Stan up and be counted

Microfinance has its problems, but it can drive the economies of developing nations. So what if it wasn't there? To find out, Euromoneyheads to the former Soviet republics of Tajikistan and Kyrgyzstan to meet its lenders and clients

By: Chris Wright

In a village in rural Tajikistan, Mastura Asoeva is flicking through her accounts. Perched on a stack of wooden boards in front of piles of stick bundles and clay bricks, the mother of four doesn't look an obvious CEO, but business is good: her basket-weaving operation is growing and, for a fee, she trains women in other Tajik villages in the same skill.

Some 2,400 kilometres by road to the north-east in Maevka village, Kyrgyzstan, Taalaibek Gaipberdiev is surrounded by traditional, local carnival costumes that his company makes for lease to the growing population of the nearby capital Bishkek. It wasn't how he planned to build his business. "Initially, I just wanted a photo studio where children could take pictures in carnival outfits, such as fairy-tale pictures, but at the end of the year our customers asked to lease out the costumes for New Year parties," he says. "I said no. But they wouldn't leave my office." Now he has 3,000 costumes and employs 40 people in an outlet and workshop.

Meet the next generation of banking clients. Asoeva is a customer of Tajikistan microfinance lender Humo and Partners; Gaipberdiev a borrower from Kyrgyzstan's Bai Tushum & Partners. They represent a growing constituency of people in the world's poorer and more obscure locations who are building businesses on the back of microfinance lending. Modest in scale individually, they are a powerful force in aggregate, and steadily growing to be a driver of their national economies.

Microfinance has problems: that's understood. There are those who feel it encourages inescapable indebtedness; that its interest rates are intolerably high; and that lenders lack governance or prudence.

But what if it wasn't there? To find out, Euromoney travelled to two of the world's least-visited nations, the former Soviet republics of Tajikistan and Kyrgyzstan, to meet the lenders and clients of microfinance.

Euromoney starts its trip in the Tajikistan capital Dushanbe, where a swirling Afghan dust storm has given its wide tree-lined boulevards an orange hue and closed the national airport. There's always a local theme or need that distinguishes national microfinance industries – post-war rebuilding in Bosnia, agricultural efficiency in south Asia – and in Tajikistan, it's the empowerment of women.

In a parallel of Yugoslavia, Soviet rule kept a lid on deep ethnic tensions here that dated back centuries. When the Russians left, civil war erupted, killing around 60,000 people and making refugees of half a million. After peace was declared in 1997 what was left of the gutted economy – its GDP per capita had fallen 70% – offered little hope. Many of the remaining working-age men went to Russia, often not returning. "The men in the country unleashed the war, fought the war and left the country, and the consequences fell in a burden on women, children and old people," says Sulamo Khoshakova, director of the Association of Microfinance Organizations of Tajikistan (Amfot). Every client, banker, leader who Euromoney meets in Tajikistan is a woman.

Microfinance is youthful here. International organizations came in at the end of the war, and the first 10 years of microfinance were under their remit. It's only in the past six years that local institutions have set up under Tajik legislation. It has not always been straightforward. "Extending loans to women was complicated at the beginning," says Khoshakova. "Women were only expecting humanitarian assistance. The first steps were to make them understand these loans needed to be repaid." There were social issues too. "The mentality in this country is that assets belong to men," she adds. "Women have the capacity, but they don't have the economic opportunities."

The message has got through: Amfot says there are 123 registered microfinance organizations in the country, 78 of which are members of the association. Shoira Sydykova, director at microfinance lender Arvand, says her institution has 15,000 clients – making up a credit portfolio of just 54 million somoni (TJS), or $11.36 million – and believes that in Tajikistan there are 160,000 micro borrowers. Loans vary in scale: $300 used to be a common starting point; these days it's not considered sufficient to launch a business, and some loans might be as much as $5,000 (Arvand's average is $660, with 60% of loans going to rural areas). Khoshakova estimates that 12% of able-bodied people in Tajikistan have received microfinance loans. "If there were no local microfinance organizations, most women would not have access to loans," she says. "I'm quite sure rural women would not approach banks to receive a loan. The word 'bank' dissuades women from approaching."

It seems approaching microfinance institutions (MFIs) is less intimidating than approaching banks. Nazokat Hafizova runs a beauty salon on one of Dushanbe's main thoroughfares. It is bustling when Euromoney visits, and the tape-recording of the interview is full with the vibrant background noise of blow-dryers and bellowed Tajik and Russian chatter. Hafizova is on her fourth loan from local microfinance lender Imon International: the first, in 2007, bought the equipment; the second the property; the third rehabilitated it; and the fourth bought additional equipment, for more sophisticated laser treatments.

Talking to Hafizova explodes one myth: that microfinance recipients have no idea about finance and approach the lenders wide-eyed. She is, no doubt, among the sharper end of the borrower pool, but one lesson of the trip is just how savvy people tend to be about what is available. "There are numerous microfinance organizations in the city," she says. "I selected Imon because it has the most attractive interest rates." Talking about the benefits of information and training Imon has provided involving income and expenditure, she notes: "It is crucial when the world is facing the financial and economic crisis." Euromoney hears more calm common sense in these interviews than at the G20 press conference in Washington two weeks earlier.

The street-smart nature of microfinance recipients can be a double-edged sword. A challenge in microfinance is indebtedness, particularly where the same borrower will go to multiple lenders. Even in rural areas, people know how to shop around for loans. Khoshakova says: "When they approach us, we begin to explain something to them, and they say: 'Of course we know that. Finco is doing this and Imon is doing that.' They are well informed about what schemes there are in the country." She adds it is common to find "women receiving multiple loans, borrowing several times".

A comment from Hafizova, repeated by others on the trip, concerns the broader social impact of microfinance lending. "My successful business has had an immense impact on my personal and family life," she says. "I have been able to buy an apartment through the income from this business. I have created new jobs for skilful ladies who are working for me. And my husband has become a client at Imon and launched his own business." Her sister is about to take a loan to launch her own business too. This is what microfinance advocates argue: improve one person's life and the spill-over effects can be transformative.

left to right: local bakery, basket making and manufacturing

Euromoney leaves Dushanbe for the suburbs to find Khakifa Sobirova, who runs a bakery. It's a hive of industry in a dim room, where a young man in a white bandana hoists loaves in and out of a clay-walled oven while another kneads the dough. They emboss the bread with local patterns.

In a courtyard, Sobirova is a woman of few words; it later turns out that, in this patchwork country of races and clans, she is Uzbek and understands little of the translator. However, she tells a story of climbing a rung up the ladder: how the bakery, in the family for 40 years, was galvanised with a $300 loan in 2000 and now bakes its way through five bags of wheat-flour a day for sale in the local market; how it employs three family members and has helped her daughter set up an embroidery business, proudly displayed in a room off the courtyard; and how it has not only empowered a family but kept it in existence.

"Our business helps us to keep the family together," Sobirova says. "I have been able to arrange marriages for three of my children. Two are remaining. Hopefully I can manage a marriage for them as well." With business good, her husband and son have never had to follow the herd to Russia for work; both drive taxis in Dushanbe.

Paid marriages and family unity will never show up in microfinance statistics, but nothing comes through more strongly in borrower comments than this: not the size of a house, or the food on the table, or a car, or a cow, but the sense of providing properly for a family. Sobirova sums it up: "Before, life was difficult."

Lenders, too, like to keep families together – it's good for business as well as society. "It is a role model for the next generation: to have a family consisting of a mother, father and children," says Mavsuda Vaisova, general director of Humo and Partners – the suggestion being that this has not been the norm.

This is one of the happier borrower relationships. Sobirova poses cheerfully for pictures with an Imon branch manager, staging a chat about company accounts at the kitchen table, before handing out generous amounts of fresh bread. But is it always like this?

From the customer side, the big problem with microfinance is the rate of interest – although, lacking anything to compare it with, no client we met complained about it or described any problem in meeting terms. Amfot says interest rates in Tajikistan vary from 2.4% to 3.5% per month. "Of course it is a very high interest rate – we do understand," says Khoshakova. "But we cannot extend loans at lower interest rates because the funding we receive is expensive itself."

Deposits

Microfinance in Central Asia is chiefly about lending, though some institutions are taking deposits. It is not easy to do so. Arvand, for example, has just 660 deposit clients. "The population has not developed a culture of savings," says Shoira Sydykova, director at the microfinance lender.

At Bai Tushum, Gulnara Shamshieva, general manager, says deposits are vital and not just for customers. "When we started, we considered this mainly from one side: a cheaper source of funding, but it's also a product for poor people. It's one thing to get a loan and use money to develop your business, but one day this loan must be repaid: there has to be something at the end of the cycle, something to save." She says deposits are "one of the ways to reduce poverty" and generate internal sources of funds for the country, but she notes that, these days, they are not a cheap source anyway.

Cost of funds is a common refrain among microfinance lenders, particularly when lending in local currency. "The basis for pricing is the cost of funds," says Sydykova at Arvand. "Since somoni are much more expensive, the interest rates are accordingly higher." Arvand charges 22% to 26% per year in dollars, 30% to 38% in somoni, but Sydykova says this is much better than working with a loan shark. Robiya Asrorova, a loan officer at Imon, says 10% per month is not an uncommon loan-shark rate – without sympathetic repayment terms – and adds: "There were cases where individual lenders gave out loans for a term of three or four months, then required the money back before the term expired."

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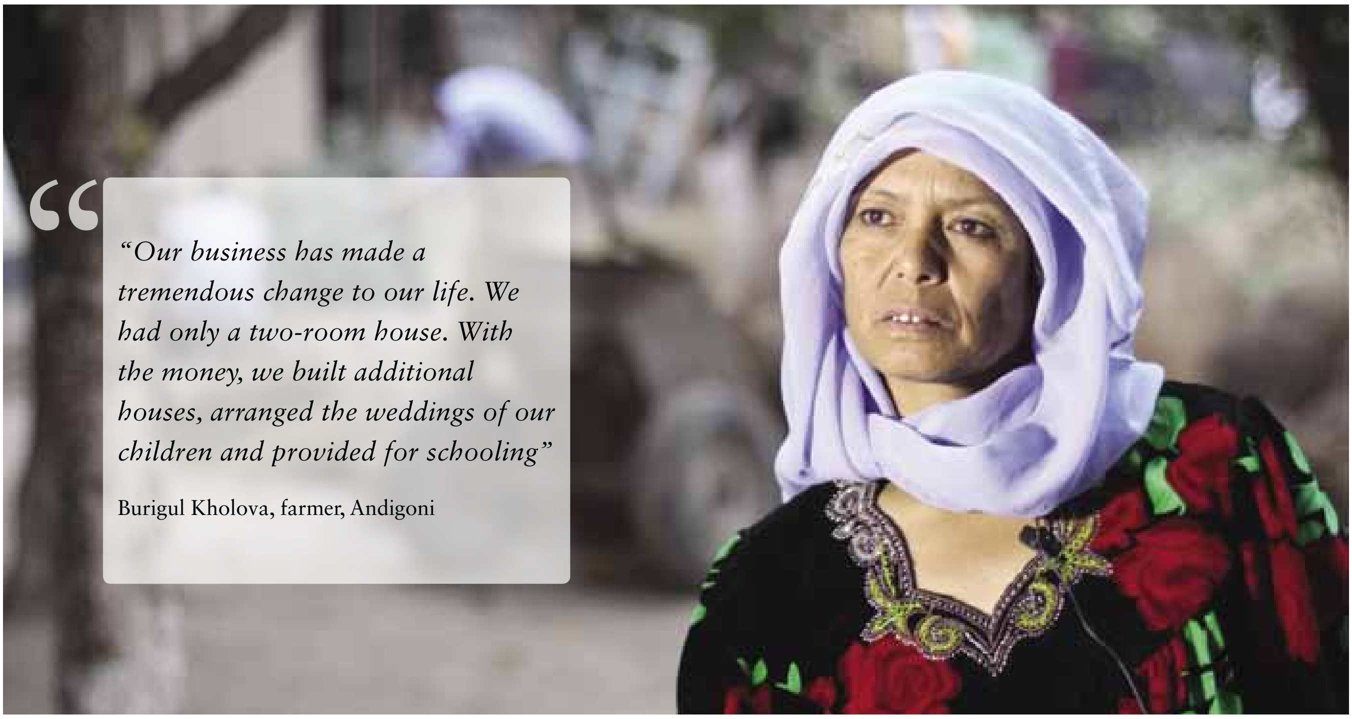
Cost of funding comes up in Kyrgyzstan too, where MFIs cannot do transactions in hard currency, yet get their funding from overseas. Bai Tushum & Partners, a Kyrgyz MFI, says that four years ago the hedging costs for it to manage this risk were 3% to 4%; today, a commercial bank will charge 12% or 13%. "In this situation, it is hard to talk about reducing interest rates for our loans," says Gulnara Shamshieva, general manager. She says that, depending on external factors, interest rates on loans have swung from 48% a year in 2000 to 24% in 2005, before climbing again. "We have to provide a balance, but MFIs cannot directly affect this situation," she says. Besides, it's not an easy business to do cheaply. "We are an institution that operates in rural remote areas, trying to reach clients far from towns and cities," she says. "We provide loans without any collateral. It's high risk, high cost."

Lenders say they have flexible repayment schedules, giving the impression that they are not particularly tough on missed payments, and that their delinquency rates are incredibly low, from negligible to 2%. Asrorova says that Imon has never, in 12 years, sold any property that was pledged as collateral for a loan: Sydykova says Arvand's non-payment rate is 0.5%, adding: "The repayment rate is very good. It is because the loans are short term." This is an interesting point, and on the face of it counterintuitive: why does a short-term loan make it easier to pay? Perhaps for someone new to debt, the immediacy of a deadline makes it easier to plan for. Sobirova, the baker, asked about the challenge of repayment, says: "It wasn't difficult for us. The first loan I received was just six months and I had to repay in instalments."

Some 25km east of Dushanbe, the scenery turns to farmland. Near a cluster of houses, a boy is driving a cow across a field. Neat pats of manure dry outside the entrances to the homes, to be used for fuel. In one of these homes, we meet Mastura Asoeva, the basket-maker. "I am an entrepreneur and



> “Our business has made a tremendous change to our life. We had only a two-room house. With the money, we built additional houses, arranged the weddings of our children and provided for schooling”
>
> Burigul Kholova, farmer, Andigoni

farmer,” she begins. “[Before microfinance], our living standard was average.” Then 10 years ago, an international NGO got involved in the local community, providing training in agronomy, engineering and farming, building capacity and eventually an introduction to Humo, one of Tajikistan’s bigger MFIs. A loan provided agricultural inputs, from seeds to training, and the modest 0.1 hectares of land she owned became the source of tree branches for her basketry.

Asoeva exemplifies that – apart from the fact entrepreneurs can thrive anywhere –money is not a lot of use without training to go with it, which somewhat blurs the line between a commercial lending operation and a development organization. “Initially, the quality of our products was low,” she says. She got advice on improving them; now she trains people throughout the local region, receiving income for doing so. Today, she talks like a venture-capital recipient. “I have always been able to pay on time,” she says. “I was confident in myself and I have always produced my products with confidence that I would be able to sell them and repay my loan.” She has bought a plot of land to build a new workshop “to expand my production”; the foundations are being put in as we talk.

She has no doubt that, as a woman, life would have been much worse without the loan. “It’s important women have got this motivation, this desire of developing, of moving forward,” she says. “If a person tries her best, she will never fall into poverty.” Without microfinance, though, she says she’d have to go to “individuals”, a common shorthand for loan sharks. “There are many of them in this country,” she says. “They try to make you bogged down in debts.” All four of her children have been educated on the proceeds from the baskets.

Further out of Dushanbe, Burigul Kholova is a farmer in the village of Andigon. Where Asoeva could run Hewlett Packard with a bit of training, Kholova, a mother of eight, is more guarded and probably more representative of the ordinary rural people who make up the bulk of microfinance clientele. Her first loan was just TJS68 ($14.30) for potato production, followed by another of TJS300 for goat farming, and then others totalling TJS7,000. Today, she combines land farming and livestock, with one hectare devoted to wheat, maize, tomatoes, potatoes and cucumbers, and then cattle that are milked.

The loan started simply: Humo came to the village to explain what it did. Along with the loan came training, on subjects including canning vegetables, cooking biscuits and writing project proposals. Asked what difference microfinance has made, the answer is familiar. “Our business has made a tremendous change to our life,” she says. “We had only a two-room house. With the money we received, we built additional houses, we arranged the weddings of our children and we provided for our children’s schooling.” One is at university. The next goal is “to buy a new tractor to improve our life”.

It is time to get moving to Kyrgyzstan. Heading south in a Land Cruiser with Lotte Pang from the global development institution International Finance Corporation (IFC), which is producing a video on microfinance, Euromoney is swiftly among cotton fields, then craggier, dusty land where little agriculture is supported, beyond hardy troops of goats. It’s out here, in the rural areas, where microfinance reaches places with no alternative. The road becomes uneven, then disintegrates. At times, it is a river bed. Late in the night, the driver points across a river at dim lights on the other side. “Afghanistan,” he says.

After that it takes a full day of driving along the Panj River, which marks the Afghanistan border, to reach Khorog, the capital of the semi-autonomous Gorno-Badakhshan region of Tajikistan. This is not so much Tajik as Pamir territory, and fiercely independent. Tribally and culturally different, it took the losing side in the civil war, and not much development funding has come this way from the government since. There was a time when money in Khorog ceased to exist, and traditional barter took its place, before the Aga Khan started pouring in money. Today, it hosts the University of Central Asia.

Getting this far into the wilderness gives one a new perspective of the challenges that face MFIs. “There are some technical problems faced by microfinance organisations in remote areas, such as not having a computer or internet,” says Khoshakova. Also, keeping track of a far-flung and often large client base with a low average loan amount is a headache. Sourcing personnel is another challenge, since microfinance organisations generally don’t pay well.

Euromoney might have overdone it. Driving up the Pamir Highway, built over the mountains by the Soviets, we blow a tyre at 2am, at an altitude of 4,000m and 90km from the nearest village – in a blizzard. The drivers get out to change the wheel. They hand me a torch and tell me to walk in circles around the car. “Watch for wolves,” one says.

Surviving this, we arrive at dawn in Murgab, a half-Tajik, half-Kyrgyz town, where electricity alternates between the two halves throughout the day. It is utterly bleak and barren but beautiful, and it’s hard to see where an economy could be built here. Much employment comes from the NGOs who have set up here to help. As the sun rises, a stream of grinning children, some probably no older than four, arrive with pails to get water from the well. Japanese stickers on the well’s pump show its foreign providence.

> *“The mentality in this country is that assets belong to men. Women have the capacity, but they don’t have the economic opportunities”*
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> Sulamo Khoshakova, Association of Microfinance Organizations of Tajikistan

It is another full day’s drive amid the mountains and alongside a Chinese border fence, newly moved after Tajikistan ceded a chunk of its territory to China in exchange for road-building assistance, before we reach the magnificent inconvenience of a Central Asian border and cross into Kyrgyzstan. On the other side, the land is more fertile; more populated by yurts. And that brings us to Kyrgyzstan’s theme of microfinance: the fact it is 66% rural (and 34% below the poverty line). “We are a mountainous country and we don’t have many big cities or towns,” says Shamshieva at Bai Tushum, whose own client base is 80% rural. That’s a business model, as well as a challenge. “We provide access to financial services for all unbankable people in rural areas,” she says. “They have no attractive collateral.”

It is not an easy model to run. In a place lacking financial literacy, the problem of over-indebtedness is acute. “Our credit bureau [an IFC-backed initiative aimed at helping lenders assess indebtedness of potential clients] says about 35% of clients are running between institutions,” she says. “When business is going well, maybe you are able to repay multiple loans, but when it comes to a crisis, it creates problems – and not only for one institution.” Bai Tushum won’t lend to any client who has more than 70,000 som (KGS) – $1,536 – in outstanding loans. Not every lender applies such standards.

There are other problems. We spend the night in the city of Osh. Barely a year ago, this was the scene of bitter violence that one could justifiably call ethnic cleansing. There is still an edge here; a policeman was killed the night before we arrive. Stalin has a lot to answer for in this part of the world: it was he who set the random jigsaw puzzle of borders around these Central Asian states, where in the space of 100 kilometres one can go from Kyrgyzstan to Uzbekistan, back to Kyrgyzstan, and back, and back again, and in to Tajikistan, without turning left or right off the road. Tensions between these nations flare frequently, particularly if something such as a proposed hydro plant in one country threatens to cut water flow to agriculture in another – and this is yet another challenge microfinance must face.

Driving further through Kyrgyzstan, another problem becomes evident: corruption. Euromoney is stopped seven times in a day and fined each time. “It is illegal to photograph gas stations,” says one policeman, moving through the pictures on the cameras. There are no photographs of gas stations, but he fines us anyway.

There is a big push on microfinance in Kyrgyzstan. President Roza Otunbayeva has long championed it as a cause, and the National Bank’s Emil Saryazhiev, who heads the department for methodology and licensing, lists the statistics with some pride: 630 microfinance organisations, including four microfinance companies; 317 microcredit companies; 111 microcredit agencies; and 198 credit unions. Shamshieva at Bai Tushum says there is KGS18 billion ($397 million) in microfinance lending nationwide, or 30% of the total banking sector loan portfolio, covering almost 400,000 clients – far more than the banks. Even then, she estimates that only 17% of the economically active population of the country is banked.

Despite the huge numbers, Saryazhiev says: “The National Bank is doing its best to focus more on the quality of microfinance institutions than the quantity.”

International Finance Corporation/Lars Thunell

Microfinance has become one of the mainstays of the World Bank's International Finance Corp arm and a passion of its Swedish CEO Lars Thunell.

IFC is working with 110 MFIs in more than 50 countries. Its investee clients had an outstanding portfolio of nearly eight million loans as of June 2011, worth just under $12.6 billion. Yet the feeling internally is that much more can be done; that there are three billion poor people on Earth and, at best, microfinance reaches less than 20% of its potential market.

Microfinance can be defined in a number of ways, but to Thunell, it is chiefly about "the very base of the pyramid. It's a way of providing access to finance and loans to these people." IFC's role, as he sees it, is not just about pouring money in but helping to shape a sustainable industry, with proper training, improved capacity and a supportive regulatory infrastructure. And he likes the idea that microfinance can be an engine for gender equality. "It's a lot about women," he says. "Women are the ones who are picking up this opportunity and moving it forward. It allows them to create their business – which in certain cultures creates some tension – and we see that they reinvest the money and spend it on their children's education, rather than going to a bar and spending the money there."

Some of the key debates internally at the IFC concern job creation and productive use of loans. Thunell sees microfinance as being a spur to self-employed entrepreneurs in particular, but wonders how many other jobs are created as a consequence. "The debate now is how we move some of the small informal companies into real companies and get them to grow," he says. There's also an explicit goal at the IFC to ensure that microfinance lending goes into productive investment, not consumption. "But there is a question how stringent you should be about that," he says. "If an entrepreneur has a sick child, the best thing might be for him to use the money for that. It's not all black and white, and you have to recognize that."

The IFC acknowledges the debate about interest rates but tends to come down on the side of lenders. "The costs are high in terms of administering the systems – there is the cost of money and losses," says Thunell. "And we have to remember, what is the alternative? Not getting the money at all, or going to one of the peddlers and paying over 100%.

"As a development institution, of course we'd like interest rates to be lower, but at the same time we would like the microfinance institutions to be sustainable. In some countries, a government has come in and said you can't have an interest rate higher than X. And in some cases that has meant the MFIs disappear. The interest rate came down, but the loan volume came down even more dramatically."

Asked about the possibility of encouraging a culture of indebtedness, Thunell speaks about improving financial literacy around responsibility, but also makes a more fundamental point about inclusion. "Who am I to decide that here in Europe and the US we should be allowed to borrow but we should not allow the bottom of the pyramid to?" he says. "These are intelligent people, capable people, and if you give them the right education and incentives they will handle it. I've been amazed when I've visited slums around the world, you see micro businesses all over the place. The question is how you bring those ecosystems into the bigger world to benefit from trade."

Thunell believes microfinance is "still at the beginning" and says there are "big parts of the world we haven't really been able to reach". The financial crisis has made this worse still: as Western banks deleverage, the ability to source funds for MFIs is getting worse. A long-term answer is the development of local currency capital markets, but that takes time.

Part of the problem can be at the top. "There are many places where you still have governments that are either suspicious, or haven't put in place regulations," he says. "You have banking regulators who are watching their turf. You need different regulation for microfinance; sometimes that's hard to get."

Other challenges include lenders to MFIs overestimating the risks involved – IFC

Amendments are going through on the licensing of microfinance, allowing institutions to upgrade to commercial banks, with the aim that they can provide a greater range of services to rural people, including leasing.

Talking to a central banker, though, exposes another area of potential conflict with this rapidly growing sector. "[Microfinance organisations] should be for the people, not the people should be for them," he says. "Therefore they should not think about their own profit, they should rather think about assisting people to make up capital and start their own business. Those that are concerned only about their own profit should be pressed out of the market."

This approach sounds public-spirited but provides no reason to encourage anyone to lend. Microfinance providers believe they do good. "This is our social mission, to help eliminate poverty," says Shamshieva. However, they also hope to turn a profit. Sydykova at Arvand says: "The profitability and sustainability of microfinance means it is a long-term activity. It means it will exist, it will expand and it will cover larger areas." It prompts efficiency too, she argues. And Asrorova at Imon suggests customers don't mind lenders making a profit. "There is immense trust between our organisation and its clients," she says. "Both parties are interested in getting profit out of this business."

MFIs are also wary of being seen as somehow an infallible solution to poverty. "Sometimes microfinance is perceived as a treatment for all pains, all diseases," says Vaisova at Humo. "Microfinance provides access to finance. It is not a solution to all problems."

She is right, and as Euromoney leaves Bishkek, questions remain about the whole model: the rates, the supervision, the habits it can engender. But it is, today, the best available model, and indisputably improving many lives. "If an MFI does not operate in this country, just think of all those people in remote rural areas," says Shamshieva. "Who will go there? Who will finance them? Nobody."

With thanks to Morag Livingston and Jonathan Lewis EM

attempts to guarantee first losses to alleviate the risk – and quality of information, for which IFC often works to develop credit bureaux to help lenders make risk assessment on clients.

However, the message that keeps coming through is the need to build capacity in individual institutions. “In the long run, if we’re going to scale this and reach as many millions of people as we think we need to meet, then we need to make institutions sustainable,” says Thunell.