

MICROFINANCE

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Abstract

Microfinance refers to the provision of financial products and services by banking firms to low-income clients that are not fully integrated in the ordinary financial system and refused by formal institutions because of their lack of guarantee and economic stability. Both in developed and developing countries, microfinance institutions such as credit unions and no-profit organizations, enable small producers, breeders, craftsmen and dealers to have access to credit, savings, insurance and other financial products in order to lay the foundations for income increase and standard living improvement. While microcredit refers specifically to loans and credit needs of clients, microfinance covers a broader range of financial services that create a wider variety of opportunities for success.

Microfinance refers to the provision of financial products and services provided by banking firms to low-income clients not fully integrated in the ordinary financial system. Microfinance customers consist of small and domestic enterprises without any kind of guarantee and economic stability, therefore they are refused by formal financial institutions. Thank to microfinance the poorest have access to credit, savings, insurance and other financial products thus creating basis for income increase and standard living improvement. Most poor people in the world do not have access to common financial services, this could be an opportunity for starting and improving their business. This is particularly true for people living in extreme

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poverty in rural areas of developing countries.

Small producers, breeders, craftsmen and dealers means devoid or in trouble make use of microfinance services. Borrowers, increasing their labour income, have the chance of securing the family food supply, dealing with health costs, paying for school fees, reaching better standard living, without being forced to emigrate or being exploited. A minimum amount of resources can be crucial for people living precariously. Traditional financial institutions do not grant loans to those households because of low income, absence of collaterals and limited number of transactions even in the case they have some guarantees; microfinance can be seen as a tool against poverty, ensuring credit, saving, insurance and other basic financial services.

Microfinance institutions such as credit unions and no-profit organizations –an example is given by banks for the poor – enable to get a loan, to receive remittance transfers, to cover savings. These banking firms, working in developing countries, offer their help to poor people living under the subsistence level – small craftsmen, dealers and farmers – lack of a formal financial system, would be forced to address to the black credit market.

1. Differences between microfinance and microcredit

Microfinance gives women and men in rural areas of the world the great opportunity to improve their standard living through the access to credit, saving, insurance, housing loans, remittance transfers and other financial services. In particular, microcredit refers specifically to loans and the credit needs of clients, while microfinance covers a broader range of financial services that create a wider range of opportunities for success.

Microfinance associations' goals have been achieved with a great success,

therefore United Nations proclaimed the year 2005 as International Year of Microcredit; it calls for building inclusive financial sectors and strengthening the powerful, but often untapped, entrepreneurial spirit existing in communities around the world.

In this framework poverty refers to the powerlessness of fulfilling primary needs such as nutrition, clothing, transportation and housing and microcredit is recognized as the main tool for poor people to reach a minimum level of income. Furthermore – referring to period 1990-2015 – halving the number of people living on only a dollar a day is one of microcredit objectives.

2. Beneficiaries of Microfinance

People ruled out of traditional financial system, both in developed and developing countries, because of the impossibility of providing collaterals, paying high financial transaction costs and in the absence of available borrower information, end up referring to informal finance and in worse cases are victims of usury. In order to create a wider range of possible financial services and *ad hoc* products to offer to excluded people, microfinance uses instruments and techniques from formal and informal sectors. Microfinance does not follow the traditional caring logic and poors are seen as the engine of the economic and social development of their communities.

The evidence shows that microfinance clients are excellent credit risks with a repayment rate higher than the repayment rate of conventional loans. For instance, the repayment rate is around 97 percent in Bangladesh, Benin and Dominica.

Banks of poors provide loans and manage savings, reaching people excluded from financial services because of the absence of elements such as bureaucracy and other administrative costs. Clients make weekly loan payments, so possible financial

difficulties can be promptly solved. Sometimes loans are distributed to small groups of people in order to solve business and personal problems that prevent repayments.

3. Development of microfinance projects

Microfinance consists of making small loans. A 50 or 100 dollars loan allow an inhabitant of a small village in India to start a self-supporting business and improve his living conditions.

Microfinance developed its activities throughout the last thirty years; its origins date back to the first years of 1950 during which projects in the agricultural sector have been carried out by using microcredit. Most of these credit programmes aimed to increase productivity in marginal areas and revealed themselves a total failure; in many cases loans were not repaid by clients or poorest farmers did not received all the money which was managed by richest ones, thus declining the level of microfinance institutions' capital.

During 1970 more sustainable programmes have been implemented, they referred to loans repayment and correct interest rates to cover costs. The Bengladeshi economist and banker, Nobel Peace Prize in 2006, known as the "banker of the poor", conceived and developed microcredit system. He is also the founder of Grameen Bank, the first one which provided credit to the poor, based on confidence rather than on clients' solvency. By the beginning of its activity, the bank had loaned over USD 5 billion to over 5 million poor; the borrowers are usually featured by "support groups", small informal groups, whom members support each others and share loan repayment.

Over the years Grameen Bank expanded its activity, now it offers a wide range of financial services in addition to traditional microcredit loans; Bank's products include home loans, tools needed to build irrigation and fishing systems as well as risk

capital management consulting. Its success has inspired similar projects in more than 20 developing countries.

In the Philippines, for instance, the International Fund for Agricultural Development (IFAD) and the Asian Development Bank (AsDB) funded a national project based on the distribution of loans – weekly repaid – to small groups rather than to individual borrowers and with no collateral required. Recent statistics has shown that 98% of the loans go to women because they are more likely to reinvest their earnings in the business in order to improve their families' living conditions. A great number of poor women living in rural areas of Indonesia came out of a heavy financial crisis thank to a IFAD project called P4K; all these women borrowing small loans started their self-sustaining businesses without getting into other kind of debt.

Microfinance is a concrete tool to fight poverty and hunger, especially in rural areas where credit access weakness is one of the main component of the unsuccessful economic and social development. In this way, poorest societies become independent by using resources at their disposal, respecting human dignity and improving local contexts' potentialities.

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