

IBM AND THE FUTURE OF MICROFINANCE

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WASHER: Welcome to a podcast on the Future of Microfinancing. I'm Tim Washer. Two thirds of the world's population earns less than \$5 a day. Among the many efforts to alleviate global poverty, one of the most promising is microfinance.

As of last year, there were 3,100 microfinance institutions providing services to over 100 million people with a gross loan portfolio exceeding \$23 billion in US dollars.

Here to discuss the future of microfinancing are Jessica Jackley Flannery, co-founder of Kiva.org, and Kevin Thompson from IBM's corporate citizenship and corporate affairs organization. Thank you for joining us.

FLANNERY: Thanks for having us.

THOMPSON: Thank you.

WASHER: Let's start by, if you would, just give me a basic, simple explanation on what we're talking about when we say microfinance.

FLANNERY: Sure. Well, almost everyone listening to this has a checking account. Well, think of that, think of other services and products that your bank provides to you whether it's savings, insurance, anything like that. And then think of those products and services and how those might be tailored to the needs of somebody who makes two or three dollars a day.

So microfinance as I think about it is sort of the whole suite of products and services targeted at the very poor and the entrepreneurial poor, often.

THOMPSON: These are loans that get repaid. This works. The repayment rates are in the high nineties in many instances, sometimes better than...well, certainly in this country with the mortgage situation we're having now, is that you're getting repayments of these loans at very, very high levels.

This is money that's delivered in very, very small quantities through a number of mechanisms. They can either be direct as the kiva model does where an individual who has money lends directly to somebody who needs it, or it can filter through a number of players in an ecosystem that can start with a large

multinational financial services organization or a bank.

It can start within an individual country at an agricultural bank, wherever there can be a source of capital. And it passes through a number of organizations: microfinance institutions, lending officers, and eventually gets delivered to someone, an individual, who has an idea; an individual who has a mechanism that they see to make more money. And so when you look at microfinance you're looking at a more effective vehicle for helping people help themselves.

WASHER: Okay. Can you give us an example of a small loan that kiva has administered?

FLANNERY: Sure. A fishmonger in a small village called [Turoro, Uganda]. And basically she received a few hundred dollars on kiva two years ago and was able to take that money and invest in transportation and rent a truck to go directly to Lake Victoria and to buy fish directly from the fishermen that would be pulling them in off the lake right then and there.

In doing that, basically her costs were cut I think by two thirds, something like this, and she was able to increase her profits, you know, by an order of magnitude because she was able to then take those fish, go right back to the village and other markets nearby and sell them at the same price but make a lot more money.

I'm thinking of people to whom I have had the privilege to lend, a popcorn seller in Samoa, a butcher in Afghanistan, a rug weaver in Iraq, a fruit stand seller in Ghana. There are fishermen, fisherwomen, people selling all sorts of small goods, any kind of agricultural business.

WASHER: So how does that work, family relationships, as collateral?

THOMPSON: Well, sort of the original Grameen model started by Muhammad Yunus, which was, when an individual wanted to sign up for a loan, they didn't put up for collateral some group of assets they have, they didn't put up their land because they didn't own it.

They made everyone in their family circle sign on to this loan and say, if this individual does not repay their loan, then no one else in the extended family can get access to a loan, ever.

So all of a sudden if you got the loan and you did not pay it back, your brothers, your sisters, your uncles, your aunts, your father, your mother, your grandmother, your whole extended family would never have access to these services. You would be, your name would be mud.

And so that's what they were leveraging, was...is the importance of family

relationships and using that as the form of collateral.

WASHER: Okay, in a sense, there's some similarities to being a co-signer, I guess.

THOMPSON: Yes.

FLANNERY: Um-hmm.

THOMPSON: But again, the co-signer doesn't have collateral.

WASHER: Right. Okay, very different model. So what needs to happen to scale this?

THOMPSON: In my opinion there's sort of two major roadblocks in the way that need to be addressed if microfinance is going to really prove really catalytic. So one major impediment is policy, and the second is skills.

I can reflect back to my time as a Peace Corps volunteer in Ghana driving down the road and seeing literally 80 women selling exactly the same thing: exactly the same kind of bread at the same price in stall after stall right next to each other.

And you look at that situation and you say, we've got a supply and demand problem. And there needs to be some business skills development in this space, so that people can begin looking to fill market niches beyond, you know, commodity trading, you know, manufacturing soap, delivery of fish, fairly quickly.

You know, the example in Uganda -- other people are going to figure out how to go direct to market with fish. And so eventually your competitive advantage is going to go away.

FLANNERY: I really agree with that, and you know, where the magic happens is on the ground in the relationship between, say, a loan officer, who's the person employed by the microfinance institution that actually hops on the bike or takes the bus, or you know, gets out to say, for example, a really rural area and does the training and the relationship building with clients, right?

As an example, let's say you have a loan officer in, you know, [Kakamega, Kenya], on the other side of the country, and they go out a few hours to a small village and they meet with lending groups and individual borrowers.

They do training, they do mentoring in a very...it's really a rich often relationship building thing that happens between loan officers and all the borrowers. You know, they'll know the clients by name, they'll know their family stories, they'll know the troubles and challenges they're going through.

And they're the ones that actually help that person develop the best version of their idea that they can and give them the tools and resources to make that

happen. They actually hand the cash or the capital equipment, whatever the loan looks like, to that client.

They're visiting that person maybe even every two weeks to collect for payments and to really make sure they're on track. And just to check in with them.

So it's a very intense and high-cost process. And as you could imagine, technology at any points along that way, really makes...makes things just fly.

THOMPSON: Jessica described sort of the individual connection, but if microfinance existed without any underlying technology, that individual lending officer, there's a limit to how many people they can engage with. It may be 40, 50, 60 people.

If you want microfinance as a business activity to scale much larger, you do need some sort of standard technological infrastructure to enable that to happen.

Only half of the microfinance institutions in the world even have any sort of technology. And those that do pay enormously high cost -- sometimes 12 to 15 percent of the revenue stream -- on information technology.

in Africa we're looking at a potential partnership with Care International to deliver what we're calling this microfinance hub concept or the financial grid concept, which turns microfinance information technology costs from a fixed cost to a variable cost and cuts them more than in half.

When you have an open source core banking solution that sits in the middle of all of this, it enables two things. It enables innovation, because everyone can get access to the code, and it dramatically reduces cost because you're not paying a licensing fee.

I've talked to a number of microfinance leaders in Africa who say, look, once I get the money, how do I distribute it, and how do I make sure I know where it's all going? And how do I catalog all this information?

At every step of the value chain of micro credit and micro finance, you know, you have skills needs and you have technological needs. And that's going to be a very interesting area to watch mature over the next three to five years.

WASHER: What's the next barrier, I guess, that would keep technology out of the hands of those other MFIs?

THOMPSON: Well, we've mentioned before that there's regulatory issues, so if you're using an open standard and if you're using one of the...this hub concept or this financial grid concept, oftentimes the processing of financial information may occur in a separate country.

And oftentimes countries have regulations which restrict the processing of financial information for citizens of their country having that done in another country.

But again, there's a skills issue with this. A lot of the microfinance institutions that aren't using technology aren't because of the cost is one reason; but also their people don't have the skill sets yet.

FLANNERY: Think of it as, if you were selling something on eBay, the type of experience you'd have to have to post something. And so I mean, it's a very rough analogy, but just imagine that, that some of our MFIs are using, to be able to source this flexible and free and very friendly debt capital from lenders.

So anyway, we try to make that experience really...or that our back-end really dovetail with the technology that they are using. And the more standard it is, the better. And you know, that's our little piece and how we can plug in there.

So we can work on distribution, we can also work on incentives as I mentioned, right, like a lot of the MFIs we work with, because you've got to remember the vast majority are super small and they're serving maybe a few hundred or few thousand people.

So in a world of scarcity, sometimes, if you have a scarcity mentality, it's a difficult thing to make that longer-term investment in technology when you have your day-to-day...other day-to-day things to take care of.

So anyway, if we can provide the incentive as well to say, look, learn...you know, start to put your records in some time...in some type of electronic form. Maybe, for example, with ours, so you can start to use our site, and use these other management information systems that can help you scale and just down the road it will really pay off.

If we can deliver that message and provide incentives today for them to do that, we feel like we're doing our part in this.

WASHER: Well, thank you both for being with us today. Kevin Thompson and Jessica Jackley Flannery, we appreciate it.

FLANNERY: Thank you.

THOMPSON: Thank you.

[END OF SEGMENT]

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