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THE MARKET FOR MICROFINANCE IN BRAZIL: AN INDUSTRY ANALYSIS

A REVIEW OF THE LITERATURE AND EVIDENCE FOUND IN THREE CITIES IN THE STATE OF GOIÁS

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ABBREVIATIONS

BCB	Banco Central do Brasil – Brazilian Central Bank
BNB	Banco do Nordeste (a major government supported bank offering microfinance services)
BNDES	Banco Nacional de Desenvolvimento Econômico e Social – Brazilian National Bank for Economic and Social Development
CEAPE	Centro de Apoio aos Pequeno Empreendimentos – Center for Assistance to Small Enterprises
CEPAL	Comissão Econômica Para a América Latina e o Caribe – Economic Commission for Latin America and the Caribbean (ECLAC)
IBGE	Instituto Brasileiro de Geografia e Estatistica – Brazilian Institute for Geography and Statistics
IBS	Instituto Brasil Solidário
IPEA	Instituto de Pesquisa Econômica Aplicada – Institute for Applied Economic Research
MFI	Microfinance Institution
NGO	Nongovernmental Organization
OSCIP	Organização da Sociedade Civil de Interesse Público – Civil Society Organizations of Public Interest
PRONAF	Programa Nacional de Fortalecimento da Agricultura Familiar – National Program to Strengthen Family Agriculture
SCMs	Sociedades de Crédito ao Microempreendedor – Credit Societies for Micro-Entrepreneurs
SEBRAE	Serviço Brasileiro de Apoio as Micro e Pequenas Empresas – Brazilian Agency for Assistance to Small- and Micro-Enterprises
SEPLAN	Secretaria de Estado do Planejamento e Desenvolvimento – State Secretary for Planning and Development

INTRODUCTION

Despite the many different forms of MFIs active in Brazil, it is commonly acknowledged that the Brazilian microfinance industry is largely underdeveloped as compared to its neighboring countries. Today, microfinance operations are highly concentrated, with only a handful of large players in the field. The purpose of this study is to analyze the different reasons commonly cited in the relevant literature to explain the low penetration rate of MFIs in Brazil. This will be done through a review of the existing arguments and analyses, as well as personal observations and findings from field research conducted in the Summer of 2006.

Among the factors that are commonly cited to explain the low penetration rate of MFIs are:

- the harsh macroeconomic climate before the stabilization of hyperinflation in 1994;
- the inadequate regulatory structure, despite recent efforts;
- a lack of understanding of the demand for microfinancial services;
- a strong tradition of government-subsidized credit programs; and
- the availability of substitutes such as consumer credit.

This study will explain and analyze each of these arguments in more detail, the purpose being to understand their role in hindering the expansion of the microfinance sector, as well as to test them – where possible – against the observations made during the field research.

In a preliminary **first chapter**, the research methodology followed during a field trip last summer will be explained. I will set out the research objectives, as well as define the target groups that were interviewed. The main substance of this study was gathered through secondary research, while findings of the primary research are to test some of the hypotheses formulated through the former.

In a **second part** of this study, a short introduction to the state of Goiás and the three cities visited will provide the reader with a better understanding of the context where research was conducted. It is important to understand the social

and economic conditions of the communities visited in order to analyze the information collected and gain meaningful insights.

In the **third chapter**, the Brazilian context will be examined. MFIs in Brazil operate in a very challenging environment, where a long history of hyperinflation has led the government to implement a policy framework that produces very high interest rates. The accompanying commitment to fiscal discipline has led to a heavy and burdensome tax regime, which not only acts as a deterrent for potential start-up MFIs, but also has implications for the – mostly informal – micro-enterprise sector. In order to understand the target market for traditional microfinance service providers, it is important to understand the micro-enterprise sector, as well as the problem of growing informality.
Finally, the strong presence of the State in the form of social programs not only drains the government's budget, thereby adding to the high interest rates and need for tax income. It also reduces incentives for poor people to engage actively in the economic life, a consequence being that government assistance programs compete with efforts made by NGOs and MFIs to foster productivity and economic inclusion.

The **fourth chapter** contains an overview of the supply of microcredit in Brazil. More specifically, three different categories of microcredit providers – formal, semi-formal, and informal – will be carefully analyzed and assessed- The level of use of each of these sources of small loans will be tested against our findings from field research, in order to assess the competitive environment an incoming MFI would operate in. We will also briefly analyze the "traditional" microfinance landscape in Brazil, providing an overview of the main players in the field and their performance.

The demand for microcredit will be analyzed in a **fifth chapter**, with a special focus on the cultural pecularities concerning credit and savings in Brazil. For example, we will examine the alleged preference of "time over money" for credits, i.e. longer repayment terms over interest costs. We will test this assumption against our own findings from research in Goiás. Further, we will analyze the savings behavior of Brazilian, reviewing the arguments made in literature and studies on the topic, and adding our own insights gained in the communities visited.

Cultural pecularities shape the demand for credit, and it is essential to better understand the nuances of the specific cultural context to be able to develop microfinance products that respond to people's wants and needs.

In a **sixth chapter**, the two most cited challenges to growth of the microfinance industry in Brazil will be scrutinized in more detail; namely argument about the "crowding-out" by government subsidized credit, and the idea that competition from consumer credit lines from retail stores hinder MFIs from entering the market. We will discuss these two arguments closely, providing examples, and test them against our own findings from research.
We will come to the conclusion that, in spite of competition from public sector credit lines and easy access to store credit, the competitive environment allows for MFIs to find their own niche and become viable players in the field of microcredit provision.

Finally, the **last part** of this study will draw final conclusions on the microfinance industry in Brazil, reviewing the main arguments and points made in the previous chapters. We will then make a set of tentative recommendations for both incoming MFIs and policy makers in order to allow this still underdeveloped sector to grow and help to cover the large unsatisfied demand for microfinancial services in Brazil.

CHAPTER I - METHODOLOGICAL ASPECTS

I. Primary Research

Last summer, with a mandate from the Brazilian NGO 'Instituto Brasil Solidário' (IBS)[1], two teams conducted market research to gain greater understanding of households' needs and consumption patterns, attitudes and knowledge with respect to financial services in four different states across Brazil. In two groups of four and two, respectively, we conducted personal interviews based on detailed questionnaires, with the overall objective to explore the demand for microfinance services in the communities visited.

In this part, the research objective will be explained in more detail, indicating the broad categories of information gathered in order to explore the existing demand and needs. Several people and groups were targeted for conducting interviews, and different data was to be obtained from different groups and individuals.

A. Objectives of the Research

Providing clients with *what* they need is essential for the success of an MFI. For example, in Brazil, the traditional microfinance sector is dominated by one product, productive credit for micro-entrepreneurs, as we will see below. However, low-income families who constitute the potential market for a new and existing MFIs are not *only* micro-entrepreneurs and often have financial necessities that go beyond productive credit. Indeed, micro-entrepreneurs do not operate in a vacuum that separates their business from their household. Family and business budgets are almost always intertwined and as such, financial pressures that disrupt the income flow or force the reallocation of resources in one setting will have an effect on the other. Understanding such linkages and, more generally, what people's necessities are and how they are currently being satisfied is therefore critical for the development of useful financial services. Through our research, we tried to identify the needs of people, and the short-comings of the existing financial services offered.

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[1] The IBS, a major Brazilian NGO, mandated the research with the long-term objective to establish a microfinance project as part of its activities. Part of the information to be gained was therefore specifically aimed at identifying both opportunities and risks for a potential start-up microfinance institution in the communities studied. In this paper, the focus will be on the general context MFIs work in, so as to explore the difficulties and opportunities both existing and new MFIs face.

Moreover, providing a service *how* clients want it is an equally important factor to the expansion and development the microfinance sector. This means designing and adapting products and processes according to what is acceptable in the minds of the clients. To meet these preferences, it is necessary to identify what they are, and to understand the social and cultural factors that influence them. Perceptions of financial institutions and culturally defined notions of credit strongly influence what clients use and do not use, what they like or do not like. For instance, in Portuguese, *empréstimos*, or loans, are what MFIs and other cash lenders provide; the word carries negative connotations because borrowers ultimately pay more than the face value of the money they receive. In contrast, *crédito*, or credit, emphasizes the idea of just committing to pay for something – later. In a detailed study of financial services in Brazil, Bonnie Brusky and João Paulo Fortuna write, "While it is widely recognized and understood that buying on payment plans is in the end more costly than taking a loan, when the choice is available it is rarely made in favor of a loan." [2]It is thus essential to understand the cultural sensitivities and peculiarities, and to design new or adapt existing products to respond to people's preferences. Further, understanding the role social relationships play in how people manage their money can provide important insights into guarantee mechanisms and repayment issues. All these questions were addressed in our research.

Based on the above general objectives, more specifically, the following research objectives were defined:

- determine how credit and savings are perceived among low-income populations;
- examine the behaviors, strategies and mechanisms poor people use to manage their financial resources;
- determine the demand for additional sources of microcredit, as well as examine the competitive environment of new or existing MFIs.

In order to gain the relevant information, the following broad categories of data were collected:

- *What are local patterns of consumption and expenditure?* (everyday needs)
- *How are consumption, expenditures, and lifecycle needs paid for?* What are people's income sources (salary, remittances, savings, consumer credit, government assistance, etc.)? What are their major expenditures?

[2] Brusky et al., *op. cit.*, p.29

- *How do poor people manage their savings (if they save)?* Are savings banks, or deposit takers, or savings clubs (such as ROSCAs or ASCAs), or self-help groups? Do the poor have access to them? If not, how do they save, and how convenient do the poor find the available forms of savings?
- *What are the available sources of credit / loans?* Do people have access to banks / credit cooperatives / government sponsored financial services? What types of informal sources (moneylenders, family, friends, etc.) of credit are available?
- *What is the general attitude towards financial institutions?* Do people trust in financial institutions? Are there moral / ethical / societal obstacles or barriers to take up loans?
- *What is the potential for supporting or developing start-up micro-enterprises?* Are there people interested in establishing their own micro-enterprises? What skills / ideas do they have? How refined are their ideas or business plans?
- *How is the local community structured?* How are relations between citizens / gender relations / class relations? Who are the community leaders / respected members of society, and why? How would we assess the existing social capital?

The risks for MFIs can be of a financial nature, such as default and drop-outs, but also imply competition and local politics, such as corruption and "clientelism".

The issues addressed were the following:

- *What is our assessment of the local repayment discipline for loans?* What are the incentives to pay back loans (moral / economic)? What are the reasons for not paying back loans?
- *Who are the local competitors for credit provision?* Who do people turn to for credit? What are their terms and conditions? What are the concerns expressed by people with respect to these credit sources?
- *How is the structure of the political and business environment?* How politicized is society? How important is the influence of nepotism, "clientelism" and corruption on economic and political life?

Two broad categories of people were interviewed: a) potential clients, such as low-income families and individuals, households and micro-entrepreneurs; and b) influential members of society, such as politicians, community leaders or major employers.

For the purpose of the present study, only the data with relevance to the testing of the arguments explaining the low penetration rate of MFIs will be used. However, the broad observations regarding these arguments are based on the overall information and impressions gained through the interviews as based on the full questionnaires, as well as the ensuing conversations on certain specific aspects.

B. Methodology

Through its activities, the IBS has close contacts with civil society representatives in all the communities visited. These contacts were of great value in order to get an introduction to the towns, their peculiarities, history and geography, as well as to be referred to the target neighborhoods and individuals to conduct interviews with. Two strategies were adopted to get the data. (1) Door-to-door, to get random and statistically relevant data about interviewees' financial situations, needs and preferences; and (2) Identification of micro-entrepreneurs with a reputation of trustworthiness and business savvy through the help of our local contact person.[3] Interviews were conducted with representatives of both sexes, and we paid attention to have equal proportions of both male and female interviewees in every town.

In our interviews, we spent considerable time establishing a friendly and trustworthy relationship with the interviewee, so as to get as complete a picture as possible of the person's situation, experiences and ideas. Thereby, we gained a lot of information 'between the lines' of the formal questionnaire.

A profile of the interviewees in terms of age, family structure, social conditions and educational background for all three cities can be found in Table 1 in the Appendix.

[3] The latter were targeted as potential future clients of the IBS' microfinance project.

I. Secondary Research

The main substance of this study was gained through secondary research, namely a review of the existing literature on microfinance and, more generally, financial services in Brazil. While there is an abundance of literature on the topic published before the major innovations in 2002 and 2003,[4] most likely in an attempt to address and publicize the shortcomings of the Brazilian legal system, more recent literature was hard to find. The most comprehensive source found was a World Bank study led by Anjali Kumar, which analyzes the overall access to financial services in Brazil. Furthermore, several studies published by research institutes such as CGAP or IRIS provided useful information. Finally, government studies led by the Brazilian development bank BNDES and the Brazilian Central Bank BCB helped to highlight the potential and shortcomings of the microfinance sector from a domestic perspective. Furthermore, for a more thorough understanding of the industry, its evolution and the different models, several theory books on microfinance proved to be helpful and instructive sources. For statistical and historical information, official Brazilian web-sources and textbooks provided useful data.

[4] In response to the lack of understanding the demand for microfinance, a thorough analysis of the demand for microfinance has been published by the BNDES in 2002, which provided many important insights for the present study: Bonnie Brusky and João Paulo Fortuna, „Understanding the Demand for Microfinance in Brazil: A Qualitative Study of Two Cities“, Rio de Janeiro: BNDES, 2002.

CHAPTER II - SOME FACTS ON THE STATE OF GOIAS

One of the two research teams conducted interviews in the central-western state of Goiás, in the cities Alto Paraíso, Cavalcante and Teresina de Goiás. This chapter shall provide a contextual framework to the data collected, as well as help to assess the primary data's significance in testing the assumptions retrieved from secondary research.

In many ways, Goiás can be considered the "average" state of Brazil. The 5,5 million people state is largely dependent on agriculture and cattle raising and with a rapidly growing industry sector, the state is ranked number ten among the twenty-seven Brazilian states in terms of GDP. With 41.316 million Reais, or 20.080 million US dollars, in 2004, Goiás contributed 2.34 percent to the national GDP. Ranking number twelve, the state's per capita income amounted to 7.501 Reais, or 3.646 US dollars, somewhat below the national average of 9.729 Reais (4.728 US dollars).[5]

I. Statistics and Indicators of the State of Goiás

A. Geography

The state of Goiás is located within the highlands in the central part of Brazil, and borders (from north clockwise) with the states Tocantins, Bahia, Minas Gerais, the Federal District where the capital Brasília is located, Mato Grosso do Sul and Mato Grosso. Goiás, with a 5,5 million population, stretches over an area of 341' 289 km^2 and has 246 municipalities, with the capital being Goiânia with 1,3 million inhabitants.[6] The state's highest point is Pouso Alto, at 1676 meters above sea level, in the Chapada dos Veadeiros, a natural park where the three cities visited lie. The state is covered with a woodland savannah known in Brazil as *Campo Cerrado*, although there are still tropical forests along the rivers. The Cerrado has been seriously diminished in recent years due to cattle raising and soybean farming with great loss of animal life and forest cover.

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[5] Latest figures as of 2004. Source: SEPIN (Superintendência de Estatística, Pesquisa e Informação), Produto Interno Bruto de Goiás, http://www.seplan.go.gov.br/sepin/pub/pib/pib2004/tab03.htm

[6] Latest figures as of 2004. Source: PNAD (Pesquisa Nacional por Amostra de Domicílios), IBGE

The Great Central West Region, consisting of the states of Goiás, Mato Grosso, Mato Grosso do Sul, and the Federal District, is among the fastest-growing regions of Brazil. The population of Goiás state tripled in size in the period from 1950 to 1980 and is still growing very quickly. However, outside the Federal District and the Goiânia metropolitan region, most of Goiás is very thinly populated. The chief concentration of settlement is in the southeast, in the area of Goiânia, across the border from Minas Gerais, and around the Federal District.

There are a number of cities with tourist interest due to their natural endowment, such as Caldas Novas with its hydrothermal springs; Cristalina, one of the largest centers of production and commerce of precious and semi-precious stones and crystals in Brazil; and Alto Paraíso, one of the municipalities visited for our research, which has become known for its ecological and New Age tourism.

B. Social Indicators

Goiás is the most populous state of the Central West, concentrating 43% of the population in the region. In the nineties, demographic growth rates approached 2.4%, in comparison with an average increase of 1.28% of the whole country.[7] This fact is explained by the increase in migration in the direction of the regions near Goiânia and the cities neighboring the Federal District. In 2005, the urban population accounted for 88,24% of the total population in Goiás,[8] a result of the country-wide phenomenon of rural exodus, often spurred by tales and the illusion of an easier and more prosperous life in the cities. This phenomenon has serious implications as urban poverty requires the government to increase social spending in order to prevent and alleviate misery in the cities' *favelas*. It is therefore essential to device strategies to prevent people from migrating to the cities. We believe that the promotion and support of micro-enterprises can provide incentives for people to stay in their towns, and foster local development. This is of particular importance in a state like Goiás, where the urbanization rate is already strikingly high.

At 3.646 US dollars per year, the average per capita income in Goiás is the lowest of the Center West, and less than that of the average Brazilian per capita, as mentioned above. The number of houses with water and sewage and garbage col-

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[7] Source: IBGE, www.ibge.com.br

[8] Valter Estácio Maia, *Desenvolvimento Econômico de Goiás*, 1a edição, Goiânia: Kelps, 2005, p. 51

lection is also below the national average. The great rural properties (more than 10 km^2) represent only 4.9 percent of the agrarian establishments of the state, and control 47.1 percent of the territory. The small properties (up to 1 km^2) correspond to 60.5% of the total number of properties but occupy only 9.2% of the area of the state.

Table 1: Main Social Indicators for Goiás, the Central West Region and Brazil
(Source: SEPIN)

	Goiás	Central West	Brazil
GDP per capita (USD) - 2004	3.646	5.079	4.728
Human Development Index - 2000	0.776	-	0.766
Illiteracy Rate (%) - 2005	10,2	8,9	11,1

The state's Human Development Index, as based on live expectation and levels of education and income, was 0.776 in 2000, which is somewhat above the national average of 0.766 and ranks Goiás number eight among the twenty-seven Brazilian states.[9] The illiteracy rate of people above 15 years of age was 10,2 percent in 2005, which is below the national average of 11.1 percent, but above the average rate of Brazil's Central West of 8.9 percent. 16.41 percent of the rural population in Goiás cannot read or write, while of urban illiteracy lies at a lower 8.15 percent.[10] The higher rate of rural illiteracy is also shown in our field research, which was conducted in rural municipalities. Indeed, overall, 24 percent of the heads of households interviewed in the three towns were reported to be illiterate.

C. Economy

Goiás is a leader in the country in cattle raising; possibly only the states Minas Gerais and Rio Grande do Sul have more cattle. Agriculture and cattle raising represent almost 21 percent of the GDP of the state, with great production of sugarcane, soybeans, corn, tomato, rice, cotton, manioc (yucca), and beans. Minerals are also important with the state being a major producer of nickel, manganese, cobalt, iron, gold, and silver.

[9] Latest figure as of 2000. Source: SEPIN, http://www.seplan.go.gov.br/sepin/pub/serieEB/Port/Rev25/15-tab02.htm

[10] Latest figures as of 2005. Source: SEPIN, http://www.seplan.go.gov.br/sepin/pub/serieEB/Port/Rev25/12-tab06.htm

The strongest growing area in the state has been in industry and commerce. The capital Goiânia and Anápolis have become centers of food-processing industries and pharmaceutical factories. Rio Verde, in the south, is one of the fastest growing small cities with many new industries locating in the area.

Table 2: Percentage-Contribution of Main Sectors to Goiás' GDP, 2000 – 2004
(Source: SEPIN)

Sector	2000	2001	2002	2003	2004
Agriculture and Cattle Raising	17.19	17.54	22.51	21,94	20.74
Manufacture	15.35	15.03	15.95	18.63	18.72
Electricity, Gas and Water	2.67	6.93	5.84	6.48	7.04
Construction	14.12	12.81	10.59	9.79	9.30
Trade	8.17	8.49	7.26	7.34	6.87
Real Estate	7.75	6.90	5.86	5.34	5.24
Public Administration	15.96	14.69	14.65	14.29	15.43
Other	18.79	17.63	17.33	16.20	16.64

II. Statistics and Indicators of Alto Paraíso, Cavalcante and Teresina de Goiás

All three cities are part of the *Chapada dos Veadeiros* region, and are located northwest of the country's capital Brasília. The *Chapada* is estimated to be 1.8 billion years old, the oldest geological heritage in South America. The beautiful *Parque Nacional da Chapada dos Veadeiros* was founded in 1961 by the then-President Juscelino Kubitschek, and, with its mountains, canyons, crystal mines, rivers and waterfalls, has become a major tourist attraction in the 1980s. So far, the National Park can uniquely be accessed through São Jorge, which is part of Alto Paraíso. While this has brought economic benefits to the municipality's tourism sector, it is a major obstacle to the growth of the sector in Cavalcante and Teresina de Goiás. Negotiations for a second access to the Park in Cavalcante have been ongoing for several months.

Given their location inside or bordering the National Park, we believe that the three cities have significant potential for a sophisticated tourism industry. The proximity to the rapidly growing capital Brasília further contributes to the sector's promising expectations. Many of the persons interviewed thus seek to create or expand micro-enterprises linked to tourism.

A. Alto Paraíso

Alto Paraíso was founded in 1953 and stretches over an area of 2.593.885 km^2. It is located 425 kilometers northwest from the capital. There are three commercial banks in town, Banco Itaú, Bradesco and Banco do Brasil, offering credit to those who can present the necessary documents and guarantees. While there is a Banco do Povo offering microcredit at low rates of 1-2 percent monthly, interviewees reported that bureaucratic requirements are numerous. Moneylenders in town offer very costly credit at interest rates ranging between 10-20 percent for those unable or unwilling to apply for loans with formal institutions.

The town's economy is based on farming, cattle raising, tourism and services. On the agricultural side, the town's income stems mainly from soy, yucca and corn production. In the service sector, as well as overall, the municipal government is the biggest employer, with 253 employees as of 2003 (source: IBGE). Located adjacent to the Chapada dos Veadeiros National Park, Alto Paraíso attracts many followers of mysticism, natural therapies, and spiritualism. The exuberant nature has mountains, canyons, waterfalls, crystal mines, and wildflowers. In the town there are more than 40 mystical, philosophical, and religious groups, transforming the town into what locals like to call the "Brazilian Capital of the Third Millennium". According to believers, the fact that latitude 14, which crosses the legendary city of Machu Picchu, in Peru, also crosses Alto Paraíso, has caused appearances of flying saucers and extraterrestrials. The town has a growing infrastructure for tourism, with hotels, inns, and camping.

As regards income, 25 percent of the population earn less than the minimum salary of R$350 ($170), and close to 27 percent of the population earn between 1 and 2 minimum salaries (ca. $170-304 monthly). Over 60 percent gain up to three minimum salaries, while over 14 percent have no registered income whatsoever.[11]

[11] http://www.seplan.go.gov.br/sepin/

B. Cavalcante

Founded with the discovery of gold in 1740 and formally becoming a municipality in 1831, Cavalcante still has traces of the colonial architecture of the gold period. It is located at only 82 kilometers further northwest from Alto Paraíso, and stretches over a large area of 6.953.646 km². In the golden age of mining, Cavalcante was considered to be a great producer of gold and other minerals. These years are no more, and now livestock raising is the strong point of the local economy. The city also gets some tourism, which enters the National Park through Alto Paraíso, however. Tourists come to visit the more than 150 catalogued waterfalls, most of which can only be visited on foot.

In spite of its historic and natural endowment, the town Cavalcante is one of the poorest municipalities in Goiás, and is home to communities of descendants of runaway slaves called Kalungas (see Box 1 below). These runaway slaves lived in isolation, building their own identity and their own culture, with African elements added to European elements, mainly the traditional Catholicism of the rural milieu, and intermingling with the indigenous population. Today the Kalunga (approximately 4.500 people) occupy a territory that takes in part of the municipalities Cavalcante, Monte Alegre and Teresina de Goiás. In these territories there are four population centers: the region of Contenda and Vão de Calunga, Vão de Almas, Vão do Moleque and the former Ribeirão dos Negros, later renamed as Riberão dos Bois. We believe that the presence of these communities bears major potential for growing ethno-tourism. Already, researchers and the media from all over the world have taken interest in this only recently discovered *quilombola*[12] community.

There are a Banco do Brasil offering regular credit, and a Banco do Povo offering microcredit at subsidized interest rates in town. Interviewees also reported that there are moneylenders in town, offering credit at high interest rates of 10-20 percent monthly.

Like Alto Paraíso, the town produces predominantly corn and yucca, as well as sugarcane, and is thus dependent on agriculture. In 2000, of a total population of 2.214, almost 41 percent gained less than the minimum salary, and 22 percent gain between one and two salaries. 67 percent have incomes below three minimum salaries ($510), and a total of 21 percent have no registered income.

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[12] *Quilombolas* is the official name for descendants of Brazilian slaves.

Box 1: The Kalungas

The history of the Kalungas, which has been transmitted only orally, bears many secrets. To understand it, one has to travel to the times when Brazil had no roads and no freedom. "My grandfather was a Kalunga. He was a real Kalunga, one that came from up there, to escape his master", tells Dona Joana Torres, 109 years old, who lives in the community Engenho II, which is part of Cavalcante.

Around 1700, Bartolomeu Bueno and João Leite da Silva started the colonization of the region that today is the state Goiás, and the region got populated by people looking to exploit the goldmines. Native populations were enslaved, killed or managed to escape and tried to find a new habitat. The need for labor was high, and Africans were taken to the province from the ports of Santos, Salvador and Rio de Janeiro. The were forced to 'forget' their origin, their native language, their religion and their identity. Apart from having to work under the burning sun all day long, they were submitted to torture. However, where there was slavery, there was resistance, the most powerful of which being individual or collective escape. That's when the *quilombos* formed, a Bantu expression for a warrior camp in the woods.

That's how the quilombos appeared in the *sertão* of Goiás, which today comprises almost 4.500 *quilombolas* (slave descendents) in the rural towns of Teresina de Goiás, Cavalcante and Monte Alegre. Over time, they adapted to the *sertão* and discovered how they could use the many resources of the area to reconstruct their lives. They called the place *Kalunga*, which in Bantu language means sacred place of protection.

Since the Kalungas settled in the *sertão*, little has changed. From their ancestors, they learned how to survive in this environment, and they mostly live of subsistence agriculture with purely natural production techniques. Cars, for example, cannot be used in the mountain ranges, and there are very few streets to access the Kalunga territory. Within the territory, the only means of transport is the mule or walking. That's how the Kalungas carry their goods and bring the production from their small farms. It is common to see women, men and children of all ages walking kilometers carrying their bags of yucca, rice and fruit found on their way.

Light is still a luxury good within the Kalunga territory, even though today some families have access to electricity. Many Kalungas never saw a lamp, however, and they use candles made of bee wax found in the cerrado.
The Kalunga are a very hard working people with admirable dignity. While they are simple and very modest, they have a big heart, and they fight for their survival and help others. Today, they have gained space to make themselves heard in the local government, and it is important that their history be known, understood and that they be treated with the respect they deserve – which implies that they are given the opportunities to grow through access to education and through integration into the local economy.

Sources: M. Ferreiro Perillo Júnior, "Se Liga no Futuro", Governo do Estado de Goiás, Cavalcante, GO: 2004.

C. Teresina de Goiás

Teresina, located Cavalcante and Alto Paraíso (or 485 km from the capital), is the smallest of the three towns, stretching over an area of 774.635 km^2. Despite its proximity to the National Park and Kalunga communities, Teresina is the least attractive of the cities in terms of tourist potential, and the infrastructure is relatively poor. There is no bank in town, and

interviewees reported that they have to travel to Cavalcante for financial services. Moneylenders have filled this gap offering credit at very costly interest rates of up to 20 percent per month.

The economy is based on subsistence agriculture, cattle raising, services, public administration, and small transformation industries. In 2002, Teresina was ranked 245 out of 246 municipalities in terms of GDP. On the agricultural side, the town produces insignificant amounts of yucca, corn and sugarcane, mostly on small plots owned by subsistence farmers. Out of a total of 625 households, 41 percent earn less than the minimum income, and 20 percent earn between 1 and 2 minimum incomes. Almost 68 percent thus live with less than three minimum incomes, while 18 percent have no registered income.

Table 3: Main Indicators for Alto Paraíso, Cavalcante and Teresina de Goiás, 2006

Data as of 2006	Alto Paraíso	Cavalcante	Teresina de Goiás
Population	7.625	9.885	3.481
GDP (in thousand dollars)	$20.530	$92.838	$3.655
GDP per capita	$1.651	$9.610	$1.140
Literacy (as in 2000)	86,4%	61,75%	74,2%

CHAPTER III - THE BRAZILIAN CONTEXT FOR MICROFINANCE

Microfinance institutions in Brazil operate in a complicated and very challenging environment. Years of hyperinflation have paralyzed the development of the microfinance industry, as uncertainty and monetary volatility deterred MFIs from entering the market. In comparison to many other emerging and developing countries, Brazil's microfinance industry is thus still relatively young. Today, hyperinflation is widely considered overcome, but the conservative monetary policy framework implemented in the mid-1990s is at the root of high interest rates, which act as a deterrent to the provision of credit. The same policy framework, moreover, requires fiscal discipline and has led to strikingly high levels of taxation which, in turn, have contributed to the expansion of the informal sector. Thus, while the micro-enterprise sector constitutes a large part of the Brazilian industry, the States has not been able to reap the fruits of a large part of that sector. Furthermore, informality has many implications, one of them being limited access to formal sources of credit. There is thus a role to play for MFIs, but the macroeconomic environment, strong government assistance and subsidized credit lines, as well as the regulatory environment for microfinance make the Brazilian context a very challenging one.

I. The Inflation-Targeting Policy Framework, Interest Rates and Taxation Policies

The Brazilian economy was confronted with hyperinflation from the mid-1980s to the early 1990s. In response, in 1997, ex-President Fernando Henrique Cardoso's *Real Plan* implemented a stabilization policy, which successfully got rid of high inflation by adopting an exchange rate anchor system. The policy reforms introduced in the 1990s, moreover, helped this disinflation process by liberalizing trade and the capital market, which significantly increased market competition and capital inflows. However, Brazil has paid a price for stability. The stabilization policy based on a slowly crawling dollar peg inevitably caused overvaluations of the real exchange rate, which eventually led to external imbalances and higher dependence on foreign capital. Since 2002, under President Ignácio "Lula" Da Silva, economic growth has averaged just 2.6% a year, which is barely better than the dismal average of the last 15 years. According to the *Economist*, there are at least two culprits. The Brazilian real interest rates are still among the highest in the world, even though

they have been lowered to 8.03% over last few months. Moreover, the government is said to grab an estimated 38% of GDP in the form of taxes and contributions.[13]

The high interest rates and heavy tax burden have important implications for the Brazilian economy, and lie at the heart of two important problems that microfinance looks to alleviate: high cost of – and consequently limited access to – credit; and a heavy informal sector, further reducing the potential client base of formal banks. Moreover, the high tax environment is not very conducive to the growth of MFIs, which – when established as SCMs[14], as will be explained below – will face heavy tax requirements.

These factors combined are not only important obstacles to Brazil's growth, but contribute to both inequality and poverty. President Lula has adopted several programs with a view to fulfill his electoral promises and alleviate poverty.[15] However, critics express doubts about the fiscal sustainability of the policy measures adopted. Most controversial is probably Lula's introduction of a real 25% rise in the official minimum wage, which also affects publicly financed pensions. This rise in the minimum wage is symptomatic of an overall increase in government spending, one of the main reasons why debt, taxes and interest rates are so high. This link was emphasized recently by the IMF's Managing Director, Rodrigo de Rato. He stressed that disciplined fiscal policy would "provide maximum room for the central bank to continue on its path of bringing down interest rates further and in a sustained way".[16] This, in turn, would contribute to a reduction in the cost of credit, and thus improve accessibility to financing for micro-entrepreneurs.

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[13] With respect to Brazil's crushing tax burden, Lula stresses that the government has not raised a single tax rate yet, but that revenue is up because profits are higher and tax collection is better („Lula's leap", *Economist*, March 2nd 2006). Note, moreover, that in its recent *Inflation Report* of September 2005, the BCB introduced a new tax revenue ceiling: estimated federal tax revenues, net of refunds and tax incentives, may not surpass 16% of GDP in 2006.

[14] Credit Societies for Micro-Entrepreneurs, a legal category of MFIs that will be explained in more detail below.

[15] Upon taking office, Lula unveiled an anti-poverty program called *Fome Zero* (zero hunger), which was however, clearly unworkable, and soon replaced with *Bolsa Familia* (family fund). This consolidated five pre-Lula programs that transferred cash to poor families, raised the benefit and expanded the number of beneficiaries so far to 8.7 million families, roughly a fifth of Brazil's population.

[16] *Brazil Resurgent*, Remarks by Rodrigo de Rato, Brasilia, Brazil, January 10, 2006.

II. The Micro-Enterprise Sector

The micro-enterprise sector[17] has a very important role in Brazil's economy given the relatively high rate of unemployment. SMEs constitute an professional alternative for those members of the low-income society that have the conditions to develop their own little business, and an alternative to formal or informal employment for the unskilled workers. In the 1980s, when the slow-down of economic growth spurred unemployment, SMEs were able to absorb a large part of the excess work force. As a consequence, by the end of the decade, concrete initiatives were taken to provide incentives for the establishment of micro-enterprises. Among these measures, the government set up special credit lines for small businesses through the Brazilian National Bank for Economic and Social Development BNDES, the Caixa Econômica Federal and the Banco do Brasil. These programs are still in place today and are an important source of credit for micro-entrepreneurs.

It is estimated that in 2001, Brazil's economy counted about two million commercial and services SMEs, employing close to 7,3 million people, or 9.7% of the country's labor force.[18] Among these, there are 1.5 million micro-enterprises (with up to five employees), occupying almost 3 million people, or 4% of the total work force. Studies show that over the last few years, the trend has been for this percentage to rise.[19] Brazil's micro-enterprise sector – which constitutes the potential client base of MFIs – is thus substantial, and it is important to understand its opportunities and limitations.

Generally, an IBGE study found that micro-enterprises have a number of characteristics that differentiate them from larger businesses:[20]

- low capital intensity;
- prevalence of owners, partners and family members as work force in the business;
- centralized decision-making;
- overlap of owners and their businesses (physical and legal person);

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[17] Micro-enterprises, for the purpose of the study, are defined as small businesses with annual revenues up to R$244'000 ($117'000), in line with Law No. 9.841 of 05/10/1999, and up to five employees (as used in IBGE studies).

[18] Alone in the state of Goiás, there are 55'677 SMEs, employing close to 200'000 people.

[19] IBGE, *As Micro e Pequenas Empresas Comerciais e de Serviços no Brasil*, Rio de Janeiro: 2003, p. 21

[20] *ibid.*, p. 18

- use of low-skilled or unskilled labor;
- low investment rate in technological innovation; and
- limited access to credit.

In addition, the BNDES study found that the rates of start-up and failure are higher for SMEs; indeed, the study shows that the rates are higher for the smallest businesses.[21] It is argued that the reasons for this phenomenon are restricted access to credit and limited human capital. While the barriers to entry are very low, the limitations with respect to human and financial capital seem to be the major reasons for failure. This finding is of special importance as it is an MFI's *raison d'être* to address these shortcomings.

III. The Problem of Informality and Limited Access to Credit

While informality is a serious problem in many developing countries, it is a particular problem in Brazil. According to an authoritative measure developed by Professor Friedrich Schneider from the University of Linz, informal activity accounted for 42 percent of Brazil's output in 2002-03, compared with 16 percent of China's, 26 percent of India's, and 33 percent of Mexico's.[22]

One reason for the high incidence of informality is Brazil's high level of taxation, which prevents wide sectors of the active population from registering their businesses. Indeed, about half of the Brazilian population works in the informal sector [23], and resulting tax evasion is a big drain on the public budget. The high tax rates are the result of an urgent need to increase revenues, but are ill conceived and have a very poor structure. For example, for businesses, not profits are taxed, but taxes are levied on turnover. This implies that a start-up business will be taxed even before it makes profit, which reduces productivity and acts as a barrier to entry for new formal businesses. Numbers confirm this: Brazil is

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[21] In 2000, the start-up rate for commercial micro-enterprises occupying up to five people is estimated at 22.7 percent, and the failure rate is 15.8 percent. In comparison, the same rates are 6.6 percent and 6.2 percent respectively for businesses with twenty or more employees. (IBGE, *As Micro e Pequenas Empresas Comerciais e de Serviços no Brasil*, Rio de Janeiro: 2003, p. 19)

[22] Friedrich Schneider, „Shadow Economies of 145 Countries All over the World: What Do We Really Know?", Crema Research Working Paper 2005-13, Center for Research in Economics, Management and the Arts, Basel (Switzerland): 2005.

[23] Paulo Vieira da Cunha from the Banco Central do Brasil, *Conversa* at the Center for International and Government Studies at Harvard, February 15, 2007.

ranked number 121 of 175 in the order of countries' business-friendliness. On average, it takes 152 days to start a new business, as compared to 35 days in India and China. Non-wage labor costs in Brazil are as high as 37.3 percent of the salary, as compared to a regional average of 12.5 percent, which further discourages formal employment. And even more strikingly, the average time spent preparing, filing and paying taxes is 2,600 hours, as compared to only 203 in OECD countries, which is an indicator of the complexity of the country's tax system.[24] As BCB's Paulo Vieira da Cunha put it, "the Brazilian tax system has its tentacles everywhere". It is thus not surprising that the informal sector booms, one of the consequences being that over half of the Brazilian population has limited access to financial services.

Note, moreover, that increasing taxes have not been accompanied by improvements in the provision of services. On the contrary, Brazil's dismal standard of public education is worrisome, and those who can afford it opt for private schools and universities. This adds to the spiral of poverty, as poor people must send their kids to low-quality public schools, diminishing the chances of improving their situations.

The implications of informality are manifold; being outside the regulatory and tax umbrella means that informal enterprises can afford to be less productive than their competitors in the formal sector. But it also means that they are locked out of markets for finance, technology, and other resources that would enable them to close the gap.[25] An estimated 15.7 million people work in the informal economy as micro-entrepreneurs, outnumbering formal sector entrepreneurs by more than three to one. Of these informal micro-entrepreneurs, 93 percent run profitable businesses, but 84 percent did not have access to credit in 2003.[26] This is due to the high interest rates resulting from the inflation-targeting objective described above, but also reveals that the penetration of MFIs is weak compared to the size of the potential market. Indeed, Mugica and Moura (2003) estimate that 50 percent of these informal micro-entrepreneurs would effectively demand a micro-credit loan, representing a potential of R$ 11 billion per year in loans, or US$ 3.7 billion.

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[24] http://www.doingbusiness.org/ExploreEconomies/Default.aspx?economyid=28 . Data as accessed on Monday 19, 2007.

[25] Thomas Kenyon and Emerson Kapaz, „The Informality Trap: Tax Evasion, Finance, and Productivity in Brazil", Note Number 301, Public Policy for the Private Sector, The World Bank, Washington D.C.: December 2005, p. 2.

[26] Yerina Mugica and Frederico Moura, „ABN AMRO's Real Microcrédito: A Multinational Bank's Entry into the Micro-Credit Market", UNC Kenan Flagler Business School, 2003

IV. Strong Presence of the State Through Social Assistance Programs

One of the reasons for Brazil's relatively slow growth as compared to the other three BRIC countries – Russia, India and China – is the country's heavy public sector, which keeps interest rates high and has grown more voracious under President Lula. While suppressing inflation and containing the deficit, Lula has transferred more cash to households, partly through the Family Fund (*Bolsa Família)*, which helps the poor, but also through the increase in minimum wages, which raises publicly financed pensions. Brazil has implemented a wide range of government assistance programs that target the poor. While some of them are unconditional (e.g. *Bolsa Família*, *Cesta Básica*) others are linked to an incentive structure, such as *Bolsa Escola*, which is only disbursed if a family's kids regularly attend school. These programs have come to help the poorest segments of the Brazilian society, but they also represent a heavy drain on the government budget, further nurturing the need for a high level of taxation.

For MFIs, it is important to understand the extent and implications of government assistance programs in Brazil. Indeed, during our research, we found that in some areas, mostly among the poorest sectors of society, government assistance has led to complacency and reduced incentives for self-help strategies. Many critics of Lula's social policies question the sustainability of the assistance programs, and dependency on government subsidies can have disastrous implications in case of a policy change. It is therefore essential for MFIs – as well as other social programs and NGOs – to provide incentives for poor people to graduate themselves out of government assistance programs.

On a more positive note, however, it must be recognized that while it is a drain on the state's budget, the mix of subsidy and stability has improved the situation of the poor. The poverty rate, as measured by the Getulio Vargas Foundation, a renowned business school, fell from 28 percent of the population in 2003 to 23 percent in 2006. However, those that benefited least of this process are found in the middle class; although the total real income of Brazil's poorest households rose 28 percent between 2004 and 2005, that of the middle class increased just 1.6 percent.[27]

[27] „Love Lula if you're poor, worry if you're not", *The Economist*, Sept./Oct. 2006, p.30.

V. The Regulatory Environment for Microfinance

Notwithstanding the considerable advances in recent years, Brazil's regulatory and legislative framework continues to present a significant challenge to MFIs in Brazil in different ways: the substantial prudential controls, the frequent changes, its complexity on tax and labor issues, and its restrictions on the types of products that MFIs can offer are just a few examples of a long list of legal impediments for the creation and development of MFIs in Brazil. [28]

In contrast to their international counterparts, Brazilian MFIs are legally prohibited from offering savings and insurance. This policy does not only reinforce the focus on microcredit and passed up a chance to develop and enhance a savings culture among low-income households in Brazil, it also impedes MFIs to expand their liquidity through the mobilization of deposits. Deposits are a funding source that has numerous advantages such as low financial costs, wide availability, and relative stability. Moreover, such prohibition discriminates between MFIs and formal banks offering microcredit to the same target group, and leads to unfair competition in favor of the latter.

There have been and still are numerous other regulatory obstacles that have hindered the expansion of the microfinance industry in Brazil. For example, the Consumer Protection Code defines soliciting payment before the loan is five days past due as "harassment", which could hamper the collection of credits. Also, as in many other countries, seizing client assets involves a lengthy and costly legal process. In Brazil, lending institutions (of any type) are prohibited from repossessing collateral; only representatives of the court system are authorized to do so. Another example is the Usury law, which for many years prohibited non-regulated organizations (such as NGOs) from charging interest rates above 1 percent per month. Though not strictly enforced, this law created uncertainty for many NGOs.[29] More generally, prior to 1999, microcredit in Brazil could be extended only by NGOs, constrained in their funding to donations, and limited technically in lending practices to unrealistic ceilings on interest rates under Brazil's Usury Law.

There have been considerable advances in Brazil's regulatory environment for microfinance in recent years. A set of important legal changes was adopted in 1999, when a new law allowed microcredit NGOs to act as Civil Society Organiza-

[28] For more details, see PDI/BNDES, Haus et al., *Regulamentação das Microfinanças*, 2002.

[29] Nichter, et al., *op. cit.,* 2002, p. 36.

tions of Public Interest (*Organização da Sociedade Civil de Interesse Público*, OSCIP), legal non-profit entities.[30] Moreover, in 2000 a regulatory framework for specialized microfinance institutions was enacted.[31] These institutions, the Micro-Enterprise Credit Societies, are known by their Brazilian acronym as SCMs (*Sociedades de Credito ao Micro-empreendedor)*. These are for-profit financial institutions that are only allowed to offer micro-credit – loans up to R$10,000 – and are not permitted to mobilize savings or offer insurance. Also, a law was enacted to exclude some institutions, such as OSCIPs, from the Usury law. [32]

In 2003, new measures were introduced to expand funding flexibility of MFIs.[33] Under these regulations, banks are obliged to invest minimum 2 percent of their sight deposits into microcredit operations.[34] However, these funding sources are subject to conditions that include constraints on loan size and interest rate caps of 2 percent monthly.[35] Note that a number of authors are voicing their concerns about the effectiveness of the state-led initiatives to promote microfinance. Anjali Kumar from the World Bank argues that directed bank lending has a negative effect on the spontaneous growth of the sector, as it puts an implicit tax on the financial sector. Moreover, he points out that interest rate ceilings on micro-lending squeeze profit margins and discourage private microcredit.[36] The real costs of these recent programs thus needs to be carefully monitored.

The current legal framework, there are two categories with different regulations: non-profit and for-profit organizations.[37]

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[30] Law No. 9.790/1999, later complemented by Provisory Measures 1.914 and 1.894.

[31] Resolution 2.627/1999, later substituted by Resolution 2.874, which – among other changes – allows for microcredit OSCIPs to control SCMs. The objective of this amendment was to create conditions in which the controlling OSCIP would be able to continue working in the poorest sectors of society, whereas the controlled SCM could seek micro-credit market niches with higher profitability, thereby "democratizing" the revenues of the organization.

[32] For a summary of the key characteristics of SCMs and OSCIPs, see Table 2 in the Appendix.

[33] Resolutions 3.156/2003 and 3.110/2003

[34] Provisory Measure 122/2003

[35] Anjali Kumar, *op. cit.*, 2005, pp. 85 and 117. Also, for more details, see BCB, *Democratização do Crédito no Brasil: Atuação do Banco Central*, 2004, pp. 46-49.

[36] Anjali Kumar, *op. cit.*, 2005, p. xxxix

[37] BCB, *Democratização do Crédito no Brasil: Atuação do Banco Central*, 2004, p. 35

Non-Profit	*For-Profit*
NGOs (legal persons under private law): Subject to interest rate restrictions (max. 12% p.a.).	**SCMs** (authorized by BCB): Can be administered by physical or legal persons, including private financial institutions and OSCIPs : no interest rate restrictions.
Municipal Funds (People's Banks): Also subject to interest rate restrictions (max. 12% p.a.) .	**Organizations** offering micro-credit that are **intermediated by public financial institutions**: no interest rate restrictions.
OSCIPs: No interest rate restrictions.	

The specialized microfinance companies (SCMs) grew in number to about 40 in four years, and then leveled off. Their total portfolio has continued to grow substantially, between 30 and 50 percent annually, but their overall average size remains tiny at just over $300,000 each. There is substantial concentration in the sector, with 45 percent of clients being served by the top three institutions, and 76 percent belonging to the top ten SCMs. In general, these organizations are very profitable, charge high interest rates, have high loan delinquency and high write-offs.[38] In this, they look more like consumer finance companies than the typical best practice MFIs, even though they are prohibited from making consumer loans by law.

Recently, other entities have started to support the provision of financial services for micro-entrepreneurs, such as the Brazilian Agency for Assistance to Small- and Micro-Enterprises (SEBRAE), which offers capacity building and other services to SMEs.

More generally, MFI expansion has been significantly motivated by public sector support. There is substantial presence of the public banks BNB and BNDES, which offer microcredit at subsidized rates. Microfinance institutions also rely substantially on relatively low-cost government lines of credit extended at below comparable market rates.

Though not strictly a regulatory matter, the Lula government initially tried to further lower interest rates prevalent in the microfinance industry by putting in place a cap on on-lending rates by MFIs on those funds sources at the state-owned development bank BNDES. Given the high level of participation of the BNDES in the financing of most SCMs and OSCIPs, this restriction effectively reduced income levels of MFIs across Brazil and became the case of a major lobbying

[38] Patrick Meagher, et al., "Microfinance Regulation in Seven Countries: A Comparative Study", IRIS Center, University of Maryland: 2006, p. 16

effort by the sector to have this policy reversed. Eventually, after two years, the cap was raised to 4 percent monthly for loan amounts above between R$1,000 ($472) and R$10,000 ($4,722). Loans below R$1,000 still carry a 2 percent monthly interest cap. This eased the situation for many MFIs. [39]

Conversion from NGOs to new institutional forms with no interest rate restrictions, such as SCMs, although increasing access to wholesale funding, is rendered less attractive by the implications of new regulatory requirements for the provision of both non-prudential information and information on prudential ratios. There are also tax implications that would subject SCMs to the full range of financial sector taxation. Plus, Brazil's MFIs are subject to regulatory and reporting requirements that may be more rigorous when compared to other models, in view of their non-deposit-taking scope of activities.[40] All of this acts as a deterrent to the establishment of new MFIs, and any potential start-up institution must be fully aware of the legal implications and restrictions placed on its activities.

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[39] Patrick Meagher, et al., *op. cit.*, pp. 40-43

[40] Anjali Kumar, *op. cit.*, 2005, p. xxxviii

CHAPTER IV - SUPPLY OF FINANCIAL SERVICES

In this section, the discussion of Brazil's financial sector provides a broader context for the microfinance industry. It is crucial to understand the existing array of financial services supplied when trying to analyze the potential for growth of the microfinance sector. In particular, for the case of Brazil, it is noteworthy that, unlike many countries where microfinance has achieved high rates of penetration, Brazil has a sophisticated financial sector that is highly developed technologically and that offers a wide range of services. However, it still largely fails to reach the poorest sectors of the Brazilian population, and the microfinance industry is relatively underdeveloped, with the industry being highly concentrated with only a handful of large players in the field. Indeed, until 1997, the development of microfinance services in Brazil lagged substantially behind other Latin American countries. This was due in part to

- the long period of high inflation which prevailed before the Real Plan pegged the currency to the dollar;
- restrictions on the ability of NGOs to serve as financial intermediaries and mobilize external financing; and
- a strict usury law limiting interest rates charged by NGOs to unsustainably low levels.

One of the events that prompted the expansion of the microfinance sector was a large political debate on the potential role that microcredit could play in Brazil. The meeting that was organized by Comunidade Solidária, a public body created in 1995 to strengthen civil society initiatives in Brazil. The participants concluded that microcredit could play a strategic role in terms of employment and income distribution, but that its expansion required a different approach from that typically associated with credit operations. In this context and with the help of Acción International, Banco do Nordeste, a commercial bank active in the Northeast of Brazil, conceived the CrediAmigo program, currently the most successful MFI with the largest outreach. Aside from Banco do Nordeste's initiative, few public or private banks in Brazil have been active in microfinance. Next to CrediAmigo, the market relies primarily on specialized microfinance institutions, most of which are very limited in size.

The first part of this section will be attributed to a description of the traditional banking sector and the alternative resources for credit in Brazil, microcredit being one of them. These sources must be understood when analyzing and assessing the competitive environment MFIs are operating in. Indeed, the abundance and sophistication of alternatives to

credit from microfinance institutions are commonly cited as one of the major obstacles to the growth of the industry. Special attention is therefore given to the different sources of credit. The frequency of use of each of them will be tested against our findings from the primary research. In addition, Table 3 in the Appendix provides a detailed listing of formal, semi-formal and informal sources of credit, indicating the respective conditions and requirements for access to loans, the categories financial services, as well as the level of their use.

The second part of this section will take a closer look at the traditional microfinance landscape. Given the huge potential market for microfinance services, the high interest rates paid to informal lenders, and the lack of penetration by the formal financial sector, it is not surprising that there are several microfinance programs operating in Brazil. The market for microfinance services is, moreover, evolving very rapidly in Brazil with new programs emerging almost monthly[41], but the penetration ratio is still relatively low and allows for a substantial expansion of the microfinance industry across the country.

I. Banking Credit and Other Formal Sources of Credit

A study conducted by the BNDES in 2002, analyzing the demand for microfinance, found that in Brazil, people have two modalities of credit, notably lump sum and installment credit, being provided by formal, semi-formal and informal sources.[42] Lump-sum credit refers to credit that is disbursed in the form of cash upfront, while installment credit takes the form of an object being purchased. Both forms are repaid over time according to a pre-established repayment calendar.

Formal lump-sum credit includes bank loans or lines of credit, cash advances from credit cards, consumer-lending agencies, or loans from MFIs. Formal installment credit, in turn, can be in the form of credit cards, overdraft facilities or post-dated checks.

The BNDES study found apart from bank lines of credit, loans from consumer lenders, credit cards, as well as store credits and postdated checks were the most prevalent formal sources of loans.

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[41] World Bank, Steven S. Schonberger, *Microfinance Prospects in Brazil*, Sustainable Development Working Paper No.12, Washington, D.C.: 2001, p. 15

[42] Bonnie Brusky and João Paulo Fortuna, *op. cit.*, 2002, p.15

A. Banks and Credit

The banking sector in Brazil is by far the largest and most developed in Latin America. Moreover, unlike in other countries of the region, domestic banks have dominated in Brazil: foreign banks have just one-quarter of the Brazilian market, whereas in Mexico just three foreign banks command about two-thirds of the overall banking market. In addition to their profitability and market dominance, local banks are relatively advanced in terms of product offerings; for example, they are market leaders for insurance and investment management products.[43] However, as pointed out by Planet Finance, the banking infrastructure does not cover all regions equally, and the location of banks depends on the intensity of economic activity and population density. Thus, some regions such as the Northeast are relatively less served by the banking sector.

It is important to note that although the banking sector in Brazil is advanced, the commercial credit market remains less developed. Years of hyperinflation shifted attention away from credit activities, as banks and other financial players could earn considerable profits on a variety of inflation-related activities. The importance of credit to banks increased after the Real Plan in 1994 reduced inflation rates, and credit operations continue to grow rapidly.

The banking sector is increasingly viewing lower-income markets as a growth opportunity, and several leading banks have explicitly established moving down-market as a core business strategy. In an attempt to attract additional individuals to the banking sector, banks are leveraging alternative channels to open new points of service. Examples of such channels include post offices (used by Bradesco), supermarkets (used by Banco do Brasil), and lottery offices (used by Caixa Econômica Federal). However, while private commercial banks in Brazil already play a significant role in the provisions of financial services to the poor, there is a high degree of segmentation in the types of banking services private banks wish to provide. Transaction-based needs and needs for safe stores of value are met, but needs for returns and investments are served less often.[44] The impact of these services on the situation of the poor must be carefully moni-

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[43] Customers of Unibanco – one of the largest private banks in the country – on average purchase six bank products, approximately double the amount of the strongest banks in continental Europe. (BNDES, Simeon Nichter, Lara Goldmark and Anita Fiori, *Understanding Microfinance in the Brazilian Context*, Rio de Janeiro: 2002, p. 12)

[44] Anjali Kumar, *Access to Financial Services in Brazil*, a World Bank Report, 2005, p. xliii

tored. Over-indebtedness can have very dangerous implications, and the absence of a clear social mission could make commercial banks a somewhat dangerous actor on the scene.

As will be discussed below, new measures have been introduced in 2003 that require banks to expand micro-lending from their sight deposit resources, up to an obligatory ceiling of two percent – alternatively these funds go to raised reserve requirements. While this measure is intended to promote the provision of financial services to the poor, critics argue that it is an implicit tax on the financial system and discourages spontaneous growth of the microfinance sector.
Moreover, in our research in Goiás, we found that people perceive bank credit to be very difficult to access. When asked where they would go to get a loan, most respondents pointed to local banks; meanwhile, however, many mentioned that they perceived the probabilities of obtaining credit to be low, due to documentation and collateral requirements.

One interesting point to consider is that most MFIs in Brazil use traditional banks as the channel for disbursing loans and accepting payments. This practice is in part reflective of the omnipresence of banks in the Brazilian economy – unlike in many other countries, individuals do not need to have bank accounts to make payments to other parties using banks offices of automatic tellers.[45]

In sum, the banking sector, while well developed, still excludes a majority of the population. A Planet Finance study estimates that in 2001, 70 percent of the total population were excluded form the traditional banking system; 98 percent of micro-entrepreneurs were estimated to have no access to credit.[46] Although accessibility of bank credit has increased over the past few years, a large proportion of the population is still excluded from access to formal credit. They are thus dependent on other sources of financial services.

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[45] Nichter, et al., *op. cit.,* 2002, p. 13

[46] PlanetFinance, *Synthèse Pays: Brésil*, 2001, www.planetfinance.com.br

B. Other Formal Credit Providers

In addition to a highly developed banking sector, there are numerous other sources of credit – some of which are accessible to micro-entrepreneurs. Some products target the poor; for example, many *financeiras*[47] offering consumer credit impose loan limits that are below the average loan sizes of many MFIs in the South and Southeast regions of Brazil.

➢ **Consumer credit offered by *Financeiras*** is a costly alternative to microcredit. These are personal loans that often carry ten percent monthly interest rates or more and have terms between one and twelve months.[48] Despite advantages such as rapid disbursement and unrestricted use of funds, surveys show that people primarily use *financeiras* in case of emergencies due to their high cost.[49] Indeed, consumer-lending agencies have a very bad reputation, and are considered 'legalized *agiotas*' – or moneylenders –, because of the high interest rates, the paperwork necessary, the aggressive collection techniques and the unwillingness to negotiate repayment.

None of the respondents in our research mentioned *financeiras* as a possible source of credit, which confirms the unpopularity of these institutions.

➢ **Credit Cards** issued by banks, retailers or consumer-lending agencies are widely used in Brazil. Those who do not have a card because of insufficient income or a marred credit record generally have no problem using the card of a friend or relative. Credit card companies are increasingly targeting lower income customers, who are expected to drive future growth. Several MFI s have reportedly experienced direct competition from credit cards.[50] Credit cards are practical, easy to use, and with no bureaucracy once the initial contract is out of the way. Moreover, credit cards offer automatic renegotiation of debt. However, they are not available to all micro-entrepreneurs, as they typically require proof of

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[47] *Financeiras* are regulated financial institutions that typically offer products with fewer guarantees but at higher costs than banks. Several major *financeiras* are owned by traditional banks.

[48] Gallagher, et al., *op. cit.,* 2002, p. 67

[49] Brusky, et al., *op. cit.,* 2002, p. 92

[50] Nichter, et al., *op. cit.,* 2002, p. 14

minimum income, a clean credit record and several forms of identification. Indeed, in our interviews, only one respondent indicated that he is in possession of a credit card and has actually used it as a means of payment.

➢ **Store credit and checks** are major substitutes to microfinance in Brazil. Buying products in store using installment credit is a universal practice in Brazil across consumers of all income levels. Moreover, stores often extend credit through the widespread acceptance of post-dated checks. Store credit is often given through payment plans. These are proposed by large retailers, and are a commonly used form of credit, as Brusky and Fortuna found. While these plans are mostly used to purchase furniture, appliances, clothes and shoes, payment plans are available for almost anything. Users appreciate them because they involve little bureaucracy and they offer the possibility to make payments over a relatively long period in small installments. These plans enable low-income populations to access consumer goods that otherwise would be very difficult to acquire.[51]

For those who have a bank account, post-dated checks are widely used in order to 'buy time' to pay off purchases. Post-dated checks are practical; they offer immediate credit with few requirements. Usually, these checks are used once a certain level of trust has been established between the client – who has previously purchased with cash – and the shop owner. Although there is no surcharge of interest on post-dated checks, consumers can receive a 7-10% discount if purchases are made up-front; interest rates are thus camouflaged in the final price.[52]

Note that store credits refer mostly to non-productive consumption loans, whereas as most MFIs' lending policy is restricted to productive uses of credit. This will be discussed in more detail in a later Chapter.

➢ **Microcredit**, as offered by traditional microfinance market, will be discussed in more detail below.

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[51] See Box 2 below.

[52] Brusky, et al., *op. cit.*, 2002, p. 20

II. Semi-Formal and Informal Sources of Credit

Other substitutes are more informal but also commonly used. This part provides a short overview of the major alternatives to credit offered by formal credit providers, but the list hereafter is not intended to be exhaustive.

A. Semi-Formal Credit Supply

In the semi-formal credit sector, the most used services are salary advances, loans from *agiotas*, loans from workplace *caixinhas* and payment plans from small retailers.

➢ **Salary advances from employers** are common for salaried workers (both formal and informal). It is also common to take loans for larger amounts, paid over a longer period via monthly deduction to the salary. There is usually no interest on such loans, but they are generally conceded only for very specific needs, such as emergencies, to pay off a specific debt, to make home improvements or to purchase some needed consumer good.[53] Normally, a conversation between the borrower and director or employer of the company is necessary to approve the advance. There are no requirements or guarantees, since repayment is made through salary discounts.

In our interviews, salary advances were not mentioned as a source of credit; however, this does not mean that those respondents who are employed are deprived of that source of credit. Rather, we assume that salary advances are not considered to be 'credit' in the actual sense of the term, but rather a claim against a future income stream, and were thus not among the sources of credit indicated.

➢ ***Agiotas* (moneylenders)** represent a source of credit available across most income levels and usually has few formal requirements, depending on to what extent the *agiota* relies on money-lending activities to support his livelihood, the amount of the loan and how well he knows the borrower. Though little appreciated, they are said to be relatively widely used and present in most communities. However, the high expense of *agiotas* typically makes them a source of last

[53] Brusky, et al., *op. cit.,* 2002, p. 22

resort.[54] In case of non-payment, it is not uncommon for the *agiota* to seize some household good or even take control of the borrower's bank card, if s/he has one; violence and threats are common recovery tactics.

In our research, we came across one single person that admitted to have borrowed money with an *agiota* in the past. While this is a surprisingly low number, we believe that moneylenders are associated with immorality; this could be read in the reaction of respondents when asked whether they had ever made business with an *agiota*. It can therefore be assumed that our finding is only suggestive and not necessarily a representative measure of the actual use of moneylenders.

➢ ***Caixinhas* or *sorteios***, accumulating savings and credit organizations (ROSCAs), are almost exclusively found in formal workplaces, as the study of the BNDES shows. There are both informal versions, where employees organize and manage the loan funds, and formal versions, where the employer offers employees the option to have a fixed amount of the employees' paycheck deposited into the fund on a monthly basis, and employees can then take low-interest loans from the *caixinhas*. In both cases, the principle and any profits are re-distributed to the members at the end of the year, in proportion to the contributions made by each one.

Although they are relatively common and very much appreciated by their users, we did not come across any such organization in either of the three town visited in Goiás.

➢ **Payment plans from small retailers** are very popular. Small neighborhood stores often offer such plans, just like larger retailers. Generally, few requirements are necessary to purchase a good on a payment plan in small retailers. While many of the small retailers charge interest, the rates are low and generally imperceptible to the buyers. Very low-income populations appreciate this service because of its accessibility, facility and rapidity, although the client must be a regular customer before he or she can use it.

[54] In 2002, their fees ranged from 6% per month for loans with guarantees to 45% per month for unsecured loans. (Gallagher, et al., *op. cit.*, 2002, p. 71)

Our research confirms the frequent use of payment plans from retailers. As the table below shows, payment plans are mostly used for food purchases from local food markets, where payments are usually made at the end of the month. For clothes, the same is true, but for medication, pharmacies and doctors usually insist on up-front payments.

Table 4: Percentage of respondents using payment plans (according to product categories)

	Food	Clothes	Medication	Business Supplies
Alto Paraíso	27%	36%	18%	29%
Cavalcante	30%	28%	13%	38%
Teresina d. G.	55%	40%	25%	40%
Average	**37%**	**35%**	**19%**	**36%**

➢ **Supplier credit** is also a major substitute to micro-credit and is used extensively across businesses of all sizes. Suppliers use payment terms as a way to attract customers in a competitive environment, as well as to develop a long-term business relationship with existing customers. Since very few micro-entrepreneurs dispose of sufficient capital to purchase stock up-front with cash, supplier credit is often the only reasonable option for renewing stock without compromising the business' liquidity. Access requirements are usually a good and relatively long relationship with the suppliers. Usually, the business serves as a guarantee for the credit. Supplier credit is greatly appreciated by the users due to the possibility to renegotiate payment when household emergencies or business problems make it difficult to reimburse on time.

As Table 4 above shows, 36 percent of those respondents who do own a business pay their supplies in installments, in agreement with their suppliers. Respondents explained that they did so because of their liquidity constraints, even though often times interest payments were substantial. However, several interviewees emphasized that access to micro-credit would help them to make up-front payments and potentially reduce interest expenses.

B. Informal Credit Supply

Informal credit usually refers to loans from family and friends, or informal store credit (*fiado*), and is mostly based on personal relationships.

➢ **Personal relations** also offer alternatives to microfinance, and loans from family members and friends are extremely widespread. Loans are usually characterized by small lump-sums and very short terms, since relatives and friends usually do not dispose of the resources to lend larger amounts. The advantages of rapidity, zero interest and no bureaucracy are, however, counterbalanced by the ill-ease that borrowing from family members or friends can cause. Indeed, a refused loan request or not being able to repay the loan on time can create a very uncomfortable situation, and most persons interviewed explained that they avoid it where possible.

As Table 4 in the Appendix reveals, respondents have borrowed from friends and family, but less frequently than from other sources such as banks. Indeed, only an average of 8 percent have taken loans with their kin in the past. In most cases, interviewees explained that family and friends face similar liquidity constraints and are thus unable to lend money. Some also pointed out that they didn't want to mix friendship with business, and that they preferred to look for credit with professional institutions.

➢ **Informal store credit (*fiado* or *pendura*)** differs from payment plan services in that there are no installments or no documentation required at all. Interest may be charged, but this is not the rule. Purchasing on credit is simply the process by which one can acquire a good with a very small up-front payment, or none at all, paying of the rest 15 to 30 days later. Such purchases range from R$ 1 to 50, rarely more, and are very common, especially among the very poor. Among these groups, purchasing *fiado* is the only way they can acquire basic goods like food, gas or medicine during the low period of the month. Indeed, for them, credit signifies more than just a financial transaction; as Brusky and Fortuna put it, credit "is the fine line that separates citizenship and marginality".[55] As our research has shown, *fiado* is the most sacred form of credit for the very poor. Only regular clients that consistently pay off their debts can buy on credit; losing the right to buy on credit in the neighborhood store often means losing the last recourse that enables them to survive with a minimum of dignity. News of defaults spread rapidly, marginalizing the debtor within the community, and making it impossible to purchase the basic necessities. Consequently, non-payment is rather rare; it is usually either calculated (when someone plans to move away) or due to a total incapacity to repay. Note that for micro-entrepreneurs, selling *fiado* is obligatory. Refusing to do so would lead to a significant loss of clients.

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[55] Brusky, et al., *op. cit.,* 2002, p. 26

In our research, we did not explicitly differentiate between payment plans and *fiado*; we therefore conclude that the numbers in Table 4 above are representative of both payments made in installments and *fiado*. Hence, most purchases made by our respondents are paid in installments given their liquidity constraints, which is in line with the argument made by Brusky et al.

As can be seen by the wide range of credit products discussed in this section, the overall financial sector in Brazil offers numerous substitutes to formal banking services. While some of them are out of reach of most poor people and micro-entrepreneurs, others are specifically targeted at the lower-income population. Other products available to poor people not only pose potential substitutes, but also shape the perceptions and expectations of actual and potential microfinance clients. It is thus crucial to understand them when conducting market research.

III. The Traditional Microfinance Landscape

This part of the paper will discuss the supply of microfinance, focusing on specialized institutions or programs that were created with the explicit goal of providing financial services to micro-entrepreneurs. These institutions can constitute important competitors for incoming or start-up MFIs, and it is thus important to understand the country's microfinance industry as a whole in order to be able to define the local needs and demand for MFIs in Brazil.

The "traditional" microfinance sector, for the purposes of this paper, is defined as

> *specialized institutions or programs that where created with the explicit goal of providing financial services to micro-entrepreneurs and/or other low-income clients.*

In the past few years the number of specialized MFIs operating in Brazil has expanded rapidly.[56] Numbers vary, but estimates suggest that by mid-2002, there were around 120 microfinance players, of which only a dozen catered to more

[56] Microfinance in Brazil began to grow significantly only at the end of the 1990s. There was a rapid burst of growth for the next three to four years, with total clients tripling between 1998 and 2001 (from about 46,000 clients in December 1998 to more than 140,000 clients in June 2001, an average annual growth rate of 49 percent). Total loan portfolio nearly quadrupled (from R$25 million in December 1998 to R$95 million in June 2001, an average annual growth of 61 percent). But a part of this success is the result of low initial levels. (A. Kumar, *op. cit.*, 2005, pp. 102-103)

than 2,000 clients.[57] Apart form the state-owned bank initiative, CrediAmigo[58], microfinance institutions in Brazil are mostly small, private, and independent from formal financial institutions. Moreover, private banks have not been active players in microfinance for a long time, but have recently designed strategies to reach the poorer segment of society. One example is Real Microcrédito, ABN AMRO's microfinance entity, the first international commercial bank involved in microfinance in Brazil. The bank partners with Acción to get expertise and technical assistance for its operations, and has currently a portfolio of 8250 clients, 48 percent of which being women.

Among the 40 to 50 larger private microfinance institutions, the CEAPE[59] network of NGOs constitutes the second largest microfinance provider in Brazil, with more than 26,000 clients in 220 municipalities across the country served via a network of 13 CEAPE entities in 2002. Banco da Mulher, a group of NGOs, some affiliated with Women's World Banking, had more than 2,300 clients and a loan portfolio close to R$2.4 million (US$ 1.0 million) in June 2001. Several small institutions are also active in the Rio area, including VivaCred and RioCred. It is noteworthy that, according to a BNDES study of 2002, the largest nine MFI in Brazil serve more than 2,000 clients, accounting for a combined 79 percent of the current microfinance clients in Brazil.[60] Moreover, six of these nine MFIs are located in the Northeast, demonstrating the relatively more developed nature of the region's microfinance market. Furthermore, studies show that in terms of regional distribution, most microfinance is urban in character (especially in the Northeast) and thus well equipped to target the urban poor, who account for the bulk of the poor in Brazil.

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[57] These and subsequent numbers in this section are the latest reliable figures that the author of this paper could find. They stem from the aforementioned World Bank study led by A. Kumar (2005).

[58] CrediAmigo was launched in 1997 by Banco do Nordeste do Brasil, a state-owned development bank with a mandate to promote economic development in the Northeastern states. It benefited from the technical advice of Acción International as well as from GCAP (Consultative Group to Assist the Poorest) and was financially supported by the World Bank. This large-scale microfinance program has remained unrivaled in scale in Brazil and constitutes a significant part of its microfinance expansion of the past decade. According to the BNDES study, the majority of the growth of the microfinance sector in Brazil stems from CrediAmigo; Banco do Nordeste expanded from 35,322 current clients in December 1999 to 85,309 current clients in December 2001 (Nichter, et al., *op. cit.,* 2005, p. 19). In 2005, with 138,497 clients and an active portfolio of R$ 85,4 million, Banco do Nordeste's microfinance program was one of the largest in Latin America. It served approximately 54 % of the current microfinance clients in Brazil (Publication of USAID "Banco do Nordeste", 2005, p 11).
Note that the planned project will offer microfinance services only in municipalities where CrediAmigo is not present.

[59] Support Center for Small Business (Centro de Apoio aos Pequeños Empreendimentos)

[60] These MFIs are: Banco do Nordeste (CrediAmigo), Banco do Povo de São Paulo, Banco do Povo de Goias, CEAPE (MA), CEAPE (RN), CEAPE (PE), Visão Mundial, CEAPE (SE), and Portosol.

In terms of the nature of services provided, credit for commerce and services in the informal sector dominate.[61] Moreover, solidarity group lending is the dominant means of addressing the absence of 'legal guarantees' for micro-lending. Note that as regards the gender balance of lending, most of the Brazilian programs lend about equally to men and women.

In the three communities visited, Banco do Povo was the only MFI, and only very few respondents have gotten a loan with the institution in the past. This is mainly due to lack of information as well as the Banco's heavy bureaucratic requirements. 'Traditional' microfinance institutions are thus currently only marginal players in the microcredit industry. The high unsaturated demand for small loans indicates that incoming MFIs could have a substantial client base.

A. Players in the Field

In the Brazilian microfinance industry there are several types of MFIs. Numerous institutions are ***affiliated with international microfinance networks***, including the Sistema CEAPE (with Acción International), the Banco da Mulher (with Women's World Banking), and Visão Mundial (with World Vision). These MFIs have partially been able to leverage the methodologies, capacity and technical experience of their international networks.

Other MFIs are ***civil society organizations***, which either used municipal and sometimes state government support to launch operations, or have garnered private sector resources. However, these organizations – an example is Portosol, operating in Rio Grande do Sul – typically demonstrate an initial period of fast growth until reaching a plateau; then, they often experience structural and marketing difficulties expanding beyond this level and thus fail to achieve significant scale, but often demonstrate low delinquency levels.[62]

In several states, political leaders have launched microfinance initiatives intended to serve their constituencies. These are basically ***government initiatives***. Political motivations, however, often become intrinsically linked to program objec-

[61] Note that as of 2001, CrediAmigo, being a program of Banco do Nordeste, was the only regulated financial institution and therefore the only one authorized to provide deposit, savings, and other financial services in addition to lending. (Schonberger, „Microfinance Prospects in Brazil", 2001, p. 19) As of today, other banks such as Banco Popular (a subsidiary of Banco do Brasil) are also regulated financial institutions that offer saving services.

[62] Nichter, et al., *op. cit.*, 2002, p. 23

tives, and, since they are offering below-market interest rates that cannot cover operating costs, they rely on government support to continue operations. An example is Banco do Povo de São Paulo, a partnership between the state and municipal governments of São Paulo, which offers loans to local micro-entrepreneurs at a highly subsidized rate of 1% per month.

Finally there are ***financial institutions*** operating in the microfinance market, including recently created Microcredit Societies (SCMs). These institutions are committed to developing sound business models, and strive to grow their operations to achieve significant scale; commercial considerations thus guide strategic and operational decisions.[63]

B. Performance of the Traditional Microfinance Landscape

With respect to financial performance of microfinance institutions in Brazil, it is noteworthy that some institutions in Brazil charge heavily subsidized interest rates, violating the generally accepted basic principle of sustainable microfinance. This, for instance, is the case for municipal programs such as Banco do Povo de São Paulo or de Juiz de Fora. These programs are essentially social services, financing the creation of work for employment or other welfare purposes, which justify their low interest rates on social grounds. Other microfinance providers cite this unfair competition as a key obstacle to their growth. There is an ongoing debate in Brazil between advocates that microfinance should be sustainable and therefore market driven and advocates that microfinance is a social policy instrument to distribute interest rate subsidies to the poorest. New measures introduced in mid-2003 clearly attempt to support the expansion of credit to the poorest through measures that include lending quotas and interest rate ceilings.[64] It remains to be seen whether these will be effective in increasing sustainable long-term microfinance, as desired.

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[63] CEPAL, Silvana Parente, *O Mercado Financeiro e a População de Baixa Renda*, Rio de Janeiro: 2003, pp. 16-18

[64] A. Kumar, *op. cit.*, 2005, p. 112

C. Concluding Remarks

In conclusion, the key findings that emerge from the foregoing analysis of the supply of financial services in Brazil, and that are of interest for this study are the following:

➢ With regard to the banking sector, it is noteworthy that access of Brazil's population to financial services has been dominated by banks, through the many bank branches. Brazil is obviously not 'underbanked' in international comparison. However, while many people may have a bank account, it is argued that a large proportion of the Brazilian population has no access to bank credit.

➢ There are several substitutes to microfinance available for poor people to get credit. They can be formal, semi-formal or informal, and must be taken into account when assessing the level of competition faced by MFIs. The level of sophistication and accessibility of products and services offered by the overall financial sector have a profound influence on the market potential for growth of the microfinance industry in Brazil. This will be discussed in more detail below.

CHAPTER V - DEMAND FOR MICROFINANCE

As discussed above, the "traditional" microfinance market in Brazil is not considered to be well developed. With the exception of Banco do Nordeste, few traditional microfinance institutions have achieved significant scale. Available estimates suggest that demand for microfinance in Brazil far outstrips supply: more than 70 percent of the Brazilian population[65] lacks direct access to the formal banking sector and of every 100 micro-enterprises, that would want and be eligible for microfinance products, only 2 were served in 2002.[66] This penetration rate is far lower than in many other countries in Latin America.[67]

The low penetration rate may suggest that there remains a huge opportunity for growth of the microfinance industry. Several recent demand studies have indeed identified that the traditional microfinance sector does not meet the needs of low-income entrepreneurs and households regarding credit and other financial services.[68] The low-income segment of the Brazilian population seems to make more use of other types of credit, especially store credit and supplier credit, than the ones that are offered by the traditional microfinance sector.[69]

It appears thus that a lack of understanding of the demand for micro-financial services has been an obstacle to the sector's development. Providing clients with what they want is essential for the growth of any industry.

Assessing people's financial needs is of equal importance as assessing the competition in the targeted market. Identifying and understanding what the exact needs of micro-entrepreneurs and low-income households are, and how they are currently being satisfied is critical knowledge for every starting, as well as for an existing micro-financial service provider. Understanding these preferences includes analyzing the cultural and social factors that influence them. Throughout the microfinance industry there is a tendency to copy other ideas without tailoring them to the specific circumstances of

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[65] USAID, DAI (Development Alternatives Inc.), Anita Fiori and Robin Young, Banco do Nordeste, Washington D.C.: 2005, p. 4: refers to Banco Nacional de Desenvolvimento Economico e Social (BNDES), website: www.bndes.gov.br.

[66] Nichter, et al., *op. cit.,* 2002, p 32

[67] For example, Chili, Peru and Paraguay have penetration rates of approximately 25-35%. El Salvador and Nicaragua have penetrated roughly 70 % of potential demand; Nichter, et al., *op. cit.*, 2002, p 32-33.

[68] See Brusky, et al., *op. cit.*, 2002; Gallagher et al., *op. cit.*, 2002.

[69] For example, a study of low-income Rio de Janeiro neighborhoods found that lack of resources was cited as a leading obstacle to business expansion, but micro-entrepreneurs did not view traditional credit as a solution; Nichter, et al, *op. cit.,* p 33. See also Brusky, et al., *op. cit.,* p 29.

the market in which one wishes to provide its services. The key for growth and success is providing a service that meets the needs of the clients.

This section therefore examines – through secondary research – the demand profile and perceptions of credit and financial institutions in Brazil. The purpose is to understand why MFIs are growing so slowly despite the high potential demand. The slow growth and low penetration of the "traditional" microfinance sector is in contrast with the popularity and the rapid growth of retailers offering store credit to the poor. It will further identify the cultural factors that are linked to these perceptions and that influence the use of financial services.

1. Cultural Pecularities Concerning Credit and Savings

Being excluded from the formal banking sector, micro-entrepreneurs and low-income households appeal to a variety of other services to meet their financial needs: microcredit, store credit, credit cards (consumer-lending issued or department-store issued), or post-dated checks, as discussed above. Various demand studies[70] reveal that store credit and supplier credit are by far the most commonly used forms of credit among the low-income segments of the Brazilian population. The continuing growth of retail and department stores offering store credit to poor people is in sharp contrast with the slow growth and low penetration of the "traditional" microfinance sector. It is justified to say that these two forms of credit are the major substitutes to microcredit in Brazil, and they are cited among the reasons why international MFIs are wary of venturing into the Brazilian market.[71]

The same demand studies also demonstrated that Brazilians mainly fall back on credit to satisfy their financial needs, rather than savings. People do use savings mechanisms,[72] but authors point out that the concept of putting money aside for later usage is infrequent in Brazil.[73]

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[70] See, for example, Brusky, et al, *op. cit.*, 2002

[71] Personal conversation with Katherine Torrington from FINCA International.

[72] As mentioned above, people in Brazil usually save in the context ROSCAs known as *sorteios* and *caixinhas*. C*aixinhas* take almost exclusively place within the workplaces where the guarantee and repayment mechanisms are bound to the receipt of salaries. *Sorteios* have a more general application.

[73] Brusky, et al., *op. cit.,* 2002, p. 15.

A. Credit

The credit behavior and preferences of Brazilians can be narrowed down to the following general characteristics:

- ***"Buying time, not money"***

Store credit and supplier credit, the most popular forms of credit, are installment credits, while the credits that are typically offered by MFIs are lump sum credits. While it is widely recognized and understood that in the end, store credit is more costly than taking a loan, the choice is rarely made in favor of a loan. This preference towards installment credit can be understood, in part, from a cultural perspective.

Research conducted by Brusky et al. in the cities Rio de Janeiro, São Paulo and Recife has found that in the eyes of the Brazilians, *crédito* has a more positive connotation than *empréstimos* (loans). For them *crédito* signifies a means to facilitate the payment of goods or services. It does not, like *empréstimos*, involve a physical transfer of cash from the lender to the borrower. In the case of *crédito*, what is being bought is the good or service (although for a higher cost), which constitutes a normal part of their daily lives. Taking a loan is perceived as the purchase of money for an amount higher than the face value, which is associated with "abnormal behavior". What is being negotiated with *crédito* is time needed to be able to make the payment, and in the mind of the majority of the Brazilians, there is little correlation between purchasing on credit (installment credit) and loans (lump sum credit). [74]

- ***Smaller payments over an extended period of time***

The traditional microfinance sector mainly works with productive loans that feature weekly payments for a few months. Brazilians, however, prefer products that offer lower payments for longer periods of time. Brazilians feel more secure paying off small amounts for a longer time than having to "tighten the belt" during a shorter period. They prefer buying time over money. The reason is that such credit conditions fit household economics, as they allow loan payment to be added to an already existing schedule of installment payments. What counts is the size of the installment and not the end cost of the good.

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[74] Brusky, et al., *op. cit.,* 2002, p. 29.

- ***Consumer culture***

Installment credit enables the immediate acquisition of goods, something that is extremely valued in Brazilian society. While this is partly a question of necessity – indeed, if it were not possible to purchase groceries on the store credit card, many houses would go without food – it is also linked to the very strong consumer culture in Brazil. In television, consumption is advertised as a sign of success, a means to "happiness".

- ***Practical advantages***

Besides the cultural explanation, the success of installment credits can also explained by its higher lever of practicality. In general, installment credits are highly appreciated because of their accessibility, availability, rapidity[75] and adaptability allowing clients to choose repayment schedules that suit their capacity and willingness to repay.

B. Behavior Towards Savings

Despite the important base of security savings can offer to low-income families, there appears to be no real saving culture among the poor. In Brazil, however, it has nothing to do with not being able to save because of a lack of money; the omnipresent use of installment credit clearly indicates a capacity to save. Poor people who buy on credit nearly all manage to set aside money to pay off a debt for a previously purchased item. The money that is currently used for paying off debt could go towards savings, which, in turn, could be used to purchase at a cheaper price what normally would be bought with a payment plan.

The Brazilian poor have thus clearly the capacity to save, although not a willingness. The choice to buy a good by means of an installment plan rather than to use savings, is related to Brazil's consumer culture: purchasing a good is perceived as much more satisfying than placing the little money that is left over in a savings account.

Nevertheless, the existence of demonstrates that savings behaviors do exist, as Brusky et al. argue.

[75] No additional approval is needed once registered in the store's system, the good can be taken home immediately

II. Our Findings

As regards savings, primary research in Goiás yields few deviations from the secondary findings above. What is most surprising, is that almost two-thirds of all interviewees hold current accounts with one or several of the commercial banks in town.[76] Demand for credit for both productive and consumption uses is generally high, which is an indicator of the potential for growth of the microfinance industry in the region. Given their accessibility in terms of accounts, most interviewees indicated commercial banks to be the most likely credit provider. However, it was repeatedly mentioned that bureaucratic requirements often times put an obstacle to their credit request, and respondents emphasized that they would welcome other credit providers such as MFIs in their region. Finally, our research confirmed the Brazilian preference to for "time over money". Desired loan terms are usually very long, ranging up to four years in some cases.

As regards savings, the primary findings support the argument that there is no culture of savings among Brazil's poor. Indeed, most interviewees indicated that their modest income is just enough to cover their monthly spending, which makes it impossible for them to set aside money for future expenses.

A. Bank Accounts and Credit

Somewhat surprisingly, we found that most of our interviewees have access to the conventional financial sector for certain services. Indeed, as the table below reveals, in each of the cities, between 67 and 84 percent of the people interviewed do have a current account.

Table 5: Percentage of people owning a bank account and main use of the account

		Alto Paraíso	Cavalcante	Teresina d. G.	Average
Do you have a bank account?	yes	83.8%	67.4%	70.0%	**73.7%**
Since when?	< 6 months	3.5%	3.5%	0.0%	**2%**
	6 months - 2 years	24.1%	17.2%	7.7%	**16%**
	2 years - 5 years	31.0%	27.6%	30.1%	**30%**
	> 5 years	41.4%	51.7%	61.6%	**52%**
Main use of bank account	deposit / withdrawal	62.5%	53.5%	51.9%	**56%**
	payments	32.5%	23.3%	22.2%	**26%**
	savings	2.5%	0.0%	0.0%	**1%**
	other	2.5%	23.2%	25.9%	**17%**

[76] Note that given the absence of commerical banks in town, interviewees from Teresina de Goiás hold their accounts in neighboring Cavalcante.

The accounts are mainly used for deposits, withdrawals and, less frequently, payments. In some cases, people indicated that they have a savings account, even though most are unable to put money aside on a regular basis.

It is interesting to note that, while compulsory downscaling of commercial banks was legally imposed in 2003, a majority of the bank account holders have had their accounts for more than five years. They thus had access to commercial bank services even before legal measures were taken to allow poorer segments of the population to open accounts.

As the table below reveals, there is substantial demand for microcredit among the people interviewed. Furthermore, the field studies revealed the assumption that people have varying needs for credit, ranging from productive credit for their business to consumer credits, though productive credit appears to be more sought for. Potential credit sources for most people were formal banks, while friends and family were also cited as possible credit providers. As opposed to secondary findings, the interviewees' potential credit sources only marginally included credit institutions such as consumer credit providers. This might be due to their preference for productive rather than consumer loans.

Table 6: Credit needs and preferences

		Alto Paraíso	Cavalcante	Teresina d. G.	Average
Would you take up credit for business?	yes	83.7%	86.2%	88.9%	**86.3%**
	no	12.2%	7.8%	11.1%	**10%**
	depends	4.1%	6.0%	0.0%	**3%**
Would you take up credit for consumption?	yes	30.9%	48.7%	5.9%	**29%**
	no	69.1%	51.3%	94.1%	**72%**
Potential credit source	family	20.0%	26.5%	21.1%	**23%**
	friends	15.0%	4.1%	15.8%	**12%**
	credit card	0.0%	4.1%	0.0%	**1%**
	agiota	7.5%	0.0%	0.0%	**3%**
	bank	42.5%	42.9%	57.9%	**48%**
	credit institution	5.0%	8.2%	0.0%	**4%**
	other	10.0%	14.3%	5.3%	**10%**
Desired credit term	1 week	0.0%	0.0%	0.0%	**0%**
	1 month	0.0%	5.3%	5.0%	**3%**
	2-3 months	12.9%	5.3%	0.0%	**6%**
	4-6 months	12.9%	10.5%	5.0%	**9%**
	1 year	25.8%	23.7%	25.0%	**25%**
	> 1 year	38.7%	39.5%	25.0%	**34%**
	depends	9.7%	15.8%	40.0%	**22%**
	average months *	20	36	48	**35**

* when indicated

Mainly in Teresina de Goiás, interviewees seem to be wary of taking up consumer credit, which was mostly based on fears that they wouldn't be able to pay back the loans. There is thus a slight deviation from secondary research, which finds a very strong consumer culture among Brazilians, which is said to lead to high demand for consumer credit. Given that our research was conducted in rural areas, it may be argued that consumption patterns respond largely to basic ne-

cessities, while in urban areas, the accessibility of consumer credit for 'luxury goods' leads to higher demand for such goods.

Our findings also support the statement that Brazilian's prefer to "buy time over money". As the table shows, interviewees have a preference for long credit terms, with most people desiring terms of over a year. Among those respondents indicating how much time they would need to pay back a credit, the preferred credit term averaged almost three years. This implies that interviewees would be willing to pay interest for longer terms rather than paying back sooner.

In addition to the above findings, conversations with interviewees also revealed that there are several aspects of the loan process of banks that are highly criticized by the low-income segments of the population, such as the high interest rates,[77] the bureaucracy, the rigidity of the loan terms and the co-signer requirement which is apparently very hard to satisfy.[78]

B. Behavior Towards Savings

The data below supports the argument that there is no real savings culture among Brazil's low-income population. Indeed, less than 50 percent of the interviewees save, and when they do, it is usually not for productive purposes but rather to provide for emergencies. Amounts save vary, but are below 50 US dollars per month in most cases.

In spite of the low savings rate, it is surprising to see that most interviewees that do save deposit their money on savings accounts with banks. This shows that many people do have access to formal banks if they want to set up a deposit account, while accessibility of credit is much more limited and complicated.

Finally, none of the interviewees in any of the three cities mentioned participation in a savings or credit group such a as *caixinha* or *sorteio*.

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[77] This argument is somewhat surprising since this issue is not raised in the case of installment credits. Here the installment size seems to be of much more concern than the interest rates that are charged.

[78] The reservations towards the cosigner requirement and solidarity group lending concept may be partly explained by the uneasiness of taking responsibility for someone else. For poor people it is hard enough to be responsible for one's own debt, let alone someone else's. Another reason put forward is that the concept of a guarantee leads to a sensation that one is incapable or dishonest. (Brusky, et al., *op. cit.*, 2002, p. 19 and 32)

Table 7: Savings bebavior

		Alto Paraíso	Cavalcante	Teresina d. G.	Average
Do you save?	yes	46.0%	32.6%	50.0%	**42.9%**
	no	54.0%	67.4%	50.0%	**57%**
Reason for saving	money left over	9.1%	1.2%	0.0%	**3%**
	emergency	45.5%	37.5%	61.5%	**48%**
	future business	18.2%	12.5%	23.1%	**18%**
	expand business	0.0%	4.2%	0.0%	**1%**
	production cycle	13.6%	4.2%	0.0%	**6%**
	education	4.6%	12.5%	7.7%	**8%**
	buy house	0.0%	4.2%	0.0%	**1%**
	future (general)	0.0%	12.5%	0.0%	**4%**
	other	9.1%	8.3%	7.7%	**8%**
Savings vehicle	bank	66.7%	33.3%	77.8%	**59%**
	home	27.8%	46.7%	11.1%	**29%**
	buying goods	5.6%	6.7%	11.1%	**8%**
	other	0.0%	13.3%	0.0%	**4%**
Amount of savings (per month)	$0-25	17.7%	14.3%	50.0%	**27%**
	$26-50	23.5%	21.4%	0.0%	**15%**
	$51-150	17.7%	14.3%	10.0%	**14%**
	$151-500	17.7%	0.0%	10.0%	**9%**
	> 500	5.9%	0.0%	0.0%	**2%**
	depends	17.7%	50.0%	30.0%	**33%**

CHAPTER VI - RECAP: SURPRISES AND DEVIATIONS FROM SECONDARY RESEARCH

Brazil is the largest economy in Latin America in terms of land area, population and gross domestic product (GDP). However, as discussed in the foregoing analysis of the supply of microfinance in the country, it is well behind most other countries in the region in the development of its microfinance industry. This is particularly surprising given Brazil's large and dynamic micro-enterprise sector. In addition, many microfinance practitioners point to Recife in the northeast Brazil as home of the first 'modern' microfinance organization in Latin America.[79]

Obstacles to the growth and expansion of the sector have come from various sources. When microfinance as a tool to fight poverty started to take off internationally, the macroeconomic and regulatory environment was not conducive to promoting such initiatives in Brazil, as explained above. Inflation increased the riskiness of engaging in credit operations and decreased the trust in the value of the currency, deterring MFIs from entering the market. The legal restrictions and excessive regulations concerning loans amounts and interest rates, moreover, made it difficult for microfinance providers to reach financial sustainability. Both challenges could partly be overcome over the last decade; an inflation-targeting policy framework successfully stabilized price levels, and regulatory changes have been adopted in an attempt to promote the provision of credit to the poor. However, challenges remain; keeping down inflation has its prices in terms of high interest rates and conservative fiscal policy, and regulatory obstacles to the provision of certain microfinancial services remain.

Other challenges come from within the microfinance sector. Heavily subsidized public sector credit lines are said to crowd out the demand for more costly microcredit offered by MFIs, and shape expectations regarding interest rate levels and repayment discipline. The presence of institutions that charge highly subsidized interest rates creates a distortion in the market likely to be a barrier to entry for new private players. For institutions such as the Banco do Povo do Goiás, financial self-reliance is clearly a subsidiary objective. Anjali Kumar from the World Bank argues that in the long run, such programs could "perversely choke off total credit to the system, as private providers are not bale to compete in this

[79] "Projeto Uno", an NGO founded in 1973, was a predecessor of the current Center for Assistance to Small Enterprises (CEAPE) programs in Brazil.

market".[80] The problem of such crowding-out is accentuated by the existence of numerous 'low-cost' programs and credit lines, implemented mostly by Brazil's development, federal-, or state-owned banks.

On the private sector side, the abundance of and easy access to consumer credit is said to undermine the attractiveness of loans provided by MFIs, which often imply conditions concerning the productive use of the credit and involve more bureaucracy.

These two arguments will be tested against the findings of our primary research in three cities in Goiás. In fact, we find that government credit lines are difficult to access, as they require extensive documentation and are accessible only for very specific purposes and under specific conditions. For subsidized credits offered by government-supported MFIs, similar complaints were raised, and accessibility of these financial services is perceived to be very limited. Demand for credit is found to be high, and the microcredit market is far from saturated. We therefore conclude that there is ample space for new and existing MFIs to expand their operations.

On the part of consumer credit, we found that consumer credit is generally not considered real 'credit'. When asked whether they had ever taken up credit, respondents automatically excluded consumer credit such as store credit, and only referred to bank credit. We conclude that consumer credit agencies and retail stores offering payment plans are indeed competitors to MFIs. However, they do not undermine their *raison d'être*. The nature of financial services provided is different, and demand for loans remains high and is defined as need for credit that goes beyond consumerism.

1. "Crowding-Out" By Government Subsidized Credit

Although public sector credit lines pose challenges to microfinance in rural areas, competition from these subsidized credit programs is less pronounced in urban areas. This section explores how programs focused on agricultural credit may affect microfinance demand, as well as why other programs in urban areas less frequently reach potential microfinance clients.

[80] *ibid.*, p.123

Brazil's response to the challenge of rural finance has been similar to that of other countries: direction of credit with a combination of quantitative controls, in the form of mandatory lending to agriculture, and price controls, or lending at below market rates of interest. Selective or directed credit has been channeled largely through public financial entities, either directly or through on-lending arrangements with private financial entities. Brazil's largest banks, Banco do Brasil and Caixa Econômica Federal, have served as the primary vehicles for the channeling of credit to rural sectors.[81] Hence, in rural areas of Brazil, there are numerous public sector programs offering credit, such as PRONAF (National Program to Strengthen Family Agriculture), which may influence demand for microfinance in the few rural areas where MFIs are operating.

Public sector credit lines focused on agriculture comprise a relatively large share of public bank activity. For example, in 2002, Banco do Brasil extended 49 percent of its loans to the agricultural sector, while private banks extended only 15 to 20 percent to the sector. These loans are often subsidized and sometimes even have negative real interest rates[82]; for example, the PRONAF B credit line offers agricultural sector loans at a nominal annual interest rate of 1 percent in the Northeast, but since it provides a rebate of 40 percent off the principal if payment is made before the due date, effective rates are negative.[83]

The availability of cheap credit provides a competing source of funds in rural areas, and relaxed collections policies also affect the mindset of potential microfinance clients. Accustomed to receiving cheap credit from the public sector, rural clients do not automatically assume that loans must be paid back, as pointed out by Nichter. Certain institutions or programs can be stereotyped, and subsequently it may be difficult for them to change their image; this was the case with one program targeting settlements of landless workers: "PROCERA [loans] have been characterized by the certainty on the part of loan recipients that loans are not meant to be paid." [84] Under these conditions, the mindset associated with public sector credit lines could pose an obstacle to microfinance institutions wishing to penetrate rural areas, although it is worth noting that thus far few MFIs have made deep incursion into such regions.

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[81] Anjali Kumar, *op. cit.*, 2005, pp. xlviii-xlix

[82] Nichter, et al., *op. cit.*, 2002, p. 41

[83] Brusky, *Prospecting the FUNDAF Market: An Overview of Demands, Competition, and Client Satisfaction*, 2002 (as cited by Nichter, et al., *op. cit.*, 2002, p. 34)

[84] Baer, 2001. (as cited by Nichter, et al., *op. cit.*, p. 42)

Note, moreover, that the Brazilian rural financial system today is far from good practice. As Anjali Kumar puts it, "it has limited outreach at high cost instead of mass outreach at low cost".[85] Most rural households still have no access to formal financial services, and there are opportunities to address these gaps.

In urban areas, public sector credit lines do not appear to affect significantly microfinance activity. Although there are a host of programs targeting micro-entrepreneurs such as PROGER (Development Program for Employment Generation and Income), it is widely acknowledged throughout the Brazilian financial sector that almost no resources from these directed lines of credit actually reach informal micro-enterprises – defined as those with four or fewer employees. Lengthy processes and slow disbursement time are also particularly problematic for these enterprises; unlike agricultural firms that may be able to plan crops to make use of delayed funds, urban micro-enterprises often require immediate capital to cover cash flow shortages. Even small formal enterprises seeking capital from public sector credit lines find themselves tied up in months of paperwork, multiple analyses of the same information, and obligatory training courses. Thus, as Nichter et al. conclude, "the largest potential impact these credit lines might have on MFIs is related to image – to the extent that PROGER and other programs are referred to as 'micro-credit', this may confuse potential MFI clients".[86]

As discussed above, crowding out by public sector credit lines appears to be mainly limited to rural areas. Since only some 20 percent of Brazilian micro-enterprises are located in rural areas, it follows that public sector credit lines pose a more limited challenge to the overall microfinance industry than the other factors mentioned earlier. We will test this assumption below, analyzing the interviewees' usage of public sector credit lines.

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[85] Anjali Kumar, *op. cit.*, 2005, p. xlix

[86] Nichter et al., *op. cit.*, 2002, p. 42

II. Competition from from Retail Stores

One of the obstacles to the growth of the microfinance sector that is most commonly cited is wide and relatively cheap availability of *crédito direto ao consumidor* (consumer credit) provided by large retail stores. Indeed, Brazil has a highly developed system of retail store credit, with Casas Bahia being the first and most prominent example in case (see Box 2 below). It is often argued that this alternative to credit from MFIs is widely used by micro-entrepreneurs to finance their businesses,[87] in spite of the high interest rates charged. As we will discuss below, however, the wide use of store credit is not surprising, as people care more about the size of installments than about interest rates – in line with the preference for "buying time over money".

Consumer credit takes different forms, as we have discussed in the section on credit supply above. Being clearly directed towards consumption, it can be provided by *financeiras* or other credit institutions – at relatively high cost, as we have seen above –, or directly by stores, at low initial but exponentially rising interest rates. Mostly, such credit is destined towards the purchase of vehicles, electronic household supplies, furniture, construction materials, machines or – more recently – computers or cell phones. As discussed above, requirements for obtaining store credit are minimal; in most cases only a permanent address is required for credit below $500, and the process takes the customers no more than a few minutes, as credit is approved immediately when the purchase is made. Once repayment terms are negotiated with the store, the buyer gets a *carnê de loja* – a membership card – and payments are usually made in equal installments, which makes the process relatively easy. Once a customer is registered with a store, has received a *carnê*, and has made payments on time, s/he will get store credit with no further documentation in the future.

[87] This argument is made by Brusky and Fortuna (*op. cit.*), as well as Jaime Mezzera and Ivan Guimarães in an ILO-study (J. Mezzera and I. Guimarães, *Créditos para Pequenos Empreendimentos no Brasil*, 2003), among others.

Box 2: Consumer Credit: The Casas Bahia Model

"We speak a language that our clients understand - installments. And we are sparing them a trip to the bank for a loan." Michael Klein, Chief Financial Officer, Casas Bahia

Casas Bahia was founded as a clothing and furniture store by the Polish immigrant Samuel Klein, in 1958. The store immediately attracted customers due to its unorthodox installments scheme. When customers said that they could not pay, Samuel readily offered convenient terms of payment.

Today, Casas Bahia is the largest retail chain store in Brazil. It offers highly successful credit sales schemes mainly aimed at selling electronic and other household products to the urban poor. Indeed, through its marketing strategies, the company was able to unlock the enormous purchasing power of Brazil's low-income working class by providing them with credit finance schemes wherein the customers can purchase branded consumer goods in easy installments. The case is mentioned in *The Fortune at the Bottom of the Pyramid* written by University of Michigan Business Professor C.K. Prahalad's. For the author, Casas Bahia exemplifies how, through "inclusive capitalism", where the bottom of the pyramid is bootstrapped upward through consumerism, poverty can be alleviated. Indeed, the company fills a need for credit among the poor that risk-averse banks and most mainstream Brazilian retailers won't meet.

80 percent of the store's total sales are paid in installments, and the average monthly installment at Casas Bahia is about $14. For purchases up to $300, only a permanent mailing address is required to get credit approval, tough about one-tenth of applicants are rejected, usually because their names appear on a federal list of defaulters. The default rate is relatively high, at 8 percent for electronics, and 2 percent for furniture. However, S. Klein points out that poorer customers are better payers, because non-payment can compromise all they own: a clean record. By requiring its customers to return to the store each month to pay, Casas Bahia induces them to make another purchase.

Casas Bahia has become a successful and sustainable business serving Brazil's poor. Its figures are significant: US $1.2 billion in revenues, 330 stores, 10 million customers and 20,000-employees. And the chain continues growing. No wonder that many others have joined the Bandwagon: Marabrás, Lojas Cem, Magazines Luiza are just a few examples of retail and department stores providing credit to the low-income segment of the population to finance the acquisition of durable goods. Currently seventy million store cards have been issued by retailers, while only forty five million people hold traditional credit cards (MasterCard, Visa and Amex).

The ease and rapidity of this credit system benefits both parties. For the customer, after the first successful transaction, accessing further store credit will be almost automatic. This will induce her or him to make future purchases in the same store, which, in turn, helps the retailer gain faithful customers.

All of this makes it easy to understand why poor people would rather go get store credit than apply for credit with an MFI, if they have the option. However, it is important to examine to what extent consumer credit provided by large retail stores really competes with traditional microcredit institutions. The next section will discuss this question in more detail, based on the findings from field research in Goiás.

III. The Credit Behavior of our Respondents: Testing the Assumptions

A. General Credit Behavior

In our research, we made a number of surprising findings concerning the respondents' credit behavior, as shown in Table 4 in the Appendix:

- An average of 60 percent of the respondents have taken up credit in the past.
- Of these, 70 percent have received their loans from banks, which challenges the argument that poor people have no access to formal bank credit.
- A majority of those who have never taken up credit explained that they were afraid of debt. Only 14 percent argued that they were not qualified for loans.
- Respondents have invested their credit almost equally in productive use and consumption. While this conflicts with findings on the preference for productive credit (as seen above in the section on demand for microfinance), it suggests that there is demand for and supply of both types of loans, and MFIs must define their product offering accordingly.
- Credit terms are relatively long, with 36 percent of loans being paid back over 12 months or more.
- Most surprisingly, loan sizes very high, at an average of $3259. However, the numbers must be read with caution, as many respondents claimed not to remember the exact amounts borrowed, but vaguely remembered size and number of installments. We are therefore not sure whether these numbers and our calculations represent correct loan sizes.
- Loans are overwhelmingly repaid in installments, with only roughly 11 percent paid back in a single payment. This is due to the same reasons why a credit is taken up in the first place, liquidity constraints.
- Finally, over 90 percent of the past credit-takers indicated that no physical guarantees were required. In many cases, however, an *avalista*'s – or guarantor's – signature had to be sought.

These findings lead to question the main arguments made in literature on the microfinance industry in Brazil. Moreover, it leads us to wonder whether the obstacles to growth of the microfinance sector that are most commonly cited – avail-

ability of government subsidized credit and easy access to consumer credit – are accurate reasons for the quasi-absence of MFIs in the three cities visited.

B. Testing the Two Arguments

Are main finding with respect to the two the two obstacles to the expansion of MFIs discussed above are as follows:

- ***Overall, government credit lines and subsidized credit institutions are marginal players in the microfinance market of the three cities analyzed. This leads us to conclude that these credit providers do not put direct obstacles to MFIs' growth, and that there is a space for innovative microfinance institutions to enter the market.***

In our questionnaires, we asked respondents whom they had gotten credit from in the past, and who they would turn to in the future. As seen above, both for past and future loans, commercial banks were cited as the main source of credit. When asked whether they knew about government institutions providing subsidized credit, most respondents – over 60 percent – were well informed about Banco do Povo, which is present and active in all three municipalities (c.f. Box 3 below). Information and knowledge about available subsidized credit lines such as PRONAF[88] or other programs, however, was scarce, as can be seen in the table below.

Table 8: Familiarity with government sponsored credit programs

		Alto Paraíso	Cavalcante	Teresina d. G.	Average
Do you know any government programs providing credit? If so, which?	Banco do Povo	72.7%	50.0%	68.8%	**64%**
	PRONAF	15.2%	36.1%	12.5%	**21%**
	other	12.1%	13.9%	18.8%	**15%**

Even though Banco do Povo (BdP) is well known, the predominant perception of respondents was that credit from this institutions was also impossible to get. The requirements are numerous, including CPF (the Brazilian equivalent of the

[88] Note that PRONAF is a very cheap credit line restricted to agricultural investments, as discussed above. Given that only a small percentage of our respondents made its living primarily with farming, it is not surprising that knowledge about this program was scarce.

Social Security Number), prove of residence, a guarantor and – first and foremost – a good relationship with the local bank manager.

Box 3: Access to Microcredit in Goiás: The Banco do Povo Model

Banco do Povo, established in 1999, is a state-sponsored NGO, and is the most accessible financial institution for the poorer segments of Goiás' population; it is also the institution that was cited most frequently in our research as a potential credit provider. Given its visibility and presence in all the three municipalities analyzed, a more thorough examination of the bank's operations and conditions reveals what other MFIs I have to compete with.

Banco do Povo's stated mission is to "democratize the access to credit for small entrepreneurs that want to produce and grow, supporting their skills and their experience in production and services."92 Through a spill-over effect, the bank hopes to generate employment and local development, thereby emancipating people out of government assistance. Credits are given to low-income individuals that work in the formal or informal sector, to associations, and to people that are benefiting from the *Renda Cidadã*, a government program that provides R$60 (~$30) plus some basic services for the lowest-income segments of society. A productive credit from the bank is hoped to help them achieve self-sufficiency.
Banco do Povo's resources come largely from the Special Fund for Employment and Income Generation (Fundo Especial de Geração de Emprego e Renda, FUNGER) which was set up by the state government of Goiás. Every municipality is assigned resources ranging from R$50,000 to R$150,000 ($24,000 to $72,000), according to demand. To receive a loan, an applicant needs to have lived in the municipality for at least three years. Moreover, he has to prove that he has the professional necessary skills and is dedicated to his new (or existing) business. Finally, in order to get a loan, a parent must prove that his or her children are attending school. The loan amount ranges from R$300 to R$2000 ($144 to $960), and monthly interest rates are 0.6 percent. Loan terms can stretch up to ten months, for some investments including a two months grace period. The collateral is physical, where possible, and mostly social (a guarantor or group liability).

Ever since its inception, Banco do Povo has worked in close cooperation with SEBRAE Goiás, the Brazilian Agency for Assistance to Small- and Micro-Enterprises, which provides financial training and capacity building. This comprehensive approach – and affordable state-subsidized interest rates – has made Banco do Povo a popular credit provider. Until today, alone in Goiás, the bank has loaned almost R$90 million ($43 million) under 62,306 contracts, of which 51 percent to men and 49 percent to women, and claims to have contributed to the generation of 96,410 jobs. This results in an average cost of job creation of R$930 ($446) per job, as compared to R$14,492 ($6,953) in the automobile industry, for instance. [93]

The Banco do Povo data for the three cities analyzed can be found in the following table: [94]

	Total amount of loans disbursed	Number of contracts	Number of jobs created
Alto Paraíso	$ 311,796	430	479
Cavalcante	$190,696	248	470
Teresina d.G.	$28,980	40	64

Even though numbers in the Box above suggest that the BdP is very active in the three cities visited, we only came across a total of about three respondents who had been approved credit with that institution. While some claimed to have applied for loans with BdP in the past, most were discouraged from applying *ex ante*, simply based on the reputation of the institution. None of the persons interviewed had received credit from any other government credit line.

We therefore conclude that these institutions and credit lines, while they do offer low-cost credit at a small scale for a few "lucky" applicants, are no direct competitors to incoming MFIs. Indeed, many respondents voiced their hopes for

other microcredit providers to enter the market. Where we do see a problem, however, is with respect to the attitudes and expectations created by these institutions. BdP's low interest rates are well known, and seems difficult for people to understand and accept that a MFI would likely be compelled to charge much higher rates in order to achieve financial sustainability. An incoming MFI would thus have to invest special efforts into explaining the model, the product offerings and its competitive position in a visibly underserved market.

- ***Store credit is not considered to be outright "credit", but rather a category of financial services of its own. The wide possession of electronic and household equipment, despite low income levels, suggests that most of these goods were paid in installments; none of the respondents, however, indicated store credit as one of their past loan sources.***

In our interviews, we found that store credit is not considered to be real "credit", in the sense of *empréstimo* (borrowing) or loan. Instead, store credit is simply perceived to be a purchase with delayed payment. When asked whether they had ever taken up credit, respondents automatically referred to cash loans taken with banks or other financial institutions, family or friends. Store credit is considered to be a category of its own, and even though debt is incurred, people seem much less hesitant to accept store credit than bank credit. With store credit, at least they get a physical good in return, whereas the concept of taking on debt by receiving a lump-sum of cash is much more fungible and abstract.

In conducting our interviews, we were impressed with the level of electronic and household infrastructure the respondents owned. As can be seen in the table, even though household incomes are mostly between one and two minimum salaries ($170 – $505), 88 percent of all respondents own a TV (or several), almost 80 percent have a fridge, and more than half of the interviewees have a radio. These numbers are substantial given that the average price of a TV is around one minimum income of $170, and that of a fridge around two to three minimum incomes (around $600, on average)[89]. While we did

		Average
Household Income	< $170	**18.5%**
	$170 - $505	**55%**
	$506 - $840	**20%**
	$841 - $1345	**6%**
	> $1345	**0%**
Property	television	**88%**
	radio	**66%**
	car	**35%**
	laundry machine	**46%**
	video/dvd	**42%**
	fridge	**79%**
	freezer	**24%**

[89] Prices are taken from the popular retail chain *Magazine Luiza*, which also offers store credit.

not ask respondents how they had paid for their infrastructure, it can be assumed that most of these equipments were paid with store or other credit. None of the people interviewed explicitly mentioned such credit, though.

From this, we conclude that demand for credit is high *outside* of the credit for consumer goods – and in spite of its wide availability. As seen above, respondents widely demand microcredit, whether for productive or unproductive use. However, when asked what they would need credit for, a majority of respondents mentioned productive uses, not consumption. The fact that people nonetheless widely accept store credit confirms that they perceive such credit and bank loans to be different categories. Hence, *carnês de loja* do not – and most likely cannot – substitute traditional microcredit. We therefore conclude that, while store credit might satisfy part of the demand for loans – specifically, consumption loans for specific goods – there is ample demand for newcomers in the microcredit market. By developing a well-designed niche product, MFIs can complement the existing array of microfinance offerings.

The question that remains, is whether the cities visited are indeed "underbanked". As we have seen, a majority of respondents have taken up loans in the past, most of them – quite surprisingly – with commercial banks. Is there a need for MFIs? Are MFIs the appropriate institutions to fill the gap, to cover the unsatisfied demand for microcredit? Or, are banks, in conjunction with consumer credit providers, enough? Doesn't their purely financial mission allow them to serve the poor in a more sustainable and long-term fashion, now that they have discovered the "bottom of the pyramid" as a potentially lucrative client base?

In a last part, we will try to answer these questions, taking into account the foregoing analysis of country context, supply and demand of microcredit. Some tentative recommendations will be made to policy-makers for a macro-level approach to enhance and promote the growth and sustainability of the Brazilian microfinance industry.

CHAPTER VII - THE WAY FORWARD: CONCLUSION AND RECOMMENDATIONS

The analysis of the country context, a discussion of the supply and demand of microcredit, and an assessment of the two main "endogenous" challenges to the expansion of MFIs have helped the reader to gain a better undestanding of the microfinance industry and its specific characteristics in the Brazilian context. In sum, the following key observations were made:

- When microfinance started to take off internationally, a **challenging macroeconomic environment** stifled its growth in Brazil. Hyperinflation, regulatory restrictions and requirements made the Brazilian market an unattractive one for MFIs.
- There was a remarkable acceleration in Brazil's microfinance sector from the end of the 1990s; despite this rapid acceleration, however, **microfinance penetration** in Brazil today **remains low**, especially compared to neighboring countries. There is thus a market for an increase supply of microfinance services.
- Until today, microfinance expansion has remained largely **government-led**. Institutions have relied substantially on relatively low-cost government lines of credit extended at below-comparable-market rates.
- Some so-called microfinance institutions in Brazil, run mainly by municipal governments to achieve social objectives such as employment, provide highly **subsidized credit** for this purpose. Such price-distorting subsidies could affect the expansion of market-oriented microfinance.
- Nonetheless has research in three rural communities the state of Goiás led us to conclude that the **supply of microcredit does not yet meet demand**, as government sponsered credit programs have very limited outreach. We therefore conclude that there is space for MFIs to enter the market with innovative and diversified financial services.
- **Store credit**, though widely and easily available, can only partly replace the role of MFIs. Such consumer credit is available only for certain types of goods (such as electronic and household supplies, among others), and is a costly in terms of high and exponentially rising interest rates.

- Since the late 1990s, large **banks** are increasingly adopting **"downscaling" strategies**, consisting of targeting lower income individuals or smaller businesses. This proves to be a profitable commercial banking line of business, not least due to the benefits arising from the use of a large pre-existing branch network to distribute products, which allows a much faster roll-out of microfinance services. Banks thus have a significant comparative advantage when compared to small start-up MFIs. The latter, thus, may consider developing **partnerships** that allow them to distribute their products via bank networks.
- Demand for microfinance was found to be high, and Brazilians have a strong **preference for "time over money"** – longer terms over higher interest payments. This suggests that MFIs entering the market must be well aware of the cultural pecularities and nuances of the demand for microfinance products.

In view of the above findings, one fundamental question remains: Given the challenging macroeconomic context and the increasing competition from government subsidized microcredit providers, retail stores and commercial banks adopting downscaling strategies, what is the role of MFIs in the future and how can they assert themselves as viable players in the Brazilian microfinance industry?

In order to try to answer this question, we came up with a set of recommendations to policy-makers for the improvement and sustainable expansion of financial services targeting the poor.

Recommendations for Policy-Makers

For microfinance to become a thriving and sustainable sector, it is essential that their be a policy environment that is conducive to the creation and expansion of MFIs. In a study of microfinance services in Latin America, led B. Marulanda and M. Otero from Acción,[90] the authors emphasize the importance of **political will** in developing the microfinance market. This implies that central banks and relevant ministries must take MFIs seriously and move to address regulatory issues, so as to allow the institutions to operate effectively and grow. In his first term, the Brazilian president

[90] Beatriz Marulanda and María Otero, "The Profile of Microfinance in Latin America in 10 Years: Vision and Characteristics", ACCION International, Boston: 2005.

Lula undertook a number of regulatory measures in order to formalize MFIs as OSCIPs or SCMs, and mandated the BNDES to play a more active role in the provision of microfinance services. The latter has mixed implications, as subsidized credit lines undermine the competitiveness of MFIs, as discussed above. Moreover, the regulatory framework is still relatively complicated and legal standards and processes make it hard for new institutions to enter the market. It is important for the growth of the microfinance sector that there be genuine interest in creating thriving microfinance institutions, not a mere passing political interest, which may set in motion precisely a regulatory environment that will harm microfinance in the long term.

This hints to the importance of having **financial policy preconditions** in place that foster the growth of MFIs. In Brazil, the presence of interest rate ceilings, which are meant to protect small borrowers, hinder the sustainable growth of microfinance providers. The high administrative costs of making small loans are a signature characteristic of microfinance, and they require higher interest rates to cover the costs fo lending. Restrictive interest rate caps create great pressure on MFIs in Brazil. They also hamper the efforts to reach the smallest clients and to cover their costs. It is essential for the sustainable growth of the sector that the government reconsiders this policy and makes allowing for microfinance lending in these caps, so as to make it possible for them to cover their costs.

A further aspect pertaining to the financial policy preconditions is the **role played by public banks**. Government-run MFIs in Brazil which use subsidized interest rates are creating havoc in the sector. They distort the market, reach the larger and more powerful clients, create a poor repayment culture, and make ineffective use of public funds. However, there are examples of well-managed, commercially driven public MFIs that make good use of existing infrastructure and have become important microfinance players. Banco do Nordeste is one of them, as we have mentioned above. However, Banco do Povo is less of a poster-child example, and measures should be adopted to restructure the Bank so as to enable it to turn into a high quality and significant microfinance provider.

One insight that is of primary importance for MFIs entering the market or wishing to expand, is that **a portfolio of products is a necessity**. As the study by Acción mentioned above predicts, in the next ten years the "boutique" and spe-

cialized microfinance institutions will face increasing competition from the commercial sector, in which their financial margins will be dropping. "Thus their ability to access less costly funds such as those coming from savings accounts will define whether or not they can be profitable, even within this market niche", Beatriz Marulanda and María Otero write. On the other hand, the increased variety of products demanded by the market will give MFIs more opportunities to offer a diverse range of products, which through cross-selling to existing clients, will reduce the costs of direct contact with the micro-enterprise household.[91]

The Brazilian legal restrictions with respect to savings and insurance put an obstacle to the progress and sustainability of MFIs. Microfinance in Latin America today not only refers to facilitating access to credit, but also to serving all the financial needs of low-income families. This implies providing access to basic services such as secure, low-cost **transfers of funds (remittances)** on both a domestic and international basis, and to offering **savings and insurance products** that can help stabilize the income of families working in the informal sector. Indeed, as Table 5 in the Appendix shows, savings and credit product offerings that commercial banks, regulated MFIs ares NGOs are providing in Latin America are broadly diversified. Not only banks provide consumer credit and mortgage loans, but also MFIs and NGOs have entered these markets.

On the savings side, it is interesting to note that 44 percent of Latin American MFIs offer passbook savings – a funding activity which Brazilian SCMs or OSCIPs are deprived of. Indeed, funding the portfolio with money from the public gives institutions more independence in their growth strategy and in developing products to meet the needs of their clients. While commercial banks do have this option in Brazil, MFIs remain dependent on their equity and on loans from local and international financial institutions to fund their growth. This characteristic makes them more vulnerable.

Hence, while institutions in other Latin American countries have pursued product diversification in response to their client's diversity of needs, Brazilian MFIs are confined to credit services. This not only hinders their growth and the diversification of their risk, but also deprives them from potentially viable sources of additional income and funding. As Marulanda and Otero point out, the financial needs of low-income families are varied, not just those of micro-entrepreneurs but also those of families where the source of income is in the form of a salary. "Access to consumer, housing and/or

[91] Marulanda and Otero, *op. cit.,* p. 17

educational loans is unquestionably important, and the financial system should provide these kinds of credit products if it is to achieve greater penetration into poorer sectors of the economy." [92]

Recommendations for Microfinance Institutions

In analyzing the demand for microcredit, we found that Brazilians have a **preference for installment credits, and little familiarity with the concept of interest rates**. What can be learned from this insight is that it appears preferable that financial fees be presented as a fixed amount and not as a percentage. This was illustrated by the fact that the majority of the interviewees that had taken up loans could remember how much the installment was, but rarely the administrative fees included, unless the latter was expressed as a fixed amount.

There is a clear shift taking place in microfinance from a monoculture offering solely productive credit to a more **diverse offering of microfinance products**, such as housing improvement credits, insurance and – most importantly – savings. The growing appreciation and preference for savings-led MFI models has taken place in the light of recent works on what poor people want and need.

Surprisingly, this study did not observe an overwhelming desire or willingness to save. However, if MFIs lobby more actively for the easing of restrictions and engage in active **savings mobilization**, they could slowly help to change the savings behavior of low-income clients. This would not only be to their own benefit in terms of additional sources of funding, but also create awareness for the advantages of savings over debt.

We noted earlier that Brazil has a much more **sophisticated financial system** than other Latin American countries. The Brazilian population is acquainted with advanced banking technologies and marketing techniques, which makes them more sophisticated and demanding on the quality of service. This relative sophistication of clients vis-à-vis the level of development of the microfinance industry is a key distinguishing characteristic of the Brazilian market,[93] and definitely

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[92] *ibid.*, p. 20

[93] Nichter, et al., *op. cit.*, 2002, p 52-53.

represents a significant challenge for start-up MFIs. Until now, most MFIs have typically used their own loan officers as a distribution channel in order to acquire new clients. In Brazil, however, credit is not typically sold door-to-door, but is obtained within stores or at traditional banks. As a result, customers might be unreceptive to or even suspicious of this practice.

In order to attract such sophisticated customers, "traditional" MFIs might have to **explore alternative distribution channels**, such as stores,[94] gas stations, cellular companies, post offices (for example, bank Bradesco), lottery agencies (for example, Caixa Econômica). Using alternative distribution channels by developing partnerships could offer benefits such as extended reach, the ability to offer new products, and cost savings,[95] which, in turn, contribute to growth. It is clear that leveraging alternative distribution channels is a tremendous opportunity for a incoming MFI to reduce the cost burden.

In conclusion, the foregoing analysis suggests that a number of operational and institutional changes may be necessary to make the traditional microfinance sector truly relevant and attractive to the populations it is designed to meet. In order for microcredit providers to remain or become viable competitors and to achieve growth, it is essential to adopt appropriate strategies based on the following changes:

- **Redefinition of the target market and the actual products**: the potential demand for microfinance consists of a broader population than the "higher income" micro-entrepreneurs. In order to reach low-income households and "lower income" micro-entrepreneurs, start-up MFIs entering the market could try to
  - find alternatives to current guarantee mechanisms (for example, step loans,[96] credit histories, social capital,[97] the legal seizure of the debtor's goods, etc…)

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[94] Traditional banks are already exploring this path. In 2001 Unibanco (a Brazilian private bank) started partnerships with two chains of low income department stores, Ponto Frio and Magazine Luiza, in order to provide financial services to their (5 million) customers.

[95] In areas such as client acquisition activities, payment collections, advertising and use of infrastructure.

[96] Methodology according to which first-time clients are given relatively small loans compared to how much they are able to pay, with the lure of more substantial loans once a payment history is developed.

[97] Gaining local knowledge about credit histories, personalities during the client selection process through consulting of priests, local associations, etc. and to harness social pressures in favor of repayment. Can only work in rural areas.

- develop tailored products addressing clients' needs: adaptation of terms of payment (such as installment credits with small payments)
- involve community leaders and other influential individuals from the lower-income communities in promoting microfinance products.

- Use of **marketing strategies** to create awareness and understanding of the products that are offered, for example through local NGOs, influential members of society, etc. This is important given the lack of information on existing microcredit providers and their requirements that we found in our conversations.
- **Develop partnerships** with local stores, post offices, banks or even large retail stores to distribute the products.

APPENDIX

Table 1: Profile of Interviewees

		Alto Paraíso	Cavalcante	Teresina d. G.	Average
Number of interviewees		37	43	20	Total: 100
Average age of interviewees		38.5	37.6	26.7	**34.3**
Marital status	married	40.5%	44.2%	55.0%	**46.6%**
	single	37.8%	41.9%	35.0%	**38.2%**
	other	21.7%	13.9%	10.0%	**15.2%**
Average number of children		2.6	3.1	2.2	**2.6**
Occupation	student	0.0%	7.0%	0.0%	**2.3%**
	with social security	10.8%	9.3%	24.0%	**14.7%**
	w/out social security	16.2%	25.6%	8.0%	**16.6%**
	autonomous	64.9%	58.1%	52.0%	**58.3%**
	housewife	13.5%	16.3%	12.0%	**13.9%**
	invalid	2.7%	0.0%	0.0%	**0.9%**
	unemployed	8.1%	4.7%	4.0%	**5.6%**
	retired	2.7%	4.7%	0.0%	**2.5%**
Average # of persons living in the household		4.2	4.6	4	**4.3**
Average # of persons in the household working		1.8	1.8	1.5	**1.7**
Average # of children living in the household		2.2	2	1.75	**2.0**
Property	house	81.0%	67.4%	75.0%	**74.5%**
	television	86.5%	86.0%	90.0%	**87.5%**
	radio	81.0%	58.1%	60.0%	**66.4%**
	bathroom	81.0%	81.4%	100.0%	**87.5%**
	car	37.8%	23.3%	45.0%	**35.4%**
	household assistance	18.9%	9.3%	10.0%	**12.7%**
	washing machine	51.4%	32.6%	55.0%	**46.3%**
	video/dvd	51.4%	18.6%	55.0%	**41.7%**
	fridge	86.5%	60.7%	90.0%	**79.1%**
	freezer	18.9%	11.6%	40.0%	**23.5%**
Level of education	illiterate	18.9%	37.2%	15.0%	**23.7%**
	primary school	21.6%	18.6%	25.0%	**21.7%**
	secondary school	13.5%	20.9%	19.0%	**17.8%**
	college	40.5%	23.3%	45.0%	**36.3%**
	university	5.4%	0.0%	5.0%	**3.5%**
Household income	< $170	5.4%	30.2%	20.0%	**18.5%**
	$170 - $505	64.9%	51.2%	50.0%	**55.4%**
	$506 - $840	21.6%	9.3%	30.0%	**20.3%**
	$841 - $1345	8.1%	9.3%	0.0%	**5.8%**
	> $1345	0.0%	0.0%	0.0%	**0.0%**
	average *	$370.5	$264.3	N/A	**$317.4**
Main source of income	salary	34.1%	35.2%	55.0%	**41.4%**
	government assistance	18.2%	20.4%	15.0%	**17.9%**
	autonomous activity	54.6%	38.9%	65.0%	**52.8%**
	pension	0.0%	3.7%	0.0%	**1.2%**
	loans	0.0%	1.9%	0.0%	**0.6%**
Do you have your own business?	yes	62.2%	46.5%	75.0%	**61.2%**
	no	37.8%	53.5%	25.0%	**38.8%**
If yes, do you have (a) partner(s)?	yes	12.5%	35.0%	20.0%	**22.5%**
	no	87.5%	65.0%	80.0%	**77.5%**
Employees	0	43.2%	70%	73%	**62.2%**
	1-5 persons	21.6%	20%	27%	**22.8%**
	6-10 persons	0%	0%	0%	**0.0%**
	more	0%	10%	0%	**3.3%**
	average *	1	6	2	**3**
Family members working in business	yes	54.2%	60.0%	66.7%	**60.3%**
	no	45.8%	40.0%	33.3%	**39.7%**
How old is the business?	< 1 year	4.6%	10.0%	13.3%	**9.3%**
	1-3 years	31.8%	30.0%	20.0%	**27.3%**
	3-5 years	27.3%	25.0%	13.3%	**21.9%**
	6-10 years	22.7%	30.0%	26.7%	**26.5%**
	> 10 years	13.6%	15.0%	26.7%	**18.4%**
	average months *	87	66	103	**86**
Who are your clients?	community	42.3%	52.6%	34.6%	**43.2%**
	tourists	34.6%	34.2%	46.2%	**38.3%**
	outside	23.1%	13.2%	19.2%	**18.5%**

* when indicated

Table 3: Regulated Microfinance Institutions: OSCIPs and SCMs

OSCIPs (*Organização da Sociedade Civil de Interesse Público* – Civil Society Organizations of Public Interest**)**

- OSCIPs are non-profit organizations whose social objectives must fall within a specified list;
- They are currently exempt from Usury Law restrictions;
- They are subject to reporting requirements (including audited accounts of activities carried out under a Cooperation Agreement with a public entity) to the Ministry of Justice;
- Sources of financing are limited to donor funding, owners' investments and government funding (including lines of credit from the Brazilian state-owned development bank BNDES);
- OSCIPs can own an SCM as a subsidiary.

SCMs (*Sociedades de Crédito ao Microempreendedor* – Credit Societies for Micro-Entrepreneurs)

- SCMs are for-profit financial institutions deemed to be part of the national financial system;
- They are thus exempt from Usury Law restrictions;
- They are also thus subject to the tax regime for financial institutions including income tax, etc.;
- As financial institutions, they are subject to reporting (non-audited accounts) and regulatory requirements of the Central Bank of Brazil, which supervises them;
- They are subject to minimum capital requirements (R$100,000 or $47,221); liquidity requirements; and restrictions on leverage (five times liquid assets);
- Sources of financing include all those allowed to OSCIPs, plus loan or credit lines from national and foreign financial institutions and from OSCIPs;
- They can extend loans and guarantees to individuals and micro-enterprises, up to R$10'000 ($4,722) per client, for professional, commercial or industrial use only; they are prohibited from extending consumer loans;
- They can operate Microcredit Serving Points (Posto de Atendimento de Microcrédito) with full flexibility in terms of location, opening hours, etc., and no additional capital requirement;
- They cannot collect deposits from the public, participate in the interbank deposit market, or issue securities for public offering.

Source: IBRD/World Bank, Anjali Kumar, *Access to Financial Services in Brazil*, Directions in Development, Washington D.C.: 2005.

Table 3:
Formal, Semi-Formal and Informal Credit Providers: Conditions, Financial Services, and Level of Use[98]

	Conditions	Category of Financial Services	Use
FORMAL SECTOR	1. *Requirements*: - Cadastro de Pessoa Física (CPF) - Identity Card - Proof of residence - Proof of income or Personal guarantee - Clean credit record 2. Use of a *written contract and receipts* upon disbursement and repayment. 3. *Terms and conditions:* - Amounts: R$ 50 – 5000 - Repayment: biweekly or monthly - Terms: 1 – 36 months - Interest rates (not including fees or late payment penalties): 0 – 11,5% per month	• Bank lines of credit • Loans from consumer lender (*financeiras*) • Credit cards • Store credit and checks • Microcredit from MFIs	* ** **** ***** **
SEMI-FORMAL SECTOR	1. *Requirements*: - No or few documents required - Clean credit record not necessary (no name verification with credit protection agencies) 2. Usually *personal relationship* between lender and borrower; no written contract or receipts that register the operation, except in case of payment plans made in small store and certain agiotas. 3. *Terms and conditions*: - Amounts: R$ 10 – 2000 - Repayment: biweekly or monthly - Terms: usually 1 – 4 months - Interest rates (not including fees, late payment penalties): 0 – 45% per month	• Salary advances from employers • Moneylenders (*Agiotas*) • ROSCAS (*Caixinhas* or *Sorteios*) • Payment plans from small retailers • Supplier credit	*** *** **** ***** *****
INFORMAL SECTOR	1. *Requirements*: - No documents required - No credit record check 2. Usually *personal relationship* between lender and borrower; absence of written contract or receipts. 3. *Terms and conditions*: - Amounts: R$ 10 – 200 - Repayment: biweekly - Terms: usually 1 month - Interest rates: 0 – 5% per month	• Credit from family or friends • Informal store credit (*fiado* or *pendura*)	**** *****

[98] Data adapted from Bonnie Brusky and João Paulo Fortuna, *op. cit.*, 2002, pp. 15-17

Table 4: Credit Behavior of Respondents

		Alto Paraíso	Cavalcante	Teresina d. G.	Average
Have you ever taken up credit?	% of total	75.7%	44.2%	60.0%	**60.0%**
If not, why?	never needed	25.0%	11.4%	25.0%	**20%**
	shame	0.0%	2.3%	0.0%	**1%**
	fear	75.0%	29.6%	33.3%	**46%**
	lack of information	0.0%	9.1%	16.7%	**9%**
	lack of trust	0.0%	9.1%	0.0%	**3%**
	lack of option	0.0%	11.4%	8.3%	**7%**
	not qualified	0.0%	25.0%	16.7%	**14%**
	other	0.0%	2.3%	0.0%	**1%**
Origin of credit	family	14.3%	8.3%	0.0%	**8%**
	friends	10.7%	8.3%	7.7%	**9%**
	bank	71.4%	62.5%	76.9%	**70%**
	credit institution	0.0%	4.2%	7.7%	**4%**
	credit card	0.0%	4.2%	0.0%	**1%**
	agiota	3.6%	0.0%	0.0%	**1%**
	other	0.0%	12.5%	7.7%	**7%**
Use of credit	production	61.5%	60.0%	38.9%	**53%**
	consumption	39.5%	40.0%	61.1%	**47%**
Credit term	< 1 month	5.9%	0.0%	0.0%	**2%**
	1 month	23.5%	22.2%	0.0%	**15%**
	2-3 months	0.0%	0.0%	33.3%	**11%**
	4-6 months	11.8%	33.3%	33.3%	**26%**
	7-11 months	41.2%	0.0%	0.0%	**14%**
	1 year or more	29.4%	44.4%	33.3%	**36%**
Average credit size (USD)		1850	5311	2614	**3259**
How was credit paid back?	single payment	20.8%	13.3%	0.0%	**11%**
	installments	79.2%	86.7%	100.0%	**89%**
Collateral	yes	12.0%	10.5%	0.0%	**8%**
	no (or guarantor)	88.0%	89.5%	100.0%	**93%**

* when indicated

Table 5: Credit Behavior of Institutions in Latin America

(Source: Marulanda and Otero, "The Profile of Microfinance in Latin America in 10 Years: Vision and Characteristics", ACCION International, 2005.)

Product Offerings of the Institutions Included in this Study

	Commercial Banks		MFIs		NGOs	
	Directly	Alliances	Directly	Alliances	Directly	Alliances
LOANS						
Consumer	90%		78%		38%	
Commercial	70%		67%		31%	
Mortgage	60%		44%		25%	
Microcredit	90%		100%		100%	13%
Rural	50%		33%		44%	6%
SAVINGS						
Accounts	70%		44%		6%	
ATMs	60%	10%	44%	11%	6%	
Internet	20%					
Remittances - Nat'l	50%		22%	22%		
Remittances - Internat'l	30%	20%		33%		6%
OTHER SERVICES						
Insurance	50%	10%	11%	11%	6%	25%
Training		20%	11%		38%	19%

Note: These statistics collected from 10 banks, 9 MFIs and 16 NGOs.

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