How MFIs and their Clients Can Have a Positive Impact on the Environment

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Introduction

The United Nations conceived The Millennium Development Goals for the purpose of eliminating poverty. The Microcredit Summit Campaign is concerned specifically with the objectives of Goal #1: *Eradicate Extreme Hunger and Poverty*. This proposal, however, is also concerned with Millennium Development Goal #7: *Ensure Environmental Sustainability*[1]. Our question is, can microfinance, which contributes to achieving Goal #1, harm the natural environment? Or, more positively, can microfinance be a means to achieve both Goal #1 and Goal #7 at the same time? This paper will discuss both sides of the argument, and hopefully convince our audience that microfinance can, and should, contribute to a healthier natural environment for the benefit of the poor.

Negative impact of microenterprises

The livelihoods of the poorest of the poor are often directly connected to their environments and, as a result, significantly impact the environment. The opposite is also true; that the environment has a significant impact on the livelihoods of the poor. Consequentially, it is inevitable that some microenterprises (a term that we use here to include both urban and rural microenterprises and income-generating activities such as farming, fishing, and livestock-raising) negatively impact the environment.

Microenterprises that have negative impact on the environment create problems for the greater community. These problems range from disturbance (sound pollution and litter) and health problems (respiratory sicknesses, diarrhea), to less intuitive consequences such as worsening the impact of

[1] Goal #7's subgoals are: *Integrate the principles of sustainable development into country policies and programmes; reverse loss of environmental resources; reduce by half the proportion of people without sustainable access to safe drinking water; and achieve significant improvement in the lives of at least 100 million slumdwellers by 2020.*

natural disasters through the destruction of natural protective barriers (mangroves and swamps).

Why do microenterprises have a negative impact on the environment? The nature of their inputs (inorganic fertilizer, pesticides), the type of production methods (burning or mining), the inefficiency of production technologies (leading to over utilization of natural inputs), waste (litter, diesel smoke) and outputs (lumber, sale of endangered species) all significantly, and negatively, affect the environment. These microenterprises create waste and litter, cause air and water pollution, damage riverbanks, ruin soils, and deplete forests and wildlife.

It is true that the small size and scope of microenterprises limits their negative impact. On the other hand, their sheer numbers, ubiquitous presence, extended hours of operation, lack of supervision by regulatory and environmental agencies, low technological level, and lack of supporting infrastructure and services (trash collection, enclosed marketplaces) all heighten their negative impacts. Some examples of microenterprises that have obvious negative impacts include: charcoal production, livestock grazing, timber harvesting, tanneries, textile dyeing, slaughter of animals, and small mining operations.[2]

Positive Impact of Microenterprises

Of course microenterprises can also have a positive impact on the environment. Microenterprises that use green inputs for production, (such as certified/sustainably grown lumber, organic seeds, compost or green fertilizer, and organic dyes) can contribute to a healthier environment. Sustainable production techniques such as reforestation, controlled water

[2] Wenner, M., Wright, N., Lal, A. (2004) "Environmental Protection and Microenterprise Development in the Developing World: A Model Based on the Latin American Experience." Journal of Microfinance. Volume 6, No. 1.

usage, natural pesticide applications, and environmentally friendly technologies (including micro drip irrigation systems, solar water pumps) all conserve environmental resources. Microenterprises that recycle trash or used goods, and those that utilize recycled materials as inputs, are helping the environment.

Microenterprise, Microfinance, and the Environment

Having established that microenterprises can have negative or positive (and perhaps both at the same time) impacts on the environment, why should this be important for microfinance practitioners?

Scale

Microenterprises in many countries are supported by, and grow through support from, microfinance services. There is, however, very little (if any) monitoring of the environmental impact caused by this growth. According to the Microcredit Summit, at the end of 2004 microfinance institutions had reached 92 million clients. This represents a nearly 7-fold increase from the 13.5 million loan recipients in 1997. The increasing availability of financial services will undoubtedly result in greater negative environmental impact unless microfinance practitioners ensure that this does not occur.

Risk

Exposure to risk is an important issue for MFIs. Environmental issues can increase an MFI's risk and, in turn, affect its profitability. Poor people are more dependent on natural resources, frequently using natural resources as inputs for their production. Handicraft artisans, farmers, food vendors, textile producers, charcoal sellers, and many others use natural resources for their production. The depletion over time of these inputs reduces the sustainability of the business, thereby increasing the risk to the MFI. As inputs become scarce, they become more expensive, which jeopardizes the client's ability to save or to repay a loan. Since MFIs tend to support sectors in which many

clients are doing the same activity, if this activity depletes natural resources, the MFI's portfolio in that sector is at risk.

MFIs and microentrepreneurs can also increase their risk levels by destroying natural habitat in order to make a living. In doing so they put themselves in danger of landslides or floods. The loss of business and life in the event of a natural disaster that was caused or exacerbated by environmental destruction will affect an MFI's bottom line.

Finally, pollution creates risk for an MFI. When microentrepreneurs become sick from pollution, they are less productive, and their ability to pay off loans or save decreases. If their clients become sick from environmental pollution, the same thing occurs.

Regulation

MFIs should pay attention to those countries in which governments are beginning to promulgate and enforce environmental regulations. If clients are located in a bio-sensitive region that the government wants to protect, it may relocate clients to a less sensitive area. This action will disrupt a client's ability to save and to work. If the government enacts legislation on reducing air pollution and forces vehicles to switch to compressed natural gas (CNG), as happened in India and Bangladesh, then microentrepreneurs' profits may suffer in the short term and their ability to make their lease payments on their assets will decrease.

Access to funding

As MFIs become independent from traditional donor funding they are starting to access investor funding. At the same time, the socially responsible investment community is interested in microfinance and looking for ways to invest. Many socially responsible funds, and the foundations linked to them

(such as the Calvert Foundation), use environmental criteria in their due diligence procedures for lending. Foundations established by global entrepreneurs (such as Bill Gates of *MicroSoft* and Pierre Omidyar of *eBay*) are likely to have environmental criteria or value the environmental sustainability of their investments. This is because their own business activities are subject to government-imposed environmental controls and regulations. These companies and organizations are also interested in their own public image because the public in the countries where their businesses are based is aware of, and concerned about, environmental issues and impact.

Ethical or Religious Considerations

Some MFIs have grown out of microfinance programs started by faith-based organizations. These organizations often feel that stewardship of the earth is a part of their religious conviction. Other MFIs feel that they are a part of their communities and that they have the responsibility of maintaining or improving the community. *Opportunity International*, *MEDA*, and *Oikocredit* are examples of organizations that support microfinance activities and have environmental lending criteria as well.

New Markets

Environmentally friendly technologies that save people money are becoming more efficient, more available, more affordable and better known. Examples of these are solar panels (which are increasingly affordable for low-income families), solar chargers for cell phones, micro drip systems, solar water pumps and cookers, and low-wood-use (e.g. Lorena) stoves. At the same time, MFIs in a many countries are facing steeper competition from other MFIs. As MFIs look to become more competitive, they should consider lending for the purchase of these technologies as a potential market niche.

MFIs and Environmental Practice

Given everything previously stated, how can MFIs make a difference? And how can they do so without affecting their own profitability and without passing on extra costs to their already overburdened clientele?

MFI Operations

There are many ways that MFIs can decrease or avoid environmental damage from their own operations without undue cost. MFIs can follow the environmental mantra: *Refuse, Reduce, Re-use, and Recycle.* MFI management can do a quick and low-cost environmental audit. They can examine their use of resources, look for ways to reduce inefficiencies, re-use resources, and recycle what can no longer be used. This will result in lower costs for the MFI in addition to lower impact on the environment. Large banks, spurred by the Global Reporting Initiative (GRI) and the United Nations Environmental Program Financial Initiative (UNEP-FI), are beginning to do just this.[3] In fact, UNEP-FI is beginning to include microfinance institutions in its membership.

MFIs can create low-cost environmental messages for both staff and clients. A message is the first step to behavior change. The message about caring for the environment and the interconnectedness of people with their environment can be embedded in other MFI materials, such as newsletters, posted on the walls of branch offices, or incorporated into the MFI's marketing slogans. The message can be transmitted verbally in orientation meetings with potential clients, in group meetings, or when clients visit the branch office. The inclusion of the phrase "I certify that I will do my best to use business practices that will not harm the environment" on a loan application can raise client and staff consciousness, even if it is difficult to verify these actions. The phrase signals that the issue is important to the

[3] www.globalreporting.org and unepfi.org, respectively.

MFI, and can be built upon in later stages as the MFI increases its efforts towards environmental conservation.

Environmental consciousness in MFI staff can be raised in staff meetings. Staff can be educated on environmental issues pertinent to the region, and then acknowledged, praised, and/or rewarded for incorporating their learning into their work. If there are environmental/conservation NGOs working in the area, management might coordinate with these entities to arrange seminars and trainings on the subject for MFI staff and Board. Where funding is available, the same environmental NGOs can be contracted to develop training materials for and/or to provide training to clients. One cost-effective method is to incorporate Green Microfinance Pocket Guides™ containing a few talking points on an environmental issue. These are used by MFI loan officers and other staff, in meetings with clients, for raising consciousness about their impact on the environment. The goal here is NOT to turn MFIs into environmental entities, but rather to create an overall awareness of the environment and how it affects the sustainability of clients' businesses and hence of the MFI itself.

MFIs expanding into new geographic areas, or beginning to finance new sectors (e.g. agriculture) should add some questions about the environment to their analytical process or marketing study. Are there sensitive biological areas in the region where the MFI wants to expand? How can the MFI ensure that its services and products will not damage the area? This is equally true of new sectors being financed – the MFI should think about whether there is negative environmental impact from those sectors. Can the financial services be used to minimize that impact, or is it better not to finance these harmful activities?

MFI management can create an environmental policy for their institution, and then publicize it. Once publicized, the MFI should be held accountable by staff, clients, and donors/investors. The next step is to develop systems for

putting the policy into practice. How can the policy be implemented and internalized within the institution? An exclusion list can be developed. This is a list of microenterprises that have such negative impact on the environment that it is better not to finance them. These microentrepreneurs can be encouraged to save and to modify their business practices or change businesses before being given a loan.

One caveat – many MFIs are already managing too much information, under pressure from donors to collect nearly every piece of information possible about their clients. Most of this information is never used. MFIs should not collect environmental information about their portfolio except for the businesses with the very highest impact or those lending for environmental technologies and practices. It may be useful to know if loans have failed due to environmental problems, and therefore worth the cost of collecting and analyzing the information. Environmental indicators should be carefully considered before investing in collecting information. Some indicators might include the number of "green" loans (recycling, environmental technologies), the number of loans that defaulted due to environmental risk, the percentage of portfolio in risky sectors, the number of loan applications rejected for environmental risk or hazards, etc. These indicators should be developed specifically for each MFI, taking into consideration its mission and clientele's needs, and in consultation with its Board, staff and clients.

Environmental Lending

Using microfinance to encourage people to adopt environmentally friendly technologies is not easy. There are many challenges in this area, and there have been many failures. What are the obstacles? From the supply side, some issues are availability of the technology (distribution networks), quality and capacity of the technology provider, and the quality of the technology. From the demand side some issues are: affordability, lack of knowledge about the technology, uncertainty about the returns, the complexity of

operation, and security/safety.

Some of these obstacles are being addressed by the market. Many alternative technologies within the reach of the poor (e.g., small-scale solar electric systems, biogas, efficient stoves, water saving devices, cleaner fuels and manufacturing equipment, etc.) have become cheaper. In some countries these technologies are locally assembled, or even manufactured, reducing their cost further. Technology providers are searching for financing options. Global consciousness about environmental problems both past and future is pushing research and development of new inexpensive technologies. The quality of the technology is improving.

From the MFI perspective, there are a number of factors, in addition to the market ones mentioned above, that stand in the way of microfinance for environmentally friendly technologies. MFIs themselves don't understand the technologies. Many MFIs are reluctant to finance assets in general, especially those that do not clearly relate to income generation.[4] MFIs prefer to finance working capital with short-term loans that better match their portfolio terms. Many MFIs are not familiar with using assets as collateral, and there are few MFIs with experience in leasing. The push by donors to achieve financial sustainability limits MFIs' ability to innovate and experiment with new products. Many MFIs have only one credit product, often a rigid one, and no experience in developing new products. MFIs are risk-averse, and most are not facing the kind of competition that will force innovation or promote new financial products for new markets. Many MFIs are still donor-driven, and those donors have paid little attention to financing for alternative technologies.

[4] In 2002, a UNDP/World Bank study analyzed the socioeconomic benefits of rural electrification in the Philippines. The study found the benefit of electricity for home-based businesses to be $34 per household/month, and for new businesses, the benefit was $75 per household/month. The authors concluded that even if the benefits were overestimated by a factor of two, they would still outweigh the costs of providing solar electricity. From ESMAP, "*Rural Electrification and Development in the*

There are some successful examples of uptake of environmentally friendly technologies using microfinance. These often come out of a long term and workable relationship between a financing institution, its clientele, and a technology distributor. This relationship takes time and perseverance to develop. There are few documented case studies, but interested readers can refer to the National Renewable Energy Laboratories' publication *Renewable Energy for Microenterprises*[5], or SELCO.[6] The Grameen Bank's renewable energy subsidiary Grameen Shakti is a successful venture.[7] The SEEP Network has an ongoing action research project in east Africa with several MFIs that are embarking on lending for renewable energy technologies and the results will be published as case studies.[8]

There are new opportunities. MFIs are expanding their product lines. Many are becoming regulated, and can now offer savings services. Some are experimenting with leasing, which could be adapted to environmental technologies. Dependence on donor funding is decreasing and MFIs are starting to access commercial and investor capital (which is longer term and has fewer strings attached). In countries where MFIs face competition, there is more innovation happening as MFIs search for new markets. All of these factors create opportunities for MFIs and their clients.

Not Microfinance "Plus"

People in the microfinance world know that microfinance is often viewed as the solution to many development problems, from poverty to HIV/AIDS to

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Philippines: Measuring the Social and Economic Benefits", Washington D.C: The World Bank, (2002).

[5] www.rsvp.nrel.gov

[6] www.selco-india.com

[7] www.grameen-info.org/grameen/gshakti/index.html. Typical solar energy systems financed by Grameen Shakti are 50 watts, and in the price range of $400-$500. Grameen loans are available for terms of either 24 or 36 months.

[8] www.seepnetwork.org

illiteracy to weak markets. We know that development practitioners who are not microfinance experts look for ways to link microfinance to a myriad of other development objectives. Many non-microfinance development practitioners see microfinance as a means to an end, rather than as an end in itself. For immature MFIs, pressure to achieve non-financial objectives can distract them from the mission of providing financial services to the poor. For mature institutions with access to many donor funds, the funds "compete" within the operations of the MFI, again distracting the institution from its focus on financial services. The need for additional portfolio funds is a powerful incentive for MFIs to agree to pilot non-financial services, but the opportunity cost of doing so means that these services come at a high price.

On the other hand, some development initiatives have been successfully linked to microfinance products and service delivery. If the inclusion of other services and products adds value to the financial product for the client, such that the client is willing to absorb the cost of the non-financial service and benefits from doing so, then the relationship has the potential to work.

The linking of microfinance to other non-financial services has led to the term "**microfinance plus**". This refers to microfinance plus other services, such as HIV/AIDS counseling or prevention, literacy training, or health education and services. "Microfinance plus" initiatives are those that target specific populations (e.g. people at risk for HIV/AIDS, poor farmers, illiterate women) with specific services that are designed to meet their needs.

The subject of this paper is the effect that microfinance has on the environment. Addressing environmental concerns in the context of microfinance is **NOT** "microfinance plus" because the environment is pervasive, and affects everyone, not just specific populations. Degradation of the environment especially affects all **poor** people because they are dependent on natural resources, and have little ability to mitigate the negative effects of environmental degradation because of their lack of

financial resources. Moreover, all economic activity takes place within the constraints of the natural environment. If the resource base that economic activity is dependent upon is damaged (severe erosion, over-fishing, unsustainable harvesting of raw materials, etc.) it undermines the existing enterprise and potential for economic development of future generations.

Conclusion

Are microenterprises the primary causes of environmental problems? Of course not. No one is arguing that poor microentrepreneurs are solely or even mostly responsible for environmental problems. Nor is anyone arguing that the environment is more important than the poor, or that the poor should pay the price of reversing environmental degradation. We are saying that the poor are already paying the price, and that they will continue to so, while suffering greater consequences from environmental degradation than the populations of the developed world. We believe that the poor understand the need to reverse some of the damages and that they have the will to do so. We also know that they will need tools if they hope to be successful and, more importantly, that microfinance can be one of those tools.