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Impact of microfinance on empowerment of Micro-entrepreneur in Rural Sectors

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ABSTRACT

The practices of microfinance services for the poor have grown immensely since its beginning in the 1970s. It has become one of the most popular poverty reducing strategies in the world. The study used Grameen bank model and development as freedom theory to analyze the effect that microfinance had on poverty reduction. The study aimed at exploring the contribution of microfinance products such as microcredit, micro insurance and micro saving to the youth who make up to more than 60% of the country's population. The contribution involved the role of microfinance in enhancing entrepreneurship development, sighting problems surrounding the credit barriers, and creation of employment through innovative business activities. The research employed descriptive research design using simple random sampling which enables every member of the population to have an equal and independent chance of being selected as respondents and also simplest, most convenient and bias free selection method. The data was collected by use of questionnaire thereafter analyzed using both quantitative and qualitative techniques. The study results showed that MFIs have role to play in economic empowerment of the youth. Loan repayment default was largely a result of non supervision of borrowers by the MFIs, as well as inadequate training of borrowers on utilization of loan funds before they received loans. The study recommended that for sustainability all the costs involved need to be recovered and kept minimum to ensure a continuous sustainable growth of both the MFIs and the youth in poverty alleviation.

Key Words: Microfinance, microcredit, micro insurance, micro saving, entrepreneurship development.

INTRODUCTION

Microfinance continues its insane expansion. While the year 2005 has already been declared "Microcredit Year" by the United Nations, the G8 Member States have just reaffirmed the crucial importance of microfinance as a development tool. The 2004 action plan of the G8, adopted at Sea Island in June 2004, is entitled "applying the power of entrepreneurship to the eradication of poverty". To reinforce the private sector is thus a priority, and the development of financial markets and microfinance constitutes the heart of it. "Facilitating Remittances to Help Families and Small Businesses", "Improving the Business Climate for Entrepreneurs and Investors", "Providing Housing and Clean Water by Supporting the Development of Local Financial Markets" and "Expanding Access to Microfinance for Entrepreneurs" are the four strategies announced.

The action plan also mentions that "Sustainable microfinance can be a key component in creating sound financial market structures in the world's poorest countries" and foresees that "[…] with the support of the World Bank-based Consultative Group to Assist the Poor (CGAP), G8 countries will work to launch a global market-based microfinance initiative"1 . This will to create "global market-based microfinance" echoes processes already well under way. Two recent publications, one of the International Monetary Fund (Littlefield and Rosenberg 2004), the other of the Asian Development Bank (Nimal 2004) also plead for a complete integration of microfinance in formal financial systems. In 1992, the transformation of the NGO Fundación para Promoción el Desarrollo of Microempresa into a financial institution (Bancosol) in Bolivia started the process of integration between microfinance and the formal financial system. Since then, the line between microfinance and the formal financial sector continues to fade.

According to the study carried out by the International Monetary Fund, IMFs increasingly allow market forces to come into play, while basing themselves on the techniques and rules of commercial finance. They invest in more sophisticated systems of management and information, apply international accountability standards, entrust the annual auditing of their accounts to traditional auditing organizations and subject themselves to the evaluation of commercial grading agencies (Littlefield and Rosenberg 2004). New technologies reduce the costs and the risks, thus making the provision of services to poor clients more profitable. The commercial success of certain IMFs started to attract new operators from the traditional sector. Financial information, evaluations and audits are today better and easier to compare, and national and international investors invest in this sector. For instance, in July 2004, the USA Grameen Foundation (GF-USA) announced the launching of the first significant micro-finance investment by the American capital market. This transaction, valued at $US 40 million, is regarded as the most important ever realized in the world of microfinance2.

India does not escape this scenario. The entry of the banks into the microfinance sector happened first under pressure because of the guidelines of the Reserve Bank of India (RBI)3 . Nevertheless more and more banks go beyond those guidelines and innovate in order to conquer new market shares in a sector which they regard now as lucrative. The ICICI Bank is probably the one which displays the most aggressive attitude. Apart from various specific products as well as partnerships with multiple IMFs, at the beginning of 2004 ICICI concluded two security deals with two leading IMFs: Bhartiya Samruddhi Finance Ltd of the BASIX group and SHARE Microfin Ltd. If ICICI is the likely pioneer in this sector, others have followed. For example the Andhra Bank (District of Coimbatore, Tamil Nadu) has recently launched a credit card scheme4 for the SHGs, allowing them to withdraw up to Rs. 200,000 in credit (revolving fund with an annual rate of 8%). The credit card holders can also benefit from free insurance issued by the Life Insurance Corporation of India as well as scholarships for their children's studies. Obviously, the RBI guidelines are not the sole argument anymore: the “poor” truly are considered a new market niche.

IMPACT OF MICROFINANCE ON RURAL HOUSEHOLDS INCOMES

Rural Poverty: A Challenge to the Provision of Financial Services

About 1.3 million people of the world live with less than one dollar a day (World Bank). About half of the world’s people (nearly three billion people) live on less than two dollars a day. The total wealth of the world’s three richest individuals is greater than the combined gross domestic product of the 48 poorest countries; (about a quarter of the entire world states (Ignacio 1998). Little wonder that poverty and inequalities have become global concerns. Poverty can be generally defined as the inability to attain a certain predetermined minimum level of consumption at which basic needs of a society or country are assumed to be satisfied. The core concept of this general definition of poverty is the fact that to be poor is defined by access to basic goods and services like food, shelter, healthcare and education.

The food concept in this definition goes beyond just food passé but also includes clean water and sanitation services. Given this definition it is not surprising at all that in Kenya poverty is mainly a rural phenomena while urban poverty is mainly concentrated in slums3 and other informal dwellings. About 65 % of Kenyans live in the rural areas deriving their livelihoods mainly from agriculture. However over the years the subsistence agriculture sector has continued to suffer declining productivity. The declining agricultural production for small scale farmers has to a large extent been caused by erratic rainfall since most of the subsistence agricultural productivity in Kenya is rain fed. However, on the other hand even when the rural areas receive a reasonable amount of rainfall peasant farmers who form majority of farmers still have to content with low yields and food insecurity due to lack of proper or non utilization of farm inputs to enhance productivity and also lack of proper storage and preservation of farm produce.

Low agricultural production has serious implication on welfare not only in terms of food insecurity but also in terms of lost incomes thereby leading to inability to afford social services like health care and education. The effect of this decline has been lost incomes, food insecurity and widespread poverty. The poor constitute slightly more than half the population of Kenya, and three quarters of these poor population lives in the rural areas. Women constitute the majority of the poor and also the absolute majority of Kenyans (GOK 2003). Many public policies in the recent times have been focused towards poverty reduction, finding ways to improve household productivity and thereby incomes. Apparently the thinking that rural poverty is a consequent of liquidity constraints has not changed much since independence.

More than ever before, policy makers in Kenya believe that empowering the poor with financial resources may be the key to their economic empowerment. Since the 1960s and 70s, there have been policies on the role of microfinance in the rural development process. These policies focused on the provision of agricultural credit as a necessary support to the introduction of new, more productive agricultural technologies that would ensure that farmers improve their incomes and feed the nation (Moll 2005). Given the argument that labor productivity could be unleashed by removing or reducing the liquidity constraints, the approach to micro credit broadened to include individuals involved in both small and micro-enterprises like handcrafts and home based business. The following figure explains the general perception of the poor emphasizing on the interlink to low productivity within the vicious cycle of poverty,

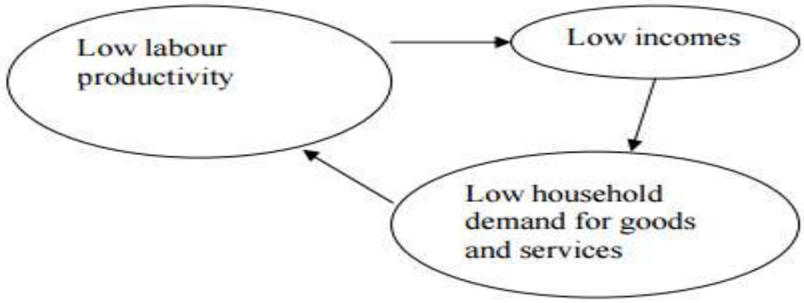

Figure 1: the poor are held up in a vicious cycle of poverty:

The Role of Microfinance in Fighting Rural Poverty

The forgoing figure has that household labor, which is an important household resource, becomes unproductive4 due to different constraints including a liquidity constraint. As already discussed, many governments and donor communities believe that the liquidity constraint is the most important constraint impeding poor households and that if it is addressed it will be possible for households to escape poverty. Economists argue that to break the vicious cycle of poverty, there needs to be an outside force that will intervene at some point of the cycle to improve demand for goods and services. This could be done by injecting some liquidity that is believed to unleash the productivity of household labour. Microfinance promises not only to break the vicious chain of poverty by injecting liquidity in to the vicious chain, but also it promises to initiate a whole new cycle of virtuous spirals of self enforcing economic empowerment that lead to increased household well-being. Figure two is illustrates the microfinance promise.

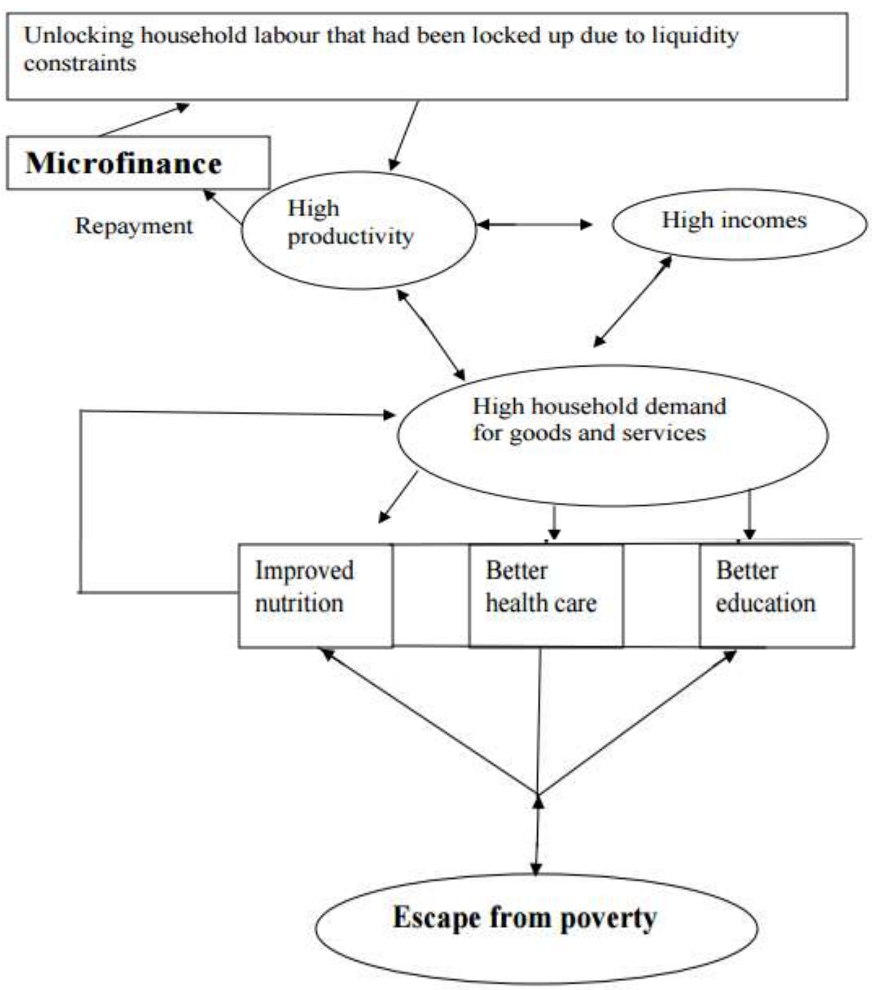

Figure 2: Microfinance promise

Such is the model that has promoted the microfinance institution and given it the "polite and respectable" image it currently enjoys. There are several assumptions that go with this model; first it is assumed that poor people can become micro-entrepreneurs if only they were given a chance through credit. In essence this implies that the level of entrepreneurship and managerial skills required is already given or can be easily acquired by the poor. The model further assumes that there is a vibrant market for goods and services and that it is possible for micro-entrepreneurs to get linked up to markets for their products. Lastly some proponents of the model also assume that the fact that the poor can repay at market interest rates or slightly above market rates is a good indication that they are improving their financial status; and therefore it is a sign of good impact of microfinance. The irony of the this assumption being that even before the microfinance revolution many governments and non-governmental organisations believed that informal money lenders were exploiting the poor by charging high interest rates; and that is why it was justified to bring to the poor a cheaper alternative; yet the poor were still paying for the money lender services.

THE ROLE OF SUSTAINABILITY IN REDUCING POVERTY IN LDCS

The concept of sustainability is difficult to define, and its precise definition varies within differing contexts. However, regarding the development process, two primary aspects of sustainability emerge: economic and environmental sustainability. Both tie in with the notion of sustainable microentrepreneurship; economic sustainability refers to a continual supply of finance to meet a person/community's needs, usually in the form of secure and accessible loans from a microfinance institution; and environmental sustainability is the aim to preserve environmental resources for use by future generations. Littlefield (2004) claims, "If you're going to provide financial services permanently to people, they've got to be sustainable, and that means charging interest rates that cover your costs."20 Similarly, the IFC (2004) notes, "Well-managed microfinance institutions…have convincingly demonstrated that they can become profitable and sustainable institutions while making major contributions to poverty reduction by increasing economic opportunities and employment."

This is core to sustainable microentrepreneurship. Sustainable development bears relevance to the developing world, primarily due to the role of the private sector in reducing poverty (such as microfinance institutions, business organisations and multinational corporations). This affects them because the growing public awareness of corporate governance and of environmental and social issues is driving changes in consumer behaviour, investment, and policy or regulatory adjustments. All signs point to continued pressure on the private sector to demonstrate that economic growth and sustainability are compatible.21 In an examination of 'ordinary' businesses in LDCs, who have strategically integrated sustainability into their operations, it was noted that, "the evidence confirms that there are compelling commercial reasons to take action, despite a common assumption that sustainability is a luxury which emerging markets cannot afford. Thus, economic and environmental goals may be pursued simultaneously, and it is now becoming apparent that this may be in firms' interests. Strategies exist to promote sustainable development in LDCs all over the world.

However, it is argued that, "Sustainable development will only be achieved by ensuring that the economic, social, cultural and environmental dimensions of development be addressed in an integrated and balanced manner. This requires breaking down institutional and mental barriers between different sectors of society…"23, and in forging close cooperation between the sectors of LDCs. However, there are challenges as well as opportunities in putting a greater emphasis on sustainability in emerging markets. Some may argue that the business case for sustainability does not apply in markets where incomes are low and mostly spent on basic needs, but also firms might not see benefits from improving environmental or social performance. However, others argue that businesses resisting sustainable practices, may put themselves at a long-term competitive disadvantage by missing opportunities, such as economically efficient and environmentally sound production methods that allow new market entrants to produce for less. Such businesses may also face greater downside exposure to changes in the competitive environment and consumer behavior. 24 Whereas non-sustainable operations were in the commercial interests of firms in the past, this may not be the case in the future, especially in the developing world, where efficiency and cleanliness are vital to the development process.

CONCLUSION

The economic benefits of sustainable microentrepreneurship in LDCs are compelling, and its potential effects on the development process are equally promising. In terms of development and social impact, the microfinance industry allows significant improvements in quality of life for the microentrepreneurs of LDCs around the world. They can now stabilise the cash flow of their economic activity, bringing security to the enterprise. This allows them to better manage spending, which often generates savings; and this provides better standards of living to their family, and dependents in terms of housing, nutrition, health and education. Finally, an access to banking and increased security promotes a sense of entrepreneurship, and thus their self-esteem and reputation increase. The initial small loan of usually less than $100 can eventually reintegrate these entrepreneurs into formal networks of the economy and foster the structural and sustainable development of local communities. Furthermore, estimates indicate that today only 5% of the micro-credit demand is fulfilled, thus, the microfinance industry is expected to grow significantly in coming years. Despite several challenges ahead, this emerging industry, and the process of sustainable microentrepreneurship combine to offer a potential alleviation solution to the poverty crisis of the 21st century, and into a sustainable future.

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