MICROCREDIT SUMMIT CAMPAIGN
A Project of RESULTS Educational Fund

WORKSHOP CHALLENGE PAPER

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Innovative Practices for Industrialized Nations: One Stop Shopping, Standardized Credit Platforms, E-Money Systems, Reaching Poor Youth, the Excluded, and Most Vulnerable.

1. Growth of the microfinance in industrial countries

Microfinance offers people excluded from formal financial services the opportunity to access basic financial services – from savings to loans to insurance. Microcredit specifically focuses on income generating and productive activities often focusing on small business.

Modern microfinance really began as an economic development tool of the 60s and 70's and has rapidly grown to prominence in Asia, Africa and Latin America. It has also flourished in Eastern & Central Europe after the fall of the Berlin Wall. Growth has been characterised by speed and many innovations. In many ways microfinance has filled a huge gap in the market where there were no banking services and proving that people excluded were credit worthy. The market has seen many MFI grow into banks and many banks downscale operations into microfinance.

More recently in Western Europe and North America microfinance has grown in prominence. Often these have built on strong roots of well established co-operative institutions and community banking models that have existed for hundreds of years. In the US a growing community development finance movement has widened

Growth in Western Europe and North America has been characterised by lending to small business, both start up, small and informal business. It has been seen primarily as a tool to promote enterprise and job creation.

The microfinance sector in Europe has been characterised limited growth and a high dependency on public sector funds. This has led to many 'projects' rather than institutions, and a lack of a favourable legal environment is often cited as a barrier to expansion.

Often a lack of entrepreneurial culture is sighted as a reason for lack of growth, with a huge amount of technical assistance needed to ensure potential clients are able to set up and/or formalise their business. As such very few MFI here have been able to be profitable, attract investment or commercial finance and scale.

Recent high profile forays by the Grameen Bank to New York and potentially Scotland suggest that new players may shake this market up.

2. Issues

Europe and North America have large and well established banking systems. Having a bank account is a necessary part of life and hence there are very low levels of unbanked compared to other parts of the world. Indeed the scale of bank lending would suggest that there is little need for microfinance here.

However numerous studies have shown the following groups consistently having difficulty accessing finance:

- Individuals from certain BAME groups;
- Women;
- Individuals in receipt of income-related benefits;
- Young or elderly people;
- Individuals with a criminal record;
- Residents of deprived communities.
- Recent migrants

In addition the following types of businesses find themselves more excluded:

- Start-up businesses;
- Businesses from the informal sector[1];

For many of these communities access to finance for not just enterprise but often basic financial services are met by a myriad network of sub prime lenders offering unsecured loans at rates between 70-150%. In addition certain specialised lending practices are well utilised in these communities:

- Door step lending, often called Home Credit, is delivered by local agents who come to your home to make small loans from as little as £100 but often up to £2000. Collections are made weekly or monthly and rates are around 500%
- Payday lending are short term cash advances till the next paycheck and usually up to a month initially. They are often rolled forward for a fee if the borrower is unable to make the payment. Interest rates vary from 1000%-4500%

In the UK around 4m use use doorstep collectors and around 2m people access payday lenders. While in the US the payday lending industry is estimated to have revenues around $40bn in 2010.[2]

[1] Fraser, S. (2007) Finance for Small and Medium-Sized Enterprises: Comparisons of Social Enterprises and Mainstream Businesses. A Report on the 2006 UK Survey of SME Finances Social Enterprise Booster Survey

3. A case of the UK – Fair Finance experience of targeted the excluded.

Fair Finance background

Fair Finance was launched in April 2005 after a 5 year pilot of a successful microcredit project which helped over 600 women on peer groups circles and made over 300 loans to excluded women in East London, proving that the poor repaid; and a debt advice project which worked with local Housing Associations to provide debt advice to hundred of indebted tenants, that proved the business case that paying for debt advice made long term financial sense.

Fair Finance is a not for profit social enterprise attempting to tackle unfair and usurious lending in London, and potentially the UK. It competes directly with usurious lenders and predatory lenders, offers people advice and support to manage their finances sustainable and campaigns locally and nationally for change. It is recognised as one of the most high profile and high impact community finance organisation in the UK and has a presence both nationally and internationally.

Through its two offices it offers:

- Personal loans of to £2,000 at affordable rates to help people out of the clutches of usurious lenders
- Microcredit loans of up to £10,000 to entrepreneurs unable to access mainstream finance for their business ideas
- Debt advice to over-indebted residents and housing association tenants facing eviction.
- Bank Account access for people without bank accounts.

In addition Fair Finance has relationships with banks that allow it to open bank accounts in its offices for the unbanked, and has been offering financial capability workshops to local residents on improving their financial management.

Fair Finance is recognised as a leader in its field in the UK microfinance market and has successfully build a model that is moving to sustainability.

In 2011 Fair Finance secured social investment from a range of social investors to build the business across London and commercial finance from 3 banks to expand the loan book. It did this with no subsidy or government grant and became the first UK or Western European microfinance organisation to do so.

The UK context

The United Kingdom has seen a rapid growth in its sub prime lending market over the last 20 years, driven by the deregulation of the credit market this has increased access to finance but often at high cost. Some details are noted below from the Financial Inclusion Taskforce, various press reports and Competition Commission in the UK

- 7-10 million with limited access to financial services[3]

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[2] http://www.paydayloaninfo.org/facts

[3] http://www.fsa.gov.uk/pubs/consumer-research/crpr03.pdf

- 2m without bank accounts [4]
- 3-5m using doorstep lenders[5]
- 2m+ using pay day lenders[6]
- 200k using illegal money lenders[7]

The interest rates for these companies are eye wateringly high and you wonder why people use them.

Our learning of the market

There are a number of issues of people being able to get into the formal financial system – they lack the basic **ID of a passport, driving license, utility bill** and may not be on the **electoral role**.

However lending models are designed on credit scores which value: **employment, home ownership, assets and credit history**. A lack of these will result in a low credit score and no access to mainstream finance.

Many assume people pay these rates because of a lack of understanding about the rates being charged, and most policy has focused around greater transparency in pricing and more education. But, hard as it might be to accept, we have rarely met a user of a payday loan or home credit service who didn't know how much they were being charged or what they were paying.

Every year Fair Finance run’s a focus group with it’s clients and ask them what are their five most important considerations when choosing a financial product. The response is always the same:

High on the list is **accessibility** – "Can I access the product because of my income, location or background?" Unlike banks, all these companies providing alternative sources of credit advertise that people with county court judgments, benefits claimants and part-time workers are welcome, and doorstep lenders will even come to your home.

Flexibility is usually next: can the product accommodate a variable and flexible income – "Can I change a payment date if the Department for Work and Pensions withholds a payment for a week or I miss a week off work?" A doorstep lender allows for missed payments – contrast this with how hard it is to convince your bank to hold a direct debit payment for a few days.

People tell us that **honesty and simplicity** are key factors in deciding to use a product. They find APRs difficult to understand and bank products can be complicated; people like the simple approach of £20 a week for a £500 loan over a year from a doorstep lender; £15 per £100 a week from a payday lender; or 10% a month on what you borrow from a pawn shop. These products rarely have penalty charges or additional payments.

[4] http://www.hm-treasury.gov.uk/fin_fit_index.htm
[5] http://www.oft.gov.uk/OFTwork/credit/review-high-cost-consumer-credit/
[6] http://news.sky.com/home/uk-news/article/15683484
[7] http://www.circle.org.uk/corporate/media/15-january-2010-the-real-cost-of-christmas,1277,LA.html

Speed is also cited as important, particularly with payday loan clients – "I can walk in off the street, sign up for a loan and leave in 20 minutes with £200 cash." Paperwork is minimal.

Clients value **respect** – they want the person offering them the product to treat them with respect and to value them. I hear many stories of people being treated badly at banks – either being made to feel small or looked down upon. Doorstep lenders are not people with baseball bats and Rottweilers, they are often members of your community, understand your predicament and probably live on your estate. They build **relationship**s.

As a result it is clear to see that although these are expensive products they are bespoke, designed around the lifestyle choices of the poor, flexible to address issues and built on human relationship and interaction.

4. Some conclusions for reaching these target groups

1. Greater access to data can help reduce exclusion to the mainstream. This has been done effectively in many industrialised nations where the unbanked is a very low number. However there are limitations for some groups who lack often the basic ID requirements, and rigidity of the system mean that people with alternative data often overlooked.

2. Greater use of technology to improve decision making has allowed many banking institutions to make better, smarter and cheaper decisions. However for people who have limited data to make those decisions on, they find that a lack of data means a negative decision. This is the issue of a 'thin credit file'. Collecting and analysing non standard data can be expensive and often lending institutions are unwilling to do so.

3. Many who continue to use expensive sub prime do so because the products fit their needs. They are personalised, bespoke and tailored to their requirements. Many value this over price and continue to use it even if they could access cheaper.

4. Overwhelming financially marginalised communities value relationships and direct face to face to contact in their financial transactions. The original model of relationship based lending and building trust is seen as key to giving these clients what they want.

5. The mainstream banking industry is not interested or unable to adapt its lending and business methodology to meet this need.

For microfinance organisations there is a challenge here. Greater use of technology will clearly reduce costs and streamline process, helping them achieve break even and profitability.

However will they end up missing out on serving the very clients they were set up target because they find that want something different? Are the MFI's falling into the same trap the mainstream has and end up excluded communities? And is the challenge in industrialised countries less about technology and more about people?