AN OVERVIEW OF THE ROLE OF MICROFINANCE IN ERADICATING POVERTY IN KENYA; A LESSON TO BE LEARNT FROM THE EMERGING ECONOMIES.

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Abstract.
This paper reviews the role microfinance has had in the emerging economies in the eradication of poverty. Data for this paper was ascertained from secondary sources. Most developing countries record very high poverty index. The majority of the poor live in rural and remote areas as well as in informal settlement in urban areas. These people as the paper realized do not have access to finances from commercial banks because of varied reasons among; them being fear of default risk by banks. The paper also reveals that microfinance in the Kenyan plays in empowering the poor and finally makes recommendations based on the successes achieved by microfinance programmes in emerging economies.

Introduction

Meaning of microfinance:

Microfinance is simply defined as credit advanced to the poor who normally do not have collateral to pledge. It involves the provision of financial services via microfinance institutions (MFIs) either to the working poor or those people who rely on their small businesses for income and who are not considered bankable because they lack collateral to be pledged as security or are considered high risk by the main stream or traditional commercial banking sector (Daley Harris 2002).

Microfinance is a type of banking service that is provided to unemployed or low income individuals or groups who would otherwise have no other means of gaining financial services.

In 2003 the world Bank estimated that approximately 1 billion people live on less than one dollar per day and out of about 3 billion only about 300m poor people are considered suitable for microfinance services. The main ultimate goal of microfinance therefore is to give low income people an opportunity to become self reliant and sufficient by providing a means of micro saving , borrowing money and insurance.

The history of microfinance:

Microfinance is not a new concept. Small micro credit operations have existed since the mid 17th century. However most modern micro financial institutions operate in developing countries. The advent of what is now called modern microfinance is dated to the 1970s when related lending programs were first proven to pass two key tests: to show that poor people can be relied on to pay their loans and to show that it is possible to provide financial services to poor people through market based enterprises (Otero 2006)

Historically, the main goal of microfinance was the alleviation of poverty. Alleviation of poverty was the primary social objective and so traditional microfinance institutions consisted of only of non-governmental organizations , specialized microfinance banks and public sector banks. In developing countries it is worth noting that in the recent times the market place has been evolving such that the traditional microfinance institutions have and are transforming themselves into profit seeking institutions. The argument attributed to this is that they want to achieve greater strength, sustainability and market rich.

Although most microfinance institutions consider alleviation of poverty their primary goal , experimenting with new techniques and strategies to raise more incomes and create jobs in order to sell more products to more consumers is also a motivation to many new entrants.

Microfinance appeared hundreds of years ago in rural and poor communities to offset the lack of savings and credit institutions and avoid expensive money lenders . Microfinance has been around in most developing countries for over 30 years providing small scale financial services to poor rural and urban communities. However the concept has gained a lot of popularity recently with the award of the 2006 Nobel Peace Prize to professor Muhammad Yunnus with his Grameen Bank. Professor Muhammad Yunnus , after realizing the dire need of microcredit by the poor in Bangladesh , initiated a savings programme from where the poor would access microfinance.

In the last few years a number of major institutions, investors and NGOs have plunged into this sector. The driving force has been and continues to be increased awareness of social responsibility and interest in sustainability, development and the believe that lasting peace cannot be achieved unless the large population find ways in which to break out of poverty.

Primary objectives of microfinance:

Scholars and researchers in microfinance have been posing rather interesting questions”Is microfinance a way of helping the poor or just make them poorer? “

In the face of ever changing world, microfinance is seen as a highly potential tool to alleviate poverty. In the 1970s and 1980s the provision of savings and credit services were seen as key instruments for economic empowerment ` of disadvantaged people. In Kenya microfinance was not seen as an organized way of offering grants rather to stimulate entrepreneurial activity. If free financial provisions are given entrepreneurial activity and efficiency are never stimulated .Free financial provisions undermine the development of a healthy financial infrastructure and local economy. With the provision of credit, micro enterprises will always grow and transform into small and medium sized ventures hence empower communities in which the enterprises are operating.

Microfinance services are aimed at reaching those people who do not have access to formal banking services. Microfinance aim at contributing to a structural improvement of the social and economic position of the excluded and disadvantaged poor.

The poor remain jobless especially in developing countries where creation of employment opportunities both in the private and public sector is very minimal. Provision of microcredit will enhance job creation because owners of micro-enterprises will be self-employed and may transform the micro-enterprises into small scale or medium business which will consequently absorb more labourers.

An overview of the impact of microfinance in the emerging economies.

Microfinance has had varied impacts in different economies based on the policies of governments, perceptions held by the individuals as well as economic and political conditions in the countries.

Impact of microfinance in Bangladesh. Grameen Bank, a brain child of professor Mohammed Yunus, was started by the Bangladesh government in 1983 as a formal bank specializing in micro-credit where lending is done without the requirement of collateral . The studies done so far in Bangladesh show that living standards of the people has greatly improved through diversification and strengthening of their salaries , improved their security , increased their self-respect and given them independence. The poor have been able to undertake diversified economic activities which generate flow of income throughout the year .With microfinance services the poor households now own and command assets and savings in which they use to meet contingencies without sacrificing their independence or peace of mind by indebtedness . Micro-credit borrowers can now depend substantially on their own property to meet their financial obligations without depending on borrowing from expensive money lenders with unfriendly borrowing conditions like high interest rates and the requirement for the collateral .

Micro-credit in Bangladesh has raised self-respect and empowered borrowers as well as raised their social standing and participation in activities like building community roads , running health programmes and community schools. A study conducted by World Bank in 1999 showed that income of the poor had increased by 97-93% of the borrowers. The study also showed that quality and quantity of food intake improved by 88.59% clothing and housing also improved by 87.85% and 75.26% respectively. Poverty reduction was generally manifested in improved sanitation and overall quality of life by 68.74 and 94.96% respectively. The study showed that the number of families with food deficit reduced from 82.20% to 9.6%. Again 77% of the families have either better economic condition compared to mere 4.7% before their involvement with microfinance programs.

The impact of microfinance in china.

In the Chinese context there has been rapid and continued economic growth over the 2 to 3 decades. However chine is home to millions of the world's poorest people. Many of the poor live in impoverished rural areas with mild prospects of economic improvement. There has been a deepening inequality between the urban and rural population. The Chinese government has been attempting in the recent past to tackle this problem by promoting economic development in rural areas through creating small and medium sized enterprises .The promotion has been by provision of micro-finance services. The government of China has granted licenses to companies offering micro-finance services in rural areas to ` bridge the gap between the rural poor and the urban population. The People's Bank of China and the China Banking Regulatory Commission has encouraged the creation of rural credit cooperatives and village microfinance banks by offering big subsidies to them to offer micro credit at affordable and friendly conditions .According to christein 2005, micro-credit has demonstrated that people can safe , borrow and meet their financial obligations in cities and rural areas. Besides the government of china has facilitated the creation of specialized and dedicated micro-credit companies.

Microfinance in Malaysia.

Micro-finance in Malaysia is operated by credit unions, cooperative banks and specialized micro-finance institutions. There are specialized rural credit institutions that provide micro-credit to the agricultural sector.

Besides, a number of NGOs engage in microfinance. In 2006 the government gave colossal sum of money to local financial institutions offering micro-credit to carry out micro-credit programs. The aim of the government was to make individuals and micro enterprises who do not qualify for existing bank products due to lack of collateral or guarantors to access funds.

The aim of microfinance institutions is giving loans to finance income generating activities to the poor households and eventually move out from the poverty group. It is the government's objective in the eradication of poverty among the poor households in Malaysia. A big percentage of the microfinance comes from the government with no interest. Borrowers are given interest free loans to undertake income generating projects. The loans are rapid on a weekly basis. After the completion of repayment relatively bigger loans are granted. The advancing of loans follow Grameen Bank model where borrowers form groups who guarantee themselves. After formation of groups, the members undergo thorough training for one week on management of their businesseses and how to repay the loans. Malaysia has reached 80% of the targeted poor households.

The government carries out screening of the poor before the loans are advanced. The loans are advanced through a special delivery system, no collateral, no legal action and no guarantors other than members of the group. What is striking is that the loans are delivered to the poor in the village. Formation of groups is meant to enhance peer pressure and support collective responsibility. Besides, loans being given to the poor for income generating activities , there is close supervision by fields staff at designated centers and business premises.

Challenges to microfinance:

The most serious challenge is the view that poor people are also poor credit risks hence they do not benefit from financial services. Providing banking and other financial services to the poor present a serious challenge. The exclusions of the poor from the financial system means they have no basis in participating in modern financial transactions.

Another challenge is that beneficiaries are poor hence have little if any collateral to pledge against credit. This compound the problem of being a risk sector for lending.

In large areas of the world, most poor people live in remote rural areas without access to the infrastructure of modern commerce and communication. This makes them not to benefit from financial services preventing them from making modest improvement in their lives and consequently they are left trapped in poverty. In china the government facilitated establishment of rural credit cooperative and village microfinance banks.

An overview of microfinance in Kenya

The main aim of microfinance in Kenya was and is to address poverty. Between 1980s and 2000, NGOs and multlational agencies were behind many MFIs. They were co-financing agencies. The co-financing agencies were concerned with alleviation of poverty and creation of employment as well as increasing the income of the poor. They were also concerned with improving social capabilities availability and access to resources and participation in decision making.

Between 1980s and 1990s the dominant and specialized microfinance institutions in Kenya were Kenyan women finance Trust(KWFT) , Kenya Rural Enterprise program(K-REP), faulu Kenya and Family Finance . So far some of them have converted into full pledged commercial banks. Profit generation and sustainability are attributed to such move and they are charching relatively high interest rates.

With the implementation of structural Adjustment programs (SAPs) in the early 1990s microfinance became more vibrant to counter the social economic effects of the liberalized economy. The government identified micro enterprises as a need sector that required donor funding through microfinance agencies. The government's intention was to promote micro-enterprise sector as a means of accelerating economic growth and generating employment opportunities. Initially the pioneer microfinance, the Kenya Rural Enterprise program (K-REP) was concerned with lending to existing enterprises and not starters just because of lack of capacity to train and provide technical assistance to starters . This started becoming business oriented approach and not integrated with training. Due to pioneering and supportive roles of K-REP as well as donors, much appreciating NGOs emulating Grameen Bank approach. Kenya witnessed emergence of NGOs, microfinance Agencies in the 1990s using Grameen Bank group lending model.

Two categories of microfinance operate in Kenya; formal and informal based on the statutes under which they operate or registered. They are also based on customer- provider relationship in the management and ownership of the finance service provider. Member based ones include savings and credit cooperatives and merry-go rounds. Client based and the specialized microfinance institutions include Faulu Kenya, KWFT K-REP among others.

Lending by microfinance is either group or individual based or minimalist verses intergraded approach. Group based which take the form of Grameen bank method is common. Also unregistered shylocks lend at very high interest rates. Interest rates charged by specialized microfinance institutions are monthly which reflect that they are low but are actually higher than commercial banks. It has been proved that group guarantee schemes are an inconvenience to many because each want to plan his finances and create fear of default among members.

KWFT lends to women either in groups or individuals. Savings of the members become security. It lends at rates between 15% to 18% per annum. Sometimes conditions like registration of groups is a requirement and that the group members must be operating businesses.

Conclusions

From the above review empowerment of the poor is seen as a key growth indicator to boost the eradication of extreme poverty and hunger. With the provision of microcredit coupled with training on business management skills, poverty in developing economies will be a thing of the past . Studies in emerging economies show that a lot has been achieved through affordable and convenient micro-financing. The vast poor are able to increase their cash inflows, develop in entrepreneurship which consequently can lead to the overall development of the economy.

Recommendations

Most microfinance institutions in Kenya have converted to full pledged banks like Faulu Kenya, KWFT, Family Bank , Equity Bank, among others because they are profit motivated microfinance. They are charging market interest rates which are scaring away the poor from borrowing. The government should either subsidize the interest rates or partner with micro finance institutions to grant interest free loans to extreme poor people.

There is misconception by the rural folk that credit makes the poor even poorer. They fear that if they default all that they posses will be confiscated by the microfinance provider. The government should endeavor to erase the misconception through vigorous awareness campaigns about the role of microfinance in eradication of poverty.

Provision of micro-credit without follow-up on the use of credit is like giving a child wheat flour to bake when he /she does not know how to bake. In agricultural sector statistics show that there is only one extension officer to 1400 farmers in rural areas. Furthermore the extension officers do not have the required means of transport and communication to reach the vast rural and remote regions. The government should provide extension services in diverse fields for microfinance to be beneficial and relevant towards the achievement of the 2030 vision goals.

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