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The Rapid Development of International Microfinance

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Abstract.
Microfinance is a form of financial services for entrepreneurs and small businesses lacking access to banking and related services. The two main mechanisms for the delivery of financial services to such clients are: (1) relationship-based banking for individual entrepreneurs and small businesses; and (2)group-based models, where several entrepreneurs come together to apply for loans and other services as a group. In some regions, for example Southern Africa, microfinance is used to describe the supply of financial services to low-income employees, which is closer to the retail finance model prevalent in mainstream banking. Microfinance is a broad category of services, which includes microcredit. Microcredit is provision of credit services to poor clients. Microcredit is one of the aspects of microfinance and the two are often confused. Critics may attack microcredit while referring to it indiscriminately as either 'microcredit' or 'microfinance'
Keywords: *Microfinance, entrepreneurs, prevalent, microcredit, indiscriminately.*

I. Introduction

One of the **concepts of Finance** that has continued to excel over the last two decades and to which numerous groups and institutions attribute their *financial success* in the various development projects is International Micro-finance. Though not so active, microfinance has been prevalent for centuries with savings and credit groups and numerous savings clubs all over the world offering financial services to the poor population that was often neglected by commercial banks. With the little profit that they made from these services, the various savings and credit developed further to form cooperatives and other development financial institutions such as *micro credit organizations* which provided small loans mainly to the poor people in the rural areas who could not meet the high collateral requirements of the existing commercial banks.

The origin of global micro-finance institutions can be traced back to the mid -1970's in Latin America and South Asia whereby various credit and savings groups merged to form more stable **micro-finance institutions** which paved the way for the international micro-finance industry that has proved to meet the numerous financial requirements of individuals and development of numerous projects on a global basis. Over the last two decades, the global micro-finance industry has been on an increased rate of growth taking up the international financial market by storm. Statistics indicate that the industry has expanded its limits and currently it can serve up to 200 million clients across the world's geographical regions. For instance in Sub-Saharan Africa, the Micro-finance Institutions serve about seven million borrowers and records gross savings of nearly US$ 2.8 Billion with a total of about 17 million savers. Due to the numerous growth and prevalence of the micro-finance industry in the region, gross loans portfolio together with savings growth has raised to 69% and 60 % respectively.

A similar trend was evident in Europe whereby various types of large and more formal credit institutions came were formed. The micro-finance institutions established then primarily majored with rural and the urban poor population and were referred to as People's Banks, Credit Unions as well as savings and Credit Co-operatives.

This research paper will go further to discuss the development of micro-finance on the international level. The paper will address various aspects and trends of the International Micro-finance as well as the general state of the industry on a global base. This paper is divided into four subtopics which include: the Causes of the Rapid development of international Micro-finance; Constraints to the development of a *fully-fledged micro-finance* in developed Countries; the Impact of development of International Micro-finance in developing economies and the Role of Public Policy in the Development of International Micro-finance.

II. Literature Review

Causes of The rapid development of International Micro-finance

Over the last two decades, the micro-finance industry has been on an expansive mission, taking over the **financial and credit role** over the various commercial banks and other related institutions. One of the main reasons behind the rapid growth of the micro-finance industry is the fact that there has been a high demand for capital among the poorest. The main goal of micro-finance is to generate and hold savings for future financial needs. These savings play such a significant role in that they protect against the seasonality of cash flows especially among the poor people in the rural areas and the urban poor (Robert, 2002). By so doing, they help to fulfil an insurance role in covering the financial needs of the clients. More so, the various Micro-finance institutions across the globe facilitate the building up of deposits which enable the yielding of significant collateral levels which enable them to serve as a source funding for their customers. The Micro-finance industry across the globe has been on endless mission to counter poverty especially in less developed countries. Moreover, the microfinance institutions help to *speed up economic development* in the developing countries by offering a viable source of finance to the masses of people who wish to in invest and build up their financial basis.

Micro-finance institutions have also played a significant role by ensuring that their members are protected against financial shock that has seen their children remain in school despite the bad financial times such as inflation. There are two major factors why Microfinance compares favourably to other financial institutions and interventions. These include the cost-effectiveness and the prospects for sustainability.

According to Colin (2007), microfinance is advantageous by the fact reason that their donor investments are usually reused or recycled over time which facilitates the principle of sustainability in the financial flow and credit provision. According to statistics and data collected from the comparisons made between microfinance and other lending institutions such as commercial banks, microfinance stands out as a more cost effective developmental tool compared to the available alternatives such as formal rural financial intermediation and the rural infrastructure development projects (Andrew, 2006). In addition to these benefits, costs incurred in the application of microfinance services tend to diminish with the range of the outreach of their services unlike other related interventions which add on their costs and chargers as they cover more people (Colin, 2007).

The second significant factor that has added to the rapid development of International microfinance across the globe is the sustainability that comes along with microfinance services. Normally, most of other related developmental tools do not have the potential to remain sustainable after offering the first or the initial **start-up grants**. In most cases, after offering the initial start-up capital, these institutions find themselves in need of new inputs for each and every client who joins the organization or the union in future (Colin, 2007). Unlike these institutions, microfinance remains stable so that they don’t require their future clients to meet such barriers such as initial inputs and new inputs for the sustenance of their financial services and their lending endeavours. This is despite the fact that they there are no rigorous econometric models to substantiate its operations and capital requirements given the fact that their main target is usually the on clients who are not so well up financially. However, statistics and research have proven that Microfinance institutions that target poor customers are at a better place to achieve fairly considerable repayments rates compared to those institutions that major with richer clients (IAMFI, 2008).

The other factor that has facilitated the rapid development of International Microfinance is the formation of microfinance networks in the regions across the globe. These microfinance networks act as umbrella organizations for the functioning and the welfare of multiple microfinance institutions, thus providing a viable avenue their cooperation which guarantees support for each other and a centre for sharing ideas, experiences as well as articulating solutions to the common challenges that face them in their daily functions. According to Colin (2007), microfinance networks have been instrumental in the development of the microfinance institutions, and I quote, “Country and regional microfinance networks have an additional focus on advocating local microfinance policies and help members transform into *regulated deposit-taking financial intermediaries*.” An ideal example of such one of the largest microfinance networks in the world that has facilitated the rapid development of international microfinance is Accion. This is an NGO which is based in the United States and offers technical and consultancy services to the various microfinance institutions under it leadership. The major services offered by the network is concerning the management of the institutions, investment as well as governance support and guidance all aimed at building the institutions’ capacity and financial strength so as to fully meet the needs of the low-income households across the globe (IAMFI, 2008).

Constraints to the Development of a Fully-Fledged Micro Finance in Developing Countries

In as much as there have been numerous expansion and growth of international microfinance, we must acknowledge the fact that the mission to achieve the excellence and development records has not been without some impediments. There are various constraints that the international microfinance industry faces in their bid to meet the financial needs of their clients. This is more evident in developing countries where most people turn to the services offered by the microfinance institutions due to their numerous financial needs occasioned by low capital endowment. The constraints or barriers that face the **development of international microfinance** can be analyzed in terms of their efficiency, their profitability as well as their levels of the overall outreach. One of the major constraints of the rapid development a fully fledged microfinance industry in developing countries is the establishment of inappropriate government regulations which affect the welfare and the functioning of the microfinance institutions in the various economies across the globe. The major issue with governments is the fact that the policy makers exhibit difficulties in formulating effective legal frameworks around facilitate the smooth operation of microfinance institutions operations (Robert, 2002). Countries which have taken the initiative to draft specialized microfinance laws in their economies have helped to enhance growth and innovation in the international microfinance industry.

However, most economies around the globe formulate lenient policies on the microfinance frameworks thus creating environments that only lead to weak institutions which are undercapitalized. As such, they encounter numerous challenges and impediments in the development of their operations and scope of coverage. One of the most prevalent regulations which is more evident in various economies in Sub-Saharan Africa which undermine the global growth and development of the microfinance industry is the creation of interest rate ceilings; commonly referred to as usury laws, which limit the level of at which microfinance institutions can invest (Robert, 2002).

The other major impediment of the development of fully-fledged international microfinance is the poor utilization of modern technologies in developing countries. This is more common with economies in regions such as Asia and Sub-Saharan Africa whereby there is underinvestment in the technology among the prevailing microfinance institutions in the regions. This effect can be attributed to the constrained resources of the Microfinance institutions as well as the failure of the responsible management team to recognize the significance of integrating technological advancements in the microfinance industry (Robert, 2002). More so, the system of management information systems forces is either absent and in the few economies which have adopted the system is not well managed. This in turn leads to poor loan-processing and poor record keeping by methods such as paper work and spreadsheets-based solutions which incapacitates the efficiency of the institutions to manage numerous numbers of clients across the globe thereby limiting the profitability and the growth potential of the microfinance institutions.

In addition to the above impediments, the lack of transparency and consistency in lending activities among the various developing countries across the globe has amputated the rapid development of international microfinance. According to research findings on the consistency of lending activities of microfinance institutions in developing countries by Andrew (2007), and I quote, “Most microfinance institutions in developing countries display poor asset quality, with higher portfolio at risk metrics than other microfinance institutions in developed economies of the world.” This has mainly been caused by the lack of viable credit scoring methodologies among the institutions in the developing countries which have resulted in the inefficiency and the poor transparency in the management and their lending procedures. This in turn leads to increased costs incurred in funding for the microfinance institutions occasioned by the high risk involved in the investment due to inefficient management of the lending.

Last but not the least of the constraints that limit the development of a fully-fledged International microfinance is the lack of early-stage funding among numerous institutions. One of the major problems that still face most microfinance institutions especially in the developing countries is the fact that the funding which should facilitate the growth of early-stage companies in developing economies remains limited (Colin, 2007). This has been the case despite the increasing recognition of the commercial viability that is attached to microfinance institutions. It has been a major challenge for the small institutions that are emerging to develop and to expand their scope due to the lack of access to affordable finance sources. This has been the case due to the fact that most investment in the microfinance activities in the developing economies is has been concentrated in only a few leading institutions which are fully developed (Andrew, 2007).

Impact of Development of International Micro Finance in Developing Economies

The impact and the significance of the rapid development of international Microfinance in developing countries cannot be over stated. The *financial support* offered by the microfinance institutions to the various development groups and individuals has brought positive change in the lifestyle of people across the globe in various ways.

One of the most clear and evident impact of the development of international microfinance is the reduction of poverty and vulnerability especially among the low income earners in the developing economies and among the upcoming investors. According to findings by Robert (2002), and I quote, “Microfinance has also facilitated the trend of saving among numerous households. Consequently, this has made it possible to **invest and plan their life** such that their livelihood is not affected by some unexpected financial setbacks that they may face in life. Through such investments, people across the globe have been able to increase their levels of income. More so, people have benefited from the jobs created by the various microfinance institutions that have been established across various regions in the world. As such, households are able to cover their expenses and improve on their lifestyle in areas such as nutrition, housing and improved health care standards (Robert, 2002). More so, there has been a significant reduction in the rate at which harmful child labour take place especially in less developed countries. On a general note, reports indicate that there has been a significant improvement among the participants or members who have consistently invested their loans on long term basis in terms of their incomes, assets and their livelihood security. For instance report indicates that participants or members of the microfinance institutions in Vietnam recorded 50% increases in their income levels since 1996 when they joined the microfinance institutions in their country (Colin, 2007). More so, as Robert (2002) carefully notes, and I quote, "poverty reduction estimates based on consumption impacts of credit show about 5 percent of program participants can lift their families out of poverty each year by participating and borrowing from microfinance programs."

The other impact of the international microfinance has been experienced on the per capita expenditure especially among the women members of the institutions whereby women have been empowered and can manage their own development activities as well as their expenditure needs without having to rely on external support. More so, the net worth of the active members of the microfinance institutions has been significantly increased, with more changes being evident among women.

In addition, the development of international microfinance has led to the creation of **favourable economic environment** in the various regions which have adopted the microcredit programs. These programs have been significant to help the members who are not only faced with financial problems but also with issues to do with worries of possible economic crisis, political instability as well as the occurrence of natural disasters. The savings invested in the institutions are normally given back to the members in the form of credit loans which they use to recover and correct their affected projects and to support their daily needs in case such problems take place.

Last but not the least among the impact of the rapid development of international microfinance programs especially among the developing and the developed economies is the smoothening of consumption as well facilitating the reduction of the seasonality of labour supply. This is due the numerous employment opportunities that have been created by the numerous microfinance institutions across the globe and the fact that members have substantial amounts of capital to invest and create self employment through business ventures (Andrew, 2007). This way, the long-term members of the institutions are assured of regular in flow of income from the diversified investment projects that they have already initiated to facilitate alternative source of income.

Role of Public Policy in the Development of International Micro Finance

The implementation of some public policies in the various nations across the globe has also affected the rate of development of international microfinance across the globe in a number of ways. Some policies have had a positive impact on the rate of growth whereas others slow the rate of development of the international microfinance institutions by limiting their scope and interest rate levels thereby limiting their potential to grow into marginal financial institutions.

One of the public policies that affect the development of microfinance institutions and operations is the *monetary and the taxation policy*. Some taxation and monetary policies formulated and implemented by the respective governments may channel substantial amounts of capital or resources away from credit so that they are used in other investment instruments (Robert, 2002). This problem is more common in developing countries whereby the exchange rates as well as the interest rates are usually politicized so as to satisfy the selfish objectives of the politicians.

More importantly, the formulation of poor monetary policies by the responsible financial bodies and the various governments such as inflation and economic instability usually reduce the level of savings for the low income earnings who happen to be the majority of the members of the various microfinance institutions across the globe. This consequently affects the group-based microcredit programs so that they are financially unstable to meet bigger projects of the various development groups and the financial requirements of their clients.

Another policy that significantly affects the rate of development of the international microfinance institutions across the globe is the government regulation which reduces the capital available for the small businesses to lend their clients. This is due to the fact that the government values the stability of the banking system over the idea of widespread access as is the case with microfinance institutions. In other occasions, banks have shown their willingness to lend the microenterprises. Unfortunately, the policy regulators in these countries counter their efforts by initiating policies that inhibit such procedures.

The other issue that affect the efficiency and the development of international microfinance operations is the numerous political interferences in the credit markets, which is more rampant in developing countries. In most cases, politicians have been known to divert development funds to moribund state-owned firms and political or worse off to a few wealthy and influential personalities (Robert, 2002). Rarely do these funds reach the hands of the poor people who seek credit to finance their developmental projects. This leaves the poor with a challenge to form their own credit system which is quite a hurdle given their low resource basis.

III. Conclusion

The topic of the rapid development of international microfinance is such a significant topic especially with the current need and challenge of the small scale entrepreneurs to engage in more viable financial development projects. This has been necessitated by the need to counter the high cost of living occasioned by the inflation and other economic challenges. It is important to acknowledge the role that the microfinance institutions play in the international economics welfare such as employment creation and the reduction of poverty among the poor people especially in the less developed and the developing countries. More so, the services rendered by these institutions such as microcredit lending and the mobilization of members' savings has enhanced the income of the members especially those who have remained loyal to save on a long term basis.

It is also important to acknowledge the fact that there are some constraints that hinder the full development and growth of the microfinance across the various economies in the world. Such constraints as lack of transparency in the lending of credit to the clients among others must be fully addressed in order to achieve the full growth and expansion of the scope of the microfinance institutions I across the globe. The active NGO's and the various policy making bodies across the various economies must take upon themselves the responsibility of ensuring the formulation of favourable policies and viable procedures that enable the free operation and the rapid development of *international microfinance across the globe*.

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