“Charging to Teach a Man How To Fish: Why Is That A Bad Idea?

A Case For the For-Profit Microfinance Institutes”

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Abstract

Microfinance, whether for-profit or non-profit, has proven to be an effective solution to alleviate poverty because it helps the poor generate an income for themselves, while strengthening their nation’s economy. A recent trend of emerging for-profit microfinance institutes has raised concern that turning microfinancing into a for-profit endeavor will not be beneficial. However, there are many benefits to for-profit microfinance companies and valid counters for potential arguments against for-profit microfinance ventures. Through research it is clear that for-profit MFIs will be able to reach the demand of micro financing needs, they will have more incentive to run their businesses efficiently, and they will give the poor self-confidence. Despite arguments against for-profit Microfinance Institutes, not all for-profits will manage their business in a harmful way, they will not have the ability to take advantage of the poor, they will not charge outlandish interest rates, they will not hurt the non-profit microfinance industry, they will not put negative pressure on the poor, and they will be able to manage their company with a desire to both help others and generate profit. My conclusion is that for-profit microfinance institutes are able to better help the poor, rather than take advantage of them, because of their profits.

Everyone knows of a charity organization whose purpose is to send money to developing countries with the intent of alleviating hunger and poverty of those who live in the neediest countries. However, what many people do not realize is that charity and foreign aid are not solving the problem of poverty. In fact, many would argue that foreign aid is only creating dependency and making the problem even worse, as will be discussed below. A famous Chinese proverb says, "If you give a man a fish, you feed him for a day. If you teach a man how to fish, you feed him for a lifetime." Recently, many scholars have taken a different approach to tackling poverty. Rather than creating more funding to send fish to the poor in developing countries, a new school of thought looks for ways to help these local people learn how to fish. A specific example of this is microfinancing. A microfinance institute (MFI) serves as a type of bank for the poor. They offer banking services, chiefly loans, to the poor so that they can start their own businesses and generate an income to help their families, as well as grow the macro-economy of their nation. As MFIs have proven successful at helping with poverty and even financially profitable, people have looked at the idea of turning non-profit MFIs into for-profit ventures. Of course this idea has been met with much opposition as people argue that this will only give corporations the opportunity to take advantage of the poor. However, is this really the case? While foreign aid is not helping to alleviate poverty in developing countries, microfinancing can help, especially when the funds are placed in the right hands. For-profit MFIs are not unethical, but rather a beneficial idea because there is an increasing demand for MFIs, for-profit MFIs offer incentives which allow them to run at maximum efficiency, and they give the poor opportunities and confidence.

Foreign Aid Is Not Solving the Problem

Before understanding why microfinancing is such a viable solution, one must see why the problem of poverty is currently not being solved, despite efforts to send money to the poor. As mentioned above, some may not believe that MFIs are actually necessary for solving the problem of poverty, because they believe that the best solution is to send more money to developing countries. However, foreign aid is not helping the situation, and many would argue that it may actually be making the situation even worse. In his article *Does Aid Work?*, Dabisa Moyo (2012) says, "Africa has received over $1trn in international aid over the past 50 years, intended for health care, education, infrastructure and agriculture, among other things. Unfortunately, despite good intentions, much of it has been ineffective in combating poverty and spurring economic growth in a sustained way, which is what it was meant to do" (25). When a country's leader receives money from foreign aid, he or she must make the decision about the allocation of its funds. Sadly, many leaders are making poor decisions and often use that money in corrupt ways for themselves. In an interview with Economics Professor David Campbell (2012), he agrees that the government of developing countries who receive foreign aid often uses the funds for their own purposes, which is not always to help the poor. This could be creating a whole host of problems, while allowing poverty to continue to increase. Even when foreign aid reaches the poor, it often has a negative effect by encouraging an attitude of dependency. Moyo (2012) explains, "There is no country today or in the history of the world that has achieved sustainable economic growth and slashed poverty by relying on aid to the extent that many African countries do today" (26). The only way to effectively eradicate poverty is to help people fish by themselves, rather than rely on others to bring the fish to them. Professor Campbell (2012) elaborates, "The only true way out of poverty is through productivity." A successful way to enact this idea is through microfinancing institutes.

What Microfinance Institutes Are

Microfinance institutes are an ideal solution to help the poor out of poverty by giving them the opportunity to sustain themselves, while generating their own economy. Microfinancing is defined well by James Scott (2009) when he wrote, “Microfinancing extends needed banking services, especially small loans, to entrepreneurs so that they can work themselves out of poverty over time” (35). He continues to explain that the loans are typically around a couple of hundred of United States dollars (35). Although small amounts, these loans are given to people who would not otherwise be able to find the money to start their own businesses. By starting their own business, individuals can generate an income for themselves to support their families, while at the same time putting money back into their community and local economy to strengthen the economy of the entire nation. This offers a two-fold solution as it not only helps individuals families to grow out of poverty, but also helps the nation as a whole to develop.

Benefits of Microfinancing

Not only does the idea sound like a successful theory, but there are many benefits that result from microfinancing. As the poor are receiving funds and able to pay back their loans, while simultaneously taking care of their families and communities, many benefits are reaped. Scott (2009) points out that the benefits extend beyond an individual making some money. Households are becoming more stable because the family is able to financially sustain itself. Women are empowered and given a voice where they typically have been denied (35-36). This is specifically a unique benefit because microfinance can address social issues other than poverty. Women are specifically empowered by microfinancing because they are seen as ideal candidates to receive loans. Women are successful in business for several reasons, one of which being their ability to deal with stress and be optimistic, according to Joyce Gannon (2009) in her article "Businesswomen better at handling stress" (1). Women have also shown that they use their funds in ways that benefit their family and children, instead of just themselves. Lorraine Dusky's (2008) studies have shown that "Women spend 89 cents of a collar earned on children, education, housing, and health care, where men spend 60 cents that way" (18). Not only are women creating revenue, but the are also spending money in the most helpful ways possible, creating many more benefits. This shows that microfinance is making a positive impact in the world, especially when placed in the right hands.

Recently microfinance institutes have wanted to take the industry a step further. Although met with great confrontation, some MFIs have decided to become for-profit. Eric Bellman (2006) points out in his article in the Wall Street Journal that in 1998, SKS India (a non-profit microfinance institute) decided to go public and become a for-profit company (1). Another well known for-profit MFI is Compartamos in Mexico. At first the idea of a MFI making money through their services might sound like a horrible, greedy idea of a corporation simply preying upon the circumstances of the poor. However, with some careful study one can see that for-profit microfinance institutes have much to offer for the alleviation of poverty.

Advantages of For-Profit Microfinancing

Making an MFI become a for-profit opportunity offers many benefits. The emergence of for-profit MFIs can help meet the increasing demand for banking services for the poor. Through becoming a for-profit institute, a company will be forced to work as efficiently and effectively as possible. Vikrum Akula (in charge of SKS in India) has already shown a specific example of the increasing efficiency of making a non-profit become for-profit, when he took SKS's non-profit model and changed it to a for-profit model. A greater number of MFIs would increase the competition, therefore giving customers a variety of options with attractive rates and services. More funding would give MFIs the opportunity to conduct better research to help the microfinancing industry. By generating an income for the company, MFIs will be able to sustain themselves and serve without donors and government fees, also allowing employees to be compensated well. For-profit MFIs will give the poor an opportunity to see themselves as customers rather than beneficiaries, raising their self-confidence. Finally, for-profits will be able to offer jobs to locals.

Growing Demand for Microfinance

Firstly, there is a considerably large and growing demand for microfinance services in poverty stricken areas. According to an article published by Wharton School at University of Pennsylvania, only one tenth of the need is being met (1). To reference a specific example, Jonathan Lewis (2008) says that Compartamos offered loans to 60,000 people when they were a non-profit operation, but now as for-profit MFI, they are able to help 616,000 people (55). By commercializing a non-profit MFI, the company can meet the needs of the poor and serve an even greater amount of people than ever before. When more people are reached, more doors are opened to help people out of poverty. While operating costs are expensive, making an organization for-profit could help it generate enough funds to effectively reach the need that is already there.

Incentive to Run Business More Efficiently and Effectively

Second of all, commercializing an MFI will offer greater incentives to run the business more efficiently and effectively. In order to understand this, one must first understand that people operate chiefly because of incentives. Adam Smith (2007) wrote *An Inquiry Into the Nature and Causes of the Wealth of Nations*, in which he is famously quoted as saying, "It is not from the benevolence of the butcher, the brewer, or the baker, that we can expect our dinner, but from their regard to their own interest” (9). One would like to believe that all people will do their best and work hard solely for another person’s benefit. However, this is not true. Not all humans are benevolent and simply want to help people who need or want help. In fact, most people who do help do so because of some incentive. As Christians, this incentive may be to please God by following his commands and living like Jesus. For others, the incentive may be tax credits, a better reputation for themselves or their company, or more profits. Rajesh Chakrabarti and Shamika Ravi (2011) agree, “Without the profit motive, it is difficult to have organisations that would engage in the activity in a sustained and efficient manner” (137). Profit is an incredibly motivating incentive driving people and companies to ever-increasing levels of success today.

Akula Sets the Example

As MFIs are preparing to generate profits, they must run their company to maximum efficiency in order to generate the most profit. In fact, Bellman (2006) explains that Vikram Akula made SKS a for-profit institute because he saw how the non-profits were being managed poorly and inefficiently. He thought he could do better, so he decided to run SKS like a proper business, such as “Starbucks or McDonalds.” Akula started right away by making changes to the system. He effectively reduced the amount of time spent on accounting, along with developing software that helped with the loan process. Although one cannot eliminate the risk entirely, Akula was able to spread out the risk of loans, and manage loans better than before (2). Because of his motive to do the best for his company, Akula rethought the process and made sure that his company was being run to create the best profit and lead the industry successfully. Profit gave him the money, as well as the incentive to do this.

Competition among MFIs

As becoming for-profit would make an MFI work more efficiently, MFIs would also be forced to work more competitively. Lewis (2008) says, “With more investment comes more MFIs competing for both investors and customers. Customers then have a wider array of products and providers from which to choose, and thus demand better services ad lower interest rates” (57). Some may argue that the creation of for-profit MFIs would only create competition that would harm the industry. However, competition forces each company to perform at its best to attract customers and investors. In order to gain business, companies would need to offer lower interest rates, reach out to potential clients with excellent customer service skills, and provide services that rival other MFIs. Instead of becoming worse and taking advantage of the poor, for-profit MFIs would have to become better in order to survive in the industry.

Opportunity to Conduct Better Research

One problem with non-profit MFIs is the inability to conduct as much research as they could if they had better funding. As MFIs gain more funding, they will be able to research the best ways to help the poor through microfinancing. Kylie Charlton (2008) shows the need for research when she argues, “Developing countries typically lack timely and accurate macroeconomic and financial information which, when combined with political and regulatory risk, makes it difficult to construct reasonable projections for an investment in MFI” (79). By becoming for-profit, companies would not only have the incentive, but also the funding to ensure that they are knowledgeable about microfinancing and able to offer cutting edge tools, technology, and information to their clients, as well to report information to investors and others in the microfinance industry. Akula himself was a successful example of this as he researched to develop new software which enabled him to manage SKS better. Research and development costs money, which is much more accessible for a company that is making profits.

Ability for MFI to Sustain Itself.

Regardless of how much social good an organization is able to accomplish, it is only going to be able to continue operating if it can generate enough income to allow business operations to keep running. Non-profits, though helping the poor, are only able to do so with money from donations and possibly the government. Chakrabarti and Ravi (2011) state that, “The commercial MFIs have typically lower operating costs than the ones with overwhelming social objectives” (135). While it is good to have a company mission dedicating the company to providing assistance to the poor in the hopes of alleviating poverty, a charitable purpose is not enough. A problem with MFIs is the expense of microloans. Matt Bishop (2011) authored an article entitled “Muhammad Cronus”, discussing the for-profit vs. non-profit MFIs. One point he brings up is the expense factor of many little loans. It is difficult to make a profit with low interest rates. For example, as loan for $100 for one year with 40% interest, will allow a profit of $40 at the end of the year. If the same company offered a loan for $1,000 at only 10% interest, they would generate a profit of $100 after a year (1). Besides the cost of investments, Bellman (2006) invites people to consider the other costs. He says, “Transaction costs and paperwork can be overwhelming. Most microlenders live hand-to-mouth, relying on wealthy patrons or development agencies to keep the money flowing” (1).

Not only does the company need to generate income to continue to supply their services, but also care for their employees. Employees of MFIs need to take care of their families and generate an income for themselves, as well. If they are not able to care for their families with their job at the MFI, then they will have to choose one of two options. They may take a second job, which can detract from their work at the MFI, or they may need to leave the MFI altogether to find work elsewhere. A for-profit MFI can compensate its employees properly to ensure that they are able to fully dedicate themselves to the company, without being distracted with another job or worries about caring for their family. With so many costs to keep an institution running, one might think that a for-profit MFI will need to charge high amounts of interest. However, SKS has proven this a myth. Bishop (2011) says that SKS was able to lower their interest rates when they become for-profit. As a non-profit, their interest rates were 36%, but have decreased to around 24%, which happens to be substantially less expensive than the prices charged by loan sharks in the area (4). Rather than worrying about for-profits increasing prices of interest, one can see that they can actually decrease the prices for local borrowers.

Giving Confidence and Opportunities to the Poor

Some people will say that for-profit MFIs will treat the poor as customers rather than needy people, since they are generating a profit and not a charity group. However, is this really a negative concept? Treating the poor like customers rather than beneficiaries will not hurt them, but rather raise their self-confidence and views of themselves, which is an essential step to helping them out of poverty. As a for-profit company, an MFI would need to have realistic expectations of their clients. Bellman (2006) explains one of the expectations that are laid out for customers: “Borrowers have to meet at a certain time. Instead of letting borrowers decide how much to repay each week, they are told to pay the same amount each time in exact change” (2). By making rules for their clients, the process becomes more formal and the poor see it as a job. They are more motivated to pay back their loans on time. When a non-profit is willing to continuously negotiate a “comfortable” or easily achieved option for repayment, the process becomes incredibly inefficient and gives the poor less motive to work to the best of their ability to earn money. As a for-profit company, the MFI will hold their clients to a higher standard, and as the clients meet those expectations and standards, they will gain confidence in themselves.

They will see themselves as customers, just like other people in the world, rather than special charity cases who are seen as unable to help themselves.

Providing Jobs for Locals

Another direct benefit that for-profit MFIs can offer the local poor is a job. Bellman (2006) tells the story of Ms. Swarnalatha. She is an uneducated individual, who at one point only knew how to sew. As SKS became a for-profit venture needing employees, they hired Ms. Swarnalatha and taught her the SKS system. She now makes around $90, which is a very profitable amount for the area in which she is located (4). Being able to find jobs is a special opportunity for the poor as not only is microfinance able to offer services to many people, but it can also create jobs for others.

Some Companies Are Already Handling Their Business Wrong

People are happy to point out for-profit institutes that are not taking their business in the right direction, but they often forget to mention the others that are doing it right. Just because some companies are abusing the system does not mean that all will. Lewis (2008) claims that Compartamos charges up to over 100% interest sometimes on their loans (56). While people are apt to notice the companies who are flawed, they forget about companies like SKS who are helping ten times as many people as they were able to help before. In the real world, no matter what the industry, there will always be businesses that are taking advantage of people. One cannot prohibit certain industries from being for-profit just because a certain company is taking advantage of people through that industry. While some specific for-profit MFIs may handle their business incorrectly, that does not mean that all will, nor should it justify prohibiting other companies who could be doing much more good than the few companies who are managing their company in the wrong ways.

Easier for the poor to be taken advantage of

As people argue that MFIs are handling for-profit incorrectly, they believe that allowing for-profit MFIs to exist simply allows too many opportunities to take advantage of the poor. This is an invalid point. Firstly, a company who sets their loan pricing higher than others will not get any business. This destroys any incentive to make loan prices ridiculously high. Chakrabarti and Ravi (2011) say, "Loan pricing is fairly homogenous across MFIs" (136). It is easy to understand why this is true. Secondly, for-profit MFIs can be regulated with certain rules to prevent them from taking advantage of people and can be offered benefits to make them more wiling to help people. Lewis (2008) reminds people that as a rule, if a company becomes for-profit, they will need to keep careful records and make them available to the public (57). Any company desiring to gain credibility and investors will not be able to take advantage of the poor, simply because they could not hide it. Companies in all industries are faced with certain requirements (such as making information public) that prohibit the corporation from taking advantage of people. Microfinancing is not the only industry that uses regulation to prevent problems. Also, if the government offers companies benefits to help people, there would be no desire to take advantage of the poor, but rather a stronger incentive to help them. Perhaps the government can offer tax credits to companies that are having a positive influence on poverty reduction in their region. Finally, a for-profit MFI would not be apt to take advantage of the poor, because they will want the poor to succeed perhaps even more than a non-profit MFI would. No one gives a person a loan and then hopes that they default. In fact, as a for-profit institute, the MFI would be even more motivated for the borrower to succeed in generating an income so that the MFI will get their money back from the entrepreneur. A company must act in a humane way with their clients, so they will not be able to physically attack the borrower if he cannot pay back his loan. In fact, they will be inclined to treat the client well in order to gain a good reputation with their other clients and others companies and scholars in the industry. Because of this, a for-profit company will strongly desire that their borrowers succeed in their entrepreneurial endeavors in order that the company continue with business, make profits, and (according to Charlton (2008)) make the company look better to investors (70).

For-profits will hurt the non-profit MFIs

Some say the emergence of for-profit MFIs would hurt the non-profits still in existence and potentially destroy the non-profits altogether. While it is true that those with money often have greater power than those who do not, this does not mean that for-profits would drive out the non-profits. Professor Campbell (2012) explains that non-profits have benefits that for-profits do not have, such as not being required to pay taxes, or being required to make their company's records available to the public. Fewer requirements will also allow non-profits to be competitive. Competition brings about the best options of microfinancing to the poor.

Pressure on the poor

Some will argue that for-profit institutes will put more pressure on the poor to pay back their loans. However, anyone who has a loan should feel some amount of pressure, regardless of how or where they obtained the loan. Some pressure is healthy, because this is the reason why people pay back loans. Borrowers realize that lenders expect repayment for their services and that there will be negative consequences if they do not meet those expectations. However, this pressure does not necessarily lead to problems. For example, I am a student in college and have already incurred several thousand dollars in loans. In a few years I will be expected to pay back these loans. Knowing this fact does make me feel pressured and sometimes extremely stressed, but it does not make me want to take my life. In fact, it pressures me enough to force me to make wise financial decisions so that in a few years, I will be able to pay back the loans. This pressure is what ensures that I make smart choices, while allowing my lenders to know that I understand the consequences of making choices that would prevent me from being able to pay. Those who receive loans from microfinancing should feel a pressure similar to this, and that is not a negative effect.

You cannot have a double bottom line

Perhaps the greatest argument against for-profit microfinancing is that a company cannot have multiple objectives. Many believe that a company cannot be determined to help other people, as well as help themselves by making a profit. However, a successful company really can desire to make a profit and help people. Muhammad Yunus, in charge of the Grameen Bank (perhaps the most well known non-profit MFI), has openly discussed his views about MFIs becoming for-profit. According to Vivian Norris de Montaigu (2010), Yunus basically argues that there is a part of people that is selfish and part that is selfless. He believes that it is beneficial for the selfish part to start businesses and make profits in various industries, while the selfless part should be helping people in microfinance (1). This sounds true, until one carefully analyzes the motives behind every single business in the world today. While everyone is both selfish and selfless, why can a business not satisfy both? For example, Yunus says the "selfish" part can go into various industries and make profits. But are they not making profits because they help someone? No one is going to give a person money just for fulfilling their own interests. When someone starts a company, he must offer a service or product that helps someone else ("selfless"), in order to generate an income that helps sustain himself and his life style ("selfish"). So essentially, all businesses, whether for-profit or non-profit, seek to help others. The difference lies in whether the business is able to benefit the people managing said business.

Therefore, companies can exist with more than one purpose, therefore having a double bottom line.

Conclusion

To reference the proverb stated earlier, why is it wrong to earn a profit from teaching a man how to fish and helping him in that process? No one criticizes a person who charges for tutoring lessons to a struggling student. Just because someone (be it an individual tutoring a student, or a company offering banking services to the poor) charges another person money does not mean that they are hurting the person whom they charge. For-profit MFIs may have the opportunity to take advantage of the poor, but non-profit MFIs have just the same opportunity. The profit factor affects little, if at all. For-profit MFIs can help the poor, as long as they are governed by certain principles and regulations that prevent them taking advantage of the poor.

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