IS MICROFINANCE FUNCTION AN EFFECTIVE TOOL TO FIGHT AGAINST POVERTY?

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Analysis

705 million[1] people in the world suffer from extreme poverty, and the number is increasing every year. The most prominent problem of these people, whose daily earnings are lower than 1.90 dollars and are in need of other people's help to survive, is their lack of access to a stable financial support to help them stand on their own two feet.

While facilitating the production of wealth since 1970, liberalization in the finance sector had limited intervention capability of governments. Despite the success in the social and economic policy application at the macro level, with no intervention by government bureaucracy, and the increasing significance of economic growth at the global level, there hasn't been much of a change in the ability of the poor to benefit from these economic opportunities. Global capital grew, credit capabilities and brandings increased, export goals widened, yet the 3rd world or southern countries stayed undeveloped under the new economic and political order. On the contrary, many countries paralyzed their economies by resorting to foreign loans and failed to distribute their wealth equally.

Certainly, there are poor people all over the world. However, in regions with basic economic problems like Southern-Asia Pacific and Sub-Saharan Africa, poverty inflated like a balloon and affected the public. Factors like insufficient governmental support, rapid population growth, besides economic turbulences such as slow economic growth, high inflation, import-bound consumption and devaluation, seem to have sabotaged investment and entrepreneurship opportunities.

Many different solutions are debated due to the absence of a unanimous formula to fight poverty. Internationals unions, namely the UN, initiate programs to fight poverty by calling for the initiation of economic forums such as the World Bank and civilian movements for the organization of international cooperation to fight poverty. In this regard, the UN's Sustainable Development Goals seem to be the most prominent global plan in the fight against poverty.

One of the subjects regarding the fight against the poverty at the global and regional level is undoubtedly the microfinance method. Aside from the macro goals on the governmental level and large corporations, this method which aims at supporting micro initiatives to minimize poverty in small residential districts was supported by the UN and the year 2005 was announced as "the year of micro credit".

What is Microfinance?

The core of microfinance, which made its name in the 70's and 80's in the global agenda, is the provision of funds for the poorest section which cannot benefit from the commercial banking system of a given country and, thus, helping them found their own businesses. The individual who is using the microfinance, is not only going to provide their own basic needs, but also going to form a wealth and protect their future.

The term "microfinance" expresses financial services, which include microcredits. Therefore, microcredit becomes an economical system that aims at public welfare, increase of growth and national revenue per capita by adding the figures created by small businesses into production.[2]

As it is well known, the biggest limitation for the underprivileged to funds is their lack of sufficient requirements. The ability of poor people to convert their talents into income through funds is thought to be a solution for poverty, especially in rural areas. Therefore, the aim of providing small amount of money to the underprivileged who cannot obtain credit through common procedures was for them to fund their own business independently; and at the macro level, to solve the country's unemployment problem. It was thought that an unprecedented leveled wealth could be formed with the creation of small businesses.

The first microfinance methods were applied in Germany; however, the popular ones were those applied in Bangladesh. German puts its microfinance activities as its official development policy; they used it as a tool to support the country's economic growth at the macro level. The system in Bangladesh that popularized microfinance was born as a special initiative that aims entirely at the rural growth.

Bangladeshi University lecturer Muhammad Yunis started to encourage poor people - who had to deal with loan sharks to be able to work in the rural sides of the country - to have income by lending them small amounts of money. The aim was to enable them to buy the basic tools and items that they need for their crafts and to free themselves from the loan sharks. The amount of the first credit was 27 dollars per capita. It was seen possible for them to move from an "extreme poverty level" to "mild poverty level" with the small loan that freed themselves from their debts to loan sharks. Bangladesh-centered microcredit system that developed since the year Yunis gave the first loans with his own individual initiatives, was institutionalized in 1983 under the name "Grameen Bank" and increased its loan capacity.

This system turned into a way to salvation for countries in South America, Asia, and Africa where the poverty is chronic; approximately 70,000 micro credit institutions were founded in 58 countries. Despite the common view that it was working without a hitch, these institutions that work with the financial sustainability logic couldn't find any solutions besides placing high interest rates even though they were substantially different from commercial banks. Though these banks work to help the poor, they must also make profits and financial sustainability. Collaboration with NGOs, receiving government support, or working in a financial-institution style changes the way the credits and aids are returned.

Microfinance institutions differ in some ways in each country. Besides the banks and financial foundations that aim at making profits, many non-profit organizations work actively in the microfinance sector. For instance, while some banks in Indonesia work with low interest rates and support the rural population, there are banks that work like that of a cooperative. Similarly, in Malaysia, stronger government-backed microfinance banks were founded and many Islamic financial institutions entered the microcredit sector. Though not being entirely a microfinance example, Turkey's KOSGEB, which supports small businesses, can be named as a successful institution in this area.

However, financial wealth cannot form any kind of development on its own. Financial markets that take form between the thin line of risk and safety are directly linked to infrastructure, foundations and capacity of labor besides the creation of financial wealth. The right investment and the effective use of capacity and population are important in risk management.[3]

Did it Work?

For poor people, to get loans based upon trust means a guarantor is not needed and the main requirement is the usage of the fund in establishing a businesses. The payback time of the microcredits, which especially aims at women's employment, is rather short. In many applications, the due date to pay back the loan is two weeks, along with high interest rates.

Despite the number of payback rates (98%), the payback conditions could hamper the target outcome. Even though low-budget credits enabled the rural population to obtain funds for their businesses, in many instances, high interest rate payback conditions prevent targeted revenue in the already stunted economic atmosphere. As a matter of fact, analyses carried out in the towns where loans are given show that only 5% of the people could benefit from it, the situation of the 45% of the people worsened and the other 50% could only stabilize their condition by getting loans from other banks.[4]

While some people take loans to pay other debts or make the ends meet, some do it to open businesses. Therefore, only 5-10% of the people could truly benefited from the loan and able to continue their businesses. This figure corresponds to only 1% of the population that used the loan. Many microcredit customers were not able to find the right market for their businesses and had to shut down their stores or workplaces.

Microcredit firms were founded almost everywhere in Bangladesh's rural areas for mechanism control. However, in payback time, the relationship between the firm and the customers turned from a creditor-credited into a bully-bullied relationship. By seizing the properties of microcredit users that fail to payback, poverty was in fact deepened instead of terminated. This problem is not only caused by lack of control, but also by the specifications regarding movement areas and rights of microcredit institutions in law.

In an environment where natural disasters take place, health care is weak, viral diseases are common, general economic situation is poor and individual poverty rates are high, how can individual investments progress in such a time when risk and trust balance couldn't be addressed?

Can NGOs Become an Actor?

An important step in the provision of microcredits is to determine the right beneficiaries. Even though government-backed microcredit seems to be an effective method, countries with weak social justice and unstable regulations might cause the program to reach the wrong people. In this regard, it is important for non-profit organizations to prevent this by making microfinance as part of their aid programs. NGOs' wide communication network, their direct connection to poor households and their constant donation flow can play an advantageous role in microfinance initiatives.

One dead-end of the aid program is the donation culture with which people have to live an aidbound life. To reach and provide funds to help people open their business seems a more possible role to be taken by NGOs. In order to strengthen this system with each NGO's entrepreneurship goals, the setup of affective methods in the juridical area is necessary. Because of these steps are not taken, these NGOs might in fact shift their role from providing aid to working as a finance firm.

To prevent such negative instances, cooperatives that are to be created legally with the mediation of NGOs in countries with strong control mechanisms, can create alternative work opportunities to fight against poverty.

With this in mind, it can be seen that microcredit is not a feasible method to fight poverty in the institutional area. Microfinance is a system with constructional issues and that may lead to new humanitarian problems in the process. In addition to not being able to lift the poor from poverty, economic and social structures that enrich certain group of people seem to be dragging poor people to a system with even more financial debt. If it were a method that could function rightfully on its own, the situation of poor people would improve parallel with the growth of microfinance institutions.

Micro-entrepreneurship can be used as an effective tool in the employment attempts and creation of wealth. This is because it can play a welfare-improving role in the lives of underprivileged people in the cities. However, the same method might be harder to implement in rural areas.

No interest-impropriation system seems to be feasible for the fight against the poverty in both the urban and rural areas. This system may serve as an indicator of the increase in aid and fight against the poverty, with the prevention of loan sharking.

Micro development policies that are supported with public policies will not give the targeted results. Without governments' macro-economic precautions, encouragements and the decrease of inflation, it seems wrong to expect miraculous results from micro credits.

Endnotes

1 https://worldpoverty.io/

2 Dişbudak, Cem, İnci, E. Melisa, "Yoksulluğun Finansallaştirilmasi: Mikrofinans Uygulamalari", Ekonomi ve Yönetim Araştırmaları Dergisi, p,72, Volume:8 , Issue:2, December 2019

3 IngridMatthäus-Maier, J. D. von Pischke, Microfinance Investment Funds Leveraging Private Capital for Economic Growth and Poverty Reduction, Springer,2007,p.15

4 Hartmann, Kathrin, Wir müssen leider draußen bleiben: Die neue Armut in der Konsumgesellschaft , Blessing, German, 2012, p,285.