



The Social and Economic Developers Association, Laos  
Report of micro-credit scheme

## **A response to micro-credit critics August 2009**

### **Introduction**

Micro-credit, a program of providing unsecured small loans to poor people in developing countries, has recently come under fire by critics for a range of issues. Reports from leading universities and research centers<sup>1</sup> have leveled a number of charges against micro-credit schemes in developing countries around world. Criticisms include corruption, profiteering, high interest rates and hidden charges, and creating debt.

The Social and Economic Developers Association (SEDA) runs a micro-credit scheme in Laos that is loosely based on the traditional model, but that differs in key ways. This report seeks to address criticisms and demonstrate that SEDA takes a socially responsible approach to lending that manages to avoid the pitfalls of comparable schemes elsewhere.

### **Background to micro-credit**

Since the mid 1990's, micro-credit has been making a big impact in the international development community. It was originally conceived by Nobel Prize winning Professor Muhammed Yunus of the Grameen Bank in Bangladesh in the 1970's, but has been taken seriously as an approach to economic development in the last 15 years.

The hopes for using micro-credit as a long term solution to poverty were so high that the UN declared 2005 'the Year of Micro-Finance'. Evidence from Bangladesh indicated that 5% of loan recipients exit poverty each year as a result of the scheme and other measurements demonstrated higher school attendance for the offspring of borrowers.

For many it seemed that providing the start up capital for small entrepreneurs was a cure-all for developing countries' needs: that micro-credit could miraculously and single handedly solve economic and societal problems.

In 2009 it would seem that those hopes were too high. Like any program involving money, micro-finance has been subject to corruption and profiteering, and the results have not always lived up to the high expectations.

Recent reports have shown that in developing countries micro-finance is having very mixed results: in many cases it really does help empower vulnerable and disenfranchised women (and men) to create financial stability. In other cases, high interest rates, hidden costs, and a lack of fundamental business skills have left people indebted far beyond their means.

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### **SEDA-Laos**

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There are other contributing factors to the failure of small businesses that are cultural in nature and which some micro-credit institutions have failed to address:

- The majority of micro-credit programs loan exclusively to women, to help empower them against gender inequality and because of a perception that women in developing countries are more reliable with finances than their male counterparts. New research indicates that in some countries, women are pressured into handing over any profits to their husbands rather than to reinvest in their businesses and repay loans. Women are also more likely to use funds to help their families, rather than to invest in the expansion of their enterprises.
- In less developed countries, men and women often lack education, business skills, basic financial understanding and the conditions to save money. Without training and support systems in place, they are much more likely to default on loan repayments and to fail in their business enterprises.

### **SEDA's approach to micro-credit**

#### Training and support

SEDA uses a different approach to micro-credit, based on over two years of research with potential loan recipients in Laos.

Before accepting participants into the micro-credit scheme, applicants are interviewed in-depth to determine their financial, training and assistance needs. Upon acceptance into the program, all participants are enrolled into a training course that teaches skills such as accounting, writing business plans, budgeting and how to save money for emergencies, or business expansion.

Where requested additional support is provided. In the case of one group of women, this comes in the form of assistance with price negotiations with suppliers and buyers. For other participants it may be technical training, in agriculture or weaving for example, or marketing support.

#### Interest rates and loan defaults

As a non-profit organization, SEDA keeps interest rates low: ranging from 3% for women in urban areas to just 1.5% for those in the remote parts of the country. The interest rates are adjusted to the relative costs of living and profit making potential in different regions.

Unlike many schemes, there are no hidden charges to the credit; no charges for missed payments, and no closing or administrative fees. And SEDA has a unique approach to dealing with businesses that fail and unpaid loans.

Each loan default is treated on a case by case basis. If the woman has failed because of a lack of skills, or unforeseen circumstances, her debt is cleared; she is re-enrolled in business training and is eligible for a second small loan. If, on the other hand, the woman has demonstrated no effort to generate an income or to make monthly repayments, she is not forced to pay back the loan, but is removed from the program and ineligible to for future credit.

#### Funding

The approach is unusual and may seem counter productive in creating a self sustaining micro-credit scheme, and yet it is working. The screening process and training that participants go through ensure that failure is rare. The scheme is not self-sufficient yet, and may never be fully self funding, if achieving sufficiency is at the expense of poor people through higher interest rates and the creation of debt. SEDA uses donations, alongside low

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amounts of interest on repayments, to sustain the program: as long as people are willing to donate the program can continue to run.

Another funding source is from large scale buyers of products created by women in the project. Any company that buys in large volumes is asked to make a contribution that is invested into the micro-credit scheme.

Souly QuachAngkham, Founder of SEDA, explains, “SEDA is not profiting in anyway from our micro-credit initiative. Currently we depend on donors to fund the original loans, and once they are repaid we re-invest in other women. But if one of our recipients is unable to repay, we don’t force them to – our goal is not to lead people already struggling with poverty into debt, but to help them, and we know that our donors feel the same way.”

### **Conclusion**

For all the criticisms leveled against it, the basic premise of micro-credit remains a powerful tool in the fight against poverty. It is important to recognize that developing countries suffer from a range of socio-economic problems: micro-credit schemes can’t fix everything, but they do work as part of a range of tactics designed to tackle problems at various levels of society.

SEDA has a wide range of activities outside of micro-credit to help provide a more rounded approach to economic development, including education and literacy programs, health care initiatives and environmental projects.

To find out more about SEDA’s activities in Laos, please visit <http://seda-laos.org> or email [info@seda-laos.org](mailto:info@seda-laos.org)

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<sup>i</sup> Including “Expanding Micro enterprise Credit Access: Using Randomized Supply Decisions to Estimate the Impacts in Manila” by Dean Karlan and Jonathan Zinman (Yale and Dartmouth Universities), July 2009, and “The Miracle of Microfinance? Evidence from a Randomised Evaluation” by Abhijit Banerjee, Esther Duflo, Rachel Glennerster and Cynthia Kinnan (MIT), May 2009.

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