A village bank in northern Ghana.
(Photos by J. Adu-Boahene)

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Microfinance and anti-poverty strategies: A donor perspective

Building up MICROFINANCE structures in developing countries to finance the poorest.

By José Garson

In most developing countries, financial intermediation at the local level cannot be expected to come about by itself. Isolation combines with poverty and other factors to make significant changes in the present situation extremely difficult without external (i.e., government) intervention. Local financial infrastructure will continue to perform little intermediation because the many institutions are too weak and not interconnected. The benefits of efforts at national level to increase financial deepening would reach the local levels. But these efforts often end up worsening the local situation by encouraging banks to close branches in poor areas. Therefore, any development of financial intermediation at the local level will result only from a proactive policy to promote microfinance.

The specific design of the strategies that governments and donors can implement to promote microfinance depends upon many factors. Some are country-specific (e.g., economic situation, size of the poor population, strength of the financial sector). Others are derived from the nature of microfinance itself and from the role it can play in alleviating poverty.

Gaining acceptance for the microfinance concept

Microfinance is a new reality; in most countries, governments do not know very much about it. Governments are usually aware of, and concerned by, the problem posed by poverty in villages in specific poor and isolated areas. They are concerned about the lack of savings mobilisation, especially in rural areas where people complain that credit is scarce while, at the same time, abundant quantities of cash are said to circulate. They also know that small credit is needed to cater to the needs of small entrepreneurs but that it is not extended by the local bank branches to those entrepreneurs. This understanding, however, does not go so far as to recognise that the leap to microfinance must be made. Most governments, when confronted with such issues as savings or credit in relation to poverty, would turn towards the banking system and demand that banks play a more proactive role in the development of the country.

The lack of clarity of the institutional situation at the local level further strengthens the tendency of governments to overlook microfinance. Therefore any effort to implement microfinance strategies should begin with an initiative to help government representatives to understand the concepts. Because governments are dealing with policy (and not technical) issues, such an internalisation process should focus first and foremost on the issue of poverty at the local level.

Gathering information on actors and needs

Microfinance strategies must be supported by a comprehensive understanding of the financial situation of poor households at the local level since the objective of microfinance is ultimately to increase household income and address basic needs. Concern for safety is required to assess the need for the most elementary intermediation between those who have resources and those who need them. Information about attitudes and preferences is also needed. The objective is to identify patterns, in terms of both preferences and behaviour, that will contribute to the design of an effective strategy. Qualitative findings are likely to be as useful as quantitative ones.

A secondary, but no less important objective should be to put together a complete picture of the actors that are already involved in microfinance at the local level. Surprisingly enough, accurate information on revolving funds, NGOs involved in microcredit, etc., in provinces or districts is often not available at the national level. Surveys can assist in finding the information and in bringing it to the attention of the government.

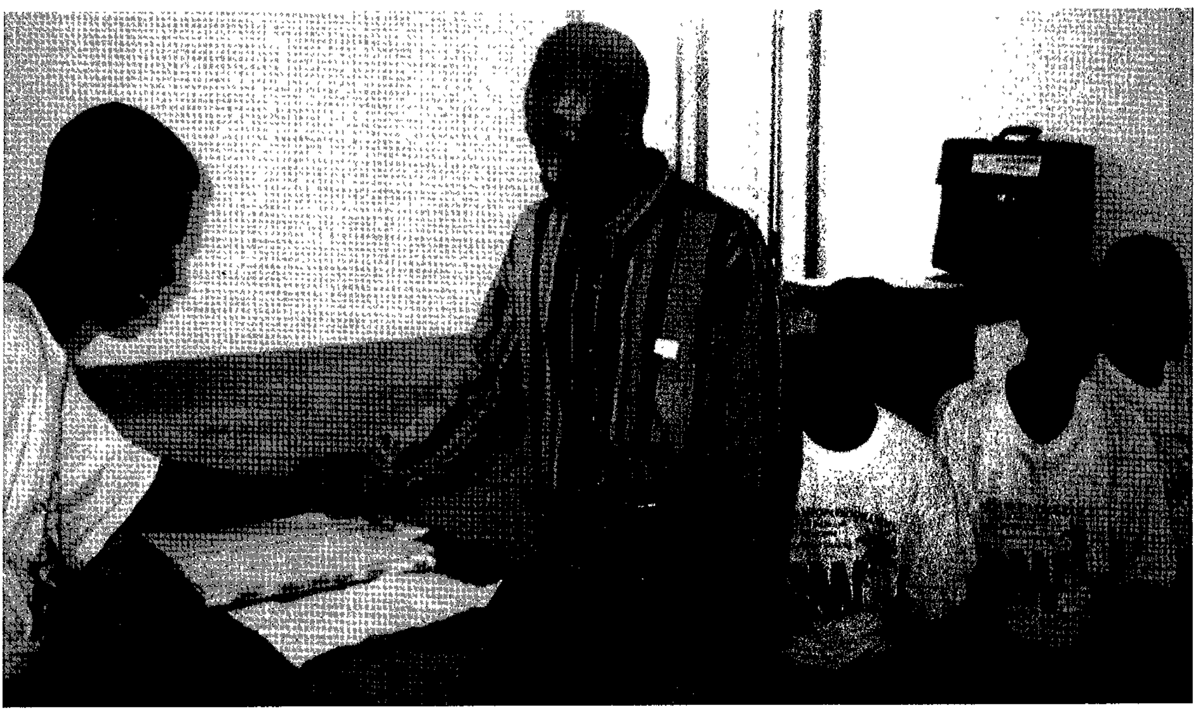
The findings of the household surveys and their interpretation in terms of specific strategies needed to develop microfinance in given areas allow Governments and central banks to decide on the optimal course of action regarding microfinance. Consensus can be sought through the organisation of high-level policy forums, which can serve as a way of gathering all important decision-makers involved in the development of microfinance around a microfinance-oriented agenda.

Interlinking intermediaries

Financial intermediation can be developed only by taking into account all the elements of the local financial infrastructure (i.e., existing as well as new organisations at the local level). The critical objective of microfinance strategies is to get all the existing intermediaries to work together in an optimal way. To do so, intermediaries need to be interlinked .

Linkages among financial institutions are possible only when each institution trusts the other institutions and agrees to do business with it. In the case of financial institutions (banks, quasi-banks, NGOs and groups), risk is the most critical problem that must be overcome to create trust. The network approach taken to build up the local financial infrastructure is likely to attach a critical and overwhelming importance to risk.

Financial intermediation at the local level is optimal when the complementarity among the interlinked elements of the local financial infrastructure is maximal. At the local level, financial intermediation is performed by a set of different organisations that, at the outset, are isolated. Capacity building should therefore aim to strengthen these organisations and to develop complementarities among them, keeping in mind the long-term global approach of the local financial infrastructure.



Making loan repayments at a Ghanaian bank.

The author used to be a UNCDF Senior Technical Advisor. The article is a summarised excerpt from his book Microfinance and Anti-Poverty Strategies: A donor perspective

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