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Significance of Microfinance in Emerging Economies

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Abstract: ***Access to microfinance is known to lead to an increase in the income generation capacity of beneficiaries. Micro-entrepreneurship and self-employment have developed continuously during the last few decades, and they have succeeded in creating jobs in low-income countries. Microfinance is playing a vital role in economic development through entrepreneurship development in India and other developing countries like Bangladesh, Indonesia, and Vietnam etc. The success of small business in India depends upon the accessibility of working capital that is supported by small credits provided by financial institutions. These microfinance institutions face considerable challenges, especially during the start-up phase. Also these Microfinance institutions are suffering from many shortcomings that needed to be removed. As currently, the key focus seems to be on credit facilitation which could be profit-driven by developing culture of sound business. The paper provides an overview of the micro finance industry in developing countries. The objective is to summarise and highlight the key aspects of its status and future challenges.***

Keywords: Microfinance, Microenterprises, Entrepreneurship, Credit facilitation

1. Role of Microfinance in Economic Development

Economic development can be defined as "the process of improving the quality of all human lives", (Todaro, 1994), which incorporates three equally important aspects: raising incomes and consumption; fostering self-esteem through institutions that promote human dignity and respect; and increasing people's freedoms.

According to Robinson, "the first thing that many poor families do when their incomes rise is improve their nutrition, and send their children to school." This is fundamental to economic development, but also, "Because financial services help the poor expand their economic activities and increase their incomes and assets, their self-confidence grows simultaneously." And finally, "Large-scale sustainable microfinance helps create an enabling environment for the growth of political participation and democracy." Thus, the economics of microenterprise make it a compelling anti-poverty strategy (Rubinstein, 1993). With a loan of $100, in a poor country one can start a small business; repay the loan in a year, while still owning the productive assets. Over time, a poor person can earn enough to escape poverty.

Microfinance intervention has enabled farmers in villages to shift from agriculture to other nonfarm occupations such as animal husbandry, trading and small business, sericulture and others. A number of studies have confirmed that microfinance has enabled shift into non-farm activities

Microfinance Impacts on Micro Entrepreneurship

Entrepreneurship development in any country leads to the employment generation and poverty eradication. That‘s why each country unendingly tries to hurry up the entrepreneurship. In the scenario of India, small entrepreneurs need small fund to enhance the small business but the government has failed to provide it. Therefore, this creates the dependency of the micro-entrepreneur on microfinance lending institution.

The economic benefits of sustainable microentrepreneurship in LDCs are undeniable, 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 stabilize 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 ultimately reintegrate these entrepreneurs into proper networks of the economy and promote 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 merge to offer a potential alleviation solution to the poverty crisis of the 21st century, and into a sustainable future.

Bangladesh is a pertinent example of, the role of microfinance in economic development. In the same line, India is also applying and experimenting with the flourishing outcome of microfinance. Microfinance is playing a vital role in economic development through entrepreneurship development in India. The success of small business in India depends upon the accessibility of working capital. It is only possible by microfinance lending. The challenge is to build capacity in the financial sector drawing on lessons from international best practices in micro, small enterprises and rural finance

Rakhal. (2015).This study shows that it is found that the majority of women are running income-generating activities. Access to a loan to poor women is essential for income generation through entrepreneurship. Microfinance provides access to financial services that can help to decrease poverty by promoting opportunities in financial access to the poor including women. Therefore, the microfinance program has improved the lives of many poor through income-generating activities.

This study also points out that credit access to women not only improves the economic condition of the family but also increases social relations. A flexible policy should be formulated to help poor women in cases of business failure. Many poor women can become active entrepreneurs if their entrepreneurship is developed through positive strengthening and support for financial access.

Competency Development through Professional Skills:
In a study done in Quetta district in Pakistan inferred that microfinance was helpful in empowering female entrepreneurs socially as well as economically in an urban area. After the study it was recommended that there is a need to introduce the availability of consumer credit through conventional channels. It was suggested that before providing business loan, the eligible clients should be trained for business skills by Micro Finance Institutions. Also the Microfinance services should be extended to the remote rural areas too (Naeem2014).

In another study on microfinance in developing countries (Abeysekera 2016), revealed that a number of related factors, such as client selection, social mobilization programs, planning, performance evaluation and financial sustainability influence co-production in Business Development Services (BDS). Moreover, the findings show that aspects of the counselor/owner-manager relationship, such as expertise, readiness, follow up by the counselor, owner-manager willingness, and counselor-owner manager communication and interpersonal relationships enhance coproduction.

Mngadi. (2016).The study focused on relationship between microfinance institutions and entrepreneurship development. Results of the study indicated that microfinance institutions were still greatly focusing on providing credit and credit facilities that had positive effects on capital assets but not the overall welfare of entrepreneurs. Therefore it is important that Microfinance institutions should emphasize training programs that will nurture a culture of building sound businesses, with proper risk management and are willing to adjust to change. As currently, the key focus seems to be on credit facilitation which could be profit-driven.

The main findings of a study done in Yemen (Eissa.2018) showed inefficiency in loan officer productivity and operational self-reliance. It was recommended to provide proper training to their loan officers. Institutions should also enhance the role of performance management in order to strengthen the overall organizational performance, It was realized that most microfinance institutions were inefficient in terms of capacity building and development and should implement a strategic plan for expansion and diversification of financial products and services supplied to SMEs.

Sadeq. (2016). study findings indicated that the institutions and programs specialized in funding small enterprises in Yemen provides unparalleled financial services to many small enterprises. However, it was observed that these financial resources are still inadequate to meet the funding needs of existing production enterprises, and also to encourage the establishment of new ones to solve the unemployment problem. The reason can be attributed to their poor financial capabilities compared to the financial needs of the community. The study most important recommendations call for the state and other donor institutions to support the financial capabilities of these institutions to the extent that they can meet the needs of the Yemeni society

Similarly in a study done on performance of Nigerian Microfinance banks(Taiwo 2016), it was recommended that the government should increase their efforts in encouraging microfinance banks and institutions to support the small businesses and Microfinance banks should expand the repayment period of their customer‘s and also should support their clients by offering training on credit maximization as well as should try to find long-term capital from Pension and Insurance Companies within the country.

Importance of Microfinance on SME in Developing & least Developing Countries
About 90 percent of the people in developing countries lack access to financial services from institutions, either for credit or savings, which further fuels the “Vicious Cycle of Poverty”. Therefore, productivity is restricted, incomes are inhibited, domestic savings remain low, and again, any increases in productivity are prevented. A lack of access to financial institutions also hinders the ability for entrepreneurs to take on new business ventures, inhibiting economic growth, and often, the sources and consequences of entrepreneurial activities are neither financially nor environmentally sustainable.

Microfinance serves as a means to empower the poor, and provides a valuable tool to assist the economic development process. However, unavoidably, various barriers and obstacles limit the roles of microfinance, entrepreneurship and sustainability in reducing poverty in developing and least developing countries around the world

In different studies done on microfinance in developing countries reveal that microenterprises can make a significant contribution to the economies of the developing world but that such firms face considerable challenges, especially during the start-up phase. Microfinance supports in the form of microcredit and business development services (BDS) that helps such firms to address these challenges. They provide financial support in the development of key skills to facilitate start-up and foster growth.

In India new microfinance approaches have emerged involving the provision of thrift, credit and other financial services and products, with the aim to raise income levels and improve living standards. It was observed that despite robust economic growth, poverty continues to be a major problem in many parts of Asia-Pacific. It was recommended that if poverty is to be eradicated, sustainable livelihood avenues must be created at a rate much faster than poor people population growth. Microfinance practitioners have proved that the poor are indeed creditworthy, capable of utilizing scarce capital efficiently in viable income-generating projects, and able to pay back their loans.

The Asia Pacific Development Council in Bangladesh, an intergovernmental organization supported by 21 governments and states of the region, has adopted Microfinance for the Poor as a leading strategy in its poverty eradication program. In supporting institutions committed to the poor, it is learned that the poor not only have the desire but also the capacity to improve their situation. If they cannot find wage work, they create work by capitalizing on their survival skills. They are also good borrowers and eager to succeed. They use credit to start new activities or expand existing livelihood projects and pay back their loans on time. Robinson (2002), a prominent expert in the field of microfinance, notes that “The formal sector has begun to realise that financing the poor can be both economically and socially profitable.

Approaches of Financial Institutions & Other Supporting Agencies

In Bangladesh, where about one third of the world’s estimated 30- 40 million microborrowers reside, the growth has come from specialised microfinance NGO’s and Grameen Bank. What began with a few small grants and loans from international donors has now provided over 100 million dollars in loans. The most distinctive feature of the credit delivery system is the absence of middle men between the credit supplier and end user. The bank’s cumulative recovery rate is an astounding 98 percent. Grameen Bank has its own special legal structure, and does not fall under regulatory oversight of the central bank. The bank also aims to raise health and environmental consciousness. Each of its members must plant at least one sapling a year as part of an afforestation programme. Grameen is perhaps the only bank in the world that encourages birth control, sanitation and a clean environment as part of its lending policy (Yunus, 2001).

In India, despite the large size and depth of its financial system, the majority of the rural poor do not have access to formal finance and financial services. For this reason, innovative microfinance initiatives pioneered by nongovernmental organizations strove to create links between commercial banks, NGOs, and informal local groups to create the "SHG Bank Linkage". The success of SHG Bank Linkage has been largely attributed to good policy and strong leadership, in conjunction with facilitating government policy and legal framework.

India’s approach to microfinance – making it profitable and so widely available – helped the country reduce the incidence of poverty from about 40 percent of the population in the mid-1970’s to about 11 percent in 1996 (Robinson, 2002) . Members of SHG recognise that “several challenges lie ahead,” but still believe it has “the right ingredients to be scaled- up into offering mass access to finance for the rural poor while improving sustainability.” (World Bank, 2003)

In a study done in India (Devi 2013), it was experienced that microfinance forms a part of almost all development intervention targeted at poverty alleviation. The microfinance programs and institutions have become increasingly important components of ways to cut back economic condition or promote small enterprises. One of the most important microfinance approaches, pioneered by Nongovernmental Organizations (NGOs) is to create links between Commercial Banks (CBS) and NGOs and informal local groups. Microfinance through Self Help Groups (SHGs) is propagated as an alternative system of credit delivery for the poor.

This study recommends that guidelines by microfinance institutions to finance SMEs need to be flexible to accommodate the SMEs only when financial institutions appreciates and give technical assistance to the SME would be contributing to the SMEEIS to ensure success in the SME sector.

In a similar study (Ashish-2016), it was observed that microfinance is dominated by SHGS (self-help groups) banks linkage programs. Its main aim is to provide a cost-effective mechanism for providing financial services to the poor. The study shows, there was prevailing gap in the functioning of MFI‘S such as practice in credit delivery, lack of product diversification, customer overlapping and duplications, consumption and individual loan demand with lack of mitigation measures, less thrust on enterprise loans, collection of savings, loans and highest interest rates existing in the microfinance sector. According to results the deposits, government subsidies, and interests charged on loans given to poor all of which have made them bear financial suffocation need to revitalize them through serious commercial orientation.

2. Conclusion

There is a growing need for the development of infrastructure and marketing facilities in the absence of which the success of these units can‘t be ensured. Consequently, the inculcation of economic discipline among MFIs individuals and the growth of the tertiary sector are necessary for tapping the full potential of the economy.

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.

One of the most vital microfinance approaches, pioneered by Nongovernmental Organizations (NGOs) is to create links between Commercial Banks (CBS) and NGOs and informal local groups. In India SHGs have played a very important role in the spread of Microfinance. A number of benefits and programs of the Government target SHGs.

It is observed that, there was prevailing gap in the functioning of MFI'S such as practice in credit delivery, lack of product diversification, customer overlapping and duplications, consumption and individual loan demand with lack of mitigation measures, less thrust on enterprise loans, collection of savings, loans and highest interest rates existing in the microfinance sector. The success of Microfinance in the growth and development of emerging economies largely depends on efficient management and eradications of these bottlenecks. Needy entrepreneurs must be revitalize through serious commercial orientation.

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