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MICRO-FINANCE IN AFRICA AND THE DEVELOPMENT OF THE CONTINENT

Introduction

At the beginning of the 21st century several African economies have positive economic development ratios. High commodity prices on global markets, a significant decrease of foreign debt and Chinese investments in the region are factors that stimulate the economic growth of the continent. However, despite visible Africa's successes on its road to development, many African people still live under the line of poverty. Providing these people with financial services may result in the elimination of that vicious circle of poverty.

Both small business and most of the citizen of African countries have a limited access to credit and deposit services of banks. That constitutes a development barrier for the region where the majority of population is poor and lacks regular income. In response to the increasing demand for financial services in Africa, a micro-financial services sector emerged to meet the needs of the poorest groups of society. Some of such institutions focus their operations on credit services and the other ones on deposit services; however, the combination of both types of the offer is the most commonly applied solution. Thanks to the offer directed to the poor that are beyond the interest of the formal bank sector, micro-finance institutions initiated new processes of down-to-top development of the African continent in opposition to the hitherto top-down model that is applied by western countries.

The article in an attempt to analyze the significance of micro-financing in Africa with regard to Africa's development issues.

1. Africa's development issues

The basic problem of Africa (particularly of Sub-Saharan Africa) is a very low level of social and economic development and the resulting numerous negative consequences. That situation, as it is in the case of other present development issues of the world, has its roots in the colonial times, although – without no doubt – it is not the only reason of such state of affairs.

In the 19th century almost the whole South America, Africa and the majority of Asia had the status of overseas colonies of the then empires: Great Britain, France, Netherlands, Portugal, Italy and Germany. The expansion in Africa was accompanied by a common use of slavery, which resulted in the depopulation and plundering of a significant part of the continent. That was one of the reasons why the development of peoples of Africa was stopped. South Africa was ruled by the English, Portuguese and Germans. The western and central part of the continent belonged to Belgium, France and England while the North to France, England and Spain. The conquest of Africa resulted in the creation of colonies whose borders were determined by new political order, irrespectively of ethnic factors or any respect to local traditions. However, it was not possible to maintain the dominant role in the colonies on the long run. World War II brought significant changes. As a result of hostilities, the colonies got under the rule of other countries and the colonial empires that concentrated on the war lost their interest in the fate of the overseas territories. That lead to the wave of independence movements in the colonies. In the next decade over 20 new independent stated were established and the number was continuously growing. However, most of them were poor and overpopulated. Internal problems overshadowed quickly the success of gaining the independence and economic problems became dominant[1].

At first the states expected to receive assistance from their metropolis. However, the new governing elites had an anti-colonial attitude and wanted to remain independent. Consequently, some of the states chose the non-capitalistic model of development in which the state is the owner of the production means; the property was nationalized and the reforms were conducted in accordance to the rules of central planning. Other states accepted the post-colonial structures and the rules of market economy[2]. In spite of their attempts, both groups of

[1] More in K. Czaplicka, *Problemy społeczno-gospodarcze krajów rozwijających się i wybrane koncepcje ich przezwyciężenia*, [w:] *Międzynarodowa współpraca na rzecz rozwoju. Ewolucja, stan obecny i perspektywy*, Polskie Wydawnictwo Ekonomiczne, Warszawa 2009, pp. 16-20.

[2] Cf. F. Kuhen, *Causes of underdevelopment and concepts for development*, Institute of Development Studies, The Journal of Development Studies vol VIII, 1987, pp. 11-12.

the states still remain significantly backwards in relation to the developed countries, which is caused by the African numerous barriers of economic growth that are present on the continent. Apart from the mentioned above historical reasons, there are natural ones (severe climate, deserts, lack of water), political (unstable governments, internal and international conflicts, dictatorships and nondemocratic structures), social (low level of education, the lack of qualified workers, social inequalities, corruption, illnesses) and purely economic ones, which include economic homogeneity of the majority of economies, the lack or shortage of local production factors, low competitiveness of the production and exports, improper macro-economic policy, inadequate development of the infrastructure and many other factors[3].

As a result, a significant amount of funds, time and effort were wasted and half a century after decolonization the structure of production and trade in many African countries have not changed much. Half of Africa's population lives in the world's least developed countries (LDCs) [4]; in Sub-Saharan Africa approximately 45% of the population live on less than 1 USD a day and 75% on not more than 2 USD a day and the poverty does not show any symptoms of decrease. Quite the contrary: in 1981-2001 the number of people living in poverty in Sub-Saharan Africa doubled from 164m to 315m people who have to survive for less than 1 USD a day[5].

According to the UN statistics that apply the Human Development Index (HDI)[6], the African countries are at the bottom of the UN Human Development Report (HDR). Sierra Leone is ranked 180th , followed by Burkina Faso, Liberia, Chad, Mozambique, Burundi, Niger and the last (187th) the Democratic Republic of Congo. In 2000-2009 over 80% of the population of Burkina Faso and Burundi lived on less than 1,25 USD PPP. The figures are similar when the new UN synthetic measure (Multidimentional Poverty Index, *MPI)* [7] is used, which is not reduced to the determination of the number of people living on 1 or 2 USD per day but also takes into account other shortages such as the access to education, health care, services and other things. In that approach, Niger is at the very bottom (0.64), before Ethiopia

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[3] More in S. Miklaszewski, *Sytuacja gospodarczo-społeczna w krajach Trzeciego Świata* [in] S. Miklaszewski (ed.), *Kraje rozwijające się w światowym systemie gospodarczym*, Difin, Warszawa 2007, p. 179-180.

[4] P. Lamy, *Regional integrations in Africa: ambitions and vicissitudes*, p. 39-40, www.notre-europe.eu (20.07.2012).

[5] S. Chen, M. Ravaillion, *How Have World's Poorest Fared Since Early 1980s?,* World Bank Policy Reasearch Working Paper, 3341, June 2004, pp. 21-22.

[6] HDI consists of ratios embracing three basic dimensions: living a long and healthy life (measured by life expectancy at the moment of birth), access to knowledge and education (measured by average and expected number of years of education) and standard of living (GNP per capita, PPP), http://www.undp.org.pl (20.07.2012).

[7] In 2010 MPI replaced Human Poverty Index, HPI which was used by UN from 1997. http://hdr.undp.org (20.07.2012).

(0.56) and Burkina Faso (0.54) [8]. The poverty in Africa is not only multidimensional but also deep and durable. Despite internal and external efforts it has been a major problem of the continent for decades. Although in the last 10 years a 5% economic growth has been noted in Africa, inflation rates have decreased and the monetary and fiscal policies have become more transparent, a permanent development of Africa remains one of the biggest challenges of the contemporary world.

2. Development of micro-finance

Various forms of micro-financing have been functioning in the world for ages. There are many historical examples, ranging from the informal crediting clubs that functioned in England, Ireland and Germany in 18th century to credit co-operatives functioning in Indonesia already in the 19th century. In the case of Africa, micro-finance dates back to the 15th century. The term *susu* in Yoruba, the West African language, which at that time referred to such activity, is still used. The micro-financing system in Africa in its formalized form that is a part of the continent's financial system dates back to the late 1990s.

The 20th system of micro-financing has undergone four phases of evolution before reaching its present shape.

Phase one started in 1950s, when micro-financing consisted mainly in giving subsidized loans mostly to the poorest people who had no means to pay them off. Such system assumed that the lack of money was the main reason of poverty among the Africans.

Phase two started in 1970s and was based mainly on loans granted by Non-Governmental Organizations, NGOs; starting with the Grameen Group in Bangladesh; NGOs provided financial means to the poorest groups of society. In this phase, the self-sufficiency of micro-financing institutions was not taken into consideration as NGO's were the main sponsors of the loans. Agencies from the developed countries provided the subsidized funds and, consequently, the permanence of the means to be granted was the main assumption.

Phase three of the micro-finance of the 20th century was related to the formalization of the micro-financing institutions in the 1990s which reacted to the growing demand and started offering an increased number of such services as crediting and insurance. In this way they proved that their operations could improve the financial condition of their clients and help them leave the vicious circle of poverty.

[8] http://hdr.undp.org (20.07.2012).

In mid-1990s phase four has began, which is focused mainly on the formalization of micro-financing and the integration of this kind of operations with the formal financial sector with the aim to help the poorest groups of society. Thus, the activities aim at the increase of transparency, the introduction of international accounting standards and the increase of the availability of micro-credits to the poorest Africans[9].

3. The significance of micro-financing

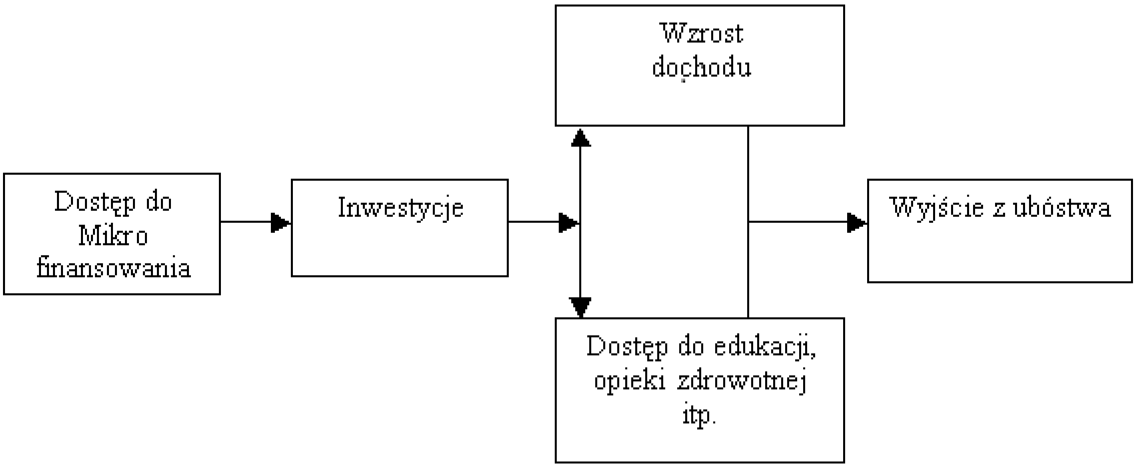
In comparison to traditional bank loans, micro-credits (as their name suggests) account for significantly lower amounts (up to approx. 100USD) and, what is more, their interest rate is much lower, yet high enough to ensure the profitability of the crediting institution. The credit payment period is usually short and the payments are frequent but low. At present micro-credits or micro-loans are granted both by banks and non-bank institutions. The system of micro-credits is based on social trust. Bank lends a debtor an insignificant amount of money for a specific period of time and then the loan must be reimbursed together with the interests that were determined before. If the debtor does not pay off the loan, another person will not get the credit. Thus, the whole community is supportive as the reimbursement of the loan is of interest to the whole group. Another important element of micro-financing is the fact that it is the first time that the poorest citizens are taken into consideration and given the chance to develop and improve their material situation by investing in their own businesses.

As a result of the development of micro-credits or micro-loans, the term *micro-financing* has become more common as it is wider and takes into account other operations of financial institutions that have expanded their services by introducing deposit and insurance services.

Even such insignificant support as the one provided by micro-financing may contribute to the improvement of efficiency, the creation of new job places and – first of all – the reduction of poverty in Africa. The mechanism of the phenomenon is presented by scheme 1.

[9] *Microfinance policy and strategy for Bank Group*, African Development Bank, Issues Paper 7, May 2006, pp. 1-4.

Scheme 1. Simple causual chain from micro-finance to poverty alleviation



Source: S. van Rooyen, R. Dickson, C. Majoro, K. de Wet, *What is the impact of microfinance on poor people*, *Institute of Education*, Social Science Research Unit, UK, 2010, p. 11.

Access to micro-finance > Invest in the future> Increase income // Increase education, health, etc. > Lift out of poverty

The economies of African states have a very low income per capita and, consequently, there is a problem with savings to be turned into investment. The access to micro-finance makes investing possible; investments stimulate the increase of income, which results in the opportunity of better health care or education and that has its impact on the alleviation of poverty.

W ramach mikro finansowania wyróżnia się cztery rodzaje produktów:

Micro-finance includes four types of products:

- micro-credits,
- micro-savings,
- micro-insurance,
- money transfer.

Micro-credits and savings services are the best developed products. Micro-insurance and transfers are not as popular as the other two[10] despite the fact that each one of them may have an impact on poverty alleviation. The opportunities to reach particular results by the application of the above mentioned products are presented in table 1.

[10] *Enhancing Micro Finance for Africa's Development*, Forum on Financing for Development: Mobilizing Resources for Economic Transformation in Africa, African Development Bank, May 2011, p. 1.

Table 1. Types of micro-finance services

Service	Result	Impact on poverty alleviation
Insurance services	Increased savings in society; Additional income from the savings; Accumulation of means that may be allocated in one's own business; Accumulation of means that may be invested in hi-tech; Increased resistance to external shocks; Elimination of the need to borrow means from informal lenders; Accumulation of means to purchase manufacturing assets; More effective allocation of means; Initiation of economic growth.	Reduction of households' vulnerability to external shocks; Stabilization of consumption in households; Generation of income; Reduction of poverty level; Higher social status of the poorest; Reduction of social exclusion.
Micro-credit services	Expansion of micro-business; Diversification of business; Reduction of liabilities against informal lenders; Increase of the return on investments; Initiation of economic growth.	Increased consumption level; Diversification of income sources; Stabilization of the levels of income and consumption; Easier access to the education of children; Reduction of social exclusion.
Insurance services	Increased savings in financial assets; Reduction of risk and potential loss; Reduction of vulnerability to external shocks; Initiation of economic growth.	Increased consumption level; Reduction of consumption fluctuations; Increased security.
Payments/transfer services	Facilitation of trade and investment	Increased income and consumption

Source: Author's research based on: *Finance for the Poor: Microfinance Development Strategy*, Asian Development Bank, 2000 p. 3, http://www.syngentefoundation.org, (20.07.2012).

Micro-credits function in economies as credits; they provide access to money capital, give a chance to increase the savings and, consequently, to spend some of the generated means on investment. Micro-credits may be used as an investment capital and, as a result, they may bring additional profits to the debtors. In time, when their operations are becoming increasingly effective, the income grows. That results in the accumulation of savings which may be spent on new investment and better technologies. Moreover, the savings constitute a reserve of the households for the expenditures related, for example, to education or any emergencies (illness, drought or theft) i.e. situations that may contribute to the increase of the already existing poverty. Thus, the implementation of various techniques of micro-finance may result in the development of the property and the improvement of the standard of living. In other words, the food safety is increased, accommodation is improved and the access to sanitary facilities, health care and education is easier. Micro-financing may be one of the ways that lead to gradual independence of foreign assistance; in the long term it may result in a sustainable social and economic growth of the continent.

4. Costs and benefits of micro-finance

Due to the fact that micro-finance has been gaining popularity in the last decade, the UN declared 2005, the International Year of Micro-Finance. The following year, M.Yunus, the greatest supporter of microfinance and the founder of the Grameen Bank received the Peace Nobel Prize for his activities. At present, microfinance is perceived as one of the most effective ways of the development of poor countries, the one that initiates a bottom-to-top development that is opposed to the top-to-bottom model offered by developed countries[11].

A significant demand for the micro-finance services is a proof of its beneficial impact. According to the latest report (2012), at the end of 2010 over 205m clients benefited from micro-finance; over 153m of them were women, and over 137m clients belonged at the moment of taking a loan to the poorest citizens[12]. Micro-finance institutions specially value women as their customers for two reasons; the reimbursement of liabilities among this group is more reliable and the acquired means are spent in a more sensible and pro-development way.

Apart from several material benefits, micro-finance is also beneficial from the non – material point of view. Individual and collective micro-financing strengthens the social position of individuals. Steady income, savings and credit payment discipline increase the self-esteem and the social status in a society where the poor are usually treated as the second-class citizens. Institutions granting credits frequently offer training to their clients on how to manage their capital, run the business or even on their civil rights. As a result of such activities the social status of African people improves and they often make attempt to find better jobs, to have better working conditions or easier access to health service and education. Moreover, micro-finance contributes to the improvement of the social position of African women by encouraging them to fight for jobs and their rights. Meetings with the social group within which a micro-credit is distributed are a perfect, if not the only one, opportunity to discuss with other women current issues or to start joint initiatives. Such groups constitute an information channel through which they may learn about consulting services for women who are the victims of violence or are addicted to alcohol or drugs. Thanks to this type of activities

[11] A. Haylins, Micr*o-finance revolution comes to Africa. OFID partners with leading micro-lender*, OFID Quarterly Vol. I, No. 2, p. 12.
[12] *State of Microcredit Summit Campaign Report 2012*, s. 3, http://www.microcreditsummit.org (20.07.2012).

the material situation of African women is improved as they show men their commitment in lucrative projects[13].

Although it seems difficult to criticize a system whose main aim is to reduce poverty, its several drawback have to be mentioned. In recent years it has gained both strong supporters as well as equally strong opponents. It is criticized by western economists who stress the fact that despite 35 years of the functioning of the micro-finance idea, several households that take the advantage of the system still remain in deep poverty. 55% of women who receive means within the framework of the micro-finance system are forced to spend the money on such basic goods as food, instead on investing it in the development of their own businesses[14]. When receiving another form of international assistance, the poorest citizens become dependent on these means in the same way as in the case of the international aid funds from benefactor states.

What is more, few micro-finance institutions have adequate instruments that could monitor the working conditions of their debtors. There are no solutions that would eradicate compulsory work, the lack of social benefits or the work of children. There are no inspections aiming at the change of the existing work conditions and, consequently, the change of the living and working conditions of the poorest strata of society seems to be impossible[15].

Most of the micro-finance credits are granted for 6-24 months, which is too short a period to develop one's own business. Such terms have a negative impact on the choice of business areas where the clients would invest the acquired means. As a result, micro-credits are mainly used in commercial and not manufacturing activities that would result in higher rates of return of the invested capital[16].

There are also some controversies concerning interests and fees. On the one hand, they are indispensible for the micro-financing institutions to be self-sufficient and financially stable but on the other, additional payments imposed on the poorest are ethically dubious.

Despite the lack of complex solutions, micro-finance remains one of the few solutions aiming at the alleviation of poverty in the world, especially in Africa, that applies the top-to-bottom development mechanisms. As long as there is no other idea that would stop the

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[13] *Microfinance in Africa: Combining the Best Practices of Traditional and Modern Microfinance Approaches towards Poverty Eradication*, s.13., http://www.un.org/esa/africa/microfinanceinafrica.pdf . (05.10.2011).

[14] *Evaluating the Criticism of Microfinance, Microloans, and Microlending*, s.14 http://compassioninpolitics wordpress.com (15.02.2012).

[15] J. Reid, *The MicroLoan Foundation: A hand up, not a hand out*, http://microfinanceafrica.net (15.02.2012).

[16] B. B. Kereta, *Outreach and Financial Performance Analysis of Microfinance Institutions in Ethiopia*, National Bank of Ethiopia Economic Research and Monetary Policy Directorate, United Nations Conference Center (UNCC), Addis Ababa, Ethiopia 15-17 November 2007, p. 25.

vicious circle of poverty, micro-credits remain the main opportunity for the poorest to improve their material situation and strengthen their social status.

Conclusion

Africa's inability to achieve a stable, long-term growth is inevitably caused by the combination of difficult geographical, historical, cultural, demographic and institutional reasons. However, none of these factors should result in the eternal poverty and underdevelopment.

Among other things, micro-credits are an opportunity for Africa to develop. Effectively implemented micro-credits may have a beneficial effect not only on particular households but also on whole societies. They may stimulate entrepreneurship and generate the growth of savings in the society. The important element of micro-financing is that for the first time it takes into consideration the poorest citizens of developing countries who get the chance to develop and improve their material condition by investing the acquired means in their own businesses. As a result, economic growth and development is generated by a bottom-to-top process.

A lot must be done for the African continent to overcome poverty and reach higher development ratios. The development of Africa requires innovations and determination in activities that aim at the introduction of the principles of good management. The assistance model that has been applied so far did not succeed, so the time has come to start a new way of development. Micro-finance is an important tool of economic growth. People are given self-sufficiency and acquire the spirit of entrepreneurship and willingness to act. Micro-finance, and particularly micro-credits, strengthens the position of women and arouses self-discipline among the poor as regards the payoff. The increase of the standard of living facilitates the access to the goods of a higher order, which were beyond the reach of the poorest. Being aware of the drawbacks of the system, one has to state that the positive effects of micro-finance will have a long lasting effect on African countries and will accelerate the development processes.

The governments of African states face several challenges as regards the development of the micro-finance sector such as the decrease of credit costs or the creation of effective partnership relations between the financial institutions and the expanding micro-finance industry. In order to transfer the beneficial effects of micro-finance onto the development of the whole continent, micro-finance institutions should focus on operations related to the reduction of poverty, a better education to their clients and the realization of the Millennium Development Goals (MDG). Moreover, they should be assisted by a number of other activities supporting the development.

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Summary

Small business and most of the African population have a limited access to credits and loans offered by banks. It is a great barrier for the development of the region, in which great majority of the population lives under the poverty line and has no regular income. In response to the growing demand for financial services, a sector of micro-finance services has developed, aiming to provide services to the poorest communities.

Through the last five years, significant changes have been noticed on the African continent. Africa has been following a path of economic and social development. There is no doubt that micro-financing may contribute to those processes as one of its outcomes is the alleviation of poverty and an increased access to goods, services and income. Micro-financing helps African people achieve economic security.