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Helping the Needy: Factors Influencing the Development of Microfinance in Barbados

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Creating and sharing knowledge to help end poverty

Abstract

As an effective financial tool for socio-economic development, today microfinance has gained enormous success in tackling poverty on a global scale and helping various governmental and non-governmental actors to achieve their Millennium Development Goals (MDGs). Given the positive impact of microfinance on small business, agriculture, education, health, and other indicators of development, the practice of micro-credit is crucial to poverty alleviation, which is a key feature of many Caribbean government agendas. This article sheds light on how the governments in the Caribbean region have incorporated microfinance in their economic development efforts, reporting findings from our recent research conducted in Barbados. Drawing on contemporary practices, we examine the challenges faced by the microfinance sector within the Caribbean, with an emphasis on the Barbadian context.

Keywords: Barbados, Caribbean, microcredit, microfinance, non-governmental organisations, credit unions, remittance, poverty reduction strategies.

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Introduction

Over the past three decades, microfinance has emerged as one of the most significant innovations in contemporary development policy and practice, spreading to more than 65 countries around the globe, among them numerous industrialized nations (Chowdhury et al., 2004). By adopting microfinance as a core component in their development programmes, various governmental agencies and non-governmental organisations (NGOs) are reducing poverty and raising the status of women and disadvantaged communities (Hossain, 2002). Christen et al. (2003:5) define microfinance as ‘the provision of banking services to lower-income people, especially the poor and the very poor’. A central service provided under microfinance is microcredit which involves provision of small-scale loans to the low-income and the poor. Other innovations include housing microfinance, pensions, savings and transfer services, microinsurance and remittance management. Given their impoverished state, the beneficiaries of microfinance are often classified as ‘unbankable’, often falling below the poverty line. As a consequence of poor credit history, unstable employment and lack of collateral, such individuals have limited access to traditional credit. Microfinance is also used for the purpose of financing small and microenterprises (SMEs) and social obligations, emergency and home improvements and acquisition of household assets (Hossain and Rahman 2001; Christen et al. 2003; Hulme and Moore, 2006), where small and microenterprises (SMEs) are ‘those businesses which produce good and services utilizing few employees and limited capital’ (Hulme and Moore, 2006:2)

While commonly conceptualized as an initial success of the Grameen Bank in Bangladesh, Hulme and Moore (2006) observe that microfinance was in fact preceded by two unsuccessful forms of microfinance, small farmer credit and rural credit. These failed interventions unfortunately resulted in high default rates which prevented establishment of financial institutions in such rural areas, political interference and limited access of the poor to credit. Similarly, in his native Bangladesh, Muhammad Yunus encountered several challenges in his efforts to increase provision of financial services to the poor via commercial banks. As a result, he founded the Grameen Bank, a separate bank specifically serving the rural poor. Grameen Bank, which is now owned by its borrowers, provides collateral-free banking to approximately seven million poor people (mainly women) via group lending (The Nobel Foundation, 2006). Owing to the success of Grameen Bank, several adaptations of the Grameen model have been established around the world. Microfinance, with a clientele of approximately 92 million within the developing countries, has thus become a common feature of today’s national poverty reduction strategies (Hulme and Moore, 2006).

Within the Caribbean region, the effectiveness of microfinance provision has been hindered by the presence of several economic, regulatory, cultural and political factors.

This article aims to examine the challenges faced by the microfinance sector within the Caribbean, with an emphasis on the Barbadian context. It draws on our recent study on microfinance in Barbados and the Caribbean, which consisted of an analysis of the existing Caribbean microfinance literature and institutional surveys on selected Barbadian microfinance institutions. It commences with an overview of the Barbadian microfinance sector. This is followed by the advantages and the disadvantages of microfinance, particularly with regards to the Barbadian context. The article concludes with presentation of several recommendations for the advancement of the microfinance sector within Barbados and the Caribbean. As in other regions, microcredit is the most popular of the financial services provided under microfinance in the Caribbean and hence will be used interchangeably with the term microfinance throughout the course of the study. Similarly, indicators of the Caribbean will be used in conjunction with Barbados, given the proximity between Barbados and other neighbouring Caribbean countries and resulting similarities in history, culture and standards of living.

The microfinance sector within Barbados and the Caribbean

The relevance of microfinance to Barbados and the Caribbean

Barbados is a small English-speaking island, situated northeast of Venezuela. A former colony of the British empire, it is the most easterly of the Caribbean islands and is located between the Caribbean Sea and the North Atlantic Ocean. It is a densely populated island, boasting approximately 280,946 people over an area of 431 square kilometres (CIA, 2006). The largest sources of foreign exchange are offshore finance and information services, leading to a dependency of the economy of Barbados on financial services (Lashley and Lord, 2002; CIA, 2006; Government Information Service, 2007).

The social and economic development of the region, while characterized by relatively strong economies, has also suffered from widespread poverty, high levels of indebtedness, poor transportation networks to crucial sectors such as tourism and hospitality and a progressively weakening agricultural sector, the latter presenting severe implications for the rural poor (Caribbean Development Bank, 2007; Bowen, 2007). Of these constraints, poverty, with approximate rates of 30% of the Caribbean population, poses the greatest challenge to the social and economic development of the Caribbean region (Bowen, 2007). Large numbers of the poor reside just above the poverty line and are at high risk of falling below (Bowen, 2007; Caribbean Development Bank, 2007). Additionally, several unique conditions within the region, ranging from environmental degradation and economic shocks to continuous exposure to natural hazards such as hurricanes, have exacerbated the vulnerability of the Caribbean's poor, and hampered the social welfare in the region (CIDA, 2007; Caribbean Development Bank, 2007). Therefore, given the positive impact of microfinance on education, health, and other indicators of development (Chowdhury et al., 2004), microfinance provision is crucial to poverty alleviation (Lashley, 2004), which is a key feature of many Caribbean government agendas.

With entrepreneurial development, the need for finance naturally follows (Arestis, 2005) and as Wenner and Chalmers (2001) observe, most businesses in the Caribbean are small and microenterprises. This underscores the relevance of microfinance as a means of financing small businesses, thus creating new products and services, encouraging industry and innovation and improving employment opportunities and economic growth (Wenner and Chalmers, 2001, Griffith and Brathwaite, 2003; Lashley, 2007). Despite the abundance of SMEs within the region, access to credit has been persistently low, thus negatively impeding their growth (Wenner and Chalmers, 2001; Lashley and Lord, 2002; Navajas and Tejerina, 2006). As in other countries, this is in part as a result of hesitation on the part of Caribbean banks to incur the high transaction costs and high risk perceived to be associated with the provision of financial services to SMEs (Wenner and Chalmers, 2001). Consequently, only a small percentage of microenterpreneurs, approximately 3-5% have access to funding (Wenner and Chalmers, 2001). Additionally, adverse operating conditions, demand for small loans with resultant high transaction costs and lack of collateral for guarantee purposes compromise their repayment capacity (Wenner and Chalmers, 2001; Navajas and Tejerina, 2006).

The major microfinance players in Barbados

As observed by von Stauffenberg (2000), the success of Latin American MFIs spearheaded the development of the Caribbean microfinance sector in the 1980s. Owing to the high proportion of Barbadian SMEs in Barbados, there is a high demand for microfinance in Barbados. Despite relatively good standards of living in Barbadian society, poverty dominates the rural parishes and consequently, poverty eradication and entrepreneurial development have been prioritized in Barbadian government policy, as outlined by the Barbados National Strategic Plan 2005 - 2025 (Ministry of Finance and Economic Affairs, 2005). Microfinance is therefore essential to the achievement of both of these goals.

Until the mid-nineties, the Barbados Development Bank was the sole source of funding to the micro and small enterprises in Barbados (Griffin and Brathwaite, 2003). Upon its closure in 1995 due to insolvency (Wenner and Chalmers, 2001), collaborations between the private sector and the Barbados government resulted in the establishment of several institutions charged with the responsibility of providing micro and small enterprises with funding. While Christen et al. (2003:6) defines a microfinance institution (MFI) as a ‘formal organization whose primary activity is microfinance’, such institutions provide both non-traditional financing as well as the necessary technical assistance to its clients (Griffin and Brathwaite, 2003). They are presented as follows:

- Barbados Agency for Micro Enterprise Development (Fund Access) aims to enhance the development of micro enterprises via the provision of training, technical assistance and credit in businesses, self-employed and unemployed within the retail, tourism, agricultural, manufacturing and service. Applicants' participation in training programmes is mandatory and accounting services and technical assistance provided within the first 6 months is provided at no additional charge.
- Urban Enterprise Programme of the Urban Development Commission: They assist in the provision of employment opportunities and provide support to existing arrangements within the informal sector. Their aim is to decrease the urban unemployment and underemployment by enhancing sustainable microenterprise development.
- Rural Development Commission: By financing microbusinesses, they promote poverty alleviation, create sustainable development within the agricultural sector and enhance rural agricultural product output.
- Barbados Youth Business Trust is a charitable organization that provides business development loans and training for youth aged 18 to 35 years. They also support the counselling provided by the Youth Entrepreneurship Scheme (Griffin and Brathwaite, 2003).

A comparison of the various characteristics of Barbadian MFIs is outlined in the following Table 1.

Table-1. Comparison of various microfinance organisations in Barbados

ORGANIZATION	PUBLIC SECTOR/ PRIVATE SECTOR/ NGO/ OTHER	SPECIFIC PURPOSE OF THE ORGANIZATION	LOAN RANGES (US$)	REPAYMENT ARRANGEMENT
FundAccess	Private sector (Public sector affiliation)	Entrepreneurship	350 – 10,000, subsequent loans at a ceiling of $25,000	1 – 10 year repayment period; collateral, guarantors required
Urban Development Commission	Public sector	Urban employment	Up to 12,500	collateral required
Rural Development Commission	Public sector	Poverty alleviation	Up to 50,000	3 years, collateral required
Barbados Youth Business Trust	NGO	Youth Entrepreneurship	500 – 15,000	asset and character-based lending

Source: Adopted by the authors

The results show the flexibility of the various MFIs towards provision of adequate finance to micro and small enterprises, given the higher range of funding than the US$ 300 – 700 range of 'true MFIs' observed by Lashley and Lord (2002:13) in other countries. Unlike the Grameen model, collateral is generally required. However, collateral requirements (e.g. equipment) are generally less stringent than those in the commercial banking sector in Barbados.

Lashley and Lord (2002) have also highlighted several other organizations and programmes that serve to support and promote development of the small and microenterprise sector in Barbados. These include:

- Small Business Act: The aim of this act is the provision of a regulatory framework that enables the development of the small business sector. Griffin and Brathwaite (2003) classify small businesses as having fewer than 25 employees, with local ownership exceeding 75% of its shares, less than US$500,000 in paid up (stated) capital and US$1,000,000 in annual sales.
- Barbados Small Business Association specializes in the provision of technical support to its small enterprise members via networking and coordination assistance.
- Barbados Small Business Development Centre of the Barbados Investment Development Corporation facilitates competition and business development via provision of business counselling, dissemination of information and technical assistance.
- Central Bank of Barbados has established a credit guarantee scheme for small and medium enterprises in Barbados, with the purpose of protecting commercial banks and other funding institutions against credit they provide to SMEs.

Finally, the following organizations serve to provide additional support to the Barbados microfinance sector:

- Caribbean Technological Consultancy Services has been established by the Projects Department of the Caribbean Development Bank to provide technical assistance, loans and grants to micro, small and medium businesses, as a means of support to the small scale private sector.
- Enterprise Growth Fund Ltd assists with the provision of technical assistance and venture capital within the range of US$50,000 to US$750,000 via six funds which are venture capital fund, tourism loan fund, small hotels investment fund, agricultural development fund, industrial investment and employment fund and lastly, the innovation fund (Griffin and Brathwaite, 2003).
- Additional support systems: The Youth Entrepreneurship Scheme equips young entrepreneurs with the skills and knowledge necessary for the business world via technical assistance, access to finance and business training. Similarly the Business

Development and Entrepreneurship Division of the Barbados Institute of Management and Productivity, as well as the Department of Management of the University of the West Indies' Cave Hill Campus both provide management training for development of business skills (Lashley, 2006).

Globally, microfinance provision is not limited to NGOs but includes commercial and state-owned development banks as well as financial cooperatives and various licensed and unlicensed non-bank institutions (Christen et al. 2003). While Wenner and Chalmers (2001) observe current domination of the Caribbean microfinance industry by non-governmental organizations (NGOs) and credit unions (CUs), Table 1 shows that the role of government in microfinance provision in Barbados in particular is much more prominent, with the majority of Barbadian MFIs operated by government. Even microfinance providers operating in the civil society and private sector are usually affiliated with government, which may occasionally provide funding for the purpose of underwriting the loan portfolios, as occurs in the case of the Barbados Youth Business Trust (Lashley, 2006). Additionally, the last 5 years have marked renewed commitment by the Barbados government to policy initiatives (Griffin and Brathwaite, 2003) concentrating on the development of the small and medium enterprise sector. The aim of such initiatives is to both to evaluate and establish potential relationships between the small business sector and governmental financial institution, as well as to provide support to existing policy initiatives. Included are potential increases in capital and decreases in interest rates of major MFIs, and in the case of small businesses, loan guarantees, technical assistance and reduced corporation tax, in addition to exemptions from withholding tax on earnings on investment, stamp duty and import duty paid on plant and equipment (Griffin and Brathwaite, 2003). Other initiatives occur in the area of agriculture where the provision of funds for the development and implementation of products in the agricultural sector are prioritized (Griffin and Brathwaite, 2003). Emphasis on agriculture has also been underscored by the high ceiling for loans provided by the Rural Development Commission which far surpasses the ceilings of the remaining 3 MFIs, as shown by Table 1.

Challenges of the microfinance sector within Barbados and the Caribbean

With the benefits of microfinance firmly emphasized and its extensive support framework outlined in the discussions above, several factors further serve to underscore its importance both in the Caribbean and globally. Firstly, given the value of microfinance in improving the major indicators and causes of development (Chowdhury et al., 2004), microfinance has therefore assumed an important role in the achievement of the Millennium Development Goals (Morduch and Haley, 2002; CGAP, 2003 cited in Greeley, 2006). The most recent goals of the Microcredit Summit Campaign are to provide, by 2015, adequate credit to 175 million microenterpreneurs and their families (with a special concentration of women) as well as to raise 100 million families above the US$1 a day poverty threshold (Microcredit Summit Campaign, 2007). With the year 2005 declared the United Nations' 'International Year of Microcredit' (Deheija et al. 2005), microfinance's most esteemed accolade was the award of the 2006 Nobel Peace Prize to Muhammad Yunus and the Grameen Bank for their contribution to social and economic development (The Nobel Peace Prize, 2006).

Secondly, within the Caribbean, Westley (2005) has noted the large untapped potential for the development of the Caribbean sector, given the presence of several factors that naturally enhance its effective provision within the region. Upper limits on interest rates are seldom enforced and operational and client transaction costs are low, owing to small sizes of densely populated Caribbean countries (Westley, 2005). Costs are further reduced by well-established road and telecommunications infrastructure, which also enable better access to clients (Wenner and Chalmers, 2001; Westley, 2005). Such systems are more superior than countries that have achieved success in microfinance provision and are supported by high macroeconomic stability and secure financial markets, both of which greatly encourage expansion of the Caribbean microfinance market (Wenner and Chalmers, 2001).

However, despite these innate advantages, the microfinance industry has been described as immature (Wenner and Chalmers, 2001) and is characterized by poor marketing, weak financial performance, inadequate outreach to SMEs and disparate service expansion among the various countries within the region (Wenner and Chalmers, 2001; Lashley and Lord, 2002; Lashley, 2004; USAID, 2004, Westley, 2005; Navajas and Tejerina, 2006). Several account for the limitations of the Caribbean microfinance sector:

- <u>Small markets</u>: smaller and more concentrated microfinance markets exist within the Eastern Caribbean, compared to Latin America and other such areas that boast of successful microfinance sectors, thus reducing potential for expansion and hindering achievement of economies of scale (von Stauffenberg, 2000; Wenner and Chalmers, 2001; Lashley, 2004; Westley, 2005). This extends to the size of the MFIs where Lashley and Lord (2002) reveals that one MFI in Dominica was five times larger than the combined size of all of the MFIs in Barbados.
- <u>Poor repayment discipline</u>: This stems from an abundance of subsidies as well as a laid-back tolerant attitude of government towards default (von Stauffenberg, 2000; Lashley, 2004; Westley, 2005). This perpetuates the 'handout mentality' that is common throughout several other countries, particularly regarding government loans and has compromised portfolio quality. Westley (2005) also notes that other clients begin themselves to exhibit poor repayment after witnessing the occurrence in others, thus reducing accessibility to funds and hindering expansion of the organization.
- <u>Competition</u>: The Caribbean financial sector is relatively developed, thus providing strong competition to microfinance providers and negatively impacting on its development potential (von Stauffenberg, 2000; Lashley, 2004; USAID, 2004;

Velasco and Marconi, 2004). Poaching, the process which Lashley (2004) describes as pursuit of wealthier MFI clients by commercial banks, should be eliminated as it encourages premature graduation which can compromise potential of a business particularly during times of economic difficulty.

- Insufficient technical cooperation between business and support organizations: A study by Lashley (2002 cited in Lashley, 2004) found that more than 80% of small businesses neglected to engage in networking or utilise support supplied by other organizations. This results in inadequate social capital and ineffective allocation of finances, both of which are important to the success of the microfinance sector (von Stauffenberg, 2000; Lashley and Lord, 2002).
- High social and economic development: This has reduced the demand for microfinance by encouraging more opportunities for informal or self-financing via family members or friends (Wenner and Chalmers, 2001). As suggested by Westley (2005), owing to the macroeconomic stability of Caribbean countries such as Barbados, high interest rates may render borrowers unprepared and resentful. In Barbados, with the highest Human Development Index (UNDP, 2007) among its Caribbean and Latin American neighbours, and adequate social safety nets, this phenomenon may be more pronounced.
- Poverty targeting: Lashley (2004) reveals insufficient insight into, and targeting of the undereducated, young, rural and female, with these groups constituting the specific characteristics of Caribbean poverty. In Barbados, targeting of the rural poor and the young is restricted to the Rural Development Commission and the Barbados Youth Business Trust, respectively and no Barbadian MFIs specifically cater to women.
- Overemphasis on collateral: Insufficient concentration on character assessment and household cash flow as an indicators of willingness and ability to pay has been compounded by fact that fixed collateral is usually limited in SMEs (Wenner and Chalmers, 2001; Wenner et al. 2003), thus diminishing the appeal of microfinance in the Caribbean. This classifies many MFIs as small business (not microfinance) lenders (von Stauffenberg, 2000). While presence of collateral proves to be a major constraint within the traditional banking sector, a study on MFIs by Knight (2007) has highlighted the flexibility of MFIs in accepting assets that are not eligible within the traditional banking sector, as previously mentioned. Although no collateral is offered in some countries, in light of the poor repayment culture, it serves as a just precaution.
- Divergent missions: Lashley (2004) has identified direct poverty alleviation, sustainability (self-sufficiency) and microenterprise development as the three main goals of microfinance in the Caribbean, with the latter involving a degree of poverty prevention. However he notes a distinct lack of clarity with regards to responsibilities and allocation of these goals among key players.
- High subsidization presents a major challenge to sustainability: Heavy reliance on subsidies results when NGO MFIs lack both continuous technical assistance and sufficient time for the production of commercial sustainable microfinance (Wenner

and Chalmers, 2001). Westley (2005) notes increased access to funding from alternative sources such as governments, credit unions and donor programmes as further encouragement on dependency on subsidies. Subsidized interest rates also present one of the largest challenges to Caribbean microfinance as they serve to deter funding from international sources (Wenner and Chalmers, 2001; Ffrench, 2007). Traditional low stable interest rates within the Caribbean financial system have rendered MFIs hesitant to charge higher rates (Wenner and Chalmers, 2001). While favourable to beneficiaries of microfinance, this serves to decrease funding availability (Wenner and Chalmers, 2001).

- Strong government intervention: Caribbean governments which have been described as highly interventionist, especially regarding the setting of interest rates, have distorted the market thus undermining demand for microfinance (von Stauffenberg, 2000; Wenner and Chalmers, 2001; Lashley, 2004).
- High transaction costs: Highly subsidized loans and high default rates have negatively affected the autonomy of MFIs regarding quality of the portfolios and cost of operation, so that interest income fails to adequately cover operating investments (von Stauffenberg, 2000; Westley, 2005).

Further challenges identified by Griffin and Brathwaite (2003) include, increased liberalization due to regional trade agreements, an absence of transparency in business operations and a lack of dedication within the small business sector. Donor withdrawal at critical instances, insufficient physical infrastructure in SMEs, unfriendly policy environments and inadequate access, both to strategic markets as well as to critical resources such as training and credit, have further compromised the development of Caribbean microfinance sector (Wenner and Chalmers, 2001; Lashley and Lord, 2002; Lashley, 2004). As proposed by Lashley (2004), inadequate consideration of context and strategic direction has resulted in several of the challenges presented above. It may also be responsible for the unsound operating models and poor knowledge of microlending methodologies (von Stauffenberg, 2000). Therefore, several of the above factors outlined indicate the importance of consideration of culture.

The group lending phenomenon, for example, has been met with some hesitation within the Barbadian microfinance sector (Knight, 2007), given the individualistic culture of Barbados and its history of distrust and suspicion among Barbadian businesses (Lashley 2002a cited in Lashley, 2003). Boxill (2003) and Punnett et al. (2006) have also noted the negative social psychological impact of colonialism, slavery and plantation economies on the management culture and success of the micro and small enterprise sector within the English speaking Caribbean. This may also have contributed to poor entrepreneurial participation and the absence of technical cooperation among MFIs and support organizations within the country. The microfinance sector in Barbados is therefore doubtful about the success of group lending methodologies. In a case study involving provision of microfinance by a commercial bank in the Caribbean (Knight, 2007), poor group dynamics contributed to default. Incompatibility of loan sizes, age ranges and customer needs with repayment potential of customers and organizational goals also contributed to the demise of the programme. Consequently, as noted by Knight (2007: 81) and confirmed by Lashley (2007) ‘microfinance methodologies cannot be inserted unchanged from one developing environment to the other. Social, cultural and economic adaptations of such programmes are crucial to their survival and effectiveness’.

Recommendations and conclusions

The intention of this article is not to heighten scepticism of microfinance practice in Barbados but rather to bring awareness of its main shortcomings as a means of encouraging further development of the microfinance sector. Microfinance, while undoubtedly faced by several challenges, is of indisputable relevance to the Barbadian context as demonstrated by its high demand. In enabling livelihoods, it directly improves quality of life and promotes poverty reduction. Microfinance clients thus become more empowered and self-sufficient.

The government policy initiatives described above are positive, as they reflect a willingness to achieve real social and economic change within the Barbadian society. Also encouraging is the expressed unanimous interest of the Barbadian microfinance sector in increased collaboration and networking between MFIs and related support organizations, which presents positive implications for microfinance in the country and region. One such benefit is improved technical microfinance knowledge. However several interventions must pave the way for the development of the Barbadian microfinance sector.

Poor repayment attitudes within the Caribbean region must be revisited (Lashley, 2004) and the programmes that encourage default must be revamped (Westley, 2005) so that they mirror the more positive examples provided by Bangladesh and other countries known for successful microfinance practice. Development of MFI infrastructure technology and other operating infrastructure is important to efficient monitoring of microloans and can be supported by provision of incentives (Chowdhury et al. 2004) which, for example, associate earnings of MFI employees with client delinquency rates and loan volumes (Westley, 2005). Additional microfinance products such as leasing, crop insurance and deposits serve to lower transaction costs and improve risk management, as does reduced emphasis on fixed collateral via removal of financial regulatory and supervisory biases (Wenner and Chalmers, 2001;Wenner et al. 2003). Finally, greater advertising and marketing can bring awareness of microfinance to specific target groups and continuous research and development can be supported by ‘institutional inspiration’ (Chowdhury et al., 2004:294) which involves sharing of ideas among MFIs at no additional cost. Given consideration of the recommendations above, microfinance in Barbados and the Caribbean can overcome harsh environments and emerge from the ‘infancy’ (von Stauffenberg, 2000:3) by which it has long been characterized, to achieve a maturity that, with cultural, social and economic adjustment of traditional microfinance, is highly possible.

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