

Microfinance: A Powerful Tool for Social Transformation, Its Challenges, and Principles

Puspa Raj Sharma*

ABSTRACT

This paper attempts to explore the role and importance of microfinance in reducing poverty by generating the income of the poor. Microfinance has been emphasized for poverty reduction in developing countries through executing dual activities such as collection of domestic saving and investment of small loan. In this connection, this paper suggests microfinance practitioners and MFI to follow certain principles for making the microfinance services more sustainable in the long run and sheds light on the problems and challenges of microfinance.

MICRO LOANS ARE OF key importance in alleviating poverty. Prof. Yunus realized this with his work in Bangladesh and set up the Grameen banking system. In the search of practical measure to alleviate poverty, the microfinance movement offers a set of powerful tools for social and economic development. Whether in terms of addressing problem of malnutrition and disease, flight from rural to urban areas in the search of work, environmental degradation or the breakdown of families and communities, programs that provide small scale loans and economic training to resource- poor people are one of the brightest spots in the new development paradigm (Yunus 1980). The underlying success of microfinance programs stems, in part, from the fact that the principles are based not only on sound economics but also the practical application of spiritual principles. The sounding principles of the movement is a belief in the inherent nobility of humankind-of the integrity innate capacities and commitment of the resource-poor to work hard , take responsibility for their own lives , and repay credit. From those principles and from other essentially spiritual values like trust and self-reliance, the methodologies of successful microfinance programs worldwide have emerged (Lidgerwood 1998).

1. Microfinance in Nepal

Nepal is the 12th poorest country in the world (World Bank 2000) and poorest in South Asian region. Out of 23.6 million population, 38 % lie below poverty line and most of the poor live in rural areas having no opportunity. Many programs have been implemented for the poverty alleviation in Nepal. But only microfinance program is seen as a poor targeted rural based program. However, the program of microfinance is not fully covering the poorest of the poor. The present status and estimated micro-finance outreach of various programs is given in Table 1.

* Mr. Sharma is Lecturer, Faculty of Management, PNC, Pokhara.

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Table 1: Outreach of Microfinance in Nepal

S.No.	Institutions	Members (in 000)	Borrowers (in ,000)	CD* (Rs.000)	*OL (Rs.000)	GSB (in Rs. 000)	*RT (in %)
1	SFDP#	189	189	NA	890597	50388	40.42
2	SFCL##	69	69	1829125	980431	NA	80.05
3	PCRW###	67	67	360000	168000	NA	64.0
4	EGB*	53	49	2895883	354172	125803	97.50
5	CGB*	36	35	957597	220930	37873	100.00
6	WGB*	40	39	1481506	271314	78954	99.70
7	MWGB*	19	16	568250	92219	42195	93
8	FWGB*	19	11	668351	101097	45859	75
9	NUBL##	35	28	1184017	206900	56673	97.20
10	CSD###	38	32	800874	178969	47209	100.00
11	DEPROSEC#	9	6	66570	30201	8561	100.00
12	Chimek Samaj##	4	3	40826	20121	5379	100.00
13	NRDSC priority sector	3	2	4410	3724	302	100.00
14	Lending (RBB and NBL) Total	130	130	NA	NA	NA	NA
15	Informal Groups (SHGs)	240	120	-	480000	400000	95%
16	SCCs	320	160	-	320000	300000	95%
	Total	560	280	-	800000	700000	

Source: Upreti up dates and CMF estimates, NRB..

Mid July 2001, # Mid July 2002, *Mid October 2002,### Mid January 2003. *CD=cumulative distribution, *OL=outstanding loans, *GSB=group saving balance, *RT=repayment rate

Last decade of the 20th century it is accepted that micro- finance is one of the most significant contributors for poverty alleviation. In Nepal, the poverty reduction rate is slower. If proper model is used to the hill and Terai region, poor people's life standard could be raised very fast. Diversity of regulatory act shows that it is necessary to cater all the MFIs under one act for licensing, regulating, and supervising and needs to make national policy on micro- finance. In Nepal the experience shows that MFIs managed by private sector are better than the government owned MFIs. So it became necessary to handover all Grameen Banks to the expert group of micro- finance. In the Nepalese micro- financing area, there is large participation of private sector. So the role of government, NRB and micro- financier should be defined as early as possible. Now our ultimate challenge is poverty. This is the challenge of the government and private sector. For the fair implementation of micro- financing in Nepal government role should be as a guardian and referee by which all players can play fairly.

A number of private, public and non-governmental institutions have been claiming their contribution in the field of microfinance by showing their high repayment rate. Based on

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this fact these questions-Are these institution really delivering microfinance services to the poorest of the poor ? Are they really sustainable in the long run ? Are they financially efficient ?- are being raised.

Many MFIs often wish to focus the poorest segment of the population. In most of the countries, many people do not have access to financial services. MFIs commonly measure their outreach of services in terms of scale, or the number of clients they reach, and depth , or the level of poverty of their clients. One of the most important studies on whether microfinance is appropriate for the poorest of the poor by Hulme and Mosley in their book *Finance Against Poverty*. Using the data from MFIs seven countries, they compare increases in borrower income with those in a control group . Their findings suggest that successful institutions contributing to poverty reduction are particularly effective in improving the status of the middle and upper segment of the poor.

2. Microfinance and its Sustainability

Achieving financial sustainability is crucial for microfinance institutions, as it not only assures their existence but also guarantees financial services to the poor on an everlasting basis. A microfinance institution requires covering its costs of funds and other forms of subsidies when received at market prices to achieve financial sustainability. It is also important for an institution to adopt recognized accounting practices of income recognition, portfolio analysis, losses and expenses. For a long time, microfinance has existed in the realm of the informal sector and achieving financial sustainability has been an uphill task. But as microfinance edges towards the formal sector, financial sustainability can no longer be disregarded. Several organizations like CARD in Philippines, BAAC in Thailand, BASIX in India have been able to achieve sustainability. There are several studies that have focused the sustainability of microfinance institutions.

3. Key Principles of Microfinance

We can deliver the services to the poor more effectively and make MFIs sustainable in short and long run by adopting the following key microfinance principles:

1. The poor need a variety of financial services, not just loans (Lidgerwood 1998). Just like everyone else, poor people need a wide range of financial services that are convenient, flexible, and reasonably priced. Depending on their circumstances, poor people need not only credit, but also savings, cash transfers, and insurance.
2. Microfinance is a powerful instrument against poverty (ADB 1997). Access to sustainable financial services enables the poor to increase incomes, build assets, and reduce their vulnerability to external shocks. Microfinance allows poor households to move from everyday survival to planning for the future, investing in better nutrition, improved living conditions, and children's health and education.
3. Microfinance means building financial systems that serve the poor. Poor people constitute the vast majority of the population in most developing countries. Yet, an overwhelming number of the poor continue to lack access to basic financial services. In many countries, microfinance continues to be seen as a marginal sector and primarily a development concern for donors, governments, and socially-responsible investors. In order to achieve its full potential of reaching a large number of the poor, microfinance should become an integral part of the financial sector.
4. Financial sustainability is necessary to reach significant numbers of poor people (Sharma 2003). Most poor people are not able to access financial services because of the lack of strong retail financial intermediaries. Building financially sustainable institutions is not an end in itself. It is the only way to reach significant scale and

impact far beyond what donor agencies can fund. Sustainability is the ability of a microfinance provider to cover all of its costs. It allows the continued operation of the microfinance provider and the ongoing provision of financial services to the poor. Achieving financial sustainability means reducing transaction costs, offering better products and services that meet client needs, and finding new ways to reach the poor unable to access the financial services proved by other financial institutions.

5. Microfinance is about building permanent local financial institutions. Building financial system for the poor means building sound domestic financial intermediaries that can provide financial services to poor on a permanent basis. Such institutions should be able to mobilize and recycle domestic savings, extend credit, and provide a range of services. Dependence on funding from donors and governments-including government-financed development banks-will gradually diminish as local financial institutions and private capital markets mature.
6. Micro credit is not always the answer (Asian Development Bank 1998). Micro credit is not appropriate for everyone or every situation. The destitute and hungry who have no income or means of repayment need other forms of support before they can make use of loans. In many cases, small grants, infrastructure improvements, employment and training programs, and other non-financial services may be more appropriate tools for poverty alleviation. Wherever possible, such non-financial services should be coupled with building savings.
7. Interest rate ceilings can damage poor people's access to financial services (Yunus 1980). It costs much more to make many small loans than a few large loans. Unless micro-lenders can charge interest rates that are well above average bank loan rates, they cannot cover their costs, and their growth and sustainability will be limited by the scarce and uncertain supply of subsidized funding. When governments regulate interest rates, they usually set them at levels too low to permit sustainable micro credit. At the same time, micro-lenders should not pass on operational inefficiencies to clients in the form of prices (interest rates and other fees) that are far higher than they need to be.
8. The government's role is as an enabler, not as a direct provider of financial services (ADB:1997). National governments play an important role in setting a supportive policy environment that stimulates the development of financial services while protecting poor people's savings. The key things that a government can do for microfinance are to maintain macroeconomic stability, avoid interest-rate caps, and refrain from distorting the market with unsustainable subsidized, high-delinquency loan programs. Governments can also support financial services for the poor by improving the business environment for entrepreneurs, clamping down on corruption, and improving access to markets and infrastructure. In special situations, government funding for sound and independent microfinance institutions may be warranted when other funds are lacking.
9. Donor subsidies should complement, not compete with private sector capital. Donors should use appropriate grant, loan, and equity instruments on a temporary basis to build the institutional capacity of financial providers, develop supporting infrastructure (like rating agencies, credit bureaus, audit capacity, etc.), and support experimental services and products. In some cases, longer-term donor subsidies may be required to reach sparsely populated and otherwise difficult-to-reach population. To be effective, donor funding must seek to integrate financial services for the poor into local financial markets; apply specialist expertise to the design and implementation of projects; require that financial institutions and other partners meet minimum performance standards as a condition for continued support; and plan for exit from the outset.

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10. The lack of institutional and human capacity is the key constraint (Mayoux 1998). Microfinance is a specialized field that combines banking with social goals, and capacity needs to be built at all levels, from financial institutions through the regulatory and supervisory bodies and information systems, to government development entities and donor agencies. Most investments in the sector, both public and private, should focus on this capacity building.
11. There should be financial and outreach transparency (Mayoux:1998). Accurate, standardized, and comparable information on the financial and social performance of financial institutions providing services to the poor is imperative.

4. Conclusions

By looking these principles, Nepalese MFI should work very effectively and efficiently (Sharma 2003). Nepalese MFIs are not being able to reach the poorest due to inability of proper identification of the poor and lack of commitment and clear vision of their action . At present these institutions are suffering from the problems such as inadequacy of resources, inappropriate regulations, loss of confidence of depositors, narrow level and area of operation, excessive overhead and ineffectiveness of activities. In addition to these, peace and security situation of the country, strategic planning, government policy environment, operational planning, financial viability and sustainability, operation cost and interest rate, delinquency management, human resource management, evaluation, monitoring and follow up system are equally challenging for the coming days (Sharma 2003a).

Nepalese microfinance institutions should need to enter in a new paradigm of financial market and for their sustainability. In order to develop favorable environment for microfinance institutions there are three major areas for improvement: develop conducive policy environment, create suitable financial base and give proper attention for institution development (Thapa 2001)

Microfinance institutions need to adopt strategic approaches in order to address these management challenges as supportive policy with one door controlling and monitoring mechanism, effort to linkage formal and informal financial sectors involved in micro-financing program and flexibility in financial management regulation. Additionally, financial institutions themselves need to develop business planning practice and efficient management of human resources within the institution. Expansion of financial services in general does not necessarily enhance the outreach of the poorest of poor to institutional credit. Nor commercial banks and finance companies are the suitable institutions do deliver rural credit. Microfinance programs are better suited for this . However, high cost of service delivery and low rate of loan recovery, among other, have constrained microfinance programs from being effective in uplifting the level of income and employment of the poor households through the channel of credit and other services. Therefore, expanding microfinance programs along with restructuring the whole financial system is essential so as to ensure financial system to better serve the rural economy. In light of the need for most MFIs to reach financial sustainability, consideration must be given to the trade off between minimizing costs and focusing on the poorest clients (Wilson 2002) . While serving the ultra -poor may indeed be possible in a financially sustainable way, it is likely that the time frame to reach or grants based on clients serving to reach financial self -sufficiency will be shorter for MFIs serving the economically active poor . if the target market identified is the poorest of the poor , donors and practitioners alike need to be committed to supporting the institution over a longer period. .

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