Microfinance, entrepreneurship and sustainability

Education, Sustainability

Introduction

Theoretical Framework

According to the Asian Development Bank (ADB), Microfinance can be defined as “ the provision of a broad range of financial services such as deposits, loans, payment services, moneytransfers, and insurance to the poor and low-income households and their microenterprises” (ADB, 2000). Another definition is provided in Ledgerwood (1999) who contends that microfinance is “ the provision of financial services (like savings, credit, insurance and payment services) to low-income clients (the poor) including the self-employed”.

The aforesaid suggests that there is a positive relationship between microfinance and entrepreneurship or microenterprises. Microenterprises promote income generating activities thus promoting repayment. Being able to repay microfinance loans by income generated from microenterprises enables microfinance to be sustainable. Microfinance is specifically designed to offer financial services to microentrepreneurs. Microfinance enables microentrepreneurs to expand and run their businesses.

The foregoing shows that microfinance and entrepreneurship are mutually beneficial to each other.

Microfinance witnessed an evolution in the 1970s. This evolution has been regarded as a means of breaking the barricade of access to capital by poor people who are interested in carrying out development projects. Microfinance empowers the entrepreneurial spirits that exist among small-scale entrepreneurs worldwide (Olu, 2009). It facilitates the establishment of microenterprises and encourages best practices among individuals involved in small and medium size enterprise (SMEs) (Olu, 2009). Governments in developing countries have over the last two and half decades formulated great programmes to promote economic development. Lack of access tofinancehas been cited in developing countries as one of the major reasons behind the relative absence of SMEs in less developed economies. Large firms can obtain finance from banks because they have an asset base that can serve as collateral. SMEs on the other hand do not have such and asset base and as such cannot gain access to large banks. Rather, SMEs rely on small scale financing in the form of microfinance to finance small scale development projects (Olu, 2009).

Approximately 90 percent of people in less developed economies do not have access to financial services from banks and other financial institutions. Most people neither save nor have access to credit facilities (Marguerite, 2002). The foregoing suggests that people in less developed countries have limited capacity to invest. Limited investment capacity results in restricted productivity which in turn limits incomes, domestic savings and productivity growth. The lack of access to financial services reduces the ability of entrepreneurs to engage in new business ventures which in turn limits economic growth. The sources and consequences of entrepreneurial activities are therefore neither financially nor environmentally sustainable. Microfinance serves as a means of empowering the poor and is considered as a valuable means of enhancing the economic development process. Despite the importance of microfinance in development, it has been argued that microfinance; entrepreneurship and sustainability tend not to have a great effect on alleviatingpovertyin less developed economies. Accordingly, microfinance they say can only successfully alleviate poverty if it is combined with entrepreneurial skills. This means that one should expect a positive link between microfinance and SME development or entrepreneurship. Despite this relationship, microfinance and entrepreneurship may have a negative relationship or may even have no relationship. In addition, some people with entrepreneurial skills tend to be risk-averse. This group of entrepreneurs may not use microfinance credit because they may not be willing to take on high levels of risk. As such their projects may remain unfunded even in the presence of microfinance loans. In addition, the poorest of the poor including the sick, the mentally ill and the destitute cannot adequately handle microfinance projects which means that microfinance cannot be used as a means of alleviating poverty for this group of the population. This group of the population would prefer direct basic assistance to microfinance. They are mostly interested in meeting their daily needs of shelter, food, clothing and food.

Empirical Evidence

Two competing theories have been advanced withrespectto the relationship between entrepreneurship and microfinance. One school of thought advocates that lack of credit hinders the growth of microenterprises, indicating that microfinance and entrepreneurship have a positive relationship. The second school of thought on its part suggests that microfinance has a negative effect on the poorest in society.

The first school of thought believes that lack of credit is a major constraint to the development of microenterprise and believes that microfinance plays a positive role in enabling a society achieve its larger goal of deriving social and economic benefits (Hashemi et al., 1996; 1994; Schuler et al., 1997). According to the International Finance Corporation, more than 500 million poor people across the world are engaged in microenterprises (IFC, 2002). When asked what their major constraint is, most of them conclude that the main constraint to business growth is lack of credit. This evidence suggests that microfinance has a positive impact on entrepreneurship. Similar evidence is provided in Sen (1999) who argue that the greater the financial security of an entrepreneur, the higher is his probability of becoming more successful. Furthermore, Eversole (2000) contends that credit is important for the success of micro businesses.

The impact of microfinance on poverty alleviation has also been studied. Nair (1998) identifies two schools of thought regarding the effect of microfinance on poverty alleviation. On the one hand, it has been argued that credit is one of the most important tools for alleviating poverty. This school of thought believes that microfinance credit is always invested in a productive investment which will help in poverty alleviation.

However, this school of thought is flawed on because it makes the unrealistic assumption that microfinance credit is always invested in a productive investment. The theory ignores the fact that some investments may not be productive which indicates that not all microfinance credit can actually result in poverty alleviation.

Rangarajan (2005) observes that microfinance is important for the evolution of “ Self-Help Group” at three basic levels. These include:

Level 1 where microfinance is used by households to satisfy their survival requirements by using small savings and loans as a buffer in emergencies;
Level 2 where households use microfinance is used to meet subsistence needs; and
Level 3 where households become mature enough to take on a higher degree of risk; at this level, microfinance can be employed in setting up enterprises or facilitating the creation of employment in one way or another thus promoting the sustainability of households.

The aforesaid shows that the argument that microfinance cannot help the poorest of the poor lacks empirical support. This argument is further weakened by evidence from India, which shows that a large portion of the Indian population falls in the “ poorest of the poor” category. Despite this, microfinance has had a significant positive impact on this group of the population in India. A study based on 20 microfinance institutions in India provide evidence that microfinance has made a significant contribution to both the savings and borrowings of the poor in India (Sinha, 2005). Kuzilwa (2005) provide evidence that credit has been very instrumental in the success of microenterprises in Tanzania. The study provides evidence that most business start-ups have been financed by own sources while expansion has mainly been finance by microfinance credit. The study further observes that inadequate credit resulted in the abandonment or postponement of entrepreneurial projects. Some studies have concluded that microfinance credit contributes to the growth of enterprises although the impact of finance has not been very significant. Empirical evidence shows that after receiving finance, the firm’s output increased by 40 percent. This evidence shows just how important microfinance is for the growth and expansion of enterprises and thus emphasises the positive relationship between microfinance and entrepreneurship in poor countries.

In order for microfinance to help foster entrepreneurial activity, the activity must be sustainable. This means that only enterprises with the potential to evolve from micro to small and to medium enterprises can be considered entrepreneurial businesses (Harper, 1998; Kuzilwa, 2005). Businesses that are merely surviving to sustain afamilycannot be considered entrepreneurial (Harper, 1998).

The operating cycle of microenterprises is relatively short compared to that of large enterprises. Microenterprises are therefore in need of short term loans in small amounts. Due to their short-term operating cycles, microenterprises are in constant need of small scale loans to finance their business. Consequently, sufficient and timely capital is necessary for the success of microenterprises. According to Alagappan and Nagammai (2003), any entrepreneur’s main problem is finance. Adequate finance is required at reasonable cost to meet the expectations of any entrepreneur (Alagappan and Nagammai, 2003).

Small scale entrepreneurs find it difficult to access large financial institutions. This is mostly because of information asymmetries between large financial institutions and small scale businesses. Moral hazard and adverse selection bias often make it difficult for small firms to gain access to finance from large institutions. The process is often complex and may result in delays. Consequently, the only hope for small scale businesses is microfinance. According to a study by Vincent (2004), an initial loan of approximately $100 helped in reintegrating entrepreneurs into formal networks as well as promoting structural and sustainable development in communities. However, the study observed that only 5% of entrepreneurs in these communities were able to obtain micro credit thus hindering the growth and development potential of communities in less developed economies (Vincent, 2004). Vincent (2004) concludes based on this evidence that sustainable entrepreneurship and microfinance can contribute tremendously to poverty alleviation in less developed countries.

While credit is important, it is not the only factor that can facilitate entrepreneurship in less developed economies. According to a study by Roy and Wheeler (2006) on 12 microfinance institutions in four West African economies, growth of microenterprises is not restricted only by poor access to credit. Rather, other factors such as poor training, lack of trust and corporation as well as risk aversion are other factors that must be taken into account when evaluating the factors that restrict the growth and expansion of microenterprises in less developed economies (Roy and Wheeler, 2006). While microfinance can help in stimulating growth of microenterprises, its availability is only an important part of the story (Roy and Wheeler, 2006). Microfinance needs to be provided only to entrepreneurs who satisfy a host of other requirements such as adequate training, risk tolerance, trust and corporation.

While other factors may affect the growth and expansion of microenterprises in less developed countries, Adams and Pischke (1992) believe that lack of funds is the most important problems facing microenterprises. Adam and Pischke (1992) argue that access to small and short-term credit is more beneficial for poor microenterprises than large long-term credit. The evolution of microfinance has been very important because it has enabled microfinance institutions to handle small scale transactions efficiently as well as establish long lasting links with borrowers. The main focus of microfinance institutions is on small and short-term loans which can help small scale entrepreneurs finance short-term investment projects and thus alleviate poverty in the community as a whole.

As mentioned earlier, a second school of thought believes that microfinance has a negative impact on the poorest in society (Adams and Von Pischke, 1992; Buckley, 1997). While microfinance programs can create a positive impact on the poor, these programs often fail to reach the poorest people when trying to achieve sustainability. While the programs can serve the poor, they do not necessarily help the poorest of the poor (Copestake et al., 2001; Hulme 2000; Hulme and Mosely 1996; Mosely and Hulme 1998). While superficial analysis shows that microfinance can foster entrepreneurial growth and thus reduce poverty in society, deep analysis suggests that microfinance credit does not create opportunities. Rather the ability of the community to generate income and thus alleviate poverty depends heavily on the entrepreneurial nature of people in the community (Kulziwa, 2005). This does not amount to saying that credit is not important for entrepreneurship. Credit certainly plays a significant role in improving the competence of the entrepreneur to make use of the opportunity available. However, the entrepreneurial skills must be there to fully realise the benefits of microfinance.

Empirical evidence suggests that microfinance has not had a positive impact on entrepreneurship in very poor countries. Shaw (2004) investigated the impact of microfinance on poverty in Sri Lanka. The study provides evidence that not all microfinance projects have been able to alleviate poverty in Sri Lanka. The study contends while microfinance can work well for those very close to the poverty line, it can only help those who are interested and able to engage in high-value entrepreneurial activities (Shaw, 2004).

According to Shaw (2004) microfinance loans are not sustainable in that they only serve to protect current consumption levels while offering limited opportunity for exiting poverty. For microfinance programs to be successful, they must be complemented by investment in physical and social infrastructure.

Another argument against microfinance programs is that these programs are capable of pushing the poor into a debt trap. This is because the programs often turn out to be unsustainable if the poor are not able to engage in an activity that can generate enough income for repayments (Mead & Liedholm, 1998).

A study was conducted on NGO led microfinance programs in several developing countries. The objective of the study was to evaluate the performance of microfinance programs in these countries using a set of four indicators including their ability to target the poor, their ability to increase assets of the poor, their ability to generate income and their ability create skill employment and financial viability. Comparisons were made with state-led credit based poverty alleviation programs such as the Integrated Rural Development Project (IRDP) and the Regional Rural Banks (RRBs) in India (Chavan & Ramakumar, 2002). The study provides evidence that microfinance programs have helped in achieving a marginal improvement in the income of their beneficiaries. However, the evidence suggests that the beneficiaries have not obtained any significant benefits in terms of technological improvements because the programs focus primarily on survival skills (Chavan & Ramakumar, 2002). Focusing on Bangladesh, the study observes that microfinance programs which are designed to help customers repay Grameen Bank loans through fresh loans from moneylenders has resulted in the creation debt cycles (Chavan & Ramakumar, 2002).

Anand (1994) examine the performance of microenterprises in Botswana the balance between lending and borrowing activities of microfinance institutions. The study observes that Microfinance institutions focus more on lending than borrowing. Lending activity constituted 75% while borrowing constituted only 10% of their total activity (Anand, 1994). This clearly shows that finance cannot be considered a constraint for entrepreneurs in Botswana.

The foregoing shows that in order for microfinance to be sustainable, it has to be complemented by savings and other factors. There is a common misconception that the poor cannot save. However, the evolution of microfinance has proven that this is a misconception. Microfinance loans are often made based on the saving capacity of the borrower (Stemper, 1996). Savings are used as a means of establishing the history of the borrower and serves as a important input to evaluating the loan application (Stemper, 1996). Savings can also serve as collateral for borrowers who do not have landed property. This view has been reinforced by Buckley (1997) who views savings as the means of achieving financial independence and self sufficiency for micro enterprises.

India created Rotating Savings and Credit Associations (ROSCAs) which serve as microfinance institutions in the country. These associations support the need of financial services for the small scale entrepreneurs in India. They are popular because of their simplicity and the freedom that they provide on using funds (Buckley, 1997). Guha and Gupta (2000) provide evidence suggesting microfinance institutions improve the saving habit of the poor by creating income generating activities and improving their loan repayment habits.

Critique of The Literature

The empirical evidence above suggests that microfinance institutions play an important role in alleviating poverty in developing countries. This is achieved through their impact on entrepreneurship. Microfinance institutions are sustained by promoting savings and investment schemes for the poor. This suggests that microfinance institutions.

A key short-coming with the studies above is that most of the studies focus on the relationship between entrepreneurship and microfinance, with little emphasis on sustainability. Sustainability of entrepreneurship and microfinance are important if they have to be used as a means of alleviating poverty in the long run. Despite the importance of sustainability, the existing literature has not exploited it in great detail.

Togo has witnessed significant developments in its microfinance industry. Microfinance was initiated in Togo by the Association for Community-Based Self-Promotion (ACOMB), which operates in two very low-income districts that have experienced excessively high levels of HIV/AIDS with very little government or foreign support (Parker, 2000). The goal of the association was to providehealtheducation, information, and referrals to clients as an important complement to financial services (Parker, 2000). In addition, the Faitiere des Unites Cooperatives d'Epargne et de Credit (FUCEC) is a Togolese-based Microfinance institution which comprises of credit unions aimed at offering credit with eduction as one of its financial products (Dunford, 2002). FUCEC provides underprivileged people (especially poorer women) to join a credit union. The Microfinance institution provides members with the opportunity to save and obtain credit to finance local projects. This means that most members of FUCEC and net borrowers (Dunford, 2002).

Despite these developments, the role of microfinance in alleviating poverty in Togo has not been exploited. Likewise, the relationship among microfinance, entrepreneurship and sustainability are yet to be exploited in Togo. It is against this backdrop that this study aims at investing the relationship among microfinance, entrepreneurship and sustainability in Togo. This will help in the formulation of policies regarding microfinance, entrepreneurship and sustainability in future.

This paper will look at two hypotheses as follows:

Microfinance programs have a positive impact on entrepreneurship in Togo; Entrepreneurship has a positive impact on the sustainability of Microfinance in Togo.

Conclusions

Based on the literature above, it can be concluded that there is a significant link between entrepreneurship and microfinance. Despite the apparent importance between sustainability and microfinance, very limited research has been conducted to explore this relationship. In addition, most studies on microfinance in less developed countries have focused on other countries thus ignoring Togo altogether. This study extends the paper by incorporating sustainability into the relationship between entrepreneurship and microfinance using Togo as acase study.

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