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## MICROFINANCING AS A POVERTY REDUCTION TOOL

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### **Abstract**

*This study is conveyed in order to examine the microfinance perceptions in the country based on a survey that gives answers to a set of questions related to the general characteristics of the poor households, their problems, needs, savings, borrowing and financial exclusion.*

*The findings underline some issues concerning the availability of financial resources offered by the financial institutions in RM to the citizens, with particular focus on microfinance and its use for improvement of the financial and economic situation of the citizens.*

*The results show very low consumption of the financial institutions' offer in the country. In addition, the concept of microfinance is not widely known by the people in Republic of Macedonia – just 2% in the sample have borrowed from MFI.*

*As a result, a number of policy issues should be considered by MFIs and the government regarding the improvement of the outreach, the impact, and the legal background of the concept of microfinance in order to offer the citizens better availability to microcredits and loans.*

**Keywords:** credit, borrowing, microfinance

**JEL Classification:** G21, O16

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### **DEFINING MICROFINANCE**

There is a great volume written on microfinance from the perspective of the practitioners and economy theorists, which contains valuable insights about the concept of microfinance and its realization and validation. In this study, the microfinance concept would be examined from both retrospective and prospective recourse.

The simplest approach to defining microfinance is given by Robinson (2001) who refers to microfinance as the small-scale financial services, primarily credit and savings, provided to people who farm or fish or herd, who operate small enterprises or micro enterprises where goods are produced, recycled, repaired, or sold,

who provide services, who work for wages or commissions, who gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools and to other individuals and groups at the local levels of developing countries, both rural and urban.<sup>22</sup>

Banking the “un-bankable” is also a provision of financial services such as cash transfers and insurance to poor and low-income people. These services generally focus on the entrepreneurial poor - provision of services to low-income clients, women and men, lacking access to other financial institutions. They present client-appropriate lending - simple and convenient access to small, short-term, and repeat loans, with the use of collateral substitutes (for example, group guarantees or compulsory savings) to motivate repayment. They also refer to informal appraisal of borrowers and investments, with simple cash flow and project appraisal for larger and longer-term loans. The provision of secure, voluntary savings services facilitates small deposits, convenient collections, and ready access to funds, either independently or with another institution.<sup>23</sup>

According to Sapovadia, microfinance is “meeting the special goal to empower to under-privileged class of society, poor, women downtrodden by natural reasons or men made, caste, creed, religion or otherwise, the principle of microfinance is founded on a philosophy of cooperation and its central values of equality, equity and mutual self-help. It means providing poor families with small loans to help them engage in productive activities or grow their tiny businesses.”<sup>24</sup>

Brigit Helms draws attention that the comprehensive financial system is consisted of micro, meso and macro level. In the micro level, the providers of the financial services are those who offer them directly to poor and low-income clients. The range of those who offer these services is moving from informal moneylenders to commercial banks and saving clubs, and everything that stays in between.<sup>25</sup>

Considering the objectives of microfinance directed towards poverty alleviation and development of micro and small enterprises, the key points of the concept of microfinance are: *the poor, the loans, and the social benefit*.

*The Poor* – clients of microfinance programs are those who are excluded from traditional financial system on account of their lower economic status. In the same time, they refer to micro-entrepreneurs who lack collateral and do not qualify to traditional bank credits. In developing countries, they are engaged in self-employment projects that generate income. The premise is that the poor have skills which remain unutilized or underutilized. It is definitely not the lack of skills that make poor people poor. Unleashing of energy and creativity in each human being is the answer to poverty.<sup>26</sup>

It should be emphasised that the microfinance concept could not be separately viewed from its target group, not consisted by the poorest of the poor, who need other interventions such as food and health security, but by the poor who live at the border of the so called poverty line. These are the poor who could reach more easily a decent quality of life and who have entrepreneurial ideas, but lack access to formal finance. These people usually do not lack finance in a broad sense: they can borrow money from friends, relatives or local money lenders, but of course they cannot access a wider and safer range of services. They need a formal financial institution to rely on, to ask not only for credit, but also saving or insurance.<sup>27</sup> So, they can invest in better nutrition, housing, health, and education for the children. They can create productive businesses, and

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22) Robinson, Marguerite. 2201. “Microfinance revolution: Sustainable finance for the poor.” p.9. *World Bank Publications, Washington DC, USA*

23) Judith Brandsma, Deena Burjorjee. 2004. “Microfinance in the Arab states: Building inclusive financial sectors.” *UNCDF*

24) V. Sapovadia. Micro Finance - A tool for socio-economic development & Women Empowerment <http://topics.developmentgateway.org/>

25) Helms, Brigit. 2006. p.28 “Access for all: Building inclusive financial systems”. World Bank, Herndon, VA, USA

26) Muhammad Yunus. 2003. “Expanding microcredit Outreach to reach the Millennium Development Goals.” International Seminar of Attacking Poverty with microcredit, Dhaka, Bangladesh

27) Chiara Segrado. 2005. “Islamic microfinance and socially responsible investments”. Meda Project, University of Torino

recover more quickly in the aftermath of natural disasters. In short, they can take real strides towards breaking the vicious circle of poverty and vulnerability.<sup>28</sup>

As an effective and efficient financial system offers variety of products and financial innovation to satisfy the different needs of different customers, so should the microfinance system. All of those different clients of microfinance have specific and different occupations and needs, so they should be approached and treated differently.

*The microfinance loan* is the second element of the trilogy. It is just one of the microfinance services which enable entrepreneurs to satisfy their needs for working capital, or to purchase money for emergency needs, such as illness and other emergencies.

The expansion of the MFI and the increasing understanding of the importance of offering financial services for the poor provoked an appearance of wide portfolio of microfinance products.

#### **Box 1: Types of financial services**

**Loan products:** Low-income households demand loans for both income generation and income smoothing and risk management.

**Housing loans:** Low-income households seldom have financial resources to buy an already constructed house, rather their life cycle calls for loans for home improvements and progressive house building. There is a close connection between housing and income generation since a house often is used as a shelter and as a place to house income-generating activities. Few MFIs provide housing loans today, but new initiatives are emerging.

**Savings:** Studies show that even very poor people do save. Savings are often the only way of managing emergencies, smoothing consumption, paying for a major life event and taking advantage of a business opportunity. The poorest often prefer to save instead of taking a loan, mainly due to risk and cost aspects.

**Micro insurance:** Micro insurance is the provision of insurance to low-income households, including insurance for life, health, property, disability, and agriculture (crop). Poor families are especially vulnerable to risk, both in the form of natural disasters, and more regular incidences of accidents and illness. PRIDE and FINCA in Uganda have formed partnerships with American International Group to offer life and disability insurance to its clients.

**Money transfers and remittances:** In many countries, remittances far outstrip total development assistance, and account for a significant amount of GDP. Microfinance institutions have recently started to enter the remittances market, and they will have an important role in reducing the transaction costs of remittances in the future.

**Agricultural and rural finance:** One of the main reasons why few subsidized rural credit schemes have been successful is that they failed to address the special characteristics, opportunities, and constraints in rural and agricultural credit markets. Special characteristics of rural markets include seasonality in income flows, less defined property rights, and dispersed populations, higher level of price and production risk, and poor physical infrastructure. Agriculture lending is increasingly seen in the context of building permanent rural financial systems rather than separate agricultural credit schemes, and as one among many necessary interventions for food security and rural development.

*The microfinance institutions (MFI)* are organizations which offer financial services to poor people, accessing the resources from the banks. These institutions could be: credit unions, commercial banks, non-governmental organizations, cooperatives, and sectors of government banks. Some of the MFIs offer not just loans, but different kinds of microfinance services. In addition, we can say that MFIs are playing the role of intermediation, transferring the financial and support from banks to the clients. Microfinance has a significant role in bridging the gap between the formal financial institutions and the rural poor. MFI is like a small bank with the same challenges and capital needs confronting any expanding small venture, but with the added respon-

28) Kofi Annan. Q & A on International Year of Microcredit and importance of microfinance

sibility of serving economically-marginalized populations. Many MFIs are creditworthy and well-run with proven records of success, many are operationally self-sufficient. Nowadays, the appearance of “for-profit” MFIs is growing. On the other hand, non-governmental organizations mainly work in the distant rural areas with no access to banking services.

*The social benefit* is the third element of the trilogy. It could be seen from every aspect of microfinance. From the perspective of microfinance clients, it helps strengthening their small enterprises. From the perspective of non-clients, it has indirect impact, because they could find jobs in the enterprises developed by microfinance clients or through backward and forward linkages. Successful microfinance activities in many countries have proven that it could be an effective and powerful instrument for poverty reduction by increasing the ability of poor people to raise income, build assets, and reduce their vulnerability in times of economic stress. However, “poverty is not only an outcome of economic processes – it is an outcome of interacting economic, social, and political forces; underlines, the accountability and responsiveness of state institutes, corruption, lack of rule of law, social barriers, gender discrimination, inequalities in voice and access to resources, and social fragmentation and conflicts. That is why with facilitating empowerment through making state institutions more accountable and responsive to poor people, strengthening the participation of poor people in political processes and local decision making, and removing the social barriers that result from distinctions of gender, ethnicity, race, religion, cast, and social status could reduce poverty.”<sup>29</sup>

“Social benefits depend on worth, cost, depth, breadth, length, and scope of the loan, but the greatest of these is length.”<sup>30</sup> According to Townsend and Yaron (2001), and Khandker (2005), the cost-benefit analysis is essential for measuring the social benefits, but the problem that arises is how to measure the qualitative effects of microfinance, such as tender empowerment, equalities in voice, rule of law, is difficult to put in monetary terms, and the dynamics of those benefits.

In conclusion, microfinance influences on financial constraints such as access to credits, employment opportunities, risk management, by smoothing income and expenditure, and let the potential of the people to achieve their goals.

## THE GENERAL PRINCIPLES OF MICROFINANCE

The key principles of microfinance were developed by Consultative group to assist the poor (CGAP<sup>31</sup>), and were approved by the Group of Eight world’s leading industrialized countries – G8 who accentuate how access to financial services by the poor could contribute poverty reduction. However, according to the analysis of UNDP, some of these general principles of microfinance do not correspond to the real situation with micro-finance.

The general principles of micro-finance are the following:<sup>32</sup>

**Poor people need a variety of financial services, not just loans.** *Like everyone else, the poor need a range of financial services that are convenient, flexible, and affordable. Depending on circumstances, they want not only loans, but also savings, insurance, and cash transfer services.*

**Microfinance is a powerful tool to fight poverty.** *When poor people have access to financial services, they can earn more, build their assets, and cushion themselves against external shocks. Poor households use microfinance to move from everyday survival to planning for the future: they invest in better nutrition, housing, health, and education.*

29) Faheem Jehangir Khan. 2003. “Poverty Reduction Strategies: Role of Microcredit and Empowerment in Realizing Income Opportunities.” *Institute for Agricultural Economics and Social Sciences in the Tropics and Subtropics*

30) Mark Schreiner. 1999. “Aspects of Outreach: A Framework for Discussion of the Social Benefits of Microfinance.” *Journal of International Development, Washington university*

31) The CGAP is a consortium of 28 public and private development agencies working together to expand access to financial services for the poor in developing countries.

32) The Consultative Group to Assist the Poor. “Key Principles of Microfinance.” <http://www.cgap.org>

**Microfinance means building financial systems that serve the poor.** In most developing countries, poor people are the majority of the population, yet they are the least likely to be served by banks. Microfinance is often seen as a marginal sector—a “development” activity that donors, governments, or social investors might care about, but not as part of the country’s mainstream financial system. However, microfinance will reach the maximum number of poor clients only when it is integrated into the financial sector.

**Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor people.** Most poor people cannot get good financial services that meet their needs because there are not enough strong institutions that provide such services. Strong institutions need to charge enough to cover their costs. Cost recovery is not an end in itself. Rather, it is the only way to reach scale and impact beyond the limited levels that donors can fund. A financially sustainable institution can continue and expand its services over the long term. Achieving sustainability means lowering transaction costs, offering services that are more useful to the clients, and finding new ways to reach more of the unbanked poor.

**Microfinance is about building permanent local financial institutions.** Finance for the poor requires sound domestic financial institutions that provide services on a permanent basis. These institutions need to attract domestic savings, recycle those savings into loans, and provide other services. As local institutions and capital markets mature, there will be less dependence on funding from donors and governments, including government development banks.

**Micro-credit is not always the answer. Micro-credit is not the best tool for everyone or every situation.** Destitute and hungry people with no income or means of repayment need other kinds of support before they can make good use of loans. In many cases, other tools will alleviate poverty better—for instance, small grants, employment and training programs, or infrastructure improvements. Where possible, such services should be coupled with building savings.

**Interest rate ceilings hurt poor people by making it harder for them to get credit.** It costs much more to make many small loans than a few large loans. Unless micro-lenders can charge interest rates that are well above average bank loan rates, they cannot cover their costs. Their growth will be limited by the scarce and uncertain supply of soft money from donors or governments. When governments regulate interest rates, they usually set them at levels so low that micro-credit cannot cover its costs, so such regulation should be avoided. At the same time, a micro-lender should not use high interest rates to make borrowers cover the cost of its own inefficiency.

**The role of government is to enable financial services, not to provide them directly.** National governments should set policies that stimulate financial services for poor people at the same time as protecting deposits. Governments need to maintain macroeconomic stability, avoid interest rate caps, and refrain from distorting markets with subsidized, high-default loan programs that cannot be sustained. They should also clamp down on corruption and improve the environment for micro-businesses, including access to markets and infrastructure. In special cases where other funds are unavailable, government funding may be warranted for sound and independent microfinance institutions.

**Donor funds should complement private capital, not compete with it.** Donors provide grants, loans, and equity for microfinance. Such support should be temporary. It should be used to build the capacity of microfinance providers; to develop supporting infrastructure like rating agencies, credit bureaus, and audit capacity; and to support experimentation. In some cases, serving sparse or difficult-to-reach populations can require longer-term donor support. Donors should try to integrate microfinance with the rest of the financial system. They should use experts with a track record of success when designing and implementing projects. They should set clear performance targets that must be met before funding is continued. Every project should have a realistic plan for reaching a point where the donor’s support is no longer needed.

**The key bottleneck is the shortage of strong institutions and managers.** Microfinance is a specialized field that combines banking with social goals. Skills and systems need to be built at all levels: managers

*and information systems of microfinance institutions, central banks that regulate microfinance, other government agencies, and donors. Public and private investments in microfinance should focus on building this capacity, not just moving money.*

**Microfinance works best when it measures—and discloses—its performance.** *Accurate, standardized performance information is imperative, both financial information (e.g., interest rates, loan repayment, and cost recovery) and social information (e.g., number of clients reached and their poverty level). Donors, investors, banking supervisors, and customers need this information to judge their cost, risk, and return.*

## THE HISTORY OF MICROFINANCE

Microfinance is one of those small ideas that turn out to have enormous implications.<sup>33</sup> Speaking about microfinance today, one must recall about Mohamad Yunus and Grameen Bank in Bangladesh, developed in 1970s. Everything started when the professor of economics in a Bangladesh University - Muhamed Yunus (Nobel Prize winner) started to give small loans to the poor local villagers in 1970. He created his microfinance paradigm basing on his belief in reliability of poor, low-income people, who didn't have collateral to guarantee their loans. With this model, it was shown that poor people could rely on to repay their loans, and that it was possible to provide financial services through market based enterprises to poor people without any subsidy.

But, the roots of microfinance can be traced much earlier, even in the middle ages. In 1946, the Italian monk opened a pawn shop to counter usury practises. Later, in 1515 it was permitted by the Pope Leon X for the pawn shops to charge interest in order to cover their operating costs. In 1700 the Irish Loan Fund System was opened providing small loans to poor farmers without collateral. In 1800, Raiffeisen developed the financial cooperatives, and his movement reached 2 million rural farmers by 1901. In Europe and Latin America, People's Banks, Credit Unions, and Savings and Credit Cooperatives began to emerge.<sup>34</sup> From 1950 to 1970 state-owned development finance institutions offered loans with interest rates set below market interest rates, directed towards development of the agricultural sector.

From 1990s, the term micro credit begins to be replaced by the broader range of services, such as savings, insurance, money transfers, etc, called microfinance. This new system of microfinance characterise with very efficient repayment rate, better than in ordinary commercial banks. The microfinance institutions became important part of the financial systems of the countries, attracting poor people with small businesses to take loans, to put savings or to use insurance services.

UN declared 2005 as a Year of microfinance and sets the following goals:<sup>35</sup> assess and promote the contribution of microfinance to MFI, make it more visible, make it inclusive to financial sector, make a supportive system, support partnerships and innovation to build and expand the outreach and success of MF for all.

The future tendencies of this movement are directed to commercialization, development of profitable organizations that could attract more capital and become stronger element of the financial system. Specifically, three major challenges define the frontier of financial services - scale, depth, and cost:<sup>36</sup> quality financial services to serve large numbers of people, reaching increasingly poorer and lowering costs.

Many scholars and practitioners agree that after successfully overcoming of these challenges, microfinance would become an integrated part of the financial system. Moreover, the contemporary concept of microfinance would be abandoned, and the financial institutions would offer various services to the poor, as their regular, respected and reliable customers.

33) Beatriz, Armendariz de Aghion; Jonathan, Morduch. 2005. "The Economics of Microfinance". *The MIT Press*

34) Helms, Brigit. 2006. p.4 "Access for all: Building inclusive financial systems". *World Bank, Herndon, VA, USA*

35) Report on International Year of Microcredit and Global Micro-entrepreneurship Award Activities. 2005. UNDP

36) Helms, Brigit. 2006. p.5 "Access for all: Building inclusive financial systems". *World Bank, Herndon, VA, USA*



## APPROACHES TO PROVIDING MICROFINANCE

There are two approaches to providing microfinance - poverty lending approach and financial intermediation approach. These two approaches differentiate by the target groups towards which they are directed and the goals that they should accomplish.

### Poverty Lending Approach

In this approach, also called "welfarist approach" we are talking more about micro-credit, not microfinance. Most of the institutions which provide micro-credit using poverty lending approach are not sustainable, because they have low cost of their services and their interest rates are too low for full cost recovery. They do not offer saving services. This concept is more about charity. This is justified by the fact that when we are talking about extremely poor people, we know that they need microfinance to satisfy their basic needs, such as food, clothes, shelter, health, etc. This approach by providing credits often provides some complementary services such as skills training and the teaching of literacy and numeracy, health, nutrition, family planning, etc. Using this approach, government and donors provide credits to poor borrowers with interest rates lower than those in the market, so they could reach the poor, especially the extremely poor, the poorest of the poor with credit to help overcome poverty and gain empowerment. Except for mandatory savings required as a condition of receiving a loan, the mobilization of local savings is normally not a significant part of the poverty lending approach to microfinance. One of the successful examples using poverty lending approach is Grameen Bank in Bangladesh and some of its replications in other countries represent leading examples of the poverty lending approach.

Considering this, we can say that commercial microfinance is not appropriate for extremely poor people who are badly malnourished, ill, and without skills or employment opportunities. Starving borrowers will use their loans to buy food for themselves or their children. Such people do not need debt. They need food, shelter, medicines, skill training, and employment for which government and donor subsidies and charitable contributions are appropriate. For these people, microfinance is the next step, after they become able to work.<sup>37</sup>

### Financial Intermediation Approach

In contrast, the financial systems approach or "institutionist approach" focuses on commercial financial intermediation among poor borrowers and savers. The MFI which provide these services are mostly self-sustainable. They serve poor people with entrepreneurial characteristics, who need additional financing to develop or increase their businesses, in order to provide income for their households or to increase the consumption. Mainly, their services have higher costs and their clients could pay high interest rates they charge. These MFI arose from the unmet demand for micro-credit which exists worldwide and which is estimated in hundreds of millions of poor people needing small amounts of money or saving accounts or insurance. The government and donors are not appropriate providers of services using this approach, because generally they don't deal with creditworthy borrowers.

In addition, within the past several decades fully sustainable commercial microfinance intermediaries have emerged. These intermediaries provide loans and voluntary savings services to the economically active poor, and they offer easy access at reasonable cost. Their loan portfolios are financed by savings, commercial debt, and for-profit investment in varying combinations. These institutions are able to attain wide outreach profitably, and they represent a globally affordable model.<sup>38</sup>

37) Robinson, Marguerite. 2001. "Microfinance revolution: Sustainable finance for the poor." p.8. *World Bank Publications, Washington DC, USA*

38) Robinson, Marguerite. 2001. "Microfinance revolution: Sustainable finance for the poor." p.8. *World Bank Publications, Washington DC, USA*

The concept of high-interest rates that is a necessary request when using this approach is justified by the diversified portfolio of these institutions. They serve large number of clients who take small loans, so their operating and transactions costs are very high. Microfinance institutions are necessarily labour intensive. They must maintain and staff many small, widely dispersed outlets that are conveniently located for clients.

However, the interest rates of microfinance services offered with financial intermediation approach are higher than commercial loans, but much lower than rates charged by money lenders and other sources from whom the poor borrow. Also, consideration of the law of diminishing returns<sup>39</sup> shows how the clients who take small loans could pay larger proportion of money as interest to their lenders, because their returns are higher. In the same time, the empirical studies and successful results of the microfinance institutions show that the rate of repayment of the loans is very high which means that the clients of microfinance institutions are creditworthy. The high rate of savings reported by many microfinance organizations demonstrates that the poor can value savings as much as credit.

The financial systems approach focuses on self-sufficiency of the institutions because there is widespread client demand for convenient, appropriate financial service for microfinance, and that is the only way to satisfy that demand. Some famous institutions that provide microfinance under this approach are Bank Rakyat Indonesia (BRI), BancoSol in Bolivia, and the Association for Social Advancement (ASA) in Bangladesh.

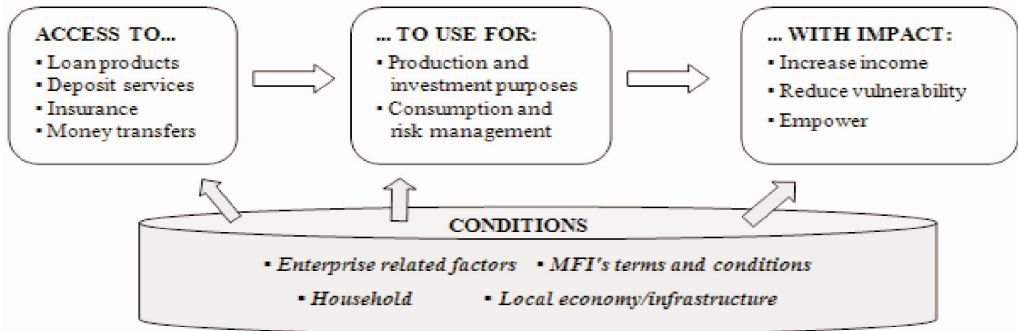
The tools of the poverty lending approach are poorly suited for building microfinance on a global scale. Resources for developing microfinance are limited, and donors and governments must choose among options if microfinance services are to be made available to all who can use them. That is why it should be complemented by financial intermediation institutions.

## LENDING METHODOLOGIES

Micro-lending methodologies can be divided between group lending and direct lending to individuals. Group lending methodologies provide micro-credit to a group of homogeneous individuals who distribute the loan among them. Group lending involves weekly group meetings, group monitoring of loan repayments and frequently group guarantees, thus enhancing social cohesion and improving clients' financial management skills. Examples of group borrowers are solidarity groups (groups of 4-6 poor urban micro-entrepreneurs), village banks (groups of up to 50 poor individuals in rural areas, frequently women) or credit unions (groups of 50-200 people that are often regulated). Micro-credit to groups is usually provided 10 with a maturity of 6-12 months for working capital purposes. Direct micro-lending to individuals normally targets owners of existing micro-businesses in rural and urban areas and provides loans for working capital and/or asset financing. Loans aim at enhancing micro-enterprise growth or enterprise transformation into small businesses. Credit is frequently given based on the business potential and the borrower's character, but can also involve traditional forms of collateral such as fixed asset charges.

The main contribution of financial and banking services - savings, credit, insurance and money transfers - is to address people's financial constraints and facilitate management of money. Use of financial services can be classified into two broad categories: production and investment purposes, and consumption and risk management. Financial services thus play dual roles: protecting the poor, and promoting their economic well-being and welfare. However, various factors can influence the actual outreach of and impact of microfinance programs, as outlined in figure 1 below. For instance, intra-household power structures and property laws can influence women's access to and use of a loan, entrepreneurs' business skills and the viability of the local economy influence the result of an investment, availability of rural roads and electricity condition both MFIs' operations and households' livelihood activities, and MFIs' terms and conditions influence who gets access to financial services.



**Figure 1: The relationship between access to financial resources and poverty reduction**

<http://www.norad.no/en/tools-and-publications/publications/norad-reports/publication?key=109392>, p. 10

## GOVERNMENT AND DONOR SUPPORT TOWARDS MICROFINANCE

As concluded in previous part, the microfinance market needs both microfinance institutions and government and donor support to satisfy the emerged demand of microfinance services.

The donor agencies provide funds for private organizations in developing countries. Some donors work just with the governments, providing soft loans for traditional aid activities, such as building roads, hospitals, and schools. They don't support the financial system in the private-sector domain. Wholesale financial institutions called apexes fund the retail microfinance institutions and provide efficient channeling of the funds and technical support.

The donor funding model has not been proven as very successful. There are many obstacles that make it non-efficient. For instance, it showed that it is not consistent. Also large proportion of money is not used effectively, because it often comes to complicated funding mechanism, which makes it to fail. There are many cases when the partners that donors choose are not capable for successful performance. In some cases, poorly conceived programs have retarded the development of inclusive financial systems by distorting markets and are placing domestic commercial initiatives with cheap or free money.<sup>40</sup>

Non-governmental organizations are the pioneers in the microfinance world. They provide microfinance services completely or combined with other services. From the beginning they are committed to financial sustainability. When talking about NGOs working with microfinance in numbers, we can say that the Micro-credit Summit Council has collected information on about 3,000 NGOs that provide financial services to more than 80 million clients. Estimates of worldwide NGOs offering financial services reach up to 9,000. The most famous national NGOs include Bangladesh Rural Advancement Committee (BRAC), ASA, and PROSHIKA in Bangladesh, which have a combined clientele of a staggering 5.6 million people.

It is very well known that in the world of microfinance NGOs are restricted with many constrains in the path of their development and growth. In most of the cases, they are donor dependent, especially the smaller ones, because they are established with donor funds. Their loans range is restricted, their organizational structure and governance structure is not well suited, they could not mobilize savings, because of the legal restrictions, etc.

One way to overcome these obstacles, which is increasingly used in contemporary economy, is the trend of commercialization and independence, while pushing the poverty frontier. This refers to seeking sustainability and becoming independent from unpredictable donor financing and tap commercial sources of funding to fuel growth and reach more poor people. Commercialization doesn't only mean that microfinance is a profitable business, but also products' diversification.

40) Helms, Brigit. 2006. "Access for all: Building inclusive financial systems". World Bank, Herndon, VA, USA

The donor agencies use variety of instruments to provide support, such as policy support, technical assistance, grants, loans (which can be offered at subsidized or commercial interest rates, quasi-equity which usually means low-interest loans that can be converted into equity, equity investments in those institutions that can sell shares, and guarantees. These instruments help for: funding financial institutions' loan portfolios, providing technical support to financial institutions and governments (often called capacity building), improving financial institutions' ability to tap domestic capital markets through helping to forge relationships and guarantees, building the skill sets of technical service providers, such as local consulting firms or training facilities, and supporting the operations of networks and associations.

Operating in the macro level, the government support of microfinance could have essential role in building efficient and effective microfinance system with primarily goal to reduce poverty and reach social welfare. The government has a potential to do that establishing financial sector reforms, especially in those countries with a history of huge state involvement, also creating formal national strategies for microfinance, incorporating finance for the poor into their overall development policies, adjusting banking sector regulation and supervision to facilitate microfinance, while protecting poor people's deposits. Governments can further support financial services for the poor by improving the legal framework for contract enforcement and collateral rights, ensuring practically and legally feasible systems of land titling, and ensuring that tax systems do not discriminate against different types of institutions engaged in microfinance.

Many governments' operations are directed towards repressing or eliminating the informal sector, not to improve the management of the formal economy, so to increase its absorptive capacity. The informal sector is in fact the poor people, low-income, unemployed people who are trying to find ways to earn money for their survival. The government should not remove the micro-entrepreneurs from the streets, by sending urban informal laborers back to their villages, because they had usually left them because of unemployment. The main goal of the government should be to integrate these people in the formal sector, and to create macroeconomic environment which will support the contribution of the informal sector in a legal way. Because this sector creates employment, provides income for poor people, recycle and repair goods that would otherwise be treated as waste. They provide cheap food, clothes and transportation not only for those in informal sectors, but also for those low levels in the formal sector, which don't have money for these things. "These people generally have strong survival skills, shrewd business sense, and long experience of hard work, knowledge of their markets, extensive informal support and communication networks, and a fundamental understanding of flexibility as a key to micro-enterprise survival."<sup>41</sup>

## THE REPUBLIC OF MACEDONIA MICROFINANCE PROSPECTIVE

A modest research has been done on the subject of MF till now,<sup>42</sup> there are just internal evaluations of the programs by the practitioners, which are not publicly presented and their scope is constrained to sustainability and outreach of the organizations. This information is gathered from discussions with key informants from the institutions.

This study is conveyed in order to examine the microfinance perceptions in the country based on a survey that gives answers to a set of questions related to the general characteristics of the poor households, their problems, needs, savings, borrowing and financial exclusion.

41) Robinson, Marguerite. 2001. "Microfinance revolution: Sustainable finance for the poor." p.12. *World Bank Publications*, Washington DC, USA

42) See more in: H.Cipusheva, 2008. "The impact of microfinance on poverty alleviation - the case of Republic of Macedonia", Master thesis, SEEU. The present study examined important issues related to the impact of microfinance. The objectives of the study are to evaluate the impact of microfinance on individuals, on households, on small-enterprises and on community. The survey covered 200 individuals, equally presented by incoming and existing clients from two MFI in Macedonia. The sample geographically was taken from the municipality of Shuto Orizari in Skopje, the capital of Macedonia, since this area suffers from high incidence of poverty. The ethnical background of the sample consists of Roma population, from which (70%) are unemployed, according to the state statistics (2002).

## RESEARCH METHODOLOGY

The survey of a household financial decision was conducted during the month of December, 2012. For this purpose a structured questionnaire was developed based on which people who were selected according to previously established methodology were surveyed. The survey is conveyed by Center for economic analyses-CEA.<sup>43</sup>

### Sample structure

The survey was conducted in 208 households in 21 municipalities in the country. The number of respondents in each region is selected using the official statistics from the National Census of 2002. The sample consists of respondents from urban/rural municipalities that satisfy certain demographic, social and economic criteria relevant for the subject matter of the research.

### Field work

The interviews were carried out face-to-face in people's home, using Paper-and-Pencil (PAPI). The selection of the respondents in the urban areas was done in such a manner that the person conducting the poll was obliged to select every fifth house, starting from the municipality premises, considered as static point. In cases when the living premises are unoccupied, or when the citizen does not wish to participate in the poll due to any reason, the person conducting the poll selects the house next to those premises. In rural areas, the selection of the households was performed on both sides of the main country street. Within the household, the person who is of age and whose birthday comes first when calculated from the polling day was selected for interviewing.

## KEY FINDINGS

### GENERAL INFORMATION

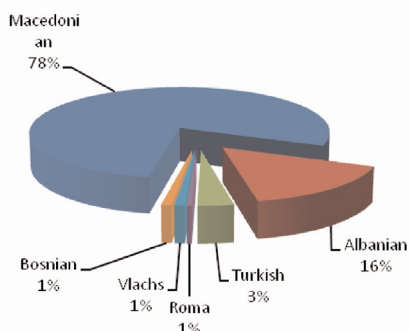
The distribution of the respondents by municipality is shown in table 2. The gender distribution of the respondents is 39% male and 61% female. 88% of the respondents are from urban areas and the rest 12% from rural areas. The ethnicity structure of the respondents is shown in the Figure 2.

Table 1.

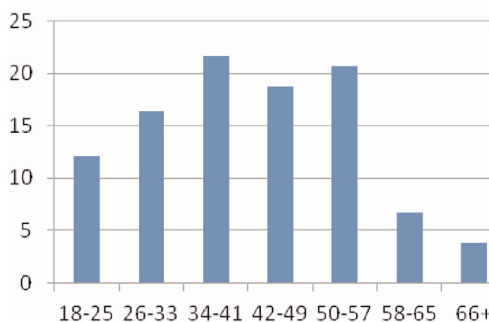
Municipality	Percent	Municipality	Percent
Aerodrom	9	Negotino	3
Bitola	8	Ohrid	4
Bosilovo	3	Prilep	7
Cair	8	Resen	3
Cashka	1	Shtip	3
Centar	3	Struga	5
Ceshinovo	3	Strumica	4
Gevgelija	3	Tetovo	7
Gostivar	7	Veles	5
Karpos	3	Zhilce	4
Kumanovo	7	<b>Total</b>	<b>100</b>

43) [www.cea.org.mk](http://www.cea.org.mk)

**Figure 2. Ethnicity distribution**



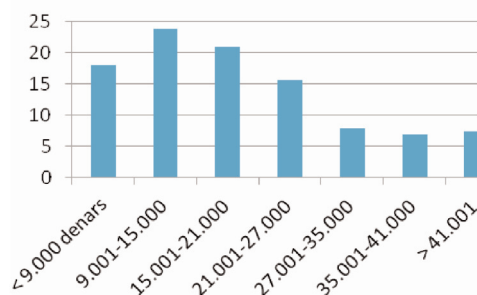
**Figure 3. Age distribution**



**Figure 4. Employment**



**Figure 5. Economic status**



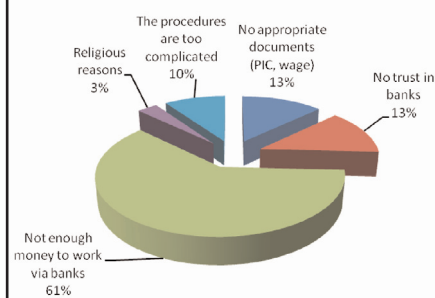
The age distribution shows that the age groups from 26-57 years comprise 77% of the respondents. Majority, 48% of the respondents work in the private sector, whereas 21% in the public sector and 14% are unemployed. The educational profile of the respondents shows 51% participation of the people that own secondary school diploma, and 44% owning university diploma. Almost everybody surveyed has a health insurance and the families with children consist 70% of the respondents, whereas 13% are single without children and 10% are couples without children. The majority (64%) of the families have 3-4 members. 75% of the income sources of the families come from salaries, whereas 15% come from social welfare or pensions. The housing status is 95% represented by own house possession.

## FINANCIAL INFORMATION

Most of the respondents (86%) claim that they own bank account. The people that do not have one, give different reasons about it, as given in the figure 6; 61% of them do not have enough money, and 26% think that they do not own the needed documentation and do not trust the banks.

The structure of the responses related to savings shows that 25% of the people have savings, 47% do not save and 22% could not save. 75% of the respondents that have savings keep them at the bank deposit accounts, and some of them keep them at home. Most of the reasons why people save are for no particular reason (31%), family reasons (26%), housing (16%), etc. The high life expenses (60%) and low income (31%) are given as reasons for not saving.

**Figure 6. Reasons for not having bank account**



The respondents show little investment/borrowing activity (20%). Most of them get the information on which they base their investment/borrowing decision from the internet; magazines and daily newspapers; bankers, brokers and other financial agents.

### WELFARE CONCEPT

The respondents' perceptions about what is the amount of income that distinguish rich people vary from 120.000 denars of income (as a statement of 53% of the respondents) to 60.001-120.000 denars (claimed by 38% of the respondents).

The health, the family and happiness are being considered as the most important aspects of the wealth, whereas the money and the residential property are considered as less important. The intangible aspects of the wealth go beyond the material ones.

The largest share on the type of financial assets that is being owned by the families of the Republic of Macedonia are the transaction account, although a high 55% has no financial assets. The nonfinancial assets are being represented by the own home ownership and cars.

Out of 208 respondents, 92 have claimed that have some kind of debt. Analysed by the type of the debt, 42% have debt represented by the credit lines that are not secured by residential property, 21% for credit card balances and 12% for primary residence. The purposes of the debt ranked by the frequency of appearance are as follow: education, improvement of the primary residence, purchase of primary residence and for urgent or health reasons.

During the last 12 months the people that have borrowed money have done it mostly from the official financial institutions and from relatives and friends. High 65% of the respondents claim that do not borrow at all.

The analyzed households imply that during the last three years 48% have had a reduction in their income. 50% of the ones that have suffered reduction in their income state *the reduction of their salary* as a reason and 43% have stated the *loss of their jobs*, as a reason.

As a main reasons why families who applied for credit were turned down or received less credit than the amount requested are because they are not employed (45%), and they do not have a collateral (20%), or simply, they do not know the reason (31%).

### MICROFINANCE

Concerning the question if the respondents know what MFI is, only 16% answered positively that they do know some MFI, 62% do not know any and 22% do not know what MFI's are. Based on the settlement of the respondents, 17% of the people living in urban areas know MFI's, opposed to the 8% of the people living in the rural areas.

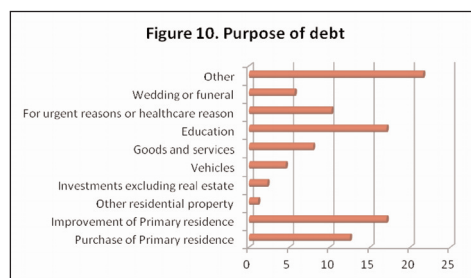
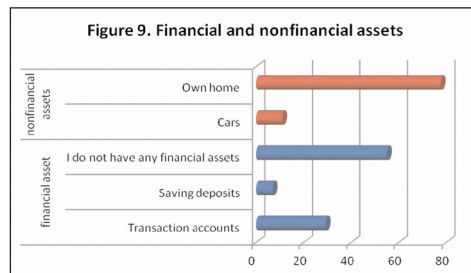
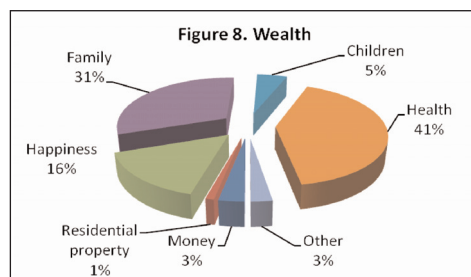
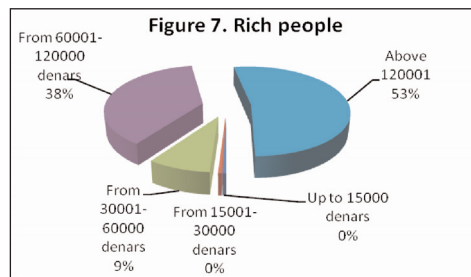


Figure 11. Borrowing institutions

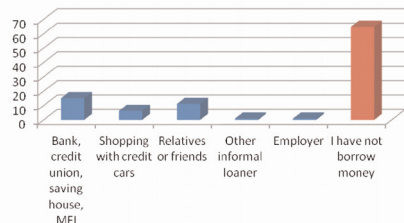


Figure 12. Reduction in income and reasons

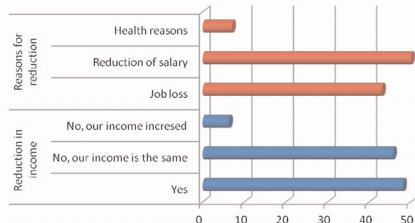


Figure 13. Borrow from MFI for self-employment (by gender, settlement and ethnicity)

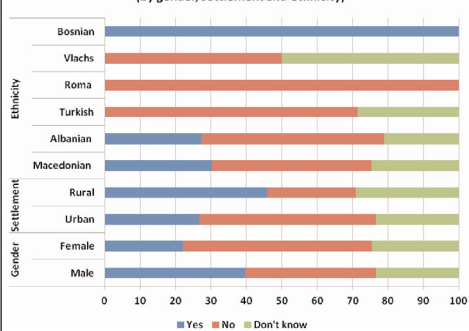
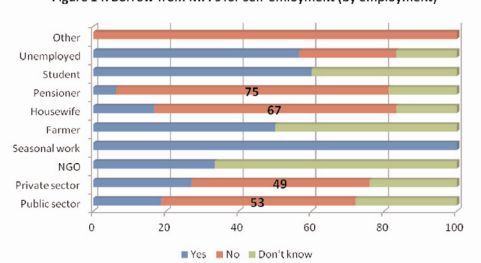


Figure 14. Borrow from MFI's for self-employment (by employment)



The percentage of those who have already borrowed or landed money from the MFI's during the last 12 months is very low, just 2%. However, people find interesting the idea for some institution to offer them money for starting a small business or self-employment without any collateral, by group landing - 29% of respondents support this idea; whereas 47% do not want, and 24% expressed that do not know. Male respondents are much more interested in this idea than woman; while the urban/rural distribution shows that 46% of the rural respondents like this idea, opposed to the 27% of the urban respondents. Considering the ethnic background of the respondents, Macedonians (30%), Albanians (27%) and Bosnians (100%) give support to this opportunity.

The age group consisting of people with 18-33 years of age wants to use this opportunity with 44-48% range of positive answers. Students, unemployed people, people working in NGO's and seasonal workers are attracted by this possibility; on the contrary, most negative answers are given by pensioners, housewives and public sector employees.

The possibility to use help with the financial management and realization of little savings is accepted by 43%, and refused by 57% of the respondents. Rural respondents, Albanians, students, NGO's, unemployed and etc., have higher preference towards getting financial management support. The 18-25 age group shows highest readiness for this kind of support.

Concerning finding useful any kind of help in legalizing their potential businesses, consultancy for business development, and information on the cheapest raw materials, except for the youngest age group, substantial number of respondents from other age groups, especially from 42-49 years is interested in this kind of support. A raising interest comparing to the other previously stressed kinds of support is being shown from the respondents grouped by employment.

Figure 15. Financial management

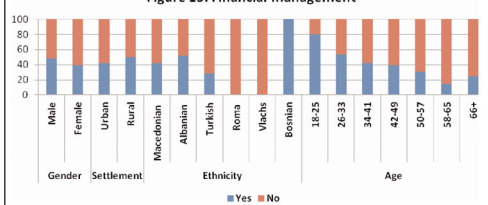
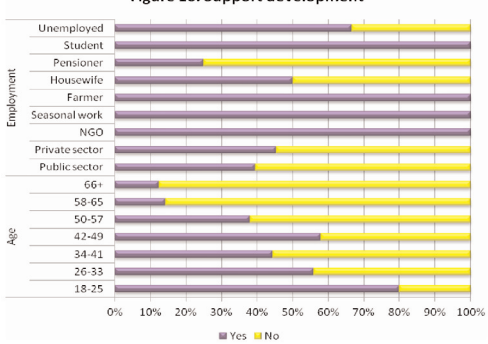
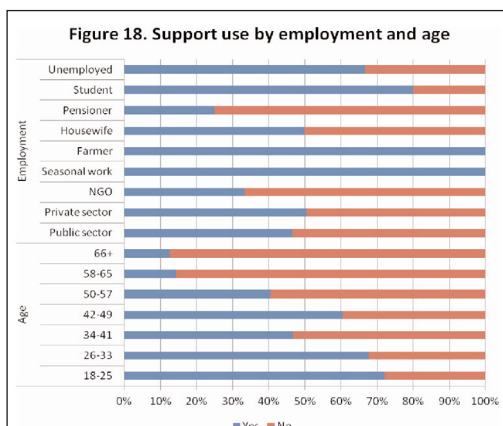
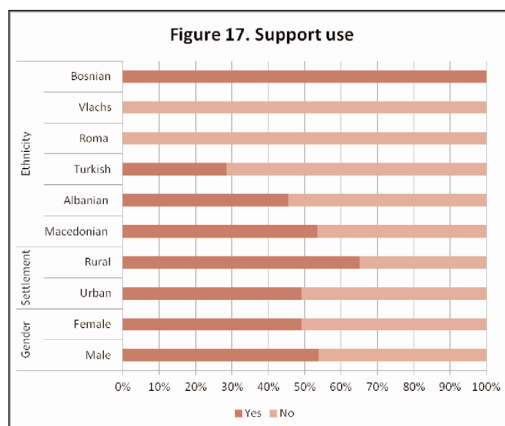


Figure 16. Support development







The hypothetical financial and consultancy help offered by the existing banking and government institution is appreciated by 51% of the respondents. The rural respondents are more optimistic about this usefulness compared to the urban respondents. Within the age groups categorization, people above 50 and mostly people from 34-41 years are not attracted by this opportunity. Pensioners, people working in NGOs and in the public sector are also less optimistic. Macedonians and Albanians show highest interest in this area.

## CONCLUSION

This study underlines some issues concerning the availability of financial resources offered by the financial institutions in RM to the citizens, with particular focus on microfinance and its use for improvement of the financial and economic situation of the citizens.

The results show very low use of financial offer of the financial institutions in the country. Significant part of the people does not possess a bank account because they think that they do not have the documentation needed or do not trust the banks. The situation with savings is also gloomy, since just 25% of people have savings due to the high life expenses (60%) and low income (31%) – almost half of the respondents have suffered from reduction of their income in the last 3 years. A high, 55% has no financial assets.

The investment/borrowing activity corresponds to the situation with the savings - 20%, out of which the largest share is made by the credit lines that are not secured by residential property.

The respondents in the survey borrow because of the several reasons: education, improvement of the primary residence, purchase of primary residence and for urgent or health reasons. They usually borrow from financial institutions or relatives and friends. Some of the respondents were not given loans because they were not employed or did not have collateral.

As long as microfinance services are concerned, the concept of microfinance is not widely known by the people in Republic of Macedonia; the majority of the people living in urban, as well as the rural areas do not know what microfinance is. However, people find interesting the idea for some MF institution to offer them money for starting a small business or self-employment without any collateral, by group lending; men are much more enthusiastic for this idea than women, as well as the rural respondents vs. urban. What is worth to stress is that half of the young people in the sample, aged 18-33 are eager to practice the MF concept and try with self-employment or entrepreneurship.

As emphasized in the literature review, the contemporary MF services include some additional products for their clients, like trainings, help in legalizing businesses, consultancy for business development, and information on the cheapest raw materials. The majority in the sample who expressed willingness to try microfinance, especially those from 42-49 years are interested in this kind of support represented with the additional microfinance services.

## POLICY IMPLICATIONS

A wide-ranging framework where many addressed issues concerning MFI should be prepared.

A number of policy issues should also be considered by MFIs and the government regarding improving the outreach, the impact, and the legal background of the concept of microfinance. The critical relationship between risks that borrowers face and risks to the MFI portfolio should be improved and continued role and broader scope for donor investment in microfinance programs should be supported.

Except the borrowing or credits that MFI give, they should also provide “credit plus” services, such as different trainings, development techniques, marketing facilities and business counselling services to their clients, particularly low income groups to help them to sustain their economic activities supported by microfinance.

The demand for credit by the people is not questionable, but their needs go beyond credit for investment or income generation activities, the supply portfolio of MFI should consist of many other different instruments, like savings, insurance, etc. emergency credits for consumption and credits to reduce vulnerability to various risks, credit to diversify the asset base and facilities. Conversely, most of the existing microfinance programs should address the issue of satisfying the demand for financial services derived from the people. Thus, it is of great importance to take into account the differences among the potential microfinance clients and their needs in designing more effective microfinance instruments.

While there are limits to how much microfinance alone can do to alleviate the poverty, appropriate financial products and delivery mechanisms can play an important role in helping clients reduce their vulnerability and improve their capacity to bear risk. Towards this, on the short term a Law on microfinance should be brought that will arrange the terms of use in order to achieve decreasing poverty on the long term.

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