

MICROCREDIT: A MECHANISM AT EVERYBODY'S REACH

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ABSTRACT:

Microcredit is essentially meant to bring relief to the poor and those who are unable to find work. Since its inception, This new means of financing has proven successful in several countries such as Bangladesh, may be because this funding was adequate, but that does not stop us from trying to adopt it, of course, after adjusting it according to the characteristics of our societies.

And to make it succeed, we have to insure access to all commercial banks, and allow all non-governmental organizations to adopt it without constraints, to finally create a financing space for the poorest among us.

ملخص :

تخدم القروض المصغرة طبقة البطالين والفقراء وهي آلية أظهرت نجاحها في بعض من البلدان مثل البنغلاديش وهذا النجاح راجع إلى خصوصية هذه المجتمعات لكن بإمكان مجتمعاتنا استنساخ هذه التجارب وتكييفها مع خصوصياتها والاستفادة من إيجابياتها وذلك بإتاحة الفرصة للبنوك التجارية والمنظمات غير الحكومية دون قيود الدخول في هذا المجال من أجل بناء نسيج انتمائي خاص بهذه الفئة.

SUMMARY:

Microcredit is helpful for categories of unemployed and poor people. This mechanism has shown success in some countries such as Bangladesh. This success is due to the specificity of these communities, but our societies can imitate these experiments and adapt them to their specificities and take advantage of their positive aspects and give the opportunity for commercial banks and non-governmental organizations unrestricted access to this field in order to create a web of credit for this stratum.

INTRODUCTION: Economic activities are mainly based on funding, which allows them to exploit market opportunities, and provides them with financial support in case of insufficient funds when carrying out a project.

The funding is the transfer from the owners of the surplus money to those who are in deficit, for temporary periods, is mainly related to the acceptability of the owners of the surplus to the length of Hth and short period, and the willingness of employers to fulfill their commitment to deficit during that period.

The credits obtained through funding are often characterised by an important volume and the length of repayment period, and this is what projects need.

However, the community has other stratum of individuals who cannot carry out projects or enter the business world. These groups are characterised by insufficient and unstable financial resources (incomes), and in some cases non-existent means... This category is the stratum of the poor and the unemployed, and finds itself face to face with the economic changes that affect their standards of living, unfortunately and often, for the worse.

So came the idea of microfinance (in Bangladesh) which aims to provide funds and loans with appropriate sizes and intervals in relation with the requirements of this category, allowing them to create specific activities, not to create wealth, but as a first stage in improving incomes, and to insure their stability, so they are able to develop these activities, and why not, to enter the world of projects that need bigger funds.

Because of the importance of this funding and its satisfying results, most of developing countries quickly adapted it in order to reduce ratios of unemployment and poverty in their societies, and try to make them create activities to ensure their financial stability and to stimulate local economies. Algeria is among the countries that take this direction by the launching of its loan program which started in the year 1999, and because of the extreme importance of this new sector in the world of finance and its recent inception around the world in general and particularly in Algeria, we liked to show interest to this subject

in this research titled: “Microcredit: a mechanism at everybody’s reach”. It is also an attempt to give an answer to the following question:

- * What is microfinance?

- * What are its principles and how does it work?

- * How does it get deeper into the community by providing mini loans, and can it extend and keep on working?

THE NATURE OF MICROFINANCE

Microfinance is offering financial services such as credit, savings, cash transfers and insurance for the poor and low-income citizen (1). These services are generally customized as follows:

- * Focusing on poor and small entrepreneurs in offering services to clients with low-income, males and females, who cannot have access to other financial institutions.

- * Provide the appropriate lending to customers and clients. i.e. making possible the availability of simple and convenient way to get short term small loans which can be frequent, with informal assessment of borrowers and investments as well s a simple assessment of cash flow and projects, concerning larger and long-term loans.

- * Providing savings services, conducting small deposits and procedures, making easy the access to funds either independently or with another institution (2).

FINANCIAL SYSTEMS APPROACH:

There is an overlap in the credit sectors views on the necessity of providing microfinance in a sustainable manner in order to bridge the offer gap and to help governments in fulfilling their commitments and reaching the credit targets, such as the reduction of poverty and unemployment by half by the year 2015. The need for these services is very important and that makes them unaffordable through government and donor funds.

This need must be taken in charge by commercial capital, thereby, emphasis must be put on micro financing institutions that operate on a commercial basis and are able to mobilize resources locally, either through borrowing from local banks or through issuing bonds (3).

This commercial approach is also followed by sound practices in the application of business management, a commitment to operational and financial sustainability, a compliance with good governance and transparent reporting. To achieve these objectives, a financial system method must be followed to build local financial institutions for microfinance able to endure so that they form an integral part of the formal financial sector, particularly when the sustainability of financial services which are provided to the lowest categories in the market and the insurance of a permanent access to financial services for the poor and the unemployed cannot be granted.

THE CAUSE OF INCREASING INTEREST RATES ON MICROCREDIT

Costs of micro-credit are high but not because lending to the poor and the unemployed involves high risks which are inherent in it. In fact, microcredit programs have rates of default on payment which are lesser than those of normal commercial banks, but the costs of microcredit are high because of high costs of carrying tiny transactions which involve dealing face to face and because microfinance institutions are using personal contact as a substitute for the formal insurance and as an alternative assessment of the credit by using computer.

The cost of a small loan is often higher in terms of percentage than the cost of a larger loan. This can be explained by considering the structure of the microcredit cost, compared with the structure of the normal credit cost.

RESTRUCTURING OF THE MICROCREDIT COST, COMPARED WITH NORMAL CREDIT:

If we consider two virtual lenders, the first as a lender of large sums of money and the second for small amounts, and allocate each of them one million dinars, so that the big lender is given one unique loan, while the second is given 10.000 loans each

one worth 100 dinars. The costs of capital and the risk of losing credit are different in proportion to the size of the loan. Each one of the lenders needs to mobilize one million dinars to set up his loan, and both of them must assume the same market rate supposed to be 10% for these sums of money. If each of the lenders history indicates a loss of 01% of their loans each year because of non-payment, they would need a custom to debt losses equivalent to that amount and the lenders can cover the cost and risks of their capital by charging 11% on the size of loans provided to their customers. But administrative costs are not proportionate to the size of the loan because giving one loan of one million dinars could cost the big lender 30.000 dinars (03% of the original amount) corresponding to the time of employees and other expenses in relation with the assessment of the loan, its payment, monitoring and collecting. The big creditor can also cover the costs by getting from the borrower an interest rate equivalent to 14% (10+1+3) %. On the other side, the administrative costs of the small amounts creditor for each sum of 100 dinars will be much higher than 3% of the global amount. Instead of 3 dinars per borrower, the small amount creditor will more likely spend 20 dinars or more per borrower.

The big lender has to deal with one and only borrower, but the small lender will have to deal with 10.000 borrowers who do not usually have guaranties or financial statements. Lot of these clients are illiterate and lending money to such customers and recovering it from them later requires dealing personally with them, which takes a lot of time. If we assume that the loan granted by a big lender is paid every quarter of a year, than it takes four transactions per year. On the other side, it is likely the smaller borrowers from lending institutions will pay in monthly instalments or even at smaller intervals, making the number of transactions at least 120.000 per year. While administrative costs for the big lender are 30.000 dinars, the costs for microcredit provider are at least 200.000 dinars, and they need to cover this cost to a fee of 20% of the loan amount. The result is an interest rate of at least 33% and thus, we realize that the administrative costs are much higher in microcredit institutions than in commercial banks, particularly the more recent ones

which are characterized by small size, which does not allow them to take benefit from big scale economies (6).

COMMERCIAL BANKS IN MICROFINANCE (RESTRICTIONS AND QUALIFICATIONS)

Only a little has been written about the role of commercial banks in microfinance... The reason for that is simply because there was not much to write about, since the absence of commercial banks in this field was pretty obvious. In such a situation, a large number of non-governmental organisations, along with other institutions specialized in funding techniques appeared and are serving a growing number of unemployed and poor, and strengthening loan repayment rates. They are not only competitive with traditional commercial banks, but are also making profit without any help or subsidies.

But now, commercial banks in developing countries start looking at microfinance not only as a tool of great importance in public relations, but also as a profitable venture. They are currently proceeding to study the microfinance market. At the same time, some non-government organisations transformed their legal status to become subject to banking regulations, and micro financial parameters of the current funding systems are developed by banks working on microfinance and subject to the regulation in force. (7)

Traditionally, bankers in large commercial banks point out the risk of default, high costs, as well as social, economic and cultural drawbacks, as the main reason that prevent entry into microfinance world, and there are some internal constraints, such as: (8)

A- Institutional commitment:

In their orientation towards the field of microfinance, large commercial banks are often relying on the points of view of a little number of their board members, rather than on the institution mission.

B- Organizational structure:

Commercial banks find it difficult to integrate microfinance into the culture of the parent banks, as their institutional structures are not meant to address business

activities requiring the offer of a large number of small loans.

C- The methodology of funding:

In the majority of commercial banks, there is a lack of finance methodologies which are necessary to reach low-income customers who need small capital, and keep them.

D- Human resources:

Topics such as recruitment, training and incentives related to performance, require specialized considerations and efforts, given that microfinance operations are characterised by the need for intensive labour and require people with special skills.

E- The cost-effectiveness:

The mechanisms and cost structures of traditional banks make it difficult for banks to reduce loan processing costs to a minimum, increase employees' productivity, and rapid expansion in the scope of microfinance loan portfolios. These efforts are compulsory to cover expenses and make benefit.

In spite of these limitations, commercial banks have many organizational and structural characteristics that enable them to succeed in implementing microfinance operations, given that:

- * They are institutions subject to the regulations, complying with the conditions of ownership, satisfying disclosure of financial information and the adequacy of the capital needed to help ensure good management.
- * Many of them have the physical infrastructure including networks of branches, which enable them to reach a large number of microfinance clients.
- * They have well-established internal controls, administrative and accounting systems, to track large numbers of transactions.
- * In these banks, ownership structures of private capital tend to encourage the adoption of sound corporate governance structures, cost-effectiveness, profitability, and sustainability.
- * The ability to access sources of self-financing (deposits and capital invested in company shares), the freedom from dependence on donor resources that may be characterized by scarcity and volatility, are ensured.
- * Their ability to provide loans and deposit services as well as other financial services, allow them to attract clients of microfinance.

THE ROLE OF DONORS IN FACILITATING THE

ENTRY OF COMMERCIAL BANKS IN THE WORLD OF MICROFINANCE: Donors can make an important contribution in improving the environment of the financial sector, so banks can enter the world of microfinance. For example, donors can urge governments to remove restricting financial regulations such as interest rate ceilings and conditions for cumbersome

precautions, or targeted credit schemes. These changes will help microfinance loan providers to compete in open markets and to cover operating and risk costs, and the costs of alternative opportunities to capital. Donors can help in developing and promoting the adoption of balanced frameworks which take into consideration the special nature of microfinance.

Terms of strict legal precautions, cumbersome reporting requirements, and inappropriate criteria for the classification of loan portfolios and their allocation, restrictions on the size of secured loans (loans without collateral), inappropriate percentage of operating costs...are some elements that need to be modified to suit the microfinance operations. Donors should support dialogues between banks that offer microfinance services and regulators to help in informing supervisors on the difference between microfinance and traditional banking services (10).

APPROACH TO FINANCIAL MARKETS FOR MICROFINANCE:

It is worth mentioning that microfinance has enabled a large number of families to lift themselves out of poverty and unemployment, yet it did not honour its promise to most households so that the demand in the market for microfinance is estimated more than 300 billion US dollars while the available supply market is estimated only 4 billion USD.

In spite of the important and effective role played by international community of donors in promoting microfinance, only 2.1 billion dollars were invested in this sector, including the allocation of between 800 million dollars and one billion dollars per year specially reserved for new funding. Hence, local funding is a major source to finance microcredit, but microfinance seems to be insufficient to meet this demand. As a consequence, if microfinance institutions have to fill in the gap between supply and demand, they must look for external wide sources, and in the long run, only financial places will be the markets that keep in store ready resources available allowing maximum growth for microfinance (11).

THE NEED TO RESORT TO FINANCIAL MARKETS

In terms of challenges associated with growth, microfinance institutions have to deal with the same problems faced by any organisation undergoing significant expansion. Management skills, responsibility for performance, information systems, a clear definition of responsibilities, effective mandating of executive power, implementation of action procedures..., are all vital factors like that of any organisation in developing, while funding is considered as the main obstacle to the growth process in leading microfinance institutions. In order to reach the required capital which is sufficient for microfinance institutions so they close the gap between supply and demand, there will be a need to provide billions of dollars in new funding in the form of both debt and property, and microfinance institutions will have to rely on capital markets to finance their deficit, as long as financial market represents a long-term opportunity for the microfinance sector.

RECOMMENDATIONS TO ATTRACT FINANCIAL MARKETS

We will consider here few recommendations to attract the financial market for microfinance. This short list is meant to be a principle preliminary strategy for microfinance institutions and the other operators concerned with providing capital from financial markets, and suggest as well a vision for investors of what to possibly expect from microfinance institutions.

1) Showing microfinance as an investment opportunity:

To overcome issues concerning the ability of microfinance to provide financial offers and to what extent traditional strategies are appropriate, microfinance institutions need to present microfinance as a business investment opportunity (12).

2) Cash flow for smaller lending:

The potential inherent to microfinance market for the poor, by taking into account the big gap between supply and demand together with the attractive returns of microfinance institutions, gives investors a unique investment opportunity, although this has not largely convinced investors, as due partly to a lack of understanding the nature of cash flows of microfinance. The microfinance institutions are expanding on a traditional way on the basis of creating branches or adding one branch or more when funding is available. And during periods of high growth, investments are generally oriented for training of personal, travel, marketing, and some infrastructure investments limited in new branches.

Usually, branches start with an integrated team of workers and are considered important enough to affect materially and negatively compact earnings, especially when the company is doubling in size annually. Then, these branches stand start to make profit very quickly, because stray costs stand still when revenues are growing quickly, allowing significant cash flow and generating attractive returns on investment. (13).

3) Increase the degree of transparency in reporting and risk measurement:

The financial markets assess the risk, and investors are concerned with performance and its relationship to their investments. They are interested in financial indicators of information, and management analysis as it relates to investment risks. If investors don't get the necessary information about investment opportunities, they often refrain from these opportunities, especially when the investment opportunity is in new industries (14).

MICROFINANCE AS A TOOL FOR DEVELOPMENT:

Under the approach to financial systems, microfinance programs should be designed to establish financial systems for the poor, as an overriding target, not as an end in itself, but in every critical way to achieving the goals of alleviating poverty. Microfinance programs should then be focused to build institutions and local markets on all of the macro-level (policy), the middle tier (infrastructure of industry), and micro-level (institutions providing funding at retail level).

It is essential for this program to provide support to local automatic intermediaries concerning access to commercial capital and mobilization of domestic deposits, in order to achieve independence from funding provided by donors and governments, and also to involve the private sector. Microfinance programs that do not support this purpose or impede its fulfillment should be avoided, and more relevant interventions should be undertaken. Therefore, in line with this approach, it is no longer appropriate to use microfinance programs backed by the government and designed to achieve other credit goals such as job creation or reduction of unemployment. These programs with low interest rates, lower rates of payment, have shown that they are not only a tool that is inappropriate to find a job, but also unsustainable and they distort the market for other like-minded trade institutions.

Governments, if they want to be involved in microfinance, should focus their support on macroeconomic stability, and create an environment on policy basis in order to create a dynamic financial sector which includes the poor (15).

THE MOST SUCCESSFUL EXPERIMENT IN FINANCING SMALL PROJECTS:

Funding for small projects owned by the poor and the unemployed all over the world as recorded limited success, except the experience of GRAMEEN BANK ("Village Bank")- BANGLADESH, which is so far, the more successful experience worldwide, in financing broad segments of poor and unemployed an institutional way. The Grameen Bank was established in 1976 by Professor MUHAMMAD YUNUS, who was then a University lecturer who dedicated himself to serve the unemployed and the rural poor in Bangladesh. By the end of 1990, there were 781 branches, and by the end of 1995, the number of branches climbed to 1,100, with a proportion of women of the total of borrowers equal to 96%... 92% of the bank shares were owned by its members (16).

In the field of financing, the bank operates a community system which consists of 5 members all of whom are women or men from the poor and the unemployed. Any number of groups is a center. Offices and heads of centers are changed every year. Community members are trained for one week to two weeks on the law of the bank and its slogans.

In the first weekly meeting of the group there is adoption of contribution to the collective Provident Fund for the group, rated one TAKA per day (35 for the 1st week)... And so on at each weekly meeting.

The collective saving contains also 5% of the value of each loan from the bank and 5% of loan granted from the amount of savings for the group, the fines that are imposed on one of its members for delay in the payment, and the interest rate to be paid from the bank for these funds (8, 5% per year). The group can take a loan of up to 50% for opportunities and 50% for collective projects among the members of the group. In addition to the collective Provident Fund there is a private Provident Fund which contains one Taka per week for each member, taken from the weekly contribution for the purpose of community services such as having a place for meetings. The third fund is the Provident Fund for emergencies, which consists of 25% of the value of the interest rate for loans, obtained by the members

and paid back at the last payment from a member; it is also used in life insurance for members for one year or more. The fourth Provident Fund is the Child Welfare Saving Fund, and consists of an amount of one Taka per week for each member of the group in order to build schools.

After three or four meetings the group can request one or two financings of a maximum of 3,000 Taka for the first loan. The President and the secretary of group are the last two in the order of the group for taking loans. Payment is done after a week from taking the loan, and the advance payment is allowed. The group cannot take a second loan if payment is not made, or if there are arrears.

Loans for investments in income-generating projects such as trade and animal husbandry are granted at an interest rate of 16% per year, and the loan is for 52 weeks. Re also granted for members, loans to build or improve housing with an average of 15,000 Taka and paid over 10 years at an interest rate of 5%. This last loan is granted to members who were able to repay

three or more loans in succession without a hitch, and who are members of a successful group for three years or more. Payment is made weekly during the meeting in one's member home, and the group is held accountable for non-payment of any of its members! (17).

CONCLUSION:

Through our presentation of the various concepts related to micro-loans, mechanisms of success and sustainability, we can say that this technique is successful in view of the experience of Grameen bank, and because this product is directed in particular to the poor and the unemployed of society.

The key factor behind the success of the Grameen Bank is the low level of the estimated cost of the assessment on loans given to the customers of the bank through the availability of information from the local community and the collective pressure for payment.

This system works strictly on reducing risk and increasing the reimbursement rates, which amounted to more than 98%.

The experiment stands on unique components that cannot be repeated in other areas, including the system of dealing, strict discipline, the outstanding personality who achieved this, and the characteristics that distinguish the poor and the unemployed in Bangladesh.

This is perhaps the main reason for the inability to reproduce this successful experience at world scale as one of the multiple mechanisms which are used to tackle poverty and unemployment.

It takes drastic changes in the known economic models to make this microfinance affordable at a large scale. Banking systems, market regulation, monetary policy, and social welfare have to be reformed in a global way with comprehensive interactions; otherwise, the Grameen Bank experiment would stay difficult to adapt and confined in Bangladesh-like countries.

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