Microfinancing and Microeconomics: Influence on Individual Lives

Bensson Samuel

Swiss School of Business and Research, 8001 Zurich, Switzerland

Abstract: There is a growing concern over the need to ensure equity in the access to resources to promote economic development and well-being. However, scarcity of resources makes it difficult to produce or access products and services that satisfy individual needs. This paper identifies microfinancing and microeconomics as crucial drivers of effective resource allocation and distribution because they help individuals navigate economic challenges. In this regard, microfinancing ensures small businesses and poor entrepreneurs get credit and saving products by removing collateral restrictions. The loans match their business goals and visions. Microeconomics entails improving the production, distribution, and consumption of goods and services among the building blocks of the economy-wide phenomena – individuals or households and businesses. Through a review of various literature, this paper identifies four influences of microfinancing and microeconomics. First, they help individuals break from poverty by improving their access to basic needs. Second, microfinancing and microeconomics create the possibility of income streams by promoting financial inclusion. Third, the strategies encourage innovation by allowing individuals to establish businesses that solve their socio-economic challenges. Last, they cultivate entrepreneurship by providing simple, time-saving startup capital and other credit and saving products. The paper seeks to serve as a point exploring the role of microfinancing and microeconomics in the economic development of nations.

Keywords: poverty; economic mobilization; grassroot growth

1. Introduction

The scarcity of resources in society is one of the main challenges of development. This condition makes it difficult to produce or access products and services to satisfy individual needs. According to Mankiw and Greenlaw and Shapiro, individuals have to be mindful about how they spend their income, take risks or make other decisions in order to overcome the constraints caused by this scarcity [1,2]. Microfinancing and microeconomics are crucial strategies leveraged by policymakers to ensure effective allocation and equitable accessibility of resources and cushion individuals from the challenges they experience [3]. These strategies help in the distribution of resources to where they are needed the most. Microfinance, according to Jafar et al., entails banking strategies undertaken to ensure small businesses or poor entrepreneurs who have no collateral have access to financial services, including savings, loans and insurance [4]. It ensures that those individuals who do not qualify for standard loans get a chance to live out their dreams and goals but remove the collateral restrictions. Microfinance operates through relationship-based banking or collective banking [5]. In relationship-
based banking, individual small businesses or entrepreneurs apply for small loans that match their goals. On the other hand, collective banking involves a group of entrepreneurs or small businesses in a given market coming together to apply for a loan.

Microeconomics focuses on understanding how individuals or firms make decisions to access scarce resources and improve their performance [1]. Microeconomics focuses on the building block of the economy-wide phenomena. For this reason, microeconomics is closely related to macroeconomics because economic decisions made by a country affect how individuals or businesses spend on services and goods [1].

Jafar et al. and Brau and Woller indicate that microfinance institutions provide short-term small loans. If the client pays the loan at one-time, they automatically qualify for another[4,6]. The loans are characterized by higher interest rates compared to commercial banks. They allow individuals and small businesses to make small amounts of savings. These institutions offer easily accessible services and ideas to solve social and financial issues. For instance, there are no collateral requirements and the loan application process is simple and saves time. This way, the client makes better investment decisions.

Microfinancing and microeconomics services have a positive impact on the lives of poor people and small-sized businesses. The impact can be measured in terms of solving their economic and social issues [3, 4]. Evaluation of how it helps individuals or small businesses grow comprehensively presents the importance of microfinance services in any economy.

2. Helps in Break out of Poverty

According to Banerjee and Jackson and Miled and Rejed, poverty is a global problem hindering individuals from accessing basic needs such as education, quality healthcare, shelter, and quality food [7,8]. A World Vision report by Peer indicates that over 689 million, which represents 9.2% of the world's population, live in extreme poverty [9]. In the United States, close to 34 million people live below the $35.28 a day poverty line. Globally, the poverty line is $1.90 a day. Since poverty is a multi-dimensional issue, it has to be tackled through multifaceted intervention [10]. Microfinancing services is one of the approaches embraced by financial institutions to lift individuals out of poverty [11]. As Durrani et al. and Khandker and Samad heed, providing individuals with short loans at reasonable interest rates with no collateral empowers them economically [12,13].

Access to small loans cushions individuals and their families from running into unmanageable debts. As Bateman indicates, microfinancing detaches the poor from loan sharks and commercial banks with high interest rates [14]. Rather than directing more money in paying their depth, they can redirect it to fruitful investments. As Banerjee and Jackson and Bateman indicate, high dependency upon high interest commercial loans means that the poor will use their incomes to cover up the interests [7,14]. However, Bateman notes that it is important to educate the poor about developing good investment and saving cultures before and after awarding them small loans to avoid a microfinance crisis [14]. Microfinancing institutions helped in cultivating saving culture in Bangladesh during 1996 to 2010. It is also crucial for microfinance institutions to avoid adopting commercial loans [13]. Such a crisis is experienced in most Asian and Latin American nations, including India, Peru and Bangladesh. In these countries, the poor have access to tiny loans, which offer little or no impact on the individual’s goals.

Through microfinancing, the poor gain self-confidence to overcome their conditions and pursue their dreams. Microfinance service providers ensure the poor have access to timely credit [12]. A study by Arifin et al. the importance of microfinance services targeting fishmonger communities in Makassar, Indonesia reveals that the fishmongers were more confident in meeting with microfinance institution administrators to share their business goals and discuss reliable investment approaches [15]. Unlike loan sharks and commercial banks, Arifin et al. found out that this level of self-confidence was inspired by lack of collateral requirement, easy and timely and easy access to small loans [15].

Another way microfinance helps in eradicating poverty is by facilitating informal finance. The informal finance sector consists of a number of players, including relatives and friends, savings and credit cooperatives, money lenders, among other unregistered microfinance service providers[10,16,17]. Providing small loans to the poor ensures there is enough money circulating within their circles. For instance, they can save in their savings
and credit cooperatives or supports their friend’s business. In addition, they can take care of their family’s healthcare or food needs. Informal finance sector helps in improving the lives of the poor because it is less complex in terms of operational and legal procedures compared to the formal system [10]. In this essence, if the microfinance sector is properly developed and regulated, it offers great potential in eradicating poverty across the globe.

3. Creates Possibility of Income Stream

Microfinance plays an important role in promoting and sustaining a reliable revenue stream by encouraging the poor to participate in economic activities. According to Fanconi and Scheurle and Durrani et al., microfinancing creates financial inclusion by facilitating access to smaller loans and other financial products that promote higher income [12,18]. The idea of reducing financial inequity through microfinancing is attributed to Muhammad Yunus, a Bangladesh entrepreneur and economist. Yunus established Grameen Bank to offer small loans. Fanconi and Scheurle posit that, through his initiative, Yunus ensured the poor gained access to microcredit capital [18]. Even though no collateral had to be provided, Grameen Bank grew while the villagers set up businesses that provided a steady and sustainable income. For this reason, Fanconi and Scheurle heed that microfinance allows the poor to tap into a variety of financial services and boost their household income [18].

Mecha agrees that microfinancing helps the poor to start their own businesses, become self-employed, and generate income [10]. Creating an income stream is only realized when microfinance institutions go beyond awarding small loans. As such, most of these institutions offer education to ensure the poor make good investment decisions and enjoy a smooth running of their businesses.

It is urged that access to savings, small loans with no collateral and other microfinance solutions enables the poor to enhance their productivity [19]. An evaluation of the impact of microfinance services in developing countries such as Pakistan and Bangladesh reveals that there is an increase in employment opportunities among the poor. By starting their own business, they earn more income [10]. They also employ other poor individuals to help in running these businesses. For instance, a retailer who benefits from microfinance services can employ one or more shopkeepers to meet their customers’ needs and expectations.

Microcredit products such as small loans and savings facilitate cash flow within poor communities [20]. When borrowers redeem their interests, repay their loans, and receive new loans, their economy grows. Mecha heeds that such a reliable and sustainable cash flow extensively increases the income of individuals and households, allowing them to cross the line of poverty and meet their basic needs [10]. In essence, microfinance causes an increase in per capita income.

4. Encourages Innovation

The less complex microfinance system fuels innovation and excellent financial performance within the target communities. Arifin et al. indicate that cultivates innovation by encouraging the poor to come up with businesses that solve their economic and social challenges [15]. Durrani et al. indicate that they "are very hardworking [individuals] and [they] may have innovative ideas about business but they [do not] have opportunity.” Through micro-credit and other microfinancing products, they get the capital to invest in their ideas and come up with revolutionizing products [12]. As Ayers and Harman explain, microfinancing expands the access to capital and a spectrum of support services designed to incubate innovative ideas and solutions [21]. This way, the poor get to live out their dreams.

Microfinance encourages innovation by improving the skills and attitudes of the poor who want to venture into businesses. According to Mecha, microfinance institutions tend to offer saving and investment training to their clients [10]. In most cases, this training is aimed at improving the clients’ entrepreneurial skills. On the other hand, Datar, Epstein and Yuthas suggest that most clients do not know how they can make better investments. They lack prior business experience or education [22]. To realize the goals of microfinancing, microfinance institutions need to provide formal education tailored towards meeting the unique needs of the poor clients and spark their creativity and innovation. Training is instrumental in increasing human capacity [10]. In essence, the skills the poor gain from training programs organized by microfinance institutions
decreases the financial risk in relation to making investment and growth decisions. Through training, innovative clients become more productive [23]. For instance, microfinance institutions in the United States require clients who are provided with short-term small loans to make their business their main source of income. About “67 [percent] of the borrowers [show] a significant increase in their income as a result of their participation in certain micro-loan programs…” [10].

Another way microfinancing encourages innovation among the smallest units of society is through facilitating competition. By providing small loans, microfinance institutions facilitate the growth of small businesses within the target society. As Crowley and Jordan and Aghion, Cassar and Herz indicate, the entry of new businesses affects the sector’s environment and composition [24,25]. This way, small businesses compete for scarce resources and customers. To establish and sustain their competitive advantage, small businesses are forced to drive efficiency by coming up with ideas and solutions that bring value to their customers. In essence, increased competition increases aggregate innovation [25]. Generally, microfinancing provides resources for individuals to cultivate their innovation to establish their businesses and grow.

5. Helps Entrepreneurship

Microfinance services have a great influence on entrepreneurship. According to Fanconi and Scheurle, lack of capital coupled with soaring transactions inhibits poor people, who occupy the lower section of the economic pyramid, from being motivated [18]. It hinders them from accessing resources to establish businesses. Commercial banks, loan sharks and other money lenders offer loans at exaggerated interest rates. For poor people, these rates indulge them further into unmanageable financial debts. For this reason, Hussen, Wodajo and Tasente and Fanconi and Scheurle indicate that microfinance institutions bridge this capital gap and ensure the smallest unit of society are included in the financial systems [18,26].

First, microfinance promotes entrepreneurship by providing simple and time-saving access to startup capital and other credit solutions. Commercial banks, loan sharks and informal lenders offer loans at higher interests and collateral requirements. Unlike loans issued by commercial banks or loan sharks, microfinance short-term small loans require no collateral [4]. For this reason, microfinance institutions serve as the primary credit and lending service providers for poor individuals and small- to mid-sized businesses that have no collateral. Thanks to microfinancing services, entrepreneurs can fund their businesses’ growth plans and create new revenue generation avenues [18]. Easy access to loans facilitates the participation of the poor in businesses activities. Raza explains that microfinance services empower people to invest in opportunities that they believe will generate reliable income and improve their families’ livelihood [27]. In essence, the availability of microfinance service providers in any society fuels the establishment of businesses.

Second, microfinancing helps entrepreneurship by providing micro-credit for expansion and growth. Turner and Endres indicate that, in 2013, over 400,687 small businesses in the United States were closed [28]. In addition, over 50 percent of small- to medium-sized businesses do not survive beyond the fifth year of operation and only one-third reach the tenth year. One of the main reasons causing such a high failure rate, as identified by Turner and Endres, is the lack of access to low interest rate loans to stir their growth and instill sustainable competitive advantage [28]. A majority of investors are unwilling to contribute venture capital because they perceive investment in the small business sector to be very risky [27]. For this reason, small poor entrepreneurs typically use bootstrap financing or their own resources such as mortgage loans, personal credit cards, savings or home equity to expand their businesses [28]. According to Malmstrom, bootstrap financing delays self-compensation and eliminates saving. It stretches the existing resource [29]. In addition, it inhibits the business owner from directing profits earned towards fulfilling their families’ basic needs such as food and healthcare. Microfinancing provides a reliable opportunity to ensure small businesses overcome operational hurdles and grow to live out their visions. A study done by Raza to evaluate the role of microfinance in the entrepreneurial development of Pakistan reveals that microfinance helps in increasing entrepreneurship profitability and productivity [27]. Micro-credits improve the liquidity position of small- to medium-sized businesses and enhance the growth of the assets of an enterprise [30].

Third, microfinancing spurs the growth of businesses by providing entrepreneur training. According to
Mecha, microfinance institutions’ training programs go beyond fostering innovation [10]. Karlan and Validivia indicate that training is beneficial to both the client and microfinance institution [31]. They help their clients identify existing market niches and ideal target markets [30]. In addition, they focus on improving their clients’ analytical, problem-solving, and decision-making skills. In essence, the clients show improved entrepreneurial knowledge and processes and increased sales and revenues. To microfinance institutions, training is an effective strategy in ensuring timely loan repayment and cultivating client retention [31]. Generally, training fosters the development and implementation of effective savings and investments decisions.

Last, microfinancing aids entrepreneurship by cultivating financial inclusivity and equitability in the business environment. Commercial banks and loan sharks target rich individuals and established businesses by providing long-term loans with collateral. According to Basel Committee on Banking Supervision, this approach promotes discrimination in access to credit and saving solutions [32]. It isolates the poor and small businesses. Microfinance institutions ensure financial inclusion by targeting the marginalized, under-resourced and deprived communities. They help these communities identify opportunities in the market and develop business models tailored towards solving economic and social challenges [32]. By offering loans without collateral, microfinance institutions ensure every community member participates in business activities.

6. Conclusion

Microfinancing and microeconomics play an important role in ensuring individuals and small businesses have access to financial resources and knowledge. The scarcity of financial resources is fueled by the provision of high interest loans by loan sharks and commercial banks. Microfinance institutions bridge this gap by providing short-term small loans (micro-credit) and other microfinance solutions. The small loans require no collateral and attract lower interest rates. The application process is easy and quick. Borrowers can use the loans to improve their families’ living standards, invest in businesses or repay other loans. Since they target the poor or under-resourced communities, microfinance institutions provide a sustainable approach to solving society’s social and economic challenges. Microfinancing helps in fighting poverty by providing loans that are easy to repay, empowering the poor to be self-confident and pursue their dreams, and facilitating informal finance. It creates the possibility of income streams by offering loans to startups, improving cash flow, and encouraging a saving and investment culture. It improves encourages innovation by improving the knowledge, skills and attitudes of the poor and facilitating competition among small- and medium-sized businesses. Microfinance cultivates entrepreneurship by cultivating financial inclusivity and equitability and providing startup capital, micro-credit for business growth and expansion, and saving and investment training.

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