work in the US, a new strategy for decreasing risk must be explored for microfinance to serve its target group; the poorest. Even Painter and Tang (2001) stress that microcredit programs in the US are separated from the programs in the third world and are not comparable.
3 Methodology

3.1 Method chosen
The study of the implementation of microfinance in a developed country has been performed in a qualitative manner. It constitutes of a case study of two of the largest and most well-known microfinance institutions in the world, Grameen America and Acción USA, as well as one of the earliest actors in New York; Project Enterprise (PE). The two first-named institutions are chosen because of their size, their former success in developing countries and because of their recognition factor. The former organization is picked due to its early appearance in New York and the fact that it is modeled after the famous, and in the developing world, successful Grameen Bank. In addition, representatives of the Federal Reserve Bank of New York (FED), was interviewed in order to get the authorities point of view on microfinance in the US.

3.2 Execution and interview methodology
This case study has been executed through numerous interviews with staff and clients from the three organizations observed. The interviewed staff has been loan managers as well as representatives from a variety of positions, representing fundraising, financial and development departments.

Contacts with the MFIs were first established in November to December, 2010, when we e-mailed a request to visit the organizations. Interviews took place in March-April, 2011. No questions were sent to the respondents beforehand but the organizations received a list of the areas that we were interested in. The interviews with the staff were relatively standardized (see interview guide in appendix 1). We did, however, take on a passive role in the interview, why the respondents sometimes deviated from the preset interview questions. This was made on purpose as we were concerned with the respondents own opinion and did not want to direct them too much throughout the interviews. The interviews lasted approximately 60 minutes and they were observed by both authors. In addition, note-taking and recordings were performed. The interviews with the clients were executed in a more informal manner as some of them were held at the clients’ actual workplace and some of them were held in connection to centre meetings. Again, we highly emphasized the importance of getting the respondents own thoughts and opinions. While performing the interviews with the organizations we discovered a need to get the opinion of the regulating authorities, why we scheduled a meeting with Federal Reserve Bank of New York. Two representatives from the Regional and
Community Outreach department were interviewed on the FEDs role in the microfinance industry and their opinion of the work of MFIs in New York.

3.3 Interview questions

The interview guides were constructed to reflect the topics brought up in the theory section. In the interviews with the MFIs, the questions were divided into six sub groups:

- Target group
- Microfinance programs
- Lending in practice
- Financial sustainability
- Social impact
- Challenges faced by MFIs in the US

In the interviews with clients, there was a clear focus towards the perception of the lending institution, as well as whether or not the clients considered their situation being positively affected by the MFI. In addition the interview with the Federal Reserve Bank of New York strived to examine the authorities’ view of microfinance, why the questions were designed to map their knowledge and opinion regarding the institutions and the industry as a whole. The complete interview guides are attached as appendices (see appendices 1-3).

3.4 Observations

In addition to interviews, this study also contains the findings from the authors’ observations of the lending process, observations of training and site visits to clients’ businesses. These observations have led to an increased understanding for the operational processes and an extra dimension of the characteristics of microfinance in the US. We have in our previous study (see Bredberg & Ek, 2009) examined the work of Grameen Bank in Bangladesh. Throughout that study, we gained knowledge about how the microfinance activities are carried out and perceived in Bangladesh. Our belief is that those observations have given us excess knowledge beyond the theoretical framework and the knowledge has thus been used to compare the findings from the observations in New York with the observations from Bangladesh.

3.5 Ethical and practical aspects

This paper is surrounded by a number of both ethical and practical issues. While carrying out this study we had to cope with difficulties regarding the actual execution of the case study and we also had to consider aspects with respect to both the institutions and their clients. When it comes to the execution of the case study, our greatest concern was to get access to the
institutions and their clients. The time planned for the field trip was limited and the schedule was tight, why it was challenging to get hold of the organizations and execute a proper case study. Regarding the institutions, there have been concerns regarding the access to financial data and to their work processes. The institutions have also demanded some degree of confidentiality, why we could not use a recorder in all interviews. In terms of clients, the main issue has been to reach them and while conducting interviews we were also faced with some cultural differences and language barriers, although not to the extent that was expected beforehand.
4. Empirics

4.1 Microfinance institutions

This section contains a brief overview of the three MFIs in this study. The information is based on interviews as well as printed information from brochures, annual statements and the organizations’ websites. Figure 1 below illustrates the main characteristics of the MFIs followed by three sections in which the respective organizations will be described more in detail.

![Figure 1 The MFIs in the study](image)

<table>
<thead>
<tr>
<th>Established</th>
<th>Acción USA</th>
<th>Grameen America</th>
<th>Project Enterprise</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of borrowers</td>
<td>3000</td>
<td>5600</td>
<td>400</td>
</tr>
<tr>
<td>Target Group</td>
<td>low- to moderate income hhs</td>
<td>the very poorest from $1.500</td>
<td>the unbanked $1.500-$12.000</td>
</tr>
<tr>
<td>Loan amount</td>
<td>$500-$50,000</td>
<td>$10,000</td>
<td>$1.9M</td>
</tr>
<tr>
<td>Interest rate</td>
<td>8.99%-15.99%</td>
<td>15%</td>
<td>12%</td>
</tr>
<tr>
<td>Loans disbursed</td>
<td>$119M</td>
<td>$16.7M</td>
<td>$1.9M</td>
</tr>
<tr>
<td>Repayment rate</td>
<td>89%</td>
<td>99%</td>
<td>88%</td>
</tr>
</tbody>
</table>

4.1.1 Acción USA

Acción USA is a non-profit microfinance institution with the objective of lending money to and assist low- to moderate income business owners with financial education. The target group is micro entrepreneurs that are rejected from the regular bank system due to business type, too short time in business or a lack of credit history. In 1991, Acción USA applied its first microlending model to Brooklyn, New York, and in 2006 Acción USA became the largest MFI in the nation, serving more than 3000 active borrowers. Acción offers loans from $ 500 up to $ 50,000 with an average loan size of $ 6,300 (Acción USA, 2011). To get a loan
from Acción USA, a credit score of 575 on the FICO report\(^3\) is needed, whilst a regular bank demands a score of approximately 750-800. If an applicant does not reach a credit record above 575, a smaller loan for stimulating credit building is provided to help create a credit score. Acción USA is dependent on donor money and are today self-sustainable up to approximately 40%. In the future Acción wants to be self-sustainable up to 80%, but does not see it as realistic to be completely independent of donor money.

### 4.1.2 Grameen America

Grameen America, a non-profit organization, started its business in New York as late as in January 2008. It has its origin in Grameen Bank that received the Nobel Peace prize in 2006 together with its founder Muhammad Yunus, who strongly believed that the concept would work as well in the urban America as it does overseas. The reason to start in New York was because of the large amount of immigrants in the city. The Grameen concept implies that poor people can be trusted to pay back and that credit is to be seen as a human right. During Grameen Americas first three months the business grew with $350,000 in micro-loans and 165 borrowers. (Grameen America, 2011) The organization is not legally connected to Grameen Bank in Bangladesh although it is based on the same model. Grameen America works with low-income individuals who aim to start their own income-generating activity. The majority is women and many of them are immigrants. The target group is the really poor who generally earn less than $15,000 a year, leading to small loan amounts starting around $1,500. Grameen’s focus on the poorest of the poor separates them from other microfinance institutions in America. In addition Grameen America also requires that the borrowers start to make regular savings to qualify for a loan. Concerning funding, Grameen America, as well as previously the mentioned microfinance institution, relies heavily on donors, but the objective is to be financial sustainable in the future.

### 4.1.3 Project Enterprise

Project Enterprise is a non-profit organization, established 1997 in New York. The organization is providing microloans, business development services and network opportunities, without any requirements of credit history or collateral, to people in under-resourced communities in New York City. The primary aim of Project Enterprise is to increase the living standard for the unbanked and to make them create jobs for themselves as well as for the communities. In December 2006 PE reached $1 million in outstanding loan

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\(^3\) FICO score is the most widely used credit score system in the US, ranging between 300 and 850. It measures the risk of default, the higher the score the better. (myFico, 2011)
balance (Project Enterprise, 2011). The organization is modeled after Grameen Bank and is a member of Grameen Foundation. Project Enterprise serves clients in Upper Manhattan, Brooklyn, Queens and the Bronx and approximately 99% of the clients served represent a minority in the community. The organization has just about 400 active members and the average loan size was in November 2010 $2.319. The members are mainly African-American and approximately 50% are women. The majority of the members is not borrowing, but is provided with business development services (Project Enterprise, 2011). In five years time, Project Enterprise is planning to lend $ 1 million a year, serve 1000 small businesses and give out 300 loans within the New York area (Project Enterprise, 2011). The financing of PE is mainly based on external sources of funding i.e. donors, but there is a strive towards becoming more self-sustainable and diversify among different donors in the future.

4.2 Findings

In this section, all findings from the case study will be presented. They are based on interviews and observations and the results are, if not otherwise stated, general for all the observed organizations.

The aim of microfinance in the developing world has been, and still is, to help poor people out of poverty by empowering micro-entrepreneurs to start their own income generating businesses (Bredberg & Ek, 2009). The objective in the developed world is almost the same, but the focus is a bit diverse and tends to be more towards job creating rather than poverty alleviation. Acción USA has no intention of helping the really poor, but the low- to moderate income and unbanked clientele, since there is a need for a credit record to get a loan, whilst Grameen America has an upper income level limit to qualify for a loan. The majority of Project Enterprise’s customers does not have a loan, but are using other services offered by the institution to develop as micro entrepreneurs.

Since the amount of self-employed in the developed world is a lot smaller than in developing countries, the demand for microfinance activities in the US has been questioned. During the financial crisis, however, the issue of how to create more jobs has been raised; this has increased the interest for microfinance and the urge to self-employment.

4.2.1 Measures of success

As mentioned in the theory section, it can be hard to measure the success of MFIs and the success measures can be divided into business success for the organizations and success in terms of improved conditions for the clients. The MFIs in this study are aware of the
difficulties in showing the actual impact of microfinance and they are working in different ways to measure how successful they are. One important tool to measure the impact on their clients’ lives and businesses is surveys and questionnaires to the clients in which they ask about variables such as business development, improved business knowledge and increased business profit. Grameen America has not been into business long enough to evaluate the answers from their surveys yet, but the other two organizations claim that they have received satisfying feedback from their clients. The MFIs also measure the impact on the society as a whole, they measure how much local wages their loans have generated and also how many jobs that were created or retained thanks to the microloan. Aspen Institute (2009) recently conducted a study on Acción USA in which they found that the microloans were generating more jobs and wages well above the federal minimum wage level. The organizations’ operational success is primarily measured by growth and health of the outstanding loan portfolio as well as repayment rate levels. All organizations have been able to generate high repayment rates ranging from 88 % to 99% and they are all growing their loan portfolio and increasing the number of borrowers. Since none of the organizations are working on a for-profit basis and since there is not a uniform strive towards total self-sustainability, the organizations do not use financial performance measures to the same extent as more business-driven organization do, but however, they have the aim to become more self-sustainable than they are today.

4.2.2 Microfinance activities

Even though microfinance in the developed world shares the mission of helping small businesses growing by empowering them with small loans and financial education, the way of reaching this goal differs to some extent.

Microfinance activities refer to the lending process as well as the products offered. Important to point out here is that none of the interviewed organizations are banks, but microfinance institutions. Therefore they are not eligible to offer savings, and they do not obey under the same regulation system as the banks do.

Outreach

Even though the supply is far from meeting the demand for microfinance in the US, marketing is still essential for the industry to take a larger part of the market. Informing people about this considerably new phenomenon is a focus for all three organizations. The most widely used method as well as the cheapest and most effective one, is the word by
mouth or client referrals. Clients within the different MFIs’ recommend their friends and families to either apply for a loan or just get financial education. Field workers are also present within the communities inviting potential clients to information sessions by delivering flyers.

Another way of branding is through partnerships. Development centers recommend the MFIs’ to unbanked entrepreneurs for a loan or financial training. Henceforth the commercial banks recommend their less creditworthy applicants to MFIs. Another example is that Acción USA has cooperation with KIWA, an online-based MFI-partner, who is administering the loans whilst Acción is disbursing them.

If the demand is not a big problem for MFIs’ in the US, the alternative sources for credit are more of a challenge. Unlike in the developing world, Americans are frequent users of credit cards, which are more accessible. Families and friends are other sources for capital as well as informal money lenders taking usury interest on the loans.

**Lending in practice**

The first step to become a borrower at a microfinance institution is to qualify as one; a prerequisite is that you have or want to start some kind of income generating activity. All types of businesses are approved as long as they are legal. Frequently appearing businesses are daycare, taxi, restaurants, street stalls and beauty care. In addition to the entrepreneurial skill, the different MFIs have different requirements for whom to accept as a borrower.

For Grameen America it is important that the very poor are being captured, why there is a prerequisite that the potential borrower lives below the poverty line. To prove their creditworthiness, the potential borrowers need to save $2 a day and come to a meeting every day for 5 days. If they succeed they have qualified. At Project Enterprise, training once a week for 6 weeks is the entrance for becoming a member, followed by a certification process where the potential borrower hopefully gets approved. Acción USA does not accept borrowers who do not have a credit score of 575 or more. Further, Acción requires that the applicant has not been late on rent or mortgage payments during the last 12 months, has been up to date on all bills, has a steady cash-flow and are able to provide a co-signer if needed. In addition, if the potential borrower has a mortgage, the rate must be on a fixed basis or an adjustable rate that does not change during the term of the loan. There is however some special conditions for start-up businesses, where the requirements are not as hard. Some kind
of business plan is then needed, as well as a co-signer and an income beside the business that can fully cover the loan expenses.

Common to Grameen America and Project Enterprise is that they both apply group lending, where groups are formed to encourage and support each other. Grameen America urges their clients to form groups of five, whilst Project Enterprise allows three to eight people in a group. The group members are not grouped after businesses and they are mixed genders (even though Grameen mainly has female borrowers). Only one member from a household can join a specific group. Living in the same community, close to each other, is another condition required so that the group could meet regularly. Grameen America also requires that the borrowers open a savings account with their depository-taking partner in order to qualify for a loan.

Acción USA works with individual lending, since they consider group-based lending not suitable for the company due to diversification amongst their clients. Unlike Grameen America and Project Enterprise, Acción USA does not believe that the peer group model is appropriate for the American culture. Instead Acción has a large focus on references to be able to track borrowers if they “disappear”. The most common reason for having to write off a loan is that they lose contact with the borrower. In addition, Acción requests documents for obtaining a loan; the larger loan amount, the more documents needed. For microcredit, the physical meeting with the potential client is absolutely crucial for being accepted. For loans over $10 000, Acción USA in addition applies site visits to assure well-functioning businesses.

Once the client has been approved for a microloan, the money is disbursed. For the group model this happens on a centre meeting, which is held each or every other week. A center usually consists of 6-8 groups. For Project Enterprise the group model implies that one group member gets a loan, and if he or she fulfills the next coming two repayments, two other members from the group get a loan. For Accións individual program, the borrower repays their loan on a monthly basis by check, money order or automatic payment service.
Figure 1 and 2 below illustrates simplified versions of the two different lending processes.

**Figure 2** The group-based lending process

**Figure 3** The individual lending process

All three of the studied MFIs in this survey offer microcredit. In addition, PE and Grameen America provide savings through partnership, education and training and assistance on creating a credit score. Acción has the intention to offer debit cards and insurance in the future.

If a borrower suffers from having repayment problems, the MFIs in general does not have as much policies and procedures as a regular bank. For the group lending institutions there is a focus towards communication and visiting the borrowers trying to solve the problem by for example adjusting the repayment schedule. The group can also help repay the loan but it is not mandatory; all the borrowers are individually responsible for their own loans. They are however expected to do what they can to make the default borrower repay, for example by visiting their homes and assisting them. If someone in the group does not repay on time, the “punishment” is that no one in the group can progress to a new loan. Acción USA, who are dealing with individual lending, are making a personal approach trying to solve the problem together with the client in an initial stage. After five days, the errand is transferred to the collections department that either writes off the loan, makes a new repayment plan, collects a collateral or, in worst case scenario, the errand ends up in court.

**Interest rates**

Finding an appropriate benchmark interest rate to compare the MFIs interest rate with is hard, since the borrowers would not be accepted for a loan on the regular financial market. Anyhow some kind of benchmark is needed to get an understanding for the price of a loan on the American financial market. The interest rate for a personal loan without collateral is applied for this manner. Citibank (2011) offers a personal loan between $500 and $50 000 with fixed rates ranging from 10,49% to 25,49% depending on credit score. The interest rate on a credit
card for a person with a bad credit score range between 8% and 20% (Bankrate.com, 2011). Worth noticing is that none of these two examples are completely applicable since the MIFs’ clients usually are even worse off, without any credit score at all. The examples are just to provide an understanding for the interest rate levels set by the MIFs.

Grameen America and Project Enterprise does not use interest rates as a tool to get paid for risk. Grameen is charging 15% whilst PE charges 12% plus 2% that goes into a group fund used for paying off defaulted borrowers. The interest rates are on a declining basis and are equal for all borrowers and also between programs. The loan terms vary between 6, 12 and 18 months. The rates have not been changed since they were set during the startup period of each institution. Acción USA has different interest rates depending on the risk level, ranging from 8.99%-15.99% annual fixed rates. Further, Acción apply loan terms up to 60 months.

Throughout the interviews with the clients the general attitude was that the interest rates charged on the microcredit were not set too high, as they did not see a cheaper alternative source for financing.

4.2.3 Financial Sustainability

**Funding**

The MFIs in this study are all highly dependent on donors and grants. There seems to be a general opinion that being so is important and necessary for the survival of the organizations. The lending is differently financed through the different organizations. While some of the organizations finance their lending with donors and grants, others get subsidized loans from the commercial banks as a result of the Community Reinvestment Act. The Community Reinvestment Act is an American federal law, constituted to encourage banks to meet the credit needs of the communities in which they act, including low- and moderate-income neighborhoods (Federal Reserve Bank of New York, 2011). One way for banks to engage in the communities is to give subsidized loans to organizations that operate in the microfinance field. The organizations that can fund their lending through the Community Reinvestment Act mean that they have no problem with funding and there is a potential for those organizations to increase their lending a lot without running short of funding. The organizations that rely on grants and donors on the other hand, have limited resources to increase lending. The operational costs of all the organizations in this study are mainly covered by grants and donors.
When it comes to fundraising, the organizations in this study consider each other as competitors and not only do they compete with each other and other MFIs, they also have to compete with a lot of other charity organizations. The organizations are all stressing the challenge of attracting donors and they argue that it is difficult to convince the developed world that microfinance can make an impact. This argument is supported also by the Federal Reserve Bank of New York. Because of the difficulties in showing evidence of impact, the organizations cannot apply for funding within anti-poverty programs. Instead, they have to apply within the economic development field, an area more associated with infrastructure projects, which increase the difficulties with attracting donors further. The organizations also express a need to diversify among donors since depending too much on one donor can be devastating if the donor withdraws from funding.

In comparison to their counterparts in developing countries, MFIs in the US cannot facilitate savings in order to fund the lending. There are extensive requirements to become a deposit-taking institution and the transformation would imply significant costs. To fund the lending with deposits is accordingly not feasible for any organization in this study at the moment. Grameen America has, however, the long-term objective to be able to facilitate savings in the future. The organization’s counterpart in Bangladesh, the Grameen Bank, points out savings as a highly important component towards self-sufficiency and Grameen America is modeled to follow the same path. Grameen America is also the only organization in this study that express a will to become fully self-sufficient.

**Competition**

Microfinance is a relatively new phenomenon in New York, with some of the earliest organizations established in the early 1990’s. The businesses have therefore not grown enough to become a viable industry, according to the Federal Reserve Bank of New York (2011). There are only a few actors on the market and they are still operating on a rather small scale-basis. The organizations in this study all agree that, when it comes to attracting clients, there is no real competition within the business yet. So far, the problem has not been that the clients choose another actor, but the potential clients not being aware of the actors’ existence. The MFIs in this study are also currently approaching slightly different segments. The organizations do, however, stress competition from other sources such as informal moneylenders and above all the credit cards.
Regulation

The microfinance industry in New York is not subject to heavy regulation much due to its early stage. The Federal Reserve Bank of New York does not require any specific reporting from the organizations within the business and they are not governed by any specific bank law. The only reporting the organizations are doing today is what the respective funder requires. This lack of regulation also means that there are limited requirements when it comes to transparency regarding the organizations’ operations. Representatives for the Federal Reserve Bank of New York do, however, stress the need for more systematization and guidelines for the organizations and they also want to be able to assist the organizations to track down borrowers. There has in addition been an increased focus on the importance of providing credit to low- and moderate- income households. Ben Bernanke, chairman of the Federal Reserve, launched an information gathering operation with focus on small businesses as job- generators in 2010, and the Federal Reserve Bank of New York organizes focus groups with MFIs and other actors. The FED does mention the great need for small loans but stress the need for job creation rather than the need for poverty alleviation.

4.2.4 Social impact

Poverty alleviation

It is as mentioned earlier, difficult for the organizations to measure and prove the exact impact on poverty. Microfinance has not reach a mature state yet, why few studies measure the actual impact on the poor. The organizations try to measure the impact that the programs have on their customers’ lives and the business performance through surveys, but the process is in a too early stage to give any indications on the impact. The fact that the focus is not the same as in the developing world also play an important role. Instead of emphasizing poverty alleviation, many organizations as well as the regulatory authority, are more concerned with job creation. This aspect is not highlighted in the studies made on microfinance in the developing world but it actually plays an important role in the promotion of success for MFIs in America. A recent study done by Aspen Institute (2009) shows that for every loan disbursed by Accion, 2,4 jobs could be created or retained, the borrower not included. It was also found that these jobs generated a significantly higher salary than the federal hourly minimum wage.
Empowerment

Even if the US and the developed world in general are considered more equal in terms of gender equality, there are still differences. Recent statistics from the U.S. Census Bureau (Short, 2011) show that a majority of those considered poor are women. None of the MFIs in this study are explicitly targeting women, but Grameen America has expressed a focus towards female borrowers. Several of the microfinance borrowers in this study highly emphasized the intangible values that they receive through the participation in a microfinance program. Throughout the interviews, the borrowers have expressed how they almost view the organization and the other borrowers as family. By meeting people in the same situation they get an opportunity to get support, motivation and inspiration.

Business training

Apart from the loans, all organizations in this study offer training to their clients. The training stretches from financial education to creating business plans, as well as lectures and workshops on taxes, advertisement and other business activities. The borrowers in group-lending programs also accentuate the training and knowledge they get from being in a group of other entrepreneurs. Being a member of a microfinance program can also generate a higher credit scoring which enables the clients to take traditional bank loans in the future. All the organizations welcome the scenario when a client has improved their financial situation enough to move from microfinance to the traditional financial market and they are also willing to assist in the transformation. Such a scenario has not happened hitherto but is likely to happen in the future.

4.2.5 Challenges from the MFIs’ perspectives

The institutions have throughout the interviews identified a number of obstacles that they consider the biggest challenges for making microfinance work in the US. One of the absolute biggest challenges stressed by all the organizations is the limited access to funding. Since none of the organizations are self-sustainable, donors are making up a large part of their funding. Fundraising is limited and the fact that the organizations are competing not only with other MFIs, but also with other charitable organizations, is making it even harder. Furthermore, does the ambiguity regarding the actual effect of microfinance making donors resistant to contribute, according to the MFIs in this study. They stress the need for better ways to measure and prove the impact of their activities, along with bigger awareness and knowledge regarding their organizations and microfinance in general. Not only the donors, but the potential clients and the regulating authorities must gain knowledge and awareness.
according to the organizations. The concept microfinance is used for a variety of meanings, microloans in the US for example is all kind of loans up to $50,000. Some of the staff interviewed find a need to narrow down and define the concept further in order to increase the knowledge about the industry. Being self-sustainable or being donor-dependent is considered a controversy by the people at the interviewed organizations. Some argue that self-sustainability cannot be obtained without worsening the conditions for the borrowers, while others state that a donor dependent organization is not operating as efficient as it could and that self-sustainability is the only option in the future.

From the operational point of view, the microfinance employees highlight the difficulties of putting a group of strangers together and make them cooperate in order to meet the group objectives (stressed by those organizations that facilitate group-based lending). Additionally, there are difficulties in convincing the clients to show up on centre meetings once a week as the clients sometimes live far away from each other and consider the meetings too time consuming. The organizations also identify the heavy documentation, required by the American authorities for running a business as a complication. The borrowers, who usually are from different cultures, and not used to the American financial system, seem to be resistant to share the documents and above all they usually have lack of knowledge on what documents they need to have. Cultural differences and language barriers are also mentioned in the interviews as factors that challenge the microfinance operations. Sometimes clients cannot be reached due to language difficulties and the MFI's strive to employ staff with multiple languages. The MFI's also emphasize the complexity of understanding the client’s actual needs.

Another issue stressed by some of the microfinance personnel is the immense use of credit cards in the US and how this usage potentially can lead to a situation in which the user might end up with a bad credit record score. As the American bank system relies heavily on credit scoring, people without a credit record score, or with a bad score, tend to obtain credit cards to build a better record. Credit cards are accessible and it is easily happened that the use of credit cards puts the person in a vicious circle where he or she gets another card in order to pay for the first one. MFI’s are a potential substitute for credit cards as it provides cheaper loans and at the same time helps building a credit record score. The problem is, however, to make those persons aware of the microfinance alternative and to change their attitudes towards the use of credit cards.
5. Analysis and conclusion
The progression of microfinance in the developed world is a somewhat new phenomenon, but indications of how to apply the activities in a successful way can yet be identified. Primarily, it can be stated that the definition of microfinance has a wider implication in the US than it has in its original market area. The basic meaning that microfinance is credit for the unbanked entrepreneurs lacking collaterals and not qualifying for the regular financial services is the same, but the focus on poverty alleviation is not crucial in the US. The actors studied suggest that job creation, especially after the financial crisis, has got an increasingly important meaning. The target group is therefore not as oriented on the poorest, but on the low- to moderate income households. A general adoption is that the developed world needs to carry out job creation as an important consequence from microfinance, to make the industry credible and sustainable within its new market area.

Because of a slightly different focus, even the success factors are a bit diverse from the measures in the undeveloped world. Based on our study, we can identify business performance and job creation as important areas while measuring the impact of microfinance. Henceforth the growth rate, the performance of the loans and repayment rates are key indicators for the success of the MFIs. Poverty measures do not seem to be as frequently used. Nor financial performance seems to be a focus measurement, which can be suggested to depend on the immense use of donor money within the industry in the developed world.

According to our case study the demand for microfinance seems to significantly exceed the supply. Nevertheless marketing and reaching new clients are identified as challenges. We suggest that there is a need for a bigger awareness of the industry in the US as well as for the remaining developed world, not least for the viability of microfinance. The word of mouth is an important tool for spreading the message of microfinance, although more effort needs to be put into the marketing according to the MFIs. Another challenge identified for the microfinance activities to really succeed to take place on the market, is the usage of credit cards in the US. The interviewees express their concern regarding the extent of indebtedness that this contributes to meanwhile the credit cards are very accessible on the market. There is a need for microfinance to be seen as a cheaper and better alternative. The conclusion from this is, once again, that the knowledge of microfinance needs to be expanded in the developed world.
In contrast to previous theory, where criticism has been directed towards the replication of the group lending programs, we suggest that the group lending technique does work in the US, and can thus be a lending process applicable into the developed world. What underlies this claim is that the clients have, repeatedly, expressed their appreciation towards the centre meetings, where they can share their business experiences and get support and feed-back as well as assistance if they suffer from any financial difficulties. The study does not imply any indications of the potential moral hazard problem with free-riders, brought up in the theoretical framework. The group rather tends to work as an incentive for the members to improve their businesses and work harder as they feel the social pressure of not letting the group members down. This concept, though, requires that the clients live close to each others to facilitate for the frequent centre meetings. In addition, the individual lending MFI, Acción USA, has about 10% lower repayment rates compared to the group-based lending institution Grameen America, which indicates that the group concept could work as well in the developed world as it does where it once started. The other group-based lending institution, Project Enterprise, has, however, the same repayment rate level as Acción USA, which makes the argument contradictive. We do, nonetheless, argue that group-based lending potentially can lead to higher repayment rates, as Project Enterprise did express that the quality of their loan portfolio and their repayment rate level have decreased during the financial crisis.

Further, the screening processes are a lot more costly for the individual based lending programs, in contrast to the group-based programs, where the borrowers to a big extent do the screening. This might be a reason for the tendency of the individual focused institutions not targeting as poor clients.

The nonfinancial services offered by the MFIs are not to be underestimated for the impact of microfinance. Consistent with previous research, it has been shown that side effects, such as improved business knowledge and more persistency, are frequent among the clients. Thus, it can once again be assumed that the replication of the programs from the developing world works even in the industrialized countries.

Concerning the target group, differences can however be identified. In the developing world the borrowers are to 99% women, due to their weaker role in the society. In the industrialized countries the genders of the borrowers are mixed. Nevertheless, there are no indications that microfinance would work better in the US if the focus was only on females, since the inequality can be considered a larger problem in the developing countries.
Regarding the interest rate levels, clients do not oppose against too high costs for the loans. What can be questioned is the method by which the MFIs’ set the interest rates. No consideration is taken to risk at Grameen America and Project Enterprise, and none of the three studied institutions have regulated their rates since the start of their businesses. Referring to the theory section, where it was stated that the global interest rate average is well above the interest rates charged by the MFIs in this study, the interest rate levels indicate that there might be room for an adjustment of the rates to increase the revenues, but usury laws might be making it hard to do so.

The MFIs in this study are not self-sustainable and it is not a general objective for the institutions to become so. The findings from this study imply that there is a tendency to view microfinance activities as charity rather than consider MFIs as valid businesses. From the interviews with MFIs as well as with the Federal Reserve Bank of New York, indications showed that this view does not only apply for New York but for the US in general. It is however not possible to come to any conclusions to whether or not this is the case for the rest of the developed world. The lack of focus on financial sustainability can though be regarded as a somewhat risky strategy. By depending to a large extent on donors, the organizations are exposed to the risk of losing funding in economic down-turns or in times when microfinance loses its popularity. Thus, it can be questioned whether or not depending on donors will make the microfinance survive as a viable industry in the long run. Furthermore, some of the institutions indicate that the lack of business focus might lead to inefficiency, hence there might be a potential to improve the organizations operations in order to cut costs and increase revenues. It is on the other hand hard to determine whether or not a shift towards more business driven MFIs, with a clear focus on financial sustainability, would affect the clients. As shown in the theory section, financial sustainability and social aim are by many considered as non compatible. Since this study does not contain any financially sustainable institutions, it is complicated to elaborate on whether or not such a trade-off exists. Throughout the interviews we can, however, come to the conclusion that the microfinance actors appreciate striving towards more self-sustainability but resist a for-profit approach. A prospective instrument towards self-sustainability is becoming a depository institution. As mentioned earlier, this is recognized by the institutions although there are some obstacles hindering this transformation. Depository institutions are subject to more examination and intense regulations and it is a costly process to be allowed to facilitate savings. As by today only one of the organizations studied have a clear objective of being able to facilitate savings in the
future. It is, however, confirmed that savings can be an inexpensive source of funding in the developed world and it is our belief that, if the process of mobilizing deposits in the US can be simplified, this would help the MFIs to become more sustainable and even expand significantly.

Microfinance activities in developing countries are more mature and most microfinance programs are considered credible and viable. This study of microfinance in the US implies that the approach is utterly different there. The activities are more than anything considered charity and even the Federal Reserve Bank of New York is not sure whether or not microfinance is really an industry. This calls for a great need to build awareness and credibility of the business not least as the organizations’ survival currently depends on donor and grants. It is thus highly important that the potential donors consider the organizations as trustworthy and that they can observe the actual impact of their contributions. In building the awareness for the industry we suggest that the regulating authorities play an important role. By standardizing regulation and demanding higher degree of transparency for the institutions, more credibility can be obtained.

As mentioned earlier, this study implies that microfinance in the US is not as focused on poverty alleviation as it is in the developing world. Accordingly, it is motivated to elaborate on how this affects the industry and above all the clients. The conclusion from this study is that it can actually be an advantage to emphasize other effects than poverty alleviation. First of all, poverty alleviation is hard to prove and in addition poverty is much more associated with developing countries, why it can be difficult for the industrialized world to recognize the need for microfinance. Job creation has been an important effect highlighted by the MFIs in New York and recent research supports the argument that microfinance contributes to job creation. Although poverty alleviation is the foundation for microfinance, it can actually be an advantage to accentuate effects that the developed world more easily can relate to. In order to achieve acknowledgment and credibility in the developed world, we therefore suggest that job creation could be used as the main argument for the use of microfinance services.

Other social impact has been hard to prove; unlike in developing countries it is difficult to identify any strengthening of social standings or female empowerment, due to the fact that there is not the same kind of inequalities in the US. However, opposite to what previous research say about social impact in the developed world, this study actually indicates that the clients are empowered by their participation in a microfinance program. This conclusion is
based on the clients’ expressions of feeling strengthened by the group activities. The empowerment factor should not be underestimated as it was one of the most frequently and most strongly emphasized benefits, articulated by the clients.

The purpose of this study was to examine key factors for successful implementation of microfinance in a developed country. As this is done in the form of a case study with only a few observed institutions in one country, it is not possible to say that all conclusions drawn in this section will actually be applicable in developed countries in general and for all types of MFIs. We have, however, identified what we consider as significant indicators of success factors. Those indicators are illustrated in figure 4 below.

*Figur 4. Key success factors for implementation*
6. Discussion

We have with this case study attempted to scrutinize on microfinance activities in the industrialized world and we have in the previous section illustrated the conclusions from this attempt. In order to answer the question of how microfinance activities can be successfully implemented in developing countries, we have identified what, according to us, are the key factors for a successful implementation. It is, though, important to point out that those conclusions are based upon a case study with only a few observations and from one single city. The findings from this study should therefore only be used as indications and guidance rather than as an illustration of the industrialized world in general. The three organizations in this study are, however, well-known organizations and they have been participating in several studies with recognized research institutes. Furthermore, they all have connection to microfinance programs in developing countries, why their opinions on implementation in the US are highly relevant. Worth noticing is the recent criticism towards microfinance in general and Nobel Peace Prize winner Muhammad Yunus, in particular. He has been suspected of fraud which has affected the whole industry and has complicated this study. Instead of meeting the criticism, the organizations and especially Grameen America, have been quiet about the event. We have observed a degree of resistance against giving interviews. This approach is a clear example of the lack of transparency in the microfinance industry and we argue that this must be changed in order to achieve credibility for the MFI’s operations. Further, we have identified some key areas for evaluation within the market for microfinance in the US, which we consider need to be disputed.

As a result of this case study we want to highlight the similarities between people in different cultures and different economies, and assert that social capital is working even in wealthier countries. It should not be underestimated that people, who do not have another alternative for financing, will not misuse the chance to get into business and start growing a stronger economy. We claim that a group-based lending concept, where people screen each other and give mutual guarantee, should be the model for microfinance even in the developed world, as this study is indicating.

As one of the biggest challenges for microfinance, we appoint the issue of self sustainability. For a viable industry in the future, donors cannot be accountable, and more of a business approach is needed. The market today is too much seen as charity, which makes it less trustworthy and temporary. One way to make it more commercial is to look over the interest rate settings, where we can identify a possibility to get paid for risk without taking usury.
rates. An incentive program with higher rates initially and lower rates as the business of the client grows would increase revenues for the MFIs’ as well as the clients’ driving forces. An even more important aspect for establishing the microfinance industry is to facilitate savings. As of today, none of the organizations consider it as an alternative, since it is costly and regulated. Without savings the industry will not manage to be financially sustainable, and without self-sustainability the risk of microfinance not surviving in the future is impending. The competition within the industry today is almost nonexistent, but with a more commercial market, where financial measures are used, the competition would increase and in turn stimulate the microfinance market to grow. In addition, we can see a need of more efficiency within the MFIs, which competition would help to increase.

As mentioned earlier, we consider that the authorities should play an important role in the process of making microfinance a recognized industry. However, in our meeting with the Federal Reserve Bank of New York, we sensed a lack of acknowledgment for the MFIs’ operations. It is from our point of view crucial that the authorities participate in the development of the industry and support the organizations’ actions as microfinance actually is a matter of community development, a matter that indisputably is in the interest of the regulatory instance.

The theory regarding microfinance seems to be extensive at first, but while conducting this study we have identified limitations in the existing research. First, a large amount of the research tends to be somewhat obsolete. A lot of the research used as a theoretical framework in this study refers back to the years 2002-2007, a time where microfinance gained a lot of attention as 2005 was appointed “The International Year of Microfinance”, followed by the Nobel Peace Prize in 2006. Microfinance seems to have lost some of its previous attractiveness since then, why there is not the same amount of research from the last couple of years. Furthermore, the research is primarily focusing on developing countries and it is hard to find relevant literature illustrating the industrialized world. This is however not surprising since microfinance is a relatively new phenomena in those surroundings. We are therefore requesting more research on the impact in developed countries, where concrete and measurable variables are desired. As the industry grows and the institutions get more clients and more data it is likely to expect more of that kind of research. As mentioned earlier we advocate the use of deposits as a source of funding and we therefore suggest cost/benefit analyses on the transformation process needed to become a depository institution.
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Appendices

Appendix 1. Interview guide – Microfinance Institutions

1. Can you please give us a presentation of who you are and your position in the organization?
2. How was the organization established?
3. What was the primary aim of starting up the business in the US?
4. How many borrowers do XXX have and what has the growth rate been since the start?
5. Do XXX have different microfinance programs? What do they look like?
6. How do XXX define the target group?
7. What does the application process look like?
8. Can you please describe the lending process; from application to repayment?
9. What kind of products and services do XXX offer?
10. What are XXX’s interest rates and how are they determined?
11. How do XXX measure success? Do XXX have different success factors such as the repayment rate?
12. Are XXX dependent on donor subsidies?
13. Do XXX consider helping the poorest and financial sustainability as a conflict of interest?
14. Finally, what do you consider the biggest challenges for running microfinance in the US compared to in a developing country?
Appendix 2. Interview Guide – Microfinance client

1. Please tell us about yourself. Family situation, origin, living district?
2. How did you get in contact with XXX?
3. Why did you apply for a loan? Did you try somewhere else before? Where?
4. Please describe your business.
5. How has your business changed since you became a member of XXX? Other benefits as a client?
6. How big was your initial loan and how was it used?
7. How does your repayment schedule look like?
8. How you ever faced troubles with repaying the loan? If yes, how did XXX deal with that?
9. Can you please consider any disadvantages by being a member of XXX?

1. Can you please give us a presentation of who you are and your work? How do you consider the microfinance need in New York? How many does not have access to the regular financial market?
2. Can you define the target group for microfinance in NYC?
3. What alternatives do these people have when they can’t access the regular financial market?
4. Which actors can you identify as working with this target group in NYC?
5. Most MFIs in NYC seem to be very dependent on donor money. What do you think about this? Can you see any trends coming in the future?
6. Can you see any pros and cons with for- and non-profit organizations?
7. What is Federal Reserves’ role in the industry?
8. How are MFIs regulated? Is it enough?
9. Finally, do you consider microfinance as the right tool to fight poverty in the developed world?