The micro finance institutions

Business

Through microloans, MFIs are filling the gap left by the mainstream financial institutions such as banks. Vast literature indicates that the finance sector has never witnessed bigger revolution and drift from the norm than it can be put in comparison to the microfinance boom. Professor Yunus receives credit as the father of microfinance, having introduced the culture of lending to the poor based on their group organizations other than collateral. Professor Yunus, while lecturing as a professor in ChittagongUniversity in Bangladesh, lent to the poor from personal savings.

The driver to this approach was the realization that the poor lack collateral to borrow and, as such, may remain in poverty. The realization was that the poor do have a willingness to pay and his experiments with personal finances had a remarkably small percentage of default. The consequent was a decision to take the idea of lending to full-scale idea; this lead to the formation of Grameen Bank as the first microfinance institution. The term means banking to the poor. This operation based on group lending, the entrance of donors, international organizations has led to the adoption of professor Yunus's idea all over the world.

Replicas of Grameen Bank are all over from Africa prominent Equity Bank Kenya, to the US among other places (Highlands Capital Partners, 2012). Microfinance institutions apart from lending to the poor alone have sought diversification and are exploiting the weaknesses inherent in banks. Majority of young entrepreneurs facing frustrations from mainstream banks are likely to land in the welcoming arms of MFIs. The distinguishing aspects of MFIs are their lending in the absence of collateral. Majority of young entrepreneurs

starting companies have little assets that would sufficiently guarantee sufficient funds from banks.

Banks also treat such start-up companies as risky; the lucky entrepreneurs have to pay exorbitant interest rates that are purportedly a cover for the huge risk. Since Micro-lenders receive funding from a number of well-wisher and support groups, they are able to lend at appreciable rates. Start-up companies requiring less than 40, 000 USD are likely beneficiaries of these funds. MFIs benefit from philanthropists, community development funds and small business administration’s funds (Hosmer, 2009). Due to frustration from banks, investors and entrepreneurs are approaching the MFIs.

Recent studies indicate an over 50% increase in demand of microfinance loans from the start-up capital segments. The US microfinance institutions have been making appeals to the state for increase in funds due to high demand. This is an indication of the role that microloans are playingin start-up companies and SMEs. While studies are key to note the inherent weaknesses in this form of financing start-up companies, that may require a large amount of finances; there is evidence that this may not necessarily apply as the sole source of capital. This review is the key in indicating that microloans can finance relatively small companies requiring small capital or boast other sources to create sufficiency.

In combination with other sources such as borrowing from friends and relatives, microloan can top up funds in financing a start-up company. There are also special considerations towards start-companies as encouragement to innovativeness, which boasts creation of start-ups (Galbraith, 2009). The

cost of capital is perhaps the first and the most fundamental question that an entrepreneur asks any provider of finances. Loans from Micro Finance Institutions are expensive in their costs. The cost of capital is the interest rate and MFIs index this rate higher than the conventional loans.

However, the, easy access to microloans and few requirements cancel out the high rates. The rates are ranged from 7-14% but there are higher maturity periods for loans of over six years. Below is a discussion on literature of utmost MFIs institutions in the US (Business Asia, 2008). Community Development Financial Institutions (CDFs) The global financial meltdowns and other recessions are terribly impactful, but their lessons are invaluable. Keynesian Economist state that any economic down turn push the economy into a pitch of low aggregate demand.

The father of modern economics, John Mayhard Keynes advocates for government intervention. He argues that market forces cannot pull the economy out of the pit, especially in the situation where the crisis is distressing enough to erode confidence with the stock markets. Interest rates cease to inspire any investment and fall to a level given the reference of a liquidity trap. In pursuance of Keynesian thinking, the US government aggressively came up with economic stimulus packages to stimulate aggregate demand. This explains the love affair between micro lenders and the US governments.

A facet of the Economic Stimulus Package (ESP) is the Community Development Financial Institutions (CDFIs), which encourages uptake of capital and start-up boom (Field, 2007). These CDFIs are loans funds,

community development banks, venture funds and credit unions providing a range of services to entrepreneurs. These services include loans, business support and loans to communities, mostly those in marginal areas. These CDFIs ensure that entrepreneurs in areas of low financial services have reach to financial support. TThe central role playing by CDFI is elaborate from the vigor of the US government.

Research indicates that the kitty receives an additional 100 million dollars in 2009 from the previous amount in the previous year. Some prominent CDFIs in the US include ACCION that lends up to 50, 000 USD, Sedco Financial Services offering up to 200, 000 USD and Non Profit Finance Fund that offers credit of up to 2 million USD among others (Highlands Capital Partners, 2012). Microenterprise Development Organizations (MDO) Majority has CDFI certification, and their primary role is capacity building of young entrepreneurs. They are in the class of micro lenders specializing in teaching financial literacy and imparting financial skills. Peer Lending The lending and funding of startup companies is not new to innovative trends. The most dominant name featuring under the peer-to-peer lending is the online-based organization Kiva.

org. The tailors of Kiva. org ingeniously use its web platform to appeal people around the globe to offer small loans to entrepreneurs. The empowering platform offers assistance to a selection of the entrepreneur or group on a certain criteria. This peer-to –peer lending is on the extreme end of microfinance model. While the structure of microfinance institutions concerns itself with the social dimension of a new start-up company, Kiva selects a start-up depending on its ability to generate high returns.

This facet encourages entrepreneurs to come up with companies that have high expectations of success. The peer-to-peer lending, therefore, provides a new breath in search of a source of finance by a start-up company albeit amidst challenges. The peer lending institutions such as Kiva, Loanio, Lending, and Prosper are facing a serious challenge of conformity with the financial system. The US Securities and Exchange Commission is the chief regulatory hurdle in the dispensation of these funds to entrepreneurs (Galbraith, 2009). The advantages to a start-up company utilizing microloans are evident.

The loans require the entrepreneur to have no history of default or bankruptcy, at least 575 credit score and sufficient personal income. The institutions give exceptional considerations to start companies with a social or environmental agenda that would otherwise face ignorance by banks to whom a social agenda falls far below their priorities. The loans allow a personal guarantee, which have start-up entrepreneurs; at the same time, the microloans are responsive to the social situations of the borrowers as opposed to the economic and cyclical consideration of other sources (Wiltbank & Willamette, 2007).