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Topic - Microfinance

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<u>What is microfinance?</u>

Microfinance is the term used for providing small loans (micro loans) to the poor for their upliftment. It is a banking service for low income or unemployed individuals who otherwise lack access to financial services. The goal of microfinance is to give these people an opportunity to be self sufficient.[1] It is also a source of financial services for entrepreneurs and small businesses in need of such services. Microfinance includes a range of services such as credit (loans), savings, insurance and fund transfers. It is widely believed that microfinance is a way to promote economic development, employment and growth. Microfinance is one of the most effective ways to enhance financial inclusion.

<u>What is financial inclusion?</u>

Financial inclusion is providing financial services at affordable costs to disadvanatged and low income sections of society. This is in contrast to financial exclusion where such services are unavailable or unaffordable. It is estimated that 2 billion adults today do not have access to the financial services delivered by regulated financial institutions. In Sub Saharan Africa 76% of adults do not have a bank account even though Africa's formal finacial sector has seen recent growth. The availability of financial services that meet the specific needs of users without discrimination is the main objective of financial inclusion.[2] Former UN Secretary-General Kofi Annan, on 29 December 2003, said: "The stark reality is that most poor people in the world still lack access to sustainable financial services, whether it is savings, credit or insurance. The great challenge before us is to address the constraints that exclude people from full participation in the financial sector. Together, we can and must build inclusive financial sectors that help people improve their lives."

What is the Grameen Bank?

The Grameen Bank is a Nobel Peace Prize winning microfinance organization and community development bank founded in Bangladesh. It makes small loans to the poor and impoverished without requiring collateral. Grameen Bank is founded on the principle that loans are better than charity to reduce poverty: they offer people the opportunity to take initiatives in business or agriculture, which enables them to pay off the debt. The bank is founded on the belief that people have endless potential, and unleashing their creativity and initiative helps them end poverty.[3] Grameen has offered credit to classes of people formerly underserved: the poor, women, illiterate, and unemployed people. No written contract is made between Grameen Bank and its borrowers; the system works based on trust. To supplement the lending, Grameen Bank requires the borrowing members to save very small amounts regularly in a number of funds, designated for emergency, the group, etc. These savings help serve as an insurance against contingencies. In a country in which few women may take out loans from large commercial banks, Grameen has focused on women borrowers; 97% of its members are women.[4] The bank, surprisingly, does not suffer from low payback rates. Grameen Bank is owned by the borrowers of the bank, most of whom are poor women. Of the total equity of the bank, the borrowers own 94%, and the remaining 6% is owned by the Bangladesh government.

The Grameen Bank model has been adopted successfully in some parts of the world today but the most significant story continues to be the one in Bangladesh.

What can microfinance do for Africa?

When properly harnessed, microfinance offers a variety of benefits to the African people. Foremost, microfinance initiatives can effectively address material poverty, the physical deprivation of goods, services, and the income to attain them. When properly guided, the material benefits of microfinancing can extend beyond the household into the community. At the personal level, microfinance can effectively address issues associated with non-material poverty, which includes social and psychological effects that prevent people from realizing their potential. African microfinance is as diverse as the continent itself. An array of approaches have been used, ranging from traditional group-based systems, to specialised lending by banks and funded by international nongovernmental organisations (NGO) financial intermediaries.[5] However, these approaches have either been on a relatively smaller scale or practised in a corrupt manner; hence, there isn't enough evidence of the impact microfinancing could have on a region as large as Africa.

What are some of the opinions on microfinance?

The impact of microcredit is a subject of controversy. Proponents state that it reduces poverty through higher employment and higher incomes. This is expected to lead to improved nutrition and improved education of the borrowers' children. Some argue that microcredit empowers women. In the US and Canada, it is argued that microcredit helps recipients to graduate from welfare programs.

Critics say that in some cases microcredit has not increased incomes, but has instead driven poor households into a debt trap. They add that the money from loans is often used for durable consumer goods or consumption instead of being used for productive investments, that it fails to empower women, and that it has not improved health or education. Moreover, as the access to micro-loans is widespread, borrowers tend to acquire several loans from different companies, making it nearly impossible to pay the debt back.[6]

However, the available evidence indicates that in many cases microcredit has facilitated the creation and the growth of businesses. It has often generated self-employment, but it has not necessarily increased incomes after interest payments. In short, microcredit has achieved less than what some proponents said it would achieve, but its negative impacts have not been nearly as drastic as critics have argued.

There seems to be agreement that, if put into practise, microfinancing operations need to be carefully monitored and regulated to prevent borrowers from falling into easily avoidable traps.

To conclude, microfinance has the potential to be one of the African continent's biggest hopes for an economic upturn but its viabilty is something that needs to be thoroughly discussed.

Citations:

1. http://www.investopedia.com/terms/m/microfinance.asp

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3. http://www.grameen-bank.net/what-is-microcredit/

4. http://www.grameen-bank.net/grameen-bank-at-a-glance/

5. http://www.un.org/esa/africa/microfinanceinafrica.pdf

6. Biswas, Soutik (December 16, 2010). "India's micro-finance suicide epidemic". BBC News. Retrieved July 15, 2015.