



MICRO FINANCIAL SERVICES

Inclusion of people in the regional economy

Abstract

The support for financial services can make a significant contribution to reducing poverty and to the sustainability of rural development – but only if they are adapted to local conditions. Functioning financial services are essential to allow the rural poor to take part in regional and national economic activities and to ensure that development processes are sustained.

Experience so far has shown, however, that the availability of micro financial services is not automatically linked to economic development and poverty reduction. For this reason, micro financial services should be combined with supplementary social and economic measures.

For micro financial institutions to function satisfactorily, governments must regulate the conditions in the financial markets in such a way that the micro financial services are attractive, without triggering negative social effects.

A small loan can improve an individual's life. The money can be used to develop an economic activity and so contribute to increased and diversified income. It can be used to survive a time of need – for example a natural disaster – and can reduce vulnerability to failed harvests and disease. In addition, integrating the rural poor into the money economy is a precondition for a sustainable development process. Micro financial activities help to increase productivity and to counter the risks of unstable weather conditions (cf. Section 2 on the economy).

For micro credits, no appraisal of credit worthiness takes place and no collateral is required. The typical process usually takes the form of a savings and credit group whose members in turns take out a loan and stand surety for each other. This enables loans to be taken out by poor population groups who would normally have no access to capital. For a long time, microloans have been viewed as the key to combating poverty; however, an increasing number of studies are revealing the excesses and distortions in the fast-growing sector and advise caution. Microfinancing cannot remove poverty's structural causes. Microfinance institutions

(MFIs) can only make a contribution to sustainable poverty reduction when embedded in comprehensive development processes.

The spectrum of MFIs ranges from self-help groups and their associations through cooperatives to micro banks and agricultural development banks. In 2009, the 1,000 largest MFIs worldwide served 100 million loan customers and employed around 500,000 people. The total global volume of microloans has now reached around 45 billion euros. It is estimated that 90 investment funds are active in the market with a total volume of six billion euros. The World Bank anticipates growth to 15 billion euros in this field alone by 2015. It is not surprising that private players are entering the market. The potential gains are enormous. However the high interest rates which are due for micro credits must cover the high costs for supervision and should not be skimmed by global financial players, for example through investment funds.

Micro credits are often targeted towards women because they are statistically more reliable than men in making repayments. They also are more likely to use the money for purposes which promote social development, so the economic benefit is not limited to themselves alone. The positive effects of micro credits on women's self-confidence and social status can clearly be seen (cf. Section 7 on gender equality). On the other hand, it must be stated that a loan is not a social instrument and is only of benefit to people who can work and who have sufficient status in their neighbours' eyes to be considered creditworthy. The old, the sick, children and the very poor are normally excluded from micro credits.

To achieve development goals and combat poverty sustainably, micro financial services should be promoted in conjunction with supplementary support measures. These include:

- Investment advice and support for management qualifications
- Health support and preventive measures
- Education and literacy training
- Vocational training
- Nutrition counselling

Promoting micro financial activities in rural areas is important because commercial banks and insurance companies are not keen to provide services in thinly populated areas where logistical costs are high and turnover comparatively low. In many cases, microfinance is also used to bridge financial gaps which often occur with the purchase of agricultural materials (seed, equipment etc.) or the building of small-scale agricultural infrastructure (bridges, irrigation systems etc.).

Micro insurances are a useful element of basic social security. Even poor people can use micro insurance as a protection against serious risks. Micro insurance is aimed at people of the informal sector who have no access to formal insurance systems or cannot afford high insurance premiums. For these people, micro insurances offer protection from economic shocks and crises such as illness, accidents or natural disasters (cf. Section 4 on social security). To spread the risks, there must be a sufficient number of participants and risk exposure must be spread as widely as possible. For example, health insurance cannot function if the only people who have insurance are those who are ill. Micro health insurance can be run effectively on a self-help basis with little external support. This makes sense particularly in places where the state has not created or does not support suitable structures. Inter-regional cooperation and collaboration with large insurance companies could help to even out the social balance.

In addition to credits and insurance, new financial services are continually being set up as development tools. These include mobile bank services (branchless banking) that enable customers to manage their accounts using SMS messages, as well as savings models (e.g. for retirement provision or a housing loan), credit cards (to provide a flexible way of bridging periods of low income) and leasing options (for large agricultural investments).

Welthungerhilfe sees a fundamental conflict of roles between the activities of a development-oriented NGO and an MFI. An NGO's primary role is to offer advice and support, aiming to promote and strengthen its target groups. An MFI on the other hand must behave as a business, whose existence is determined by the market and by financial success. For this reason, Welthungerhilfe does not operate an MFI itself and usually does not take on credit guarantees.

Welthungerhilfe's involvement in relation to micro financial services in developing countries:

Enabling training for our partners' staff and the members of MFIs. This includes training courses and communicating experiences in relation to supporting self-help groups, providing fully planned training modules and exposure visits to model projects and successful organisations.

Supporting the establishment of self-help structures on the basis of savings and other financial activities.

Supporting the development of financial literacy of the target groups. This includes contract and management issues as well as advice on the use and repayment of loans.

Arranging and promoting contact to funding organisations, MFIs and formal banks.

Subsidising and counselling partners to supplement funding for productive and development-oriented application of loans.

Offering assistance to partners searching for refunding sources for self-help groups and MFIs.

Supporting innovations in the field of micro financial services. These include micro savings, credit cards, the use of non-cash financial transfers in programmes for food security or self-help based micro insurance approaches.

Welthungerhilfe's demands relating to micro financial services:

Micro finance must not be misused as a new type of investment in the international financial market. The interest rates must be used mainly to cover running costs.

Developing countries must shape their national financial structures so that they do not contribute to reinforcing economic inequalities. Micro financial services must be regulated in a poverty-oriented way.

Developing countries must establish a financial structure to suit their needs, one that aims to supply liquidity in the real market and does not just accelerate speculation.

This section is an excerpt of the WHH Position Paper Rural Development. Please also consult all other sections at www.welthungerhilfe.org/position-paper-rural-development

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