

# [Microfinance improving their household economic welfare, and](https://assignbuster.com/microfinance-improving-their-household-economic-welfare-and/)

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Microfinance is ‘ the provision of economic services tolow-income poor and extremely poor self-employed people’ (Otero, 1999). Ledgerwood (1999) defines microfinance as, ‘ certain monetary services thatprincipally include savings and credit, but may comprise of alternativefinancial services such as insurance and payment services’. As outlined bySchreiner and Colombet (2001), microfinance is an effort to improve access to paymentsand credit for poor households that are mistreated by banks. Hence, microfinancealso includes monetary services such as savings, loans and insurance to poorpeople who live in both urban and rural settings who are not capable of obtainingsuch services from the formal business sector. It is very important that if this topic is to be discussedin detail, a distinction must be made between microfinance and microcredit; words which are often used interchangeably but have contrasting definitions.

Microcredit is limited to the provision of a small loan to the poor (Sinha, 1998), while microfinance is a large umbrella, under which is also includednon-credit financial services such as savings, insurance, pensions and paymentservices (Okiocredit, 2005). As a result, it can be said that microcredit is acomponent of microfinance. Supporters of microfinance believe that it has a very largerole to play in development. They believe that microfinance helps the poor inmeeting basic needs and protecting themselves from risk, improving theirhousehold economic welfare, and also helps to empower women by supporting women’seconomic participation (UNCDF, 2004). Otero (1999) states that microfinancecreates access to capital for the poor, and when this is combined with humancapital, education, training and social capital, it allows people to move outof poverty. The aim of microfinance in line with Otero (1999) isn’t just concerning providingcapital to the poor to combat economic condition on a private level, itadditionally incorporates a role at an institutional level; it seeks to form institutionsthat deliver monetary services to the poor. On the otherhand, there are many who are skeptical about the idea that microfinance hasmuch of a role to play in the overall eradication of poverty.

Hulme and Mosely(1996), while recognizing the role microfinance can have in diminishingpoverty, determined from their study on microfinance that most of the modernday microcredit schemes are less effective than they should be. Rogally (1996)argues that microfinance is irrelevant to the poorest people, and because ofthe oversimplified and simplistic definition that we have of poverty, it isvery difficult to actually measure how exactly microfinance impacts poverty. Povertyis not an easy term to define, as it is so multifaceted. The World Bankbelieves poverty is income-based, and that it should be measured based on the proportionof people who live below a secure sum of money, such as US $1 dollar a day(World Bank, 2003). On the other hand, Wright (1999) believes that poverty isnot just based on income. He justifies this by saying that even by increasingthe income of the poor, what the poor people do with this income is whatdetermines their poverty, as they may gamble it away or spend it on alcohol.

A real life example of microfinance that can be analyzed isthat of Vijayawada in India. Here, a system of saving up was involved; adeposit collector called Jyonthi would collect money from slum dwellers, inorder for them to accumulate some sort of saving. Her rate of collection wasRs. 5 per day from each person, and would collect for a total of 220 days. Atthe end of the 220 days, each person would receive Rs.

1000. Lalitha (2003)states that this project increased savings in this city by 55%. There areadvantages as well as disadvantages of using such a system. Slum dwellers areusually unable to save money at home, and are unwilling to go to the hostileand unfriendly country banks, so in this case microfinance is ideal for them. Thiscertain project also had other advantages; not only did it empower women, but it also gave parentsthe ability to save money for their children’s education (Rutherford, 2009). One of the issues with this project was that while saving, customers werelosing part of their savings as interest to the deposit collector, who wastaking in 8% commission. Giving your savings to an informal deposit collectoralso comes with an added amount of risk, but in this case, this was a risk thatthe slum dwellers were clearly willing to take. Despite an increase in savings, this did not necessarily correspond to the decrease in poverty.

According to astudy by Lalitha (2003), the size of Vijayawada’s slum areas have been risingat an alarming rate of 12% annually per square mile. Also, even though thepopulation density of Vijayawada has increased between 1993-2003 by 30%, healthcare spending by the city has only rose a meager 2%. It is said that 80% ofhouseholds are not economically stable, and only 4% of households are said tobe ‘ happy’. As a result, it can be said that despite increased savings due tomicrofinance, the city is still in an immense state of poverty. Another microfinance project, whichinvolves ‘ saving through’, takes place in Nairobi, Kenya via the RotatingSavings and Credit Associations or ROSCAs initiative. The purpose of theproject is to help marginalized groups receive lump sums to fulfill needs orfurther save. This small scale project involves groups of 15 people; 15 womensave 100 shillings daily, leaving a lump sum of 1500 shillings.

Every day, oneof these women receives the large lump sum, and at the end of the 15 days, anew cycle starts (Rutherford, 2009). This project is different from the one inVijayawada in the sense that there is no interest rate or commission involved, as everyone receives back what they put forth.  Such a scheme requires a large amount of trustand social capital, and so all members of the program must have good ethics andunderstand reciprocity.  Converse toVijayawada, Nairobi has actually seen a decline in poverty (Alder, 2005). Thesizes of slums are annually decreasing, are being replaced by new residents in suburbanareas of Nairobi. Healthcare is on the rise; in the decade 1995-2005, spendingon healthcare rose by 22%.

Having studied both of theseexamples, and assessing their contrasting results, I have come to theconclusion that microfinance does have an effect on poverty and development, but only to a certain extent. In both the examples stated above, microfinancemanaged to increase the income and saving level of a city, but in one case, povertygrew, and in the other, poverty diminished. Microfinance can be considered tobe a tool; a tool that helps give poor individuals the means to escape povertyin the form of income and savings. What microfinance doesn’t not provide is areasonable blueprint for the poor on how to spend this money, what investmentsto make, and what financial decisions to make that will ultimately push themout of poverty. Until microfinance projects do not start providing thisblueprint, such a concept will remain as a ‘ tool’, and not the ultimate, complete solution to poverty eradication.