

LIMITATION OF MICROFINANCING MODEL IN POVERTY ALLEVIATION

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Research had shown that the majority of the poor population are self-employed. They eke out livings from menial job like selling petty products, artisan, small scale farming and the likes. In spite of working from dawn to dusk, they were trapped in vicious cycle of poverty, because they spent all their earnings in meeting basic survival needs. Thus, they have little or no money left over to expand their businesses and therefore compromising improve quality of life. To take them out of this cycle they needed access to lifeline fund. Thus, microfinancing model was introduced to give them access to the much needed fund.

The model is expected to be an instrument for combating poverty from the grassroots and stimulate national economic growth. It is the believe that with access to finance, the grassroots poor can create gainful employment for themselves and others within their communities while pursuing their full economic potential. If such financial opportunities are given to small businesses to develop, the overall economic growth of the country would be enhanced. Ironically, in most developing countries, this proposition has remained practicable only in theory. On the contrary, many years after the introduction of microfinancing in these countries it has had little or no impact on the economic development at the grassroots. In most cases, it had impacted negatively on their businesses and their life.

The major obstacle confronting the model in realizing its objective had been the conflict of interest faced by microfinancing institutions in combining the commercial interest of return on equity with the social interest of poverty alleviation. They had found it challenging to allocate their costly and hard earned treasury fund to risky micro credit in promoting economic activities of the grassroots poor population. The potential risk of losing such loans is high, because it has no collateral backing in case of default. Therefore, the microfinance institutions they charge higher interest rates on loans to compensate for the anticipated risks. In Nigeria, the microfinance interest rates ranges between 5 to 8 percent interest per month, while the global average microfinance interest rate is reported to be between 2.5 to 5 percent monthly. This high loan rate and the additional transaction costs make the cost of obtaining micro credit, which is meant for the poor to be higher than the credit from conventional banks. As a result of this high and unbearable cost, the microfinance credit that was introduced as a panacea to remove the poor from the vicious cycle of poverty ended up compounding their situation. Because for a business to be able to pay back loans with such high cost, it must have the potential to earn higher returns on investment. However, most grassroots businesses are not known to possess such characteristic. They are low end businesses with low returns on investment. The few among them who eventually got the loan ended up repaying with lots of difficulties. In most cases they have to compromise some of their existing regular expenses to meet up with the repayment as their returns on investment cannot repay the cost of the loan. This resulted in the contraction of their businesses rather than the expected expansion. Consequently, the high cost of credit hindered the loan repayment, thereby increase the default rates, which eventually contributed to the distress of some microfinance institutions.

The rise in loan default rates poses a threat to the sustainability of most microfinance institutions and the entire industry. To guide against this threat, while contending with the regulatory requirement of

granting micro credit in the face of potential risk of returning negative book balances, most microfinance institutions resorted to putting more emphasis on the capability of the loan seeker guarantors to repay rather than relying on the unsure return on their investment. This act of mitigating the default risk in the absence of collateral, by relying on personal guarantee of wealthy relative of loan seeker as condition for loan approval is not only inimical but dealt a serious blow to the vital major microfinancing objective of access to finance. The condition makes it difficult for the majority of the targeted poor population to have the desire access to micro credit. For, in most cases it is extremely hard, if not impossible for them to get wealthy relative guarantor.

In summary, the poor masses at the grassroots live in a vicious cycle of poverty despite being hardworking. To get out, they needed loanable funds which they could not access from conventional banks due to their poor status. The microfinance model was introduced with the creation of specialized microfinance institutions to take care of their finance needs. However, shortcomings inherent in the model had made the vision of pulling them out of poverty a mirage. The failure of the model to alleviate poverty at the grassroots could be attributed to its inability to adequately address vital issues of collateral back up for commercial funds mobilized by microfinance institutions. This risk factor led to high, unbearable and unsustainable cost of credit to the target beneficiaries. The high costs of credit raise the default rate as beneficiaries' business could not sustained it. The increase default rate threatens the sustainability of microfinance institutions. The above risk factors impeded the access of the grassroots poor masses to finance as microfinance institutions resort to relying on alternative but hard to get wealthy relative guarantor to protect the fund. The cumulative effect of the above factors is a reflects the shortcomings of the microfinance model to solve the problem of poverty alleviation at the grassroots.