

# Chapter 30

## The Effect of Microfinance on Poverty Reduction in Developing Economies

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### ABSTRACT

*The study explores the contributions of microfinance to poverty reduction. The study used a descriptive design to establish the relationship between sales performance and access to credit in the SME sector in Ghana. Cross sectional survey was used to gather relevant data. The target population was the micro businesses in Madina in Ghana with a sample size of 200. The study reveals that microfinance has a positive impact on micro businesses. There exist a significant relationship between microfinance and sales. It was also found out that, the dependency burdens on micro entrepreneurs coupled with the low credit access from the microfinance institution for productive activities lead them to deploy the credit to meet the demand of both the business and household.*

### 1. INTRODUCTION

It is often argued that the financial sector in low-income countries has failed to serve the poor. With respect to the formal sector, banks and other financial institutions generally require significant collateral, have a preference for high income and high loan clients, and have lengthy and bureaucratic application procedures. With respect to the informal sector, money-lenders usually charge excessively high interest rates, tend to undervalue collateral, and often allow racist and/or sexist attitudes to guide lending decisions. The failure of the formal and informal financial sectors to provide affordable credit to the poor is often viewed as one of the main factors that reinforces the vicious circle of economic, social and demographic structures that ultimately cause poverty. It is imperative to understand the ways in which finance contributes to economic growth and poverty reduction. This provision of funds in form of credit and microloans empowers the poor to engage in productive economic activities which can help boost their income level and thus alleviate poverty in the economy. Microfinance institutions (MFIs) are im-

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portant, particularly in developing countries, because they expand the frontier of financial intermediation by providing loans to those traditionally excluded from the formal financial markets (Caudill, Gropper, & Hartarska, 2012). Microfinance is an effort to improve the access to loans and to savings services for poor people. It is currently being promoted as a key development strategy for promoting poverty reduction and economic empowerment. It has the potential to effectively address material poverty, the physical deprivation of goods and services and the income to attain them by granting financial services to households who are not served by the formal banking sector.

Microfinance is an effective development tool for promoting entrepreneurship and poverty reduction. Financial services enable poor and low income households to take advantage of economic opportunities, build assets, and reduce their vulnerability to external shocks that adversely affect their living standards. Yet, much remains unclear about whether, and how, microcredit can help the poor to improve their lives. Answering these questions is particularly important now that the microcredit industry is changing in various ways. Microcredit encompasses many different models and modalities and the evidence on the relative effectiveness and on the role played by different components is limited. One important recent trend has seen increased scale and professionalization leading a number of established MFIs to move from group or joint-liability lending, as pioneered by the Bangladeshi Grameen bank in the 1970s, to individual micro lending. This chapter provides evidence from a randomized sampling of 300 from both beneficiaries and Masloc. The aim of this chapter is to assess the impact of microcredit on the performance of small scale enterprises in Ghana. The paper contributes to the literature on microfinance by answering two questions: what is the impact of microcredit on the performance of micro enterprises in Ghana. How do the micro enterprises deploy the credit? The remainder of this chapter is organised as follows: section 2 discusses the related background on microfinance. It specifically looks at the poverty situation and the use of microfinance to alleviate poverty and its relative success. Section 3 focuses on the field study, section 4 presents the results and discussion and conclusion follows in section 5.

## **2. BACKGROUND OF THE STUDY**

### **The Concept of Poverty**

The definition of poverty, how it is measured and who constitute the poor are fiercely contested issues. In the poverty debate, stands the question of whether poverty is largely about material needs or a much broader set of needs that permit well-being.

Majority of the poor people from underdeveloped countries have failed to achieve the financial services that are being offered by the Microfinance Institutions (MFIs) due to the limited outreach and insufficient capital or financial resources. So, these poor people also failed to get access to health and medication and better education for their children that are the major cause of poverty. So, poor people remain poor due to the unavailability of credit or financial services. A country where poor people lying below the poverty line failed to get access to the basic needs that country is called underdeveloped country, developing economy or third world country. Microfinance becomes a sole solution to reduce or breakdown the wall of poverty. It is a blessing for poor people who do not have income generating activities and have no access to the formal credit system due to the unavailability of collateral (Muhammad, 2010).

Besides these some social resources including availability of accurate and timely information, lack of education, lack of technology and resources, health and medication facilities, social status and recogni-

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